

# Assessment of Leadership Gaps and Challenges in the Adoption of Interest-Free Banking (IFB) in Ethiopia

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## Abstract

As part of IFB's fast global growth, leaders in Ethiopia are responsible for remaining competent to run shariah-compliant products. In this regard, the research aimed at the assessment of leadership gaps and challenges in the implementation of IFB in Ethiopia. An exploratory research design was applied, with a mixed research approach. Sample units of 75 managers were conveniently drawn, and the content of the responses and documents was thoroughly analysed quantitatively and qualitatively. The findings show perception, knowledge, legal, and project management gaps and challenges: attention given by leaders to IFB was found to be minimal; leaders and employees lack IFB personality and appearance, which happens in some cases due to fear of the unknown tailored to the IFB. Sustainable training and development programmes were not planned properly. There is a lack of adoption of appropriate technology. The legal framework of IFB is viewed through the lens of a typical conventional banking context. Leadership, along with the hierarchy, should cultivate personalities that favour the success of IFB. Perception should be surveyed to rectify and leaders should be involved in IFB decision making to create an IFB-friendly atmosphere that reflects its values. It requires crafting rigorous and diverse training programmes and public awareness. A clear IFB institutional structure with appropriate technology adoption should be established. NBE should look for ways to adopt internationally accepted IFB standards, reinforce, and revisit the current NBE directives and legal framework.

**Keywords:** Interest-Free Banking, Financing, Leadership, Shariah, Perception, Knowledge Gap, Legal Framework, Project Management

## Introduction

Interest-Free Banking (IFB) is a fast-increasing element of the global financial system; it is not limited to Islamic countries and is spreading wherever there are sufficient numbers of Muslims. It has also recently attracted the interest of conventional financial markets (Greuning & Iqbal, 2008). In Ethiopia, banking industry leaders in charge of running the business are responsible and expected to remain competent in IFB services to run the business in a holistic manner. Leaders in the IFB business should be aware of the reason behind the emergence of modern Islamic finance; it is to provide to a specific market segment shariah-compliant financial services and products for those who are not able to access conventional financial services due to religious rationale. However, it is beyond that. It is a business that could run to fulfil the business demand of the entire population, irrespective of their religion, as a separate business model.

In comparison to conventional banking, Islamic banking has 5 extra pillars that are essential measurements of religious legitimacy, of which current leaders should be aware. It runs according to shariah laws, known as Fiqh al-Muamalat (Islamic rules on transactions). The fundamental pillars of IFB, according to Franzoni and Allali (2018), are the prohibition of Riba, the prohibition of Gharar in financial contracts, the prohibition of Mayser, the prohibition on the use of trade involving any element of prohibited asset or activity known as Haram, the profit and loss sharing principle, and the requirement that any given financial transaction be backed by real assets. In Islamic banking, terms like profit sharing (mudarabah), safeguarding (Wadiah), joint venture (musharaka), cost plus markup (murabaha), and leasing are used to describe

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goods (Ijarah). Rather than financing the buyer, an Islamic mortgage transaction involves the bank purchasing an item from the seller and reselling it to the buyer at a profit, letting the consumer pay the bank in cash. A natural consequence of this progress is the opening up of new challenges as well as more space for its advancement. On the intellectual and practical levels, Islamic finance is confronted with both new and old challenges, which are supposed to be identified and corrective action taken; it is a major milestone for a business's success.

There are conditions in the banking industry for a new risk to emerge, a risk that, until now, has been the risk of not being able to achieve the intended goal owing to leadership deficiencies and obstacles. Among the challenges, there is absence of conducive legal framework and complicated internal norms and procedures (Treapat & Anghel, 2013). Business has some targets for future success. However, having goals is not enough. We need to take practical steps to get them done in a better way, and these steps and actions demand knowledge, skills, talent and corrected perception, and proper project management practices in implementing changes by the leader in their business model, with an enabling legal framework (Caetano, 1999). Globally, many people have faith that leadership is a way to improve their personal, social, and professional lives, and organisations pursue those with leadership skills, as they bring special resources to their business and improve their bottom line. If firms do not prepare themselves in response to quickly changing events and scenarios, they risk losing their reputation and market share (Jofre, 2011).

In today's economy, leadership has become the primary source of competitive advantage, and many organisations have a poor track record in terms of their ability to build leadership capacity and have leadership gaps that threaten long-term organisational survival. So, assessing local bank leadership practices in terms of gaps and challenges in adopting IFB business is critical. There was no legal framework in place in Ethiopia before 2008, when the National Bank of Ethiopia (NBE) issued Proclamation No: 592/2008 to regulate banking activities related to Islamic financing (Hailu & Bushra, 2020). Conventional banks have begun to accept IFB deposits from consumers who are interested in the service as a result of this directive. NBE issued a new proclamation in May 2019 with directive No: SBB/72/2019, allowing the establishment of full-fledged IFB in Ethiopia, after 7 years of exclusive IFB

window practice in Ethiopia, which is mostly associated with a cost-plus markup financing facility. Following this, the NBE granted the ZamZam Bank and Hijra Bank a business license to begin full-fledged IFB services, which still have space for improvement. Although the approval of a full-fledged IFB in Ethiopia is a significant opportunity for IFB business expansion, challenges such as a lack of a conducive legal framework, a shortage of skilled professionals, hostile attitude towards Islamic banks, and a lack of leadership engagement may still have an impact on IFB performance in Ethiopia (Hailu & Bushra, 2020).

African banks, like all financial institutions around the world, are undergoing ongoing adjustments. In 2010, the Central Bank of Nigeria (CBN) sacked 8 senior executives from 8 banks for gross mismanagement and lack of leadership (Inyang et al., 2014). The core business concern was that the Nigerian banks' poor leadership practices resulted in poor business outcomes. The specific problem was that several Nigerian bank CEOs lacked good leadership strategies for sustaining bank growth. So far, no research has been done in Ethiopia to look into leadership gaps and challenges in the banking industry, especially in the IFB sector. Newspapers have periodically commented on the NBE's actions, such as its warnings to some private banks for being ineffective and mismanaging their businesses. As a result, it was thought worthwhile to investigate leadership gaps and challenges.

Among a number of banks in Ethiopia, those obtaining the permit from the NBE initially in 2013 include the Commercial Bank of Ethiopia (CBE) and Oromia International Bank (OIB). Since then they provided both deposit and financing products to their customers. Subsequently, other private banks, one after the other, followed the trend of these 2 local banks and joined the IFB operation in a window model. The number of banks that provides IFB service along with their conventional banking reached 11, as of March 2021, and their total deposit is about 83.5 billion, of which only 25% is consumed for financing. According to the report obtained from NBE (March, 2021), the total conventional banking deposit and loans of banks goes beyond birr 1.2 trillion and about 1 trillion, respectively. In this regard, the market share of IFB, both in terms of deposit and financing, is very minimal – not more than 7% of conventional banking. The IFB window's meager deposit mobilisation

status, low volume of funding, and restricted diversity of financing options all witness the presence of leadership gaps and challenges. For this and other potentials to be realised, IFB's company must be in a state that is friendly to both customers and banks. However, in order for this business to flourish in a safe and sound manner, banks must have strategic leaders who analyse and fill organisational leadership gaps on a regular basis.

The current performance and challenges of IFB, among other things, are a reflection of leadership ineffectiveness. The IFB financing process is sluggish when compared to the conventional one. The prospects that IFB owes in the industry in terms of deposit have yet to be touched; and the challenges that have surfaced in the IFB industry have forced clients to either remain conventional customers or go unbanked altogether. The prospective migration of Muslim and non-Muslim conventional banking clients to IFB will be determined by the leadership's ability to run the IFB business in a way that is favourable to such customers. Local research undertaken so far on IFB has been quite limited in scale, focusing on either a single bank district or a small number of banks (fewer than 5), and at the time of their research, full-fledged branches and banks were not included. Furthermore, no research into leadership gaps and barriers in the adoption of IFB business in Ethiopia has been undertaken.

Unless leadership deficiencies and problems are discovered and resolved on a regular basis, as well as crafting of enabling legal framework, the IFB will fail to achieve its stated goal of improving the well-being of the underserved people and the nation's economy as a whole. As a result, the purpose of this study is to undertake research into the leadership gaps and problems in the adoption of IFB in Ethiopia. A basic research question is a question that a researcher seeks to answer, and it serves as the foundation for creating a research report. As a result, there are many different types of research questions based on the area of study, acceptable methodology, and themes of interest. Therefore, the following were the research questions posed for the research, which needs investigation to identify leadership gaps and challenges in Ethiopia:

What are the major IFB business perception gaps by leaders that affect the implementation of IFB in Ethiopia?

- What are the knowledge gaps that hamper the success of IFB in Ethiopia?
- What gaps and challenges are observed in project management in the implementation of IFB?
- What leadership gaps and challenges in the legal framework limit the success of IFB?

## Review of Related Literature

In the early 1970s, Islamic banking emerged as a key player in the financial sector. However, the laws and regulations that govern the Islamic banking system have existed for centuries. Islamic finance was widespread in the Middle Ages, and it was widely acknowledged and applied. It aided in the expansion of trade and commerce in the Muslim world. In the European realm, Islamic traders began to play a significant role. Islamic finance has extended throughout Asia, the Middle East, and the Western world to create a worldwide system. Islamic banking is not limited to Muslim countries in the Middle East; it also operates in industrialised economies like the United States, Europe, and Asia. Today, there are over 500 Islamic banks operating from China to the United States, with assets in excess of 1.7 trillion dollars. This research assessed leadership gaps and challenges, in terms of perception, project management and implementation, leadership knowledge, and legal framework, with supportive theoretical and empirical literature review, as follows.

According to the Board term of the International Association of Islamic Banking, an Islamic bank is defined as a banking company that implements a new banking concept, in that it adheres strictly to the rulings of Islamic shariah in the fields of finance and other dealings. Furthermore, depending on the territorial architecture of the country or region, the words Islamic bank may be defined in a different way. We can define an Islamic bank as "a banking institution that performs all of its business in accordance with shariah, without involving itself or its clients in Riba".

IFB is inextricably linked to Islamic economics, which aims to achieve more fairness in human endeavours through the participation of all human institutions, including the financial sector (Adeniran, 2013). Islamic banking aims to reach this satisfying goal by prohibiting

interest and other unethical and non-shariah compatible activities. Furthermore, it tries to improve all Halal aspects of business by providing shariah-compliant products and services, as well as implementing legitimate profit and loss sharing, monopoly, and other types of unethical commerce and transactions, such as dealing with pork, alcohol, and gambling (Sanusi, 2012). As a result, the IB way of financing is predicated on the ability to address the inherent inequity associated with interest-based banking. Though the primary purpose of these principles is to open the path for social and economic improvement (Metawa & Almosawi, 1998), they have also created an alternative method of finance capable of disrupting conventional business's lengthy dominant position (Gumel & Othman, 2013).

### Leadership Theory and Islamic Banking

IFB's business model and products are well-known as ethical products, with the leaders expected to conduct themselves in a respectful manner. Any breach of this code of ethics will have a negative influence on the company's success; leaders in the industry are expected to be knowledgeable and have a correct perception of each product to properly respect the principles, prohibition, and standards set by shariah. IFB business is a new phenomenon to the Ethiopian banking industry, with high potential growth, following the adoption by 2 Ethiopian commercial Banks (CBE and OIB) in 2013. Since the business is new in the Ethiopian market, the role of leaders in this business model is very significant and their failure entails the failure of the overall business.

Leadership tailored to IFB is defined as "the process of persuading people to achieve group or organisational goals" by combining intelligence, value, emotional stability, cognitive capacity, desire to lead, and self-confidence with respect for and non-compliance with the respective business's laws and regulations (Zubair et al., 2017). There is no difference in the definition of leadership from the conventional one, but when leadership is considered in Islamic finance it demands the understanding and implementation of the shariah principles and standards. Trustworthy leaders are needed in the Islamic banking industry, so that there is a sense of ownership in operating Islamic banks that have an

impact on boosting performance. On the other hand, the current Islamic banking is still reliant on management that comes from the parent bank, which is a traditional bank. The success of Islamic banks in establishing and gaining a position in the economy is inextricably linked to the role of Islamic bank leaders. The leader is responsible for nurturing, mobilising, and channelling all of the organisation's potential, so that the organisation's success in attaining its objectives is dependent on the leader's role. The rapid expansion of Islamic banking at this time has not been accompanied by the provision of enough human resources. The adequacy of an Islamic bank's human resources is defined not merely in terms of the quantity of personnel, but also in terms of people who have the skill, competence, and experience to manage Islamic banking.

### IFB Leadership Perception

Perception includes both actively and unconsciously searching for and digesting information to make sense of the world. Customers' perceptions of a brand, its products, and services are determined by how they choose, organise, and interpret information and stimuli related to them, and deciding what they think and feel about them. Perception is the process of absorbing information about and making sense of the world around us. It requires deciding which data to focus on, how to categorise it, and how to interpret it in light of our previous knowledge. Through this process, people select, organise, comprehend, and respond to information from the world around them (Buck et al., 2017). Perceptual errors/frequently used shortcuts in judging others include

- *Selective Perception*: Where people selectively interpret what they see, based on their interests, background, experience, and attitudes;
- *Halo Effect*: Drawing a general impression about an individual, based on a single characteristic;
- *Contrast Effects*: A person's evaluation is affected by comparisons with other individuals recently encountered;
- *Projection*: Tendency of people to see their own characteristics in other people;
- *Stereotyping*: Judging someone on the basis of your perception of the group to which that person belongs;

- *Expectancy Theory*: Tendency to bias perception of events, objects, and people based on prior expectation.

In an increasingly competitive world where differentiating your product or service based on objective and functional attributes is becoming more difficult, marketers are focusing their efforts on customer perception, a hot topic that has been at the centre of some of the most successful marketing campaigns in recent years. The ability of various leaders and managers to grasp their customers' and employees' perceptions is critical to the success of IFB. Furthermore, leaders must be able to manage their own perception as well as that of their customers and employees to manage appropriately.

### Leadership Knowledge Gap IFB Perspective

There are many different definitions of 'knowledge'; most of them are broad, with significant changes based on practical settings. Knowledge is defined as "a form of instruction that specifies how a product or service can be manufactured (Blakeley, Lewis & Mills, 2005). The fact or situation of knowing something earned via experience or education." Awareness, on the other hand, is described as "having or demonstrating realisation, observation, or understanding of a situation or truth" (Jaffar & Musa, 2014). Knowledge is a concept generated by combining a variety of intellectual components, the most basic of which is information. Every excellent leadership theory emphasises the importance of having a strong mentality. No amount of advice or small strategies supplied by management gurus would ever aid an aspiring leader unless they have a clear attitude on how to reach particular goals. When leaders try to execute a new method and it fails, it is usually because their basic thinking is not up to the challenge. Make a clear difference between the specific mentality modifications needed to integrate a theory into how one thinks and acts in real life. Learn what leaders need to do and make sure their brain is ready to correct themselves every time they move away from the desired behaviour needed to achieve their business goal (Abhary et al., 2009).

Self-transformation is required for putting a leadership theory into practice, both in terms of thinking and behaviour. The greatest way to ensure that you get through

this period is to share your outcomes and mentality shifts with a trusted and informed associate who can assess your accountability levels. Even though there are a variety of leadership training institutes, leaders are still learning to be leaders by "trial and error" (Jonathan, 2017). Bank leaders are responsible for understanding the overall cognitive and conceptual rationale of the model, as well as the content and context of the product within it, and aligning with the existing business, after developing the required strategy. It is the responsibility of leaders to have an appropriate understanding of all parts of the IFB business before and after adoption. Furthermore, full-fledged banks in the pipeline are not exempt from this, since the journey thus far should be evaluated to identify the gaps accessible to leaders, such as the sufficiency of IFB gained knowledge and the banks' development plan.

### IFB Legal Framework Leadership Challenge

The fundamental factors of legislation, institutional, administrative, political, social, and economic conditions are components of a legal framework, which make the legislation enforceable and effective. The classical school of natural law theory states that law comes from a divine source. This school of thought asserts that laws descend through scripts like the Quran, Bible, and Torah. Under this theory, the most important features of law are not to be found in its source-based character, but in the capacity of law to enhance the common good, secure human rights, and govern with integrity. Thomas Aquinas, a natural law legal theorist, claims that the authority of at least some legal standards necessarily derives from considerations of moral merit of those standards. The incorporation of moral considerations to the laws governing Islamic banking therefore gives merit to the natural law theory which holds that the law must be moral.

The Islamic economic code, which is derived from both the Quran and Sunna, tries to maintain a balance between both the material and moral needs of human beings, to ensure the achievement of socio-economic goals. In this regard, neither the capitalist nor the socialist theories are able to satisfy the requirements of Islamic banking (Abdulahi, 2016).

Metaphysical beliefs are not the only constituency to Islam, they also provide a system for governing all forms

of human activity. Thus, it regulates human beings' conduct, both individually and collectively. It has a legal framework, with foundations, ideals, and principles underlying that framework. It is rather a simplified system with a definite hold in every Muslim's mind. Actualisation of the Islamic system of governance goes back to those times the Islamic code has remained in force in all countries ruled by Muslims in Medina (Khan, 2010). The significance of the Islamic economy in some instances are controversial, but it is proof that Islamic finance is one of the prominent phenomena over the last decade in the Middle East and South-East Asia, especially in the banking industry. In this aspect, the legal framework in Islamic banking is more important. Scholars in many ways confirm that for Islamic banking to expand and develop to the point where it can effectively compete with its conventional counterpart, there needs to be proper legal and institutional frameworks that are dedicated to the governance of Islamic banks and adheres to the principles of shariah law (Abdulahi, 2012). However, there is no independent body for standardising and regulating the Islamic banking sector in Ethiopia, other than the National Bank of Ethiopia.

In 2021, various estimates indicated that Ethiopia's total population reached close to 117 million, of which 35% to 40% were Muslims. Up until 2011, no banking products and services have been availed to serve such a segmented market of the Muslim community. Although the National Bank of Ethiopia (NBE) has launched an IFB directive, there is still a need to develop an adequate legal framework to effectively grow and capitalise on a prosperous IFB sector. In Ethiopia, it is well identified that legal framework challenges, like the exclusiveness of banking business activity, limitation on investment of banks, tax system, and unavailability of controlling mechanism, and last, but not the least, lack of experts and skilled resources are identified as the main impediments of the sector (Hailu & Bushera, 2020). Amid others the central premise of this paper is to explore the gaps in the current legal framework of IFB business in Ethiopia.

The mentality and behaviour of leaders are shaped by their life experiences and knowledge, which are heavily impacted by cultural and religious beliefs. This study examines leadership gaps and problems in the implementation of IFB in terms of knowledge, perception, legal framework, time, and project management. Several

Western leadership ideas are disputed, and it is still unclear which is the best and most sustainable. Some countries have accepted specific leadership approaches, because they were obliged to follow, or because they were still looking for the best. Early debates on the concept of leadership frequently suggested that such qualities were solely innate characteristics that people have from birth; it implies "born to lead". Recent theories have claimed that, in addition to possessing some characteristics that help people become natural born leaders, other significant aspects such as experience and dependent variables are also important in becoming a good leader.

The gap between theories and their application can be bridged through proper adaptation on the leader's part, having a clear mindset, and creating well-defined goals. The numbers of interest-free banks are growing, with the aim of offering Islamic banking products and services. However, since the inception of Islamic banks, there have been worries about operational issues, such as a lack of skilled staff, a lack of human resource policy, and a lack of planning and training to accelerate IFB company growth. In this situation, it is critical for Islamic banking executives to address negative concerns and identify answers to certain significant impediments that jeopardise an Islamic bank's reputation (Tahreem Noor Khan, 2015).

A leadership gap is a weakness that a supervisor's capabilities in the workplace closely corresponds with, something that prevents them from reaching their full potential. In Libya, Wahda bankers discovered that one of the greatest roadblocks to conversion was a lack of awareness among clients and bankers, as well as misunderstandings among senior management (Yahya, 2017). Islamic banks are getting their market in the overall banking industry, but the difference is that the Islamic bank works within the boundaries set by shariah, thereby discouraging interest-based financing activities where Islamic banks take care of the moral and ethical standards by encouraging real-time economic activities through participatory modes of financing based on profit and loss concept (Fada & Wabekwa, 2012). *Increasing effective leadership in an organisation requires understanding where a leadership gap currently exists.* A leadership gap or deficit may have one of 2 causes: lack of mastery of the required competencies or lack of focus on necessary skills (Jean Brittain Leslie, 2015). In this research, leadership gaps will be assessed in terms of knowledge, perception,

legal framework, and project management. Addressing the leadership gap means committing to the holistic leadership approach where leaders are responsible, among others, for knowledge, perception, legal framework, and project management.

According to a research conducted in the UK, a majority of Muslims are unhappy and unsatisfied with the products and services of Islamic banks; there is concern about the cost of products compared to conventional ones, lack of advertising, focus on the rich in society, and just changing and rebranding the names of conventional products to produce shariah-compliance. Further, there is an absence of efforts to achieve social justice and equality in the society; and employing the same shariah scholars across shariah boards, thereby reducing opportunities for newer and younger scholars, which shows that leaders did not take the desired measures in a proactive manner (Umair Ahmad Riaz, 2014). According to a study done in the United Arab Emirates, non-Muslim students saw Islamic finance as intrinsically desirable to Muslims, but not as a producer of superior products (Bley & Kuehn, 2004). IFB should no longer be viewed as a religious organisation attempting to fulfil religious responsibilities, but rather as a successful business that can attract clients (Dusuki & Abdullah, 2006). Not only that, but the main apparent potential benefit of Islamic banks is the peace of mind that comes with knowing that money would not be used to fund “unethical” projects of which leaders of the time should be aware. However, banking personnel stated that they were unaware of Islamic products and that the business lacked qualified shariah scholars (Riaz, 2014).

Employees are entrusted to managers in organisations, and they must work with and through them to achieve organisational goals. The climate and effectiveness of the working environment are shaped by the perceptions of leaders, managers, and employees in businesses. The way we interpret our events is referred to as perception. For an effective leader, having the appropriate perception is a crucial ability. It is critical to recognise that perspective is frequently expressed through communication in any business, large or small, and hence, communication is a vital tool in leadership. What distinguishes exceptional leaders is their ability to control perceptions while dealing with organisational difficulties. What people see as a leader’s abilities becomes their perception, which then becomes reality (Otara, 2011).

Preconceived notions about product qualities influence product perception, as does the judgmental frame of reference. When these preconceived assumptions are about the product, they are referred to as perceptual or analytical expectations or product beliefs, and it is critical that the leader intervenes to correct the error. The most important bank selection criteria for clients who frequented Islamic banks were the provision of a quick and efficient service, the bank’s reputation, and confidentiality. Religion, on the other hand, was shown to have a smaller impact on customers’ decisions to use Islamic banks (Erol & El-Bdour, 1989). An assessment was conducted by Sohail et al. (2014) on perception of individual consumers towards Islamic banking products and services in Pakistan. The study showed that most of the respondents were not aware of the Islamic banking system, and they believed that Islamic banking and conventional banking were the same thing, with the same products and services. The results showed that bank switching is strongly influenced by various branch-level and product-related incidents. As a matter of fact, 75% of bank switching is caused by more than one incident and customers usually give a warning before switching. Hence, understanding customer and employee perception is key for the success of IFB business, and managing own perception towards IFB is by far more relevant. Employees’ standard of awareness and attitudes would be important in the future ascertainment of the employees’ competitiveness in the Islamic banking and financial institutions where leaders failed to fill it. The general customer attitude towards IB determines the adoption rates (Bella et al., 2016).

Knowledge of IB is regarded as one of the key determinants of IB adoption. Islamic banking embarks on knowledge sharing among employees, and other motivations like promotion and rewards system (Mariadas & Murthy, 2017). Islamic banks encourage their employees to share knowledge and information. Level of understanding of Islamic banking concepts as the influential factor in the use of Islamic banks in the country is low, hence, there is little use of the banks (Nuridin, 2017). Information technology infrastructures have been a major support in the knowledge management projects in the Islamic banks. The knowledge of bankers of IB products is critical in the transformation process and practice of Islamic banking, and it was one of the primary causes for delaying the process. One of the important things

that will simplify the transition to the Islamic financial system, according to studies, is knowledge of Islamic banking. A majority of bank managers in Libya have a strong awareness of Islamic finance and its products, such as Al Wadiah Amanah, Bai Muajjal, Hajj, Hawala, Ijara, Istisna, mudarabah, murabaha, musharaka, and Quard AL Hassan, although they were unaware of some Islamic products like mudarabah and murabaha (Yahya, 2017).

Because of the rising interest in Islamic banking, knowledge of Islamic banking products has grown. This desire grew significantly following the 2008 financial crisis, which demonstrated the strength of the Islamic banking system in comparison to the conventional banking system. Understanding IB principles, as well as knowledge of IB among bankers, is critical to the Islamic banks' future success (Wahid, 2013). Several studies have focused on this issue. There are constant worries about whether bank workers have proper Islamic banking training and competence. According to Abdullah and Rahman (2007), a majority of Islamic bankers do not comprehend the differences between Islamic and conventional banking due to a lack of education and training. Similarly, leaders could not achieve the ultimate goal of IFB without having the relevant knowledge of this business in their employees and themselves.

Tara et al. (2014) looked into the role of knowledge in the intention to embrace and implement Islamic banking products, finding that while knowledge of IB was positively related to attitude and inclination to use IB products, most Islamic banking employees have limited knowledge of IB products. While going for the research work, Samad et al. (2010) found a gap in the Islamic banking industry; most of the people did not even know about the procedures and nature of the products offered by Islamic banks, i.e., they have lack of knowledge about how these banking activities are Islamic. Trying to find different reasons due to which customers are satisfied with Islamic banks, 2 main reasons emerged: Islamic banks provide multiple channels of services and offer a variety of products.

The differences and similarities between conventional financial institutions and IB in terms of business organisation, supervisory roles, economic roles, and law are as follows. In terms of business organisation, Islamic banks obtain their income from sharing profit and loss through transactions, whereas conventional banks

make profit through interests on lending. IBs focus on economic roles, whereas conventional banks focus on company expansion by charging interest; IB origin of laws is shariah, although conventional banks' are not; and IBs and conventional banks have similar financial boards in terms of supervisory functions. However, while the supervisors' approaches to administering the banks differ, the nature of governance structure follows the same pattern (Ibrahim & Ismail, 2015). The active participation of Islamic scholars in the governance of the Islamic economy initiative has resulted in their banks' present improved performance. Many entrepreneurs have struggled to identify the programme, project, or initiative that best matches their business circumstances in the midst of multiple initiatives for small- and medium-sized enterprises (Choiruzzad et al., 2012). Because Islamic finance's doors are open to pertinent monetary reforms in the recent existing economic environment, it can embrace the reform agenda for conventional finance.

The increasing number of branches and size of Islamic banks indicates the growth and success of the Islamic banking industry. The motives behind this growth are due to the initiatives taken by central banks in nations. This movement has generated new dimensions in this sector, such as the financial need of small and medium enterprises, low-cost housing, car financing, and agriculture financing in terms of global outlook (Beloufi & Chachi, 2014). The global market for Islamic banking is set to flourish significantly in the years ahead and has the potential for becoming a part of the international financial system (Nazeer, 2015). More importantly, during the global economic slowdown, Islamic finance has shown resilience, whereas conventional banks in the West experienced difficulties. The use of the shariah principle is what distinguishes IBs from conventional banks, and this differentiates their governance and legal framework engagement in business systems that creates economic values (Nurdin, 2017). Due to the absence of comprehensive and inclusive relevant legislation, each bank has adopted their own methodology, models, and benchmarks for launching IFB products with little coherence or commonality in the market. There are 2 international regulatory bodies in the Islamic finance industry, which have been widely used as standard-setting bodies and benchmarks for Islamic and IFB products: the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) and the International Financial Services Board (IFSB).

In Ethiopia, OIB has opted to follow AAOIFI, and both NBE and OIB have undertaken discussions with the IFSB on the possibility of implementing their standards at a national or institutional level. CBE looked into the UK, South Africa, and Bahrain to develop their IFB product offerings, whereas United Bank has based their products on Pakistan and Saudi Arabia. The above effort shows that the directive seems to be simplistic and leaves too much room for offering products that may not be aligned with the actual Ethiopian needs (Zaineb Sefiani, 2014).

IFB windows do not fully and effectively adhere to Islamic principles. NBE Directive SBB/72/2019 sub-article 2.2 states that IFB business “refers to banking business in which mobilising or advancing funds is undertaken in a manner consistent with Islamic finance principles”. Hence, to achieve shariah compliance, IFB windows need to have an extra layer of governance to ensure that the principles outlined in the latter article are met (Zaineb Sefiani, 2014).

Islamic shariah law provides guidance in terms of belief, moral conduct, prohibitions, and practical rulings or laws to the Muslims, under Islam (Beloufi & Chachi, 2014). The 2 basic sources of Islamic shariah are the Holy Quran and Hadith/Sunnah, which are the primary sources, while the secondary sources are Ijtihad and Qiyas, which define shariah law (Gait & Worthington, 2008). Sardar (2003) notes that shariah is a “human construction; an attempt to understand the divine will in a particular context”. Therefore, the bulk of the shariah consists of Fiqh or jurisprudence, which is nothing more than legal opinion of classical jurists. Corporate collapses like Enron and WorldCom were caused by mismanagement and fraud by the organisation’s top management and even the external auditors. Although leadership was one of the aspects that contributed to Enron’s demise, it is because the degree of governance has received little attention. Hence, the tendency to focus on the leaders’ perceptions and acceptance towards IFB, as well as its product offering, is paramount (Rezart Dibra, 2016).

Shah et al. (2017) examined the perceptions of employees in Islamic banks and Islamic branches in conventional banks concerning practices and growth of Islamic banking in Pakistan. The results disclose that most of the employees hold a positive perception regarding the practices, objectives, and growth of Islamic banking,

and they believe that banks and the government are committed towards the development of Islamic banking in the country. It is necessary to analyse the presence of such participation in Ethiopia’s instance. NBE presently does not have internal specialists to assess and monitor IFB windows in Ethiopia to ensure that they are compliant with the article. Because there is no regulatory system in place to address the issue of shariah compliance, the products are at a significant danger of not adhering to true Islamic values (Zaineb Sefiani, 2014).

## Materials and Methods

In conducting researches on the assessment of leadership gaps and challenges in the implementation of IFB in Ethiopia, an exploratory type of research design has been used, which enables one to clarify ambiguous situations or discover ideas that are potential and real leadership gaps and challenges in Ethiopia in the IFB business. This research conducted is the first in Ethiopia. The purpose of using exploratory study is it provides a picture of the situation, person, and event, and showed how things are related to each other and as it naturally occurs (Blumberg, Cooper & Schindler, 2005). In this research assessment of leadership gaps and challenges in IFB in Ethiopia, an exploratory research design is used, as it is the best fit. This type of research design is particularly useful for new products/services implementation as it could be done with both structured and unstructured research approach (Ghauri & Gronhaug, 2005). As this research study involved collecting and analysing both quantitative and qualitative data, a mixed methods approach was implemented to address the research questions. These mixed methods provided a more complete picture by noting trends and generalisations, as well as in-depth content analysis of documents. The findings on quantitative approach are supplemented further by the qualitative research approach. Without a doubt, the 3 techniques are not as distinct as they appear.

## Data Collection Method and Sources

Considering the central and supplementary research questions, in this research 2 options were used to collect the quantitative and qualitative data. The first is a developed survey questionnaire on selected issues related to perception, project management, leadership knowledge

gap, and legal framework. This method had the advantage that the study was conducted at different banks, thus incorporating diverse opinions of the bank community. Qualitative data consisted of bank procedure and policy documents; NBE directives were majorly used. There is no single or best way for qualitative approach, and any of the following may produce narrative data that require analysis: open-end questions and written comments on questionnaires, testimonial, individual interviews, content analysis, focus group interviews, books, journals and directives, documents, reports, and news articles (Powell & Renner, 2003). Data was gathered both from primary and secondary sources for this study. A set of structured questionnaires have been designed and distributed to the selected respondents who are familiar with the IFB process along the structure in the leadership position, and an onsite observation was made on the conventional branches window. Secondary data was gathered to augment primary data from a variety of sources, including interest-free banking rules, policy and procedures, NBE directives pertaining to IFB, annual reports, and other publications of Ethiopian commercial banks.

### **Sampling Technique and Size**

The unit of analysis used in the current study is drawn from the population of commercial banks operating in Ethiopia. The study utilises the census approach in the selection of banks, with purposive exclusion of banks that do not provide IFB services and employees below managerial position. This is due to the small number of commercial banks operating in Ethiopia, which is only 19 as of 2021 (NBE quarter report, 2021), including the 2 full-fledged banks, of which 13 engaged in IFB business were considered. Since the target of this study is leadership gap and challenges in the adoption of IFB, mainly leaders or employees at managerial positions who have IFB exposures were considered, including conveniently selected shariah advisory boards.

In research, sampling refers to the selection of individuals, units, and/or environments to be investigated. While quantitative studies strive for random sampling, qualitative studies frequently employ deliberate or criterion-based sampling, which involves selecting a sample that possesses the qualities relevant to the research topic(s) (Lacey & Luff, 2001). When deciding

the sample size in researches, it is important to keep in mind that there is no one direct rule. However, we have to consider the sample sizes that reach saturation or redundancy, and a large enough sample is considered to assess an appropriate amount of diversity. Sampling in research typically starts with a specific group or type; thus, the goal is credibility and representativeness or the ability to generalise, in both qualitative and quantitative studies (Nastasi, 2004). Hence, defining sampling units clearly before choosing cases is essential to avoid mess and an empirically shallow research (Gobo et al., 2001). Therefore, a more appropriate approach of sampling technique which was applied to this research was census in selecting banks and stratified purposeful sampling in selecting target leadership respondents of the survey questionnaire at all the commercial banks in Ethiopia carrying on IFB business. As it is a new product as a whole in the Ethiopian market, the research considered those who have the exposure and expertise towards this business and who were found to contribute significantly to the findings. Mainly, this included stratified purposeful selection of samples per banks at the leadership role in the head office and 3 conveniently selected shariah advisory boards. They are presented in Table 1.

### **Data Analysis Method**

An in-depth quantitative and qualitative analysis of the survey response and content of the responses and documents were carried out, respectively. The structured data was analysed using Statistical Package for Social Scientists (SPSS) computer software and presented mainly in tables and percentages, to give a clear depiction of the findings. Moreover, to make it more simplified, the data gathered from questionnaires were summarised and analysed using descriptive statistics method of data analysis. Then the data were described and presented using tables. These aided in making the assessment of leadership gaps and challenges in adoption of IFB more successful.

### **Results and Discussion**

All 11 banks that started the IFB services, as well as the 2 fully-fledged IFB banks, ZamZam Bank and Hijra Bank (operationalised and to be operationalised soon, respectively), are eligible to provide data to the researcher.

Furthermore, the researcher was able to critically evaluate the contents of the NBE directives, sample bank policies and procedures, as well as conduct an on-site visit and observation, and the data and information gathered are analysed and presented in Table 2.

### **Leadership Perception Gap towards IFB Business**

The researcher's first alternative metric for weighing the leadership gap in the IFB industry is perception of leadership. This is because careful management of leaders' personal perceptions and taking suitable measures to fix detected perception gaps will help the IFB product succeed.

As it was well presented in the literature review part of this paper, evaluating the leadership's image focuses on the leaders' perceptions of the IFB product, their perceptions of the business's potential, their perceptions of the goods' core principles, perceptions of the scope of product usage, gaps in customer perception management, and leaders' attitudes towards shariah advisory boards at banks; and in some instances, perception of employees who run the IFB business and customer perception are the key areas the researcher decides on, to assess leadership gaps that hinder the success of IFB business in Ethiopia. Accordingly, the researcher summarised the data gathered through a distributed questionnaire that enables one to identify leadership perception. As seen in Table 3, for the sake of simplifying the analysis, the response is further categorised into 5 sub-categories and the analysis is presented as follows.

### **Leadership Perception about IFB Products and Services**

In terms of perceived competence of IFB products versus conventional banking products and services, 61.5 per cent of respondents believe IFB products are equally competitive to the conventional ones, while only 27.7 per cent believe the opposite. On the other hand, 44.6 per cent believe IFB products and services are more affordable than conventional products, while 27.7 per cent believe the opposite. However, in terms of the level of attention provided to IFB in comparison to traditional priorities, a

majority of respondents (66.2%) either strongly disagree or disagree that IFB receives appropriate attention from the leadership. Likewise, among various IFB retail and financing products currently in use in the industry around the world, 61.5 per cent of respondents disagree or strongly disagree that Ethiopian banks have adopted enough IFB products. Furthermore, 53.8 per cent of the respondents disagree that Ethiopian banks are introducing various IFB products on a regular basis. In addition, 61.5 per cent of respondents say that there are not enough finance options released on a regular basis. Surprisingly, around 55.5 per cent either believe or prefer not to believe that IFB companies promote Islam.

### **Leadership Perception of IFB Business Potential**

According to the Global IFM Report 2019, Islamic banking is the largest industry, accounting for 71 per cent of total Islamic Finance, or USD 1.72 trillion. In line with this, 92.3 per cent of the respondents agree or strongly agree that IFB is a prospective company. Further, 64.6 per cent of those surveyed thought that IFB has a high potential for consumer transfer from traditional to IFB. However, contrary to the shariah basic principles, half of the respondents think that IFB performance should be judged through a good percentage of profit returns. In the researchers' observation and data acquired from Ethiopian Interest-Free Finance Professional Association (EIFFPA) as of March 31, 2021, from the total 83.5 billion Birr IFB deposit of commercial banks in Ethiopia, 99.6% of the total deposit is maintained in the Wadia Amana account, although banks do not share any advantage for such an account. While it is a normal practice around the world for Wadia Amana accounts to be reimbursed with Hiba (a variety of gifts organised by the banks), this is not the case with Ethiopian banks that operate IFB businesses, which abuse practically all IFB depositors. True, the IFB business should make money, but not just in any way; rather, it is monitored against shariah principles. In this regard, a majority of the respondents agree that a good percentage of profit/return should be used to judge a bank's performance in terms of IFB. However, Islamic finance is based on adhering to Islamic principles and ensuring the well-being of society through equitable wealth distribution.

## **Leadership Perception Regarding the Fundamental Principles of IFB**

In support of this claim, researcher's observation of branches' physical environment is a reflection. About 53.8 per cent of the respondents disagree or are unsure that the bank has an IFB conducive environment that adequately reflects the principles on which the business is based. It is not conducive because IFB customers expect employees to wear uniforms, which the majority of bank branches do not provide. Differentiating IFB services from conventional in terms of employees, a window is not provided, and separate record keeping is not found to be reliable.

Although trading money for money is prohibited under shariah law, a significant number of respondents (61.5%) believe that there is nothing wrong in trading money for money. Contradicting their response, nearly 90% of the respondents believe that they understand the underlying principles used in IFB. Hence, customers trust that the sources of shared profit or loss for their investment account (mudarabah and/or musharaka) are free of interest (Riba), yet a large proportion of respondents disagree, leading some customers to question whether the essential shariah principle is maintained or not. It is true that religious norms have an impact on deciding what form of banking to use on customers; however, the principles on which the business is founded are aligned with the value of the customers, whether they are Muslims or non-Muslims, and the ideas are said to be common to most religions (Hardius Usman, 2015). Contrary to this argument, most of the respondents (71%) perceived that IFB is first in conformity with Islam, then the customer. However, the presence of the IFB principle is in alignment with the customer's wants, regardless of their religion, and on top of that, more than 83.1% of the respondents agree that IFB is meant for both Muslims and non-Muslims.

## **Perception with Respect to Shariah Advisory Board**

The Shariah Advisory Board (SASB) has an advisory function in most banks, with management making the final decision; nonetheless, SASB recommendations are applied during operations. SASB, on the other hand, has reservations about how rigidly their suggestions are

enforced; in addition, they have observed gaps in the application of their remarks, and they feel that many of the concerns they forwarded are still pending implementation.

## **Leadership Knowledge Gaps towards IFB**

Following the evaluation of leadership perception gaps and issues, the following step is to rate leadership expertise and understanding of IFB business, as this is one of the areas where the research is looking for knowledge gaps or issues. As a result, 17 questions were created to assess respondents' knowledge gaps (See Table 4).

## **Leadership Knowledge and Understanding of IFB Products and Services**

From the total respondents, 70.8 per cent believe that distinguishing IFB from traditional banking is simple, and 83.1 per cent believe that they understand the underlying principles or concepts used in IFB. However, 61.5 per cent are unaware of the basic principle of prohibition of trading money for money. Furthermore, more than half of the respondents said that the terminology employed in IFB is difficult for them to understand. Moreover, 69.2 per cent of respondents agreed, strongly agreed, or are unsure that their employees are not fully aware of the IFB services currently supplied by their bank, which is a symptom of knowledge gaps at the employee level. Around 33% disagree or are unsure about their understanding of the basic instruments utilised in financing products such as mudharabah and musharaka. More than half the respondents believe that mudarabah and musharaka finance packages are simpler and more effective than other financing options. However, the global practice shows that the murabaha product financing is the most widely used and simpler to implement. Therefore, this is a good indication that leaders themselves are not clearly aware of the basic IFB products.

It is common knowledge that if employees have knowledge gaps, this will have an impact on customer knowledge, which is the ultimate success factor for a firm, and an impact on the bottom line. As a result of the knowledge gap at the bank level, just 29.2 per cent of the respondents felt that the clients were aware of IFB products supplied through window, full-fledged branches, and banks, where banks fail to adequately educate or inform their customers

about IFB products. Despite the fact that shariah advisory boards or consular have appropriate knowledge of shariah rules, only approximately 37% of the respondents agree on their shariah advisory boards' technical competency in financial treatments. The shariah advisory council appears to be successful in its argument that goods and services deemed forbidden by them cannot be financed by interest-free banking (IFB), and just about 11% of the respondents disagree with this statement.

### **IFB Manpower Placement, Training, and Development**

The discrepancy between one's current level of knowledge and the level of information or aptitude required to achieve a goal is known as a knowledge gap. It is an activity that leads to skilled behaviour; it is the foundation of a continuous effort to increase employee competency and organisational performance by teaching individuals the fundamental skills they require to accomplish their jobs. Training benefits everyone, since it gives them a greater understanding of their responsibilities, as well as the knowledge and skills they need to do their jobs. This will increase their self-assurance, allowing them to perform better in general. The higher the quality of training, the faster the company will grow. However, 80% of the respondents disagree or are unclear if the staff at their bank branch are professionally trained and knowledgeable. In the Ethiopian banking industry, we have witnessed that most of the employee assigned along the IFB structure are trying to acquire technical knowledge on their own. Employees, as well as supervisors at all levels of the IFB structure and business, lack training. As a consequence, roughly 74 per cent of the respondents disagree that IFB training is routinely offered to managers, and an additional 80 per cent disagree that training sessions arranged on IFB for knowledge of shariah advisory board are held on a regular basis. Furthermore, according to 63.1 per cent of survey respondents, not only the frequency, but also the range of techniques for providing training are not applied.

### **Communicating IFB Products and Services**

More than 92 per cent of the respondents agreed that if a customer's company involves alcohol, tobacco, or pork, branches are encouraged to refuse IFB service. However,

in terms of public communication, a majority of the respondents (66.2%) disagree that banks have excellent advertising strategies to inform the public about financing alternatives in Ethiopia, and more than 75% disagree that customers have a good comprehension of IFB financing products.

### **Gaps on Project Management and Implementation of IFB**

The researcher showed a knowledge gap in the adoption of IFB in Ethiopia in the previous section of data analysis; in this part, the researcher assesses leadership gaps and problems in the IFB project management in Ethiopia. The following is a breakdown of IFB adoption project management gaps and challenges. Project management, in this context, refers to the complete lifecycle of an IFB, from ideation to implementation, and seamless operation as a bank's routine activity. The researcher summarised the response in Table 5, which corresponds to the analysis in the following section.

### **Analysis of IFB Business Project Management**

The project implementation alignment and completion, as per the established time schedule, is one of the parameters that define the effectiveness of project management, and for the purposes of this study, the time management of IFB is measured using 4 survey questions presented by the researcher. In response to the first question, a majority of the respondents agreed that introducing IFB business took longer than it did by conventional means, and that coming live is well behind the timeframe set for IFB implementation, with just about 20% disagreeing. Full-fledged IFB banks failing to meet their go-live schedule is partly attributed to the organisers' lack of experience in the banking business, with just about 10% refuting this point. Not only that, more than 66.2 per cent of respondents believe that after the project or product is operationalised, the IFB service is inefficient and time consuming. Banks are concentrating their efforts on the murabaha finance market, which is cost plus markup and differs from project financing. Although the primary premise of the business is to produce sustainable development of projects, only 12.3% of the respondents are aware that IFB business is not yet encouraging sustainable development of projects. Furthermore, a majority of the respondents (more than

70%) are unsure whether the IFB features presented in the window would meet IFB banking needs.

### Gaps Related with Project Management Structure

Project failure is not solely due to poor time management; structure throughout the project management process plays a role in both success and failure. Accordingly, 67.7 per cent of the respondents acknowledged that the IFB institutional structure is contradictory and unclear in traditional banks, while more than 90 per cent disagree that a shortage of skilled people in the IFB industry is a difficulty in providing services. Moreover, more than 72 per cent disagree with the placement of adequate, qualified, and presentable individuals, including board members, along the IFB structure, in terms of IFB financing, business, and shariah awareness. In addition, just 34% agreed that full-fledged IFB banks have enough well-experienced bankers on their board of directors. It is not the only structural flaw; just around 57 per cent of the respondents favour their bank's shariah advisory board's active participation, and only about 33 per cent believe that forming a shariah advisory board entails extensive bureaucracy. As a result, their influence on the success of IFB product and service implementation is limited, with only about 40% of the respondents agreeing that the bank has partnered with religious leaders to raise public awareness about the importance of IFB, which would have been better done in coordination with the shariah advisory board if they had been actively involved. This leads to a determination of whether IFB accountability and performance are assured. As a result, 64.6 per cent of the respondents hold them accountable for their actions, but in practice, according to the March 2021 IFB consolidated report of commercial banks, only 25% of total deposits mobilised are financed, and some banks have no financing at all, and accountability was not maintained in keeping those funds idle (See Table 6). A majority of the respondents believe that IFB is transparent, but in actuality, certain banks' IFB activities are not separately reported and there is no easily maintained separate general ledger.

### Leadership Role in IFB Technology Placement Gaps and Challenges

There is shariah-compliant technology that is approved by AAOIFI and is suitable for Islamic banking, and a majority of the respondents think that investing in

technology for the benefit of IFB business is worthwhile, and they believe that IFB employs modern technology in banking transactions. However, in practice, less than half of the respondents agreed that their system is capable of automatically calculating profit sharing for mudarabah saving deposits. Furthermore, while there is a system that separates IFB GL from conventional GL, most banks fail to record separate GL of IFB in an automatic manner in many cases. In addition, more than 80% of the respondents agreed that IFB transactions financial reports could be obtained in the same way as traditional financial reports. In truth, a majority of the bank's yearly financial reports do not present IFB's financial situation in its entirety.

### Legal Framework Content Analysis Presentation

It was stated in the preceding section of this document that leadership comprises those who are responsible for assisting the IFB company by developing an enabling legal framework, which leaders at all levels are expected to follow once formed. Further, to guarantee that it is correctly executed, it is advisable to have close monitoring and follow-up. Today's organisations operate in a highly regulated environment, posing significant obstacles for many executives. Regulation may compel an organisation to update its resource needs, skill sets, and examine the overall impact of the legislation on the organisation; in this section of the analysis, the legal framework gaps and the functions of a leader with respect to NBE directives are assessed. In Ethiopia, the interest-free banking legal framework is mainly composed of:

- Banking Business Proclamation No. 592/2008, in its Sub Article 22(2);
- Licensing and Supervision of Banking Business Directives to Authorise the Business of Interest Free Banking Directives Number SBB/51/2011;
- Licensing and Supervision of Banking Business (1<sup>st</sup> Replacement) Directive to License and Authorize Interest Free Banking Business Number SBB/72/2019.

The most recent IFB order (SBB/72/2019), titled '1<sup>st</sup> Replacement', incorporated the full-fledged IFB banking business. The mission of the IFB is to increase financial inclusion. 'Interest-free banking business' refers to a banking enterprise in which funds are mobilised or advanced in accordance with Islamic law or shariah principles.

‘Interest-free bank’ refers to a bank that has been licensed by the National Bank to conduct interest-free banking solely. ‘Interest-free banking window’ refers to a unit within a conventional bank that specialises in interest-free banking. There is a method of separating funds from other businesses in the interest-free banking window. To achieve successful fund segregation, a bank that operates an interest-free banking window must keep separate books of accounts for the operation of the interest-free banking window and keep proper records for all transactions.

- The NBE directive does not contain a standardised methodology to ensure that the product complies with Islamic banking principles and does not explicitly benchmark any norm. With the exception of the National Bank’s interest rates guideline, banks must follow all regulatory and supervisory criteria when undertaking IFB transactions. This allows IFB products to be regarded within the legal framework of traditional banking; this may be solved by benchmarking some IFB international standards, which is currently not being done by the legal framework’s leaders. Leaders in charge of building legal frameworks fail to complete this task.
- Prior to the adoption of the IFB in Ethiopia, the Limitation on Bank Investments Directive No. SBB/12/1996 limited banks’ participation in non-banking enterprises to 20% of the company’s share capital and total interests in such businesses to 10% of the bank’s net value. This has an impact on the use of finance solutions like musharaka and mudarabah, which are still maintained in this case. Leaders responsible for crafting the directive or legal framework fail to devise a way of filling such a visible gap, and NBE directive SBB/72/2019 addressed it.
- The legal framework that NBE leaders left in a room with directive SBB/72/2019 sub article 7(2) did not openly direct the construction of a shariah advisory board, nor did NBE take responsibility for establishing a national shariah supervisory authority. It lacks standards that ensure IFB products adhere to shariah principles, leaving the possibility of customers losing faith in shariah compliance.

### Legal Framework Contributes to Leadership Gap

A legal framework is a system of rules that control governments’, corporations’, and people’s rights and

responsibilities. In Ethiopia, NBE was principally responsible for establishing the IFB legal framework. This research evaluates the legislative framework developed in governing IFB, in view of leadership gaps and challenges, and the analysis is based on the respondent perspective and content of the NBE directives. A summary of respondents may be found in Table 7.

### Leadership Challenges and Gaps, Regulatory Framework

A substantial percentage of bankers (46.1%) are unaware that the NBE regulatory framework specifically acknowledges Islamic banking practices, despite the fact that the NBE, in its directive SBB/72/2019 Sub item 2(2), explicitly recognises Islamic banking practices. However, the preceding chapter’s analysis of the legal framework directive contents revealed that the legal framework is not yet appropriate for conducting IFB business, and only around a quarter of the respondents disagree. Around 90% of the respondents do not clearly reject the statement that Ethiopia lacks effective prudential rules for IFB businesses. Further, just 63 per cent are aware that IFB is governed by a traditional regulatory framework in Ethiopia. More than half of the respondents disagreed with this assumption, claiming that the regulatory environment has yet to build a mechanism that ensures the distinctiveness of IFB in comparison to conventional banking.

### Legal Framework Structure Impacting IFB Leadership in Ethiopia

A majority of the respondents (74%) agreed or remained neutral that the IFB regulatory structure causes challenges in banking operations, while 38.5 per cent agreed that the supervisory framework ensures a suitable corporate governance structure for IFB in Ethiopia. In practice, however, there is no clear guidance put forth by the NBE to ensure the existence of suitable corporate governance among commercial banks in their IFB operations, and a majority of the respondents agree that the shariah board has legislative jurisdiction over shariah issues confined to each bank. There is no directive that controls an IFB product’s shariah validity, and the lack of an organ to oversee such compliance causes clients to be hesitant to use the product, as they are unsure of its shariah compliance. However, bank leaders can fill this gap by

appointing their own shariah advisory as a first measure, with more than half of the respondents seeing the benefit of doing this. There is undoubtedly a gap between the NBE and the bank's shariah advisory board, which could be explained by the fact that the legal framework does not establish a structure to regulate the product's shariah compliance at the central level. Furthermore, there is no clear direction for banks on how to establish a shariah advisory board in their organisational structure, according to more than half of the respondents, and the lack of such a system leads to looser coordination between regulators and banks, according to 80 per cent of the respondents.

### **Legal Framework Practice Monitoring and Follow-up**

A majority of the respondents dispute that IFB regulators maintain standardisation and harmonisation of shariah practices in Ethiopia, and 47.7% believe that shariah permissible modes and norms are explicitly communicated to banks by IFB regulators. However, nowhere in the directive does it state that the permitted mode of the items must be explicit, other than that all IFB products must comply with the shariah concept in general. The directive clearly states that current legislation issues limit shariah-based products that are feasible or offering to the Muslim population. The licensing requirement clearly addresses shariah compliance difficulties, and while 69 per cent of the respondents agreed, the directive simply states segregation of accounting treatment and reporting as a licensing requirement, which does not include the entire shariah IB principle. About 85 per cent of the respondents did not demonstrate their agreement that NBE measures and monitors consistency of IFB contracts and goods, and not only that, but a similar number of respondents did not agree that NBE measures and monitors uniformity of IFB contracts and products. Further, respondents disagree that NBE does appropriate on-site inspections to assure performance, stability, and compliance. Many respondents agree that NBE mandate requires IFB liquidity to be managed independently from conventional liquidity, however, this is not the case in banks that operate IFB.

### **Conclusion**

It is found that attention given to IFB by leaders is minimal, due to perception and knowledge gaps. The

lack of IFB personality and presentability by leaders in their leadership action happens in some cases due to fear of the unknown. As a result, banks fail to have an IFB-friendly atmosphere that properly reflects the values on which the IFB is established. Employees were unaware of their IFB services, as they are not professionally trained and qualified. Moreover, customers are not aware of the IFB products and services available at banks. Banks fail to communicate to the public in a strategic way. Training and development initiatives for leadership and employees are not well-organised and delivered at the level of expectation. The institutional structure of the IFB sector is contradictory and complex, and there is a scarcity of experienced experts in the IFB sector, which has an impact on product implementation. Organisers at fully fledged IFB banks lack banking experience.

The other point is that although it has been determined that investing in technology for the benefit of IFB is worthwhile, in practice, the system is not in place to independently record IFB transactions and maintain separate records of general ledgers. Even getting financial data of IFB transactions, such as traditional activities and daily operations, is difficult. Hence, IFB technology adoption is very sluggish, which makes the IFB operation suffer at conventional banking. Although the NBE regulatory framework clearly recognises Islamic banking practices, Ethiopia's current legal environment is unsuitable for IFB activity due to a lack of effective prudential rules. The regulatory structure does not ensure that IFB is distinct from the conventional, but rather, IFB in Ethiopia is evaluated through the lens of a typical regulatory framework. There are no bridges between the NBE and the shariah consular of banks. NBE fails to maintain Shariah Supervisory Board at the centre. In Ethiopia, standardisation and harmonisation of shariah practices in the IFB line of business are not carefully maintained. The IFB supervisory system does not provide for continuing shariah compliance and auditing.

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## Supplementary Documents for Review

**Table 1: Local Banks' IFB Structure and Respective Sample Size Taken into Consideration**

Description	CBE	OIB	HB	CBO	NIB	WEG	ABAY	BOA	AB	DB	BB	ZB	HIJ	Total
Number of VP/Dep- puty VP	1	1		1	1				1	1		2		8
Number of Directors	3	1	1	3	7	1	1	1	2	1	1	5	6	33
Number of Division/ Manager	13	3	2	3	2	2	5	5	5	5	2	5	3	55
Sum Leadership IFB structure	17	5	3	7	10	3	6	6	8	7	3	12	9	96
<b>Total Conveniently selected Sample Size</b>	<b>5</b>	<b>4</b>	<b>2</b>	<b>7</b>	<b>10</b>	<b>2</b>	<b>6</b>	<b>5</b>	<b>6</b>	<b>7</b>	<b>4</b>	<b>11</b>	<b>6</b>	<b>75</b>

**Table 2: Banks and Number of Respective Leadership Participation in the Survey**

Bank		Frequency	Per cent
Valid	Hibret Bank S.Co	2	3.1
	Abay Bank S.Co	5	7.7
	Bank of Abyssinia S.Co	3	4.6
	Awash Bank S.Co	4	6.2
	Cooperative Bank of Oromia S.Co	7	10.8
	Hijra Bank S.Co	4	6.1
	Commercial Bank of Ethiopia	5	7.7
	Nib International Bank S.Co	7	10.8
	Dashen Bank S.Co	5	7.7
	Buna Bank S.Co	4	6.1
	Oromia International Bank S.Co	4	6.1
	Wegagen Bank S.Co	4	6.1
	ZamZam Bank S.Co	11	17
	Total	65	100

**Table 3: Respondent's Summary of Leadership Perception towards IFB**

Leadership Perception about IFB Products and Services		Strongly Agree	Agree	Uncertain/ Not Applicable	Disagree	Strongly Disagree	Missing
1.	IFB is as competitive as conventional banking, in terms of products and services.	13(20%)	27(41.5%)	6(9.2%)	17(26.2%)	1(1.5%)	1
2.	IFB products are more affordable than products in conventional banks.	8(12.3%)	21(32.3%)	16(24.6%)	14(21.5%)	4(6.2%)	2
3.	Adequate attention is given to IFB operations, similar to conventional banking.	1(1.5%)	12(18.5%)	8(12.3%)	30(46.2%)	13(20%)	1
4.	Enough IFB retail products and services are introduced.	3(%4.6)	12(18.5%)	10(15.4%)	32(49.2%)	8(12.3%)	0

<i>Leadership Perception about IFB Products and Services</i>		<i>Strongly Agree</i>	<i>Agree</i>	<i>Uncertain/ Not Applicable</i>	<i>Disagree</i>	<i>Strongly Disagree</i>	<i>Missing</i>
5.	Banks continuously enhance product and service quality of IFB, like in conventional banking.	0	19(29.2%)	11(16.9%)	26(40%)	9(13.8%)	0
6.	Enough financing products are introduced in an ongoing basis.	1(1.5%)	9(13.8%)	14(21.5%)	32(49.2%)	8(12.3%)	1
7.	Interest-Free Banking (IFB) is promoting Islam.	4(6.2%)	15(23.1%)	17(26.2%)	20(30.8%)	9(13.8%)	0
<i>Leadership Perception of IFB Business Potential</i>							
8.	I believe that IFB is a strong business potential for banks.	38(58.5%)	22(33.8%)	3(4.6%)	1(1.5%)	1(1.5%)	0
9.	There is high potential of customer conversion or migration from conventional to IFB.	9(13.8%)	33(50.8%)	16(24.6%)	5(7.7%)	2(3.1%)	0
10.	IFB performance should be judged through good percentage of profit/return.	5(7.7%)	27(41.5%)	8(12.3%)	20(30.8%)	5(7.7%)	0
11.	IFB services do not exploit its customers in any way.	6(9.2%)	27(41.5%)	15(23.1%)	14(21.5%)	1(1.5%)	2
<i>Leadership Perception Regarding the Fundamental Principles of IFB</i>							
12.	The bank has an IFB conducive environment that properly reflects the values in which the business is based.	0(0%)	19(29.2%)	16(24.6%)	22(33.8%)	6(9.2%)	2
13.	There is nothing wrong in trading money for money in IFB services.	4(6.2%)	22(33.8%)	14(21.5%)	10(15.4%)	14(21.5%)	1
14.	IFB is first in conformity with the norms of Islam and then the customer.	16(24.6%)	30(46.2%)	8(12.3%)	11(16.9%)	0(%)	0
<i>Perception on Product Implementation Scope</i>							
15.	I think Islamic banking services are offered to both Muslims and non-Muslims.	26(40%)	28(43.1%)	5(7.7%)	5(7.7%)	1(1.5%)	1
<i>Perception with respect to Shariah Advisory Board</i>							
16.	Shariah board comments are applied during operation and issuing of products.	13(20%)	31(47.7%)	14(21.5%)	6(9.2%)	1(1.5%)	1
<i>Gaps in Managing Customers' Perception</i>							
17.	Customers trust that the sources of shared profit or loss for their investment account (mudarabah and/or musharaka) are free from interest.	15(23.1%)	18(27.7%)	24(36.9%)	7(10.8%)	0(%)	1

**Table 4: Leadership Knowledge and Uptake of Interest-Free Banking (IFB)**

Level of Understanding of IFB Products and Services		Strongly Agree	Agree	Uncertain/Not Applicable	Disagree	Strongly Disagree	Missing
1.	It is simple to understand the difference between IFB and conventional banking system.	15(23.1%)	31(47.7%)	8(12.3%)	11(16.9%)	0(0%)	0
2.	I know the underlying principles or concepts applied in IFB.	18(27.7%)	36(55.4%)	4(6.2%)	6(9.2%)	1(1.5%)	0
3.	Terminologies used in IFB are difficult to understand.	0(0%)	22(33.8%)	11(16.9%)	28(43.1%)	4(6.2%)	0
4.	Employees clearly know IFB services currently offered by banks.	0(0%)	19(29.2%)	17(26.2%)	22(33.8%)	6(9.2%)	1
5.	Shariah board/advisors have technical expertise of financial treatments, other than shariah.	5(7.7%)	19(29.2%)	28(43.1%)	10(15.4%)	2(3.1%)	1
6.	I am aware of the instruments used in the financing products IFB offers, like mudarabah and musharaka.	11(16.9%)	39(60%)	8(12.3%)	6(9.2%)	1(1.5%)	0
7.	Customers know IFB products/services offered through window and full-fledged bank and branches.	1(1.5%)	11(16.9%)	8(12.3%)	30(46.2%)	15(23.1%)	0
8.	Operationally, mudarabah and musharaka financing products are simpler and more effective than other financing products.	1(1.5%)	9(13.8%)	24(36.9%)	26(40%)	5(7.7%)	0
9.	Goods and services judged illegal by the shariah cannot be financed by IFB.	33(50.8%)	18(27.7%)	6(9.2%)	5(7.7%)	2(3.1%)	1
<i>Availing Manpower, Training, and Development for IFB</i>							
10.	Branch's technical staff in charge of IFB are professionally trained and qualified.	1(1.5%)	12(18.5%)	19(29.2%)	29(44.6%)	4(6.2%)	0
11.	Technical staff in charge of IFB are professionally trained and qualified at H.O.	1(1.5%)	30(46.2%)	15(23.1%)	17(26.2%)	2(3.1%)	0
12.	IFB training is frequently delivered to managers.	1(1.5%)	16(24.6%)	20(30.8%)	21(32.3%)	7(10.8%)	0
13.	Training sessions are arranged regularly on IFB for the understanding of shariah advisors.	1(1.5%)	12(18.5%)	20(30.8%)	28(43.1%)	3(4.6%)	1
14.	Banks use a variety of methods to educate people about IFB products/services.	3(4.6%)	21(32.3%)	20(30.8%)	15(23.1%)	6(9.2%)	1
<i>IFB Products and Services Communication</i>							

<i>Level of Understanding of IFB Products and Services</i>		<i>Strongly Agree</i>	<i>Agree</i>	<i>Uncertain/Not Applicable</i>	<i>Disagree</i>	<i>Strongly Disagree</i>	<i>Missing</i>
15.	Encourages branches to avoid customers for IFB banking service, if the customer's business involves alcohol, tobacco, and pork.	15(23.1%)	34(52.3%)	11(16.9%)	5(7.7%)	0(0%)	0
16.	Banks have good advertising strategies to inform public about the financing opportunities in Ethiopia.	2(3.1%)	20(30.8%)	15(23.1%)	25(38.5%)	3(4.6%)	0
17.	Customers have gained a good understanding of IFB financing products.	1(1.5%)	14(21.5%)	17(26.2%)	33(50.8%)	0(0%)	1

**Table 5: Gaps and Challenges in IFB Project Management and Implementation**

<i>Time Management of IFB Projects</i>		<i>Strongly Agree</i>	<i>Agree</i>	<i>Uncertain/Not Applicable</i>	<i>Disagree</i>	<i>Strongly Disagree</i>	<i>Missing</i>
1.	Introducing IFB business took longer than it did for conventional banking.	11(16.9%)	29(44.6%)	12(18.5%)	12(18.5%)	0(0%)	1
2.	Lack of full-fledged IFB under formation, attributed to organisers' distance with banking exposure.	5(7.7%)	35(53.5%)	18(27.7%)	6(9.2%)	0(0%)	1
3.	Services offered by IFB are efficient and time effective.	3(4.6%)	19(29.2%)	18(27.7%)	21(32.3%)	4(6.2%)	0
4.	IFB business promotes sustainable development projects.	13(20%)	32(49.2%)	12(18.5%)	6(9.2%)	2(3.1%)	0
5.	Features of IFB offered in window can fit with customers' banking needs.	5(7.7%)	14(21.5%)	16(24.6%)	27(41.5%)	3(4.6%)	0
<i>Project Management Structure</i>							
6.	IFB institutional structure is conflicting and confusing at conventional banks.	5(7.7%)	16(24.6%)	18(27.7%)	23(35.4%)	3(4.6%)	1
7.	The shortage of experienced professionals in the IFB sector is a problem in providing the service.	15(23.1%)	36(55.4%)	8(12.3%)	6(9.2%)	0(0%)	0
8.	Adequate, qualified, and presentable personnel are placed along the IFB structure, including board members, in terms of business and shariah.	4(6.2%)	14(21.5%)	24(36.9%)	20(30.8%)	3(4.6%)	0
9.	Full-fledged IFB banks incorporate sufficient well-experienced bankers on their board.	5(7.7%)	17(26.2%)	21(32.3%)	18(27.7%)	4(6.2%)	0
10.	Accountability and performance of IFB are ensured.	6(9.2%)	36(55.4%)	10(15.4%)	9(13.8%)	3(4.6%)	1

<i>Time Management of IFB Projects</i>		<i>Strongly Agree</i>	<i>Agree</i>	<i>Uncertain/Not Applicable</i>	<i>Disagree</i>	<i>Strongly Disagree</i>	<i>Missing</i>
11.	The bank has partnered with religious leaders to sensitise the public about the importance of IFB.	3(4.6%)	23(35.4%)	23(35.4%)	13(20%)	3(4.6%)	0
12.	My bank has an active shariah advisory board.	11(16.9%)	26(40%)	15(23.1%)	11(16.9%)	2(3.1%)	0
13.	Establishing shariah advisory board involves extended bureaucracy.	5(7.7%)	19(29.2%)	20(30.8%)	17(26.2%)	4(6.2%)	0
14.	IFB are transparent in their dealings and annual reports, with respect to services.	11(16.9%)	33(50.8%)	15(23.1%)	6(9.2%)	0(0%)	0
<i>Technology Implementation Gaps and Challenges</i>							
15.	Investing in technology for the sake of IFB business is worthy.	17(26.2%)	32(49.2%)	8(12.3%)	6(9.2%)	2(3.1%)	0
16.	IFB use modern technology in performing banking transactions.	15(23.1%)	29(44.6%)	11(16.9%)	8(12.3%)	2(3.1%)	0
17.	There is a system to calculate mudarabah deposit profit sharing automatically.	6(9.2%)	23(35.4%)	18(27.7%)	14(21.5%)	4(6.2%)	0
18.	System is established that separately records accounting transaction of IFB.	15(23.1%)	37(56.9%)	5(7.7%)	5(7.7%)	3(4.6%)	0
19.	There is an IFB system that separately maintains general ledger accounts of IFB transactions at conventional banks.	13(20%)	40(61.5%)	7(10.8%)	4(6.2%)	1(1.5%)	1
20.	It is possible to get IFB transactions financial reports, like in conventional banks.	16(24.6%)	36(55.4%)	6(9.2%)	7(10.8%)	0(0%)	1

**Table 6: IFB Financing to Deposit Proportion of Banks as of End of March, 2021**

<i>Sr. No.</i>	<i>Name of Bank</i>	<i>Total Value of Deposit</i>	<i>Outstanding Financing</i>	<i>Deposit to Financing</i>
1	Abay Bank	1,115,895,144	438,408,571.43	39%
2	Awash Bank	5,701,838,343	1,634,415,408.94	29%
3	Bank of Abyssinia	6,388,137,591	486,305,010.28	8%
4	Buna Bank	535,000,000		0%
5	Commercial Bank of Ethiopia	45,995,292,645	5,656,475,643.47	12%
6	Cooperative Bank of Oromia	9,586,597,947	5,827,361,624.04	61%
7	Dashen Bank	3,992,561,075	1,212,043,637.39	30%
8	Hibret Bank	1,686,313,008	764,906,397.23	45%
9	Nib International Bank	2,683,999,698	690,706,749.29	26%
10	Oromia International Bank	4,487,486,000	3,641,716,690.00	81%
11	Wegagen Bank	1,365,725,689	380,287,084.61	28%
12	<b>Total</b>	<b>83,538,847,141</b>	<b>20,732,626,817</b>	<b>25%</b>

**Table 7: Response Summary of Legal Framework that Contributes to Leadership Gap**

<i>Legal Framework Impacting Leadership</i>		<i>Strongly agree</i>	<i>Agree</i>	<i>Uncertain/ Not applicable</i>	<i>Disagree</i>	<i>Strongly disagree</i>	<i>Missing</i>
1.	NBE regulatory framework explicitly recognises Islamic banking practices.	3(4.6%)	31(47.7%)	9(13.8%)	16(24.6%)	5(7.7%)	1
2.	The current legal spans are suitable for IFB business.	3(4.6%)	12(18.5%)	14(21.5%)	20(30.8%)	15(23.1%)	1
3.	Effective prudential regulations for IFB are lacking in Ethiopia.	16(24.6%)	27(41.5%)	15(23.1%)	5(7.7%)	0(0%)	2
4.	IFB in Ethiopia is viewed by a conventional regulatory framework.	14(21.5%)	27(41.5%)	11(16.9%)	10(15.4%)	1(1.5%)	2
5.	Regulatory framework ensures uniqueness of IFB, compared to conventional.	7(10.8%)	19(29.2%)	13(20%)	21(32.3%)	4(6.2%)	1
<i>IFB Legal Framework Structure in Ethiopia</i>							
6.	IFB regulatory structure creates difficulties in banking operations.	5(7.7%)	22(33.8%)	21(32.3%)	11(16.9%)	5(7.7%)	1
7.	Shariah board has the legislative authority over shariah issues.	13(20%)	28(43.1%)	14(21.5%)	7(10.8%)	2(3.1%)	1
8.	Supervisory framework ensures appropriate corporate governance structure for IFB.	4(6.2%)	21(32.3%)	16(24.6%)	20(30.8%)	2(3.1%)	2
9.	The first measure for banks to offer IFB requires the appointment of a shariah advisory board.	11(16.9%)	19(29.2%)	14(21.5%)	19(29.2%)	1(1.5%)	1
10.	Lack of bridges between NBE and banks' shariah advisory board.	13(20%)	19(29.2%)	22(33.8%)	9(13.8%)	2(3.1%)	0
11.	Coordination among regulators and banks are adequate.	2(3.1%)	11(16.9%)	15(23.1%)	25(38.5%)	12(18.5%)	0
12.	In Ethiopia, standardisation and harmonisation of IFB shariah practices are followed strictly.	0(0%)	14(21.5%)	22(33.8%)	23(35.4%)	5(7.7%)	1
13.	Shariah permissible modes and guidelines are made explicit to Islamic bankers by IFB regulators.	5(7.7%)	26(40%)	16(24.6%)	14(21.5%)	3(4.6%)	1
14.	Licensing requirement clearly addresses the issues of shariah compliance.	3(4.6%)	16(24.6%)	19(29.2%)	21(32.3%)	5(7.7%)	1

<i>Legal Framework Impacting Leadership</i>		<i>Strongly agree</i>	<i>Agree</i>	<i>Uncertain/ Not appli- cable</i>	<i>Disagree</i>	<i>Strongly disagree</i>	<i>Missing</i>
15.	Clear instructions by NBE are available to develop IFB products.	1(1.5%)	14(21.5%)	16(24.6%)	25(38.5%)	9(13.8%)	0
16.	IFB supervisory framework ensures auditing in relation to shariah compliance.	2(3.1%)	15(23.1%)	20(30.8%)	22(33.8%)	6(9.2%)	0
17.	NBE measures and monitors uniformity of IFB contracts and products.	2(3.1%)	8(12.3%)	20(30.8%)	30(46.2%)	5(7.7%)	0
18.	On-site inspection is performed adequately by NBE to ensure performance, stability, and compliance.	1(1.5%)	18(27.7%)	18(27.7%)	20(30.8%)	8(12.3%)	0
19.	NBE directives enforce IFB liquidity to be managed separately from conventional banking.	6(9.2%)	23(35.4%)	16(24.6%)	11(16.9%)	8(12.3%)	1