THE REPUBLIC OF TÜRKİYE

SOCIAL SCIENCES UNIVERSITY OF ANKARA

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The Evaluation of the Islamic Banking Experience Emerging in Ethiopia

Master's Thesis

Fahmi Hussein Abdulkadir

Islamic Economics and Finance

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ABSTRACT

Islamic Banking is a banking system that is supposed to adhere to the Islamic Shariah principles while implementing financial transactions. The primary goal of Islamic banking is to provide financial services that benefit households and society while following Islamic ethical standards. The Islamic banking operations started in Ethiopia in 2013 through window-based interest-free services and as fully-fledged bases in 2020.

This study assesses the emerging Islamic banking experience in Ethiopia, especially the newly established ones. The study further tries to look into the general performance of these banks, their future outlook, and the prominent opportunities and challenges that the institutions face. To collect data for the research an online survey questionnaire has been distributed to residents of Jigjiga City, Ethiopia, consisting of academics and specialists in Islamic Banking as well as the public. A total of 98 respondents participated in the study survey.

The main findings of the study have shown that the public has a great level of confidence in the newly established Islamic banks' services and the banks can play a significant role in the economic development of the country. The results further revealed that the newly established Islamic banks have good customer service and can promote financial inclusion within the nation. Another finding of the study is that the banks are struggling with issues such as a lack of transparency, absence of public awareness, shortage of skilled staff, and regulatory challenges.

The research findings seem to signify that there is an optimistic future for the Islamic banking industry in Ethiopia, and the newly established banks are generally performing effectively so far, even though they are facing some challenges, which is relatively ordinary for every novel industry. It is hence endorsed that the policymakers in Ethiopia should encourage these emerging financial industries that will potentially assist in the country's financial stability and economic prosperity.

Keywords: Fully Fledged Islamic Banks, Newley Established Islamic Banks, Ethiopia, Shariah

ÖZET

İslami Bankacılık, finansal işlemler yaparken İslam hukuku ilkelerine bağlı kalan bir bankacılık sistemidir. İslami bankacılık sisteminin ana hedefi, bir yandan hem hane halkına hem de topluma fayda sağlayan finansal hizmetler sunarken aynı zamanda bir taraftan İslami ahlak kurallarına uymaktır. İslami bankacılık işlemleri, 2013 yılında Etiyopya'da pencere tabanlı faizsiz hizmetlerle başlarken 2020 yılında tam teşekküllü bankacılık hizmetleri haline gelmiştir.

Bu çalışma, özellikle yeni kurulan İslami bankacılık sistemleri olmak üzere Etiyopya'da ortaya çıkan İslami bankacılık deneyimlerini ele almayı amaçlamaktadır. Bu çalışma aynı zamanda, söz konusu bankaların genel performansını, onların gelecek perspektifini ve karşılaştıkları önemli fırsatlar ve zorlukları ele alacaktır. Bu çalışmaya veri toplamak amacıyla Etiyopya'nın Jigjiga şehri sakinlerine, İslam Bankacılık alanında akadamisyenler ve uzmanların yanı sıra kamuoyundan oluşan bir çevrimçi anket dağıtıldı. Söz konusu ankete 98 kişi katılmıştır.

Yapılan çalışmanın ana sonuçları, halkın yeni kurulan İslami banka hizmetlerine büyük büyük ölçüde duyduğunu ve bu bankaların ülkenin ekonomik kalkınmasında önemli rol oynayabildiğini göstermektedir. Araştırma sonuçları aynı zamanda, yeni kurulan İslami bankaların müşterilerine iyi hizmet sunduğunu ve ülkede finansal katılımı geliştirebileceklerini göstermektedir. Çalışmanın başka bir sonucu da bu bankaların şeffaflık eksikliği, kamu bilinci eksikliği, kalifiye eleman eksikliği ve düzenlemelere ilişkin zorluklar gibi konulara karşı mücadele ettiklerini ortaya koymaktadır.

Araştırma sonuçları, Etiyopya'da İslami bankacılık sektörünün, özellikle de yeni kurulan bankaların, bazı zorluklarla karşılaşsalar da – ki bu da her yeni sektör için normaldir- şimdiye kadar genel olarak etkin bir performans gösterdiklerini ortaya koymaktadır. Böylece, Etiyopya'daki karar vericilerin ülkedeki finansal istikrara ve ekonomik refaha katkı sağlama potansiyeline sahip, yeni ortaya çıkan finansal sektörleri desteklemeleri gerektiği ortaya çıkmıştır.

Anahtar Kelimeler: Tam Teşekküllü İslami Bankalar, Yeni Kurulan İslami Bankalar, Etiyopya, İslam Hukuku

LIST OF ABBREVIATIONS

AAOIFI: The Accounting and Auditing Organization for Islamic Financial Institution

ADLI: Agricultural Development Led Industrialization

CB: Conventional Bank

CBE: Commercial Bank of Ethiopia

EPRDF: The Ethiopian People's Revolutionary Democratic Front

ETB: Ethiopian Birr

EU: European Union

FFIB: Fully Fledged Islamic Bank

FI: Financial Institution

GDP: Gross Domestic Product

GTP: The Growth and Transformation Plan

IB: Islamic Bank

IFB: Interest-Free Bank

IFM: Interest-Free Microfinance

IFI: Islamic Financial Institution

IGAD: The Intergovernmental Authority on Development

IMF: International Monetary Fund

IRTI: Islamic Research and Training Institution

ISDB: Islamic Development Bank

ISMF: Islamic Microfinance

NBE: National Bank of Ethiopia

NEIB: Newly Established Islamic Bank

MMP: Musharakah Mutanaqisah Partnership

PBUH: Peace Be Upon Him

PLS: Profit and Loss Sharing

SME: Small and Medium Sized Enterprises

UK: United Kingdom

UAE: United Arab Emirates

UNECA: United Nations Economic Commission for Africa

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CHAPTER 1. INTRODUCTION

Ethiopia is a nation in East Africa, with Addis Ababa serving as its capital. The economy of Ethiopia is mainly based on agriculture, industry, and service and it is growing at a good pace. Despite this economic growth, it remains one of the poorest nations in the globe. The country is also one of the most populated countries in Africa with an estimated population of 123 million according to the World Bank's 2022 report.

Banks are one of the significant institutions for the financial stability and economic wellness of a country. They act as intermediaries in the financial sector by transferring funds between the surplus and deficit units, collecting money from the depositors, and passing it to the borrowers. On the other hand, they generate profit from the services that they provide to their customers by using different kinds of products and services.

The interest margin banks earn by intermediating between depositors and borrowers continues to be the primary source of profits for most banks. But banks also earn substantial amounts of noninterest income by charging their customers fees in exchange for a variety of financial services. Some institutions, like credit card companies and mortgage banks, use unconventional approaches. They provide little depositor services then quickly dispose of the majority of their loans and make cash from the fees they impose for creating, securitizing, and maintaining those loans (Deyoung & Rice, 2004).

It is worth stressing that the conventional banking system is mostly based on interest to generate a profit even in their fee or service-based transactions. In practice, charging interest on the money borrowed and giving interest to a lender or depositor are strictly prohibited under the Islamic law of Shariah. Hence, Muslim believers cannot participate in any financial deals that have an element of interest. Owing to that, alternative financial intermediaries that are free from interest must be presented to satisfy the needs of a large Muslim community and non-Muslims who are interested in an ethical banking system. Thus, Islamic banks which are interest-free financial institutions step in to fill this gap by mobilizing funds from those who were financially excluded, thereby promoting economic growth and social welfare.

Islamic banking is a financial system that is supposed to adhere to the precepts of Islamic economics and Shariah law. This law specifically forbids the charging and receiving of interest. In broad terms, it also forbids trade with financial risk, which is regarded as a kind of gambling. Additionally, it forbids funding companies deemed impermissible, such as those that market pork or liquor (Moghul et al., 2006).

In practice, Islamic banks would conduct all regular banking operations in the same manner as conventional banks, but always within the framework of Shariah laws. A commercial bank could function as an Islamic bank. Although the bank's primary goal is to produce a profit, it aligns itself with Islamic principles, in terms of goals, values, procedures, and day-to-day transactions. For savings and investments, the bank creates reasonable, risk-averse products that offer acceptable guarantees to investors and depositors regarding the safety of their money and enhanced profits. Additionally, the bank creates advanced yet affordable financing options that fit Shariah regulations while also meeting the demands of business owners, merchants, and other industry players in today's dynamic, contemporary marketplace (Khaki & Sangmi, 2012).

The history of Islamic finance goes back to the time of the prophet PBUH. The primary business of the Prophet PBUH was trade, which involved both buying and selling dealings. The Prophet PBUH made a lot of these business transactions at the start of his prophecy and during his journey to Medina, and he also completed numerous commercial transactions during his stay in Medina (Swadjaja et al., 2023). Moreover, the fuqaha' typically draw emphasis to the Prophet PBUH's venture into Mudarabah with Khadijah, which began over fifteen years before the commencement of the revelation, when debating the validity of Mudarabah. Additionally, they discuss the widespread Mudarabah customs in the culture of the Makkah community (Khan & Kahf, 1992).

In 1963, a tiny interest-free savings bank was founded in Egypt at Mit Ghamr in the Nile Delta. In the subsequent three years, it created eight additional offices in different parts of the country (Soage, 2020). The establishment of the Islamic Development Bank (ISDB) in Jeddah, Saudi Arabia in 1975 marked a milestone in the formalization of Islamic finance on an international level.

After that, the industry expanded to other parts of the world, primarily to Southeast Asia, in addition to Sub-Saharan Africa and Western nations with sizable Muslim populations. Also, it has expanded beyond banking to include mutual funds, stocks and bonds, insurance, and reinsurance

(Soage, 2020). The assets of the Shariah-compliant company exceeded $2.4 trillion in 2017. Particularly in Malaysia, Bahrain, and the United Arab Emirates, the growth rate is rising at a pace of 11% annually. By 2023, it's predicted that these assets might total up to $3.8 trillion. Furthermore, a significant change in the Islamic financial industry is anticipated as a result of Islamic fintech (Osmanovic et al., 2020).

In Ethiopia, Islamic banking is a new phenomenon, the industry only started operating in 2013 in the country through windows schemes offered by conventional banks then after the declaration made by the current prime minister in 2019 and proclamation No 1159/2019 of the NBE that allows the launching of FFIBs some new banks started to get the license to provide Islamic banking products and services as fully fledged manner.

1.1. Problem Statement

Ethiopia's financial sector is made up of leasing enterprises, insurance, banking, and microfinance organizations. There were 40 microfinance institutions, 30 banks, 18 insurance firms of which 17 were private and one government-owned, and 6 private capital goods finance/lease enterprises offering services under the NBE observation as of December 2022 (Hailu & Tekdoğan, 2023).

In 2008, an alliance of businesspeople and civic authorities, who hoped to form a bank called "Zem-zem Bank," explained to the departed Prime Minister Meles Zenawi the advantages and significance of Islamic financing. As a result, the NBE published a Proclamation about banking business (Proclamation No. 592/2008), enabling all Ethiopian conventional banks to take interest-free funds from clients seeking such amenities (Hailu & Bushera, 2020). Nevertheless, in September 2011, NBE published Directive SBB/51/2011, allowing only interest-free banking services to be carried out via windows inside a conventional bank (Hailu & Tekdoğan, 2023).

An act was later issued by NBE on June 19, 2019, marking the first time in Ethiopian history that full-fledged Islamic banking was permitted. Window service and full-fledged Islamic banking are now permitted in Ethiopia as a result of the directive's implementation, marking the start of the nation's twofold banking system (Abdu Oumer, 2021). This led to the initiation of new FFIB (Fully Fledged Islamic Banks) inside the nation, in addition to the existing traditional banks that provided IFB through windows, which also introduced fully-fledged branches. Currently, there are four newly established FFIBs throughout the country namely ZamZam Bank, Hijra Bank, Shabelle Bank, and Rammis Bank that offer Shariah-based financial products and services.

The Islamic banking industry is still in its early phases of development in Ethiopia in comparison to other nations that have adopted Islamic financing, especially in it is fully-fledged aspect. Therefore, it is necessary to evaluate these emerging financial sectors. Of the earlier research conducted on Ethiopia's Islamic financial institutions, only a few have examined full-fledged Islamic banking. Therefore, the researcher is attempting to remedy this shortfall in the literature, by paying attention to the newly established fully-fledged Islamic banks in Ethiopia i.e. ZamZam Bank, Hijra Bank, Shabelle Bank, and Rammis Bank, particularly in Jigjiga City, where, to the best of the researcher's knowledge, no prior study regarding FFIBs has been conducted in the region.

1.2. Objective of the Study

The following objectives are attempted to be achieved in this study:

- To assess the emerging Islamic banking experience in Ethiopia
- To examine the eminent opportunities and challenges that are encountered by the newly established Islamic banks in Ethiopia.
- To determine the newly established Islamic banks' overall performance and their prospective outlook.

1.3. Research Question

The following questions are sought to be answered in the research:

1. Is it valuable to establish an Islamic bank in Ethiopia?
2. What are the main challenges that Islamic financial institutions face in Ethiopia, and what are the most promising opportunities?
3. Do Islamic banks generally perform effectively?

1.4. Assumption of the Study

The study proceeds from the following assumptions:

1. The challenges that are encountered by the Islamic banks in Ethiopia can be resolved.

2. Islamic banks in Ethiopia can make a significant difference in the country's economic progress.
3. Islamic banks in Ethiopia can satisfy the Muslims' needs regarding banking finances and services.

1.5. Thesis Structure

The thesis is divided into six chapters: The study's background, problem statement, assumptions, and research questions are all discussed in the first chapter. The second chapter examines relevant literature before discussing Islamic banking in general. Chapter three will delve into the general economy and macroeconomic performance of Ethiopia. Islamic banking in Ethiopia, its history, and its current status. The fourth chapter discusses the research methodology. It consists of the research design, procedures of data collection, sample of the study, and data analysis. The primary opportunities and challenges of Islamic finance in Ethiopia are addressed in chapter five. In Chapter Six, the findings of the collected data are presented and discussed, and finally, the conclusion and recommendation are described.

CHAPTER 2. LITERATURE REVIEW

2.1. Introduction

Policymakers and researchers are looking for a substitute economic transactional channel that can supplement the established ones because of the worldwide economic downturn. A particular approach that can lessen the pervasive danger related to dealings in money is Islamic finance, which is based on principles that are taken from the Sharia. Interest, gambling, uncertainty, and sophisticated derivatives all of which are seen as major vehicles for social exploitation, are outlawed by the Islamic financial framework (M. K. Hassan & Aliyu, 2018).

In this chapter, a review of related literature will be highlighted, and then Islamic banking, in general, will be discussed, followed by its principles and modalities of financing.

2.2. Related Theoretical and Empirical Review

Akber & Dey (2020) employed a sampling of five Islamic banks and five conventional banks to examine and assess the effectiveness of those banks in Bangladesh. The study findings indicate that, except for the administration of the quality, there are no real distinctions among these two kinds of financial institutions. Additionally, the research stated that while conventional commercial banks were superior based on asset and administration quality, Islamic banks outperformed them in terms of liquidity stance and capital sufficiency.

Kumar & Shehryar (n.d.) examined the structure of Muscat Islamic Bank in Oman. The study's results included that the bank Muscat was run by a highly qualified group and offered a unique portfolio of Islamic banking goods and services. Along with regular banking services, the institution also offered investment opportunities and loans to both individual and corporate clients.

A. Hassan (2012) assessed how Islamic banking instruments affected the Kenyan Islamic bank's profitability by analyzing the periodic financial accounts of two completely functional Islamic banks in Kenya. The study's most important conclusion was that there was a direct correlation between the financial viability of Kenya's Islamic banks and the products offered by those institutions. The volume of services has a significant favorable impact on Islamic bank's financial viability. It is connected to a variety of product aspects, including the volume of the product and excellence. The study's other findings were that the goods offered by Islamic banks significantly affect the pretax earnings of the institution, which means any alteration to the amount of an IB's goods will consequently have an impact on the profits of the institution.

Khaleequzzaman et al. (2016) developed a conceptual model that offers a comprehensive perspective, by taking societal goals into account, to help assess the permissibility of Islamic banking operations in Pakistan. The study concluded that Islamic banks appear to have little interest in income allocation that is fair. The banks have not demonstrated any interest in reducing poverty, and there are no precedents in their supporting small businesses. In addition, there are a handful of problems with the way some Islamic banking procedures operate, which favor the stakeholders from impermissible profits but fulfill no real objective. These problems call into doubt the validity of these operations. Islamic banks must therefore comply with Maqasid al-shariah, deal with moral judgments, and pursue perceived fairness objectives to be legitimated by Shariah.

Aquino (2019) sought to assess the degree of Islamic banking implementation to instrument client experience and commitment and to pinpoint potential directions for product improvement by collecting a survey from 120 participants from four Islamic banks in Muscat, Oman. The study results revealed that customer commitment, customer contentment, and excellence of service are all positively correlated. Service excellence and client commitment are largely mediated by customer contentment.

Saleh & Zeitun (2006) looked into the history of Islamic banking in Jordan, focusing on two banks: the Islamic Arab Bank and the Jordan Islamic Bank for Finance and Investment to assess how well these institutions have performed overall. The study also illuminated some of the regional, national, and international issues that the industry is dealing with. The results of the study showed that both of the two banks' performance and capability had risen, and they had expanded their investments and operations. The banks played a significant role in funding significant market initiatives. Additionally, they have been crucial in supporting and funding some industries in Jordan, including mining, building, and commerce. To boost their productivity, advertise their goods, and forge lasting interactions with consumers, the paper advised Islamic banks to finance in information technology, and a solid management board. Moreover, for clients to accept and use the products, community consciousness must be raised, and they must have a far greater understanding of Islamic financial ideas. As a result, the banks must improve their efforts to market their products and foster a positive link with their clients.

Azouzi & Echchabi (2013) studied the link between Islamic financing and Kuwait's economic expansion as measured by GDP growth and commerce. The results of the paper revealed that there is no long-term link between Islamic financing and economic expansion, although it was shown that overall Islamic financing was caused by commerce progress in the near term. The paper also offered regulators and experts ideas for potential actions to take to best utilize the economic expansion and Islamic finance enhancement for the entire advancement of the economy of Kuwait.

The current state of Islamic banking in Saudi Arabia was emphasized by Lone& Alshehri (2015), who also give insight into certain critical concerns that suggest the country might be a prospective market. Individuals opt to participate in Islamic banks in Saudi Arabia over regular banks, according to the study's key findings, and even conventional banks have been lured to create specific Islamic banking sub-offices. The authors concluded that even though Saudi Arabia has a strategic edge in building the Islamic financial industry due to its Islamic policies and norms, and also an extremely simple licensing for the formation of Islamic financial institutions, the industry doesn't have a competent human capital and also Islamic finance offering organizations.

Karbhari et al. (2004) explored the biggest issues and prospects confronting Islamic banking in the UK by providing the findings of interviews conducted with top executives from numerous major financial organizations with extensive knowledge of operating with Islamic banking. The study findings revealed that there are many issues with Islamic banking, which are likely the causes of the lack of Islamic banks in the UK. In addition to legislation not supporting Islamic banking, the institution has also failed to conform to regulation, which is why there are no real Islamic banks. Lack of cooperation among the Muslim society, a staffing shortage, and a lack of consensus among scholars are a few other problems the system faces.

Ali et al. (2010) looked into the interaction between customer satisfaction and service efficiency for conventional and Islamic banks in Pakistan. The findings showed a significant and favorable correlation between customer contentment and service efficiency. Furthermore, in contrast to traditional banks, Islamic banks had a stronger correlation between customer contentment and service efficiency. The researcher advised lenders to conduct successful marketing initiatives to raise recognition of the caliber of their goods to draw in more clients.

Hussein (n.d.) attempted to measure the operating effectiveness of 17 Islamic banks in Sudan from 1990 to 2000. The results demonstrated that Islamic banks by themselves do not foster inefficiencies. However, other factors contribute to the operating inefficiencies of the Islamic banks in Sudan. Hence, Islamic banks will function well if those issues are addressed.

Abduh & Azmi Omar (2012) looked at the short and long-term links involving the Islamic finance sector and the improvement of the economy in Indonesia. The findings revealed that, over the long term, the expansion of Islamic finance is favorably and strongly connected with economic progress and wealth generation. From this perspective, it has been discovered that local funding offered by the Islamic banking industry aids in Indonesia's economic development. The construction of new Islamic windows, and Islamic rural and commercial banks is therefore something that the state wants to support and foster. Furthermore, because the correlation is proven to be reciprocal, a robust economy will assist Islamic banks to expand even more because the industry cannot completely support economic development in a weakening economy.

Com et al. (2017) attempted to capture the monumental problems that Islamic banking companies have faced over the last three decades. The results of the study showed that the company was faced with difficulties including a lack of consensus among the Shariah scholars, a dearth of Islamic financial markets, difficulties with liquidity administration, intense rivalry from Western banks, an absence of technologically advanced Islamic financial products, false ideas among the western society and some Muslims, and shortage of proficient workers.

Rahman & Riyadh (2016) examined the current state of Islamic finance, its basic tenets, tools, developmental stage, as well as its prospects and obstacles. According to the results, the attributes that are driving the growth of Islamic finance include investors' high interest in financial instruments that adhere to Shariah law, Muslims ' willingness to conduct their lives in compliance with their religion in all respects, and corporate entities' motivation to maximize capital in a way that is both resourceful and halal while maintaining equity of the stockholder. On the other hand, the study revealed that the sector is confronted with concerns such as the gaps between principles and application, the diversity of opinions held by operators and financial analysts, and the flaws in the framework.

The emergence of the Islamic finance sector in the West was illuminated by Alharbi (2016)**.** The results of the study showed that Western states are becoming more fascinated by Islamic banking as their Muslim populations rise. An increasing number of people are also seeking out goods with ethics and socially conscious solutions. However, the study also pointed out that the industry is also dealing with problems like regulation, a lack of consensus among Muslim scholars, Islamophobia, and a shortage of educational institutions that provide programs in Islamic banking.

Grassa & Kabir Hassan (2015) assessed the prospects of Islamic finance in France, its history, and the obstacles that the company is facing. The research's most important result is that Islamic finance will help the French government by allowing foreign investors, particularly from Muslim nations, to participate in investment securities such as Sukuk. Furthermore, as an alternative to the conventional banking system, the industry will be used by a broad segment of the population, including Muslims and non-Muslims. Finally, the expansion of Islamic banking in France would assist the French authority in reducing prejudice between Muslims and non-Muslims. On the contrary, the research has also concluded that Islamic finance in France is facing obstacles such as a lack of government backing and poor governance of Islamic finance in countries such as Morocco and Tunisia, where the majority of France's Muslim population hails from.

The above literature mainly underscores a positive trajectory in the performance of Islamic banks, alongside a discernible correlation between Islamic finance and heightened levels of customer satisfaction. Furthermore, the industry plays a pivotal role in facilitating substantial market initiatives and business. Similarly, Islamic finance exhibits attributes of capital sufficiency and financial viability, and experiences pronounced public demand. This demand is not limited to Islamic regions but extends to Western societies, where an increasing preference for ethically conscious goods is observed.

However, Islamic banking encounters several challenges. Regulatory hurdles, human capital deficit, and discord among Muslim scholars regarding Shariah-compliant financial practices impede it is growth. Additionally, Islamophobia, particularly prevalent in Western contexts, poses a distinct challenge. Structural deficiencies such as a lack of strong Islamic financial markets, liquidity management challenges, and intense competition from conventional banking institutions further compound these issues.

2.2.1. Theoretical And Empirical Review of Islamic Finance in Ethiopia

When we come to Ethiopia, we find that the literature on Islamic banks in the region is quite limited. The reason for this scarcity is that the Islamic financial sector in the nation is still in the nascent stage. Recognizing this information gap, our aim in the subsequent discussion is to shed light on some of the existing literature reviews about Islamic finance.

The present state, future potential, and challenges of Islamic financing in Ethiopia were examined by Mehammed Hailu & Ahmad Yatoo (2021). According to the study, the country has three different kinds of Islamic financial organizations, including Islamic banks, Islamic microfinance, and takaful companies. Moreover, strong desire from the society, sufficient startup capital, the presence of sizable client bases, and simplicity in mobilizing profit and deposit are some of Ethiopia's possible advantages for Islamic financial institutions. On the other side, difficulties with the legal system, shortage of qualified staff, and misconceptions from non-Muslim societies are the most significant obstacles that the company is facing.

Girma (2020) tried to analyze the anticipations and issues that are encountered by full-fledged Islamic banks in Ethiopia. The findings of the paper revealed that the industry has a bright future in Ethiopia since there is a high interest in full-fledged Islamic banks from society. In contrast, the industry is having difficulties adapting to Ethiopian business. The most common issues are regulatory-based issues since Islamic banks are not able to offer services that are compatible with Islamic law. Hence, the researcher suggests that to face the issues the Islamic banks must work persistently and get support from the government. In that case, the full-fledged Islamic banks will have a bright and good anticipation in the future.

S. M. Hailu (2017) conducted a study on 321 respondents and had a semi-structured interview with a selected bank officer in Addis Ababa to investigate the role of Islamic finance in combating financial exclusion in Ethiopia. Some of the results that have been indicated in his research are mentioned below:

- Window-based interest-free banking offerings proved insufficient in promoting the integration of Muslims into the financial industry. Even though the respondents were aware of the interest-free window, the majority did not take advantage of it. The primary cause of this was Muslims' mistrust of these types of window-based offerings.
- Not having complete interest-free financial institutions Muslims' involvement in the economy in Ethiopia was impacted. This means that Muslims' only sources of funding for their businesses are personal savings and loans from friends and family. As such, they are unable to take an active role in an investment that requires a significant amount of money.

- Ethiopia's traditional financial institutions like banks, insurance firms, microfinance organizations, and the house financing sector did not take into account the unique needs of Ethiopian Muslims in terms of interest-free imposing financial services.

Seid Ali et al. (2020) tried to determine the advantages of non-interest microfinance firms over other businesses, based on socioeconomic, legal, and other factors. As a comparative descriptive technique, the study looked at other nations that adopted IFM (Interest-Free Microfinance), such as Pakistan, Sudan, Bangladesh, and Indonesia. The results of the study stated that more commitment to boosting IFM institutions in Ethiopia would help the sector flourish, and encouraging IFM firms will enable more individuals around the nation to participate in the financial sector, which will assist the economy effectively. Moreover, IFMs have the power to eliminate poverty, generate jobs, and meet the poor's micro-financial needs.

Hailu & Bushera (2020) looked into the benefits and drawbacks of the newly implemented full-fledged interest-free banking institution, and the history of the Interest-free banking system in Ethiopia. According to the paper, Islamic finance has a significant promise in Ethiopia due to the large number of clients who are not in banking and the high demand from the community. On the other hand, the sector is confronted with obstacles such as a scarcity of competent human resources, regulatory concerns, and public unawareness. As a result, the study recommended that the Ethiopian authority have to make suitable changes to the legislative systems to address the weaknesses.

Ibrahim (2019) examined the development of fully-fledged interest-free banking, the issue with implementing it, and the deficiencies in Ethiopia's legal framework in this area. The study's findings indicate that the legislative framework governing fully-fledged interest-free banking is insufficient to address the issue. Moreover, the researcher selected the idea of a single fully-fledged interest-free banking business and concentrated on raising publicity because the company is accessible to non-Muslims and Muslims.

Habib (2022) in his study on Ethiopian commercial banks in Jijiga city about the factors influencing customers' intention to use interest-free banking products and services, he concluded the following:

- The bank does not do a good job of educating its customers regarding the different interest-free banking products that both the Muslim and non-Muslim communities can take advantage of, or about Islamic banking in general.
- The opinion held by a large number of respondents is that IFB's offerings are identical to those of traditional banks, and this belief among clients could hinder the company's expansion by driving away current or future depositors.
- Due in large part to social constraints, bank customers have favorable attitudes about adopting IFB products.
- Customers have low levels of trust in the financial institution, and they are less drawn to its products.

In another study, Alemu Kebede (2021) aimed to evaluate the customer's awareness and satisfaction toward Interest-free banking and its role in Ethiopia's economic development targeting some commercial banks in Ethiopia. The researcher concluded that IFB contributes to the economic growth of the nation by attracting people to the banking sector, redistributing unused assets, and generating job opportunities. Moreover, there is a general lack of knowledge about IFB among bank staff and clients.

Aman (2019) evaluated how the window approach had grown and how well the banks had performed in accumulating deposits and providing credit for investing and commerce. According to the results, the Commercial Bank of Ethiopia and Awash International Bank are prominent figures in Ethiopia's interest-free banking operations. From 2013 to 2018, 10 additional banks entered the business, bringing the overall number of banks offering interest-free banking window products to a staggering 19 commercial banks across the country. Moreover, the sector has become firmly deposit-driven due to the deposit facilities' great dominance. Millions of ETB (Ethiopian Birr) were easily utilized by financial institutions because of this approach. The author concluded that Ethiopia's interest-free banking industry has a promising perspective. Nevertheless, challenges such as unclear commitments from Shariah scholars, shortage of qualified workers, ineffective legislation, lack of knowledge in the extremely differing population, and absence of IF teaching organizations will be faced by the industry shortly.

In his study, Abdulhade (2020) analyzed the obstacles and prospects being encountered by an interest-free branch of commercial banks in their growth, especially in the city of Dire Dawa, Ethiopia. The outcomes revealed that Islamic banks have both obstacles and prospects in their spread. The increased desire for interest-free financial services represents the most significant prospect. Additionally, the company can lead to the enhancement of the financial system and the evolution of the nation as the Ethiopian financial system is in a boom phase. Islamic financial institutions can also attract more savings from the Muslim community, which used to be excluded from the banking sector due to the belief that IFB at the window base violates Shariah law. On the other hand, Islamic financial institutions face difficulties such as competing with other traditional banks, which have greater assets and offer interest-free facilities at the subsidiary and window scale, lacking societal consciousness of Islamic banks' operations and the kind of operations the banks offer, and scarcity of competent personnel.

2.3. An Overview of Islamic Banking

2.3.1. Islamic Economy

Islamic economics differs from the positive economy because its structure is mainly based on the goal of Maqasid al-Shariah. So, its main goal is to enhance the wellness of the entire humanity by protecting their precious belongings like their soul, riches, brains, progeny, and beliefs. Although interconnected goal features are added, microeconomics' utility and profit maximization are still present. The Islamic economic scheme works to create harmony among the households, the community, the market, and the government by increasing familial and social cohesion, creating mental tranquility, and supporting the religious and economic needs of the people (Salad Kadubo, 2010). Moreover, Achieving the aims of Maqasid al-Shariah, which might be expressed in the industry as promoting fairness and progress, is the main objective of the Islamic economic model that contains Islamic finance as well. Economically, Islamic financial institutions want to create products that are not very different from conventional ones in terms of risk returns. However, from a legislative standpoint, the transactions are fulfilled by utilizing various permissible Islamic agreements to create results that resemble the traditional ones (Ahmed, 2014).

So, the main objective of the Islamic economy is to address societal needs, prioritizing adherence to Sharia law principles over mere profit maximization. It is important to note that, while the Islamic economic system upholds the principles of Islamically ethical business practices, it does not preclude the pursuit of economic productivity and profit generation. Rather, it seeks to integrate these objectives within a framework that prioritizes the holistic well-being and prosperity of society.

2.3.2. Shariah and Islamic Finance

The principal foundations of Sharia are the Quran, Hadith, Sunna, the consensus of the scholars (Ijma, the principle of analogy (Qiyas), and jurists' effort (Ijtihad). The Islamic financial system can be explained as a model that has to be performed following the core principles of the aforementioned Sharia rules (Gait & Worthington, 2007). The Islamic law of Sharia forbids the transaction of making money out of the money that is lent to another party. To put it in another way, the law restricts imposing interest on debts, no matter how little or more the amount. For good measure, Islamic financial transactions should not involve any operation or venture that has by any means linkage with an outcome that can undermine the well-being of the society. These might include transactions that generate income by selling liquor substances, adultery videos, and gambling-related services (Kamarulzaman & Madun, 2013).

2.3.3. Islamic Banking

Almost every financial organization in the majority of nations is a bank, whose main objective is to achieve the greatest earnings. Islamic banks that operate in line with Sharia standards, forbid utilization of interest and adhere to the system of splitting profits and losses with those they serve, in contrast to this actuality, which pertains to regular banks. The Islamic banks as a whole are among the financial sectors with the quickest economic expansion, considering their recent history when weighed against conventional banks (Nikolaj & Maradin, 2017).

2.3.3.1. Definition of Islamic Banking

A framework in which money is given in exchange for equity investments to a portion of foreseeable corporate earnings or the provision of goods and services in exchange for a promise to pay back the worth of those products and services at a later time is known as Islamic finance (Rhanoui, 2017). A banking scheme that complies with the philosophy and ethical framework of Islam and is regulated by the rules established by Islamic law is known as Islamic banking. "No interest banking" is a specific term for a variety of banking products that do not charge usury. Islamic banking is predicated on avoiding immoral and socially inept behaviors in addition to interest-based operations that are forbidden by Shariah. Islamic banking technique's blueprint assists in developing a framework that promotes economic growth (Ghafoor Awan & Azhar, 2014).

According to Yousfi (2014), “Islamic bank is a deposit-taking banking institution whose scope of activities includes all currently known banking activities, excluding borrowing and lending based on interest. On the liabilities side, it mobilizes funds on the basis of a Mudarabah or Wakalah (agent) contract. It can also accept demand deposits which are treated as interest-free loans from the clients to the bank and which are guaranteed. On the assets side, it advances funds on a profit-and-loss sharing or a debt-creating basis, in accordance with the principles of the Shariah”. As noted by Gait & Worthington (2007) deposit accounts of Islamic banks are mainly categorized into three primary accounts:

A. Current account: this account provides operation to customers, which allows them to make financial transfers and issue bills using present transaction and payout methods. The customers will not receive any sort of interest from their deposits, which are receivable on request.

B. Savings account: like analogous instruments provided by traditional banks, it provides services like unrestricted deposits, upon-request withdrawal, and asset safeguards. Nevertheless, it does not offer any interest on balances in an account such as the conventional banks.

C. Investment account: is intended for consumers that want to invest by adopting the profit and loss sharing technique.

2.3.3.2. The Emergence of Islamic Banking

The history of Islamic economics goes back to the time of the prophet (PBUH) and the Rashidun caliphate. The Baitul Mal (House of Money) was the first organized Islamic financial institution. It mainly consisted of spreading Zakat, administrating governmental expenses, and tax management activities. Permanent Bait Almal was unnecessary during that time because all the revenues received used to be distributed. The second caliphate Omar Bin Al Khatab was the actual establisher of the Baitul Mal. Zakat which is an applicable tax to all Muslims with a range of 2.5%, Jizya a tax collected from non-Muslims as a result of their protection, and Kharaj a land tax were the primary sources of Baitul Mal funding. Sadaqah (donations) and every asset that does not have legal heirs or actual owners were the secondary sources of funding. Omar Bin Al Khatab was also the first finder of what is called Social Security. It was composed of pensions, public trusteeship, and salaries for the poor, orphanage, disabled, and widowed (Tiby, 2011).

In the Middle Ages, traders from the Middle East would conduct business under the rules of shariah, which was, unintentionally, governed by the same laws against usury and fairness of exchange as governed by their European counterparts at the same period. They set up profit-and-loss sharing schemes that operated without charging interest. These tools, which were highly successful during as well as following the Islamic civilization era, which spanned from the late 6th to the early 11th century AD, were used to finance trade and other endeavors (Schoon, 2008).

During the year 1903, several Muslim scholars declared that the amount of interest earned by customers in the post institution violated Islamic principles and norms. By taking agreements that adhered to Sharia, Muslim fuqaha created substitutes for traditional banks (Komijani & Taghizadeh-Hesary, 2018). Moreover, the demands of many Muslims who were not satisfied, because of their religious beliefs with the conventional banking systems that charged interest on their transactions led to the emergence of Islamic banks (Ahmed, 2014).

After Mit Gahmir in 1963, Nasser Social Bank was founded in Egypt in 1971 and was the very first no-interest charging institution with the word "bank" in its title It was incorporated with public assistance from a Muslim government. Nevertheless, the Nasser Social Bank's primary goals were societal aid by performing acts like giving interest-free loans to the underprivileged and impoverished, student scholarships, and profit and loss sharing microfinancing to small businesses (Abedifar et al., 2015).

Following the founding of the Dubai Islamic Bank, the first significant Islamic commercial bank in the United Arab Emirates, the Islamic Development Bank (ISDB) was established in 1975, marking a turning point in the history of Islamic banking. As a result of the ISDB's success, in 1977 many other banks of a similar nature such as Kuwait Finance House in Kuwait and Faisal Islamic Bank in Sudan were founded (Hussain et al., 2015). Thereafter, Islamic finance continued to evolve and gained international recognition, by widely spreading across different parts of the globe including Africa, Asia, and the West.

2.4. Distinctive Aspects of Islamic and Conventional Banking Frameworks

Both conventional and Islamic banks serve as financial organizations, offering crucial services to their societies and both have some services that they provide in common. However, these two banking systems differ greatly in many areas. In the subsequent paragraphs, we will try to examine the common unique characteristics of the transactions made by these two kinds of banks thoroughly investigating their distinctions and emphasizing the special qualities that set each system apart.

2.4.1. Investment and Financing

Banks have a good link with larger firms and industries. Both conventional and Islamic banks extend credit services to these giant profit-making canters. Nevertheless, they are not similar in terms of their financial contracts. Islamic banks cannot charge interest for their loans because it is prohibited, they offer interest-free loans known as the Qard el Hasan. In contrast, conventional banks charge interest whenever they lend money to an investor. Islamic banks make a profit by investing in projects with customers through a partnership or by offering the requisite asset to the customer (Hanif, 2011).

2.4.2. Leasing

Leasing is another type of financial contract that both institutions provide. It's the transferring of the usufruct of a property to another party and obtaining a pre-agreed amount of rent in return. Under this contract ownership of the asset may or may not be transferred to the lessee. This contract is called the Ijarah contract in Islamic banks. During the Ijarah time, all kinds of risks are taken by the IFIs, and at the end of the agreement, ownership might be transferred to the client following their agreement (Hanif, 2011). There are two parties in the Ijarah contract, the lessee and the lessor. The lessee utilizes the usufruct of the subject matter by paying rent to the owner or the lessor of the subject matter (Muhammad, 2014).

2.4.3. Risk-sharing

In the process of risk-sharing, Investors are promised fixed interest at the beginning of the contract in the conventional banking system. Moreover, entrepreneurs are responsible for any kind of loss even if their projects become unsuccessful. In contrast, in the Islamic banking system, this kind of habit is not allowed as they use the mechanism of PLS. According to Kettel (2010), "In pure Islamic banking both the investor and the entrepreneur share the results of the project equitably. In the case of profit, both share this in pre-agreed proportions. In the case of loss, all financial loss is borne by the capital supplier with the entrepreneur being penalized by receiving no return (wages or salary) for his endeavors."

So, this means that unlike conventional banks, which typically impose fixed interest obligations on borrowers regardless of project outcomes, Islamic banks operate under a different paradigm. Within Islamic banks, PLS arrangements prevail, enabling entrepreneurs to share in the profits, and in case of loss, Islamic banks, acting as capital providers, absorb the associated losses, thereby alleviating the burden on entrepreneurs who are not compensated for their time or efforts.

2.4.4. Creditworthiness

Conventional banks merely care about their interest to be paid on time. Hence, the creditworthiness of the borrower is their main concern. Things are different under The PLS mechanism of Islamic banking. The main concern of the bank is the reliability of the project and the administrative skills of the businessperson since they will make a profit from the project that the entrepreneur is going to engage in (Kettel, 2010).

Table 1 Common distinctions between Conventional Banks and Islamic Banks

Element	Conventional Banking	Islamic Banking
Investment & Financing	Charge interest on their financing activities & invest in any profit-generating business.	Do not charge interest & only generate profit from Shariah-compliant businesses by using investment modes like PLS.
Leasing	Commencing of the contract: It can commence before the asset is delivered to the customer. In case of default: Penalty interest is charged. Demolishing of the subject matter: The contract will continue till the end of the tenure even if the subject matter is demolished.	Commencing of the contract: It cannot commence before the asset is delivered to the customer. In case of default: No interest is charged. Demolishing of the subject matter: The contract will be terminated if the subject matter is demolished.
Risk sharing	Do not share risk with their customers and in the event of loss, the entrepreneur bears all liability.	Share risk with their customers; in the event of loss the bank or the capital provider bears all liability, and the entrepreneur will lose his/her effort under the Muadaraba model.

Creditworthiness	Creditworthiness and the ability to pay back the principal plus interest are the main concerns.	The soundness of the venture and the administrative skills of the entrepreneur are the main concerns. The vesicle study is the most important in Islamic finance design

Source: Author

2.5. Islamic Banking Principles

Islamic banking practices are based on Sharia. This is the body of Islamic law that regulates and guides every aspect of the Muslim communities, including their financial dealings. With the help of these guidelines, an Islamically compliant financial system that is fair and just will be developed. Islamic financial institutions provide a variety of services and products that adhere to these principles by meeting the financial needs of Muslim and non-Muslim societies.

The key principles of Islamic banking are: - the prohibition of interest, Gharar (uncertainty), gambling, and sharing of profit and losses in financial dealings. Moreover, transacting in prohibited products like liquor and pork, the contribution of Zakat, and sharia-compliant Islamic insurance promotes cooperation and collective protection (Ezeh & Nkamnebe, 2020). Below the four major ones, i.e. Riba (interest), Gharar (uncertainty), Maysir (gambling), and profit and loss sharing principles will be discussed: -

2.5.1. Riba (Interest)

Riba can be interpreted as increment, growth, and extension. But not all increments and extensions have been forbidden by Islam. Riba in Islamic law denotes the high end that the debtor should have to pay for the creditor in addition to the principal quantity as a requirement for the repayment of the debt or to obtain a prolongation in its expiration. According to the unanimity of all the Islamic jurists, Riba has equal significance as an interest in this context (Chapra, n.d.). It is possible to deduce that the major motivation for forbidding interest under Islamic law is to promote human equity, unity, and prosperity. Nevertheless, due to human perception and logical ability restrictions, the genuine justification beyond its restriction fails to attain the definitive end. The application of Riba is equivalent to waging war on Allah and his prophet; its prohibition is essentially a type of ritualistic submission to Allah (Yunus et al., 2018).

The term “Rab-wa” from which the name Riba comes, carries the connotations to grow up, to be greater than in amount, and to increase. Riba has a considerably deeper meaning under Shariah than it does in the precise context that is typically interpreted as usury if the interest rate is over 20% in English. There are two groups of Riba interactions; Riba al fadl and Riba al nasi’ah, the former one, which is the amount given in value in surplus of the debt. It involves the reimbursement of a surcharge by the borrower to the lender as compensation for goods of the identical sort. The latter one, which relates to interest charged on loans, fundamentally suggests that setting an advantageous return on a credit beforehand as a prize for waiting is not allowed by Sharia (Akther, 2015). In relation to financial dealings, Riba is described as any formal increase in a loan caused by the passage of time. This is precisely what we mean by interest nowadays. Interest is seen as an additional payment made by the borrower to the lender for stretching the payingback maturity time or providing a loan. Of course, Shariah does not accept such kind of additional amount. Therefore, once a debt is formed any increase over the debt’s principal is considered interest, and that is the forbidden Riba which is mentioned in the Quran (Kahf, 2006).

2.5.2. Gharar (Uncertainty)

The second crucial component of Islamic financial dealings is Gharar or uncertainty, which aims to preserve consenting counterparties’ rights, prevent fraud, and lessen the chance that one opponent would be taken advantage of by another, preventing everyone involved from feeling deceived (Iman & Mihajat, 2016). Gharar is the deliberate risking of one’s safety or those of one’s possessions, as well as the selling of a potentially valuable object whose existence is dubious. In the setting of IF, an illustration would be to suggest to the client to purchase stock in a firm that is the target of an acquisition proposal on the basis that the value of the stock is expected to rise. Business hazards like investing in a corporation are not addressed as Gharar (Schoon, 2008).

One of the main reasons why a financial dealing is void is Gharar. These financial dealings are void because of an external forbidden feature. The prohibition on Gharar suggests that business parties must be fully aware of the subject matter being provided in the course of the deal. Deceit and illusion are connotations associated with Gharar. No business venture might be feasible without a considerable amount of hazard and ambiguity, especially not by businessmen. Nevertheless, merely situations with significant danger need to be prevented (Ashraful & Chowdhury, 2015). It can be divided into “Fahish”, which is essential and there is no way of quantifying, and “Yasir”, which is possible to be dismissed as does not result in controversy, as one of the factors why there are numerous instances in modern-day life in which there is a lack of details, which is occasionally hard to prevent but bearable to some degree. To prevent discrimination, inequity, hostility, and the appropriation of others’ wealth - all of which can lead to disagreements between the individuals to a contract Gharar restriction is maintained (Yunus et al., 2018).

So, from the last paragraph we can comprehend that complete elimination of uncertainty is often unattainable, particularly in the realm of investment and business activities, where unpredicted external factors like natural disasters, geopolitical events, and economic fluctuations may arise unexpectedly. Moreover, there are times in which providing complete information might be unattainable like the profitability of the venture under the Musharakah partnership contract. Hence, essential uncertainties (Gharar Fahish), exemplified by certain modern-day financial instruments like derivates, are deemed incompatible with Shariah principles due to their speculative nature and excessive risk. Conversely, uncertainties that cannot be entirely avoided, often referred as to “Gharar Yasir”, may be tolerated.

2.5.3. Maysir (Gambling)

The Arabic word Maysir stands for gambling. The term Maysir describes the simple, random accumulation of money, irrespective of whether it or not violates the privilege of another person. All types of gambling are completely forbidden under Islamic law (Akther, 2015). Essentially, every kind of agreement in which the rights of the contracting entities are contingent upon a stochastic event is categorized under Maysir. This idea is especially prevalent in parlor games and other games of luck. According to its semantics, Maysir was a game of luck. It is derived from the Arabic adjective “Yasir” which is interpreted as easy, prior to the introduction of Islam, the Arabs thought that playing such games was a simple path to making wealth (Dalel & Bessem, 2013)

Maysir exposes one to the purely random nature of winning and losing. This leads to someone utilizing other individuals’ assets illegally and inequitably, which is contrary to Islamic principles that emphasize values, morals, and the fundamental principles of impartiality and justice (Yunus et al., 2018).

2.5.4. Profit and loss sharing (PLS)

The splitting of profit and loss between the vendor and the consumer of money is the fundamental innovation of Islamic banking. Due to the fact that Islamic finance is meant to represent Islamic ideals, this idea of fair distribution is a crucial component of the notion. There is a concept that is called "Al-ghonum bi Al-ghorum" which indicates that in the Islamic norms of indemnification, no one may receive a reward without taking a risk before investing. This maxim gave rise to the profit and loss sharing theory, which mandates that all participants in an investment deal split both the losses and rewards. Given that it affects both the liabilities and assets that are consequently bound to the PLS requirements. The principle of profit and loss sharing serves as the main pillar of Islamic banking liaison (Ben Jedidia & Hamza, 2014). Moreover, it is a legally binding agreement that enables more than one party to a transaction to combine their financial means so that they can fund a venture. The partners then divide losses and profit according to their contribution of effort and assets, and a certain proportion of yield is not promised in the agreement. This framework creates an outcome that meets financial requirements and also adheres to Sharia laws (Marimuthu et al., 2010).

Generally, a PLS agreement involves an Islamic financial institution providing risky funds to a business whose qualified executives are in charge of determining function and strategic selections. Any earnings that are generated from the business, banks will have a share, and will also be responsible for diminishing returns (Dar & Presley, 2000). Hazard needs to be distributed amongst the creditor and the borrower, according to the main Islamic banking mediation theory. To meet the risk-sharing criterion required for the encouragement of entrepreneurship and the development of micro and middle businesses, Musharakah and Mudarabah are the two well-known mechanisms with clearly stated PLS norms (Kayed, 2012).

2.6. Modes of Islamic Banking

As we mentioned earlier, Islamic banking steers clear of unethical or exploitative financial practices to advance social and economic justice. The application of Islamic banking modes can be so different due to their interpretations based on financial rules and Sharia rules. Islamic banks only finance beneficial products and services, they do not finance detrimental products like liquor and tobacco, nor do they support ethically repugnant offerings like gambling and sexually explicit material, irrespective of whether those products and services are permitted in a particular nation. Therefore, contrary to traditional banks that use reliable credit and interest rates as guidelines in assessing their offer of finance, Islamic banks are required to employ Islamic moral specifications in examining their financing. They do not assist with operations that eventually are detrimental to the community and hence against the development despite the fact that such operations are permitted by the constitution of the nation in which they operate (Kahf, 2005). The Islamic banking model figuratively offers a connection between surplus expenditure levels and deficit expenditure levels by utilizing a variety of financial goods and services that are not against the Sharia laws and standards (Febianto & Kasri, 2007). The modes of Islamic banking are controlled by several fundamental modes or principles. Below, we will briefly highlight some of the modes commonly utilized by Islamic banks: -

2.6.1. Mudarabah

Muadarabah is a joint venture between an entrepreneur and a capital owner. The former receives the funds from the latter and invests his experience and business acumen into the venture. The administration of the partnership itself is not handled by the capital owner. This renders trust finance the ideal type of collaboration for financial institutions. A predefined percentage is used to distribute earnings. Nevertheless, in the case of a financial loss, the capital owner takes the brunt of it while the entrepreneur forfeits his labor and time (El-Galfy, 2012).

A Mudarabah agreement divides the earnings between the Rabb al-mal (provider of the capital) and the Mudarib (manager of the capital) according to a predetermined proportion. According to the consent, it could be 85:15 or 75:25. The agreement's primary distinguishing feature is giving a profit promise to the provider of the capital. Similarly, a predetermined yearly payout is not present. The diminishing returns that might be incurred as a result of the company's operation are the second important component. This implies that the capital provider is only responsible for losses up to the amount of funds that he has invested, and only energy and time will be wasted by the manager of the capital (Samad et al., n.d.). Limited partnerships would be equivalent in more traditional corporate forms. Deposits at a bank are an example of a Mudarabah transaction involving a bank and an end user. In this agreement, the financial institution provides the customer with the full amount of assets, and the FI is responsible for all the client's diminishing returns in funds. The client is merely accountable for damages in cases of negligence and inadequate oversight. The liability and asset sides of a bank's balance sheet show a reference to this deal. On the side of the liability, it is unrestricted Mudarabah, meaning that the customers accept to participate in the earnings of the bank in exchange letting it spend their funds however it sees appropriate. On the side of the asset is a restricted Mudarabah, the bank consents to split a proportion of yields that are related to the venture, and a specific amount of the funds should be spent according to the client's desire (Siddiqui, 2008).

2.6.2. Musharakah

An enterprise that splits profits and losses is referred to as a Musharakah. It aims to integrate the skills of multiple partners in a company venture where everyone provides competence, capital, time, and various essential amenities equally or to different extents. Because they contributed a certain amount of money and made a certain amount of exertion, they consequently share both the peril and profits. This type of partnering is not frequently used in IFI because the majority of the IFI do not want to directly participate in the governance of an enterprise (El-Galfy, 2012). It is an agreement between two or more entities in which each participant invests a portion of their financial resources into a shared business undertaking. Predetermined profit ratios are used, and in the event of loss, it is divided according to the percentage of the amount invested (Lewis, 2009).

Under this practice, the IFI invests the money from the savers in a business venture alongside the entrepreneur. The entrepreneur can often administer every aspect of a Musharakah enterprise with the help of the IFI. The entrepreneur and the IFI divide the cost incurred and the yields of the Musharakah capital spending equally (Mansoor Khan & Ishaq Bhatti, 2008).

2.6.3. Musharakah Mutanaqisah Partnership (MMP)

It has been noted "that the innovation of MM (Musharkah-Mutanaqisah) for home financing was firstly approved in 1991 during a workshop organized by the Islamic Research and Training Institute (IRTI), and the Sudanese Estates Bank held in Khartoum (Haneef, Kunhibava, & Smolo, 2011)" (Shahwan et al., 2013). The technical meaning of Musharkah-Mutanaqisah is a contract that consists of two or three subcontracts known as the partnership contract, the ijarah or lease, and the sale contracts. The Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) defines the MMP contract as "a form of partnership in which one of the partners promises to buy the equity share of the other partner gradually until the title to the equity is completely transferred to him (AAOIFI,2010)" (Shahwan et al., 2013). Under this contract, an IFI and a client take part either in joint ownership of property (shirkatulmilk) or in a joint commercial enterprise (shirkatul'aqd). Furthermore, the financier's share is divided into units keeping in mind that the units are going to be purchased by the customer at times. Hence, these units will increase the client's share until he purchases all the units of the financier, which makes him the actual owner of the property at the end of the contract (Finance, 2013). So, this means that on one hand, the clients' share will increase at every installment period, and on the other hand, the financier's or banks' share will decrease gradually. The notion of the MMP contract is more fit for modern-day projects such as the financing of fixed assets (Ayub, 2007).

2.6.4. Murabaha

In a Murabaha financial dealing, the bank serves as the seller and the client acts as the purchaser. The price to be sold is the sum of the vendor's asking price to the banks in addition to extra benefits. The cost and the conditions of reimbursement have to be agreed upon by both sides. The Subject matter's selling price is specified during the process, and if accepted by parties, is not subject to modification during the term of the agreement. In this arrangement, the items are provided immediately after the deal is signed, but the reimbursement is completed afterward (Afkar, 2015).

Also known as "bay bi al thaman al-ajil" is a financial arrangement that entails an IFI buying a commodity as a representative of a business owner and subsequently selling it back to them for a specific price. This pricing encompasses a mutually agreed-upon profit margin in addition to the price of the commodity. The purchaser of the subject matter will in this arrangement pay the IFI in the future, either through installments or all at once. This deal's requirement that the IFI retain ownership of the commodity till all payments are settled is one of its most important features. This strategy is widely acknowledged as an alternative to interest-based traditional financing. The fundamental differences between conventional transactions and Murabaha transactions from an economic perspective are their agreement characteristics (Samad et al., n.d.).

Numerous Islamic banks heavily rely on this contract as a primary method of Islamic financing. A significant portion of the funding activities conducted by Islamic banks is based on the Murabaha framework (Atal et al., 2022). Instead of offering cash in advance, Islamic banks adopted Murabaha as a mechanism to sell consumers things on a delayed payment plan. This contract can be interpreted as a type of sale in which IB purchases specified products from an outside vendor at the detailed instructions of the customer. The IB immediately sells back the product to the customer at an amount that includes the original price of the product plus a specified profit margin after acquiring ownership of the product and possessing it actually or constructively. Consequently, Murabaha as originally conceived, is not inherently a financing method (Shah & Niazi, 2019).

2.6.5. Ijarah

An agreement that transfers the use and enjoyment rights of commodities in exchange for the paying of rental wages but does not result in the real transfer of ownership of the assets is known as Ijarah. It can be interpreted also as a lease agreement whereby a financial institution rents out property to its clients for a pre-negotiated fixed price (Iswanaji et al., 2022)**.**

In theory, an Ijarah is an agreement of trade in which one entity receives an advantage from the staffing of its counterparty in return for payment for the services provided and access to a resource. It has been defined in a number of ways by scholars from the four madhhabs (Islamic schools of law). In essence, all classifications concur that an Ijarah dealing is one in which an entity agrees to use a service in exchange for payment (Aniza et al., n.d.)**.** In contrast to a standard lease agreement, an Ijarah lease holds the lessor accountable for any harm, maintenance, insurance, and impairment of the leased property. The property owner ought to additionally take on the risk of ambiguity associated with the leased property's lifespan. The other characteristics of the two-lease financing are somehow identical (Mansoor Khan & Ishaq Bhatti, 2008)**.**

2.6.6. Salam

In this type of sale contract, the subject matter is purchased in advance, but the product will be delivered in the future. As opposed to money, silver, and gold, the subject matter for the deal is every other kind of commodity. When it comes to quality and quantity, this contract may be said to include practically everything (Zafar & Sulaiman, 2020)**.**

According to Siddiqui (2008), "Salam is a sale of a commodity whose delivery will be on a future date for a cash price, which means, it is a financial transaction in which price is advanced in cash to the seller, who abides to deliver a commodity of determined specification on a definite due date. The deferred is the commodity sold and described (on liability) and the immediate is the price. In other words, a Salam sale contract is a futures contract".

2.6.7. Istisna

This is a legal arrangement that permits upfront payment in cash and subsequent delivery of products or services manufactured, as well as deferred payment alongside later delivery. The ability to finance the creation of homes, businesses, initiatives, and the contracting of roads, bridges, and highways is made possible through the application of Istisna (Zafar & Sulaiman, 2020). It is an agreement between two people for the manufacture of a specific good, venture, and plan with defined characteristics in a coming date. The individual who receives the subject matter agrees to fulfill the request in return for the money that has been negotiated in advance. They also intend to provide the basic components and products needed for the arranging of the project and execution directly to the employer within the agreed-upon timeframe (Millanei et al., 2016)**.**

These are the primary and widely utilized modes of finance by Islamic banks. Alongside these core modes, supplementary mechanisms like Wakalah, kafalah, and Hawalah serve specific functions within Islamic finance, encompassing agency relationships, guarantees, and fund transfers. These additional modes contribute to the diverse array of financial instruments available in Islamic finance.

CHAPTER 3. ETHIOPIAN ECONOMY AND ISLAMIC BANKING

3.1. Introduction

The economy of Ethiopia mainly depends on agriculture, which contributes meaningfully to the GDP of the country. The nation's financial sector is mainly dominated by a state-owned con ventional bank, there are also several private banks. However, the Islamic banking industry is not prevalent within the country. In this chapter we will try to look over the economy of Ethiopia, the major macroeconomic performance of the country, and business opportunities. Moreover, the Islamic banking sector of Ethiopia, it is history and current status will be outlined.

3.2. Ethiopia

Ethiopia is a landlocked nation in East Africa that is bordered by the nations of South Sudan, Sudan, Somalia, Djibouti, Eritrea, and Kenya. The capital of Ethiopia, Addis Abeba, has comparatively cool weather because of its position in the highlands at 2,400 meters (Tsunemina, 2015). It is an original part of the Non-Aligned Movement, the Association of African Unity, and the United Nations, with Addis Abeba acting as the headquarters of the African Union, the Pan African Chamber of Commerce and Industry, and the UNECA. The most extensive river on the planet, the Nile, originates primarily in Ethiopia. The country is also one of the earth's largest populated states and, after Nigeria, the second-most populated nation in Africa (About Ethiopia History, n.d.). Ethiopia will have the second-largest population in sub-Saharan Africa by 2022. The United Nations projects that the amount will climb by 27% during the following ten years, from an anticipated 117 million in 2020 to nearly 150 million in 2030. The nation's economy today ranks fourth in sub-Saharan Africa and is the most prosperous in East Africa (US$111.3 billion in 2021). However, the nation still falls under the World Bank's low-income state category and the UN's list of littlest economically enhancing nations, despite its goal of achieving middle-lower income levels by 2025 (UNDP, 2022).

About 50% of Ethiopians are Orthodox Christians, while only 2% are Protestants and Roman Catholics together. Islam is practiced by almost 40% of the population. The remaining inhabitants adopted other traditional faiths (Ofacansky & Berry, 1991).

3.2.1. Somali Regional State

The Somali region of Ethiopia, which neighbors the Afar region, the Republic of Djibouti, and the nation of Somaliland in the north, Kenya in the south, the Oromia region in the west, and Somalia in the east and south, is situated in Ethiopia's southeast. The region's 350,000 km2 of territory is divided into 68 localities and nine administrative zones, with a total population of 5,748,998, and with approximately twenty million animals, the region possesses East Africa's greatest collection of livestock. Although the majority of residents depend on livestock and animal goods for their living, some engage in farming and trading. In addition, the area is rich in materials with an opportunity to draw investment, including salt, gum arabica, oil, and natural gas. Since 2009, there have been discernible shifts in the Somali region of Ethiopia, official investment and commerce operations in the sense of the number of officially authorized merchants and investors, money invested, and the amount of local government earnings. Between 2010/11 and 2015/16, the official commerce sector received investments of almost 3.5 billion Birr, which equals 165,955,429USD, according to information acquired from the Somali regional investment agency (Berhanu, 2019).

With approximately six million residents, agriculture, timber, livestock, charcoal business, modest trade, and repatriation from the diaspora are the primary streams of income for families. Muslim pastoralists make up over 85% of the population. One of the nation's four emerging Regional States, the Somali area has socioeconomic indicators that are much worse than the national median (Unicef, 2022).

3.3. An Overview of the Ethiopian Economy

Ethiopia’s economic and development strategies are based on a hybrid model that links the concept of the developmental state with the neoliberal logic of market liberalism. At the level of rhetoric, free market principles are not contested by the government. Indeed, the overall framework of Ethiopian development is theoretically set to emerge within the context of free market capitalism. In practice, however, free market principles are considerably undermined because the overall political and economic system currently under construction is designated as ‘revolutionary democratic’: the EPRDF (The Ethiopian People’s Revolutionary Democratic Front) is to serve as a frontline party leading the people under the banner of the party representing the people. The revolutionary democratic state actively participates in this framework by directing and interfering in the market, stepping in where there are shortages, and developing foundational structures (Harald et al., 2018).

The economy of the nation is still mixed, with a sizeable presence of public businesses that operate at different productivity tiers. The existing 40 government-owned companies include Ethiopian Airlines, Ethiopian Telecommunication, and Commercial Bank of Ethiopia, which are income-generating firms. The state is now concentrating on a number of vital areas, like aviation, supply chain management, the communications industry, power, utilities, imports of petroleum, and railroads. This shift in ownership by corporations is a result of privatizing in the years 1990 and 2000s. The benefits they still have over private businesses, however, include the utilization of land, foreign exchange, and targeted financing (UNDP, 2022).

Having a yearly average growth rate of 9.1% from 2009 to 2019/2020, the nation features one of the most rapidly expanding economies in the entire globe and the quickest in Africa. The economic transition has been evident in Ethiopia. In contrast to the farming business, which saw a decrease from 41.2% to 35.5% over the same time frame, the industry sector's percentage of the entire value stated, which includes the building industry, climbed from 9.7% in 2011 to 23.1% in 2020. Poverty decreased along with the expansion, with a smaller percentage of people surviving on a day with a budget of no more than $1.90 (Raga, 2022).

3.3.1. Brief History of Ethiopian Economy

The economic history of Ethiopia has witnessed shifts in governance and policy frameworks, spanning from the imperial era to contemporary times.

An economy based on command with few or no opportunities for companies was prevalent from 1974 to 1991 (Derg regime). The economy was further impacted by a civil war that continued to rage on and frequent droughts. For example, different-sized dry seasons happened in 1975–1976, 1978–1979, 1982, and 1983–1984. Each climate blow resulted in a major drop in economic expansion since agriculture was consistently the most prosperous field throughout this time (Mengistu, 2020). The nation implemented an economic overhaul at the beginning of the 1990s to move into an economy based on markets, although with important government involvement. An approach called "agricultural development-led industrialization," or ADLI, was implemented during this time. The approach draws its inspiration from the dual-economy paradigm of sectoral connections. Through the expansion of the agricultural industry and connections between it and other economic areas, the approach seeks to promote effective industrialization and calls for a large investment in the agricultural industry. Input and demand for the industrial segment were meant to be provided by the increased efficiency of the agricultural field, which was also expected to free up extra labor and produce savings that could be reinvested in the manufacturing industry. Privatization of public companies and a major cut to tariff fees were additional measures undertaken during this time (Mengistu, 2020).

Between 1991 and 2000, when the EPRDF was in power, the GDP grew by an average of 7.2 percent per year while the population grew by 2.6 percent. Agriculture contributed substantially more to growth than it did under the Derg totalitarianism, nevertheless, it remains far from the level of the time of the Imperials (1941–1974). The industrial area nevertheless substantially promotes economic development albeit having a modest proportion of GDP (Mussa, 2002). The political situation was comparatively stable during the period (2003–2018), and there were not any major climatic disruptions. Given the lack of large events, it is at least possible to speculate on the contribution of economic policy to the nation's economic health. The economy grew quickly and steadily throughout this time with less fluctuation (Mengistu, 2020).

3.4. Major Macroeconomics Performance in Ethiopia

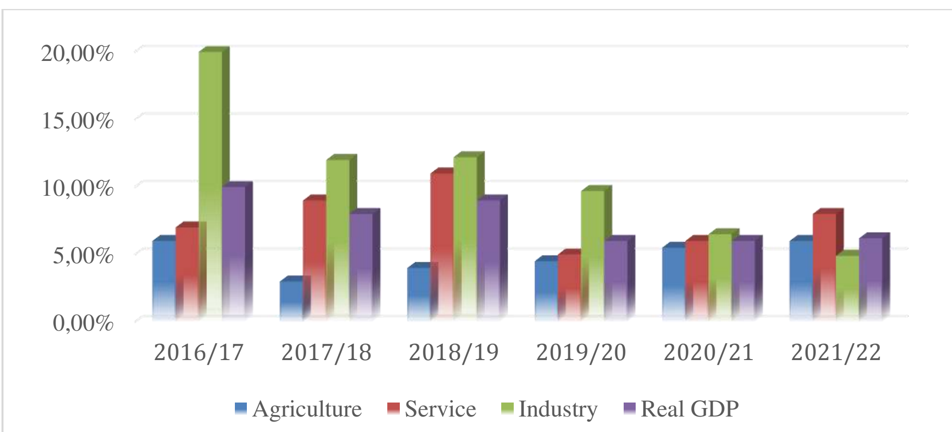
Ethiopia continues to be ranked among the world's poorest nations despite its economy expanding on average around 7% over the past few years. Ethiopia is rated 174th out of 187 nations in the UNDP's 2011 Human Development Report due to its poor human development index of 0.383. Only US$971 is earned as the average Gross National Income (GNI) per person, which is significantly less than the $1,966 average for sub-Saharan African nations. Approximately 40 percent of rural residents are in a state of poverty and roughly 29% of them earn under 1$ a day per person. The primary sector of Ethiopia's economy is land use, comprising the farming and raising of crops and cattle, which accounts for 45% of the country's Gross Domestic Product (GDP), over 80 percent of employment possibilities, and over 90% of its foreign exchange revenues. Nevertheless, outside forces like extreme weather events, changes in the worldwide value of exports and imports, and various other outside variables make Ethiopia's economy, and its agricultural growth in particular, incredibly fragile (Shitarek, 2012).

3.4.1. GDP

Ethiopia has one of the planet's rapidly developing economies. The World Bank and IMF predicted consistent median growth of 7 to 7.5% throughout the years 2015–2018, building on the country's long history of excellent development in GDP (UNIDO, 2016). The Growth and Transformation Plan (GTP), a comprehensive 5-year development strategy adopted by the Ethiopian authority, intends to reach 11.2 to 14.9% GDP growth yearly, in addition to the millennium advancement ambitions and middle-income economic status by 2025. The government is extensively funding massive community, infrastructure, and energy initiatives in order to accomplish these aims (U.S Department of State, 2014). Manufacturing, agriculture, and services make up the bulk of Ethiopia's economy. Between 2010–11 and 2013–14, when the GTP was implemented, yearly aggregate rates of development for agriculture, industry, and services were 6.6%, 20.0%, and 10.7%, correspondingly (Getaneh, 2017).

Between 2010 to 2011 and 2019 to 2020, Ethiopia's economy grew strongly and broadly, reaching 9.4% per year. However, COVID-19 caused Ethiopia's real GDP growth to decelerate to 6.1% in 2019–20. The majority of the expansion was attributed to industry, particularly building, and services. The COVID-19 outbreak had little effect on agriculture, and it contributed somewhat more to growth in 2019–20 than it did in 2018–19 (Redi & Novák, 2022).

Figure 1 Real GDP Growth of Ethiopia by Sectors (2016 – 2022)



Source: NBE

The above-depicted figure illustrates the trajectory of the real GDP growth of Ethiopia across distinct business sectors over the period spanning from 2016/2017 to 2021/2022. The industry sector service stood out as the predominant contributor to the nation's real GDP growth during this period. Nevertheless, in a notable shift witnessed in 2021/2022, the service and agricultural sectors surpassed the industry sector in terms of their respective contributions to the country's economic output. Furthermore, the broader trend of the real GDP growth of the country exhibits a decline over the described period. Beginning at a robust 10% growth rate in 2016/2017, then starting to fail, while demonstrating an uptrend in 2018/2019 reaching 9%, afterward the trajectory demonstrates a gradual decline, closing in a growth rate of 6% by 2021/2022. The figure also shows how the agricultural sector, which was the primary contributor to the country's GDP has declined in growth over the last years.

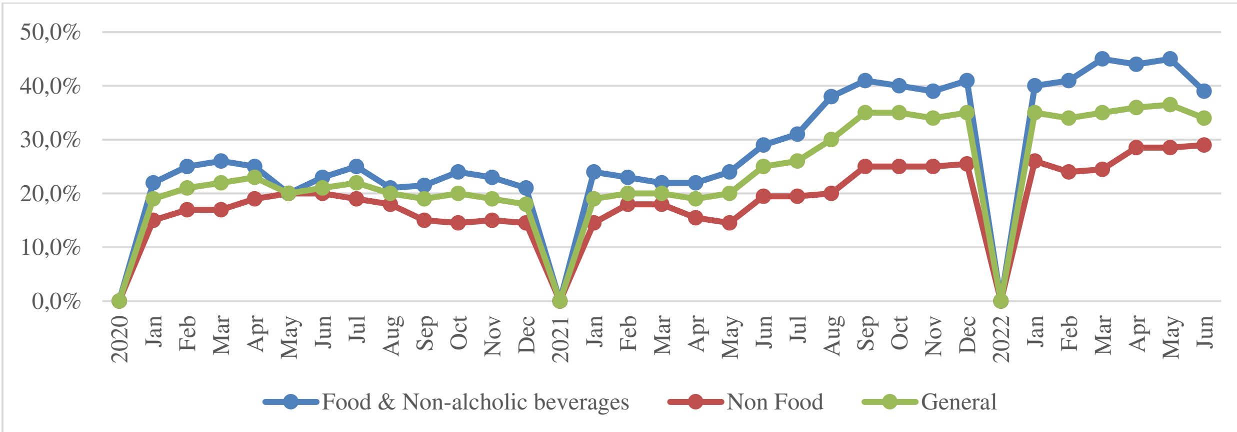
3.4.2. Inflation

Having a median rate of inflation of under five percent, Ethiopia has traditionally been among the countries with a low level of inflation. Ethiopia, nevertheless, has lost its status as a low-inflation nation since 2006, and in July 2008, the inflation rate for the nation reached a record-breaking level of 64%. The country's foreign reserves were drained as a result of the disruptions caused by the elevated fuel and food costs at the time, decreased foreign exchange revenues, and increased demand for imported goods. Poor people in cities were more exposed to the consequences of inflation because their prices increased at the highest rates: for groceries, accommodation, fuel, and transportation services (Getaneh, 2017). Inflation decreased real income, quality of life, and savings. Parallel to this, the country's exports decreased as a consequence of inflation. mainly since locally manufactured goods are more costly in the global marketplace due to rising local input costs. Additionally, it caused imports to rise. This is due to the fact that rising prices for goods made in the country led to a rise in the need for imports.

To meet its primary goal of low inflation, the National Bank of Ethiopia faced challenges. When it comes to inflation, the Ethiopian economy has seen significant hyperinflation. When it peaked in 2008, the inflation rate was 36.4%; by 2014, it had dropped to 7.2% (Mada, 2015).

As illustrated in Figure 2 below of the NBE annual report, Ethiopia's inflation rates have shown a consistent upward trend. The general inflation rate increased from 19% in the beginning of 2020 closing to slightly below 35% in the middle of 2022. Notably, the inflation rate for food and non-alcoholic beverages almost reached more than double throughout this period starting above 20% in 2020, and reaching its peak in May 2022, then closing slightly below 40% in June 2022. This pronounced acceleration in inflation shows underlying economic pressure, indicating a potential overheating.

Figure 2 Annual Inflation Rate Development in Ethiopia (2020 - 2022)



Source: NBE

3.4.3. Unemployment

In order to reduce unemployment to the advised minimal rate, the Ethiopian government communicated different plans. Even if there have been improvements in numerous initiatives in this direction, Ethiopia's strategy on unemployment has not changed significantly.

According to Getaneh (2017), "Unemployed population in urban areas of the country was 1,509,227 with an unemployment rate of 16.9 percent. This means that about 17 individuals are unemployed out of 100 economically active people aged ten years and above. The differentials of unemployment rate by sex show that the female unemployment rate (24.7 percent) is more than double as compared to the male unemployment rate which is 9.4 percent (CSA,2016)". In contrast to most sub-Saharan nations, Ethiopia's macroeconomic outlook showed an exceptionally high rate of unemployment. The nation's GDP grew by 8.0% in 2015 and 16 after averaging 9.8% yearly growth from 2010 to 2016. In essence, without any uncertainty, genuine and consistent economic expansion lowers the unemployment rate. Despite these economic advancements, widespread joblessness has persisted as one of the nation's socioeconomic issues (Sirah et al., 2020).

3.5. Business Opportunities in Ethiopia

Ethiopia is quickly rising to the top of the list of preferred locations for foreign investment. Tax reductions, cheap labor, an excellent spot for commerce, and enhanced transportation facilities are luring businesses to the region. The Ethiopian authority is attempting to boost investment in a broad range of industries whereby it has competitive benefits including, agriculture, leather and leather goods, fabrics, and apparel. Ethiopia is ideally suited for cultivation thanks to its multiple agro-climatic regions, lengthy harvest time, and access to water for irrigation and fertile soil (UNIDO, 2016).

3.5.1. Agribusiness

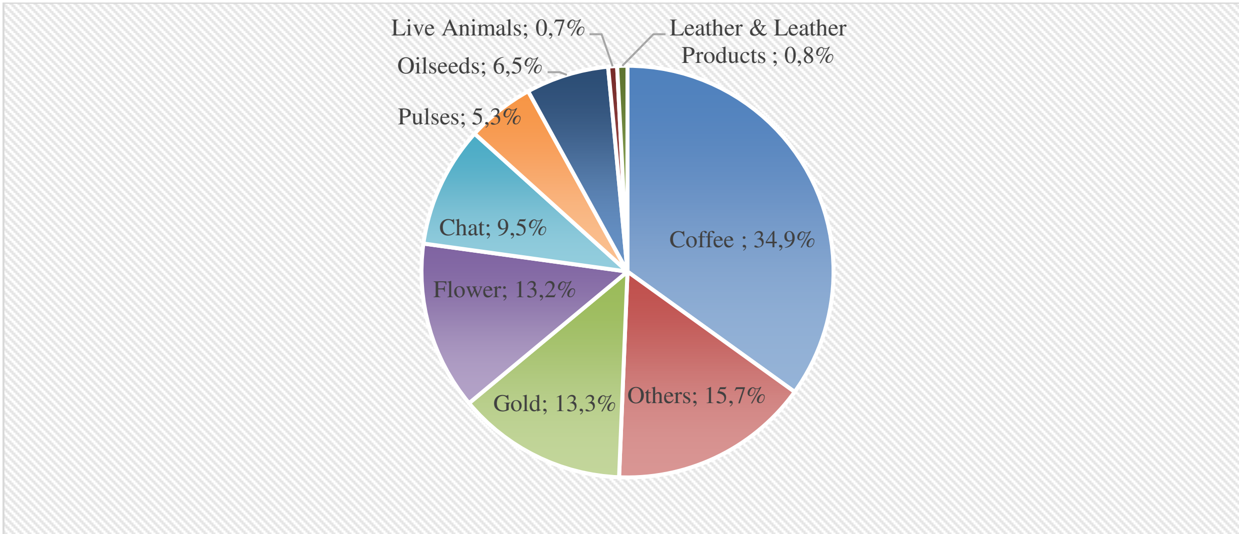
The economy of Ethiopia is dominated by the agricultural industry. As a result, it acts as the foundation of the nation's economy, which in turn influences the achievement of every other industry (Gizaw et al., 2022).

3.5.1.1. Coffee

Among the most significant agricultural products around the globe is coffee. 90 percent of its processing takes place in underdeveloped nations, bringing in money for millions of small-scale farmers worldwide (Dida, 2022). Coffee is a widely consumed product and a significant global profit crop. After petroleum, it is the second-highest precious product (Mershalo, 2020). There is a lot of genetic variety in Ethiopian coffee. As the fifth-largest maker of coffee in the entire globe and the top supplier in Africa. Coffee is a crucial component of the Ethiopian economy, with about 15 million people depending on it for subsistence (Dida, 2022). The main export goods from Ethiopia is coffee, which is also its most significant product. Ethiopia is well recognized for producing very high-quality coffee that is praised for its aromatic and taste qualities in addition to its position as the origin of Arabica coffee (Amamo, 2014).

With around 420,000 tons outputted, Ethiopian production of coffee has increased by half over the past 40 years. It is produced on approximately 560,000 hectares over five territories and is a valuable export that brought in 2014 and 2015 an amount of $780 million (mogesti, 2017). Ethiopian coffee is frequently purchased by nations including France, Germany, Italy, Sweden, Norway, Belgium, Finland, Denmark, United Kingdom, United States, Japan, Saudi Arabia, Canada, Taiwan, South Korea, Australia, and South Africa (Degaga, 2020).

Figure 3 Export Share of Major Commodities in Ethiopia (2021/2022)



Source: NBE

3.5.1.2. Livestock

Ethiopia possesses an aggregate of roughly 55.03 million cattle, 27.35 million sheep, and 28.16 million goats, making it the country with the biggest number of livestock in Africa and the tenth in the globe. These numbers exclude other valuable resources including chicken, horses, camels, and donkeys. Livestock is the primary source of income for over 70 percent of Ethiopians. 35 to 49 percent of agricultural GDP and 15 to 17 percent of overall GDP are both accounted for by livestock. The production of milk and meat, breeding and fattening animals, and the production of livestock veterinary goods all present economic prospects. A great deal of tanning facilities assist Ethiopia's manufacturing of leather, which also heavily depends on livestock (EUBFE, n.d.). The main sectors in the Ethiopian livestock industry are meat, dairy products, and live animals. 98% of the milk processed in the country is generated by small-scale ranchers, thereby maintaining the country's conventional dairy industry. Only 7% of the milk is commercialized, while approximately 85% is consumed at the family level (de Raad Sander, 2021).

The percentage of livestock and related goods in the overall value of exports ranged between 12 and 16 % for various periods from 1970 to 2008. It's crucial to remember that the majority, which is 77 % of these profits from exports came from hides and skins (Negassa et al., 2013). Ethiopia's leather, hides, and skins industries offer a wealth of options. These include the available market, the expanding domestic and global markets for skins, hides, and leather goods, the application of moist salting technology for enhanced treating and safeguarding by employing an easy and efficient way of protecting hides and skins utilizing salt, and the affordability of raw materials because of to the substantial livestock foundation in the pastoral regions. Because of their smooth texture and dense structure, Ethiopian tiny animal skins, particularly sheep skins, have historically enjoyed an excellent track record for quality in the global leather industry (Adem, 2019).

3.5.1.3. Oilseeds

With elevations ranging from beneath sea level to more than 4,500 m above sea level, Ethiopia has a wide range of weather. This makes it possible for Ethiopia to continue a long-standing practice of growing a variety of oilseeds. Ethiopia is one of the leading 5 countries in the universe for producing linseed and sesame seeds. Additionally, it is a significant supplier of Niger seed. Safflower, linseed, and castor oil all have strong export possibilities. Oilseeds may become one of the country's main sources of economic development due to rising global interest in these particular goods and the potential to increase creation (Biramo Allaro, 2011).

A substantial source of foreign exchange profits for Ethiopia comes from the oilseed industry. Niger seed, soybeans, and Sesame were the three main oilseed exports in 2016 and 2017 (October to September), and these exports brought in close to $360 million. Moreover, many producers and other market participants along the value chain also make a living from the oilseed industry (USDA, 2018).

3.5.2. Manufacturing

The manufacturing industry in Ethiopia has rapidly expanded during the past 20 years when it comes to facilitating job opportunities, marketing, and foreign direct investment (Kumar Mishra, 2018). Some of the nicest cotton in the globe is grown in Ethiopia. With the help of many government incentives, a focus on growing the textile and apparel industry along the entire supply chain, a workable business climate, and free-of-charge market opportunities in the United States and EU, Ethiopia is currently luring foreign investors and customers (EUBFE, n.d.).

Attractive incentive programs that include export privileges, fairly inexpensive electricity prices compared to other African nations, a stable macroeconomic condition, and brisk economic growth are among the prospects of the Ethiopian manufacturing industry. Moreover, owing to its impressive economic growth and high reliability, the nation has attracted significant attention from throughout the world (Eshetie, 2018).

3.5.3. Natural Resources

The Ministry of Mines and Petroleum reports that approximately $106.4 million has been invested in Ethiopia's mining industry in 2019 alone. Around $38 million of the overall investment is used for the exploration and extraction of iron, marble, precious stones, and gold, while the rest is used for searching for natural gas and the joint development of eleven petroleum resources. The contribution of mining investment to the economy of Ethiopia is occasionally growing. According to a federal report, the industry generates 4000 job possibilities, 14 percent of the nation's exports, 1% of its GDP, and 1% of its government earnings (Djigsa, 2021). Ethiopia has a wide variety of untapped natural resources, which comprises considerable gold and tantalum reserves. Additionally, found resources include gemstones and petroleum. The mining policy was created to encourage openness and equitable investment in the country and is modeled after the most effective policies of other well-known mining nations. Ethiopia's emerging economy is still dominated by public firms, while the opportunity for private investment is still mainly unrealized (Veljkovic et al., 2018).

Although it is still in its infancy, Ethiopia's oil and gas industry has great prospective growth possibilities. A variety of places in the country are presently being explored for oil and natural gas, among them are the Ogaden basin in the southern part of the country, Afar in the Northeastern part, the Mekele basin, The Gambela basin, the Abay, Metema, and Rift basins. The country administration is currently setting up corporations for the advancement of natural gas and petroleum to enhance the field and the government's ownership interest in it, following the discovery of oil and natural gas in neighboring nations along with the Calub and Hilala natural gas findings in the Ogaden territory (Djigsa, 2021).

3.6. Islamic Banking in Ethiopia

3.6.1. Banking and Ethiopia

Emperor Menelik II and Mr. Gillivray, an ambassador of the British-owned state Bank of Egypt, came to an arrangement in 1900 that laid the foundation for Ethiopia's contemporary banking system, and an agreement was signed in 1905. As a result, the Bank of Abyssinia, a subsidiary of the National Bank of Egypt that was founded in 1905 became the nation's initial bank (Abrar, 2017). On February 15, 1906, the Bank of Abyssinia was legally established and put into service with an equity capital of 500,000 British Pounds. The Bank was also given complete authority by the Ethiopian authorities to control the country's banking industry for fifty years (Abate & Kaur, 2023).

Thereafter, in light of a shortage of competent labor at the time in the nation, the Bank of Abyssinia was obliged to cease operations and be replaced in 1931 by “the Bank of Ethiopia”. This one was the nation's first bank that the Ethiopian authorities entirely possessed and managed. Nevertheless, an array of international banks also established offices in the region during that time, the majority being those with a desire to gain influence over the country's financial system. The current National Bank of Ethiopia (NBE) and Commercial Bank of Ethiopia (CBE) were birthed from the State Bank of Ethiopia (Mulisa, 2018).

3.6.2. Islam and Ethiopia

When the initial group of immigrants made their way to the Christian dynasty of Najashi at the beginning of the 7th century, Islam in Ethiopia officially began. At the outset, there was not much animosity among the Axum Kingdom of Ethiopia and the Muslims (Amenu & Laererakademi, 2008). Islam began to spread quickly once the Prophet Mohammed's message was introduced. Following Arabia, Ethiopia was the first nation to embrace Islam, and this came about as a result of a number of the companions of the Prophet seeking safety there after being persecuted by the Prophet's own Quraysh clan, which was then the most powerful clan in Mecca. By giving careful thought to the message, they were being punished for, the Ethiopian king at that time treated them with kindness and finally embraced the religion of Islam (Abdo, n.d.).

Trading proved to be the primary cause of the conversion to Islam in numerous areas across the nation. Trade that extended throughout the Indian Ocean and the Red Sea helped open the door for the spread of Islam over all of the country and the acceptance of many people to the faith. Additionally, it was clear that Muslim traders and Muslim intellectuals used to collaborate closely in order to teach others the religion (Abdu Oumer, 2021).

3.6.3. History of Islamic Banking in Ethiopia

Due to the absence of favorable regulation and governance structures that promote the setting up of Islamic financial institutions, the banking sector of Ethiopia keeps on performing the majority of its financial operations using conventional banking systems, notwithstanding the expansion of Islamic banking throughout the world and among other African nations. This is particularly significant and deserving of pointing out. Numerous potential Muslim consumers avoid depositing in the conventional banks that are operating in the nation because they fear that doing so violates the teachings of their religion (Gebregiorgies, 2022). A novel strategy is being used to set up IFB (Interest-Free Banking) operations in the banking sector of Ethiopia. Some interested parties have attempted to offer IFB products and services but got into a number of difficulties as a result of cultural and religious divides (Zegeye, 2016).

The desire to diversify the financial sector, the risk of dealing with unregulated Islamic entities that could be used to fund terrorism, the allure of oil-rich nations, a majority of which are dominated by Muslims, and the desire to invest and save the increasing financial resources of Muslim minority communities, in which the majority are without a bank account because there aren't any banks that follow Sharia law, are the main forces behind the Interest-Free Banking Business trend in non-Muslim nations. The combined effect of the aforementioned factors, as stated in the introduction of Directive No. SBB/ 51/2011 and its preceding draft directives are what derived the establishment of IFBB in Ethiopia. These objectives are to make banking accessible to Muslims who don't have the opportunity to utilize it attributed to the absence of Sharia-compliant banks, to provide a feasible reaction to the rapidly expanding universal Islamic finance industry in sequence to draw in foreign investors from Muslim-rich nations and to address Muslims' needs (Ibrahim, 2019).

A community of Muslims from the Ethiopian Muslim diaspora presented many issues to the deceased Ethiopian Prime Minister in 2007 after a protracted period of unofficial petitions to the government of Ethiopia. Subsequently, in 2008, a Muslim organization called ZamZam Bank made a presentation to the then prime minister Meles Zenawi about the significance of starting Islamic banking in the country. Following deliberation, the Prime Minister instructed the NBE's governor to draft a decree allowing the establishment of Islamic banking in Ethiopia. In 2008, NBE revised the "Licensing and Supervision of Banking Business" proclamation and published an updated proclamation that makes provision for the establishment of Islamic financial companies in response to the substantial need for Islamic financial transactions and products. The founders of Zam Zam Bank began selling shares to build fully-fledged Islamic banking, and they managed to raise 137 million Birr in just four months. The required minimal invested capital to open a bank in the country during that period was 75 million Birr. This impressive result demonstrated Ethiopia's tremendous need for Islamic finance (Mehammed Hailu & Ahmad Yatoo, 2021).

Islamic financial institutions such as Zamzam Bank, Hijra Bank, and Zad Banks began to emerge in order to fulfill their part in advancing the growth of investments and savings in Ethiopia as the National Bank of Ethiopia's directive No. 72 permitted banks to offer interest-free financial products at the window stage or as a fully-fledged business. The mandate nevertheless has only allowed the operating commercial banks to add an interest-free banking window within their functioning. Although this was put into effect in October 2011, the country's interest-free banking program didn't begin until September 2013 with the creation of the Oromia International Bank. At the end of October of that year, the Commercial Bank of Ethiopia entered the marketplace, and on May 1, 2014, United Bank took suit (Gebregiorgies, 2022).

Due to Regulation No. SBB/51/2011, launching full-fledged Islamic banking in Ethiopia became impossible, and on the 11th of January 2012, the NBE gave the founders of Zam Zam Bank the option of setting up a conventional bank that might provide noninterest charging loans by means of a window method or ending the formation procedures. The founders of Zam Zam Bank's primary goal was to offer a substitute Sharia-compliant banking solutions to people who are unable to use traditional financial services for ethical or faith-related factors. Eventually, due to their refusal to go along with NBE's provision, Zam Zam Bank's creation procedure was stopped in May 2012, with stockholders receiving a full reimbursement (Mehammed Hailu & Ahmad Yatoo, 2021).

Later on, the ambition of creating a fully operational interest-free bank in Ethiopia eventually came to pass by declaration No: 1159/2019. The declaration was made following an announcement by the Prime Minister of Ethiopia at the moment, Dr. Abiy Ahmed, while attending the Ramadan

Iftar Avenue hosted by the Ethiopian Islamic Affairs Supreme Council on the 22nd of May, in which he pledged to allow the implementation of fully functioning interest-free banking. After the commitment of Dr. Abiy Ahmed and the publication of declaration No. 1159/2019, a line of multiple share firms formed to apply for approval from NBE to offer full-fledged interest-free financial products in the country. Up to July 2019, ZamZam, Hijira, Nejashi, and Zad banks were in the creation stage, whereas a further four share firms are pursuing NBE licensing (Hailu & Bushera, 2020). According to Hailu& Tekdoğan (2023) "In line with the authorization to establish fully-fledged interest-free banks in Ethiopia, four banks, namely ZamZam, Hjira, Shabelle, and Rammis, have commenced operations to provide comprehensive interest-free banking services and products".

3.7. Newly Established Fully Fledged Islamic Banks in Ethiopia

As we mentioned earlier the Islamic banking system in Ethiopia is in its infancy stage compared to other countries, especially the neighboring ones like Sudan, Somalia, Kenya, and Djibouti. Initially, the country started offering Interest-free services through windows, later on after the proclamation made by the current prime minister regarding the approval of launching fully-fledged Islamic Banks in the country, besides the existing CBs that used to provide Islamic products on a window basis opening fully-fledged branches, new banks got into the industry. These new Islamic banks that recently began to offer services are ZamZam, Hijra, Shabelle, and Rammis. In the upcoming lines, we will try to look at these newly established Islamic banks.

3.7.1. ZamZam Bank

Named after the holly water of Zamzam in Makkah, the bank holds the distinction of being the first to get a license from the NBE to offer comprehensive Islamic banking services. 11,200 stakeholders were able to provide the bank with 872 million birr in paid-up capital and 1.683 billion birr in subscribed capital (ZamZamlinkedin, n.d).

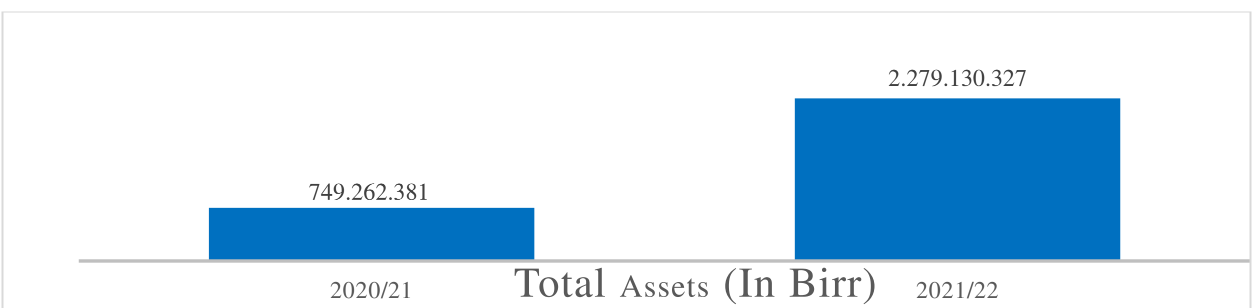
The bank has accounts like the diaspora account which provides services for international clients, especially the ones with Ethiopian decedents, Qard current account, and Qard no resident foreign currency account. The initial deposit amount for the former one is birr 250, while for the latter one is 100 USD. Financing modes like Mudarabah, Musharakah, Salam, personal financing, Murabaha, Istisna, Kefala, and Ijarah are utilized by the bank. Moreover, the bank has services like remittance, trade, and foreign transfer (Banksethiopia, n.d).

3.7.2. Hijra Bank

This is the second fully-fledged Islamic banking institution that was established in the country. The bank has financing models like Musharakah, Mudarabah, Wakalah, Istisna, and Salam. Additionally, it has an account named "Haramain" that is exclusive to users who intend to do the Hajj or Umrah. Under this account, the customer will receive a loan from the bank in the form of Qard al Hassan if they save half of the total money required to complete Umrah or Hajj. The bank also has digital banking amenities such as internet and mobile banking (Banksethiopia, n.d).

In the initial ten months of functioning, the bank has mobilized deposits totaling Birr 1.3 billion, and in the year 2021–2022, it has mobilized USD 233,535.30 from a variety of sources. Similarly, in the ten months that the bank has been open for business, it has made a total of Birr 27.6 million. Commission and fees account for 25% of revenue, with financing and investments providing the remaining 70%. Other operational incomes provide the remainder of the revenue. Moreover, assets held by the bank during the creation stage in 2020–21 amounted to Br 749 million, but after operations began in 2021/22, they climbed to Br 2.3 billion. However, In the initial year of operation, the bank lost Br 143 million, which is typical of the early stages of banking activities (Annual Report, 2022).

Figure 4 Hijra Banks' Growth of Asset



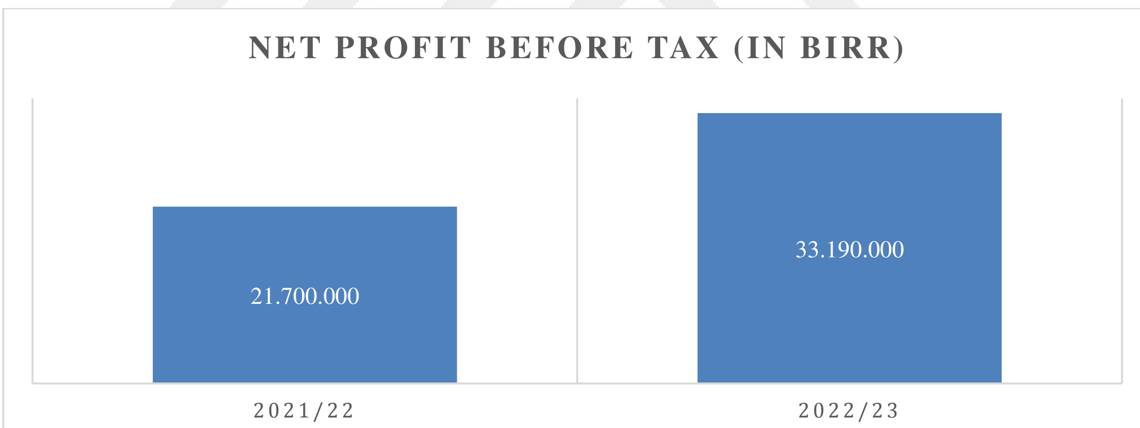
Source: Annual Report of Hijra Bank (2022/23)

3.7.3. Shabelle Bank

This bank first started its operation in 2011 as a microfinance institution and after the proclamation of allowing fully-fledged Islamic banks it obtained its banking license to continue offering services to its clients (Shabellebank, n.d). The bank presently boasts a paid-up capital of over 500 million Birr, over 52 branches, and one million customers. It provides various accounts for its customers like Al Wadiah current account, Mudarabah saving account, Hajj or Umrah saving account, and Wakalah investment deposit accounts. Furthermore, it provides facilities such as mobile banking and microfinance (Banksethiopia, n.d). It also has financing modes such as home financing based on Diminishing Musharkah, Ijarah vehicle financing, Muarabaha, and Musharakah (Shabellebank, n.d).

The net profit of the bank as it is illustrated in the below figure has shown significant growth over the two years. In the fiscal year 2021/22, the net profit before tax amounted to 21.70 million Birr, whereas in the following year, 2022/23, it increased substantially to 33.19 million Birr. This represents a notable growth in profit for the bank within this period.

Figure 5 Shabelle Banks' Growth of Net Profit Before Tax



Source: Annual Report of Shabelle Bank (2022/23)

3.7.4. Rammis Bank

With birr 2.4 billion in subscribed capital and birr 747 million in paid-up capital from 8,200 shareholders, Rammis Bank was founded in October 2022. The bank has digital banking services like mobile and internet banking. It also has accounts like the Wakalah investment account in which the bank acts as an agent for the investor and then charges a Wakalah service fee, a Wadiah saving account, and a foreign currency saving account (Rammisbank, n.d).

It was intended to include the asset or profit growth of all four banks in this section. However, efforts to locate annual reports from the remaining two banks (Rammis and Zam Zam) were unsuccessful. Despite thorough searches on their respective websites, the annual reports could not be found.

Table 2 Summary of the Newly Established Islamic Banks in Ethiopia

Name of Bank	Year of Establishment	Account Types	Modes of Financing
ZamZam Bank	2020	Diaspora Account Qard Current Account Qard Non-Resident Foreign Currency Account	Murabaha Istisna Ijarah Salam Musharakah Mudarabah Kafalah(Letter of Guarantee) Personal Financing
Hijra Bank	2022	Haramain Wadiah Saving Account Hajj/Umrah Installment Saving	Murabaha Mudarabah Musharakah Wakalah Istisna Salam
Shabelle Bank	2022	Mudarabah General Savings Account Foreign Exchange Saving Account Temporary Saving Account Investment Account Hajj Saving Account	Mudarbah Musharkah Murabaha Ijarah Istisna Microfinance

Rammis Bank	2022	Wadiah Saving Account Hajj Saving Account Investment Account Foreign Currency Exchange Account Temporary Saving Account	Mudarabah Musharkah Murabaha Ijarah Istisna

Source: From Each Bank's Website and Banks Ethiopia Website

CHAPTER 4. RESEARCH METHODOLOGY

4.1. Introduction

A research methodology is a structured process for proposing, implementing, and analyzing scientific studies. In this chapter, we will discuss the research design used in this study, the data type, the population sample, and methods for data collection and analysis.

4.2. Research Design

A rational and methodical strategy created to guide a research investigation is known as a research design. It outlines the goals of the investigation as well as the approaches and strategies that will be used to get there. It serves as a guide for gathering, estimating, and analyzing data. It is the strategy, organization, and approach that is designed to provide an answer to the question of the research (Khanday, 2023).

Explanatory, descriptive, and exploratory are the three types of study designs that may be used (Boru, 2018). Descriptive research aims to describe a phenomenon and its features. It mainly focuses more on what has occurred than why it has occurred. Consequently, data collection methods frequently include surveys and observational instruments. Although the data in this kind of research might be gathered qualitatively, it is frequently subjected to quantitative analysis, with correlations being found through the use of statistical analyses such as averages, frequencies, and percentages (Nassaji, 2015). In this study, a descriptive research design is employed and data is presented in percentiles and frequencies.

4.3. Data Type

Depending on the kind of data being sought, research may be divided into qualitative and quantitative, and a mixed method, which is research that combines two approaches and covers the benefits of both (Taherdoost, 2022).

The qualitative research method focuses on the essence of phenomena, not on their spectrum, frequency, or position in a logically established causal linkage. It examines the phenomena's quality, various expressions, context, and viewpoints from where they can be viewed (Ugwu &

Val, 2023). On the other hand, the quantitative research method involves gathering and evaluating numerical data to provide answers to systematic research questions. The approach is used to investigate causal relationships, average, identify patterns, illustrate, and extrapolate findings to larger populations (Rana et al., 2021). This study has used both quantitative and qualitative research methods to present the emerging Islamic Banking experience in Ethiopia.

4.4. Data source

Data is the plural of datum which stands for a bit of information. Data can be gathered in the course of a study, as an outcome of an experiment, by observation, or via a survey. Researchers can additionally collect the data independently (Mazhar, 2021). In scientific research, there are two sources of data, which are primary data and secondary data.

Primary data are those that have been gathered via direct observation. Primary data is more trustworthy, genuine, and impartial because it hasn't been released yet. Primary data is more legitimate than secondary data since it has not been modified or tampered with by humans. Working with original data and gathering data from primary sources are essential for research studies (Muhammad & Kabir, 2016). Observations, surveys, focus groups, and interviews are a few examples of primary data sources. The investigator could carry out a survey in the actual location by getting in touch with the respondents directly. Moreover, he/she can conduct the survey by phone, or mail (Ajayi, 2023).

The primary data of this study was gathered from the participants, which consisted of the public, academics, and experts in Islamic Banking and finance through the administration of an online survey questionnaire that was prepared on Google form. The survey was distributed to participants via e-mail or an accessible online link. The survey was prepared with the help of the supervisor. The survey was composed of four parts, the first was about the demographic background of the participants. The second part was about the level of awareness and trust that the respondents had in the Newly established Islamic Banks (NEIBs). The third section was about the prominent opportunities and challenges of the NEIBs. The questions of this part were in line with the second research question of the study, which is what are the main obstacles that Islamic financial institutions face in Ethiopia, and what are the most promising opportunities? The fourth section was about the general performance of the NEIBs evaluation and the future outlook of Islamic Banks in Ethiopia. The survey questions of this part were intended to answer the first (Is it valuable to establish an Islamic bank in Ethiopia?) and third (Do Islamic banks generally perform effectively?) research questions of the study.

On the other hand, secondary data analysis is the examination of data that was gathered by another party for a different main objective. For scholars with limited assets and time, making use of this available data offers a feasible alternative (Johnston, 2014). The information obtained by secondary data comes from publicly available sources, indicating that it has previously been acquired for a different purpose and may be utilized for different study objectives. Secondary data can come from a variety of sources, including books, journals, documents, and online publications. Because it might occasionally be difficult to gather primary data, secondary sources are nonetheless crucial for scientific investigations (Taherdoost, 2021).

This study also used secondary data by collecting data from different sources like articles, books, magazines, digital resources, and websites.

4.5. Population Sample

The main group that the research is dealing with is the target population of the research. It generally consists of groups, people, organizations, and any other similar group that one aims to comprehend and to which the study conclusions may be applied (Casteel & Bridier, 2021). The target population of this study included residents of Jigjiga City, since the total population size of JigJiga City is 428,759 according to the Ethiopian Statistical Service of 2023, a sample group was taken from the inhabitants. A sample is the portion of the population selected specifically for the research project. It represents the population to collect information and make generalizations about them. A total of 98 respondents comprising professionals in Islamic Banking as well as the public participated in the study's online questionnaire survey to give their views regarding the presented questions or statements.

4.6. Data Analysis

Data analysis is the method of carefully examining unprocessed data in order to make conclusions about it. Its primary goal is to organize the already accessible, disorganized data in a manner that facilitates decision-making and is easier to read, unambiguous, and clear (Kaur Bhatia, 2017).

In this study, the data collected from the respondents was analyzed by using the IBM SPSS Statistics version 29.0.2 software and was presented in figures and tables. Descriptive statistics such as percentile, frequencies, and mean values were employed.

CHAPTER 5. OPPORTUNITIES AND CHALLENGES OF ISLAMIC BANKING IN ETHIOPIA

5.1. Introduction

Islamic finance is still in its infancy even though it has demonstrated amazing success in a number of fields. It has suffered for over twenty-five years, having begun in a harsh climate. Although it has achieved multiple triumphs, there are still many obstacles in its way. It needs to be viewed as a growing reality, just like any other financial framework. Every step of its evolution requires pausing to reflect on the past, draw lessons from it, and map out a path of action for what is to come. From this vantage point, the sector faces a constant stream of challenges (Iqbal & Molyneux, 2005). Possible prospective challenges for the IFI include legal impacts, scalability diseconomies, an absence of versatile financing choices, an insufficient assortment of products, and limitations in handling liquidity. Nevertheless, the company has not yet ventured towards banking on investments, national financing, energy financing, or infrastructure financing for growth expenses in plenty of regions (Shaikh, 2014).

Generally speaking, the least developed nations face the following difficulties: an absence of education and awareness among the population regarding the advantages of Islamic banking; and an inherent apathy of interest in Islamic banking as a result of crude marketing tactics (Alami et al., 2021). In this chapter, the opportunities and challenges of Islamic banking and finance in the Horn of Africa and Ethiopia will be highlighted.

5.2. Opportunities and Challenges of Islamic Banking and Finance in the Horn of Africa

Across the whole African continent, the Greater Horn region has suffered the most from combat. Since Sudan gained its independence in 1956 becoming the first nation in sub-Saharan Africa to do so the people of the area have experienced numerous military wars, both inside and between states. Along with Southern Sudan, which got its sovereignty on July 9, 2011, the area currently comprises 7 nations that are members of IGAD I.e., the Intergovernmental Authority for

Development: Kenya, Uganda, Ethiopia, Djibouti, Sudan, Somalia, and Eritrea (Kidane Mengisteab., 2011).

With the majority of economic output and income located in Sudan and Ethiopia, the HOA boasts a sizable and expanding GDP, 89% of the region's $188 billion GDP comes from these two markets i.e., $95 billion and $72 billion, correspondingly. In the area, GDP growth is substantial, ranging from 5 to 9% annually in Sudan, Ethiopia, Eritrea, and Djibouti; however, fighting has caused the South Sudanese economy to contract, while Somalia's GDP is expanding slowly. Sudan has the highest GDP per capita of $2,899. Lesser than $800 is the amount in, Eritrea, South Sudan, Ethiopia, and Somalia (African Development Bank, 2018).

Just like any other Islamic financial institution around the globe, the Islamic financial institutions also in the HOA faced challenges and had bright aspects as well. In the coming section, we will try to discuss the challenges and opportunities that some countries in the HOA encounter.

5.2.1. Somalia

Somalia counts as one of the most impoverished states on earth and its people are extremely reliant on international aid, even though they are among the most industrious people on the planet. Instabilities in politics and conflict have hindered Somalia's ability to establish a cohesive and well-organized local economy (Warsame, 2016).

In his study about the effects of Islamic finance practice on the social development of Somalia particularly the capital city of Mogadishu Guled (2022) concluded that Islamic financial practices have a strong positive impact on social development. Moreover, there is a positive relationship between Islamic financial practices and factors like poverty alleviation and job creation. In another study regarding the impacts of Islamic micro-finance on small and medium enterprises in Somalia A. M. Abdi & Uluyol, (n.d.) indicated that small business activities in the capital city of Somalia have considerably fewer effects from Islamic microfinance than one might anticipate from the local marketplace. Insufficient funds for ISMF, banks not having enough capital to invest in SMEs, exorbitant ISMF rates charged by financial firms on small and medium-sized businesses and businessmen, and an absence of confidence among customers in banks are the challenges that Mogadishu faces in implementing ISMF. As opposed to this, businessmen fund their SMES through a variety of channels, including private businesses, benevolence organizations that support the act, relatives, and families.

In essence, Islamic financial institutions have more opportunities in Somalia than in other countries since IFIs are more socially accepted there than traditional financial institutions, and the reason some unofficial Islamic financial products are already in place, this makes the establishment of an official Islamic financial industry easier (O. Y. Abdi, 2014). Moreover, the sector may prosper in Somalia if the supremacy of the regulation of law may be guaranteed, as it has a strong desire for the country's banking system to be revived and for financial amenities to be provided in line with the views of the community at large, which are all Muslims. This implies that maintaining regulatory dominance and passing business-friendly legislation will be critical when it comes to the financial sector's recovery in the country. An alliance with a global financial institution is the most advantageous banking strategy for the nation (Warsame, 2016).

5.2.2. Kenya

The Muslim society in Kenya has been urging and exerting pressure on the government, and especially the Central Bank of Kenya, to permit a banking scheme with Islamic rules in the country. The finance minister did not change the Banking Regulations Act to permit Islamic banking in the nation till 2005, at which point the Central Bank of Kenya made that recommendation. The "Amana" account by Kenya Commercial Bank in July 2006 and the "La Riba" account for the Barclays Bank of Kenya in December 2005 were launched accordingly. The Banking Act's Section 4 was amended, thus paving the way for the establishment of fully operational Islamic banks in Kenya, as the country's finance minister declared in June 2006 (Kader & Kassam Musani, 2012).

After the establishment of banks that comply with sharia in Kenya, a sizable portion of Muslims shifted their banking loyalty to these institutions. This implies that the majority of Muslims favor Islamic banks because their offerings honor their faith. In addition, because the majority of Muslims endorse banking through establishments that adhere to the strictures and teachings of their faith, Muslims have an extremely favorable view of Islamic banks. However, more work must be carried out in the country to guarantee that a greater number of Muslims in Kenya have an opportunity to utilize financial services that are considerate of their desires (Warsame, 2015). The biggest obstacle facing Kenya's fledgling Islamic banking sector is the banking law and related regulations issued by the Central Bank. asymmetry of organizational and regulatory backing to Islamic banks within this nation, as well as the regulators' ignorance of Islamic banking, contributed to that. Similarly, Shariah compliance regulations in this emerging sector are insufficient. There is no overarching supervisory body that oversees compliance with Shariah and controls the conduct of sector participants. precisely a consequence of this, every financial institution offering goods under Islamic finance has independent Shariah boards. Furthermore, a problem for Islamic banks is the shortage of skilled labor in the sector, which contributes to poor adherence and a traditional banking system mindset throughout the entire banking sector (Sheikh, 2009).

In addition, the growth of Islamic banking is impacted by elements including providing products and amenities that satisfy the demands of the consumer, lowering borrowing costs, lowering the minimal criteria for opening a bank account, and providing efficient customer offerings. However, there may be a demand for Islamic financial products in the not-too-distant future. It was observed that more youthful people were utilizing these products and amenities (Kinyanjui, 2013).

According to Kader & Kassam Musani (2012), "the banks mainly offered current and savings accounts for deposit mobilization and the majority of the banks did not offer Shariah-compliant investments. Very few banks are offering financial intermediation currently while the rest of the banks are in the process of introducing it. On the side of challenges faced by these banks, developing money markets, regulation and supervision of Islamic finance, competition, legislation, and tax regulations were the most challenging respectively".

5.2.3. Uganda

Despite not being a Muslim government Uganda is among the most recent nations in East Africa to adopt Islamic banking through the Financial Institutions Reform Bill 2016. By introducing new banking products that were unknown in Uganda's traditional banking system, this reform has completely changed the banking industry (Mastulah, 2018).

A deep concern that several of Uganda's traditional bankers would view Islamic banking as a danger rather than as an avenue for profit where they may make investments to improve their operations is one of the difficult issues facing the industry. They contend that Islamic banking will probably draw customers because of its interest-free and moral project financing methods, driving them away from the company. The Central Shariah Advisory Council cannot be established, according to the Bank of Uganda, because it does not have the necessary knowledge. The top members of Uganda's society, nonetheless, believe that this reasoning is implausible and maintain that the specialists needed in accordance with Ugandan law are accessible. Moreover, due to their extreme degrees of insincerity, traditional bankers are skeptical of their customers. Since the viability of Islamic financial institutions relies on loyal clients, this renders a number of them hesitant to adopt it. Additionally, the Bankers Association of Uganda hasn't done sufficient tasks to push its associates to use Islamic finance (Muhammad Kyambadde, 2021).

Regulatory challenges that prevent Islamic banking from functioning as it truly will probably arise when Islamic banking is adopted in Uganda. It is well known that some policies and practices are likely to be at odds with the tenets of Islamic banks. If these policies and protocols were implemented, it might be discriminatory to the Islamic banks and negate the entire goal of introducing Islamic banking to the country. Therefore, ensuring the successful execution of any Islamic banking framework requires a thorough legal structure (Mastulah, 2018).

5.2.4. Djibouti

When Saba Islamic Bank in Yemen decided to create a subsidiary in Djibouti on June 26, 2006, it marked the beginning of a successful Islamic bank to be established in Djibouti. Along with after getting guarantees and promises from the Djiboutian authorities that it would supply him with every opportunity and assistance he needed when he decided to integrate into the nation, the authorities did as it was supposed to and transferred their knowledge, resources, and substance and financial capacities to Djibouti. It ended the two old banks' harsh dominance and offered the general people a wide range of banking offerings. It additionally offered an alternative for a sizable portion of the populace that avoided interactions with banks due to worry about incurring interest charges and opted for taking out loans from interest-based banks since they could not find anybody who could satisfy their financial requirements in an Islamic manner (Omar, 2021).

In terms of challenges, a lack of qualified personnel could impede the bank's expansion as it may limit profitability and lead customers to switch to a traditional bank if staff members are unfamiliar with Islamic banking concepts and practices. Since societal awareness is essential to the development of Islamic banks, customers are not sufficiently informed about the distinctions between Islamic and traditional financial services. Furthermore, the notion of IFIs is muddled due to noncompliance with Shariah principles and disparate approaches (Farah, 2019).

The potential of the Islamic financial sector in Djibouti remains restricted. A little over one percent of the company's overall assets come from the tiny Islamic microfinance industry, which is mostly comprised of Islamic banks. Despite the existence of the Takaful regulation, no Takaful institution exists. The Sukuk still lacks a market and a regulatory structure (Omar, 2021).

5.3. Opportunities of Islamic banks in Ethiopia

The concept of Islamic banking is somehow new in Ethiopia, especially fully-fledged Islamic banking. The industry has a good future in the country because of the availability of customers that are interested in financial transactions, which adhere to their religious values. Moreover, non-Muslim individuals who require an ethical-based banking system are also other supporters of the idea of interest-free finance. The company has various opportunities in the country, below we will try to investigate the most prominent ones:

5.3.1. High Public demand

FFIBs offer financial operations that adhere to Islamic law's principles of Shariah. These banks in Ethiopia have the ability to generate an extensive clientele that will ultimately be an opportunity for growth and a bright future by offering banking activities that serve the consumers of their financial services without breaking the religious beliefs of Muslim society (Girma, 2020). Though the intended audience is large, Islamic banking offerings constitute an unexplored market. By offering alternate banking products, Islamic banking services would encourage clients of traditional banks to switch to them, and that is one opportunity that exists there (Belayneh, 2020).

Interest-free financing may be available in Ethiopia in several different ways. The primary one of these prospects is the presence of a sizable pool of possible clients who, primarily for the sake of their faith, have been shut out of mainstream financial services and products. The capability of an entity to find new clients who can use its goods and services is the primary factor in determining its achievement. It is projected that Muslims would make up the majority of consumers for interest-free finance amenities since the fundamentals of Islamic finance are derived from Sharia law

(Hailu & Bushera, 2020). Within Ethiopia, the desire for interest-free financial services is stronger, especially in Dire Dawa city. The fact that Islamic banks may contribute to the upward trajectory of both the banking industry and the nation as a whole is another significant possibility for Islamic banks to expand, given that Ethiopia's financial system is currently in the developmental phase (Abdulhade, 2020).

So, the existence of a sizable prospective client base for Islamic finance goods and services represents the first significant opportunity for the sector. As was previously said, it is anticipated that half of Ethiopians are Muslims. This percentage of the Muslim community is higher than that of the majority of Muslim nations using Islamic financing. It is anticipated, nevertheless, that non-Muslim populations with an interest in moral finance would also have a choice of Islamic finance offerings and products (Mehammed Hailu & Ahmad Yatoo, 2021).

5.3.2. Profitability

The second significant opportunity for Islamic banks to grow is their ability to attract more deposits from the Muslim community, which was underrepresented in the banking sector and believed that interest-free window financial services did not adhere to Sharia principles. The increased deposit in the banking sector has the potential to boost savings and investments within the Muslim population and throughout the nation (Abdulhade, 2020).

As a result of growing up in an atmosphere that supports their religious dogma and detests interests, the excluded individuals who relied entirely on their equity and ignored financial optimization and capital accumulation will create a substantial marketplace. After that, they'll switch to profit maximization that involves equity and debt, which creates an opportunity for the development of Islamic banks (Belayneh, 2020).

The accomplishment of interest-free banking windows in accumulating large sums of funds through interest-free depositing plans is an indication of the prospective efficacy of fully-fledged interest-free banking in Ethiopia. The three main account kinds that receive deposits are profit-sharing accounts: Mudarabah, savings accounts: Wadi'a, and current accounts: Amanah. The IFB window operation had been monopolized by the government-owned Commercial Bank of Ethiopia (CBE), which also controlled the country's banking industry. From 2017, in a period of two years, the entire number of deposits gathered by all commercial banks offering interest-free banking window services succeeded in increasing from 20 billion ETB I.e., 715 million USD to 40 billion ETB or 1.5 billion USD. Therefore, in only two years, deposit mobilization in Ethiopia's interest-free window financial services has increased by 100% (Hailu & Bushera, 2020). The aggregate deposit obtained from all traditional IFB windows as of September 30, 2021, was approximately 66.5 billion Birr, according to data gathered from the NBE. This demonstrated that fully operational Islamic banks have little trouble raising deposits (Mehammed Hailu & Ahmad Yatoo, 2021).

Therefore, the growth potential for Islamic banks in Ethiopia is substantial, driven by increased participation from previously excluded segments of the population, especially the Muslim community, and the demonstrated success of interest-free banking models in mobilizing deposits.

5.3.3. Economic Growth

Ethiopian economic progress benefits from the existence of an Islamic banking institution. Ethiopia's economic development would be greatly aided by the introduction of the Islamic financial sector, which opens doors for those who have been denied access due to their religious beliefs, which have caused them to despise interests that are forbidden by the Shariah law (Belayneh, 2020).

Investors who desire to profit from the interest-free financial technique's backing will inevitably gravitate toward an environment that is without interest. An atmosphere without strict requirements for obtaining cash to finance investments is the sole one in which investment can flourish. That implies that the Islamic banking industry can help expedite the infrastructure expansion that Ethiopia needs. To promote commerce and business within the business group, the emergence of the Islamic banking operation and financial framework is useful. As a result, the actual sector of the financial system will develop and grow more rapidly. Individuals with the necessary expertise but insufficient funds could explore business opportunities on a double-sided advantage approach through the many financing options offered by Islamic banks. Together with effectiveness, it also provides doors to employment and the advancement of human potential (A. Hailu, 2015).

The introduction of Islamic banking might alleviate the issue of insufficient workforce capital ratios for farmers as well as employees in the informal economy connected to farming and factory businesses. Therefore, the bulk of Ethiopian farmers and laborers may benefit financially from Islamic banking. Additionally, the Ethiopian authorities will undoubtedly benefit diplomatically from the adoption of Islamic banking in order to conduct business with nations that are overwhelmingly Muslim and, in particular, to draw trillions of dollars in equity financing from the Gulf States (Olad, 2012).

5.4. Challenges of Islamic Banking in Ethiopia

The Islamic banking industry in Ethiopia is facing different challenges than other countries around the globe. Below we will try to mention some of those challenges:

5.4.1. Regulatory Challenges

The Ethiopian Commercial Code and related regulatory issues are the primary and most important difficulties facing Islamic finance. Ethiopia's commercial legislation is based on usury, hence certain proclamations must be amended in order to allow an interest-free financial framework (Mehammed Hailu & Ahmad Yatoo, 2021).

Islamic banking products and services are rarely included by the regulatory and legislative structures of the National Bank of Ethiopia that govern banking operations; they are primarily intended for traditional banks. The establishment of Islamic financial institutions and their entry into the banking industry would provide a couple of operational obstacles (Belayneh, 2020). Directive No. SBB/60/2015, which limits bank investments, is one of the fundamental regulatory hurdles Islamic banks must overcome. A financial institution can own a maximum of ten percent equity shares in a single non-banking corporation, aside from insurance firms, according to the directives of Article 4 (4). Moreover, article 4 (6) further specifies that a bank's total equity investment in all non-bank businesses, as well as insurance firms, is limited to no more than ten percent of its total assets. It is unclear if these articles apply to Islamic financial institutions or not. Since the majority of Islamic financial products rely on equity investment, it may be claimed that Islamic financial products like Musharakah and Mudarabah cannot be used in such regulatory environments (Hailu & Bushera, 2020).

Moreover, the majority of tax regulations in nations like Ethiopia are set up to work with traditional financial services. Because of this, the tax system is typically challenged when IFB is introduced unless nations develop regulations specifically for this purpose. Because of this, the main problem with taxing IFB items generally is that, in comparison to their traditional equivalents, these interactions need more steps to produce identical financial rewards. Therefore, there would be additional tax expenses if every stage were to be taken into account independently (Halefom, n.d.)**.** For instance, double taxation could be a problem for IFBs that perform Murabaha I.e., Cost-plus-Profit Sale transactions. Offering items with a markup profit is the goal of Murabaha, as opposed to lending clients money with interest. As a result, the bank taxes the Murabaha deal twice once when it purchases the commodity from the vendors and again when the client does so. Shariah-based products might not be viable if indirect taxes such as Turnover Tax and Value Added Tax were applied to Murabaha's financial dealings in addition to direct taxes such as income tax from commerce operations. This is because the items would cost more to customers (FCDO, 2022)**.**

5.4.2. Shariah Compliance

One can broadly classify Shariah governance models by two primary methods: decentralized and centralized. In essence, to guarantee the implementation of Islamic finance in compliance with the rules of Shariah, the latter Shariah governance model must be available. One nation that allowed the use of Islamic financial transactions was Ethiopia, where traditional banks first opened non- non-interest charging window-based banking system in 2011 and then expanded to a fully-fledged interest-free banking system at the end of 2019. Nonetheless, no Shariah governance system was mentioned under the statute of the NBE. The industry could be in danger of failing to comply with Shariah laws if there is no defined Shariah governance mechanism in place (Hailu & Tekdoğan, 2023). This is a critical oversight and mitigation measure for the functioning of the windows scheme. It becomes evident that the establishment of a Sharia supervisory board is essential to reducing the damage to reputation associated with failing to comply with Shariah broadly. It additionally, functions to ensure that the windows adhere to operating standards and safeguard the interests of the depositors and Investment account holders. Furthermore, the NBE's supervision framework has to include a distinct supervisory unit for interest-free banking operations. Distinct supervisory units also provide a solid foundation for the formation of a unique, professional panel of auditors with superior Sharia knowledge and oversight criteria for interest-free financial services (Yimam, 2019).

The problem of the Shariah governance structure is not given essential consideration by interest-free financial institutions, particularly those that offer interest-free banking services through Windows. Additionally, assumed indicators of compliance with Shariah in Ethiopia include the existence of a Shariah consultative board, the use of Arabic terminology and titles for products and amenities, the proclamation of adherence to the Islamic Financial Services Board (IFSB), and Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) standards, and involvement in corporate communal responsibility initiatives. But even if an approved outside organization supervises and regulates their use, these assertions are inadequate to support the argument that their products and services conform with Shariah (Hailu & Tekdoğan, 2023).

So, the absence of a defined Shariah governance mechanism within Ethiopia's Islamic finance framework poses a critical oversight and risk to the industry's compliance with Shariah principles.

5.4.3. Lack of Awareness and Education

The absence of knowledge within the public about Islamic banks' operations and the kinds of products and solutions they provide is another major issue. Furthermore, the majority of clients believe incorrectly that Islamic banks are exclusively available to Muslim households (Abdulhade, 2020). Allegedly the biggest issue facing Islamic banking, despite the industry's expansion over the past three decades, is reportedly a lack of information. After the initial single and collective attempts emerged at the beginning of 2008, Ethiopia's Islamic financial sector expansion and development stagnated for over five years (Olad, 2012). Ethiopians have a very low level of understanding of Islamic banking, which ultimately contributed to lower-than-expected engagement with Interest-free financial operations (Belayneh, 2020).

The incorrect linkage of Islamic banking with a particular faith is one of the primary challenges that the industry is currently facing. What's more regrettable is the lately, false, and unsubstantiated connection of Islamic finance with international terrorism activities (Olad, 2012). According to Hailu & Bushera (2020), " An article published on Gion Magazine in June 2019 by a famous economic commentator named Kibur Genna, reflects the discontent and misconceptions they have regarding Islamic finance. Kibur Genna wrote in Gion magazine that, the government has made a fatal mistake by allowing the establishment of an Interest-free bank. He based his argument on spurious cases. He claimed that Interest-free banks would be another divisive factor in Ethiopian politics, though he failed to substantiate his claim. He further argued that Islamic banks are established to serve merely the Muslim community, which by no means is acceptable".

5.4.4. Lack of Skilled Human Resources

Since there isn't a single organization that offers education in the Islamic banking business, the growth of Islamic banks might encounter difficulties due to a lack of qualified expertise for Islamic bank operations in Direr Dawa City Ethiopia (Abdulhade, 2020).

It has been challenging to maintain a seamless operation due to a dearth of skilled labor that can meet the market demand for Islamic financing. This is for window-level Interest-free banking offerings, and fully operational Islamic banking follows the same rules (Belayneh, 2020). Staff members who provide services are assigned to posts and get brief training. They were not giving their clients sufficient information regarding the service items, nor were they offering excellent service. Expertise in the sector of sharia advisory board membership is likewise lacking. There are plenty of religious people in our nation who know more about their religion than they do about business. Membership in the Sharia Advisory requires both of these qualifications (A. Hailu, 2015).

The primary cause of the shortage of Islamic finance specialists was the absence of educational institutions offering classes, workshops, and programs in Islamic finance. In both private and public educational institutions across the nation, Islamic finance is not offered as a single course of study. IFB window vendors either call in specialists from overseas or deploy their workers abroad for training. Whatever the outcome, the costs have an impact on the bank's profits. The issue can also be seen in the Sharia advisory board recruiting background of IFB window operators. A Sharia advisory board has been established by almost all IFB window offerors, and the majority of members in all financial institutions are standard religious instructors rather than specialists in Islamic finance. This demonstrates unequivocally that there is a severe lack of knowledgeable Islamic finance professionals, which could have a negative impact on IFB practice in the country (Hailu & Bushera, 2020).

CHAPTER 6. FINDINGS AND DISCUSSIONS

6.1. Introduction

In this part of the paper, we will try to exhibit and discuss the results of the data we collected from our participants. 93 respondents have participated in this survey, and their views on each presented statement will be briefly demonstrated in the following lines.

6.2. Demographic Background

Table 3 Demographic Background of the Respondents

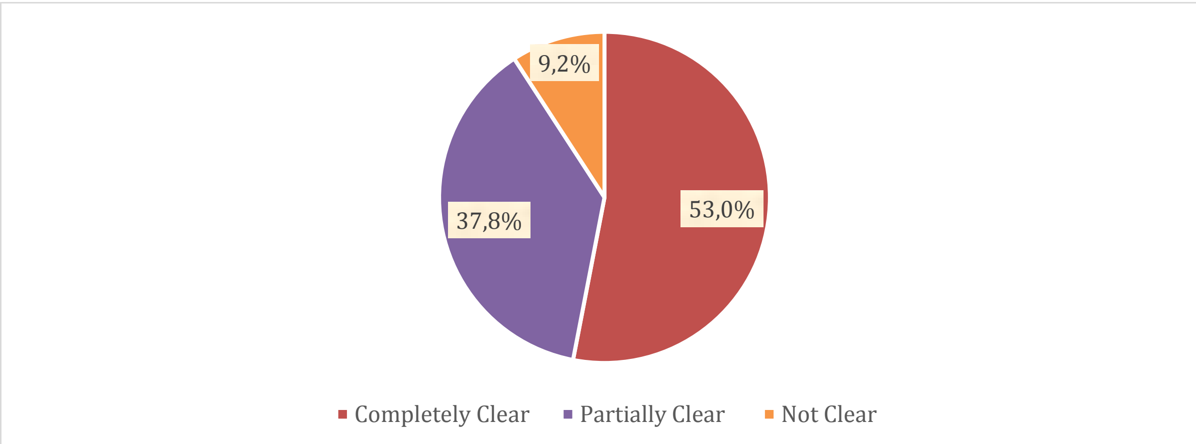
Variables	Variable Type	Frequency	Percentage	Mean
Gender	Male	81	82.7	1.17
	Female	17	17.3	
Educational background	High school	12	12.2	2.31
	Bachelor's degree	47	48	
	Master's degree	35	35.7	
	Ph.D.	4	4.1	
Occupation	Unemployed	5	5.1	2.77
	Student	26	26.5	
	Employed	53	54.1	
	Self-employed	14	14.3	
Total		98		

The above Table 3 illustrates the demographic background of the respondents. Most of the respondents 82.7 % were males, while the rest 17.3% were females. When we come to their level of education 48% of them were bachelor's degree holders, followed by master's degree completers, which accounted for 35.7% of the sample, 12.2 % were high schoolers, and only 4.1 % held a Ph.D. In terms of their occupation, 54.1% were employees, 26.5 % were students, and the remaining 14.3% and 5.1% were self-employed and unemployed, respectively.

6.3. Awareness and Trust

In this section, we will try to see the amount of trust and knowledge that the participants had about Islamic banks.

Figure 6 Respondents' Idea of Islamic Banks



Source: Author

The surveyed individuals' general conceptual knowledge of Islamic Banks is depicted in Fig 5. We tried to understand the level of awareness our sample has about IB. It is significant to highlight that the statement aimed only to identify the general concept that the respondents had about IBs, without focusing on their deep knowledge of the industry. As the figure shows 53.0% of the respondents stated that they have a completely clear idea about IBs, 37.8% claimed they have a partially clear idea, and 9.2% pointed out that they have no clear idea about IBs.

Table 4 Trust in Islamic Banking Products

Statement	Respondents' Level of Agreement	Frequency	Percentage	Mean
I have trust in the products and services that the newly established Islamic banks offer.	Strongly agree. Agree Neutral Disagree Strongly disagree.	33 41 20 3 1	33.7 41.8 20.4 3.1 1	4.04
Total		98	100.0	

The purpose of addressing this statement was to determine the amount of trust that the participants had in the products and services that NEIBs offer. As demonstrated in Table 4, 41.8% of the data providers agree with the statement, 33.7% strongly agree with it, and 20.4% submitted a neutral perspective. On the other hand, 3.1 % disagreed, and only one individual strongly disagreed. This indicates that more than half of the participants, i.e., 75.5% have a good level of confidence in the services that the NEIBs provide.

6.4. Opportunities and Challenges

In this part, we intend to investigate the collected data involving potential opportunities and challenges faced by the newly established Islamic Banks in Ethiopia.

Table 5 Newly Established Islamic Banks' Role in Economic Development

Statement	Respondents' Level of Agreement	Frequency	Percentage	Mean
The newly established Islamic banks play a significant role in the development of the economy.	Strongly agree. Agree Neutral Disagree Strongly disagree.	44 41 11 2 0	44.9 41.8 11.2 2.1 0	4.29
Total		98	100.0	

Table 5 outlines that 44.9% of the respondents strongly agree that NEIBs play a significant role in the economic development of Ethiopia. Moreover, 41.8% agreed with the statement, 11.2% were impartial or neutral, and only 2.1 % disagreed. The table implies that most of the respondents assert that the banks could play a vital role in the prosperity of the country’s economy.

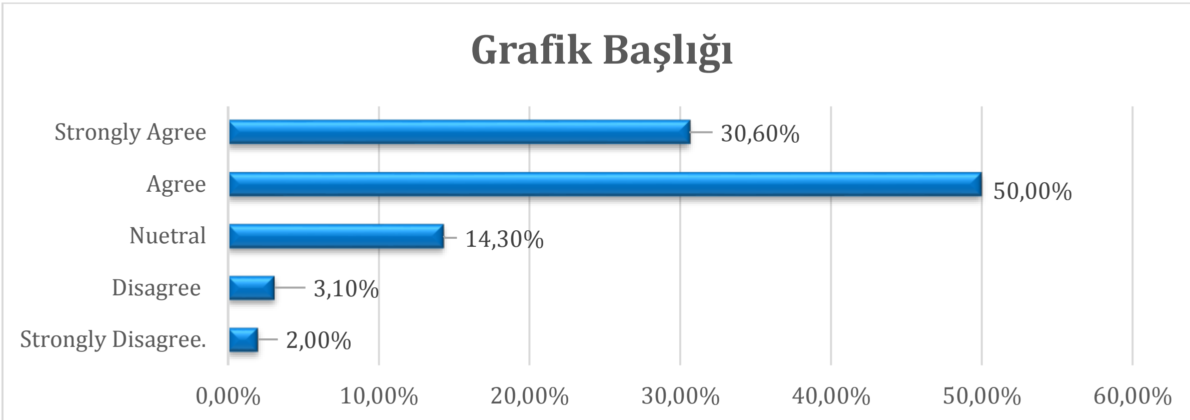
Table 6 Newly Established Islamic Banks' Role in Financial Inclusion

Statement	Respondents' Level of Agreement	Frequency	Percentage	Mean
The newly established Islamic banks can promote financial inclusion.	Strongly agree. Agree Neutral Disagree Strongly disagree.	35 52 9 2 0	35.7 53.1 9.2 2 0	4.24
Total		98	100.0	

Table 6 shows the perspectives of the survey participants on the potential of NEIBs to promote financial inclusion in Ethiopia. As the table indicates 35.7% strongly agreed, 53.1% agreed, 9.2% remained neutral, and only 2% disagreed with the statement. This shows that the majority of the participants believe that Islamic Banks might play a significant role in bringing a lot of unbanked customers to the financial sector of the country as only two respondents opposed the statement.

The below Fig 6 expresses whether the newly established Islamic Banks are encountering a challenge which is a lack of awareness from the public. The respondents' results as outlined in the Figure disclose that 30.6% of the participants strongly agree with the presence of such an issue, while 50.0% agree and 14.3% neither agree nor disagree. Conversely, 3.1% of the respondents disagreed, and 2.0% strongly disagreed. In general, a bigger percentage of the survey responses showed positive feedback on the presence of such an issue.

Figure 7 Lack of Public Awareness



Source: Author

Table 7 Newly Established Islamic Banks Employees' Qualifications

Statement	Respondents' Level of Agreement	Frequency	Percentage	Mean
Lack of skilled staff is one of the challenges the newly established Islamic banks face.	Strongly agree. Agree Neutral Disagree Strongly disagree.	32 42 12 8 4	32.7 42.9 12.2 8.2 4	3.91
Total		98	100.0	

As is apparent from Table 7 the majority of the respondents suppose that the NEIBs' human capitals are not competent enough. The feedback from the survey respondents demonstrated that 32.7% strongly agree the NEIB staff lack certain necessary skills, 42.9% of the respondents also agree, 12.2% were even balanced or neutral on their feedback, 8.2% and 4% disagreed and strongly disagreed correspondingly.

Table 8 Regulatory Issues of the Newly Established Islamic Banks

Statement	Respondents' Level of Agreement	Frequency	Percentage	Mean
The newly established Islamic Banks are facing regulatory challenges.	Strongly agree. Agree Neutral Disagree Strongly disagree.	30 40 17 10 1	30.6 40.8 17.3 10.2 1.1	3.89
Total		98	100.0	

The above statement in Table 8 attempted to ascertain if the NEIBs in Ethiopia are facing regulatory challenges. As it is apparent from the tabular data 30.6% of the respondents strongly agree that the banks are encountering regulatory obstacles, while 40.8% agree, and 17.3% were unbiased or neutral in their response. Moreover, 10.2% disagreed with the existence of that sort of challenge, and only 1.1% of the respondents strongly disagreed.

Table 9 Cultural Resistance Issues of the Newly Established Islamic Banks

Statement	Respondents' Level of Agreement	Frequency	Percentage	Mean
Cultural resistance is one of the challenges that the newly established Islamic banks are facing	Strongly agree. Agree Neutral Disagree Strongly disagree.	22 37 26 12 1	22.4 37.8 26.5 12.2 1	3.67
Total		98	100.0	

Table 9 demonstrates whether or not the respondents think that NEIBs in Ethiopia are dealing with issues connected to culture. According to the table, 37.8% of respondents agree with the statement that the NEIBs in Ethiopia are dealing with cultural resistance issues, while 22.4% of respondents strongly agree. In addition, 26.5% of respondents gave neutral responses, 12.2% disagreed, and 1% strongly disagreed with the statement. While a sizable portion of respondents, which is nearly 40%, disagreed or gave neutral responses to the type of challenge that was posed, the majority of respondents still thought that the industry faces difficulties connected to culture. As a result, the overall picture of the data findings indicates the existence of this sort of challenge.

6.5. PERFORMANCE AND FUTURE OUTLOOK

The outlook and overall performance of Ethiopia's newly established Islamic banks are presented in this section.

Table 10 Customer Services of the Newly Established Islamic Banks

Statement	Respondents' Level of Agreement	Frequency	Percentage	Mean
The newly established Islamic banks do have good customer services	Strongly agree.	31	31.6	3.94
	Agree	38	38.8	
	Neutral	24	24.5	
	Disagree	3	3.1	
	Strongly disagree.	2	2	
Total		98	100.0	

As outlined in the above Table, 38.8% of the participants agree that the NEIBs have good customer service, while 31.6% strongly agree with that, 24.5% were neutral, 3.1% disagreed, and 2% strongly disagreed. To put it simply, approximately 75% of the participants expressed satisfaction with the customer services provided by NEIBs, and the remaining respondents expressed dissatisfaction or objectivity.

Table 11 Providing Interest-Free Services

Statement	Respondents' Level of Agreement	Frequency	Percentage	Mean
Providing Interest-free products and services is the biggest strength of the newly established Islamic banks.	Strongly agree. Agree Neutral Disagree Strongly disagree.	40 39 14 5 0	40.8 39.8 14.3 5.1 0	4.16
Total		98	100.0	

The above table shows that 41.8% of the respondents strongly agree that providing interest-free products and services is the biggest strength of NEIBs, 39.8% agree, and 14.3% were neutral in their answers. On the flip side, 5.1% disagreed with the statement, and none of the respondents strongly disagreed. The most significant attribute in which Islamic banks differ from conventional Banks is offering interest-free products. Thus, observing most of the participants agreed with the given statement was projected.

Table 12 Possessing Adequate Financial Assets

Statement	Respondents' Level of Agreement	Frequency	Percentage	Mean
The newly established Islamic banks do have significant financial assets.	Strongly agree. Agree Neutral Disagree Strongly disagree.	25 37 28 7 1	25.5 37.8 28.6 7.1 1	3.79
Total		98	100.0	

Table 12 indicates that 37.8% of the participants agree that the NEIBs possess substantial financial assets, 25.5% also strongly agree, and 28.6% were objective in their responses. Furthermore, 7.1% of the respondents disagreed and 1% strongly disagreed that the banks have significant financial assets.

Table 13 Lack of Transparency

Statement	Respondents' Level of Agreement	Frequency		Percentage	Mean
The most important drawback of the newly established Islamic banks is their lack of transparency.	Strongly agree. Agree Neutral Disagree Strongly disagree.	17 39 15 18 9		17.3 39.8 15.3 18.4 9.2	3.37
Total		98		100.0	

Table 13 represents the participants' views on whether the NEIBs lack transparency or not. As the table depicts 39.8% of the respondents agree that the NEIBs are lacking transparency, while 17.3% strongly agreed, and 15.3% exhibited a neutral response regarding the provided statement. In contrast, 18.4% of the respondents disagreed, and 9.2% strongly disagreed.

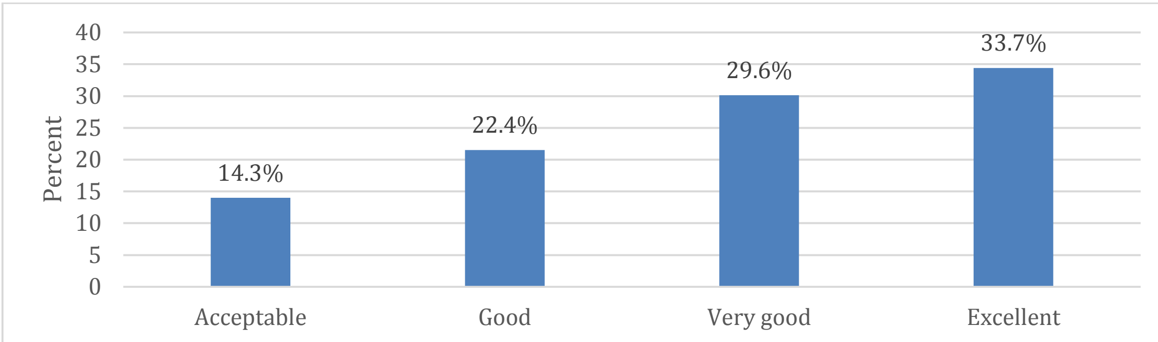
Table 14 Offering Fully Shariah Complaint Products

Statement	Respondents' Level of Agreement	Frequency	Percentage	Mean
The newly established Islamic banks offer products and services that are fully compliant with Shariah.	Strongly agree. Agree Neutral Disagree Strongly disagree.	23 39 24 11 1	23.5 39.8 24.5 11.2 1	3.74
Total		98	100.0	

Table 14 seeks to display if the NEIBs offer products and services that are fully compliant with Shariah. The outputs of the degree of agreement of the respondents show that 39.8% agreed, 23.5% strongly agreed, and 24.5% responded neutrally. On the other side, 11.2% disagreed and only 1%

strongly disagreed that the banks are providing products that are completely Shariah compliant. Overall, the majority of the respondents agreed with the proposed statement.

Figure 8 General Performance Estimation



Source: Author

The above figure shows the participants' views regarding the overall performance of the newly established Islamic Banks in Ethiopia. As the figure displays, 33.7% of the respondents think that the NEIBs are performing excellently, 29.6% rated it as very good, 22.4% responded as good, and 14.3% as acceptable. So, the majority of the respondents suggest that the banks are performing in an effective approach, and none of them assumed that they are acting poorly.

Table 15 Likelihoods of Using Islamic Banks in The Future

Statement	Respondents' Level of Agreement	Frequency	Percentage	Mean
My likelihood of continuing to use the services of Islamic banks in the future is.	Very likely Likely Neutral Unlikely Very unlikely	58 27 11 2 0	59.2 27.6 11.2 2 0	4.43
Total		98	100.0	

Table 15 illustrates the respondent’s likelihood of continuing to use Islamic Banking facilities. As it is apparent from the table, 59.2% of the participants responded with very likely, 27.6% replayed with likely, 11.2% provided a neutral response, and the remaining 2% responded with unlikely. As the results on the table display most of the respondents are eager to continue using the products and services of IBs, which is a positive aspect for the company.

Table 16 Willing to See Many Islamic Banks in The Future

Statement	Respondents' Level of Agreement	Frequency	Percentage	Mean
I would like to see an increase in the presence of Islamic banks in the future.	Strongly agree. Agree Neutral Disagree Strongly disagree.	58 29 6 5 0	59.2 29.6 6.1 5.1 0	4.40
Total		98	100.0	

The above table depicts whether the participants need to see many Islamic Banks in the country. The degree of agreement from the participants shows that 59.2% strongly agreed with seeing an increase in the presence of IBs in the future, 29.6% agreed, 6.1% gave neutral feedback, and 5.1% disagreed with the statement. In general, 88.8% of the participants desired to see widespread Islamic Banks inside the country.

6.6. Discussion

In this part of the paper, we try to briefly discuss some of the main findings of the study. The newly established Islamic Banks in Ethiopia might face some challenges as any other institution would, especially in their beginning stages. If we attempt to draw attention to some of the issues that the findings revealed, one of them is the lack of awareness from the public. The findings of the research implied that 80% of the respondents expressed their degree of agreement by either agreeing or strongly agreeing, asserting that there is a lack of awareness concerning Islamic banks among the public.

This is a common challenge that the Islamic banking industries are facing globally. A study made by Conteh & Hassan (2021) about the public awareness of Islamic banks in Gambia revealed that the perception of the Gambians concerning IBs is not complete enough, and the understanding of the public is only limited to the prohibition of Interest**.** A similar study done by Abduh &

Omarov (2013) about public awareness and knowledge of Islamic banking in Kazakhstan concluded that the public did not have enough knowledge about the products and services offered by Islamic banks, even though the majority of the participants had general awareness about the industry. Previous research regarding the challenges and opportunities of IFBs in Ethiopia done by Belayneh (2020), Olad (2012), and Hailu & Bushera (2020) also concluded the existence of this issue within the industry.

The newly established Islamic banks must create methods of approaching the public to bring a lot of clients to their industry. Moreover, since the results of the research disclosed that the majority have a good level of confidence in the industry and the services that they provide, that will be also another opportunity for the NEIBs to mobilize funds from the public, especially the ones who were anticipating for the introduction of FFIB for a long time, which is the Muslim community, and also the Non-Muslims who have devotion to the ethical banking system.

Another issue that was expressed in the survey results is the lack of transparency. Even though most of the respondents (57.1%) either agreed or strongly agreed with the stated assertion, the remaining 42.9% presented impartial or disagreement responses. The point of view is that more than half of the respondents alleged that openness and transparency are absent from the NEIBs. A similar result was revealed by İslam et al. (2017). The author concluded that certain Islamic banking customers in Tunisia have shown signs of doubt regarding the PLS-sharing techniques and transparency of the Islamic Banks.

In a world where trust has become so rare, providing a service that is more transparent for the customers will be a move ahead. Depositors of conventional window-based Interest-free banks in Ethiopia were always skeptical about the products offered by those institutions concerning their conformity with Shariah as they believed that the banks were merely using such windows to attract Muslim customers. That is why most of these window-based clients used only deposit accounts as reported in previous research done by S. M. Hailu (2017). Therefore, to avoid those kinds of issues the FFIBs, particularly the newly established ones should clarify their products and manifest the steps of their transactions and must be more open and transparent to their shareholders and customers so that they don't lose the level of confidence of their customers. Similarly, sharing their financial reports annually might be a sensible choice. Moreover, their products and services must be more simplistic and clearer for the clients.

On the other hand, if we intend to point out the survey results regarding some of the opportunities that Islamic banks might contribute to Ethiopia, the first and foremost is economic development. The findings of the study unveiled that more than 85% of the respondents either agreed or strongly agreed that the NEIBs could act as a major catalyst in the economic expansion of the country, and only 2% thought the opposite. This is consistent with our assumption, which presumed that Islamic banks would make a significant difference in the country's economic progress. A previous study about the relationship between Islamic finance and economic development in three Middle Eastern countries; Bahrain, Qatar, and UAE carried out by Tabash (2014) indicated the same. The authors specified in their findings that in the long term, there is a relationship between economic growth and the financing of Islamic banks. Moreover, the IFIs will contribute to the region's poverty alleviation and foster economic prosperity. Another research by Dhankar & Tabash (2018)**,** also concluded that Islamic finance methods, such as Murabaha and Mudarabah, provide several benefits for the community since they increase commerce and output, which helps to lower unemployment, create jobs, and lower poverty. As we mentioned earlier there are several literatures regarding the role of Islamic Banks in Ethiopia's economic flourishing.

Similarly, The NEIBs can promote financial inclusion in Ethiopia. As the survey results of the study show, a bigger percentage of the respondents, i.e. 88.8%, believe that the industry can significantly promote financial inclusion inside the country. Given that Muslims abstain from all acts that involve interest, it is reasonable to assume that they would advocate for an interest-free financial system. The Muslim communities in Ethiopia were omitted from many facilities like insurance, and services offered by government-owned banks like the commercial and development banks, as well as condominium residential plans financed by the government. The Development Bank of Ethiopia was found to complement the national growth agenda by giving projects in vital sectors of finance. Nevertheless, The Muslim population in Ethiopia was not able to get the advantages of the bank's amenities because the bank solely offered usury-oriented finance (Hailu, 2017). The inauguration of the FFIBs, particularly the NEIBs therefore can be a valuable prospect for the Muslims to take part in various financial transactions that they were previously restricted from due to their faith.

The results have also implied that the NEIBs offer products and services that are fully Shariah compliant. This is significantly different from the previous studies that were done in Ethiopia as they concluded the opposite, we assume the reasoning beyond this is that this study focused on

NEIBs, whereas the majority of earlier research was conducted on conventional banks that offered window-based interest-free services. Consequently, it seems sensible to respond favorably to this remark given the public's high level of confidence in these new institutions. Another crucial point that must be emphasized is the overall performance of NEIBs. As we have mentioned in the results, most respondents advocate that the NEIBs are performing excellently. Previous literature concerning Islamic banks' performance has shown the same. As we mentioned in the literature review section Saleh & Zeitun (2006) by analyzing the first two Islamic banks in Jordan concluded that both banks' performance metrics demonstrated that they have become more capable and efficient.

To have better insight into the real performance of a bank factors such as the soundness of the bank, capital adequacy, cost and profit ratio, etc. must be taken into account. Moreover, comparing the company with similar companies that use different approaches like conventional banks might have a more accurate implication. However, in this study, we tried to have a general opinion about the NEIBs' performance in a simple and superficial outlook, and the feedback from the participants was largely positive. This is a beneficial prospect for the NIEBs, as it entails how satisfied are the public with the facilities that they have been providing so far, even though excluding one bank, which is ZamZam Bank, the other three banks launched only in 2022.

The study findings have also pointed out the future perspectives of the NEIBs since the majority of the respondents (86.8%) asserted that they want to continue using these banks. This shows the viability of the industry in the region and the permanence that it will have in the future. Furthermore, a bigger percentage of the respondents (88.8%) wanted to see an increment in FFIBs in the future. This also indicates the appetite and desires that the public has for Islamic financial institutions. However, the Islamic banks in Ethiopia must provide a variety of products and services to be sustainable and attract as many customers as possible, since the competition from conventional banks that have more banking experience inside the country will be challenging.

CONCLUSION

Islamic finance is a type of finance that performs its financial dealings according to the principal rules of Shariah. The sources of Shariah are the Holy Quran and the authentic Hadith.

The major industries of Islamic finance are Islamic Banking, Islamic money market, Islamic capital market, Islamic wealth planning, and Islamic insurance (Takaful). Islamic banking system Is not based on interest to make a profit like conventional banks, instead, they use profit and sharing financing modes like Mudarabah, or deferred payment markup modes like Murabaha. In the latter mode, the financial contract's subject matter is an asset, not money.

Islamic finance was present even during the time of the prophet PBUH, financial transactions like bay al-salam, and Mudarabah were practiced at that time. However, as an institution, it emerged first in Egypt in 1963 through an Islamic Bank under the name of Mit Ghamr Savings Banks. The establishment of the Islamic Development Bank in 1975 was a great turn for the Islamic financial industry as the company started to spread in the Gulf and Middle Eastern countries, and South and Southeast Asian nations like Malaysia and Pakistan. Today IFI is an industry boasting a trillion-dollar value, and it is expanding rapidly around the globe.

In Ethiopia, Islamic Banking commenced operating for the first time in 2013 after a persisting demand from the Muslim society in the country. Nevertheless, the government only allowed the already existing conventional banks to offer interest-free services through windows. Zam Zam Bank which launched in 2020 was the first Fully Fledged Islamic Bank in Ethiopia.

This study aimed to assess the experience of emerging Islamic banks, particularly the fully-fledged newly established IBs. The study further intended to ascertain the NEIBs' general performance, future conjectures, and the challenges and opportunities that the banks are experiencing.

The study findings revealed that the NEIBs are dealing with issues like public lack of awareness, shortage of competent staff, lack of transparency, and cultural resistance. On the other hand, the results have shown that there is a good level of confidence in the NEIBs from the public, and the banks do possess significant financial assets. Moreover, the banks can play a fundamental role in promoting financial inclusion, and economic development of Ethiopia.

The findings also displayed that the general performance of NEIBs is on a positive trajectory and is functioning effectively. Furthermore, the banks have a bright future outlook in Ethiopia as the results indicate that the public wishes to see more similar banks in the country.

RECOMMENDATIONS

The Islamic banking scheme is still in its infancy stage in Ethiopia, especially the fully-fledged form. There will therefore be risks and anticipated rewards at the start of the journey, just like with any other emerging organization. This part of the paper will try to propose some recommendations to the policymakers and the Islamic Banking institutions in Ethiopia.

One of the issues that the Islamic Banks in Ethiopia are facing is regulatory challenges. The regulatory framework of Ethiopia, especially the commercial code impedes banks from owning more than 10% equity in any interest-free financial operations. As a result, implementing equity-based financing modes like Mudarabah and Musharakah will be reasonably challenging for Islamic banks. The NBE and the associated policymakers should therefore present a regulatory context that supports and is relevant to Islamic banking operations to have an equally balanced competitive marketplace for both conventional and Islamic banks, which is a meritorious aspect for the economic enhancement of the country.

Another challenge for Islamic banking in Ethiopia is the lack of public awareness. The Islamic banks must assemble seminars and forums that discuss the notion of Islamic finance, and the forms of products and services that are used within the industry in a clear and simple method that can be comprehended by the public straightforwardly. Moreover, the banks and the Shariah scholars can podcast Islamic finance-related topics on all possible platforms like TV, radio stations, and social media to reach the public, especially some of the non-Muslims who have wrong perceptions about Islamic banks.

There is a lack of competent human resources within the Islamic banking industry in Ethiopia as well. A possible solution to this issue might be offering training and workshops that teach about Islamic financial products and services, or maybe deploying some of the banks' employees abroad to countries with good experience in this subject for experience sharing. Another pragmatic approach for the staff to enhance their knowledge and skills in the field of Islamic fiancé is to join online courses and meetings that cover such topics. Moreover, policymakers, shariah scholars, and Islamic banks ought to explore avenues for establishing institutions that offer Islamic finance-related courses in Ethiopia or introducing an Islamic finance academic field in the already existing universities.

The Ethiopian Muslim community's lack of trust in conventional banks offering interest-free window services is partly due to their suspicion that these banks are merely using their names as marketing to draw interest-free-minded customers to their businesses rather than genuinely avoiding interest from their investment portfolio or financial transactions. As a result, the NEIBs must endeavor to prevent these kinds of routines. Additionally, since the public now has a high level of trust in them, the banks should make an effort to deepen this connection by being as open and informative as possible. A potential approach to do this would be to post annual and interim financial reports on the banks' official websites. Customers also need to be made aware of the modes of operandi for financing, the steps taken, the utilized products, and the projects that are invested in.

FFIBs in Ethiopia have a promising future and are playing a significant role in both financial inclusion and the nation's economic development. It would be a considerable approach for policymakers and the NBE to help and promote emerging Islamic financial institutions by giving them an equal footing when it comes to taxation and liquidity support.

LIMITATION OF THE STUDY

This research solely looked at Jigjiga City's newly established Islamic banks due to time and location constraints. The conclusions thus do not apply to the banks of other Ethiopian cities. Another limitation is that access to the annual reports and associated information from the banks was limited. Furthermore, due to the scarcity of relevant literature on the subject of Islamic banking in Ethiopia, it was challenging to locate sufficient secondary data.

FURTHER FUTURE STUDIES

It is advised to conduct more in-depth research into the newly established FFIB in Ethiopia.

Another suggestion fields for further studies are:

- Comparing the financial performance of Islamic Banks and Conventional Banks
- The Role of the Islamic Bank in Ethiopia’s Economic Development
- Exploring Investment Opportunities for Islamic Banks in Ethiopia

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APPENDIX I

Survey Questionnaire

Assessment of the Emerging Islamic Banking Experience in Ethiopia

Dear respondents, this survey is designed to gather data for the evaluation of the study entitled "Assessment of the Emerging Islamic Banking Experience in Ethiopia." It's part of the prerequisites to complete the Master's in Islamic Economics & Finance degree at Ankara Social Science University (ASBU)'s School of Graduate Studies. Kindly know that your responses will be kept private and will not be shared with outside parties. The results of this survey will only be used for academic purposes and will help produce a high-quality paper that serves the interests of the community and plays a significant role in offering valuable insights for the study, your assistance in providing accurate and sincere comments is greatly appreciated.

Thank you in advance for your participation and time.

Part 1: Demographic Background

1. Gender:
   - o Male
   - o Female

2. Educational Background:
   - o High School
   - o Bachelor's degree
   - o Master's degree
   - o Ph.D.
3. Occupation:
   - o Student

- Employed
- Self-employed
- Unemployed

Part 2: Awareness and Trust

Please select the one that implies your opinion on the following statements.

4. I have a clear idea about Islamic banking.
    - Completely clear
    - Partially clear
    - Not clear

5. I have trust in the products & services that the newly established Islamic banks offer.
    - Strongly agree
    - Agree
    - Neutral
    - Disagree
    - Strongly disagree

Part 3: Notable Opportunities and Challenges of Islamic Banks:

Please select the one that implies your opinion on the following statements.

6. The newly established Islamic banks play a significant role in the development of the economy.

    - Strongly agree
    - Agree
    - Neutral

- Disagree
- Strongly disagree

7. The newly established Islamic banks can promote financial inclusion.

   - Strongly agree
   - Agree
   - Neutral
   - Disagree
   - Strongly disagree

8. Public lack of awareness is one of the challenges that the newly established Islamic banks are facing.

   - Strongly agree
   - Agree
   - Neutral
   - Disagree
   - Strongly disagree

9. Lack of skilled staff is one of the challenges that the newly established Islamic banks are facing.

   - Strongly agree
   - Agree
   - Neutral
   - Disagree
   - Strongly disagree

10. The newly established Islamic Banks are facing regulatory challenges.

   - Strongly agree

- Agree
- Neutral
- Disagree
- Strongly disagree

11. Cultural resistance is one of the challenges that the newly established Islamic banks are facing.

- Strongly agree
- Agree
- Neutral
- Disagree
- Strongly disagree

Part 4: Performance Evaluation:

please select the one that implies your opinion on the following statements.

12. The newly established Islamic banks do have good customer service.

- Strongly agree
- Agree
- Neutral
- Disagree
- Strongly disagree

13. Providing Interest-free products and services is the biggest strength of the newly established Islamic banks.

- Strongly agree

- Agree
- Neutral
- Disagree
- Strongly disagree

14. The newly established Islamic banks do have significant financial assets.

    - Strongly agree
    - Agree
    - Neutral
    - Disagree
    - Strongly disagree

15. The most important drawback of the newly established Islamic banks is their lack of transparency.

    - Strongly agree
    - Agree
    - Neutral
    - Disagree
    - Strongly disagree

16. The newly established Islamic banks offer products and services that are fully compliant with Shariah.

    - Strongly agree
    - Agree
    - Neutral
    - Disagree
    - Strongly disagree

17. The overall performance of the newly established Islamic banks can be evaluated.

- Excellent
- Very good
- Good
- Acceptable
- Poor

18. My likelihood of continuing to use the services of Islamic banks in the future is.

- Very Likely
- Likely
- Neutral
- Unlikely
- Very Unlikely

19. I would like to see an increase in the presence of Islamic banks in the future.

- Strongly agree
- Agree
- Neutral
- Disagree
- Strongly disagree

20. If you have any additional views on the opportunities that the newly established Islamic banks can offer, please share your views by leaving a comment.

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