ST. MARY'S UNIVERSTY

SCHOOL OF GRADUATE STUDIES

FINANCIAL PERFORMANCE EVALUATION- A CASE OF AWASH INERNATIONAL BANK SHARE COMPANY

IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF ACCOUNTING & FINANCE (MBA)

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(FINANCIAL PERFORMANCE EVALUATION- A CASE OF AWASH INTERNATIONAL BANK SHARE COMPANY)

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DECLARATION

I, hereby, declare that this research report entitled, **Financial performance evaluation: A case of Awash international Bank of Ethiopia** is my original work and has not been submitted earlier either to this university or elsewhere for an award of any other degree.

Signature _____ **Date** _____

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I confirm that the work in this research report was carried out by the candidate under my supervision.

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Signature _____ **Date** _____

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LIST OF ACRONYMS

AIB	Awash International Bank
AU	Asset Utilization
CDR	Cash Deposit Ratio
DER	Debt to Equity Ratio
DTAR	Debt to Total Assets Ratio
EM	Equity Multiplier
IER	Income to expense Ratio
LAR	Loan to Asset Ratio
LDR	Loan to Deposit Ratio
NIM	Net Interest Margin
OE	Operating Efficiency
PER	Profit Expense Ratio
ROA	Return on Assets
ROD	Return on Deposit
ROE	Return on Equity
NPTL	Non-performing Loans to Total Loans

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ABSTRACT

This study was conducted under the title "Financial performance evaluation: a case study Of Awash International Bank (AIB) S.C.". Its main objective was to compare and examine empirically the performance of the first private commercial bank in Ethiopia, i.e. Awash International Bank (AIB) in comparison with industry average with respect to liquidity profitability; credit risk & solvency and efficiency for the period of 2004-2015.

This study was employing ratios (14 in total) such as Return on Asset (ROA), Return on Equity (ROE), Profit Expense Ratio (PER), Net Interest Margin (NIM), Loan to Deposit ratio (LDR), Cash To Deposit Ratio (CDR) Loan to Assets Ratio (LAR), Debt to Equity Ratio (DER), Debt to Total Asset Ratio (DTAR); Equity Multiplier(EM), Nonperforming Loans to Total Loans, Asset Utilization (AU), Income to Expense ratio (IER) and Operating Efficiency(OE).

From the researcher analysis, AIB to be more profitable than industry average, what we expect when it comes to risk and solvency measures is according to the basic rule of finance "the higher the expected return the higher the risk". Our findings of profitability and risk & solvency perfectly fit in this risk-return profile and allow us to conclude that AIB is more profitable, also more risky, and less solvent than industry average. Analysis of the results of all the risk and solvency measures, Debt Equity Ratio (DER), Debt to Total Assets ratio (DTAR), Equity Multiplier (EM), and Non Performing Loans to Total Loan Ratio (NPTL) indicates AIB to be more risky and less solvent than industry average.

Like in profitability, and risk & solvency measures, AIB is found to be more efficient in terms of generating income or Income Expense Ratio (IER) and managing their expenses or Operating Efficiency (OE) as compared to industry average. In contrast, AIB is more efficient in terms of utilization of their assets or Asset Utilization (AU) ratio. This gives us some insight regarding AIB's improvement in generating income, utilization of assets, and effective management in controlling expenses.

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CHAPTER ONE

INTRODUCTION

This chapter covers the background of the study, statement of problem, basic research questions, and justification of the study, objectives of the study, significance of the study, scope of the study, limitation of the study, and organization of the study

1.1 Background of the Study

The banking sector is an indispensable financial service sector supporting development plans through channeling funds for productive purpose, intimidating flow of funds from surplus to deficit units and supporting financial and economic policies of government (Sandep and Parul, 2012). The financial performance of banks has critical implication for economic growth of the any countries. Good financial performance rewards the shareholders for investment. This in turn, encourages additional investment and brings about economic growth. On the other hand, poor banking performance can lead to banking failure and crises which have negative repercussion on economic growth (Ilhomovich, 2009).

The importance of bank financial performance can be applied at a micro and macro levels of the economy. At the micro level, profit and strengthen financial performance is essential prerequisite of a competitive banking institution and the cheapest source of funds, the basic aim of a bank's management is to achieve good financial performance. At a macro level, a profitable banking sector is better able to withstand negative shocks and contribute to the stability of the financial system. The importance of bank financial performance at both the micro and macro levels has made researchers, academics, bank managements and bank regulatory authorities to develop considerable interest on the factors that determine bank financial performance (Aburime, 2008).

Various groups of individuals are particularly interested in evaluating bank performance. First and foremost, bank shareholders are directly affected by bank performance. Investors take advantage of bank information to develop expectations concerning future performance that can be used to help price common shares (in addition to capital notes and debentures that may be issued by the bank).

Second, bank management traditionally is evaluated on the basis of how well the bank performs relative to previous years and compared with similar (or peer group) banks. Hence, employee's salaries and promotions are frequently tied to the performance of the bank. Bankers also need to be informed about the condition of other banks with which they have business dealings.

Third, regulators, concerned about the safety and soundness of the banking system and the preservation of public confidence, monitor banks using on site examinations and computer based "early warning systems" to keep track of bank performance. Fourth, depositors may also be interested in evaluating the performance of the bank, as the nominal values of their deposits are not guaranteed. Fifth, and last the business community and general public should be concerned about their banks' performance to the extent that their access to credit and other financial services is linked to the success or failure of their bank (Benton and James, 2005).

Thus, the performance of banks has been an issue of major interest for various stakeholders such as depositors, regulators, customers, and investors. Financial statements for banks present a different analytical problem than manufacturing and other service companies. As a result, analysis of the bank's financial statements requires a distinct approach that recognizes the bank's somewhat unique functions and risks

An evaluation system requires specific measurable outcomes so the analyst can determine the progress of established objectives and goals. These outcomes are known as performance indicators, and they play a significant role in the monitoring process. Business owners and managers can use performance indicators to evaluate the progress of policies and projects in regard to their intended objectives and goals.

We can use various indicators to evaluate your company's performance. The various levels for evaluating a system or a business are inputs, outputs, process and outcomes. Inputs define the invested resources in the particular activities of a business while outputs are the direct results obtained.

Process identifies the planning activities and policies that review the strategies and objectives. Lastly, outcomes are the ultimate results from the activities arising from your business strategies

and objectives. Careful selection of performance indicators is necessary to identify problems and reflect goals accurately because incomplete or inappropriate indicators can lead to wrong decisions.

Performance indicators need careful selection, and they should possess certain key features for better monitoring and evaluation. They should indicate clarity with unambiguous and precise features that are relevant to your business. An inadequate amount of performance indicators can lead to misdiagnosed problems. Therefore, they should be adequate enough to access performance appropriately. An important feature for performance indicators is that they are economical and available at reasonable costs. The main purpose of performance indicators is to monitor the progress of a business; therefore, it is important to ensure that independent verification and monitoring is possible. To select the best performance indicator for evaluation systems, it is necessary to assess each possible indicator and then narrow down the list. Evaluation of business performance can include financial indicators that provide a concise and organized way of presenting financial statements into meaningful information.

The financial indicators divide theoretically into activity, liquidity, solvency, profitability and valuation ratios. Activity indicators measure the performance and efficiency of a company for their daily tasks. Liquidity and solvency measure ability of a company to meet its short-term and long-term obligations, respectively. Profitability identifies utilization of resources with profitable sales while valuation indicates the quantity of flow of earnings or an asset.

In practice, performance analysis requires collaboration and iterative refining to select useful and appropriate performance indicators. Result statements need clarification that lead to the start of good performance indicators. Also, identify the specific targets precisely and study the strategies for bringing a change directly. For example, small businesses directly aim to increase employment. A desired outcome may have many possible indicators and selection of useful ones is possible by developing a list of possible indicators.

Financial performance analysis trough the traditional method of financial indices based on balance sheet, and income statement analysis is an important theme and it is widely used to summarize the information in a company's financial statements in assessing its financial health. Banking is one of the most highly liquid industries; investors have some level of assurance in the soundness of the

banking system. As a result, investors can focus most of their efforts on how a bank will perform in different economic environments. Hence, to evaluate banks' performance, we can use different methods.

These methods can be classified in three ways: The traditional method of financial indices based on balance sheet and income statement analysis, parametric methods based on the knowledge of production function and non-parametric methods that do not require production function (Wozniewska, 2008).

Few studies have been made as related to financial performance evaluation of banks in comparison with the government and private banks, insurance, and other financial institutions. However, such analysis in the case of Awash International bank still remains unexplored. The researcher has tried to fill this gap by extending the issue to the specific context of the company.

Ethiopia one of the oldest civilizations in Africa and the economy has been state controlled through a series of industrial development plans since the Imperial Government of Haile Selassie. It was managed as a Soviet-style centrally planned economy under a socialist government from 1976-1991 and the post-1991 government led a transition to a more market-based system, and subsequent governments have introduced further reforms. However, after the change of the government different reforms including in the financial sector were undertaken which enabled the banks to set lending interest rate by their own and allows the country man to participate in the banking sector.

Banking sector in Ethiopia, according to (Admassu , Bezabeh , Asayehgn and Desta (2014) found that undeveloped and delicate. They furthermore stated that the sector is very limited, relatively weak, closed and characterized by a large share of state ownership. For them, the repressive policies imposed by the government are negatively affecting the performance of money and foreign exchange markets and weaken private commercial banks.

Controlling interest rates on deposits and the loan policies are also other impinging factors for the development of the sector. In due course of this study, the results reveal that the extent of financial repression has negatively affects savings, capital formation and financial development.

In undertaking this task the Ethiopian government adopted a strategy of (a) gradualism: gradual opening up of private banks and insurance companies alongside public ones, gradual liberalization of

the foreign exchange market, and (b) strengthening domestic competitive capacity before full liberalization (that is, restricting the sector to domestic investors, strengthening the regulatory and supervision capacity of the NBE, giving the banks autonomy, and opening up the interbank money market).

In line with this strategy various proclamations and regulations have been passed since 1992.Currently, seventeen commercial banks and two Governments owned specialized banks are operating in Ethiopia as compared to one government owned commercial bank and two specialized banks before the reform measures took place. Therefore, the aim of this study is to evaluate financial performance of Awash international bank S/C. (http://en.wikipedia.org/wiki/Bank).

.2/ Statement of the problem

Financial performance evaluation of companies is essential to provide information about company's operating performance and its net worth. Knowing organization's competitiveness and potentials of the business through financial statement analysis is useful for decision making for users of financial statement information, including managers, creditors, stockholders, potential investors, and regulatory agencies. With the objective of mobilizing resources and enhancing investments, financial institutions have irreplaceable roles in economic development of a country. Being one and may be the major category of financial institutions, banks have a very determinant role in the healthy functioning of the economy.

Moreover, financial performance of a company indicates economic interests of the company's management and reliability to challenge present or future obligations. Therefore, financial performance analysis and identification of their weaknesses and strengths using financial performance indicators has its contribution to the stakeholder in general. In a competitive financial market, bank performance provides signal to depositors and investors whether to withdraw or invest funds respectively from the bank. Similarly, it indicates direction to bank managers whether to improve its deposit service or loan service or both. Regulators are also interested in the financial health of banks for regulation purposes.

Good financial performance rewards the shareholders for their investment. This in turn, gives confidence for additional investment and brings about economic growth. On the other hand, poor bank performance may lead to banking failure and crisis which have negative consequence on the

economic growth (Okoth et al. 2013). Therefore, financial analysis which measure financial performance is then performed on these statements to provide management with a more detailed understanding of the facts. Furthermore, the rationale of financial analysis is to diagnose the information contained in financial statement so as to judge the future earnings, to be competitive in financial industry, ability to settle Current obligations, profitability of the business, effective and efficient asset utilization and financial trend of various elements of the financial statement.

Awash International Bank S.C. was established in November 1994 as the 1st Private commercial bank in Ethiopia after deregulation. It started operation in February 1995. Bank's business has expanded over the years. Although few studies have been made as related to financial performance evaluation of banks, such as performance comparison between the government and private banks, insurance, and other financial institutions such analysis in the case of Awash International bank still remains unexplored. The researcher has tried to fill this gap by extending the issue to the specific context of the company.

Therefore, the aim of this study is to evaluate and compare financial performance of Awash International bank against the industry average, to provide some comments by observing several financial ratios, analyzing elements of financial statement of AIB past ten years performance results, and to improve its banking business. Hence, this became the basis of the study.

1.3 Research Questions

The following questions were answered by the researcher in the study:

1. Does the profitability of AIB bank strong enough to exist in the financial industry?
2. What is the company's financial position to meet its current obligation?
3. To what extent the bank finance its debt and able to raise funds for future expansion?
4. How is the company utilizing its assets?

1.5. Objectives of the Study

1.5.1. General Objective

The overall objective of the study is to examine and compare the financial performance of Awash international bank S/C against the industry average.

1.5.2. Specific Objectives

The study also had the following specific objectives:

* The bank's ability to finance its debt and able to raise funds for future expansion?

* To examine and compare the overall profitability of the AIB to exist in the sector.

* To evaluate current financial position to meet its current obligation.

* To evaluate the company is utilizing it assets against the industry average.

1.6. Significance of the Study

The study is expected to have importance to internal as well as external users and having Practical significance to fill in current gaps specified by the problem in order to tackle and solves those problems at hand. Moreover, the following are the expected significances:

1) To motivate other researchers to carry out more extensive studies in this particular area.

2) It provides some insight and guidelines for the evaluation process of banking industry.

3) The results to be found from the analysis and evaluation of the Bank's past financial performance which give the bank the information as to what to expect in the future.

4) The study will be a reference material for both academicians and practitioners for further research Conducting on these topics and related issues.

1.7 Scope and limitation of the Study

There are numerous approaches to measure the performance of a bank. Calculation of average cost and presenting it through curvature is one of the means to judge the efficiency of

commercial bank. Such curvature will demonstrate a relationship between bank size and unit of production. The other most widely used methods are data envelopment analysis and the Stochastic Frontier Approach.

Due to lack of compiled data, either of the above approaches has not been used. Rather, the researcher examines and compares the financial performance of Awash international bank S/C against the industry average. The study was covered only the recent ten years (2004/05 to 2013/14) of audited annual financial statements of Awash international bank S/C using different types of financial ratios against industry average. In addition, independent valuation of attributes such as politics, economic cycle, inflation that could affect the financial performance of the company was not considered.

1.8 Organization of the paper

The paper was organized in to five chapters. Chapter one deal mainly with the introduction to the paper. Under this section, background of the study, statement of the problem, research questions, and justification of the study, objectives of the study, significance of the study, scope and limitations of the study were presented. In the next part, under chapter two, intensive literature review was made. Under chapter three, research issues regarding research design and sampling techniques, type of data and tools/instruments were discussed. In chapter four data presentation, analysis, and interpretations were made. In the last section, chapter five, findings were summarized, conclusions were drawn and recommendations were forwarded.

CHAPTER TWO

REVIEW OF THE RELATED LITRATURE

This chapter is composed of two major parts: the theoretical framework and empirical studies. The theoretical framework part presents financial statements overview, Financial Statements of banks, reason to evaluate performance, Financial Statement Analysis, purpose and uses of Financial Statement Analysis, types and Tools for Financial Analysis used in the financial performance evaluation of banks. The empirical studies part presents various related researches and their results.

2.1. Theoretical Framework

Banking and financial system soundness has become more essential in all countries over the recent years. The financial sector, and especially the banking system, is vulnerable to systemic crises which has led to the creation of costly safety nets, as depositor insurance schemes with well-known moral hazard problem. It is argued that there is increasing evidence that banks are "black boxes" due to the week transparency and banks' unwillingness to disclose information (Neely et al, 1997).

2.1.1. Financial Statements overview

Financial statements are the principal means through which a company communicates its financial information to those outside it. These statements provide a company's history quantified in money terms. The financial statements most frequently provided are: the balance sheet, the income statement, the statement of cash flows, and the statement of owners' or stockholder's equity. Notes, disclosures are an integral part of each financial statement (Donald et al, 2007).

The financial statements are prepared by the board of directors for reporting to shareholders in discharge of their stewardship function and hence corporate law enjoins upon them the responsibility of laying down them before annual general meeting of the shareholders so as to give a 'true and fair view' of the affairs of the company. The profit and loss account shall be annexed to the balance sheet and auditor's report (including the auditor's separate, special, or supplementary report, if any) shall be attached thereto (Bernstein & Wild, 2000).

A firm communicates financial information to the users through financial statements and reports. Financial statements contain summarized information of the firm's financial affairs and results organized systematically. They are the means to present the firm's financial situation to the users. Preparation of the financial statements is the responsibility of the top management. As these statements are used by investors and financial analysts to examine the firm's performance in order to make investment decisions, they should be prepared very carefully and must contain as much information as possible. The basis for financial planning, analysis and decision making is the financial information. Financial information is needed to predict, compare and evaluate the firms' earning ability. It is also required in aid for economic decision making. The financial information of any financial institution is contained in the financial statement or accounting reports.

2.1.2. Financial Statement of Banks

Financial data on commercial banks are presented in two basic documents: the report of Condition (the balance sheet) and the Report of Income (the income statement) . Benton and James(2005). The balance sheet of a bank is sometimes termed as the report of condition. There are some significant differences between the traditional balance sheet prepared by business firms and that of a bank. First, the accounts of banks may see opposites of other type of firms. Checking accounts or demand deposits are liabilities to a bank as it owns the customers money in these accounts. Similarly, loans to customers are assets for the bank. Furthermore, the balance sheet accounts of the bank do not have to be subdivided in to current and non-current accounts.

The income statement for banks is sometimes termed as the report of income or, the report of income and dividends. The principal revenue sources for the bank are usually interest income for loans, deposits and investment securities. The principal expenses are usually interest expense on deposits and other debts. Bank income statements include a separate section of other income. Typically, other income includes trust department fees, Service charges on deposit accounts and securities transactions. Expenses other than interest expense include the provision for loan losses, salaries, employee benefits, and occupancy costs (Belachew, 2007). .

The statement of cash flows provides information about a company's operating, investing, and financing activities. The cash flow statement provides insight in to how effective the management team is at utilizing available revenues and the firm's ability to generate cash flows in the future.

It provides a picture of where the cash comes from and where it goes. Cash flow statement is prepared to project the manner in which the cash has been received and has been utilized during an accounting year as it shows the sources of cash receipts and also the purposes for which payments are made. Thus, it summarizes the causes for the changes in cash position of a business enterprise between dates of two balance sheets.

The most familiar financial statements of banks are described as follows:

A) Balance sheet

The balance sheet highlight the financial condition of a company and it is an integral part of the financial statement. The balance sheet, also presents an entity's economic resources and claims to or interests in those resources .The balance sheet, also known as the statement of financial position, tells us how much it owes (its liabilities).The difference between what it owns and its equity is commonly called 'net asset' or 'shareholders equity'. A bank's balance sheet presents the institution's financial condition at a single point in time. Balance sheets are prepared on a particular date- usually the last day of a month, year or quarter .Because balance sheets capture a condition at one point in time, it is useful to compare data for several accounting periods. In this way, trends in the bank's financial condition over time can be assessed. The balance sheet, by reporting available resources and the amounts and timing of claims on those resources, provides information useful for assessing a company's financial flexibility. Financial flexibility is a measure of a company's adaptability (Lanny et al, 1998).

Assets

Cash assets include vault cash, deposits at the Federal Reserve (primarily to meet legal reserve requirements), deposits at other banks (for clearing purposes and also to compensate the other banks for providing currency and coin services), and cash items in the process of collection. All of these four categories of assets have one common feature - namely they earn no interest. As such, bank management should attempt to minimize its investment these assets.

Interest – bearing bank balances, such as short term certificates of deposit at other banks and federal funds sold are highly liquid earning assets. They are generally used as part of the bank's liquidity management program.

The next major category of bank assets is investment securities. Since banks are generally prohibited from owning equity securities (except in their securities affiliates), the securities that appear on bank balance sheets are almost entirely debts. Regulations force banks to be lender rather than investors. Loans, the least liquid of banking assets and the major source of risk, are the largest asset category for most banking institutions as well as the primary source of bank earnings.

Loans and lease are classified into the following categories.

• Loans secured by real estate

• Commercial and industrial loans, including loans to depository institutions

• Loans to individuals for household, family, and other personal expeditions

• Loan to finance agricultural production

• All other loans and lease-financing receivables

Liabilities

Bank liabilities consist primarily of the various types of deposit accounts that the institution uses to fund its lending and investing activities. Depository accounts vary in terms of interest payments, maturity, check-writing privileges, and insurability. Demand deposits are transaction accounts that are payable to the depositor on demand and pay no interest. Now accounts represent the total of all transaction accounts less demand deposits. They are accounts that pay interest and permit check writing but do not include money market deposit accounts. Money market deposit accounts (MMDAS) are savings accounts on which the bank pays market interest and check writing is limited to a certain number of checks per month. The other savings deposits category comprises all savings deposits other than money market deposit accounts and includes regular passbook accounts with no set maturity and overdraft protection plan accounts.

Capital

Subordinated notes and debentures are actually liabilities but are shown in the capital section because this type of debt has the characteristics of capital in terms of maturity and permanence and can be counted as capital in meeting certain regulatory requirements.

"All common and preferred equity" capital is the par value of all common and preferred stock outstanding, surplus or additional paid-in capital (the amount by which the original sale of the stock exceeded par value), undivided profits or retained earnings (all of the institution's earnings since its inception less any dividends paid), and capital reserves (a cushion used to absorb unexpected losses on loans and securities).

(A) Income statement

It is also called the profit and loss account. The earning capacity and potential of the firm are reflected by the income statement. The generally accepted convention requires showing one year events in the income statement, but interim income statement may be prepared monthly, quarterly or semiannually for different purposes. The income statement or the profit and loss account presents the summary of revenues, expenses and net income (or, net loss) of a firm for a given period of time. The income statement, which shows all major categories of revenue and expenditures, the net profit or lose for the period, and the amount of cash dividends declared, measures a firm's financial performance over a period of time, such as a year, quarter or month. The income statement and the balance sheet are integrally related and both should be evaluated when assessing bank performance. (Yaregal, 2007).

Revenue- revenues are periodic inflow of assets or settlement of liabilities, or both, as a result of the delivery or production of goods, the rendering of services, or other earnings activities that constitute an entity's major or primary operations.

Interest Income loans are the largest asset category for most bank balance sheets, and interest and fees on loans are the primary sources of bank income. This category of revenue, which includes all year-to-date interest and fees on loans, is presented first on the income statement. Income from lease financing is year-to-date income derived from lease financing receivables.

The analyst must realize that income reported on loans and leases are accrued, meaning that it is recognized over the appropriate time period of the loan rather than when cash is actually received. A bank can recognize this income for at least ninety days before the loan goes on non-accrual status.

The income reported is divided into full taxable and tax-exempt portions. The tax-exempt amount includes year-to-date income on loan obligations of state and political subdivisions, and tax-exempt income from direct lease financing. The fully taxable amount is total interest and fees on loans and income from lease-financing receivables less tax-exempt income. The estimated tax benefit results from having tax-exempt loan and lease-financing income from municipal loans and leases. It is estimated and added to income in order to improve the comparability of interest income among different banks over several times.

Net interest income: Net interest income on a tax-equivalent basis is total interest income less total interest expense. The relationship between net interest income – the amount by which interest received exceeds interest paid and total assets is an important analytical tool in assessing a bank's ability to generate profits through the management of interest earning assets and interest bearing liabilities.

Non-interest Income: Non-interest income includes all other sources of income from fiduciary activities, service charges on deposits, gains or losses and commissions and fees on assets held in trading account, foreign exchange trading gains or losses , loan and security guarantees, derivative securities services and other off-balance sheet activities. These categories of income have increased in relative importance for many banks as a result of deregulation's impact on the permissible financial services.

Expense- expenses are the periodic use of assets or the incurring of liabilities, or both, as a result of the delivery or production of goods, the rendering of services, or other earnings activities that constitute an entity's major or primary operations.

Interest Expense: Interest expense is the largest expense for most banks. Interest expense is allocated into six categories:

a. Interest paid on time deposits of $100,000 or more;

b. Interest on other deposits;

c. Interest expense on federal funds purchased and securities sold under agreements to repurchase;

d. Interest on note balances issued to the government treasury and on other borrowed money;

e. Interest on mortgage debt and capital leases on bank premises, fixed assets and other real estate owned; and

f. Interest on subordinated notes and debentures

Other Expense: Three other types of expenses are deducted from adjusted operating income to arrive at pretax operating income. Overhead expense includes salaries and employee benefits, expenses of premises and fixed assets (net of rental income) and other noninterest operating expenses. The provision for loan and lease losses is the year to date amount allocated to loan and lease loss reserves (on the balance sheet). Remember that unexpected losses are charged against the balance sheet reserves account.

Gains or losses on the sale, exchange, redemption or retirement of securities other than those held in trading accounts are netted against pretax operating income to determine pretax operating income on a tax-equivalent basis. Security gains and losses can be an important element in measuring bank performance. The analyst should be aware that a bank can influence operating profit for a period through these securities transactions.

Income tax Expense: Income tax in includes the total estimated federal, state, local, and foreign (if applicable) income taxes on operating income (including securities gains and losses).

Net income (loss) - net income (loss) refers to the periodic change in equity (that is, the change in net assets) of an entity as a result of transactions and other economic events that result in revenues, expenses, gains and losses.

Cash flow statement

The primary purpose of the statement of cash flows is to provide information regarding a company's cash inflows and out flows during an accounting period. The statement of cash flows provides information that, together with information on the other financial statements, should help users to assess a company's ability to generate positive future net cash flows, assess a company's ability to meet its obligations and its need for external financing and to pay dividends, understand

the difference between a company's net income and its net cash flow, and determine the effects on a company's financial position of its investing and financing transactions during the period . (Lanny et al, 1998).

2.1.3. Why do we evaluate performance?

Planning is a key to the success of financial managers. Financial plans may take many forms, but any good plan must be related to the firms existing strengths and weaknesses. The strengths must be understood if they are to be used to proper advantage, and the weaknesses must be recognized if corrective action is to be taken. Identifying strengths and weaknesses requires evaluating past performance. The first step in analyzing financial statements is to carefully read the statements and their accompanying notes (Yaregal, 2007).

2.1.4 What is financial statement analysis?

Financial statement analysis involves comparing the firm's performance with that of other firms in the same industry, and evaluating trends in the firm's financial position over time. This analysis helps managers identify deficiencies and then take actions to improve performance (Eugene & Michael, 2008).

The process of critical evaluation of the financial information contained in the financial statements in order to understand and make decisions regarding the operations of the firm is called 'Financial Statement Analysis'. The term "Financial Analysis," also known as analysis and interpretation of financial statements refer to the process of determining financial strength and weaknesses of the firm by establishing strategic relationship between the items of the balance sheet, income statement and other operative data.

According to Eugene and Michael, decision makers must be able to see important relationship among figures and make comparisons from year to year and from company to company. Much research indicates that accounting statements provide important information about the value of the firm. Financial analysts and managers learn how to rearrange financial statements to squeeze out the maximum amount of information (Jeffrey et al, 2002).It is their relationship to other numbers or their changes form one period to another that is important.

The tools of financial analysis are intended to show relationships and changes. Among the widely used of these financial techniques are horizontal analysis, trend analysis, vertical analysis, ration analysis, In using financial statement analysis, decision makers must judge whether the relationship they have found are favorable or unfavorable.

2.1.5 Purpose and uses of financial Statement analysis

The purpose and uses of financial statement analysis should be seen from two points of views, internal and external.

Internal uses- From management's point of view, financial statement analysis is useful both to help anticipate future conditions and, more important, as a starting point for planning actions that will improve the firms future performance also, firms with multiple divisions frequently compare the performance of those divisions using financial statement information. Another important internal use is that historical financial statement information and the analysis of this information is very useful for generating projections about the future. (Eugene & Michael, 2008)

External uses- Financial statements are useful to parties outside the firm, including short term and long term creditors and potential investors. For example, we could find such information quite useful in deciding whether or not to grant credit to a new customer, suppliers could also evaluate financial statements before extending credit to their customers. Credit analysis, including bank loan officers and bond rating analysts, who analyze financial statements to help ascertain a company's ability to pay its debt, and stock analysts, who are interested in a company efficiency, risk, and growth prospects. Investors also use financial statement analysis to predict the future (Eugene & Michael, 2008).

In addition, financial statements could also be used to assess the financial position of the government as a whole and several governmental agencies in particular. Moreover, Analysis of financial statements reveals important facts concerning managerial performance and the efficiency of the firm. Broadly speaking, the objectives of the analysis are to apprehend the information contained in financial statements with a view to know the weaknesses and strengths of the firm and to make a forecast about the future prospects of the firm thereby, enabling the analysts to take decisions regarding the operation of, and further investment in, the firm. (Khan, M Y, 2007).

To be more specific, the analysis is undertaken to serve the following objectives:

* To assess the current profitability and operational efficiency of the firm as a whole as well as its different departments so as to judge the financial health of the firm.

* To ascertain the relative importance of different components of the financial position of the firm

* To identify the reasons for change in the profitability/financial position of the firm

* To judge the ability of the firm to repay its debt and assessing the short-term as well as the long- term liquidity position of the firm through the analysis of financial statements of various firms, an economist can judge the extent of concentration of economic power and pitfalls in the financial policies pursued. The analysis also provides the basis for many governmental actions relating to licensing, controls, fixing of prices, ceiling on profits, dividend freeze, tax subsidy and other concessions to the corporate sector.

Types of Analysis

Financial statements can be subjected to two types of analysis. They are:

1) **Trend analysis or dynamic analysis,** which is made by analyzing the financial statements over a period of years. This indicates the trend of such variables, as sales, cost of production (or operation) profits, assets, and liabilities. For this purpose, comparative financial statements are prepared horizontally.

2) **Structural analysis or static analysis,** which is made by analyzing a single set of financial statements as are prepared on a particular date. It is called structural analysis, because the relationship between different accounting variables is studied as, for example, the ratio of net profit to sale s or the ratio of liquid assets to current liabilities.

2.1.6 Tools for Financial Analysis

The end products of the accounting process are balance sheet, income statement, and statement of cash flows. These are supplemented by detailed explanation in the director's Report, annex, and schedules. The information contained in the financial statements are arranged in such a manner that enables analyst to make inferences about the working and financial health of the enterprise.

The numbers given in the financial statements are not of much use to the decision maker. These numbers are to be analyzed over a period of time or in relation to other numbers so that significant conclusions could be drawn regarding the strengths and weaknesses of a business enterprise. The tools of financial analysis help in this regard. A number of methods can be used for the purpose of analysis of financial statements. These are also termed as techniques or tools of financial analysis. Out of these, and enterprise can choose those techniques, which are suitable to its requirements. The principal techniques of financial analysis are (Gitman, 2004):

* Comparative statements
* Common-size statements
* Trend Analysis
* Cash flow analysis and
* Ratio analysis

2.1.7. Comparative Statements

These are the statements showing the profitability and financial position of a firm for different periods in a comparative form to give an idea about the position of two or more periods. It usually applies to the two important financial statements, namely, Balance Sheet and Income Statement prepared in a comparative form.

The financial data will be comparative only when same accounting principles are used in preparing these statements. If this is not the case, the deviation in the use of accounting principles should be mentioned as a footnote. Comparative figures indicate the trend and direction of financial position and operating results. This analysis is also known as 'horizontal analysis.

Advantages

1. These statements indicate trends in sales, cost of production, profits, etc, helping the analyst to evaluate the performance, efficiency, and financial condition of the undertaking. For example, if the sales are increasing coupled with the same or better profit margins, it indicates healthy growth.

2. Comparative statements can also be used to compare the position of the firm with the average performance of the industry or with other firms. Such a comparison facilitates the identification or weaknesses and remedying the situation.

Disadvantages

1. Inter-firm comparison may be misleading if the firms are not of the same age and size, follow different accounting policies in relation to depreciation, valuation of stock, etc, and do not cater to the same market.

2. Inter-period comparison will also be misleading if the period has witnessed frequent changes in accounting policies.

2.1.8 Common-Size Statement

These are the statements, which indicate the relationship of different items of a financial Statement with some common item by expressing each item as a percentage of the common item. The percentage thus calculated can be easily compared with the results corresponding percentages of the previous year or of some other firms, as the numbers are brought to common base. Such statements also allow an analyst to compare the operating and financing characteristics of two companies of different sizes in the same industry. Thus, common-size statements are useful, both, in intra-firm comparisons over different years and in making inter-firm comparisons for the same year or for several years. This analysis is also known as 'Vertical analyses.

2.1.9 Trend Analysis

It is a technique of studying the operational results and financial position over a series of years. Using the previous years' data of a business enterprise, trend analysis can be done to observe the percentage changes over time in the selected data. The trend percentage is the percentage relationship, which each item of different years bear to the same item in the base year. Trend analysis is important because, with its long run view, it may point to basic changes in the nature of the business.

By looking at a trend in a particular ratio, one may find whether the ratio is falling, rising, or remaining relatively constant. From this observation, a problem is detected or the sign of good

management is found. For calculating trend percentages, the base year may be any one of the periods involved in the analysis but the earliest period is mostly taken as the base year. Each item of base year is assumed to be equal to 100 and on that basis, the percentage of item of each year calculated.

2.10 Cash Flow Analysis

It refers to the analysis of actual movement of cash into and out of an organization. The flow of cash into the business is called cash inflow or positive cash flow and the flow of cash out of the firm is called as cash outflow or a negative cash flow. The difference between the inflow and outflow of cash is the net cash flow. Moreover, the cash flow statement provides insight in to how effective the management team is at utilizing available revenues and the firm's ability to generate cash flows in the future. It provides a picture of where the cash comes from and where it goes. Cash flow statement is prepared to project the manner in which the cash has been received and has been utilized during an accounting year as it shows the sources of cash receipts and also the purposes for which payments are made. Thus, it summarizes the causes for the changes in cash position of a business enterprise between dates of two balance sheets. (Fabozzi, et al, 2003)

2.11 Ratio Analysis

Ratio analysis is the tool that was developed to perform quantitative analysis on numbers found on financial statements. Ratios help link the three financial statements together and offer figures that are comparable between companies and across industries and sectors. Financial ratios are useful indicators of a firm's performance and financial situation. This is so because accounting numbers do not explain any phenomenon on their own. However, when a relationship is established between two numbers figuring in the three financial statements, i.e., balance sheet, income statement, and cash flow statement, one can make an assessment regarding the phenomenon. Ratio analysis involves calculation and interpretation of financial numbers by relating them in a logical manner in order to assess the strengths and weaknesses underlying the performance of an enterprise. We calculate ratios because in this way that we get a comparison that may prove more useful. In order to comment on the quality of a ratio one has to make a comparison with some standard or benchmark (Fabozzi, et al, 2003).

These benchmarks could be:

Cross-Sectional Analysis: Involves when comparisons are made with similar ratios for companies within the same industry or to an industry average as of some point in time. Ratios computed for one year provided a rather static picture of the company's situation at that particular point in time in comparison with industry standards. To gain insight into the direction the company is moving, however, a trend analysis should be performed.

Trend Analysis (Time-Series Analysis): indicates a company's performance over time and reveals whether its position is improving or deteriorating relative to other companies in the industry. A trend analysis requires that a number of different ratios be calculated over several years to indicate the direction the company has been taking for the past several years. Each of the different categories of financial ratios may be represented in the figure. The following table provides a demonstration of these types of interpreting rations for the past ten years financial statements. Certainly, the most informative approach to ratio analysis combines both cross sectional and trend analyses. A combined view makes it possible to assess the trend in the behavior of the ratio in relation to the trend for the industry.

The analysis of bank performance concentrates on the following four type's financial ratios:

(a) Profitability ratios;

(b) Liquidity ratios;

(c) Risk and solvency ratios; and

(d) Efficiency ratios

2.11.1Profitability Ratios

Profitability ratios are generally considered to be the basic bank financial ratio in order to evaluate how well bank is performing in terms of profit. For the most part, if a profitability ratio is relatively higher as compared to the competitor(s), industry averages, guidelines, or previous years' same ratios, then it is taken as indicator of better performance of the bank.

In the banking literature, different scholars in measuring bank performance have used many profitability ratios (Iqbal et al, 2005).

The main performance indicators computed for banks are:

A. Return on Assets (ROA)

Return on assets indicates the profitability on the assets of the firm after all expenses and taxes (Van Horne, 2005). It is a common measure of managerial performance (Ross, Westerfield, Jaffe 2005). It measures how much the firm is earning after tax for each dollar invested in the assets of the firm. That is, it measures net earnings per unit of a given asset, moreover, how bank can convert its assets into earnings (Samad & Hassan, 2000).

Generally, a higher ratio means better managerial performance and efficient utilization of the assets of the firm and lower ratio is the indicator of inefficient use of assets. Firms can increase ROA either by increasing profit margins or asset turnover but they can't do it simultaneously because of competition and trade-off between turnover and margin. ROA is calculated as under:

ROA = Net Profit after Tax / Total Asset.

B. Return on Equity (ROE)

Return on equity indicates the profitability to shareholders of the firm after all expenses and taxes (Van Horne 2005). It measures how much the firm is earning after tax for each dollar invested in the firm. In other words, ROE is net earnings per dollar equity capital. (Samad & Hassan, 2000). Also an indicator of measuring managerial efficiency .Ross (1994), By and large, higher ROE means better managerial performance; however, a higher return on equity may be due to debt (financial leverage) or higher return on assets. Financial leverage creates an important difference between ROA and ROE in that financial leverage always magnifies ROE. This will always be the case as long as the ROA (gross) is greater the interest rate on debt (Ross, Westerfiled, Jaffe, 2005).

Usually, there is higher ROE for high growth companies. ROE is calculated as under:

ROE = Net profit after tax / Shareholders' Equity

C. Profit to Expenses Ratio (PER)

It measures the operating profitability of the bank with regards to its total operating expenses. Operating profit is defined as earnings before taxes and operating expenses means total non-interest expenses. The ratio measures the amount of operating profit earned for each dollar of operating expense. The ratio indicates to what extent bank is efficient in controlling its operating expenses. A higher PER means bank is cost efficient and is making higher profits (Samad & Hassan 2000).

PER = Profit before tax/ Operating Expenses

D. Net Interest Margin (NIM)

Net interest income is the difference between interest income and interest expense. It is the gross margin on a bank's lending and investment activities. The higher the ratio the cheaper the funding or the higher the margin the bank is obtaining. A bank's net interest margin is a key performance measure that drives ROA (Peters, Raad & Sinkey, 2004).

NIM= (Interest Income – Interest Expense)/Total Asset

2.11.2 Liquidity Ratios

Liquidity ratio provides information on the banks ability to meet its short-term obligations. Liquidity reflects the ability of a company to meet its short-term obligations using assets that are readily converted into cash. Assets that may be converted into cash in a short period are referred to as liquid assets. These assets are listed in financial statements as current assets. Current assets are often referred to as working capital, since they represent the resources needed for the day-to-day operations of the company's. Current assets are used to satisfy short-term obligations, or current liabilities.

Liquidity ratios provide a measure of the ability of a company to generate cash to meet its immediate cash needs to settle current liability. There are three commonly used liquidity ratios:

Liquidity ratios indicate the ability of the firm to meet recurring financial obligations. Liquidity is important for the firm to avoid defaulting on its financial obligations and, thus, to avoid experiencing financial distress (Ross, Westerfield and Jaffe, 2005).

There are several measures for liquidity

1. **Cash Deposit Ratio (CDR)**

Cash in a bank vault is the most liquid asset of a bank. Therefore, a higher CDR indicates that a bank is relatively more liquid than a bank, which has lower CDR. Depositors' trust to bank, is enhanced when a bank maintains a higher cash deposit ratio. CDR is calculated as under:

CDR = Cash/Deposit.

2. Loan to Deposit Ratio (LDR)

Loan to deposit is the most important ratio to measure the liquidity condition of the bank. Bank with Low LDR is considered to have excessive liquidity, potentially lower profits, and hence less risk as compared to the bank with high LDR. However, high LDR indicates that a bank has taken more financial stress by making excessive loans and shows risk that to meet depositors' claims bank may have to sell some loans at loss. LDR is calculated as under:

LDR= Loan/Deposit

3. Loan to Asset Ratio (LAR)

Like LDR, loan to assets ratio (LAR) is also another important ratio that measures the liquidity condition of the bank. Whereas LDR is a ratio in which liquidity of the bank is measured in terms of its deposits, LAR measures the percentage of assets that are tied up in loans. That is, it gauges the percentage of total assets the bank has invested in loans (or financings). The higher is the ratio the less the liquidity is of the bank. Similar to LDR, the bank with low LAR is also considered to be more liquid as compared to the bank with higher LAR. However, high LAR is an indication of potentially higher profitability and hence more risk. LAR is calculated as under:

LAR = Loan / Asset

2.11.3 Risk and Solvency Ratios

This is a class of ratios, which measures the risk and solvency of the bank. These ratios are also referred to as gearing, debt, or financial leverage ratios. The extent to which a firm relies on debt financing rather equity is related with financial leverage. These ratios determine the probability that the firm default on its debt contacts. The more the debt a firm has the higher is the chance that firm will become unable to fulfill its contractual obligations. In other words, higher levels of debt can lead to higher probability of bankruptcy and financial distress. Although, debt is an important form of financing that provided significant tax advantage, it may create conflict of interest between the creditors and the shareholders (Ross, Wedsterfield, and Jaffe 2005).

If the amount of assets is greater than amount of its all types of liabilities, the bank is considered to be solvent. To gauge risk and solvency of the bank, measures usually used are Debt- Equity Ratio (DER), Debt to Total Assets Ratio (DTAR), and Equity Multiplier (EM).

A bank is solvent when the total value of its asset is greater than its liability. A bank becomes risky if it is insolvent. The following are the commonly used measures for a risk and insolvency.

i. Debt Equity Ratio (DER)

The extent to which firm uses debt. It measures ability of the bank capital to absorb financial shocks. In case, creditors default in paying back their loans or the asset values decrease bank capital provides shield against those loan losses. A bank with lower DER is considered better as compared to the bank with higher DER. DER is calculated as under:

DER = Total Debt / Shareholders' Equity

ii. Debt to Total Asset Ratio (DTAR)

It measures the amount of total debt firm used to finance its total assets. It is an indicator of financial strength of the bank. It provides information about the solvency and the ability of the firm to obtain additional financing for potentially attractive investment opportunities. Higher DTAR means bank has financed most of its assets through debt as compared to the equity financing.

Moreover, higher DTAR indicates that bank is involved in more risky business.

DTAR = Total Debt / Total Assets

iii. Equity Multiplier (EM)

How many times the total assets are of the shareholders' equity is measure by equity multiplier. In other words, it indicates the amount of assets per dollar of shareholders' equity. Higher value of EM means that bank has used more debt to convert into assets with share capital. Generally, the higher is the EM the greater is the risk for a bank. EM is calculated as under:

EM =Total Asset / Total Shareholders' Equity

iv. Non- Performing Loans to Total Loan Ratio (NPTL)

Nonperforming loans, or NPL, are loans that are no longer producing income for the bank that owns them. Loans become nonperforming when borrowers stop making payments and the loans enter default. The exact classification can vary from institution to institution, but a loan is usually considered to be nonperforming after it has been in default for three consecutive months. Banks often report their ratio of nonperforming loans to total loans as a measure of the quality of their outstanding loans. A smaller NPL ratio indicates smaller losses for the bank, while a larger (or increasing) NPL ratio can mean larger losses for the bank as it writes off bad loans. NPTL is calculated as under:

NPTL = Non-performing Loans/Total Loans

2.11.4 EFFICIENCY RATIOS

The presence of inefficiencies is considered an inherent feature of banking. According to Turati (2003:2), "banks are regarded as firms that emerge as a result of some sort of market imperfections; hence they bring about a certain degree of inefficiency with respect to perfect competitive outcome". Banking efficiency is important at both macro and micro levels and in order to allocate resources effectively, banks should be sound and efficient Hussein (2000).

Efficiency in banking can be distinguished between a locative and technical efficiency. A locative efficiency is the extent to which resources are being allocated to the use with the highest expected value. A firm is technically efficient if it produces a given set of outputs using the smallest possible amount of inputs (Falkena et al, 2004).

Outputs could be loans or total balance of deposits, while inputs include labor, capital and other operating costs. According to Falkena et al (2004:38), "the notion of X-inefficiency suggests that comfortable incumbents may not produce in the most efficient method. If a few players dominate the market, they may be sheltered from competitive forces and may use rule-of-thumb rather than best practice methods". These ratios measure how effectively and efficiently the firm is managing and controlling its assets.

These ratios indicate the overall effectiveness of the firm in utilizing its assets to generate sales, quality of receivables and how successful the firm is in its collections, the promptness of payment to suppliers by the firm, effectiveness of the inventory management practices, and efficiency of firm in controlling its expenses. Higher value of these ratios is taken as good indicator, which means firm is doing well. Ratios used to measure efficiency of the bank are Asset Utilization (AU), Income to Expense Ratio (IER), and Operating efficiency (OE) (Hasan, Z. (2005).

(a) Asset Utilization (AU)

How effectively the bank is utilizing all of its assets is measured by assets utilization ratio. The bank is presumably said to using its assets effectively in generating total revenues if the AU ratio is high. If the ratio of AU is low, the bank is not using its assets to their capacity and should either increase total revenues or dispose of some of the assets (Ross, Westerfield, and Jaffe 2005). Total revenue of the bank is defined as net spread before provision plus all other income.

AU is calculated as under:

AU = Total Revenue/Total Asset

(b) Income Expense Ratio (IER)

Income to expense is the ratio that measures amount of income earned per dollar of operating expense. This is the most commonly and widely used ratio in the banking sector to assess the managerial efficiency in generating total income vis-à-vis controlling its operating expenses (Samad & Hassan 2000). High IER is preferred over lower one as this indicates the ability and efficiency of the bank in generating more total income in comparison to its total operating expenses. Total income in the study is defined as net spread earned before provisions plus all

other income while the Other Expenses in the income statement are treated as total operating expense for the study.

IER is calculated as under,

IER = Total income / Total Operating Expenses

(c) Operating Efficiency (OE)

Unlike IER, which measures the amount of income earned per dollar of operating expense, OE is the ratio that measures the amount of operating expense per dollar of operating revenue. It measures managerial efficiency in generating operating revenues and controlling its operating expenses. In other words, how efficient is the bank in its operations (Ross, Wedsterfield, and Jaffe 2005). Lower OE is preferred over higher OE as lower OE indicates that operating expenses are lower than operating revenues. Operating revenue is defined as net spread earned before provisions plus fee, brokerage, commission, and for ex income. Other expenses is defined same as we defined in the previous ratio. OE is calculated as under:

OE=Total Operating Expenses / Total Operating Revenue

2.11.4.1. Limitations of Using Financial Ratios

Financial ratios have certain limitations in their use and are not meant to be applied as definitive answers. They are usually used to provide additional details in the determination of the results of financial and managerial decisions. They can provide clues to the company's performance or financial situation. However, on their own, they cannot explain whether performance is good or bad. As for the external financial analysis, ratios also play a role of basic indicators, showing just an overview of studying business entity.

Ratios have to be interpreted carefully. Some of the limitations about using ratios in financial analysis are (Girmachew ,2010):

- ✓ Ratios with large deviations from the norm only indicate symptoms of a problem. It is essential always to carry out additional analysis based on internal data to isolate the causes of the problem. Ratio analysis just directs attention to potential weak spots. It does not provide conclusive evidence and only shows the existence of a problem;

- ✓ Ratios may not be strictly comparable for different firms due to a variety of factors such as different accounting practices or different fiscal year periods. Furthermore, if a firm is engaged in diverse product lines, it may be difficult to identify the industry category to which the firm belongs. Also, just because a specific ratio is better than the average does not necessarily mean that the company is doing well; it is quite possible rest of the industry is doing very poorly;
- ✓ Ratios are based on financial statements that reflect the past and not the future. Unless the ratios are stable, it may be difficult to make reasonable projections about future trends. Furthermore, financial statements such as the balance sheet indicate the picture at "one point" in time, and thus may not be representative of longer periods;
- ✓ Financial statements do not include all items. For example, it is hard to put a value on human capital (such as management expertise). And recent accounting scandals have brought light to the extent of financing that may occur off the balance sheet;
- ✓ Results can be distorted by inflation, which can cause the book values of inventory and depreciable assets to differ greatly from their true (replacement) values. Additionally, inventory costs and depreciation write-offs can differ from their true values, thereby distorting profits. Without adjustment, inflation tends to cause older firms (older assets) to appear more efficient and profitable than newer firms (newer assets);
- ✓ Difficulty to decide the proper basis of comparison. The problem of standards of comparison is usually an important case. It is also impossible to compile an industry wide averages or ratios that serve as a useful standard to measure all firms;

2.2. Review of Empirical Studies

Financial performance analysis trough the traditional method of financial indices based on balance sheet, and income statement analysis is an important theme and it is widely used to summarize the information in a company's financial statements in assessing its financial health. Banking is one of the most highly liquid industries; investors have some level of assurance in the soundness of the banking system. As a result, investors can focus most of their efforts on how a bank will perform in different economic environments. Hence, to evaluate banks' performance, we can use different methods. These methods can be classified in three ways: The traditional method of financial indices based on balance sheet and income statement analysis, parametric

methods based on the knowledge of production function and non-parametric methods that do not require production function (Wozniewska, 2008).

The financial performance of banks has critical implication for economic growth of the countries. Good financial performance rewards the shareholders for investment. This in turn, encourages additional investment and brings about economic growth. On the other hand, poor banking performance can lead to banking failure and crises which have negative repercussion on economic growth (Ilhomovich, 2009).

Previous Empirical studies on financial performance analysis in the context of different countries. Hempel and Simonpson (1998) have made a study on bank's financial performance and managerial efficiency in Taiwan. The study found that the higher the ROA, the higher is the financial performance or profitability of the banks. Abdus Samad (2004) in his paper examines the comparative performance of banks and the interest-based conventional commercial banks during the post Gulf War period 1991-2001. Using nine financial ratios in measuring the performances with respect to: profitability, liquidity risk, credit risk, and applying Student's t-test to these financial ratios, the paper concludes that there exists a significant difference in credit performance between the two sets of banks. However, the study finds no major difference in profitability and liquidity performances between banks.

Ahmad and Hassan (2007) analyzed the asset quality, capital ratios, and operational ratios such as net profit margin, net interest income, income to asset ratio, non-interest income to asset ratio and liquidity ratios for seven years from 1994 to 2001. Banks on an average were the preeminent performer in terms of lowest non-performing to gross loan ratio, capital funds to total asset ratio, capital funds to net loans ratio, capital funds to short-term loan ratio, capital funds to liabilities ratio, non-interest expense to average asset ratio and most of the liquidity ratios.

Conducting profit maximization, capital structure, and liquidity tests as performance evaluation methodology, the paper finds several interesting results. First, the efficiency and ability of banks have increased and banks have expanded their investment and activities. Second, banks have played an important role in financing projects.

Third, these banks have focused on the short-term investment. Fourth, Bank for Finance and Investment is found to have high profitability. Finally, the study concludes that banks have high growth in the credit facilities and in profitability.

Samad and Hassan (2000) evaluate Inter-temporal and Interbank Performance in profitability, liquidity, risk and solvency, and community involvement of an Islamic bank (Bank Islamic Malaysia Berhad (BIMB) over 14years for the period 1984-1997. The study is inter-temporal in that it compares the performance of BIMB between the two time period 1984-1989 and 1990-1997. To evaluate interbank performance, the study compares BIMB with two conventional banks (one smaller and one larger than BIMB) as well as with eight conventional banks.

Using financial ratios to measure these performance and F-test and T-test to determine their significance, the results show that BIMB make statistically significance improvement in profitability during 1984-1997, however, this improvement when compared with conventional banks is lagging behind due to several reasons. The study reveals that BIMB is relatively less risky and more solvent as compared to conventional banks. These results also conform to risk-return profile that is BIMB is comparatively less profitable and less risky. Performance evaluation of BIMB indicates that it is more liquid as compared to the group of eight conventional banks.

Saleh and Rami (2006**)** in order to evaluate the Islamic banks' performance in Jordon examine and analyze the experience with Islamic banking for the first and second Islamic bank, Jordan Islamic Bank for Finance and Investment (JIBFI), and Islamic International Arab Bank (IIAB) in Jordon. The study also highlights the domestic as well as global challenges being faced by this sector. Conducting profit maximization, capital structure, and liquidity tests as performance evaluation methodology, the paper finds several interesting results.

First, the efficiency and ability of both banks have increased and both banks have expanded their investment and activities. Second, both banks have played an important role in financing projects in Jordan. Third, these banks have focused on the short-term investment. Fourth, Bank for Finance and Investment (JIBFI) is found to have high profitability. Finally, the study concludes that Islamic banks have high growth in the credit facilities and in profitability.

An evaluation system requires specific measurable outcomes so the analyst can determine the progress of established objectives and goals. These outcomes are known as performance indicators, and they play a significant role in the monitoring process. Business owners and managers can use performance indicators to evaluate the progress of policies and projects in regard to their intended objectives and goals.

Although few studies have been made as related to financial performance evaluation of banks, such as performance comparison between the government and private banks, insurance, and other financial institutions such analysis in the case of Awash International bank still remains unexplored. The researcher has tried to fill this gap by extending the issue to the specific context of the company.

CHAPTER THREE

RESEARCH DESIGN AND METHODOLY

3.1 Research Design

The major emphasis in this study was on the description of data and insights into the facts, the research design most appropriate for the study was case study; it relies much on qualitative data and Descriptive Research design has been implemented.

3.2 Sampling method

The issue of sampling in this study has little significance, as the main aim of this study was a case study to examine and compare the financial performance of Awash International Bank (AIB) S.C. against the industry average. Hence, the researcher being used published audited annual report during the period 2004/05 to 2013/14 against industry average of all commercial banks in Ethiopia.

3.3 Source and Instruments of Data collection

The source of data for this study was predominantly from secondary data .The industry average for commercial banks during the year 2004/05 to 2013/14 computed by the researcher and audited financial statements for Awash international bank S/C were used as a source of secondary data in order to compare and evaluate the financial performance of AIB against the industry average.

In order to get relevant and accurate information other sources like literature from various books, journals, newspapers, reports of the National Bank of Ethiopia and various websites, were also used as a source of secondary data. Secondary data was collected through personal review of the above listed sources and types of data.

Furthermore, in order to support the secondary data, when clarification was required finance department of the bank was communicated personally and collect relevant information to gather best and current information for the purpose of this study.

3.4 Methods of Data Analysis

The collected data through the above tools have been analyzing using the techniques of ratio analysis to find out and evaluate the true picture of the financial performance of Awash international bank over the period 2004/05 to 2013/14 for the period of ten years

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

In this chapter, detail discussions and analysis of the study findings are presented. The financial performance evaluation obtained by thoroughly analyzing the company's financial statements. Each financial performance indicator (financial ratio) is presented independently in a table. The analysis is presented in the following sequence; first the Financial Highlights of the company's followed by the ratios analysis.

4.1 Financial Highlights

4.1.1 Total Income, Total Expenses, and Net Profit

During the ten years (2005-2014) of the study, the total growth of total income, total expenses and net profit of AIB were on average 458.7 percent, 375 percent, and 670.76 percent respectively (see appendix table 1). In appendix table 2, total income ranges from Birr 115 millions to Birr 1446 millions maintaining Birr 589.76 millions on an average with a standard deviation of Birr 436.25 million per year. Total expenses ranges from Birr 94 to Birr 1093 millions maintaining Birr 411.25 millions on an average with a standard deviation of Birr 332.86 million per year. Moreover, net profit ranges from Birr 38 to Birr 618 millions maintaining Birr 267.40 millions on an average with a standard Deviation of Birr 194.62 million per year.

Table 4.1 (Total income, Total expense and net profit)

, Million Birr

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Total Income	115	180	281	317	357	532	718	826	1126	1445.60
Total Expense	94	117	139	219	275	336	422.50	580	837	1093.00
Net profit	38	78	143	143	143	248	361	394	508	618.00

Source: researcher's own computation from financial statements

4.1.2 Total Deposits and Total Loans & Advances

During the ten years (2005-2014) years of study, the total growth of total deposits and total loans & advances of AIB were on average 273.14 percent and 228.32 percent respectively (see appendix table 1). In appendix table 2, total deposits ranges from Birr 1940 to Birr 15,040 millions maintaining Birr 6709 millions on an average with a standard deviation of Birr 4410.52 million per year. Total loans & advances ranges from Birr 1290 to Birr 9176 millions maintaining Birr 4064.8 millions on an average with a standard deviation of Birr 2600.07 million per year

Table 4.2 (Total deposits and Total loans & advances)

, Million Birr

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Total Deposit	1940	2567	3112	3870	4962	6106	7744	9204	12545	15040
Total loans & Advances	1290	1872	2512	2738	2713	3146	3986	5505	7710	9176

Source: researcher's own computation from financial statements

4.1.3 Interest Income, Interest Expense, and Net Interest Income

During the ten years of study, the total growth of interest income, interest expense and net interest income of AIB were on average 399.29 percent, 496.23 percent and 344.73 percent respectively (see appendix table 1). In appendix table 2, interest income ranges from Birr 94 to Birr 1089 millions maintaining Birr 431.80 millions on an average with a standard deviation of Birr 336.86 million per year.

Interest expense ranges from Birr 34 to Birr 476 millions maintaining Birr 185.85 millions on an average with a standard deviation of Birr 147.20 million per year. Net interest income ranges from Birr 60 to Birr 614 millions maintaining Birr 246.15 millions on an average with a standard deviation of Birr 192.40 million per year.

Table 4.3 (Interest income, interest expense and net interest income)

, In million Birr

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Interest Income	94	137	214.50	251	276	303	394.71	668.69	890	1089.10
Interest Expense	34	48	62	106	120	155	209.47	285	363	476.00
Net interest income	60	89	153	145	156	148	185	384	528	613.53

Source: Researchers own computation from financial statement.

4.1.4 Total Assets and Shareholders' Equity

During the ten years (2005-2014) of study the total growth of total assets and shareholders' equity of AIB were on average 317.38 percent, and 411.67 percent respectively (see appendix table 1). In appendix table 2, total assets ranges from Birr 2226 to Birr 20,029 millions maintaining Birr 8513.90 millions on an average with a standard deviation of Birr 5752.99 million per year. Shareholders' equity ranges from Birr 228 to Birr 2525 millions maintaining Birr 1070.70 millions on an average with a standard deviation of Birr 774.17 million per year.

Table 4.4 (Total asset and shareholder equity)

, In million Birr

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Total Asset	2226	2954	3830	4820	7132	7945	10116	11937	14859	20029
Shareholder equity	228	304	434	597	760	940	1308	1610	2011	2525

Source: researcher's own computation from financial statements

4.2 Ratio Analysis

As we know, a bank's balance sheet and income statement are valuable information sources to evaluate financial strengths and weaknesses of a bank and its business trends. Although the birr amounts found on these statements provide valuable insights into the financial performance and condition of the bank, the researcher typically use data from them to develop financial ratios to evaluate the bank financial performance. In all of the remainder of this chapter, the researcher

undertakes key ratios commonly used by bank analysts to evaluate different dimensions of financial Performance of Awash International Bank S.C., including liquidity, profitability, efficiency, and credit risk & solvency in comparison with the industry average over ten years. Since there are seventeen commercial banks started operation until 2014, so the researcher first calculated, ratios from consolidated financial statements to compute industry average and then compare this ratios with ratio of Awash International Bank in each year.

4.2.1 Liquidity Ratios

The liquidity ratios measure the capability of bank to meet its short-term obligations. Generally, the higher value of this ratio indicates that firm has larger margin safety to cover its short-term obligations. Among the various liquidity measures, the study uses the following three liquidity ratios.

Table 4.5 Loan to Deposit Ratio (LDR)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Mean
AIB	75.84%	72.93%	80.72%	70.53%	54.67%	51.52%	51.48%	46.11%	61.46%	61.10%	62.66%
Industry average	64.47%	85.59%	76.91%	69.35%	61.31%	57.05%	52.25%	57.86%	57.95%	57.04%	63.98%

Source: researcher's own computation from financial statements

4.2.1.1 Loan to Deposit Ratio

Loan to deposit ratio indicates the percentage of the total deposit locked into non-liquid asset. A higher loan deposit ratio indicates that a bank takes more financial stress by making excessive loan. Therefore, lower loan deposit ratio is always favorable to higher loan deposit ratio. This low value of loan deposit ratio also indicates effectiveness of mediation function of bank.

Low loan to deposit ratio for AIB compared with industry average during 2005-2014 indicates that AIB has been comparatively more liquid (see table 4.5). LDR of AIB decreased from 75.84%in 2005 to 61.10% in 2014. This overall declining trend in LDR of AIB indicates the tendency of comparatively more increase in deposits than loans and further emphasizes improved liquidity position of AIB.

Alternatively, LDR of AIB decreased from 80.72% in 2007 to 61.10% in 2014 as a consequence of the National Bank of Ethiopia set a maximum outstanding loan limit to all banks in the country to control inflation. Moreover, this reveals that the bank may not be earning as much as they could be. Compared with industry average, LDR of AIB has been reasonably higher in which LDR of industry average floating between approximately 64.47% & 57.04 %.The Mean LDR of AIB 62.66% is less than Mean LDR of industry average 63.98%. Hence, considering the last ten years trend in LDR, AIB is more liquid with compared to industry average.

4.2.1.2 Cash Deposit Ratio (CDR*)*

Another measure of liquidity of the bank is the cash to deposit ratio. The higher the ratio the better is the liquidity position of the bank, therefore, the more is the confidence and trust of the depositors in the bank as compared to the bank with lower CDR.

Table 4.6 Cash deposit ratio (CDR)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Mean
AIB	32.53%	28.47%	36.25%	44.29%	64.21%	53.11%	52.27%	31.90%	27.28%	20.69%	39.10%
Industry average	48.54%	41.56%	52.38%	55.46%	64.28%	67.68%	61.72%	42.58%	40.24%	36.51%	51.10%

Source: researcher's own computation from financial statements

As per the table 4.6, indicate that AIB is slightly less liquid as compared to industry average over the time period of 2005-2014. Since 2009, an increasing trend in CDR indicates that liquidity position of AIB is improving over time as a consequence of percentage of total cash and bank balance increasing at an increasing rate (see Table4.6). The CDR of AIB was 32.53% in 2005, which descended to 20.69% in 2014. However, these positively affect the profitability of the bank as less cash which has earned interest reserved in the bank. The average CDR of AIB 39.10% is highly less than mean CDR of industry average 51.10%, which reflect AIB is to less liquid than industry average over the years under the study .

4.2.1.3 Loan to Asset Ratio (LAR)

The loans to assets ratio measure the total loans outstanding as a percentage of total assets. The higher this ratio indicates a bank is loaned up and its liquidity is low. The higher the ratio, the more risky a bank may be to higher defaults.

Table 4.7 Loan to asset Ratio (LAR)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Mean
AIB	57.95%	63.37%	65.59%	56.80%	42.24%	39.59%	39.41%	46.11%	51.87%	45.82%	50.87%
Industry average	49.63%	61.37%	55.86%	51.60%	44.55%	40.49%	38.38%	41.90%	42.77%	41.76%	46.83%

Source: researcher's own computation from financial statements

Table 4.7 shows that, LAR of AIB is on decreasing trend over the years under the study except it increase in 2006 and 2007. Whereas LAR of industry average is swinging between 49.63 % and 41.76%. LAR of AIB increased to 63.37 % in 2006 from 65.59 % in 2007. This increasing trend of AIB LAR during the period is palpable evidence of more financial stress, which AIB is taking by making excessive loans and holding less liquid assets during the periods. However, this is an indication of potential betterment in profitability and conforms to our results drawn from profitability ratios of AIB for the period.

The average LAR of AIB (50.87 %) is higher than that of industry average (46.83%) during the ten years (2005-2014) of study. Therefore, Overall result of LAR indicates that AIB is less liquid than the industry average during the ten years of study.

4.2.2 Profitability Ratios

Profitability is a management concept with the objective of assessment bank's results from efficiency point of view both for entirely activity and for differently management compounds. From conceptual point of view, profitability represents the modality to achieve the major goal of bank's activity, respectively the maximization of profit in minimization risk conditions. In order to see how AIB has profitable in comparison with the industry average over ten years(2005 to 2014) under the study, the study uses four profitability ratios namely, Return on assets (ROA), Return on Equity (ROE), Profit Expense Ratio (PER), and Net Interest Margin (NIM).

4.2.2.1 Return on Assets (ROA)

ROA is defined as the ratio of profit after tax to total asset. It reflects the efficiency with which banks deploy their assets. The higher the ROA, the most profitable is the bank.

The result indicates several important points of comparison of ROA between Awash International bank and industry average.

Table 4.8 Return for asset (ROA)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Mean
AIB	1.71%	2.64%	3.74%	2.97%	2.23%	3.12%	3.55%	3.30%	3.16%	3.09%	2.95%
Industry average	2.05%	2.21%	2.04%	2.20%	1.48%	2.32%	2.70%	2.89%	2.73%	2.75%	2.34%

Source: researcher's own computation from financial statements

As it can been seen from Table 4.8, First, ROA of AIB has been greater than industry average during the years 2006 to 2014 at an increasing rate except 2005. Second, ROA of AIB increased drastically during 2006, 2007, and 2011 by 0.43%, 1.7%, and 0.85% respectively. Since 2011, ROA of AIB is consistently on decreasing trend over the years under the study as a result of percentage decrease in net interest income by reason of loan limit to all banks in the country by national bank of Ethiopia. On the other hand, ROA of industry average decreased considerably during 2006-2007

4.2.2.2 Return on Equity (ROE)

This ratio indicates how bank can generate profit with the money shareholders have invested. The higher value of this ratio shows higher financial performance. Like ROA, this ratio is also indicator for managerial efficiency.

Table 4.9 Return on Equity (ROE)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Mean
AIB	16.67%	25.65%	32.95%	23.95%	19.07%	26.38%	27.60%	24.47%	25.26%	24.47%	24.67%
Industry average	22.63%	25.29%	18.44%	17.64%	14.11%	19.24%	21.83%	22.79%	22.50%	20.22%	20.4%

Source: researcher's own computation from financial statements

From the study of ROE of both Awash International Bank and industry average under the study, the researcher underpins some important points to consider. The result shows (see table 4.9) that ROE of AIB has been greater than industry average over the years under the study except year 2005 in which AIB, ROE (16.67%) slightly surpassed industry average ROE (22.63%).

In year 2005, the difference was huge which decreased considerably during 2006 to 2014. This momentous decrease in difference of two ROEs is essentially due to overall increasing trend in ROE of AIB and decreasing trend in ROE of industry average during 2007-2009.

ROE of AIB increased from 16.67% in 2005 to 32.95% in 2007, whereas, ROE of industry average decreased from 25.29% in 2006 to 20.22% in 2014. ROE of AIB is greater than the industry average as yet except in year 2005. An average ROE of the AIB is 24.65%, whereas the mean ROE of industry average for the same periods is 20.47%.

4.2.2.3 Profit Expense Ratio (PER)

This ratio indicates profitability of the firm with regard to its total expenses. A high value of this ratio indicates that bank could make high profit with a given expenses. PER, reveals period of 2005-2014 except year 2005 in which AIB, PER (0.92) slightly decrease industry average PER (1.44) as per table 4.10).

Table 4.10 Profit expense ratio (PER)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Mean
AIB	0.92	1.61	2.65	1.81	1.31	1.94	2.37	1.80	1.38	1.35	1.71
Industry average	1.44	1.54	1.23	1.34	1.21	1.27	1.47	1.52	1.30	1.11	1.34

Source: researcher's own computation from financial statements

The analysis of PER of AIB also indicates that from 2006 to 2014 the bank has generated higher profits except in year 2005. This increase in PER of AIB is far greater than increase in PER of industry average during the same time year 2006 to 2014. PER of industry average increased to 1.23 in 2007 from 1.47 in 2011.

However, Mean PER of the AIB is 1.71, which is higher than industry average mean PER of 1.34, which reveal that the AIB to be more profitable in terms of PER as compared to the industry average over the years under the study.

4.2.2.5 Net Interest Margin (NIM)

Net Interest Margin (NIM) measures the amount of operating income to earning asset. Higher the NIM ratio, higher is the quality of the management decision. Because higher operating income is the result of higher interest income or comparative lower interest expense, which is charged upon the earning assets such as Short-term Investment, loans and investment.

Table 4.11 Net Interest margin (NIM)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Mean
AIB	3.01	3.01	3.99	3.01	2.43	1.86	1.83	3.22	3.55	3.06	2.90
Industry average	2.59	2.64	3.12	3.25	2.38	2.08	2.16	2.83	3.21	3.32	2.76

Source: researcher's own computation from financial statements

Table 4.11, presents NIM of AIB increased from 3.01%in 2005 to 3.99% in 2007 but followed downward trend afterwards due to percentage decrease in net interest income during the period 2008-2011. The average NIM of AIB 2.90% is greater than average NIM of industry average 2.76%. Accordingly, considering the ten years trend in NIM, AIB is more profitable with compared to industry average.

4.2.3 Risk and Solvency Ratios

The risk and solvency ratios measure the extent to which a firm relies on debt financing rather than equity financing. These ratios are also referred to as gearing, debt, or financial leverage ratios. These ratios determine the probability that the firm default on its debt contacts. The more the debt a firm has the higher is the chance that firm will become unable to fulfill its contractual obligations. The following ratios measure for risk and solvency were used for the study.

4.2.3.1 Debt to Equity Ratio (DER)

This ratio indicates the proportion of assets financed with debt. A high value of this ratio provides indication that firm involves in more risky business. Debt to equity ratio of AIB decreased from 8.76 times in 2005 to 7.07 times in 2008 but followed an increasing trend until 2010 and ended at 7.73 times in 2014. Decreasing trend in DER for AIB indicates that deposits base of the bank is decreasing more than its equity base i.e. AIB is more reliance on equity financing as compared to debt and less deposits base (see table 4.11). This table shows DER of AIB is greater than DER of industry average.

Table 4.12 Debt to Equity ratio (DER)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Mean
AIB	8.76	8.72	7.82	7.07	8.49	8.58	7.46	7.13	7.82	7.73	7.96
Industry average	8.03	8.82	6.19	6.53	6.62	6.64	6.85	6.51	6.54	6.27	6.90

Source: researcher's own computation from financial statements

AIB is more reliance on equity financing as compared to debt and less deposits base (see table 4.11). This table shows DER of AIB is greater than DER of industry average. Average DER of AIB is 7.96 times as compared to 6.90 of the industry average.

4.2.3.2 Debt to Total Assets Ratio (DTAR)

DTAR measures ability of the bank capital to absorb financial shocks. This ratio indicates the proportion of assets financed with debt. A high value of this ratio provides indication that firm involves in more risky business.

Table 4.13 Debt to total asset ratio (DTAR)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Mean
AIB	89.76%	89.70%	88.69%	87.61%	88.32%	88.16%	87.06%	86.51%	86.47%	87.39%	87.97%
Industry average	71.34%	83.88%	81.37%	84.70%	84.51%	84.08%	84.16%	84.59%	83.39%	83.58%	82.56%

Source: researcher's own computation from financial statements

The results of debt to total assets ratio conform to our results of DER. The results show that DTAR of the AIB is consistently higher than industry average making once again AIB to be more risky than industry average. AIB, DTAR has slightly decreased during 2005 to 2008.

It was 89.76% in 2005, which descended to 87.61% in 2008. The comparison of means of DTAR for risk measure for both AIB and industry average in Table 4.13 reveals that, the average DTAR of AIB is 87.97% whereas the average DTAR of industry average is 82.56%.

4.2.3.3 Equity Multiplier (EM)

This ratio shows how many dollars of assets must be supported by each dollars of equity capital. The higher value of this ratio indicates signal for the higher the risk.

Table 4.14 Equity multiplier (EM)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Mean
AIB	9.76	9.72	8.82	8.07	8.56	8.45	7.73	7.41	7.39	7.93	8.38
Industry average	10.20	9.82	7.19	7.53	7.46	7.44	7.45	7.31	7.35	7.21	7.89

Source: researcher's own computation from financial statements

The analysis of equity multiplier further proves AIB banks to be more risky and less solvent as compared to industry average. EM decreased from 9.76 times in 2005 to 7.93 times in 2014 and from 10.20 times in 2005 to 7.21 times in 2014 for AIB and industry average respectively. Table 4.14 shows Average EM of AIB is 8.38 times as compared to 7.89 of the industry average.

4.2.3.3.4 Non Performing Loans to Total Loan Ratio (NPTL)

NPTL ratio is one of the most important criteria to assess the quality of loans or asset of a commercial bank. It measures the percentage of gross loans which are doubtful in banks' portfolio. The lower the ratio of NPTL, the better is the asset/credit performance for the commercial bank.

Table 4.15 Non performing loan to Total asset Ratio (NPTL)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
AIB	6.20%	4.91%	4.34%	4.64%	5.49%	4.70%	3.64%	2.70%	2.31%	2.27%
Industry average	6.95%	5.09%	4.35%	4.08%	3.63%	2.82%	2.42 %	1.89 %	2.16%	1.08%

Source: researcher's own computation from financial statements

Table 4.15 reveal that the NPTL ratios for AIB has been decreased from 2005 to 2014 which imply asset quality slightly improved over the period under the study, as the non-performing loan (NPL) ratio edged down from 4.91 percent in 2006 to 2.27 percent in 2014 .

The non performing loans to total loan ratio of the AIB is below the industry average in the previous ten years which further proves AIB banks to be less risky or risky business as compared to industry average.

4.2.4 Efficiency Ratios

These ratios measure how effectively and efficiently the firm is managing and controlling its assets. A firm is technically efficient if it produces a given set of outputs using the smallest possible amount of inputs (Falkena et al, 2004). Outputs could be loans or total balance of deposits, while inputs include labor, capital and other operating costs. Ratios used to measure efficiency of the AIB are Asset Utilization (AU), Income to Expense Ratio (IER), and Operating efficiency (OE).

4.2.4.1 Asset Utilization (AU)

This ratio measures capability of firm to generate revenue with its asset. The high value of this ratio indicates the high productivity of firm's asset.

Table 4.16 Asset utilization (AU)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Mean
AIB	5.17%	6.09%	7.33%	6.57%	5.56 %	6.69%	7.10%	6.92%	7.52%	7.22%	6.62%
Industry average	5.12%	5.75%	5.67%	6.15%	4.97%	6.17%	6.62 %	7.00 %	6.89%	7.46%	6.18%

Source: researcher's own computation from financial statements

The behavior of the two lines in Table 4.16 reveals some useful information about AU of AIB and industry average. Having decrease from 7.33% in 2007 to 5.56% in 2009, AU of Awash banks showed an upward trend and increased from 5.56% in 2009 to 7.10% in 2011 but followed a downward trend in 2012. AU ratio of AIB is consistently higher during 2005 to 2014 than industry average and the mean of AU ratio of AIB (6.62%) is higher than industry average (6.18%). This proves that Awash International bank is comparatively more efficient in utilization of the assets in generating total income (revenue) than Industry average.

4.2.4.2 Income to expense Ratio (IER)

Income to expense is the ratio that measures amount of income earned per dollar of operating expense. This is the most commonly and widely used ratio in the banking sector to assess the managerial efficiency in generating total income vis-à-vis controlling its operating expenses. High IER is preferred over lower one as this indicates the ability and efficiency of the bank in generating more total income in comparison to its total operating expenses.

Table 4.17 Income to expense Ratio (IER)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	AGR
AIB	3.22	2.61	3.65	2.80	2.30	2.94	3.37	2.80	2.38	2.34	2.84
Industry average	2.28	2.53	2.23	2.33	2.19	2.26	2.47	2.52	2.29	2.11	2.32

Source: researcher's own computation from financial statements

Table 4.17 exhibits the behavior of income to expense ratio for both AIB and industry average. The results show that IER of AIB is higher than industry average during the 10- years. Compared with industry average, AIB is generating more income for every 1 birr of expense spent. The Mean IER of AIB is 2.84 times, which is greater than mean IER of 2.32 times for industry average shows AIB is generating more income for every 1 birr of expense spent than commercial banks.

4.2.4.3 Operating Efficiency (OE)

Operating efficiency is the ratio that measures the amount of operating expense per dollar of operating revenue. It measures managerial efficiency in generating operating revenues and controlling its operating expenses. In other words, how efficient is the bank in its operations. Lower OE is preferred over higher OE as lower OE indicates that operating expenses are lower than operating revenues.

Table 4.18 operating efficiency (OE)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Mean
AIB	109.10%	62.16%	37.75%	55.39%	76.73 %	51.57%	42.18%	55.56%	72.69%	74.43%	63.76%
Industry average	49.94%	25.77%	107.26%	92.66%	179.48%	59.46%	40.89 %	89.39 %	95.60%	114.14%	66.90%

Source: researcher's own computation from financial statements

Operating efficiency analysis further strengthens IER result that AIB is more efficient than industry average in managing its operating expenses and generating more operating revenues. Particularly, in 2005, the difference in performance was huge which, however, reduced drastically in 2014 and the variation in ratios of AIB and industry average was 59.16% in 2005, which reduced to 40.89% in 2011.

Moreover, in 2007, AIB OE (37.75%) decreased below industry average (107.26%) turning AIB into comparatively better efficiency position mainly because of lower percentage of total non-interest expense. Furthermore, the AIB is improving considerably in managing its operations (see table 4.18 above). The Average OE of AIB is, 63.76%, which is less than OE of 66.90% for industry average is evidence for AIB is more efficient than industry average in managing its operations over the years under the study.

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

In chapter four, the actual performance of the company has evaluated. Here are the searcher conclusions and recommendations based on the analysis of the previous chapter.

5.1. CONCLUSIONS

At this part, the financial analysis has been made in attempting to draw some rough conclusions on the performance of AIB. One of the main points to understand about the financial analysis is that all the information that would be conclusive judgment about what is going on in the company is found in the audited financial statements of the company.

From the brief explanation and illustrations of ten years, financial statements of AIB have been used to analyze the financial performance and their trend for the years under study (2005-2014). Examination of the empirical analysis makes it possible for the researcher to shed some light on his findings and draw some conclusions. Some of the findings of the study include the following:

- From the consolidated Income Statement of AIB, Operating income before Tax in 2014 was very high comparing to the other years. This was because of low Interest Expense, Salaries and benefits, and general and administrative expenses in this year.

- From the consolidated Balance Sheet of AIB, Total Loans, and Advances of the bank had covered largest portion of total assets in all the years under the study. On the other hand, Total Deposit had covered largest portion of total liabilities in all the years under the study.

- The researcher analysis of liquidity measures indicates that AIB is more liquid than industry average in all liquidity measurements. Findings also show that while Loan to Deposit Ratio (LDR) of the industry average is decreasing from 64.47% in 2005 to 57.04% in 2014, LDR of AIB is decreasing from 75.84%in 2005 to 61.10% in 2014.

This decreasing trend is due to increase in its deposits base, which can be considered a positive, and a good sign for the AIB in that it is making inroads into the society. Moreover, this shows that level of trust and confidence of the people is increasing in AIB with the passage of time. However, on average AIB was exposed to higher liquidity risk than the industry average over the years under the study.

- Examination of all profitability measures, Return on assets (ROA), Return on Equity (ROE), Profit Expense Ratio (PER), and Net Interest Margin (NIM) indicates that AIB is more profitable than industry average during the period under the study .Overall, the trend of all profitability ratios are found rising for AIB during 2005-2014.

- From the researcher analysis, AIB to be more profitable than industry average, what we expect when it comes to risk and solvency measures is according to the basic rule of finance "the higher the expected return the higher the risk". Our findings of profitability and risk & solvency perfectly fit in this risk-return profile and allow us to conclude that AIB is more profitable, also more risky, and less solvent than industry average. Analysis of the results of all the risk and solvency measures, Debt Equity Ratio (DER), Debt to Total Assets ratio (DTAR), Equity Multiplier (EM), and Non Performing Loans to Total Loan Ratio (NPTL) indicates AIB to be more risky and less solvent than industry average.

  Like in profitability, and risk & solvency measures, AIB is found to be more efficient in terms of generating income or Income Expense Ratio (IER) and managing their expenses or Operating Efficiency (OE) as compared to industry average. In contrast, AIB is more efficient in terms of utilization of their assets or Asset Utilization (AU) ratio. This gives us some insight regarding AIB's improvement in generating income, utilization of assets, and effective management in controlling expenses.

5.2. RECOMMENDATIONS

- The following recommendations, based on the above research findings, are forwarded below in order to enhance the financial performance of commercial banks. Loan to deposit ratio of AIB decreased from 75.84% in 2005 to 61.10% in 2014. This overall declining trend in LDR of AIB indicates the tendency of comparatively more increase in deposits than loans. This may indicate that AIB has conservative lending policy over the period under the study. This may be solved by revising the lending policy of the bank, such as maximizing the approval limit of branches and districts, appointing trained managers and loan officers.

- During the period, Loans and advances of AIB increased even if the National Bank of Ethiopia set a maximum outstanding loan limit to all banks in the country to control inflation. If this continues, the bank may become less liquid and be obliged to encourage deposit to increase their interest expenses and this will adversely affect the company performance as well as the overall economy. Therefore, the regulatory body has to think over it and take a corrective action.

- Overall, all results of profitability measures results indicate that AIB is more profitable compared with industry average, therefore the bank should work effectively and efficiently to control the market Share in the industry. The number of commercial banks has been increasing from time to time. The intensive and continuous increasing competition in the financial service market creates a need for an access to information that would allow evaluating commercial banks operating in this market.

- Last but not least, in Ethiopia there is no adequately compiled data and benchmarks to evaluate the performance of commercial banks. The regulatory body (National Bank of Ethiopia) or other concerned bodies have to take the responsibility. Finally, the financial performance indicators, i.e. financial ratios, independently are not enough to measure the performance of commercial banks. Thus, alternative financial measures such as Data Envelopment Analysis (DEA) shall be considered by further researchers.

Appendex A-1 (selected financial elements with growth rate)

,In million Birr

Elements	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*	*2014*	*Average*
Total Deposits	1940	2567	3112	3870	4962	6106	7744	9204	12545	15040	
Growth		32.31	60.41	99.48	155.77	214.74	299.18	374.43	546.64	675.26	**273.14**
Interst Income	94	137	214.5	251	276	303	394.71	668.69	890	1089.1	
Growth		45.74	128.19	167.02	193.62	222.34	319.9	611.37	846.81	1058.61	**399.29**
Net interst income	60	89	153	145	156	148	185	384	528	613.53	
Growth		48.33	155	141.67	160	146.67	208.33	540	780	922.55	**344.73**
Total income	115	180	281	317	357	532	718	826	1126	1445.6	
Growth		56.52	144.35	175.65	210.43	362.61	524.35	618.26	879.13	1157.04	**458.7**
Interest expense	34	48	62	106	120	155	209.47	285	363	476	
Growth		41.17	82.35	211.76	252.94	355.88	516.1	738.24	967.65	1300	**496.23**
Total expense	94	117	139	219	275	336	422.5	580	837	1093	
Growth		24.47	47.87	132.98	192.55	257.45	349.5	517	790.42	1062.77	**375**
Net profit	38	78	143	143	143	248	361	394	508	618	
Growth		105.26	276.31	276.31	276.31	552.63	850	936.84	1236.84	1526.32	**670.76**
Total loans and advances	1290	1872	2512	2738	2713	3146	3986	5505	7710	9176	
Growth		45.12	94.73	112.25	110.3	143.88	112.9	326.74	497.67	611.32	**228.32**
Net loans and advances	1210	1780	2403	2611	2564	2997	3842	5356	7532	8968	
Growth		47.1	98.6	115.78	111.9	147.68	217.52	342.64	522.48	641.16	**249.43**
Total asset	2226	2954	3830	4820	7132	7945	10116	11937	14859	20029	
Growth		32.7	72.1	116.5	220.4	256.9	354.4	436.25	567.52	799.7	**317.38**
Shareholder equity	228	304	434	597	760	940	1308	1610	2011	2525	
Growth		33.33	90.35	161.84	233.34	312.3	473.68	606.1	782.1	1007.4	**411.67**