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ASSESSMENT ON NBE BILL PURCHASE DIRECTIVE AND LOAN PERFORMANCE: THE CASE OF NEW ENTRANT PRIVATE COMMERCIAL BANKS

BY

LELISE TEMESGEN

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LIST OF ABBREVIATIONS

ATM – automated teller machine

CBE- Commercial Bank of Ethiopia

EBA- Ethiopian Bankers Association

NBE- National Bank of Ethiopia

NEPB- New Entrant Private Banks

O/D – Overdraft facilities

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ABSTRACT

This study attempts to assess NBE bill purchase directive and credit performance of new entrant private Banks (NEPB). Specifically, the study focused on six banks joined the Banking industry the last six years and assessed the relation of the NBE bill purchase directive with liquidity, credit portfolio, asset- liability matching position and credit decision of these Banks. Descriptive research design was used for the study where structured questionnaires were administered to a sample size of 100 respondents and the financial data of these Banks, effective from the issuance of the directive, were reviewed. The primary and secondary data were analyzed and presented. The result indicated that the NBE- bill purchase directive affects the liquidity position of the new entrant private Banks as the bill shows steady growth whereas slow pace is exhibited in deposit growth on the other side. Thus, it raises the stiff competition of banks for mobilizing loanable fund. In addition to this, the Banks credit decision process tilted towards fulfillment of the limit set by NBE with respect to loan tenor and product. Consequently, the Banks are facing challenges as they couldn't satisfy the customers demand. The study recommends, the National Bank of Ethiopia to revisit the NBE- bill purchase directive, in view of the following alternatives: - increasing the maturity period of short term loans, lifting the bill purchase for Export, Manufacturing and Agriculture sectors, increasing the share of revolving facility especially for new entrant Banks as the credit customer base of the Banks has not yet been enhanced. Moreover, the study recommends the new entrant private Banks should form consortium and further examine the severity of the problem and presented to the concerned organ.

CHAPTER ONE

INTRODUCTION

1.1. BACKGROUND OF THE STUDY

Banks are the major players in the financial system of a given economy towards country's economic development. The significance of the Banks more pronounced in developing countries like Ethiopia as Banks are the major source of finance.

In Ethiopia, the number of banks operating in the country during the fiscal year 2015 has reached nineteen. The Banks are licensed and supervised by the Central Bank called the National Bank of Ethiopia. In terms of ownership, sixteen are private commercial banks, and the remaining three are state-owned.

As per the amended proclamation- the National Bank of Ethiopia establishment proclamation no.591/2008, the purpose of the National Bank is to maintain stable rate of price and exchange rate, to foster a healthy financial system and to undertake such other related activities as are conductive to rapid economic development of Ethiopia. In order to fulfill its purpose, the National Bank of Ethiopia had granted around 17 power and duties which describe the role of the National Bank in the Economy in general and in the Banking industry in particular. Its role can be broadly classified as monetary stability, financial stability and regulatory, policy operation, financial structure provision (NBE proclamation, 2008).

The principal objective of the monetary policy of the National Bank of Ethiopia is to maintain price & exchange rate stability and support sustainable economic growth of Ethiopia. Price stability is a proxy for macroeconomic stability which is vital in private sector economic decision on investment, consumption, international trade and saving. Finally, macroeconomic stability fosters employment and economic growth. Maintaining exchange rate stability on the other hand is considered as the principal policy objective of NBE so as to be competitive in the international trade and to use exchange rate intervention as policy tools for monetary policy to affect both foreign reserve position and domestic money supply.

The introduction of a wide range of monetary instruments by central banks engenders competition, efficiency and transparency and broadens financial intermediation in the banking system. It also promotes liquidity management of commercial banks and gradually leads to the development of well-functioning money and financial markets which could serve as catalysts for economic growth and development.

In Ethiopia utilizing various monetary instruments has been limited since the money market is not yet developed to the required level and the absence of a financial market. Thus, the NBE use a mix of diversified monetary policy instruments so as to effectively carry out the monetary management function of the NBE which includes reserve requirement, open market operation, lending by the central Bank, setting floor interest rate, Direct Credit control and Moral suasion. (NBE, monetary policy Frame work)

The Financial Stability and Regulatory role is related with its full or shared responsibility for financial stability policy and oversight of the financial system. It is the responsibility of the Bank to set prudential guidelines which requires the financial institutions operating in the economy to exercise particular care in their operation in order that specified outcomes can be realized. In this connection the National Bank of Ethiopia had issued a number of directives and circulars which helps as a tool for supervisory and oversight role of NBE. The NBE undertakes surprise and/or regular on site and off site examination of the Banks so as to maintain the soundness of the financial system and ensure systemic risk management framework for each bank (Erchafo 2001 and NBE Monetary policy Framework)

The policy operation and financial structure role covers the liquidity management, forex intervention, current provision, payment and settlement service etc. In connection to liquidity management of the Banks, the National bank of Ethiopia monitors the Banks by setting the liquidity requirement at 15%.

In connection to the Ethiopia Growth and Transformation plan that focuses on seven strategic pillars, the Country's monetary policy is directed towards maintaining price and exchange rate stability which helps to create a macro economy that is conducive for rapid and sustained economic growth. Theoretically, Monetary policy tools/instruments are broadly classified as Direct and indirect in which the former related to the authorities' direct controlling mechanism of the monetary variables, and the latter with market-based operation.(Erchafo,2001). Thus, the government of Ethiopia had planned to use both the direct and indirect monetary policy instrument for successful implementation of the GTP

(GTP,2010). The direct monetary instrument encompasses interest rate controls, credit ceiling and directed lending whereas the indirect monetary instruments are open market operation, reserve requirement and central bank lending (Eze, 2010).

Following the direction in Growth and Transformation plan of the country, which determines the contribution of private, public and non-government organizations towards financing social and Economic program mainly through focusing growth enhancing sectors, and as per the power vested on the NBE by Article 5(3,4) and 27(2) of NBE establishment proclamation no.591/2008, the NBE had issued a directive on April 2011, on the establishment and operation of National Bank of Ethiopia bills Market Directive No.MFA/ NBEBILLS/001/2011.The aim of the issuance of the directive is increasing the participation of banks in the financing of priority sector projects which is believed to bring sustainable economic development.

This NBE bill purchase directive forced all Banks except Commercial Bank of Ethiopia and Development Bank of Ethiopia to purchase bond equivalent to 27% of new loan disbursement at interest rate of 3% per annum. And the NBE bills shall have a maturity period of five years. The purpose of the directive to draw financial resource from commercial Banks to finance and channeling the fund for government priority areas through Development Banks of Ethiopia(DBE). The calculation of the disbursement did not exclude the pre-shipment facility, advance on import bills, merchandise loans which exhibit short term and revolving nature. Following this directive implementation, the private commercial Banks are claiming that the directive is negatively affecting the loans and advance position as it create tight liquidity position and reducing earning and profit thereof. Considering this claim, the Ethiopian Bankers' association (EBA) had appealed to National Bank of Ethiopia (NBE) to revise its directive.

The National Bank of Ethiopia amended the directive that may be cited as NBE bills purchase Directive no MFA/NBEBILLS/002/2013 in March, 2013. Though the spirit of the directive is the same with the former directive, the NBE tried to address the private banks concern regarding the impacts associated with short maturing loans like pre-shipment export facility, merchandise loan facility and advance on import credit facilities. yet, the Banks are still claiming that it is a bottle neck to the credit process of the Banks as the directive dictates the short term loan (a loan that should be repaid back within one year) shall not be less than 40% of the total outstanding loans and advance of the respective bank excluding NBE bills outstanding balance at any given time.

Various studies revealed that different monetary policy instruments have various implications on Bank performance, liquidity, lending behavior etc (Brissimis & Delis, 2010, Kashyap and stein, 2000, and Goodhart,2009) . Therefore, assessment of the implication of this specific monetary Instrument- NBE bill purchase directive is important as it is blamed of creating stress on liquidity of Banks which in turn influences the lending behavior and the credit performance. Therefore, the study tries to see particularly the impact of such policy instrument on the credit performance of Banks recently joined the banking industry namely Enat Bank S.C, Debub Global Bank S.C, Addis International Bank S.C, Abay Bank S.C, Birhan International Bank S.C and Buna International Bank S.C.

1.2. STATEMENT OF THE PROBLEM

Bank's play the major role in any country's Economy. Their relevance to the economy lies as they involve in mobilizing deposit and availing credit to various economic sectors and being profitable through covering their cost of fund. Hence, a bank has to be liquid enough to meet payment obligations to depositors and credit demand for borrowers. This calls for a sound Asset-Liability Management by the bank. Asset-liability management basically refers to the process by which an institution manages its balance sheet in order to allow for alternative interest rate and liquidity scenarios (R. vadiyanathan,1999). Minimizing maturity mismatch between asset and liability and optimizing the return shall be the concern of a bank. Liquidity analysis considers the bank's ability to meet its obligations and is very critical for a bank to remain a going concern since liquidity risk may lead to failure of a bank (Habtamu 2012). Owing to the stated reasons, the National Bank of Ethiopia had issued Risk management guideline that covers the most common and interrelated risks facing banks in the country, namely, credit, liquidity, market and operational risks.

All Commercial Banks have common characteristics as they rely on deposits from the public to finance loans and advances request of their customers. Therefore, the Bank's management is responsible while funding the asset growth through meeting all liabilities as they become due and without incurring unreasonable cost in doing so (NBE guideline, 2010). Bank performance is a function of internal and external factors. The internal determinant factors are related with the bank specific variables whereas the external determinants are variables that are not related to specific bank but reflect the external economic, legal and macro environment. Among the macro economic factors, one of the direct monetary policy instrument enforced by the National Bank of Ethiopia can have a significant implication on the liquidity and performance of the commercial Banks. (Access capital 2011, IMF 2014). The NBE bill purchased by the banking sector has reached Birr 18.85 billion at the end of year 2012/13 and shows an increase and reached Birr 26.0 billion which shows a significant amount of the mobilized deposit by the commercial bank has been allocated for bill purchase. (NBE annual report)

The International Monitory Fund through its country report during Oct 2013 and 2014 commented that the NBE Bill purchase requirement continues to severely constrain private commercial bank operation. The report further noted that in the presence of the reserve requirement, the liquidity requirement and an additional requirement for banks to hold 40 percent of their loans in short term credit will be a major distortion in the financial intermediation. Thus, assessing and understanding the implication of specific and relevant monetary policy instrument on Bank performance and timely addressing the issues become important to reduce any unforeseen systemic risk. (IMF report, 2013,2014)

Even though there are various studies that revealed the general implication of direct or indirect monetary policy instrument on Bank credit performance; as this specific monetary instrument (purchasing the NBE bill based on the monthly loan disbursement calculation) is new phenomenon for Commercial Banks in Ethiopia, its implication needs an assessment. The assessment is required as other assessments made on related issues in different countries differs from Ethiopia due to the availability and strength of the financial markets of the countries in general and the capacity and technological development of the commercial Banks in particular.

On top of this, since the directive does not exclude new entrant private banks which have relatively small capital and asset bases as compared to other Banks operating in the Ethiopian Banking industry for more than a decade, the assessment will help to address specific issue of small banks. Therefore, the goal of this study is to assess specific monetary instrument that is NBE bills purchase Directive no MFA/NBEBILLS/001/2011 and amended directive no. MFA/NBEBILLS/002/2013 on liquidity and its subsequent effect on credit performance of New entrant private Banks.

1.3. BASIC RESEARCH QUESTIONS

The Study seeks answer for the following questions:

- Does the NBE bill purchase directive have an impact on liquidity position of new entrant private Banks?
- What are the impacts of the NBE bill purchase directive on the credit portfolio of the new entrant banks in terms of loan maturity and Economic sector mix?

- What would be the implications of the NBE bill purchase directive on asset-liability matching position of the new entrant Banks?
- What would be the effect of the directive in loan processing and approval process of the new entrant Banks?

1.4. OBJECTIVES OF THE STUDY

The general objective of the study is to explore the implication of the NBE bill purchase directive on the new entrant private commercial banks and recommend alternative ways of addressing the purpose of enacting the directive.

The specific objectives are to:

- Assess the impact of the NBE bill purchase directive on the liquidity of the new entrant Banks;
- Highlight the possible effects of the NBE bill purchase directive on the credit portfolio of the new entrant banks in terms of loan maturity and Economic sector mix;
- Analyze the implication of the NBE bill purchase directive on asset liability matching position of the new entrant private banks;
- Determine the effect of the NBE bill purchase directive on loan processing and approval practice of the new entrant banks;

  And forward possible recommendation from key findings that would improve the effectiveness of the NBE-bill purchase directive.

1.5. DEFINITION OF TERMS

- **NBE BILL**: A long term obligation of the National Bank of Ethiopia
- **NBE BILL PURCHASE DIRECTIVE:-** the directive issued by the National Bank of Ethiopia that dictated private Banks to purchase bill which is equivalent to 27% of the monthly disbursement. Moreover, it is a directive which limits the minimum on portfolio share of short term loans at 40% and the minimum threshold of revolving facilities at 10% of the total outstanding of loans and advances.
- **NEW ENTRANT PRIVATE COMMERCIAL BANKS;-** Banks entered into the industry during the past five years

1.6. SIGNIFICANCE OF THE STUDY

Giving the reality that the Banking industry is the primary source of finance for businesses operating in the country and the liquidity position of banks at any one time is critical to avail credit; any policy measurement should be carefully implemented for the overall well-being of the financial sector. Hence, addressing the implication of the NBE bill directive will lead to the better performance of the banks as well as increases their contribution for the overall development of the country.

Therefore, the result of this study will help the New entrant private Banks to critically pointed out the implication of the NBE bill purchase on their performance and insight possible solutions. Moreover, the result of the research will be an input to the policy makers specifically the NBE and it further initiate the NBE to give due emphasis on the problems identified and to take remedial action.

1.7. SCOPE OF THE STUDY

This study is limited to the assessment of the impact of the NBE bill purchase directive on the credit performance of new entrant Banks namely, Enat Bank S.C, Debub Global Bank, Addis International Bank, Abay Bank, Birhan International Bank and Buna International Bank.

The Credit management Department, Branch operation department and Finance Department staffs and those staffs involved in the credit approval process of the six Banks are the targeted group of respondents.

Moreover, the assessment was limited to specific monetary instrument that is the NBE bill purchase directive in relation to its effect on liquidity (loanable fund) of the banks, loan maturity and Economic sectors, Loan processing and approval practice of the Banks under study.

CHAPTER TWO

REVIEW OF LITERATURE

2.1 DEFINITION AND CONCEPT OF MONETORY POLICY

Monetary Policy is any government measure that controls the amount of money in circulation and the interest rate in which credit is availed to borrowers (Oni and Ozemhoka 2013). It is further explained by Ifeoma M and Chike(2012) as one of the tools of controlling money supply by the monetary authorities so as to achieve a desirable economic growth.

In general, the primary objective of monetary policy is attaining stable and well-functioning macro-economic environment through moderate inflation rate, low unemployment rate, balanced foreign trade, stabilized exchange and interest rates in order to achieve the sustainable economic growth and development of a country(Erchafo 2001).

2.2 MONETORY POLICY INSTRUMENT

The monetary policy instruments are classified as quantitative and qualitative. The quantitative ones can be of general type or indirect type whereas the qualitative ones may be selective or direct. These instruments may affect the level of aggregate demand through the supply of money, cost of money and the availability of credit. Quantitative instruments include bank rate changes, open market operations and reserve requirements changes. They are expected to regulate the overall level of credit in the economy through commercial banks. In selective credit controls specific types of credit are aimed to be controlled. These include margin requirements and regulation of credit to the different sectors of the economy of the concerned country. As the selective credit control , the qualitative tools are tools that affect banks' lending through any measure other than the expansion or constriction of money supply itself for example direct rationing of credit, changes in the marginal requirement of loans, moral suasion and publicity(Eze, 2010)

Monetary Instruments are also divided into direct and indirect ones, depending on to what extent they rely on market-conform operation. Direct instruments operate by setting or limiting either prices (interest rates) or quantities (amounts of credit outstanding) through regulations, while indirect

instruments act through the market by, in the first instance, adjusting the underlying demand for, and supply of, bank reserves (Alexander, William and Enoch 1996).
The most common direct instruments are interest rate controls, credit ceilings, and directed lending (lending at the behest of the authorities, rather than for commercial reasons). The three main types of indirect instrument are open market operations, reserve requirements, and central bank lending facilities.

2.3 ADVANTAGE AND DISADVANTAGE OF MONETARY POLICY INSTRUMENTS

According to Choudhry and Mirakhor (1997) direct monetary instruments are advantageous as they are reliable to control aggregate and allocation of credit and its cost. In addition they are relatively easy to implement with relative low direct fiscal cost. Quantifying them and linking to a monetary program within an economic policy framework has been easy. It is further explained that direct instruments are the only feasible monetary instruments to operate effectively for those countries with noncompetitive financial systems and less developed primary and secondary capital markets. On top of that the direct instrument is very helpful during specific or general market failures or in a severe financial crisis.

Even though direct monetary instrument is advantageous as stated above, it is blamed to be inefficient in resource allocation as banks attempt to avoid credit ceilings and impacted the distribution of credit as it is often resulted in arbitrary allocation of credit. Meanwhile it is difficult to ensure that the credit or credit ceiling will be used for the intended purpose. In countries where state-owned banks dominate,, the role of private banks will be limited due to the policy intervention as there is possibility of liquidity crunch because of limits imposed on bank lending. On top of that, the liquidity crunch will be aggravated with increase inflationary trait. Besides, frequent changes in credit limits place an undue burden on banks' portfolio adjustments (Alexander and Enoch 1996).

Developing countries' experience shows that such instruments lose their effectiveness with the passage of time because of prevention of the effect by numerous means. Banks may practice that undermines the direct controls through revised financing techniques that are covered by the existing controls and divert funds into other profitable activities created by controls themselves. Consequently, the ultimate objective of the policy objectives defeated in practice frequently, even if monetary targets are met. Thus, the perceived reliability of direct instruments can often be misleading (Choudhry and Mirakhor 1997).

In contrast to direct instrument, liquidity fluctuation can be controlled using indirect instrument on a short-term basis in line with the monetary policy objectives. Indirect instruments are known by their effectiveness as they create a room for flexibility and timely response. Influencing monetary conditions become easier as the indirect instruments operate directly through the market. In policy implementation, frequent changes in the equity-based treasury bills or central bank credit auctions to absorb or augment liquidity provide greater flexibility in timely responses that are difficult with direct instruments.

The disadvantages of indirect instruments are related with complexity and ambiguity in use. It is difficult to implement as linking the instrument with particular effect is difficult. Among the instrument only banks' reserves requirements may be controlled in the short term by reallocation of government deposits since frequent changes in reserve requirements--particularly increases--would be disruptive and costly in terms of portfolio adjustment. In addition, it is difficult to use the reserve requirement to mop up excess liquidity since the excess liquidity is asymmetrically distributed among banks; the effective means for redistribution of the reserve balances among themselves become difficult (Alexander and Enoch 1996).

2.3 IMPLICATION OF MONETORY POLICY ON LIQUIDITY OF A BANK

2.3.1 DEFINITION AND CONCEPT OF BANK LIQUIDITY

Liquidity, in general, is defined as a measure of the relative amount of asset in cash or which can be quickly converted into cash without any loss in value available to meet short term liabilities.

Bank liquidity, in particular, refers to the ability of the bank to ensure the availability of funds to meet financial Commitments or maturing obligations at a reasonable price at all times. Banks should be liquid enough to satisfy the withdrawal needs of depositors and credit demand of borrowers. It is the bank's ability to immediately meet cash, cheques, other withdrawal obligations and legitimate new loan demand while abiding by existing reserve requirements (Agabada and Osunji,2013). Hence, Commercial Banks should check their liquidity position in short time interval as the survival of commercial banks depends greatly on customers confidence that can easily eroded due to illiquidity **(**Adeyanju, David, and Oluwayinka 2011)

According to Jhingan (2000), a bank needs a high degree of liquidity in its assets portfolio since liquidity of assets refers to the ease and certainty with which it can be turned into cash. The bank must hold a sufficient large proportion of its assets in the form of cash and liquid assets for the purpose of profitability. If the bank keeps liquidity the uppermost, its profit will be low. In the other hand, if it ignores liquidity and aims at earning more, it will be disastrous for it. Thus a bank must strike a balance between the objectives of liquidity and profitability. This balance must be achieved through liquidity management.

Liquidity can also refer to a characteristic of a financial instrument that defines its capability of absorbing large trading volumes without its price being significantly affected [Brunnermeier and Pedersen 2007]. This set of attributes can be referred as market liquidity of a financial instrument. In addition to this, the quantity of liquid assets available in an economy can be taken as part of liquidity. In this case it includes central bank facilities, monetary aggregates and other highly liquid assets. This can be defined as macroeconomic liquidity. Since market as well macroeconomic liquidities are critical for liquidity risk management, these aspects of liquidity risk should be taken into account. (Stragiotti 2009)

The important element of current assets is cash which is the most liquid asset for the operation of any business. It is the input needed to effective business continuity. A bank as a business concern needs to have cash and liquid assets which it can easily convert into cash at short notice. Pandey (2011) identifies the types of assets available to a bank to include cash, deposits with the central bank, treasury bills. Thus, for banks to remain in the business of financial intermediation, they must formulate policies to ensure the availability of cash and liquid assets in the asset portfolio at any point in time.

2.3.2 MONETORY POLICY IMPLICATION ON LIQUIDITY

Liquidity creation by small banks seems to be significantly affected by monetary policy since tightening or loosening of monetary policy is associated with a reduction or an increase on the items of balance sheet. With regard to medium and large banks, even though on-balance sheet liquidity creation is affected by monetary policy, it does not seem to have a significant effect. Besides, off-balance sheet liquidity creation of any size bank class does not affected by monetary policy.

The study made by Berger (2010) on Bank liquidity creation, monetary policy and financial crises showed that the effect of monetary policy is weaker during financial crises than during normal times.

2.3.3 LIQUIDITY RISK AND ASSET-LIBILITY MANAGEMENT

2.3.3.1 LIQUIDITY RISK

Bank for International Settlements (BIS) (2006) defines liquidity risk as the risk that the firm will not be able to efficiently meet both expected and unexpected current and future cash flows and collateral needs without affecting either daily operations or the financial condition of the firm. Bank liquidity risk management can reduce the probability of an adverse effect of liquidity risk (Anas and Mounira, 2008). The core activity of banks is to offer liquidity to their customers. The liquidity preference of depositors and borrowers is different. Meanwhile, their liquidity preferences may vary over time due to various reasons. Therefore, banks should make sure that the needs of its customer fulfilled at all times. If the Bank failed to check the associated risk, they will lose customers thereby reducing the volume of deposits. When deposits reduce, the bank will have insufficient funds for other investments; this significantly reduces the level of profitability. On top of that, a high liquidity risk causes a run on the bank that can be evidenced in the panic withdrawal of deposits by customers. This in turn push away would be customers and potential investors from the bank. Consequent upon this, the bank's operations affected severely which results in a significant reduction of profit (Ojong et al. 2014)

The Liquidity risk may arise from banking intermediation that caused by lending in the long term while borrowing in the short term. This latter banking structural tendency is usually referred to as "maturity mismatch". This phenomenon originates from the maturities transformation of assets and liabilities [Diamond and Dybvig 1983, Goodhart 2008]. In addition, the BIS [2008] defines liquidity risk as the inability of a bank to fund increases in assets and meet its financial obligations in a timely manner as they come due without incurring excessive cost. This definition is also recurrent in many large banking groups' liquidity risk sections of their annual reports. Liquidity (as well as liquidity risk) may be scrutinized from three different perspectives: funding, financial markets and the macro economy [Drehmann and Nikolaou 2009].

In addition to the above stated effects arise due to liquidity risk, the effect may extend to unexpected sale of the assets of the bank which may reduce the bank's capital base (Diamond and Rajan, 1999). If any of the financial institutions faces a situation in which it has to sell a large number of its illiquid assets to meet the funding requirements (perhaps to reduce the leverage in conformity with the requirement of capital adequacy), the fire sale risk may arise. This scenario may push banks to offer price discount to attract buyers. This situation will have a knock on effect on the balance sheets of other institutions as they will also be obliged to mark their assets to the fire sale price (Goodhart , 2009).

2.3.3.2 ASSET-LIBILITY MANAGEMENT

Asset-liability management basically refers to the process by which an institution manages its balance sheet in order to allow for alternative interest rate and liquidity scenarios. Banks and other financial institutions provide services which expose them to various kinds of risks like credit risk, interest risk, and liquidity risk. Hence, employing Asset liability management provides institutions a way of maintaining such risk at acceptable level through models that enable institutions to identify, measure and monitor risk, and implement suitable strategies for managing the risk.

It is therefore mandatory for banks, finance companies, leasing companies, insurance companies, to focus on asset-liability management when they face financial risks of different types. Asset-liability management includes not only a formalization of this understanding, but also a way to quantify and manage these risks. Though the company fails to implement formal asset-liability management program, the company should understand the concept as it provides a truer picture of the risks, the opportunity cost, and the reward that the company may gain from the engagement (Fabozzi & Kanishi, 1991). Asset-liability management is a first step in the long-term strategic planning process. Therefore, it can be considered as a planning function for an intermediate term. In a sense, the various aspects of balance sheet management deal with planning as well as direction and control of the levels, changes and mixes of assets, liabilities, and capital (R.validiyanathan,1999)

Liquidity management mainly involves planning and controlling of the asset and liability of an organization to maintain enough liquid assets either as an obligation to the customers of the organization and to cover other unexpected financial needs to survival of the business or as a measure to adhere to the monetary policies of the central bank. Commercial Banks should first manage its money position by complying with the legal requirement so as to manage overall liquidity position. Actually, management of money position is essential if a bank must avoid excesses or deficiencies of required primary reserves. During a decline in market price of securities, selling securities will be definitely expensive. Hence, banks opted inter bank borrowing when additional funds are required to balance the bank reserve position (if it falls below the required level) for a very short time. Besides, it may be more desirable to borrow for bank's liquidity needs than to call back outstanding loans or to cancel or place embargo on new loans, a situation that will reduce the existing and potential customers of a bank. Commercial banks are expected to maintain certain levels of reserves. These reserves are statutory requirements stipulated by the central bank specifying the cash reserves equal to certain fraction of the banks' deposits or loans and advances which bank must maintain **(**Adeyanju, David, and Oluwayinka 2011)

Bhattachannya and Sahoo (2011) argued that Liquidity management of the Central banks should be consistent with the ultimate goals of monetary policy. Hence it is typically refers to the framework, set of instruments, and the rules that the monetary authority follows in managing systemic liquidity. In this connection, central banks modulate liquidity positions of banks by different mechanisms varying both the level of short-term interest rates and influencing the supply of bank reserves in the interbank market. Effective liquidity management is a key factor that helps sustain bank profits and concurrently keeps the banking institution and the financial system generally from illiquidity and perhaps, insolvency.

In order to maintain public confidence on the financial system of the country, banks are required to maintain adequate amount of cash and near cash assets such as securities to meet withdrawal obligations. It is paramount for the survival of the totality of the financial system of a country and the banks in particular whose core function of financial intermediation depend on the availability of adequate liquidity.

Therefore, the significance of implementing liquidity risk management process should not be underestimated in entire financial system including an individual bank as bank's are required to be in line with the changes in the entire system, if any, and perform the key role of deposit mobilization; client withdrawals and lending efficiently even in a hyperinflationary environment (Laurine and Roux 2012)

2.3.3.3 LIQUIDITY RISK AND PERFORMANCE OF BANKS

Liquidity problems may affect a bank's earnings and capital and in extreme circumstances may result in the collapse of an otherwise solvent bank (Central Bank of Barbados, 2008). During liquidity crisis, Banks may force to borrow from the market or to mobilize deposit even at an exceptionally high rate during. This ultimately reduces the banks' earning thereof. Moreover, a bank's further borrowing to meet depositors' demand may put the bank's capital at risk. This resulted in high debt to equity ratio, affecting the bank's effort to maintain an optimal capital structure.

Diamond and Rajan (2005) argued that a bank may refuse to accept credit request of even from a potential entrepreneur, if it feels that the liquidity problem is quite high. This is an opportunity loss for the bank. If a bank is unable to meet the requirements of demand deposits, there can be a bank run .No bank invests all of its resources in the long-term projects. Many of the funding resources are invested in the short term liquid assets. This provides a buffer against the liquidity shocks. Diamond and Rajan (2005) emphasize that a mismatch in depositors demand and production of resources forces a bank to generate the resources at a higher cost. Liquidity has a greater impact on the tradable securities and portfolios. Broadly, it refers to the loss emerging from liquidating a given position (Zheng and Shen, 2008). It is essential for a bank to be aware of its liquidity position from a marketing perspective. It helps to expand its customer loans in case of attractive market opportunities (Stragioti, 2001). A bank with liquidity problems loses a number of business opportunities. This places a bank at a competitive disadvantage, as a contrast to those of the competitors.

2.4 IMPLICATION OF MONETORY POLICY ON CREDIT FUNCTION

2.4.1 DEFINITION AND CONCEPT OF CREDIT

Credit is defined as transactions involve in the transfer of money or other property on promise of repayment, usually at a fixed future date. The transferor and transferee will involve in which the former referred us a creditor, and the later as a debtor; hence credit and debt are simply terms describing the same operation viewed from opposite standpoints (Donald L. 2008).

Bank credit is related with a loan extended by a bank to an individual, firm or organization, in the form of cash. The type of loan may take several forms from short term loan to a line of credit.The principal function of credit is to transfer property from those who own it to those who wish to use it, as in the granting of loans by banks to individuals and corporate bodies who plan to initiate or expand their business ventures. The transfer is temporary and is made for a price, known as interest, which varies with the risk involved and also with the demand for, and supply of, credit, (Stiglitz and Weiss, 1981).

Credit is the confidence of the bank to its customer to give him/her a certain amount, to be used in a particular purpose for a certain period, and payment is made under specific conditions, and provides guarantees for the bank to recover his/her loan. The role of banks in general and importance of credit in particular towards economic growth and development of a country is notable. The primarily functions of credit are facilitating transfer of capital or money to where it will be most effectively and efficiently used and economizing the use of currency or coin money as granting of credit has a multiplier effect on the volume of currency or coin in circulation. Credit uses an essential tool like interest and dis-count rates to control and regulate money in the economy. As it is explained by Al-Zubaidi, (2002) Banking credit is one of the most attractive banking activities for the banks management, but it is also a very sensitive and dangerous, because it is considered as important investment for the commercial banks, may lead the bank to bankruptcy or access to the very high profits. Therefore, in order to avoid any unforeseen risk and so as to satisfy customer’s credit demand, banks should strike the balance of demand and supply of credit.

There are three major types of credit. These are commercial credit, consumer credit and investment credit. Commercial credit is a credit availed to a business mainly to cover working capital requirement such as overdraft, loans and advances; trade credit from suppliers; commercial papers (or note); invoice discounting; bill finance; hire purchase; factoring, etc. Consumer credit is a loan availed to an individual for personal use which covers a loan for purchase of household goods, for mortgage loans and automobile loans. Investment credit allows a business concern such as corporate body, sole proprietorship or partnership to obtain credit project loan for capital goods for expansion of factory or procurement of machinery. The tenor of a loan varies from short to medium to long term depending on the institutions, nature and functions, the type of loans availed to the customer.(Aremu etal, 2010)

2.4.2 IMPLICATION OF MONETORY POLICY ON CREDIT PERFORMANCE

Brissimis & Delis (2010) study reveals that banks respond to change in monitory policy quite heterogeneously. The balance sheets of the banks determine the respond to the monitory policy.

Monetary policy affects bank loan supply and this in turn has an independent and significant effect on aggregate economic activity. As part of direct quantitative monitory policy, the major objective of the aggregate ceiling on banks' helps to avoid over expansion of credit and its attendant inflation. However, Banks faced with excess demand for credits, as loan rates were often fixed below the equilibrium rates during this time (Oni and Ozemhoka 2013). It must be set the costs of inefficient resource allocation and ineffectiveness arising from the evasion and inequity that direct instruments entail (Alexander and Enoch 1996).

Bank credit creation could be affected by monetary policy via two closely related sub-channels. The bank balance sheet channels and the bank lending channels that are described as follows.

As Worns (2001) Posit in the balance sheet channel, the monetary policy prompt increase in interest rate which in turn increases collateral risk by reducing the present value of the assets presented by borrowers to be pledged as collateral. The basis of the reduction might be an increase in the discount rate applied to expect future payment and / or by a reduction in the expected payments via other transmission channels (eg. the cost of capital and / or the exchange rate channel.).

In restrictive monetary policy, supply of credit by Banks may reduce fearing that the expected losses from defaults could increase as the collateral risk increases. In contrary, during restrictive monetary policy the loan demand may increase. In principle, however, this "perverse" effect should become less important over time since an adaptation of expenditures is then to be expected, resulting in a lower loan demand. This dependence of loan demand on internal funds is known as the "cash – flow effect" and is the most convincing explanation for the often found positive correlation between the interest-rate level and the rate of growth of the loan volume (Worns, 2001).

With regard to the Bank Lending Channel, restrictive monetary policy reduces the liquidity of the entire commercial banking system which results in liquidity mobilization and lending more costly.

This is due to the fact that, it is assumed that depositors withdraw their deposits from banks because they re-organize their portfolios after the restrictive policy that increases interest rate increase (i.e money demand is assumed to decrease in response to a restrictive monetary policy). If this reduction in deposits cannot be neutralized vis – a – vis non-banks or by reducing assets other than bank loans, it will decrease a bank's ability to grant loans i.e. monetary policy will change loan – supply(Oni and Ozemhoka 2013).

Kashyap and Stein (2000) stated that lending behavior of banks with less liquid balance sheets strongly affected by monetary policy. So as to reduce the impact, thus, Diamond and Rajan (2006) suggested implementation of different means through which the lending channel can be effective. They propose the use of open market operation (Indirect monetary instrument) to increases financial liquidity and alleviate the real liquidity pressures on banks, in order to finance long-term projects that enhance aggregate economic activity. On the other hand, effect of monetary policy is further intensified when banks hold huge liquid assets since banks will use the extra liquidity for availing credit facilities. Thereby one should expect lending and profitability of these banks to increase above average.

Turning to the effect that liquidity may have on the relationship between policy rates and bank risk-taking, we would expect banks with higher levels of liquid assets, which reflect huge on bank lending, risking and profitability will decrease (increase) with higher (lower) levels of bank liquidity. At following a contraction in the money growth rate, poorly capitalized banks reduce the risk aversion, to have lower incentives to take on more credit risk after an expansionary monetary policy. To the extent that this holds, the impact of monetary policy on bank risk is weakened. Also, if banks with relatively illiquid portfolios face higher risks, due for example to a prolonged period of low interest rates, then these banks may be less able to use part of their liquidity in less risky activities, and reduce credit risk thereon.

However, it may also be the case that excess liquidity of banks in a low interest rate environment provides incentives for higher risk-taking if banks feel particularly safe. This situation, although not representing typical bank behavior, can lead to a deterioration of bank asset quality and a sharp increase in bank risk.(Brissimis and Delis 2010)

As Goodhart (2009) further explained Proponents of the bank lending channel argue that during restrictive monetary policy bank loans supply reduced as banks are in short of money. Tight monetary policy reduces the deposit in a bank, consequently resulted in reduce loanable funds. Even though viable and profitable project owners approached banks for credit request, the Banks are unable to fulfill the credit demand. The primary cause for credit declines is not only the decline in deposit but also the difficulty to raise the reserve requirement from other sources.

In addition to this, as small firms are restricted to access the capital market, they depend on bank finance. However, when loan supply is reduced their primary source of fund will be affected. As small firms account for a major portion of the economy, the aggregate output, and aggregate economic activity declines due to the above stated reason. Therefore, the supply based contraction in bank loans has an independent impact on the real economy. (Goodhart,2009)

The severity of the impact differs based on the size of the bank. Small banks pass through tough situations while raising funds in times of monetary contraction. Owing to this reason, they may reduce their lending relatively more than large banks (Kashyap and Stein 1995, 2000). In contrary, bigger banks with relatively high capital to asset ratio and having strong liquidity position are less likely to reduce lending in the face of tight monetary policy. Highly capitalized banks are perceived by market participants as being less risky that helps the Banks to access external finance. (Bernanke and Gertler 1995, Kishan and Opiela 2000). Furthermore, if debtors do not have perfect substitute for bank loans, restrictive lending behavior results in added costs to them. Therefore, lending of highly leveraged banks is expected to be more responsive to monetary policy than lending of well capitalized banks.

Kashyap and Stein (1995) studied the lending behavior of small and large banks. They find that when policy is tightened, both total loans and business loans at small banks fall, while loans at large banks are unaffected. The differential response of small banks may indicate they have less access to alternative funding sources than large banks and so are less able to avoid the loss of core deposits when policy is tightened. Since small banks lend primarily to smaller firms, their finding is consistent with the view that monetary policy may work, in part, through a credit channel. Sofianos et al., (1990) examines the behavior of banks with loan commitment. Their study reveals that Banks reduce the amount of uncommitted loans in periods of monetary tightening, while loans made under the terms of an existing commitment are unaffected.

Bernanke and Blinder (1988) pointed out borrowers' behavior during restrictive monetary policy. In a monetary contraction, banks 'reserves increase because of reserve requirements and hence reduce the deposits. This may in turn increase the interest rate levied on short-term and long term loan and also reduce the lending capacity of banks. If bank dependent borrowers are dominant, thus it will reduce the investments and thereby in economic activity.

Besides that, according to balance sheet channel monetary policy may result in loss of creditworthiness as it affects the financial position or net worth of the borrower, thereby influencing the costs of external finance to the borrower. Consequently, effects the borrowers' investment and spending plan (Said and Ismail 2008)

2.6. REVIEW OF RELATED EMPIRICAL STUDY ON EFFECT OF MONETARY POLICY INSTRUMENT ON BANK LENDING

As per the empirical study made by Flexio and Akinwand (2012), the effect of monetary policy instrument on banks performance in Nigeria was examined between year 1978 and 2008. As per this paper the monetary policy instruments are not effective to stimulate credit in the long run in Nigeria. From their findings, the researchers suggested that the monetary authority should moderate the minimum policy rate as a tool for regulating commercial banks operation and facilitate investment in the economy. Aryeetey et al (1997) explain that monetary instruments that focus on control of interest on loans and deposits rates tend to affect the money circulation as it increases the demand for and depress the supply of funds. As a result, financial institutions forced to ration credit which in-turn creates unsatisfied credit demand. Kashyap and stein(1995) elucidates when money drains from the financial system due to monetary policy, Banks' lending behavior is affected this in turn affects the investment spending of the non-financial firms that depends on bank lending.

The research made in china by He and Wang (2012) on monetary policy and bank lending had focused on how loan size and loan rate was affected by monetary policy instrument. The findings were both loan size and loan rate (lending rate) was affected by the tight monetary instrument and the impact varies with the Bank size. Keeton (1992) on study on the impact of monetary policy on bank lending: the role of securities and large CDs, Monetary policy does not only affect bank lending directly by changing deposit but also indirectly by changing the return on securities and the cost of committed deposit/fixed time deposit. The empirical evidence by Ndikumana (2014) on study made on Sub sharan African counties further shows a positive link between bank credit to the private sector and domestic investment. According to the econometric results presented in this paper, a negative effect of monetary policy indicators on domestic investment and bank lending in SSA countries. Based on the findings, the researcher concluded that even though controlling inflation could be achieved through contraction monetary instruments, the result may be achieved at a substantial real sector costs due to depressed investment.

The research by Ganacorta and Mistrulli(2004) revealed that well capitalized banks have the opportunity to increase their loan portfolio as compared to less capitalized one, since the less capitalized banks are more constrained by the capital requirements.

An Empirical study was made by Lelissa (2014) on the impact of policy measures on Ethiopian private Banks performance. The study used panel date from 2007 up to 2015 of eight middle sized private banks. The study finds that the exposure to the government bills has a negative significant relationship with performance. Nevertheless, the study revealed that the magnitude is not severe.

2.7. SUMMARY AND KNOWLEDGE GAP

In line with the above theoretical as well as empirical review, in general monetary policy has positive and negative implication on Bank performance mainly liquidity, credit and customer behavior. In this connection this paper will be additional input as it deals with Implication of specific monetary policy instrument: NBE Bill purchase directive on credit performance of new entrant private banks as the impact vary depending on the size of the Banks.

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

Both primary and secondary data sources were used to undertake this research. Primary data were collected through questionnaire, and informal discussion with professionals. The secondary data sources are obtained through reviewing the last three years annual reports of the Banks under study.

As the study is made on six private Banks credit operation of namely Bunna International Bank, Birhan International Bank, Abay bank, Addis International Bank, Debub Global Bank, and Enat Bank Credit Department staffs, Finance department staffs and Branch operation staffs are participated in the research. The research is designed as a case study type and descriptive statistics like percentile is used as data analysis methods.

3.1. RESEARCH DESIGN

In this research survey approach has been used as the research questions are majorly focused on ’what’ questions. According to Yin(1994) survey methods are used to answer what questions. Trochin (1999) further explained survey methods are used for non- experimental and descriptive research methods. He further indicated that, survey can be useful when a researcher wants to collect data on phenomena that cannot be directly observed. Survey design also provides a quantitative or numeric description of trends, attitudes, or opinions of a population by studying a sample of that population.

3.2. POPULATION AND SAMPLING TECHNIQUES

Sampling is the process of choosing from a much larger population to make a generalized statement considering the selected sample represents the total group. As the study focused on six selected Banks, those staffs acquainted with the issue mainly credit management staffs, Finance department staffs, Branch operation staffs are selected for the study.

According to Cohen etal(2007) purposive sampling is used to access knowledgeable people i.e. those who have in depth knowledge about particular issues may be by virtue of their professional role, power, access to network, expertise or experience. There is a little benefit in seeking a random sample when most of the random sample may be largely ignorant of particular issue and unable to comment on matter of interest to the research in which case a purposive sampling is vital. Though they may not be representative and their comment may not be generalized, this is not the primary concern in such sampling, rather the concern is to acquire in depth information from those who are in a position to give it.

In this study purposive sampling method was adopted because the bank lending process is practiced by few employees but not all bank employees and officials. Moreover, because of time constraint the sample was restricted to Head office and Branches (the Bank's under study) resides in Addis Ababa.

The sample selection process passed through the following steps – first the Directors of Credit Department of the six banks were approached to know those staffs involved in the credit process. Accordingly, all credit department staffs were incorporated in the study; further management staffs involved in the credit decision process were selected for the study (VP operations and VP corporate services, Director/division manager Finance and Administration department, Director Branch operation). Moreover, Mangers Risk and compliance department were participated as they oversee the Bank's performance as per the NBE's requirement. Branches resides in Addis Ababa were also targeted and then the branches were proportionally selected according to the number of branches found in Addis Ababa (the bank which had more branches got more chances to be surveyed). Then, the Branch managers were selected and covered by the study.

3.3. TYPES OF DATA AND INSTRUMENTS OF DATA COLLECTION

The type of data used in the study includes both quantitative and qualitative data. Primary and secondary sources of data were used for the study. The main primary source of data was questionnaires. Structured questionnaires were used for the collection of the data both open- and close ended questions were incorporated in the questionnaire. The open-ended questions offered the respondents the opportunity to freely express themselves on the issues under consideration while the close-ended questions restricted the respondents on the options provided.

In the case of the secondary source of data, the annual reports of the Banks since the issuance of the NBE bill purchase directive were reviewed and used for the analysis. These reports contain financial performance like deposit and loan position, NBE bill purchased during the period under review is presented.

3.4. PROCEDURE OF DATA COLLECTION

Provided the number of respondents primarily determined and could be managed, staffs that involved in the credit decision process were participated in this research. All staffs who work on credit management area of the bank, branch managers, Finance department staffs, and the top management were involved in the research. Questionnaires were distributed to hundred staffs of the banks under study and follow-up calls were made to give reminder and clarification.

In addition, to make financial performance analysis the researcher needed financial information from each bank. Hence, the financial information of all banks (the secondary data) that help to analyze performance was extracted from the annual financial audit report.

3.5. METHODS OF DATA ANALYSIS

Data analysis consists of examining, categorizing, tabulating, or otherwise recombining the evidence, to address the initial proposition of a study (Yin, 1989). The qualitative data collected through questionnaire were summarized and presented by means of tables. This offered a pictorial presentation to enhance the understanding of the data. The data collected were presented in a tabular form after summarizing and classifying the data. The data was also analyzed in a simple percent method to compare responses. The higher the percentage means, the level of acceptance of the respondent. The quantitative data obtained from the secondary data source mainly annual report is also summarized and presented in a table. The data presented was also analyzed using descriptive statistics majorly percentile.

CHAPTER FOUR

RESULT AND DISCUSSION

This chapter presents the finding and discussions of the study. The chapter comprises two major parts. In the first part the primary data collected through administering questionnaire were presented and analyzed while in the secondary data collected from the annual financial statement are analyzed.

4.1 RESULTS

As it is stated in the previous chapter, questionnaires were developed for respondents. A total of 100 questionnaires for employees were distributed. Among the 100 questionnaires distributed to respondents, only 75 was filled and returned. Thus, out of the 100% questionnaires distributed 75% were collected. Therefore, the data given below is a summarized response of 75 respondents.

4.1.1. ESTABLISHMENT YEAR AND PAID UP CAPITAL OF THE BANKS UNDER STUDY

Table 4. 1 List of Banks under study

No	Name of private Commercial Banks	Establishment year	Paid up capital as of June 30,2014
1	Buna International Bank S.C	2009	417.4 million
2	Birhan International Bank S.C	2009	435.5 million
3	Abay Bank S.C	2010	452.1 million
4	Addis International Bank S.C	2011	261.6 million
5	Debub Global Bank S.C	2012	177.3 million
6	Enat Bank S.C	2013	261.6 million

SOURCE;- NBE and annual report of the Banks

As depicted in the above table, the oldest Bank under study is Buna International Bank while Enat Bank S.C is the youngest one. The Banks under study should fulfill the NBE minimum paid up capital requirement which is 500 million in year 2016. Hence, the attainment of the set limit is related with the

Bank's market share and profitability in the Banking industry. This is due to the fact that, the primary reason for investing on a share (by an individual or a company) is getting dividend which is a result of profitability. Therefore, the banks overall liquidity, loan performance, and lending practice should be assessed as these factors are determinant to profitability significantly. Therefore, the NBE bill purchase directive will be assessed in relation to +these factors.

4.1.2. SOCIO – DEMOGRAPHIC CHARACTERISTICS OF RESPONDENTS

The following socio – demographic characteristics of respondents were analyzed in terms of level of education, position and years of experience

Table 4. 2 Level of Education

Level of Education	Frequency	Percent
Bachelor	52	69
Masters	23	31
Total	**30**	**100**

Source: Questionnaire

As indicated in the above table, the analysis on the level of education indicated that, 69% of the respondents have bachelors' degree while the remaining 31% holds Master's Degree. Therefore, it can be concluded that the level of education able them to analyze the issues under study.

Table 4. 3 Years of Service

Years of service	Frequency	percentage
1-5 YEARS	4	5
6-10 YEARS	40	53
ABOVE 10 YEARS	31	41

Source: Questionnaire

The table 4.3 shows experience of the staff. And the study found that, 53 % of the respondents have Bank experience related between 6-10years. From the total number of respondents, 41% of Staff has experience above 10 years. Small portion of the respondents that is 5% have experience of 1-5 years. Therefore, it can be concluded that the respondents have ample banking experience.

Table 4. 4 Area of Experience

Area Of Experience	Frequency	percentage
Finance	17	23
Credit	30	40
Branch Operations	23	31
Other	5	7
Total	75	100

Source : Questionnaire

The above table 4.4 shows that, major portion of the respondent i.e. 40% have Bank experience related with credit while 31% of respondents are experience of Branch operations which indicates large number of respondents are acquainted with the issue under study in their day to day activities. The rest 23% of respondents are in finance area who participated in credit approval committees, manage and report the NBE bill account together with the Credit management Department and Small portion of the respondents that is 7% have other banking experience majorly Risk and compliance Department staffs(who identify, measure, monitor and control various risks of the bank.). This indicated that all respondents are in a position to have in-depth information about the topic under study.

Table 4. 5 Level of position

Current Position	Frequency	Percentage
Managerial	43	57
Non Managerial	32	43
Total	75	100

Source: Questionnaire

As it is depicted on table 4.5, 57 % of the respondents involved in the study assume managerial post while 43% of respondents assume non managerial post. This indicated that the majority of the respondents can analyze things from different perspective as they have passed through various job ladders in the industry thereby acquiring significant Banking experience. This implied that, as the issue under study is a policy issue related with banking specifically credit performance they can analyze the performance of their bank prior and after the issuance of this directive.

4.1.3 RESEARCH RELATED QUESTIONS

4.1.3.1 FACTORS THAT AFFECTS LIQUIDITY OF BANKS

As indicated in table 4.6 item (A) respondents were asked whether the Bank specific factors affect liquidity of banks. With this regard, 25 (33%) of the respondents strongly agree on the issue while 18 (24%) of employees agree, whereas 16(21%) of respondents neither agree nor disagree. On the other hand, 12 (16%) of respondents disagrees, 4 (5%) strongly disagree.

In same table item (B) respondents were asked whether macro-economic situations have an impact on liquidity of banks. The 24(32%) of the respondents strongly agree with the idea. On the other hand, 38(51%) of respondents agree, 9 (12%) of respondents neither agree nor disagree, and 4 (5%) of respondents disagree.

As can be seen from item (C) of table 4.6, the major portion of the repsondents,38 (51%) of respondents strongly agree that the government and central policies affect liquidity of banks and 34(45%) of respondents agree on the issue. Whereas 3 (4%) of respondents are neutral with the idea,

Table 4. 6 Factors affecting liquidity of banks

Item no	Description	Strongly disagree		Disagree		Neutral		Agree		Strongly Agree		total	
		freq	%	freq	%	Freq	%	freq	%	freq	%	freq	%
A	Bank Specific Factors	4	5	12	16	16	21	18	24	25	33	75	100
B	Macro-Economic Situation		0	4	5	9	12	38	51	24	32	75	100
C	Government and Central bank policies		0		0	3	4	34	45	38	51	75	100

Source: questionnaire

4.1.3.2 MONITORY INSTRUMENT THAT AFFECTS CURRENT LIQUIDITY AND CREDIT PERFORMANCE OF BANKS

As indicated in table 4.7 respondents were asked the different monetary instrument that can affect the liquidity and credit performance of Banks. In item (A) respondents were asked whether the reserve requirement set on Banks affect the liquidity of banks and credit performance thereof. With this regard, 11 (15%) of the respondents strongly agree on the issue while 23 (31%) of employees agree, whereas 25(33%) of respondents neither agree nor disagree. On the other hand, 12 (16%) of respondents disagrees, 4 (5%) strongly disagree. This implied that as the current reserve requirement is only 5% of the deposit and as the requirement was reduced to such percentage in relation to bill purchase directive; majority of the respondent(those who said strongly disagree, disagree and neutral) perceived the reserve requirement does not as such affect the current liquidity position of the Bank.

In same table item (B) respondents were asked whether Direct Credit control (credit ceiling, directing loan to specific sector) have an impact on liquidity and credit performance of banks. The 15(20%) of the respondents strongly agree with the idea. On the other hand, 40(53%) of respondents agree, 14 (19%) of respondents neither agree nor disagree, and 2 (3%) of respondents disagree and 4(5) strongly disagree. Those responses on neutral and disagreement position showed that the respondent does not consider the NBE bill purchase is among the direct credit control system.

As can be seen from item (C) of table 4.7,6 (8%) of respondents strongly agreed that the setting floor interest rate affect liquidity of banks and 16(21%) of respondents agree on the issue. Whereas 21 (28%) of respondents are neutral with the idea, 14 (19%) disagree with the idea and 18(24%) of respondents disagree. Those responses on neutral and disagreement side implied that as the current floor interest rate is only 5%, banks are paying more and more interest rate to get the deposit which is a scare resource. Moreover, as NBE did not set ceiling interest rate, the Banks set the interest for loans considering this fact.

In same table item (D) respondents were asked open market operation (purchase and sale of treasury bills) can affect the liquidity of banks 11(15%) strongly agreed and 11(15%) agreed, the major portion of the respondents 28(37%) neither agree nor disagree, 15(20%) disagree and 10(13%) strongly disagree. As the open market operation is not as such strengthen in the financial sector, except the auction announcement by the NBE for sell of Treasury bill which is not regular; majority of the responses fall on neutral and disagreement.

Table 4. 7 Monetary Policy Instrument that affect liquidity and credit performance of Banks

Item no	Description	Strongly disagree		Disagree		Neutral		Agree		Strongly Agree		total	
		freq	%	freq	%	freq	%	freq	%	freq	%	freq	%
A	Reserve Requirement	4	5	12	16	25	33	23	31	11	15	75	100
B	Direct Credit control(credit ceiling, directing loan to specific sector)	4	5	2	3	14	19	40	53	15	20	75	100
C	setting floor interest rate	18	24	14	19	21	28	16	21	6	8	75	100
D	open market operation(purchase and sale of treasury bills)	10	13	15	20	28	37	11	15	11	15	75	100

Source: questionnaire

4.1.3.4 SHORT TERM SOLUTIONS FOR LIQUIDITY PROBLEM

Table 4. 8 Banks short term solutions while facing liquidity problem

Item no	Description	Strongly disagree		Disagree		Neutral		Agree		Strongly Agree		Total	
		freq	%	freq	%	freq	%	freq	%	freq	%	freq	%
A	Attract fixed time depositors with higher interest rate		0	12	16	1	1	33	44	29	39	75	100
B	Borrow from other banks(involve in inter- bank lending)		0	6	8	14	19	48	64	7	9	75	100
C	Request loan from NBE	4	5	6	8	21	28	29	39	15	20	75	100
D	Aggressive branch expansion	11	15	8	11	25	33	21	28	10	13	75	100

Source: questionnaire

As can be seen in table 4.8 respondents were asked the short term solution that Banks would take while facing liquidity problem. In item (A) respondents were asked whether Banks attract fixed time depositors with higher interest rate or not. With this regard, 29 (39%) of the respondents strongly agree on attracting fixed time depositors with higher interest rate while 33 (44%) of employees agree, whereas 1(1%) of respondents neither agree nor disagree. On the other hand, 12 (16%) of respondents disagreed.

In same table item (B) respondents were asked whether banks opted for interbank borrowing. The 7(9%) of the respondents strongly agree with the idea. On the other hand, 48(64%) of respondents agree, 14 (19%) of respondents neither agree nor disagree, and 6 (8%) of respondents disagree.

As can be seen from item (C) of table 4.8, 15 (20%) of respondents strongly agree that borrowing from NBE is an option and 29(39%) of respondents agree on the issue. Whereas 21 (28%) of respondents are neutral with the idea, 6(8%) of respondents disagree with the idea and 4(5%) of respondents disagree.

In same table item (D) of table 4.8, respondents were asked whether aggressive branch expansion is an option or not. Accordingly 10(13%) of respondents were strongly agree, 21(28) of respondents agree with the idea, 25(33%) neither agree nor disagree, 8(11%) disagree and 11%(strongly disagree).

4.1.3.5 RESPONDENTS WERE ASKED THE REASONS FOR THE OPTIONS THEY 'STRONGLY AGREE' WITH

a) Reason for choosing fixed time deposit

Attracting fixed time depositors is the most convenient way to control unexpected liquidity problem and pay obligations due and meet operational requirement. In addition, it is considered as the best solution as compared to others since it is available in the market if one pays attractive interest rate and it is easy to get short term solutions with in short period.

b) Reasons for choosing inter bank borrowing/lending

Those respondents opted for inter-bank borrowing argued that, the interest rate of the loan between banks is low as compared to fixed time depositor. In addition, respondents also mentioned that as it is customary practice to resolve liquidity problem. However, the solution is a short term solutions like for a month or two.

c) Reasons for choosing loan from NBE

As some respondents pointed out the NBE is the only one that charges fair interest rate and borrowing from NBE creates stability in the market regarding inflation and bank borrowing capacity.

d) Reasons for choosing branch expansion

Those who opted for branch expansion argued Bank's should look for long term solutions rather than short term ones. Branch Opening should not be neglected in due course as people now days do not want to go far for deposit and withdrawal. Hence it is mandatory even to open at least three man branches to mobilize deposit.

Moreover, respondents mentioned the importance of other outlet channels like ATM, mobile banking and agency banking that facilitates the deposit mobilization effort since customers are, now days, responsive for modernization and quick service.

4.1.3.6 CAPACITY OF MEETING CUSTOMERS CREDIT DEMAND

Respondents were asked whether the Banks are meeting credit demands of customers or not. As per table 4.9, the majority of the respondents claimed that Banks are not satisfying credit demand of customers.

Table 4. 9 Capacity of Banks in meeting Customers Credit demand

Item no	Description	frequency	%
A	Yes	12	16
B	No	63	84
	total	75	100

Source: questionnaire

4.1.3.7 FACTORS LIMITING BANKS FROM SATISFYING CUSTOMER'S DEMAND

Table 4. 10 Limiting factors for not satisfying customers demand

Item no	Description	Strongly disagree		Disagree		Neutral		Agree		Strongly Agree		Total	
		freq	%	freq	%	freq	%	freq	%	freq	%	freq	%
A	stiff competition of banks in deposit mobilization for loanable fund		0		0	5	8	33	52	25	40	63	100
B	The NBE Bill purchase calculated on disbursement of loans		0	4	6	6	10	30	48	23	37	63	100
C	Excessive Credit demand		0	9	14	31	49	11	17	12	19	63	100
D	NPL position and repayment culture of customers	12	19	28	44	14	22	6	10	3	5	63	100

Source: questionnaire

As indicated in table 4.10 those respondents claimed that Banks are failed to satisfy customer demands asked the factors contribute towards this. In item (A) respondents were asked stiff competition of

Banks for loanable fund hinders Banks from satisfying customers need. 25 (40%) of the respondents strongly agree on the factor and 33 (52%) of respondents agree, whereas only 5(8%) of respondents neither agree nor disagree.

In same table item (B) respondents were asked whether the NBE Bill allotment calculated on disbursement of loans contributed for banks to unsatisfying customers demand. The 23(37%) and 30(48%) of the respondents strongly agree and agree respectively with the idea. On the other hand, 14 6(10%) of respondents neither agree nor disagree, and 4 (6%) of respondents disagree.

As can be seen from item (C) of table 4.10, 12 (19%) of respondents strongly agree that there is excessive credit demand and 11(17%) of respondents agree on the issue. Whereas 31 (49%) of respondents are neutral with the idea, 9 (14%) disagree with the idea.

In same table item (D) of table 4.10, respondents were asked whether the NPL position and repayment culture of customers is a factor to not satisfying customer needs. Accordingly only 3(5%) of respondents were strongly agree, 6(10) agree, 14(22%) neither agree nor disagree. Whereas, the majority of the respondents 28(44%) disagree and 12 (19%) strongly disagree.

4.1.3.8 INTERNAL AND EXTERNAL FACTORS AFFECTING LENDING CAPACITY

Table 4. 11 Internal and external Factors

Description	Strongly disagree		Disagree		Neutral		Agree		Strongly Agree		total	
	freq	%	freq	%	freq	%	freq	%	freq	%	freq	%
capital position of the Bank		0	1	1	15	20	43	57	16	21	75	100
Liquidity position	1	1		0	5	7	22	29	47	63	75	100
management capacity and attitude	9	12	17	23	30	40	16	21	3	4	75	100
Economic condition/activity		0%	6	8	12	16	40	53	17	23	75	100
monetary policy					26	35	30	40	19	25	75	100

Source: questionnaire

As indicated in table 4.11 respondents were asked the internal and external factors that contribute to the lending capacity. In item (A) respondents were asked whether the capital position of Banks affects the lending capacity. Majority of the respondents 43(57%) were agree the Bank's capital position determines the lending capacity of the banks.

In same table item (B) respondents were asked whether the liquidity position of their bank determine the Bank's lending capacity. The majority of the respondent 47(63%) strongly agree the liquidity position followed by 22(29%) respondents agree with the idea.

As can be seen from item (C) of table 4.11, only 3(4%) respondents were strongly agree the management capacity determines the lending capacity, whereas 16 respondents (21%) agree with the idea. However, majority of the respondents 30 (40%) are neither agree nor disagree the management capacity and attitude is related with lending capacity of the banks followed by 17(23%) respondents disagreement and 9(12%) strong disagreement.

In same table item (D) of table 4.10, respondents were asked whether the Economic condition and activity cited as an external factor contributed to lending capacity. With this regard 23(17%) of respondents were strongly agree, 40(53%) respondents agree, 12(16%) neither agree nor disagree, whereas only 6(8%) respondents disagree.

In item (E) monetary policy was cited as one external factors affecting lending capacity, 19(25%) respondents agree, 30(40%) agree and 26(35%) neither agree nor disagree.

4.1.3.9 HOW THE NBE BILL PURCHASE DIRECTIVE THAT FORCES BANKS TO MEET SHORT: MEDIUM TERM LOAN PORTFOLIO AFFECTED CREDIT PROVISION

The NBE Bill purchase directive dictates each month short vs medium term loan disbursement portfolio should be in a ratio of 40:60 respectively. Moreover, the maximum threshold of revolving credit facilities (pre-shipment loans, merchandise loan and advance on import bills) set as 10% of the total outstanding loan and advance balance of each month. In this connection, respondents were asked the effect of these limits on credit provision.

Table 4. 12 Effects of NBE bill purchase directive on credit provision

Item no	Description	Strongly disagree		Disagree		Neutral		Agree		Strongly Agree		total	
		freq	%	freq	%	freq	%	freq	%	freq	%	freq	%
A	change of credit plan(tenor, amount, interest rate)		0	5	7	13	17	27	36	30	40	75	100
B	Reducing lending capacity	4	5%	3	4	17	23	22	29	29	39	75	100
C	customer recruitment selection and ranking	3	4%	5	7	26	35	22	29	19	25	75	100
D	customer repayment attitude		0%	6	8	32	43	25	33	12	16	75	100

Source: questionnaire

As indicated in table 4.12 respondents were asked about the effect of NBE bill purchase directive on credit provision. In item (A) change of credit plan was cited as one effect, and majority of the respondents 30(40%) strongly agreed with the idea followed by 27(36%) respondent agreed,13(17%) of respondents neither agree nor disagree the directive effect on change of credit plan while only 5(7%) disagree.

In same table item (B) respondents were asked whether the directive reduces lending capacity. The majority of the respondent 39(29%) strongly agree and 22(29%) respondents agree with the idea.

As can be seen from item (C) of table 4.11, 19(25%) respondents were strongly agree the customer recruitment, selection and ranking is affected by the NBE bill purchase directive, whereas 22 respondents (29%) agree with the idea. However, majority of the respondents26 (35%) are neither agree nor disagree with the idea followed by 5 respondents (7%) disagree with the idea, and 3(4%) strongly disagree. In same table item (D) of table 4.10, respondents were asked whether the customer repayment attitude changed in relation with the directive (as customers are forced to take loans based on the set limit by the NBE bill purchase directive no.2 which dictates short term loans to be 40% of the total outstanding balance) 12(16%) of respondents were strongly agree, 25(33%) agree, majority of respondents 32(43%) neither agree nor disagree. Whereas only 6(8%) respondents were disagree.

4.1.3.10 THE ECONOMIC SECTORS ATTRACT BANKS

Table 4. 13 Economic sectors

The primary purpose of the NBE bill purchase directive is to increase the participation of Banks in the financing of the government priority sectors such as Agriculture, Export and Manufacturing sectors through DBE. In this study, the respondents were asked the priority sectors of the new entrant private commercial Banks, and reason for the selection.

Item no	Description	Strongly disagree		Disagree		Neutral		Agree		Strongly Agree		total	
		freq	%	freq	%	freq	%			freq	%	freq	%
A	Agriculture	5	7	16	21	22	29	23	31	9	12	75	100
B	Import	4	5	9	12	25	33	23	31	14	19	75	100
C	Export		0		0	8	11	10	13	57	76	75	100
D	Domestic Trade service		0	2	3	20	27	36	48	17	23	75	100
E	Transport	8	11	20	27	34	45	13	17		0	75	100
F	Manufacturing	1	1	11	15	25	33	29	39	9	12	75	100
G	Building and construction	7	9	12	16	25	33	28	37	3	4	75	100%

As table 4.13 Export sector is the 1^{st} choice of the Bank's as 57(76%) strongly agrees, followed by Domestic Trade services and Import. Whereas the other government priority sectors such as Agriculture and Manufacturing, are not among the priority sectors for the Banks under study.

4.1.3.11 RATIONALE BEHIND FINANCING EXPORT SECTOR PRIMARILY

Respondents were asked the rationale behind choosing their priority sectors accordingly the export sector is chosen by the respondents as it is the major way of channeling foreign currency to the Bank, positive implication on the growth of the country's economy, the cross selling benefit and forward and backward linkage, whereas respondents were selected import sectors to allocate the foreign currency generated were cited as the major reasons for choosing the sectors.

4.1.3.12 DEFINITION OF SHORT TERM PRIOR TO ISSUANCE OF THE DIRECTIVE

Table 4. 14 Definition of short term loan prior to issuance of directive

As per the NBE bill Purchase directive, the definition of short term loan is a loan that should be repaid with-in one year. The Banks were instructed to adjust their loan tenure definition accordingly. Prior to the issuance of this directive, definition of short term loans differs from bank to bank. Respondents were asked the definition of short term (as per their bank's practice) prior to the issuance of this directive. Loan tenure is related with customer's repayment capacity, monthly total loan collection and the frequency at which fund will be allocated for purchase of bill (as the bill is calculated on monthly disbursement).

Item no	Maturity period of short term loan	frequency	%
A	Up to one year	22	29.3
B	up to two years	25	33.3
C	up to three years	28	37.3
	Total	75	100

Source: questionnaire

As table 4.14 reveals respondents were asked the definition of short-term loan and majority of the respondent 28(37.3%) responded that the definition of short-term loan prior to the issuance of the directive was loan payable up to three years, 25(33.3%) responded the definition was up to two years, and only 22(29.3%) of respondents replied the definition was up to one year.

4.1.3.13 STRATEGIES EMPLOYED TO ACHIEVE THE SET LIMIT OF SHORT: MEDIUM PORTFOLIO EVERY MONTH

Table 4. 15 strategies employed to achieve the set limit

Item no	Description	Strongly disagree		Disagree		Neutral		Agree		Strongly Agree		total	
		freq	%	freq	%	freq	%	Freq	%	freq	%	freq	%
A	Availing O/D facility as much as possible for all economic sectors	8	11	9	12	29	39	19	25	10	13	75	100
B	Approving client's request classifying as short and medium term loan	3	4		0	14	19	27	36	31	41	75	100
C	Availing only short term loan that will be repaid wit in one year	8	11	24	32	30	40	8	11	5	7	75	100

Source: questionnaire

As indicated in table 4.15 respondents were asked how to achieve the set short vs medium loan portfolio limit. In item (A) availing O/D facility as much as possible for all economic sectors was cited as one strategy, and 10(13%) strongly agreed with the idea, 19(25%) respondent agreed, 29(39%) respondents neither agree nor disagree, 9(12%) respondents disagree and 8(11%) respondents strongly disagree.

In same table item (B) respondents were asked whether approving each client's request classifying as short and medium term loan can be one way of achieving the set limit. The majority of the respondent 31(41%) strongly agree and 27(36%) respondents agree with the idea, 14(19%) respondents neither agree nor disagree, and 3(4%) strongly disagree.

As can be seen from item (C) of table 4.15, availing only short term loan that will be repaid within one year was cited as one of the strategies, 5(7%) respondents were strongly agree, whereas 8(11%) respondents agree with the idea. However, majority of the respondents 30 (40%) are neither agree nor disagree with the idea followed by 24(32%) respondents disagree with the idea, and 8(11%) strongly disagree.

4.1.3.14 ALTERNATIVE STRATEGIES EMPLOYED TOWARDS INCREASING INCOME

Table 4. 16 Income increasing mechanisms

Item no	Description	Strongly disagree		Disagree		Neutral		Agree		Strongly Agree		total	
		Freq	%	freq	%	freq	%	Freq	%	Freq	%	freq	%
A	Increasing the interest rate levied on loans	3	4	9	12	14	19	35	47	14	19	75	100
B	Availing import letter of credit facilities with small margin	6	8	16	21	17	23	23	31	13	17	75	100
C	Aggressively availing letter of guarantee facilities with or without collateral	4	5	3	4	33	44	17	23	18	24	75	100
D	Squeezing Branch expansion	3	4	23	31	15	20	23	31	11	15	75	100

Source: questionnaire

As indicated in table 4.15 respondents were asked how to banks are act towards income increment. In item (A) increasing interest rate levied on loans was cited as one strategy, and 14(19%) strongly agreed with the idea, 35(47%) respondent agreed 14(19%) neither agree nor disagree, 9(12%) disagree and 3(4%) strongly disagree.

In same table item (B) respondents were asked availing import letter of credit facilities with small margin as one strategy. 13(17%) respondent strongly agree and 23(31%) respondents agree with the idea, 17(23%) respondents neither agree nor disagree, and 16(21%) strongly disagree and 6(8%) strongly disagree.

In same table item (C) Aggressively availing letter of guarantee facilities with or without collateral 18(24%) strongly agree, 17(23%) agree, 33(44%) neither agree nor disagree, 3(4%) disagree, 4(5%) strongly disagree.

Squeezing branch expansion 11(15%) strongly agree, 23(31%) agree, 15(20%) neither agree nor disagree, 23(31%) disagree, and 3(4%) strongly disagree.

4.1.3.15 POSSIBLE SOLUTIONS BANK'S WOULD TAKE IN RESPONSE TO NBE DIRECTIVE

Table 4. 17 Possible solutions

Item no	Description	Strongly disagree		Disagree		Neutral		Agree		Strongly Agree		total	
		freq	%	freq	%	freq	%		%	freq	%	freq	
A	pass on the burden to borrowers through increasing lending rate	8	11	28	37	12	16	23	31	4	5	75	100
B	pass on the burden to customers through increasing commission rate for guarantee and L/C facilities	9	12	25	33	21	28	16	21	4	5	75	100
C	Finding another way of income generating activities	3	4	5	7	13	17	35	47	19	25	75	100

As can be seen in table 4.16 respondents were asked possible action Bank's would take in response to NBE directive. In item (A) pass on the burden to borrowers through increasing lending rate 4(5%) strongly agree, 23(31%) agree, 12(16%) neutral 28(37%) disagree, 8(11%) strongly disagree

In same table item (B) respondents were asked passing the burden to customers through increasing commission rate on guarantee and L/C facilities. 4(5%) respondent strongly agree and 16(21%) respondents agree with the idea, 21(28%) respondents neither agree nor disagree, and 25(33%) strongly disagree and 9(12%) strongly disagree.

In same table item (C) Finding another way of income generating activity which needs further study by the banks, 19(25%) strongly agree, 35(47%) agree, 13(17%) neither agree nor disagree, 5(7%) disagree, 3(4%) strongly disagree.

4.1.3.16 BORROWER SELECTION CRITERION EMPLOYED IN THIS CONSTRAINED TIME

Table 4. 18 Borrower selection criterion

Item No	Description	Strongly disagree		Disagree		Neutral		Agree		Strongly Agree		total	
		freq	%	freq	%	freq	%	freq	%	freq	%	frq	%
A	past credit relationship	2	3	2	3	11	14	31	40	31	40	77	100
B	the economic sectors the applicant is engaged in	1	1		0	11	15	35	47	28	37	75	100
C	the cross selling benefit the bank would get(local or foreign currency mobilization	2	3		0	5	7	20	27	48	64	75	100
D	the cash flow of the applicant to repay the loan within one year		0	23	31	16	21	21	28	15	20	75	100

Source: questionnaire

Owing to the fact that the two NBE bill purchase directive is related with the loan tenure, overall portfolio of short and medium term loans, the share of revolving facilities from the total loans; Banks should select their credit customers carefully.

As indicated in table 4.18 respondents were asked the customer selection criterion applied in the liquidity constrained time. In item (A) past credit relationship is indicated as one criterion and 31(40%) of respondents strongly agree, 31(40%) agree, 11(14%) neutral 2(3%) disagree, 2(3%) strongly disagree

In same table item (B) respondents were the economic sectors the applicant is engaged in. 28(37%) respondent strongly agree and 35(47%) respondents agree with the idea, 11(15%) respondents neither agree nor disagree, and 1(1%) strongly disagree.

In same table item (C) the cross selling benefit the bank would get (local or foreign currency mobilization, 48(64%) strongly agree, 20(27%) agree, 5(7%) neither agree nor disagree, 2(3%) strongly disagree.

4.1.3.17 MEETING SHORT VS MEDIUM TERM LOAN (40:60 PORTFOLIO RESPECTIVELY)

Table 4. 19 Meeting short and medium term loan portfolio as per the NBE directive

Description	Frequency	%
Yes	21	28
No	54	72
total	75	100

Source: questionnaire

As indicate in table 4.18 respondents were asked the possibility of meeting the short vs medium term loan portfolio every month as per the directive. The majority of them i.e.54 (72%) replied that attaining monthly portfolio is not possible whereas 21(28%) is possible. This implied that the Banks will face compliance risk as the regulatory body already set the limit. On top of that, the banks should further study how to increase the portfolio of short term loans.

4.1.3.18 STRATEGIES TO MEET SHORT TERM REQUIREMENT

Those respondents that were replied ’yes’ to the above question asked for the possible strategies and they proposed availing credit facilities focusing on short term loan like O/D and dividing one loan as short and medium term loan.

4.1.3.19 CHALLENGE TO MEET THE REQUIREMENT

Those respondents that were replied ‘no’ to the above question asked to state the challenges and some of them mentioned that customers are reluctant to take short term loan in fear of the burden of repayment consequently fear of losing the collateral offered, the cash flow of most sectors didn’t justify the repayment period with in one year. On top of that as revolving facilities delimited to10% of the outstanding loan which would contribute towards the fulfillment of the threshold of short term loan.

4.1.3.20. DIFFICULTY IN ALLOCATING IN MAINTAINING REVOLVING FACILITIES

The majority of the respondents are confirmed that the difficulty of allocating only 10% of the outstanding balance for revolving facilities since exporters require such facilities to work with the banks**.**

4.1.3.21 BANKS POSSIBLE ACTION REGARDING LOAN PROCESSING DURING LIQUIDITY CRUNCH

Table 4. 20 Loan processing during liquidity crunch

Item No	Description	Strongly disagree		Disagree		Neutral		Agree		Strongly Agree		Total	
		freq	%	freq	%	freq	%	freq	%	freq	%	freq	100%
A	cease processing new loans	10	13	9	12	15	20	21	28	20	27	75	100
B	process the loans and await the liquidity improvement for approval	7	9	10	13	18	24	19	25	21	28	75	100
C	Approve the loans and awaiting the liquidity improvement for disbursement	12	16	20	27	22	29	13	17	8	11	75	100

Source: questionnaire

Respondents were asked the Bank's action towards loan processing while facing liquidity crunch Ceasing processing new loans were pointed as one of the options and 20(27%) respondents were strongly agree, 21(28%) agree, whereas 15(20%) neither agree nor disagree, 9(12%) disagree, and the remaining respondents i.e. 12(16%) strongly disagree. An idea of Processing the loans and awaiting liquidity improvement was strongly agreed by 21(28%), agreed by 19(25%), 18 (24%) neither agree nor disagree, 9(12%) disagree, and 10(13%) strongly disagree.

4.1.3.22. THE NBE BILL PURCHASE DIRECTIVE POSITIVE IMPACT ON ETHIOPIAN ECONOMY

Table 4. 21 NBE BILL PURCHASE DIRECTIVE POSITIVE IMPACT ON ETHIOPIAN ECONOMY

Description	Frequency	%
yes	42	56
no	33	44
total	75	100

Source: questionnaire

As table the majority i.e.42 (56%) of the respondents replied that the NBE bill purchase directive will have positive impact on Ethiopian Economy where as 33(44%) argued the directive will not have positive impact.

Respondents replied ‘no’ for the above question asked for the possible suggestions for win- win situation of the policy towards and the intended purpose. The respondents did not totally disagree with the NBE bill purchase rather they commented on the percentage and basis of calculation and on the interest rate which is summarized as follows

- The percentage i.e 27% should be reduced at least to 10%
- Paying comparable interest for the bills(the minimum saving interest)
- The revolving credit shall not be a part for determining the NBE bills

They argued that as the set percentage is huge, the amount injected to the economy through loan will be reduced as time goes by. Therefore, they recommended the set limit to be reduced. The interest rate on the bill is only three percent .Had it been lent out for customers, it would fetch a minimum of 8.5% per annum. Moreover, applying the calculation on revolving facilities accelerate the rate at which the deposit allocated for purchase of NBE bills which in turn reduces the loanable fund.

4.1.3.23 IS THE BILL PURCHASE DIRECTIVE WILL BE A CAUSE FOR SYSTEMIC RISK

Table 4. 22 Is the directive a cause for systemic risk

Item no	Description	frequency	%
A	Yes	31	41
B	No	44	59
	total	75	100

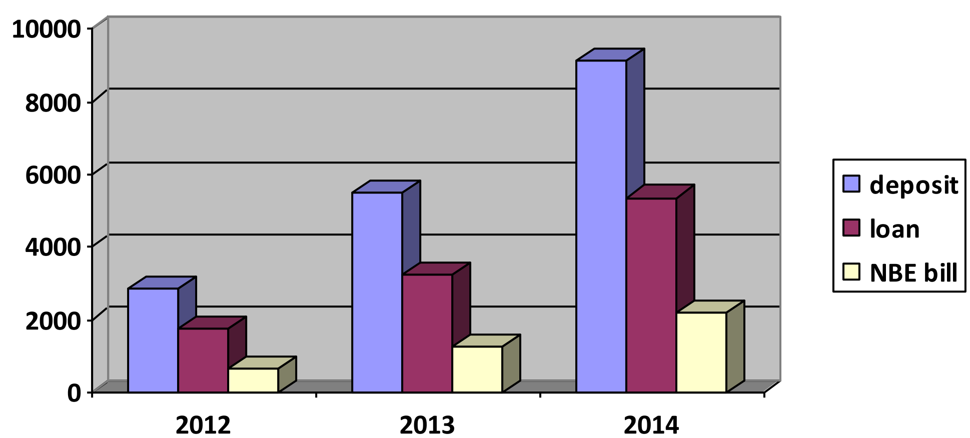
As Table indicates respondents were asked their view whether the NBE bill purchase directive will be a cause for systemic risk. Accordingly, majority of the respondents 44(59%) were replied, the directive will not be a cause for systemic risk whereas the remaining 33(41%) think that it will cause systemic risk.

4.1.3.24 ANALYSIS OF KEY FINANCIAL OF NEW ENTRANT PRIVATE COMMERCIAL BANKS BASED ON SECONDARY DATA

I. Bill purchased by NEPB

The financial Data obtained from the annual report of the Banks on key relevant financial indicators such as deposit, loans and advances, bills purchased reveals that about 24% of the deposit of Banks under study(NEPB's) worth birr 1.3 billion were used to buy NBE bills till the fiscal year ending June 30,2013. This figure has grown by Birr 0.9 billion bringing the total bill purchased by the Banks to Birr 2.2 billion or 24% of total deposit at the end of June 30,2014.

Figure 4. 1 Loan, Deposit and NBE bill compositions



As the above figure shows, during the past three years the deposit, loan and NBE bill amount continuously increasing. This implied that the market position of the NEPB's in terms of deposit and loans are improving. However, the rate of increase varies which is analyzed and presented in table 4.24. Moreover, though the banks are new entrant to the industry, they are contributing towards the government overall development goal as they allocated 24% of their deposit for purchase of the NBE bill.

II. The Bill purchased amount as compared to the deposit structure of the NEBS

Table 4. 23 Bill purchased vs deposit structure

I. Deposit Structure of New Entrant Banks							**in millions Birr**
		June 30,2014		**June 30,2013**		**June 30,2012**	
Item no	Description	Amount	%	Amount	%	Amount	%
1	Saving deposit	4,559.94	50.3%	2,709.7	51%	1291.00	46%
2	Demand deposit	2,848.49	31.4%	1,816.2	34%	950	34%
3	Time Deposit	1,651.81	18.2%	810.4	15%	583.7	21%
Total Deposit		9,060.24	100	5,336.3	100	2825.3	100%
II. Comparison Bill purchased vs various deposit types							**in millions Birr**
Total NBE BILL purchased		2188		1264		634	
NBE Bill to total deposit		24%		23%		22.4%	
NBE Bill to Saving deposit		48%		47%		49%	
NBE bill to Demand deposit		77%		67%		67%	
NBE bill to time deposit		132%		156%		109%	

Source: annual report and self-computation

The above table indicated, the total bill purchase amount is amounted to 24% , 23% and 22.4% of the total deposit at the end of year June 30,2014, year June 30,2013 and year June 30,2012 respectively.

As it is shown above the Bank could cover the bill purchase 100% from the demand deposit, the deposit that will not bear interest. The Bank would get 3% interest on the bills, as the bills are interest bearing of 3% with maturity period of five years. However, the question lays whether this resource (demand deposit) was an idle fund that the NEPB's does not need for financing or not.

III. The trend in growth of NBE Bill purchase

Table 4. 24 The trend in growth of NBE Bill purchase

Description	Year 2012(A)	Year 2013(B)	Year 2014(C)	Growth rate i.e. D=(A-B)/B	Growth rate i.e. E=(B-C)/C	Average growth rate(D+E)/2
Deposit	2861	5495.9	9144	0.92124	0.66378	0.79251
Loans	1749	3232.5	5349	0.84799	0.65476	0.75137
NBE-bill	634.3	1264.8	2188	0.99401	0.72992	0.86196
Loans including NBE bills	2384	4497.3	7537	0.88685	0.67589	0.78137
Bills to deposit ratio	0.222	0.23	0.24	0.03787	0.03975	0.03881
Bills to loan ratio	0.363	0.4	0.41	0.07902	0.04542	0.06222
Bills to Loan ratio including bill	0.266	0.28	0.3	0.05679	0.03224	0.04451

Source: annual reports of the Banks and own computation

As table 4.2.1 shown, the growth rate of the bill purchase is by far greater than the growth rate of deposit, and loans. In this connection, as the Banks tilted towards financing short term loans to comply with the directive requirement, the pace that the resource mobilized either through deposit mobilization or loan collection will go towards purchase of NBE bills will be accelerated . Therefore, the growth rate in deposit should be greater to minimize the contracting effect on loans and advance as more and more resources goes towards purchase of NBE bill as the frequency of disbursement increases.

IV. Growth trend of deposit by structure

Table 4. 25 Growth trend of deposit by structure

Deposit type	Growth rate A(year 2013 to year 2014)	Growth rate B (year 2012 to year 2013)	Average Growth trend C=(A+B)/2
Saving Deposit	0.682821	1.098916	0.890868
Demand Deposit	0.568379	0.910583	0.739481
Time Deposit	1.038265	0.388384	0.713325

Source: annual report and self-computation.

The above table indicated that, the rate at which the time deposit increases by far greater than the demand and saving deposit shows increment. This implied that, Banks are forced towards fixed time deposit in order to satisfy their customer needs.

v. Asset- liability position

The above tables indicated that the growth rate in Asset side mainly NBE bills is greater than the growth rate in liability side comprising saving, demand and time deposit. The maturity period of NBE Bill is five years whereas the maturity period of deposit is short term maximum of two years especially the demand deposit, as the name implies, mostly paid upon demand. Hence, there is maturity date mismatch between the ‘sources’ of the fund i.e. the deposit with the ‘use’ of the NBE bill.

Moreover, the directive forced the Bank’s to finance short term loans which has two contrasting effect in the short-run and medium and long run. Commercial Banks normally encouraged providing short term loans to match up with short term sources. Therefore, whenever the Banks finance short-term loans, Banks may not face asset liability mismatch. However, as per the directive, short term loan is set to be repaid within one year which in turn increases the frequency of disbursement since a loan disbursed this year will be collected within a year and the collection will be refinanced for the next round next year.

The NBE- bill has been computed as 27% of the amount of loan disbursement, the cumulative allotment on the short term will be 27% on the first year, 47% on the second, 61% on the third, 76% on the fourth and 80% on the fifth years.

On top of this, 40% of the collection of medium term loan is expected to be disbursed again in the form of short term loan which in effect increases in NBE bill purchase which has medium term maturity.

4. 2. DISCUSSION

Among the monetary policy instrument the current reserve requirement by the central bank does not as such affect the liquidity and credit performance of the NEPBs. This is due to the fact that the reserve requirement is reduced to only 5% of the total deposit as per the directive. However, the direct credit control that encompasses credit ceiling, directing credit to specific sectors has an impact on liquidity and credit performance of NEPB’s. With regard to the impact of both setting floor interest rate and open market operation was not verified by the respondents as the majority of the respondents neither agreed nor disagreed. The NBE bill purchase directive lay between the direct control monetary instrument and open market operation as the bill is sold to direct the fund to government priority sector through DBE and CBE. The impact of the bill purchase directive further explained by the secondary data analysis as it depicts on table, the growth trend in NBE-bill is by far greater than the growth of deposit and loan.

The deposit mobilization effort of the NEPB's is tilted towards attracting fixed time depositors with high interest rate since mobilizing such deposit is easy as the market is available for those Banks willing to pay competitive interest rate. This is also justified by the secondary data analysis. Table 4.25 shows that the rate at which fixed time deposit increases during the last year is much greater than the rate at which saving and demand Deposit increases. As the deposit base expands, however, involving more of fixed deposit increase the interest expense, and could further contribute to the shrinkage in the Bank's profitability position.

The NEPB's prefers an inter-bank borrowing since the interest rate charged is relatively lower than the interest rate charged by fixed time depositors. However, it is highly depend on the liquidity position of the Bank's in the industry which makes it time taking to get it. Even though, NEPB's opted for NBE's borrowing as NBE charge fair interest rate, it may resulted in a negative impression by the regulatory organ owing to the fact that the liquidity shortfall at a single bank can have a system wide repression.(NBE Risk management guideline,2010)

The NEPBs is unable to satisfy their customers' credit demand. The stiff competition of Banks in deposit mobilization and the NBE bill purchase amount calculated on disbursement of loans are the factors that played the paramount role for the scarce of loanable fund. This is correlated with both the internal and external factors that influence the lending capacity of the NEPBs. Among the listed internal factors i.e. capital position, liquidity position and management attitude, currently the liquidity position of the banks is the major influencer whereas among the listed external factors such as monetary policy and economic condition of the country; monetary policy is considered as the major factor.

The NEPBs are forced to review their credit plan due to the set limit related with the tenure of the loans. Moreover, the set limit reduces the lending capacity as more funds is allocated for short term loans and as the 27% of the amount of collection made from the short term loan account is used for further purchase of bill. In addition to this, the set limit influences the process of customer recruitment, selection and ranking. On the other hand, the customer repayment culture or attitude is not well tested by the respondents.

The practice of the majority of NEPBs showed that the definition of short term loan, prior to the issuance of the directive, is loans whose maturity period does not exceed two years. As per this research, some banks extended the definition of short term loan even to three years. Because of this variability in definition, a large sum of money which had been considered as short term prior to the directive has now reclassified into medium and long term. Since the NBE defines the tenure of short term loans as one year, Banks are obliged to redefine the tenure of the short, medium and long term loans to comply with the directive. The NBE had set a dead line (i.e January 2015) for all banks to comply fully with the NBE's definition of short term loans (for the disbursements made prior to the issuance of the directive). Moreover, the directive forces every month's total disbursement should comprise at least 40% of short term loans. Owing to this fact the NEPBs employ majorly a strategy of approving each client's request classifying as short and medium.

The interest rate levied on loans tends to increase with the liquidity stress so as to compensate the foregone income due to lack of loanable fund. This makes the loan expensive as it increases the repayment amount of the borrower, reduces the profit of the borrower.

New entrant private Banks tends to squeeze branch expansion to reduce expense and boast income. Yet, this will have a chain effect on mobilizing deposit and further aggravate the liquidity stress. The strategies suggested by the researcher like boosting the income through availing import letter of credit facilities with small margin partly supported by the respondents while majority of the respondents were neutral with the strategy of aggressively availing guarantee facilities with or without collateral.

The NEPB's didn't want to pass the burden of the NBE bill purchase directive to their customers in any form i.e. through increasing the lending rate, commission rate and service charges. Instead of the former stated options, the Banks are trying to look for other income generating activities which needs the Bank's further research.

The borrower/applicant choosing criterion during liquidity stress time lies mainly on the cross selling benefit (the local or foreign currency mobilization) that the bank expect from availing the credit facility to the applicant followed by the economic sector the applicant is engaged in. Though the NEPBs couldn’t neglect past credit relationship and cash flow of the borrower in the process of selection; the influencing level of this factors becomes minimal in choosing customers. This practice is contrary to the prudent lending practice of banks. However, Banks are forced to do so in order to mobilize deposit to safeguard the interest of the Bank.

Meeting the set limit of short vs medium term loan is a challenging exercise by the NEPB’s. Apart from unwillingness of customers to take short term loans fearing the repayment burden, the set limit on revolving facilities (that states the share of revolving facilities shall not exceed 10% of the total outstanding balance at any one time) further contribute to the challenges. If this limitation was not levied, availing revolving facilities such as pre-shipment export credit, advance against sales contract, advance against L/C, advance against export bill, advance on import bills and merchandise facilities, would support the Bank’s effort to meet the short term loan concentration minimum threshold.

During liquidity crunch, the NEPBs cease loan processing or process the loans, at times, and await the liquidity improvement for approval. In both cases, Banks experience longer queue and customers become dissatisfied as they couldn’t get the credit at all and/or they didn’t get the credit on time. This would have an impact in overall performance of the Bank.

The positive impact of the NBE bill purchase directive on Ethiopian Economy was partly recognized by the respondents. Those who doubt its positive impact suggested a reduced percentage than the flat 27% bill allotment calculated on disbursement of loans and increase the interest rate paid for the bill at least to the saving interest rate for win-win situation of the policy towards the Bank and the intended purpose. In addition to this, the majority of the respondents thought that the NBE bill purchase directive will not be a cause for systemic risk. However, those who responded the directive will cause systemic risk, fearing that as the more and more amount of deposit will go to purchase of NBE bill, the business will face finance starvation.

CHAPTER FIVE

CONCLUSIONS, LIMITATION AND RECOMMENDATIONS

In this chapter, the thesis is reviewed, the conclusions are drawn based on the major findings, and limitation of the study is presented followed by the recommendation of the researcher.

5.1 CONCLUSION

It is firmly believed that all Banks whether new entrant or older in the industry should play a significant role in the Country's economic growth through financing, as access to finance is an engine of growth. The National Bank of Ethiopia, in order to promote the economic growth of the country had issued a directive on bills market which demands each commercial Banks to purchase NBE bill equivalent to 27% of their disbursement made commencing from July 2011. On top of this, the NBE made an amendment on its directive which sets minimum threshold of short term loan to be 40% out of the total loans and advances of Banks. Moreover, the directive limits the tenure period of short term loans not to exceed one year.

The main objective of this study was to examine the impact of the NBE- bill purchase directive on credit performance of Banks. The specific objectives were assessing and determine the implication of the NBE-bill purchase directive on the liquidity position, Asset liability matching position of the New Entrant Banks, maturity and sector credit portfolio mix, and the effect on credit decision of new entrant banks.

In general, the NBE bill directive has an impact on credit performance of the New Entrant Private Banks. The findings assure that;

- The NBE- bill purchase directive affects the liquidity position of the NEPB as NBE bill shows steady growth whereas slow pace in deposit growth on the other side. As a result the Banks entered in stiff competition for deposit mobilization or loanable fund whereby the Banks are forced to involve more in fixed time deposit mobilization.

- The implementation of the amended NBE- bill purchase directive has the effect of increasing the Bank's short term portion. This implies increasing the frequency of disbursement which in effect raises the frequency and amount of resource flow towards bill purchase.

- The NBE bill purchase directive can be a cause asset liability mismatch as the ‘source’ of the fund which is deposit has short term maturity whereas the ‘use’ of the fund which is bill purchase has a longer maturity with a small interest rate.

- The NEPB’s are unable to satisfy the credit demand of their customers mainly due to shortfall of liquidity. The Banks cease loan processing while facing liquidity problem. This will slow down the business, decrease return and profitability of the business, thereby tax payment to the government.

- The credit plan of the NEPB’s is reviewed as per the set tenor portfolio i.e. short vs medium term loan and revolving funds. However, the banks are facing challenges to comply with the credit plan because customers are reluctant to take short term loans fearing the burden of repayment.

- The New entrant Banks are setting repayment period of loans of all customers by classifying as short term loan and long term loan in almost all loan cases. However, some economic sectors and businesses could not shoulder this burden. Though, clients accept the bank’s credit decision, they may face liquidity problem as they made repayments to the loan account.

- In contrary to prudent credit practice, Banks are majorly selecting their customers based on the cross selling benefit that the Banks can get for example local deposit or foreign currency. This is due to the fact that the loanable fund is not sufficient for all. On top of that, the Banks look for foreign currency generating activities like export, as allocating the foreign currency generation boosts their income.

- The NEPBs cease loan processing or process the loans at times and await the liquidity improvement for approval which resulted in customer dissatisfaction.

- The finding of the study assures that the export sector is the 1st priority for the NEPBs. On the contrary those sectors like Agriculture, manufacturing and building and construction get the lessor attention since the cash flow behavior of these businesses goes in line with medium term or long term loans.

5.2 LIMITATION

A major limitation of the study was the unwillingness of some management members to disclose the problem related with the implementation of the directive because it considered such disclosure will entail unforeseen consequence as the issue is a government issue. In addition the other challenge in conducting this research was lack of reference materials and previous researches on the area of the topic.

5.3 RECOMMENDATION

In view of the findings and the subsequent conclusions, the following recommendations are forwarded hoping that they would help to curb and address the major problems identified in the study.

As it is described in previous sections, the need of the Banks participation in the country's development is not in question, however, a win-win policy direction could be designed where these banks play a paramount role while at the same time keeping healthy liquidity position, satisfying customer's credit demand and maintaining profitability. Hence, based on the foregoing findings, the following recommendations are forwarded.

1) **Revision of the directive taking into account the following parameters**

ℵ **Extension of Maturity period of short term loans**

The current short term maturity definition set by the NBE is one year on the contrary to common practice of most Banks which was two years. While the banks were financing short term loans for two years, they didn't encounter asset liability mismatch. However, the new short term loan maturity definition will accelerate the pace in which the mobilized fund will be allocated for purchase of NBE- bill purchase which would contribute for asset-liability mismatch. In addition to this, as it is mentioned in previous sections, customers are reluctant to take short term loans as they fear the cash flow of their business could not justify the repayment of the loan within one year. Therefore, the maturity period of short term loan proposed hereby to be extended up-to two years.

ℵ **Lifting the bill purchase ratio for some sectors**

The main purpose of the issuance of the directive was participating banks in the financing of priority sector projects which is believed to bring sustainable economic development.

Therefore, it will be a win-win situation if the bill purchase on loans availed to export, manufacturing and Agriculture sectors are excluded. This can further encourage the Banks to directly involve in government priority areas.

ℵ **Increasing the share of revolving facilities**

As per the directive, the share of revolving facilities is limited not to exceed 10% of the total loan portfolio. However, the revolving facilities are directed mainly for one of the government priority sector - export. Limiting this facility will in turn adversely affect the export sector in particular and the foreign currency generating capacity of the country in general.

This limitation particularly affects the NEPB's as the Bank's total loan portfolio is at grass-root level. In addition to this, as revolving facilities have a short-term nature; it could support the bank's effort towards fulfilling the minimum short term loan concentration threshold.

ℵ **Revising Interest rates on bills**

The NBE bill rate, which is fixed at a constant interest rate of 3% is lower than the cost incurred for fund mobilization. On top of that, as long as this directive is in place, banks will collect their short maturing loans (which would bring minimum interest income of 8.5% per annum) and allocate 27% of the collection to buy NBE bills (the bill that fetch only 3% per annum for five years). Even though, the banks could cover the bill purchase 100% from demand deposit, the question lays whether the demand deposit is an excess/idle fund that the NEPB's does not need for financing. In this connection, it is clear the interest income the Bank's forego that would have been generated had they lend the money. Therefore, I suggest the NBE to further study and revise upward the interest.

2) The New Entrant Private Banks should make extra effort to increase collection of the paid up capital in order to invest on and/or further strengthen different outlet channels like ATM, Mobile banking and agency banking as the channels support the fund/deposit mobilization effort. In doing so, the banks will increase the available loanable fund which somehow neutralize the liquidity constrained resulted from the bill purchase and boost the loan performance.

3) The New Entrant Private Banks should see international practices and develop new products and services to increase the rate at which saving and demand/current deposit increases.

4) The Asset Liability Committee of the Banks should properly and regularly see the Banks liquidity position to avoid any unforeseen liquidity crunch.

5) The Bank’s credit process should base the cash-flow of the applicant’s business as majors like forcing customers to take loan that should be repaid with-in one year will affect customer’s repayment capacity which in turn deteriorates the quality of the loans. Even though, short maturing loans are safe loans to the Bank, setting the repayment ignoring the facts on the ground like the cash flow cycle and the nature of the business is against prudent lending practice. Therefore, to support the sustainable operation of the applicant’s business there should have been given the right loan maturity period in such a way that the periodic repayment will not disturb their normal cash flow.

6) The Research and development section of each bank should make a depth study on the impact and present the result to the top management of Banks which enable them to have full insight of the case. Though the Ethiopian Bankers association presented the impact of the bill purchase to NBE, the new entrant private commercial Banks should form a consortium and present their specific case to NBE as the bill purchase directive does not exclude those small banks entered the banking industry recently as the impact vary depending on the capital and Asset size of each Bank.

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