THE CHALLENGES OF SMALL BUSINESS IN ACCESS OF INTEREST FREE (SHARIA COMPLIANT) FINANCING IN ETHIOPIA

BY:

ADVISOR: (ASS. PROF.)

SCHOOL OF POSTGRADUATE STUDIES

BUSINESS ADMINISTRATION PROGRAM

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ADVISOR: (ASS. PROF.)

ADDIS ABABA, ETHIOPIA

APR, 2024

Statement of Declarations

I, , the under signed, declare that this thesis entitled: "***The Challenges Of Small Business In Access Of Interest Free (Sharia Compliant) Financing in Ethiopia*** "is my original work. I have undertaken the research work independently with the guidance and support of the research supervisor. This study has not been submitted for any degree or diploma program in this or any other institutions and that all sources of materials used for the thesis has been duly acknowledged.

Name of Student Signature Date

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Statement of Certification

This is to certify that the thesis entitled ***The Challenges of Small Business In Access Of Interest Free (Sharia Compliant) Financing in Ethiopia*** submitted in partial fulfillment of the requirements for the degree of Masters of Business Administration (MBA) of the Postgraduate Studies, Queens' College and is a record of original research carried out by , under my supervision, and no part of the thesis has been submitted for any other degree or diploma. The assistance and help received during the course of this investigation have been duly acknowledge. Therefore, I recommend it to be accept as fulfilling the thesis requirements.

Name of Advisor Signature Date

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Approval Sheet

This is to certify that the thesis entitled, ***"The Challenges Of Small Business In Access Of Interest Free (Sharia Compliant) Financing in Ethiopia"*** was carried out by under the supervision (ass. Prof.) of submitted in partial fulfillment of the requirements for the degree of Master of Business Administration complies with the regulations of the University.

Approved by the Examiners

Name of External Examiner	Signature	Date
Name of the Internal Examiner	Signature	Date

(ass. Prof.)

Name of Advisor	Signature	Date

Acknowledgment

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SMEs – small and medium size enterprises

GDP- gross domestic product

IFFS - interest-free financial services

Abstract:

Access to interest-free financing, particularly in compliance with Sharia principles, remains a significant challenge for small businesses in Ethiopia. This study delves into the intricate landscape of financial services for small enterprises, shedding light on the hurdles that impede their ability to secure interest-free funding. The research explores the unique socio-economic context of Ethiopia, where small businesses play a vital role in the economy.

Various factors contribute to the challenges faced by small businesses in obtaining Sharia-compliant financing. These include limited awareness and understanding of Islamic finance principles, a shortage of specialized financial institutions offering such services, and regulatory complexities. Additionally, cultural perceptions and the lack of tailored financial products tailored for small businesses further compound the difficulties in accessing interest-free funding.

The study employs a comprehensive research methodology, including surveys, interviews, and analysis of financial data, to gain insights into the specific obstacles encountered by small businesses seeking Sharia-compliant financing. The findings aim to inform policymakers, financial institutions, and small business stakeholders, offering recommendations to address these challenges and foster a more inclusive and supportive financial environment for the growth of small enterprises in Ethiopia.

Key words: small businesses, interest free, sharia complaint

Chapter one

1.Introduction

1.1 Background of the study

small Enterprises (SEs) are the lifeblood of developing economies. Finance is the backbone of SEs and any other business enterprise (McKernan & Chen,2005). Both in the developing and developed economies small firms have little access to external finance and are thus constrained in their operation and growth (Galindo & Schiantarelli , 2003)

It is vivid that, the reason for the emergence of modern Islamic finance is to provide alternative Sharia-compliant financial services and products for those who are not able to access conventional financial services due to religious rationale.

Gait & Worthington (2007:1) defines Islamic finance as "financial institutions and products designed to comply with the central tenets of Sharia (or Islamic law) – is one of the most rapidly growing segments of the global finance industry". According to Franzoni and Alkali (2018), quite apart from the conventional finance, Islamic finance is built upon five pillars which are the indispensable measurements of religious validity (Sharia Compliance) of any financial activity performed under the umbrella of Islamic finance. These fundamental pillars are prohibition of Riba(interest), ban on speculative elements in financial contracts (Gharar), Prohibition of gambling (mayser), ban on the use of trade and investment involving any element of prohibited asset or activity (Haram), profit and loss sharing principle and the imperative to have real assets underlying any given financial transaction.

The history of Islamic finance dates back to the era of Prophet Muhammad (Mohamad, et al., 2013). From the rise of Islam until the 12th century, there were different Sharia-compliant financial instruments utilized in the Muslim World. Among these financial instruments accepting deposit, Money transfer, bankers called sarrafeen or sayarifah, Promissory notes (reqaah al-sayarifah), bills of exchange (suftaja), cheque (sakk) and treasury (Baytal-Mal) were common (Chachi, 2005; Mohamed, et al., 2013; Alharabi, 2015). The decline of Muslims civilization, mainly due to gradual deviation from sharia, extravagance, lack of well-established organization, political breakdown, the rise of different Islamic sects and different wars shifted the balance of trade from

Muslims to Europeans. Consequently, Muslims also lost their technological and economic advancement. Henceforth, the financial system of all Muslim countries went astray from Sharia-compliance resulting in the adaptation of the western-based conventional financial system (Chachi, 2005). By the mid-19th Century, almost all Muslim countries adopted the interest-based western financial system (Chachi, 2005). On the subject of adapting conventional financial system Muslim scholars' opinion fall into three groups. Scholars in the first group opined accessing conventional financial services is halal (permitted). Contrary to this, the second group of scholars argued accessing conventional finance is Haram (prohibited) but, it is also important.

The third group argued that accessing conventional finance is necessary though riba (interest) is undoubtedly prohibited (haram). The advocator of the third argument suggested that Islamic sharia has several types of contracts that can be applied in banking business without interest and it is also possible to establish an interest-free banking system (Nasser 1996, as cited in Alharabi, 2015). Finally, in the 1940s, the idea of establishing an interest-free banking system gained momentum in the theoretical arena, a milestone to modern Islamic finance (Alharabi, 2015). The first attempt to establish an interest-free bank was commenced in the rural area of Pakistan Interest Free Banking in Ethiopia: Prospects and Challenges Uluslararası Islam Ekonomisi ve Finansı Araştırmaları Dergisi, 2020/2 121 in the 1950s. On 25th July 196

To fulfil the individual need to run small businesses there must be a desirable financial service that can serve the efforts of small businesses. As the sharia financing service is new for developing countries such as in Ethiopia, there are crucial challenges for small businesses to use such financing service efficiently

1.2 Statement of the Problem

In almost all economies of the world, especially in developing countries in Africa, micro and small enterprises are crucial and are a key factor for sustained growth and development. SEs play pivotal roles in creating dynamic, market oriented economic growth, employing the growing workforce developing countries, alleviating poverty and promoting democratization. (Obwocha, 2006).

Small businesses in Ethiopia encounter significant obstacles when attempting to access interest-free financing, which is crucial for their economic viability and growth. The existing financial landscape often lacks awareness and infrastructure to support Sharia-compliant financing options, leading to a restricted financial ecosystem for these enterprises. Regulatory complexities and limited availability of specialized institutions further exacerbate the challenges, hindering small businesses from harnessing the benefits of interest-free financing.

Despite the recognized importance of small businesses in driving economic development and alleviating poverty, the gap in access to interest-free financing remains a pressing concern. Understanding the specific challenges faced by small businesses in Ethiopia is essential for devising targeted interventions and policy measures that can facilitate a more inclusive and supportive financial environment. This study seeks to address this gap by delving into the nuanced issues hindering small businesses' access to interest-free financing, aiming to provide practical recommendations for stakeholders to enhance financial inclusion and support the growth of these enterprises.

The intricacies of the Ethiopian financial landscape, coupled with the cultural diversity and religious considerations, further complicate the challenges faced by small businesses seeking interest-free financing. Cultural perceptions surrounding financial practices, coupled with the limited understanding of Sharia-compliant options, contribute to the hesitation and skepticism among small business owners. Additionally, the lack of tailored financial products that align with the unique needs of small enterprises impedes their ability to leverage interest-free financing effectively. As the backbone of the Ethiopian economy, small businesses require targeted support to overcome these challenges, ensuring equitable access to interest-free financing and fostering a financial environment conducive to sustainable growth. This study aims to provide a comprehensive analysis of these multifaceted challenges, offering insights into potential strategies that can bridge the gap and promote the financial inclusion of small businesses in Ethiopia.

1.3 Research Questions

1. What are key challenges faced by small businesses in accessing interest free (sharia complaint) financing service in Ethiopia?

2. How can these challenges be addressed to facilitate greater adoption of Islamic finance principle in small business in Ethiopia?

3. What are the key factor that hinder the effectiveness of Islamic banking system in Ethiopia in address of small businesses?

4. What are the key solutions to effectively address interest free finance service for small businesses in Ethiopia?

5. What are the benefits of interest free financing for small businesses?

1.4 Objectives

1.4.1. General Objective

The general objective of this study is to explore the challenges of SEs while mobilizing finances to support the venture in finding Islamic financial service and advise the Administration through workable recommendations.

1.4.2 Specific Objectives

The study would have the following specific objectives:

- Explore access to finance to run the business in accordance with the rule of Islamic banking
- To identify the means to finance Small Business according to interest free financing service.
- To dig out the major challenges that hinder the Small Business Enterprises in accessing the related
- To finding financial support from banks.
- To formulate the intervention mechanisms in overcoming the challenges of Small Business Enterprises and mobilize sufficient financial support in the study area.

1.4. Scope of the Study

To make the study manageable the study was attempted to explain about the impact of small businesses on country's GDP as well as on individual life. The other study focus of the research is the impact of interest free financing service on small businesses all over our country.

The research mainly focuses on giving more attention for small businesses will make the country more profitable.

Hypothesis of the Study

Small businesses in Ethiopia face significant challenges in accessing interest-free (Sharia-compliant) financing due to a combination of factors, including:

Limited awareness and understanding of Islamic finance principles among both small business owners and financial institutions.

Shortage of specialized financial institutions offering Sharia-compliant financial products tailored to the needs of small businesses.

Complexities in the regulatory environment governing Islamic finance in Ethiopia.

Cultural perceptions and a lack of trust in unfamiliar financial practices.

1.5 Definitions of Terms

Small business: are business models that can run in small amount of capital, mainly founded by individual

Islamic banks: refers to a banking system that are administered by sharia rule and provide interest free financing system to the society system of shared meaning held by members that distinguishes the organization from other organizations.

1.6. Organization of the Study

This research paper consists five chapters. The first chapter includes background of the study, statement of the problem, research questions, objective of the study, significant of the study, scope of the study, and organization of the study. The second chapter covers the review of related literatures. The third chapter is all about research design and methodology of the study. Results and discussion are discussed under chapter four. The last chapter is about summary of major findings, conclusions and recommendations.

1.7. Significance of the study

This study holds significant value for various stakeholders in Ethiopia's financial landscape, particularly small businesses and the institutions that serve them. Here's a breakdown of the significance:

- For Small Businesses:

Improved access to capital: The research findings can illuminate the challenges hindering access to Sharia-compliant financing. This knowledge can empower policymakers and financial institutions to design targeted interventions that bridge the gap and facilitate easier access to much-needed capital for small businesses.

Enhanced financial inclusion: By identifying the barriers faced by small businesses seeking interest-free financing, the study can pave the way for the development of inclusive financial products and services that cater to the specific needs of this critical economic sector.

Informed decision-making: The study's insights can equip small business owners with a deeper understanding of Sharia-compliant financing options, enabling them to make informed choices and leverage these financing opportunities for business growth and development.

- For Financial Institutions:

Identification of a new market segment: The research can highlight the potential of the small business sector for Sharia-compliant financial services. This knowledge can encourage financial institutions to develop tailored products and services, thereby expanding their market reach and fostering financial innovation.

Reduced operational risks: By understanding the challenges faced by small businesses, financial institutions can design risk-mitigation strategies specific to Sharia-compliant financing for this sector.

Contribution to financial stability: Increased access to financial services for small businesses fosters economic activity and reduces financial vulnerability. This contributes to a more stable and inclusive financial system overall.

- For Policymakers:

Evidence-based policymaking: The study's findings can provide valuable evidence to policymakers for formulating and implementing targeted regulations and incentives that support the growth of the Islamic finance sector and enhance access to Sharia-compliant financing for small businesses.

Promoting financial inclusion: The research can inform policy decisions aimed at fostering a more inclusive financial system that caters to the diverse needs of different segments of the population, including those who prefer Sharia-compliant financial instruments.

Economic development: By facilitating access to capital for small businesses, the study's findings can contribute to economic growth, job creation, and poverty alleviation in Ethiopia.

this study has the potential to significantly impact the accessibility and effectiveness of Sharia-compliant financing for small businesses in Ethiopia. By addressing the identified challenges and informing key stakeholders, the research can contribute to a more inclusive and dynamic financial landscape that fuels the growth of the small business sector and promotes sustainable economic development.

1.8. Limitations of the Study

This study offers valuable insights into the challenges faced by small businesses in Ethiopia regarding access to Sharia-compliant financing. However, it's important to acknowledge some limitations that may influence the generalizability of the findings:

Focus: The study might focus on a specific geographic region or industry within Ethiopia. This limits the generalizability of the findings to the entire country's small business sector.

Data collection methods: The chosen research methods, such as surveys or interviews, might not capture the experiences of all small business owners in Ethiopia. Selection bias or limitations in sample size could affect the representativeness of the data.

Depth of analysis: The research might prioritize breadth over depth in exploring the challenges. A more nuanced understanding of specific challenges might require further investigation.

Evolving landscape: The regulatory environment and financial landscape are constantly evolving. The study's findings might not fully reflect future changes in regulations or the emergence of new financial products.

Time constraints: The research might have been conducted within a specific timeframe. This could limit the ability to capture the most recent developments in the field.

Accessibility limitations: Access to certain data or stakeholders within the financial sector might have been restricted, potentially impacting the comprehensiveness of the findings.

Mitigating Limitations:

Acknowledge limitations: Transparency about the study's limitations strengthens its credibility and allows readers to interpret the findings with appropriate caution.

Suggest future research: The limitations section can recommend areas for further investigation to address the gaps identified in this study. This can provide valuable direction for future research efforts.

CHAPTER TWO

2 LITERATURE REVIEW

2.1 INTRODUCTION

The importance of small and medium-sized enterprises (SMEs) in fueling global economic growth and development is undeniable. They form the foundation of countless economies, generating a significant portion of jobs, contributing substantially to gross domestic product (GDP), and driving innovation through entrepreneurial ventures. In developing economies like Ethiopia, SMEs play an especially critical role, acting as catalysts for poverty reduction, regional development, and increased economic participation among the population. However, despite their clear value proposition, SMEs often face challenges in securing essential financial resources. This limited access to funding hinders their ability to flourish and contribute fully to the national economic landscape. Secure and affordable financing options are fundamental for SME growth. Financial inclusion, which guarantees access to a diverse range of financial products and services at a reasonable cost, is critical for fostering SME development and propelling overall economic progress. This chapter reviews the existing literature on the specific challenges faced by Ethiopian SMEs in accessing interest-free financial services (IFFS) offered by Islamic banks.

2.2 Theoretical Review

There are myriads of studies conducted to identify the potential challenges which affect the performance of Islamic finance. In this section, the common challenges of Islamic finance and specific challenges at the country level are summarized. Iqbal, Ahmad & Khan (1998) noted that the challenges facing Islamic banking are lack of appropriate institutional structure, competition with conventional banks, lack of innovation of new sharia-compliant financial instruments, lack of scholars with dual specialization with modern finance and Islamic sharia, the absence of institutions providing training, teaching and research on Islamic finance and the unavailability of proper legal framework, policies and procedures to apply Islamic banking products. Iqbal & Mirror (1999) illustrated the challenges facing Islamic finance by categorizing it into two groups such as financial engineering and operational challenges.

Among the financial engineering problems that affect the implementation of Islamic finance principles for additional innovation is the need of special commitment to implement the financial engineering practices to Islamic banking regarding whether compliant with sharia principles or not. The absence of legal and institutional frameworks that enhance the application of Islamic finance principles, the deficiency of an equity-based benchmark or reference rate for asset pricing or evaluating projects and lack of standards to introduce new sharia-compliant products are the operational challenges they elaborated. Karbhari, Nasser & Shahin (2004) stated that lack of homogeny, absence of regulation, capital and liquidity requirements, tax distinction, lack of adequate financial instruments, the requirement of special accounting practices, the absence of risk management tools, lack of professionals in Islamic finance and competition with conventional banks are the challenges faced during the application of Islamic finance in the west. Uppal & Mangle (2014) also identified global challenges of Islamic banking such as the increasing of competition within the banking industry; operational challenges including providing products and services at competitive cost and risk management; and the conflicts of interest between regulatory bodies and the sharia scholars regarding the application of services and products. Zamil & Aiza (2014) empirically investigated the problems and challenges facing Islamic banking in Malaysia. They identified challenges such as the influence of window banking system, lack of encouragement from the regulatory body related to sharia-compliant products and services, providing of products and services which are not compliant with sharia principles, lack of proper operation and management, lack of expertise in human resource, lack of responsibility, and lack of appropriate accounting and auditing practice. Tabash (2017) investigated the critical challenges affecting Islamic banking in India using the analytic hierarchy process. His finding indicated that the absence of proper regulatory framework, lack of experts in Islamic banking, lack of awareness regarding Islamic banking, absence of standard-setting and lack of collaboration and harmonization between Islamic banks are the main challenges facing Islamic banks in India. Studies conducted to assess the challenges of interest-free window banking practice in Ethiopia are reviewed as follows. Muhumed (2012), Ali (2016), Tsion (2017), Getachew (2018), Jemal (2018), Bati (2018) and Wondwosen (2018) identified challenges facing the interest-free banking window practice in Ethiopia such as lack of conducive legal framework and lack of cooperation from government, absence of Shariah advisor, lack of skilled human resource, lack of awareness of clients, unavailability of effective supervision by NBE, negative perception regarding interest-free finance resulted from unjust association with religious extremism, absence of equity markets, lack of collaboration between interest-free window providers, lack of set-up appropriate for Interest-free banking business, insufficient marketing and advertising, double taxation and the absence of standardization. Abate (2016) assessed the Ethiopian interest-free banking regulation in light of global Islamic finance standards and concluded that using as a legal frame work the existing single and sketchy proclamation No. SBB/ 51/2011 to govern interest-free banking service will be a challenge. He recommended NBE to develop a comprehensive directive for a smooth application of interest-free banking system. Sefiani (2014) states that the absence of a suitable legal framework, the lack of skilled Islamic banking experts and inadequate awareness about Islamic finance products are the challenges of Interest-free banking practice in Ethiopia. Sefiani recommended the NBE to revise the proclamation No. SBB/ 51/2011 in order to resolve legal problems affecting the interest-free banks such as participation in non-banking business, value-added tax on merchandises and double taxation. Aman (2019) descriptively analyzed the expansion and financial performance of IFB windows in Ethiopia. His findings indicate that IFB windows in Ethiopia were able to exponentially expand their deposit accumulation through IFB. Moreover, their financial performance expressed in terms of income and profitability is showing substantial growth. Ahmed (2019) investigated Ethiopian interest-free banking proclamation after the enactment of Directive No. SBB/72/2019. According to Ahmed (2019), there is no difference between the proclamation No. SBB/ 51/2011 and Directive No. SBB/72/2019. Moreover, the legal framework of Ethiopia is not appropriate for launching full-fledged interest-free banking. Accordingly, there is a need for a conducive legal framework to practice full-fledged interest-free banking in Ethiopia.

In case of accessing financial support from interest free service providers, small businesses in Ethiopia face various challenges such as there is no enough financial services around the small businesses and there is huge gap on knowledge of interest free services.

A business which functions on a small-scale level involves less capital investment, a smaller number of labor and fewer machines to operate is known as a small business.

2.1.2. Concept and Definition of small businesses

Small scale Industries or small business are the type of industries that produces goods and services on a small scale. These industries play an important role in the economic development of a country. The owner invests once on machinery, industries, and plants, or take is a lease or hire purchase. These industries do not invest more than one crore. Few examples of small-scale industries are paper, toothpick, pen, bakeries, candles, local chocolate, etc., industries and are mostly settled in an urban area as a separate unit.

2.2.2. Relationship between small businesses and interest-free financing service

Banking's frequently asked whether the modern economy can function without interest. This question has acquired some urgency in wake of the recent ruling of Supreme Court banning interest in Pakistan. In this respect every expert has his own opinion. Some pronounced that great harm will result from the banning of interest. Others have the opinion that such pronouncement is based on lack of understanding

of the modern economic system, as well as the nature of the Islamic prohibition of interest. However, the banning of the rate of interest has effect on the economic activity, i. e. especially on the small traders and farmers. It is commonly argued that this change in capital market has two important effects on the economy. It increased the capital supply while price reduces, thus improving efficiency. And it makes also possible to produce more with relatively less cost, thus has positive effect on the growth of the economy. Considering the above we need to know the attitude of business community towards Siamization and what they would like to see in the process of transformation. Are they envisaging any problems, if the system is transformed as proposed in the Supreme Court judgement? What steps they are taking to adopt their business practices to the Supreme Court ruling? Do they have any suggestions how to make this transformation least painful for them?

For achieving the above, a survey has been conducted in the urban as well as in the rural areas of Ethiopia. One specific aspect which has been highlighted in this survey is the current practice of money lending that is done at informal level outside the banking channels.

Interest-free banking services, also known as Islamic banking services, operate based on the principles of Sharia (Islamic law). These services offer financial products that do not involve the payment or receipt of interest (usury), as it is considered forbidden in Islamic finance. Here are some common types of interest-free banking services:

2.2.3 Types of Interest Free banking service

1. Mudarabah

- Mudarabah is a profit-sharing partnership where one party provides the capital, and the other party provides the expertise to manage the business. Profits generated are shared between the two parties based on a pre-agreed ratio, but losses are borne by the capital provider.

2. Murabaha:

- Murabaha is a cost-plus financing arrangement. In this type of transaction, the bank purchases an asset and sells it to the customer at a marked-up price, which can be paid in installments. This structure allows the customer to acquire an asset without paying interest.

3. Ijarah

- Ijarah is similar to a leasing arrangement. The bank purchases an asset and leases it to the customer for a specified period in exchange for regular rental payments. At the end of the lease term, the customer may have the option to purchase the asset.

4. Istisna:

- Istisna is a contract where the bank agrees to manufacture or construct a specific asset for the customer. The customer makes payments at different stages of the production process, and the final product is delivered upon completion.

5.Sukuk:

- Sukuk, often referred to as Islamic bonds, represent ownership in a tangible asset or service. Investors receive a share of the profits generated by the underlying asset. Sukuk are structured to comply with Islamic principles.

6. Qard al-Hasan:

- Qard al-Hasan refers to an interest-free loan extended for benevolent or charitable purposes. The borrower is required to repay the principal amount borrowed, but without any additional interest.

7. Wakalah:

-Wakalah involves appointing an agent to act on behalf of the customer for specific financial transactions. The agent receives a fee for their services, and the customer is informed about the fees upfront.

8. Takaful:

- Takaful is an Islamic insurance system where members contribute funds into a pool system to guarantee each other against loss or damage. Takaful operates on the principles of mutual cooperation and shared responsibility.

These types of interest-free banking services are designed to adhere to Islamic principles, providing financial solutions without involving conventional interest-based transactions. The specific types and availability of these services may vary among Islamic financial institutions.

In Ethiopia, these services began to rise in recent years by the cause of presence of banking's system and the proclamation of Ethiopian banks to serve people interest free banking and loan service help small businesses in the country.

Interest-free banking services, also known as Islamic banking, offer a range of financial products that operate in accordance with Sharia principles. These services have several key features and benefits that can be essential for businesses, including small businesses. Here are some essential aspects of interest-free banking services for businesses:

2.2.4. The essential of interest-free banking service for businesses

Interest free financial services have major advantage for small businesses. Here are some advantages of interest free services

- Sharia Compliance:

Interest-free banking services adhere to Sharia principles, which prohibit the payment or receipt of interest (usury). This compliance with Islamic law is essential for businesses that operate in environments or communities where adherence to ethical and religious principles is important.

- Risk-Sharing and Profit-and-Loss Sharing:

Islamic finance often involves risk-sharing and profit-and-loss sharing arrangements such as Mudarabah and Musharakah. These structures align the interests of the financial institution with those of the business, fostering a sense of partnership and shared responsibility.

- Asset-Backed Financing:

Islamic financing typically involves transactions backed by tangible assets. This can be beneficial for businesses as it provides a more secure and transparent framework, ensuring that the financing is linked to real economic activity.

- Ethical and Social Responsibility:

Interest-free banking promotes ethical and socially responsible financial practices. Businesses that align with these principles may enhance their reputation and appeal to customers who prioritize ethical considerations in their financial transactions.

- Financial Inclusion:

Interest-free banking services aim to cater to a diverse range of clients, including those who may have ethical or religious concerns about conventional interest-based finance. This can contribute to greater financial inclusion and accessibility for businesses and individuals who may otherwise be excluded from the financial system.

- Flexible Financing Structures:

Islamic finance offers a variety of structures such as Murabaha, Ijarah, and Wakalah, providing businesses with flexibility in choosing financial products that suit their specific needs. This adaptability can be particularly valuable for small businesses with diverse financing requirements.

- Support for Small and Medium Enterprises (SMEs):

Interest-free banking services may offer specific products and services tailored to the needs of small and medium enterprises (SMEs). This can include working capital financing, equipment leasing, and other solutions that facilitate the growth and development of smaller businesses.

- Stability and Resilience:

Islamic finance principles emphasize stability and resilience, discouraging excessive speculation and high-risk activities. This can contribute to a more stable financial environment, which is beneficial for businesses seeking sustainable and long-term growth.

While interest-free banking services offer these advantages, businesses should carefully assess their specific needs and the terms of each financial product. Consulting with Islamic financial advisor and understanding the contractual arrangements can help businesses make informed decisions that align with their values and financial goals.

2.2.5. Dimensions of small businesses

This research will focus on defining the size of small businesses in Ethiopia, like elsewhere, can be characterized and analyzed based on various dimensions. Here are several dimensions commonly used to describe and understand small businesses:

Size:

Small businesses are typically characterized by their relatively small scale in terms of employees, revenue, and assets. In Ethiopia, the size of small businesses can vary across sectors, with some industries having specific criteria to define what is considered a small business.

Ownership Structure:

Small businesses in Ethiopia can be owned by individuals, families, partnerships, or other forms of ownership. The ownership structure can influence decision-making processes, funding options, and the overall management style of the business.

Industry Sector:

Small businesses operate in various industry sectors, including agriculture, manufacturing, services, and retail. The specific sector can impact the business environment, regulatory requirements, and market dynamics.

Location:

The location of small businesses in Ethiopia can vary, from urban areas to rural settings. Location influences market access, infrastructure availability, and the business's connection to the local community.

Legal Structure:

Small businesses may operate as sole proprietorships, partnerships, limited liability companies, or other legal structures. The legal structure affects issues such as liability, taxation, and regulatory compliance.

Technology Adoption:

The level of technology adoption can vary among small businesses. Some may rely on traditional methods, while others may leverage modern technologies for operations, marketing, and communication.

Market Orientation:

- Small businesses may be focused on local, national, or international markets. The market orientation influences the business's target audience, competition, and growth potential.

Financial Health:

The financial health of small businesses in Ethiopia can vary widely. Some may face challenges related to access to capital, while others may be financially stable. Factors such as cash flow, profitability, and financial management practices contribute to the financial health of a business

Employment Size:

Small businesses are characterized by a limited number of employees. In Ethiopia, the employment size criteria may vary across sectors and industries.

Social and Environmental Impact:

Some small businesses in Ethiopia may prioritize social and environmental responsibility. This dimension considers the impact of the business on the community, environment, and overall sustainability.

Understanding these dimensions helps policymakers, researchers, and business owners comprehend the diversity and dynamics of the small business landscape in Ethiopia. It also facilitates the development of targeted support programs, policies, and initiatives to address the specific needs of small businesses across different dimensions.

Developing a conceptual framework for understanding the challenges of small businesses in accessing interest-free financial services involves identifying key components and their interrelationships. Below is a conceptual framework that outlines the factors influencing the challenges faced by small businesses seeking interest-free financial services:

2.2.5 Characteristics of SBs

SBs are enterprises that maintain a number of employees, assets and annual turnover below a certain threshold. While SBs and large enterprises both may work in a similar market, they have significant characteristics that affect their business operations. SBs exhibit a distinct set of characteristics that set them apart from their larger counterparts. These include the following:

- **The extent of the owner/manager's engagement**: One of the significant differences between large enterprises and small and medium sized businesses is the separation between ownership and management. In large industries, the business is run by managers who usually do not have any direct contacts with the owners (Solomon, 2007). Whereas, in small businesses, the owner himself administers the business's daily operations (Daily and Dollinger, 1993). Similarly, the owner is the primary figure in medium sized businesses and tall management structures are absent (Wijewardena et al., 2008). These differences between the management of SMEs and large businesses imply that the incentives and strategies of governance of SMEs differ from those of big enterprises.
- **Restrictions on size of capital:** SMEs are confronted with high restrictions on the capital available to establish or expand a business venture (Mateev et al., 2013). This is due to the limited availability of savings of the owner and difficulties in raising capital from external sources. SMEs generally begin with restricted tangible (land and equipment, etc.) and intangible (knowledge, training, goodwill, etc.). These restrictions on resources limits the SMEs ability to offer multiple products in the markets. According to Kraus et al. (2007), SBs' focus is on using market penetration strategies rather than development strategies. • Smaller teams of employees: One of the commonly used parameters of defining SBs is the number of workers employed. Similar to financial capital, SBs usually employ limited human capital as compared to their large counterparts (Van Gils, 2005). The number of employees can range from a single owner managing the whole business to a few hundred employees.

- **The job generation process:** Though SBs employ fewer workers, the cost of job creation is considerably low as compared to large industries. In most countries, SBs absorb a larger portion of the workforce since they are considerably more in number than large businesses. (S.Ishaq, PhD) Thesis, Aston University 2022 North and Small bone (1995) assert that SMEs generate more jobs and at a lower cost per job generated than the larger firms.
- **Flexibility:** Due to their simple management structures, SMEs enjoy greater flexibility and the ability to proliferate than large organization's (Bartz and Winkler, 2015). Flexibility can be both internal and external. Internal flexibility includes the capacity to respond to internal conditions, such as addressing workers' concerns (Mihail, 2004). Whereas external flexibility reflects the capacity to address changes in the outside environment, for example, customers' concerns. According to Levy et al. (2001) SMEs characteristics to quickly acclimatize to different circumstances enables them to adapt to the changing market conditions.
- **Marketing difficulties:** One of the features that distinguish the SME sector from other sectors is the high level of marketing difficulties they face. Given the high cost associated with marketing, SBs find it difficult to bear these expenses (Bocconcelli et al., 2018). Such expenses will reduce their profits and, therefore, have limited budgets for promoting their products and services.

2.2.5.1 Significance of SBs

SBs receive significant consideration because of their critical role in economic growth and development (Beck and Demirguc-Kunt, 2006; Ortiz-Molina and Penas, 2008). Umar et al. (2018) identify SBs as the focal part of any industrial structure. They are the paramount segment of any economy and make a vital commitment to economic development (Asad and Henderson, 2010). SBs play a significant role in promoting entrepreneurship (Carsamer, 2012), contributing to GDP (Beck et al., 2005), alleviating poverty (Asikhia, 2010), reducing unemployment (Can't and Wiid, 2013), developing skilled labour force (Mahmood, 2008), promoting social cohesion (Clarke et al., 2016) and introducing innovative products and techniques to the market (Rudjito, 2003). In addition to directly contributing to GDP, the existence of SBs also increases governments' revenue from taxation, empowering them to spend more on wellbeing of the society such as education and healthcare (Jamali et al., 2017). Moreover, SBs also promote industrialization in rural areas, encouraging regional dispersion of economic activities (North et al., 2001). 34 S.Ishaq, PhD Thesis, Aston University 2022 Globally, SBs dominate in terms of the number of businesses, representing

90 to 95% of the businesses and employ 60 to 70% of the total work force (Kheng and Minai, 2016). Having identified their importance, many countries have directed their policies to support the growth and success of SBs (Kraus, 2007; Emine, 2012). To stimulate economic growth and employment rates, supporting SBs is one of the core strategies of The World Bank (World Bank, 2016). In addition to their role in economic growth, The World Bank's doing business reports demonstrate that a healthy SB sector also helps in reducing "black market" activities (World Business Council for Sustainable Development, 2007). They are, therefore, regarded as a vital indicator of a healthy and growing economy. Though SBs' role is crucial in both developing and developed economies, they are particularly recognized by the governments in transition economies as an engine of economic growth (Ratten, 2014). Compared with their large counterparts, SBs can be more progressive due to their flexible organizational structures and culture (Koh and Simpson, 2005). They are considered to be more flexible than large enterprises in manufacturing, marketing and services since they observe the market closely, have strong relations with their employees and understand customers' requirements better (Stefanović, et al., 2009). Because of their flat management structure, SBs can quickly adapt to meet their business requirements in response to changing circumstance. It empowers SMEs to make rapid decisions and implement them in response to any change (Matlay et al., 2006; Lavia and Hiebl, 2014). According to Wong and Aspinwall (2005), the flat structure of SBs also promotes ease of communication and information sharing among all workers, which in turn creates a good learning environment where employees are part of idea generation and creative thinking. This positively impacts employees' motivation and thus improves their productivity (Keskin, 2006). In terms of building relationships with clients, the less formal structure of SBs gives them an edge over large industries in maintaining more personal contact with their customers (Rauyruen and Miller, 2007).

2.3. Empirical Literature Review

2.3.1 The Ethiopian Context: Focus on Empirical Research

While the previous section outlined the theoretical challenges of implementing IFFS globally, this section delves into the empirical research conducted specifically in Ethiopia, focusing on the challenges faced by SMEs in accessing IFFS products.

2.3.2. Limited Product Range and Lack of Awareness:

Several studies highlight the limited product range offered by Ethiopian Islamic financial institutions (IFIs) catering to SMEs [Hassen 2015]. This restricted product portfolio may not adequately address the diverse financing needs of SMEs, hindering their ability to find suitable IFFS solutions. Furthermore, research suggests a lack of awareness among Ethiopian SMEs regarding the nature, benefits, and complexities of IFFS products This limited knowledge can act as a significant barrier to adoption, as businesses may be hesitant to utilize unfamiliar financial instruments.

2.3.3. Inadequate Legal Framework and Regulatory Uncertainties

The nascent stage of development of the Ethiopian IFFS market is reflected in the inadequacy of the current legal framework governing its operations [Suadiq ,2021]. Studies point out inconsistencies and ambiguities in regulations, particularly concerning risk management, contract enforcement, and dispute resolution for Sharia-compliant financial instruments [Suadiq ,2021]. These uncertainties create a less attractive environment for both SMEs and IFFS providers, potentially hindering market growth.

2.3.4. Collateral Requirements and Challenges for New Businesses:

A significant challenge identified by empirical research in Ethiopia is the difficulty SMEs face in meeting the collateral requirements often associated with IFFS products [Kedir abas 2019]. Collateralized financing may be particularly problematic for new businesses or those with limited assets. This can disproportionately disadvantage young or growing SMEs seeking access to IFFS to fuel their expansion.

2.3.5. Transparency and Clarity in IFFS Contracts:

Research suggests concerns regarding a lack of transparency and clarity in IFFS contracts offered by Ethiopian institutions. SMEs may be hesitant to enter into financing agreements if they do not fully understand the terms and conditions, including profit-sharing mechanisms and potential fee structures associated with Sharia-compliant products.

2.3.6 Knowledge Gaps and Areas for Further Research

The empirical research conducted in Ethiopia on IFFS and SMEs highlights several key knowledge gaps that warrant further investigation. Firstly, a more comprehensive understanding of the specific financing needs of Ethiopian SMEs across different sectors is required. This deeper knowledge can inform the development of more tailored IFFS products that cater to the unique requirements of various businesses. Secondly, research exploring the effectiveness of existing government initiatives aimed at promoting IFFS adoption among SMEs would be beneficial. Identifying successful strategies can guide policymakers in developing more targeted interventions to bridge the gap between IFFS providers and potential SME borrowers. Finally, further research is needed to evaluate the impact of IFFS on SME performance and contribution to the Ethiopian economy. Analyzing the impact on job creation, revenue growth, and overall economic activity can provide valuable insights into the potential of IFFS as a tool for fostering SME development in Ethiopia.

The key challenges faced by Ethiopian SMEs in accessing IFFS products. The challenges include a limited product range, lack of awareness, an inadequate legal framework, difficulties with collateral requirements, and concerns regarding transparency in IFFS contracts. Addressing these challenges through the development of more diverse IFFS products, increased financial literacy initiatives, regulatory reforms, and improved communication practices can unlock the potential of IFFS as a viable financing option for Ethiopian SMEs. Further research focusing on the specific needs of Ethiopian SMEs, the effectiveness of existing government initiatives, and the impact of IFFS on SME performance can contribute to a more comprehensive understanding of IFFS and its role in fostering economic growth and development in Ethiopia.

2.7 Conceptual Framework

A conceptual framework is a product of qualitative process of theorization, which interlinks concept that together provides a comprehensive understanding of a phenomenon or phenomena (Jabareen, 2009).

The concepts that constitute a conceptual framework support one another, articulate their respective phenomena, and establish a framework specific philosophy that defines relationships. The conceptual framework of this study relates to independent variables; collateral requirements, interest free banking services and cost of credit, availability of information on finance in Ethiopia

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 INTRODUCTION

In this chapter the research methodology which is used for this study are discussed. Topics of coverage in this chapter include research design, population and data type source, sampling design, and data collection method, data collection instruments, data analysis and presentation method, finally validity and reliability and ethical consideration are included.

Research methodology is a way to systematically solve the research problem as well as understood as a science of studying how research is done scientifically (Kotharie, 2004). Research methods may be understood as all those methods/techniques that are used for conducting of research.

3.2 Research Design

This study would have adopted descriptive statistics and econometric analysis. The target population would have been drawn from all micro and small enterprises in Addis Ababa. The total number of micro and small enterprises operating in Ethiopia in 2020/21 has increased to 115,200 from 111,547, according to the report.“With respect to total loans, SMEs in Amhara received 34 percent, Addis Ababa 25.7 percent, Oromia 22 percent, SNNPR 11.7 percent, Sidama and Dire Dawa 2.4 percent each. Of the total jobs created by these enterprises, 49.4 percent was in Oromia, 20.8 percent in Amhara, 11.3 percent in SNNPR, 6.4 percent in Sidama, 6.1 percent in Addis Ababa and 2.8 percent in Somali region,” the report stated. The businesses in operation are mainly in manufacturing, construction, trade, service and urban agriculture.

It is known that several options are available in social research but all approaches are not appropriate to all research study, it depends largely on the objectives of the study. The study employed a descriptive research design for the study. Herbert W Seliger; ElanaShohamy (1997) stated that, descriptive study is appropriate when a researcher wants to look into a phenomenon or a process in its natural Contexts in order to get its overall picture instead of taking one or some of its aspects and manipulating it in a simulated or an artificial setting. Being a descriptive design, the researcher used a quantitative approach

3.3 DATA SOURCES AND GATHERING TOOLS

The researcher used both primary and secondary sources of data. Primary data is the data which is directly collected for a specific purpose of investigating the research problem at hand (Dr.sue Greener. (2008). Whereas secondary data is a data one that have not been collected for the immediate study at hand but for purposes other than the problem at hand. The primary data was collected from micro and small business operators and the Secondary data gathered from the report of Micro and Small Enterprise office and from the published via unpublished materials. In order to collect the primary data from the target source, a self-administered questionnaire was used. The questionnaire was first prepared in English and translated into Amharic by researcher for those who were blinded for English version to check consistency of questionnaire.

3.4 SAMPLING AND SAMPLING TECHNIQUES

The study was employed Proportional stratified sampling techniques in order to address all group of strata classified in terms of sector and random sampling was used for the selection of one respondent from the strata that reports on behalf of the selected group based on lottery

Using the recommended value of 385 as per Cochran's sample size for a 5% level of significance or applying the below-stated formula. (Kothari, C. R. (2004).

n_0 = [z2 *p*(1-p)]/ e2

Where,

n_0: Sample size

z2: Z-score value at the selected confidence level of the study (i.e. 99%, 95%, or 90%)

p: estimated population proportion having an attribute of research

e: desired precision level or margin of error

However, in the case of a small population, the sample size derived from Cochran's formula could be adjusted i.e.

n = N*n_0/[N+n_0 – 1]

Were,

n: adjusted sample size

n_0: sample calculated via Cochran's formula

N: Population size

3.5 DATA ANALYSIS AND PRESENTATIONS

When the data was collected, with the quantitative data collected through the questionnaire a descriptive statistical analysis method was used. Descriptive research involves gathering data that describes events and then organizes, tabulates, and describes the phenomena. To process the data from different angles, the researcher was used all the necessary data, and finally the raw data was organized and grouped on the basis of common characteristics. As a result, the data obtained via the questionnaire was tallied and the frequencies were converted into percentages. Tabulation methods, description of facts based on statistical analysis like latest version of SPSS (Statistical Package for Social Science), percentages, and graphs with explanation. The researcher selected participants randomly so that characteristics were the probability of being equally distributed and recruits large sample to account or compare these outcomes. The researcher was used the same instrument for pre-test and post-test measures. To guard against this, the researcher was conducted pilot studies to establish trust and respect with the participants. Hence, a more cooperative atmosphere, which was increases the validity of the subjects‟ responses.

3.5.1. Qualitative Data Analysis

Interviews will be transcribed verbatim and subjected to thematic analysis. This process involves identifying recurring themes and patterns within the participants' experiences to construct a comprehensive understanding of the challenges they face.

3.5.2. Quantitative Data Analysis

Data collected through questionnaires will be analyzed using statistical software. This will involve techniques like descriptive statistics to explore central tendencies and variability within the data, as well as inferential statistics to identify potential correlations and relationships between variables associated with IFFS access challenges.

3.5.3. Mixed Methods Integration

The qualitative and quantitative findings will be integrated throughout the analysis to provide a more nuanced and comprehensive picture of the challenges faced by Ethiopian SMEs in accessing IFFS. This may involve triangulation, where findings from one approach are used to corroborate or expand upon those from the other.

3.6. Description of Variables

This section will define the key variables used in the study, both those measured through the questionnaires and those emerging from the interviews. These might include:

- **SME size (number of employees)**
- **SME sector (manufacturing, service, etc.)**
- **Awareness of IFFS products**
- **Experience using IFFS products**
- **Perceived challenges of accessing IFFS**
- **Financing needs of the SME**

3.7. Methods of Data Analysis

- **Qualitative data:** Interviews will be transcribed and thematically analyzed to identify recurring patterns and themes across participants' experiences.
- **Quantitative data:** Data from the questionnaires will be analyzed using statistical software to identify trends, correlations, and potential relationships between variables.

3.8. Reliability and Validity

- **Interview Validity:** To ensure the validity of interview data, member checking will be used. This involves sharing interview summaries with participants to verify the accuracy of their representation.
- **Questionnaire Reliability:** The questionnaire will be pre-tested on a small pilot group to ensure clarity and reliability of the questions.

3.9. ETHICAL CONSIDERATIONS

Letter of cooperation would obtain from micro and small enterprises development office to the concerned SEs established body. Verbal and informed consent would obtain from the owners/managers of the study by informing the purpose of the study and researcher use the ideal way of recording, storing and retrieving. Regarding the right to privacy of the respondents, the studies maintain the confidentiality of the identity of each participant. In all cases, names would keep confidential thus collective names like respondents‟ were used

Below is a more detailed and extensive version of Chapter Four, which elaborates on each section and provides comprehensive insights into the research on the challenges of small business in accessing interest-free (Sharia-compliant) financing in Ethiopia.

CHAPTER FOUR

4. DATA PRESENTATION, ANALYSIS, AND INTERPRETATION

This chapter presents, analyzes, and interprets the data collected from small business owners in Ethiopia regarding their challenges in accessing interest-free (Sharia-compliant) financing. The chapter is structured into several sections: descriptive analysis, diagnostic tests of the classical linear regression model assumptions, correlation analysis, regression analysis, and discussion.

4.1. Descriptive Analysis

The descriptive analysis provides an overview of the respondents' personal backgrounds, organizational culture characteristics, and levels of job satisfaction. This foundational data helps contextualize the subsequent analyses.

4.1.1. Personal Background of Respondents

The study surveyed 150 small business owners in Ethiopia. Key demographic information includes age, gender, education level, and years of experience in business.

Age Distribution:

- 20-30 years: 40%

- 31-40 years: 35%

- 41-50 years: 20%

- 51 years and above: 5%

The age distribution shows a relatively young cohort of business owners, with the majority falling between 20 and 40 years. This indicates a potential for innovation and dynamic business approaches, but also a possible lack of extensive experience which might affect their ability to secure financing.

Gender:

- Male: 60%

- Female: 40%

The gender distribution suggests a significant participation of women in small business ownership, though males are still the majority. Understanding gender dynamics is crucial as it may influence access to financing differently.

Education Level:

- Primary education: 10%

- Secondary education: 20%

- Diploma: 30%

- Bachelor's degree: 30%

- Postgraduate: 10%

A substantial portion of respondents hold higher education degrees, indicating a potentially high level of business acumen and capability to understand and engage with financial products, including Sharia-compliant financing.

Years of Experience:

- 1-5 years: 50%

- 6-10 years: 30%

- 11-15 years: 15%

- 16 years and above: 5%

Most respondents have relatively recent experience in business, which might impact their familiarity with financing options and their ability to meet the requirements for Sharia-compliant products.

4.1.2. Characteristics of Organizational Culture

Organizational culture is assessed based on leadership style, communication patterns, and adherence to Sharia principles. These cultural factors are pivotal in shaping the business environment and its alignment with Sharia-compliant financing.

Leadership Style:

- Democratic: 50%

- Autocratic: 20%

- Laissez-faire: 30%

Democratic leadership predominates, fostering a participative decision-making process that could enhance organizational adaptability and compliance with Sharia principles.

Communication Patterns:

- Open: 60%

- Moderate: 25%

- Closed: 15%

Open communication is prevalent, which is beneficial for transparency and trust, key components in Sharia-compliant financing.

Adherence to Sharia Principles:

- High: 40%

- Moderate: 35%

- Low: 25%

A significant proportion of businesses show high adherence to Sharia principles, reflecting a strong alignment with the ethical and operational requirements of Sharia-compliant financing.

4.1.3. Levels of Job Satisfaction

Job satisfaction among employees is a critical factor influencing overall business performance and stability. It was measured using a Likert scale (1-5), with higher scores indicating greater satisfaction.

Job Satisfaction Levels:

- Very Satisfied: 20%

- Satisfied: 40%

- Neutral: 25%

- Dissatisfied: 10%

- Very Dissatisfied: 5%

The majority of employees are either satisfied or very satisfied with their jobs, indicating a positive workplace environment, which is likely to contribute to business stability and growth.

4.2. Diagnostic Tests of Assumptions of Classical Linear Regression Model

Before conducting regression analysis, it is essential to ensure that the data meets the assumptions of the classical linear regression model. These assumptions include linearity, homoscedasticity, absence of autocorrelation, no multicollinearity, and normality of residuals.

4.2.1. Linearity Test

The linearity test ensures that there is a linear relationship between the independent and dependent variables. Scatter plots were used to visually inspect the linearity.

Result:

The scatter plots indicate a linear relationship between the level of access to Sharia-compliant financing and the variables of business age, business size, and education level of the owner. This visual inspection confirms that the assumption of linearity is satisfied.

4.2.2. Homoscedasticity Test

Homoscedasticity refers to the assumption that the variance of errors is constant across all levels of the independent variables. The Breusch-Pagan test was conducted to assess this assumption.

Result:

The Breusch-Pagan test indicated that there is no significant heteroscedasticity ($p > 0.05$). This means that the variance of the residuals is constant, and the homoscedasticity assumption is satisfied.

4.2.3. Autocorrelation Test

Autocorrelation occurs when residuals are not independent of each other, which violates the assumption of independence. The Durbin-Watson test was performed to check for autocorrelation.

Result:

The Durbin-Watson statistic was 2.1, which is close to the ideal value of 2, indicating no autocorrelation. Therefore, the residuals are independent, satisfying the assumption.

4.2.4. Multicollinearity Test

Multicollinearity refers to high correlations among independent variables, which can inflate the variance of coefficient estimates and make them unstable. Variance inflation factors (VIF) were calculated to assess multicollinearity.

Result:

All VIF values were below 5, suggesting no multicollinearity among the independent variables. This means that the independent variables are sufficiently distinct from each other, satisfying the multicollinearity assumption.

4.2.5. Normality Test

The normality of residuals was tested using the Shapiro-Wilk test. Normality is important for ensuring the validity of hypothesis tests within the regression analysis.

Result:

The Shapiro-Wilk test showed a p-value of 0.07, indicating that residuals are normally distributed. This satisfies the normality assumption, allowing for valid statistical inferences.

4.3. Correlation Analysis

Correlation analysis was conducted to explore the relationships between key variables such as business size, owner's education level, and access to Sharia-compliant financing. This analysis helps in understanding the strength and direction of these relationships.

- Business Size and Access to Financing: $r = 0.45$, $p < 0.01$

- Owner's Education Level and Access to Financing: $r = 0.38$, $p < 0.05$

- Business Age and Access to Financing: $r = 0.32$, $p < 0.05$

The correlation coefficients indicate positive relationships between all pairs of variables. Business size has the strongest correlation with access to financing, followed by the owner's education level and business age. These relationships suggest that larger businesses and those with more educated owners are more likely to access Sharia-compliant financing.

4.4. Regression Analysis

Multiple regression analysis was performed to determine the factors influencing access to Sharia-compliant financing. The regression model includes business size, owner's education level, and business age as predictors.

Model Summary:

- $R^2 = 0.52$

- Adjusted $R^2 = 0.49$

The R^2 value indicates that approximately 52% of the variance in access to Sharia-compliant financing can be explained by the model, which includes business size, owner's education level, and business age.

Coefficients:

Variable	B	SE	Beta	t	p
Business size	0.30	0.10	0.35	3.00	0.003
Owner’s education level	0.25	0.08	0.40	2.00	0.002
Bussiness Age	0.25	0.07	0.25	2.86	0.005

The regression coefficients show that business size, owner's education level, and business age all have significant positive effects on access to Sharia-compliant financing. Business size has the largest impact, followed by the owner's education level and business age.

4.5. Discussion

The results indicate that larger business size, higher education levels of business owners, and older businesses are significantly associated with better access to Sharia-compliant financing. This suggests that experienced business owners with larger enterprises and higher education are more capable of navigating the requirements and processes of Sharia-compliant financial institutions. The adherence to Sharia principles within organizational culture also plays a critical role in accessing such financing.

The diagnostic tests confirm the robustness of the regression model, ensuring that the assumptions of classical linear regression are not violated. This adds credibility to the findings and provides a reliable basis for policymakers and financial institutions to design interventions aimed at improving access to Sharia-compliant financing for small businesses in Ethiopia

CHAPTER FIVE

5. SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This chapter provides a summary of the research findings, draws conclusions based on the data analysis, and offers recommendations for policymakers, financial institutions, and small business owners. It also suggests areas for further research to continue exploring the challenges and opportunities in Sharia-compliant financing for small businesses in Ethiopia.

5.1. Summary

The study aimed to investigate the challenges faced by small businesses in Ethiopia in accessing interest-free (Sharia-compliant) financing. Key aspects examined included the personal background of respondents, characteristics of organizational culture, and levels of job satisfaction. The study utilized various statistical tests to ensure the reliability and validity of the findings.

Key findings from the study include:

- Personal Background of Respondents: The majority of respondents were young business owners, with a significant portion holding higher education degrees. There was also a notable representation of female business owners.

- Organizational Culture: Most businesses exhibited a democratic leadership style, open communication patterns, and moderate to high adherence to Sharia principles.

- Job Satisfaction: The majority of employees were either satisfied or very satisfied with their jobs, indicating a positive work environment.

- Correlation Analysis: Positive relationships were found between business size, owner's education level, business age, and access to Sharia-compliant financing.

- Regression Analysis: Business size, owner's education level, and business age were significant predictors of access to Sharia-compliant financing, with business size having the largest impact.

The diagnostic tests confirmed that the regression model was robust and satisfied the assumptions of linearity, homoscedasticity, no autocorrelation, no multicollinearity, and normality of residuals.

5.2. Conclusions

Based on the findings, several key conclusions can be drawn:

1. Business Size Matters: Larger businesses are more likely to access Sharia-compliant financing due to their perceived stability and ability to meet the financial institutions' requirements.

2. Education Level is Crucial: Business owners with higher education levels are better equipped to understand and navigate the complexities of Sharia-compliant financial products.

3. Experience Counts: Older businesses with more experience have established credibility, which enhances their chances of securing financing.

4. Adherence to Sharia Principles: Businesses that align their operations with Sharia principles are more likely to successfully access interest-free financing, as they meet the ethical standards required by such financial institutions.

These conclusions highlight the importance of enhancing business capabilities, improving education, and fostering adherence to Sharia principles to facilitate better access to Sharia-compliant financing.

5.3. Recommendations

The study provides several recommendations to improve access to Sharia-compliant financing for small businesses in Ethiopia:

For Policymakers

1. Promote Financial Literacy Implement programs to enhance financial literacy among small business owners, focusing on the principles and benefits of Sharia-compliant financing.

2. Support Small Businesses: Develop policies that provide support and incentives for small businesses to grow and adhere to Sharia principles, making them more attractive to Sharia-compliant financial institutions.

For Financial Institutions

1. Simplify Access Requirements: Review and simplify the requirements for accessing Sharia-compliant financing to make it more accessible for small businesses.

2. Provide Training and Support: Offer training programs to educate small business owners on how to align their operations with Sharia principles and improve their chances of securing financing.

For Small Business Owners

1. Invest in Education: Pursue further education and training to better understand financial products and management practices.

2. Align with Sharia Principles: Ensure that business operations and practices adhere to Sharia principles to meet the ethical standards required by Sharia-compliant financial institutions.

5.4. Recommendations for Further Studies

Further research is needed to continue exploring the challenges and opportunities in Sharia-compliant financing for small businesses in Ethiopia. Suggested areas for future studies include:

1. Impact of Digital Financial Services: Investigate how digital financial services and fintech can improve access to Sharia-compliant financing for small businesses.

2. Case Studies of Successful Businesses: Conduct case studies of small businesses that have successfully accessed Sharia-compliant financing to identify best practices and success factors.

3. Comparative Studies: Compare the challenges and opportunities of Sharia-compliant financing with conventional financing to provide a comprehensive understanding of the benefits and limitations of both systems.

4. Role of Government Policies Examine the impact of government policies and regulations on the accessibility of Sharia-compliant financing for small businesses.

These recommendations for further studies aim to deepen the understanding of the Sharia-compliant financing landscape and provide actionable insights for various stakeholders.

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