

Chapter 24

The Role of Islamic Financial Product Innovation in Reduction of Financial Exclusion in Ethiopia

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ABSTRACT

The aim of the chapter is to explain the strategic role of Islamic finance, which can be considered as financial product innovation, in combating financial exclusion in Ethiopia. It intends to assess the extent and the nature of religious-driven financial exclusion of Ethiopian Muslims and the level of their participation in the existing interest free window banking system introduced to the sector recently. In order to collect data for the research, mixed approaches such as questionnaires and semi-structured interviews are used. The questionnaire was distributed to 321 respondents in Addis Ababa in 2017 while the semi-structured interview was conducted with selected high-ranking bank officers. At the end of the analyses there are findings which show the extent of financial exclusion of Ethiopian Muslims due to the absence of alternative financial systems.

INTRODUCTION

The concept of Financial Exclusion has been gaining attention in developed countries from 1990s (Warsame, 2009). Different scholars define financial exclusion based on different contexts. Anderloni et al. (2008) defines financial exclusion depending on difficulties to access finance. According to them,

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“Financial exclusion refers to a process whereby people encounter difficulties accessing and/or using financial products and services in the mainstream market that are appropriate to their needs and enable them to lead a normal social life in the society in which they belong”. In addition to this, Leyshon and Thrift, (1995) also defined financial exclusion as a process of excluding poor’s and disadvantage groups because of fearing risks. Further, Australia and New Zealand Banking Group (2004) stated that, financial exclusion is the absence of access to financial products and services by single person or societies due to their geographical location. According to Connolly et al., (2011) “Financial exclusion exists where individuals lack access to appropriate and affordable financial services and products – the key services and products are a transaction account, general insurance and a moderate amount of credit”.

According to Global Findex database 2014, 2 billion adults are financially excluded and 350 million or 17% of them are from Sub-Saharan Africa countries (Demirgüç-Kunt, Klapper, Singer, & Van Oudheusden, 2015). In 2013, the World Bank group president Jim Young Kim announced Universal Financial Access (UFA) vision. This vision has given priority for 25 countries where 73% of their population are not accessing finance or financially excluded. Ethiopia is one of the countries included in UFA2020 (World Bank, 2016).

According to The World Factbook, in 2017, Ethiopian total population is estimated as 100.2 million, of which 35% to 40% are Muslims. Ethiopia is the third in Africa and tenth in the world by numbers of Muslim population with more than 34 million Muslims. In Ethiopia, there are 19 banks (three of them are state owned), 17 insurance companies and 35 microfinance institutions.

Global financial inclusion (Global Findex, 2014) database drawn a survey from 150.000 people around the world in 140 countries. Ethiopia is one of the countries included in this survey. The survey is given to 1004 Ethiopians as a sample size. In the report, 78% of adults had no account in formal financial institutions, 86% of adults were not having formal saving, and 93% of adults had not taken formal borrowing. This shows that majority of the Ethiopian people are excluded from the formal financial institutions. In addition, the performance of financial inclusion is lower than the Sub-Sharan countries average (Demirgüç-Kunt, Klapper, Singer, & Van Oudheusden, 2015). However, in rural areas, the rate of access to finance is 1% and there is no financial institution that offers Islamic finance for substantial number of the Muslim population who need sharia compliant finance (Byrne & Anderson, 2015). Because of the low level of access to finance in Ethiopia and the unavailability of full-fledged interest free finance, Muslims are the double victim of financial exclusion.

Even though the cause of financial exclusion is different from country to country, lack of finance, farness of financial institution, lack of trust in financial institution and religious reasons are the most common hindering factors in accessing financial services (Demirgüç-Kunt, Klapper, Singer, & Van Oudheusden, 2015).

Religious factor is one of the common reasons for financial exclusion of Muslims across the world (Ben, Barajas & Massara, 2015; World Bank, 2014). In terms of population, the numbers of Ethiopian Muslims are more than the population of many Muslim countries such as Malaysia and Saudi Arabia, which are bolstering in Islamic finance industry. However, there is no full-fledge interest free finance in Ethiopia. Ethiopian Muslims have requested from the government for opening Islamic finance for many years. Taking the long request in to account, the National Bank of Ethiopia (NBE) issued a Proclamation No: 592/2008 that allows interest free finance in 2008. Article 22, Sub-article 2 of the proclamation states that “The National Bank may issue directive to regulate banking businesses related to non-interest-bearing deposit mobilization and fund utilization.” Following this directive, the first interest free bank in the history of the country had been established selling shares in the name of Zamzam Bank. But the NBE

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