ST.MARY UNIVERSITY

SCHOOL OF GRADUATE STUDIES

INISTITUTE OF BUSNESS STUDIES

OPPORTUNITIES AND CHALLENGES OF LIBERALIZING THE BANKING SECTOR IN ETHIOPIA

BY

HABTAMU DAGNACHEW LIMENEH

ID NO: SGS/0354/2007B

A THESIS SUBMITTED TO ST.MARY UNIVERSITY, SCHOOL OF GRADUATE STUDIES, IN PARTIAL FULFILLMENT FOR THE REQUIREMENTS OF DEGREE OF MASTER OF ARTS IN BUISNESS ADMINSTRATION

JUNE, 2017

ADDIS ABABA, ETHIOPIA

ST.MARY UNIVERSITY

SCHOOL OF GRADUATE STUDIES

INISTITUTE OF BUSNESS STUDIES

OPPORTUNITIES AND CHALLENGES OF LIBERALIZING THE BANKING SECTOR IN ETHIOPIA

BY

HABTAMU DAGNACHEW LIMENEH

Name and signature of advisors and the examining board members

....   **......................................**

Deans. Graduated studies   **signature and date**

Advisors

Dr. Zinegnaw abiy   **Signature ____________ Date ____________**

Internal Examiners

Dr. Abebaw kassie   **Signature ___________ Date ___________**

External Examiners

Dr. Abebe bayou   **Signature ____________ Date ___________**

Endorsement

This thesis has been submitted for examination with my approval as the university advisor.

Main Advisor Name : Zenegnaw Abiy (PhD)

Signature ________________________________

Date___________________________

Declaration

The researcher here by declares that the thesis on the title, “opportunities and challenges of liberalizing the banking sector in Ethiopia”, is his original work and that all sources that have been referred to and quoted have been dully indicated and acknowledged with complete references.

Name: Habtamu Dagnachew Limeneh

Signature: ________________________

Date: 29/06/2017

Contents

ACKNOWLEDGMENT……………………………………………………………………..i
ACRONYMS…….……………………………………………………………………….ii
ABSTRACT……………………………………………………………………………..iii
CHAPTER ONE 1
INTRODUCTION 1
1.1. Background of the Study.. 1
1.2. Statement of the Problem.. 4
1.3. Objective of the Study.. 6
1.4. Significance of the Study 7
1.5. Scope and Limitation of the Study... 7
CHAPTER TWO 8
LITERATURE REVIEW 8
2.1. Theoretical Background 8
2.2. Effects of Foreign Bank Entry 10
2.2.2. Challenges of Foreign Bank Entry 12
2.2.3. Forms of Foreign Bank Entry and Form of Organization 13
2.2.3.1. Out Look of Current and Future of Banking Sector in Ethiopia 17
2.3. Empirical Review.. 20
RESEARCH METHODOLOGY 24
3.1. Research Design and Approach 24
3.2. Population and Sampling Design 24
3.3. Data Collection Procedure 25
3.4. Method of Data Analysis 25
CHAPER FOUR 26
DATA ANALYSIS AND PRESENTATION 26
4.1. Characteristics of Respondents 26
4.2. Opportunities of Foreign Bank Entry in Ethiopia 26
4.3. Challenges of Foreign Banks Entry in Ethiopia.. 31
4.4. How the Banks should Join the Local Market 34
CHAPTER FIVE 36

CONCLUSION AND RECOMMENDATIONS ... 36
5.1. Conclusion ... 36
5.2. Recommendation ... 37
REFERENCE ... 40

Acknowledgment

This study would not have been completed without the support from various people at different capacities. First and foremost I need to thank my God and his Mom. And also my family, friends.

Secondly the instructors at St.mary University Graduate Program who kindly and diligently shared with me their knowledge and experiences so that I become what I am in the professional area of business administration.

This thesis would not have been possible without full support from my research advisor Dr. Zenegnaw abiy who appreciated the efforts I put in writing my thesis and who took their precious time to read, review and guide me through the Thesis work.

Last but not least I owe the great thanks to the people who have participated on this research paper for sharing with me their time, knowledge and support while conducting the research.

Acronyms

AFDB African Development Bank

CBE Commercial Bank of Ethiopia

DBE Dashen Bank of Ethiopia

FDI Foreign Direct Investment

GDP Gross Domestic Product

GNP Gross National Product

GTP Growth and Transformation Plan

IMF International Monetary Fund

IT Information Technology

MNCs Multinational Corporations

MNEs Multinational Eenterprises

NBE National Bank of Ethiopia

SMEs Small and Micro-Enterprises

USD United States Dollar

Abstract

*The aim of this study is to assess the opportunities and challenges of liberalizing the banking sector in Ethiopia. With this aim the research intends to i*dentify the different opportunities that *the banks would bring and their entry challenge on domestic banks. A qualitative research approach was followed and in-depth interview was conducted with 22 experts and professionals who were selected purposely. The finding of the study shows that foreign bank entry in Ethiopia could improve the financial infrastructural system and enuance credit access for different firms who run their business in the country whether they are small or large. Apart from this, the finding of the study indicated that the entrance of foreign banks enhance the efficiency of the local banks since the competition is going to be hard, and also allowing this financial institutions could transfer new banking technologies which could develop and promote the local financial systems. However, the potential and capacity of these international banks may also drive out the domestic banks from the market since they are highly capable in terms of experience, strategy and skill; also threaten as bringing instability in the financial system of the country. In addition to these, in some instances these banks may bring their international crises experience in to the host countries. As a policy recommendation the liberalization of the financial market should be done gradually, this is because letting the banks spontaneously may harm the domestic banks and make the condition difficult to control since there is no much know how about how these banks perform and work. Hence, letting them gradually allow the government to investigate and understand how they operate.*

Key words: Liberalizing, Opportunity, Challenge, Bank, Ethiopia

CHAPTER ONE

INTRODUCTION

1.1.Background of the Study

Since 1970s, along with the development of financial globalization and promoting the internationalization of financial services and goods, national banks have achieved multinational business through establishing branches in foreign countries or purchasing the local banks directly. At the same time, financial liberalization is further promoting the internationalization of the banking sector. Until 1980s, many countries began to adopt comparatively loose policy which can help foreign banks access into their markets. In the following more than ten years, the transnational business are growing rapidly and the banking industry has become an example of the world economic integration and interdependence of national economies (Zhao 2009). During the last decade several emerging market economies have lifted restrictions on foreign direct investment (FDI) in their financial systems. As a result, foreign ownership of domestic institutions has been growing rapidly (Cárdenas *et al*. 2002).

According to Alfaro *et al*. (2015), the effects of foreign bank entry have been controversial in both theory and empirical research. On the one hand, removing entry barriers that limit foreign bank entry should reduce the costs of external finance for bank-dependent borrowers by allowing banks to diversify, and allowing banks with low costs of raising capital in one country to redeploy that capital in countries with higher indigenous costs of capital. Claessens (2001), argue that foreign banks may give a better service than domestic banks. In particular, since foreign banks provide a great deal of know-how to domestic banks, and train a great many professional managers to help them, many consumers believe that foreign banks are the leaders in the financial market. Furthermore, the entry of foreign banks into the domestic market has improved the quality and availability of financial services in the domestic financial market by increasing competition, and enabling a greater application of more modern banking skills and technology (Levine 1996). On the other hand, authors such as Alemayehu (2013); Tassew (2015) argue that the participation of foreign banks in domestic banking sector has some potential risks such as foreign banks dominance in the financial sector, exposure of the host country's economy to economic shocks and fluctuations in home countries, less credit to small and medium-sized

enterprises and profit remittances and capital flight especially during economic crisis, which lead to shortage of foreign exchange.

1.1.1. Ethiopian Banking System

Ethiopian Banking sector dates back to 1905 when an agreement was reached between Emperor Minilik II and Mr. Ma Gillivray, representative of the British owned National Bank of Egypt .Following the agreement, the first bank called Bank of Abysinia was inaugurated in Feb.16, 1906 by the Emperor. The Bank was totally managed by the Egyptian National Bank and the following rights and concessions were agreed upon the establishment of Bank of Abyssinia (Tassew 2015). Within the first fifteen years of its operation, Bank of Abyssinia opened branches in different areas of the country. In 1906 a branch in Harar (Eastern Ethiopia) was opened at the same time of the inauguration of Bank of Abyssinia in Addis Ababa. Another at Dire Dawa was opened two years later and at Gore in 1912 and at Dessie and Djibouti in 1920. Mac Gillivray, the then representative and negotiator of Bank of Egypt, was appointed to be the governor of the new bank and he was succeeded by H Goldie, Miles Backhouse, and CS Collier were in change from 1919 until the Bank's liquidation in 1931.

Ethiopia has some notable historical differences compared to other countries in the region. Although occupied by the Italians for a short time in the 1930s, Ethiopia does not share the colonial legacy of its neighbors. Its population (now nearly 80 million) has historically been, and continues to be, almost evenly divided between Coptic Christians and Muslims, with a very small Jewish population still located in the Northwest of the country. The Ethiopian 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. The post-1991 government led a transition to a more market-based system, and subsequent governments have introduced further reforms. Although state control has been reduced and domestic and foreign (private) investment promoted, the state still plays a dominant role in the economy today (Kiyota *et al*. 2007).

Moreover, two other foreign banks (named Banque de l' Indochine and the Compagnie de l' Afrique Oreintale) and a new development bank (societe nacionale d'Ethiope Pour le Development l'Agriculture et du Commerce) were established in 1915 and 1908, respectively. Since all of these banks were wholly foreign owned, they were criticized and as a result the Bank

of Abyssinia was purchased by the Ethiopian government in 1931, which was re-named as the Bank of Ethiopia- the first nationally owned bank on the African continent (NBE, 1999) cited on (Amanuel 2008). Foreign banking activities particularly that of Italian banks were expanded during the five years of the Italian occupation. Year of establishment (European year), name of bank are given in table 1 below.

Year of Establishment (European Year)	**Name of Bank**
1914	Banco di Italia
1914	Banco di Roma
1939	Banco di Napoli
1939	Banco Nacionale (De's voro)
1939	Casa de Creito…
1939	Societe Nacionale di Ethiopia

Source: adopted from Alemayehu 1999

Bank of Ethiopia took over the commercial activities of the Bank of Abysinia and was authorized to issue notes and coins. The Bank with branches in Dire Dawa, Gore, Dessie, Debre Tabor, Harar, agency in Gambella and a transit office in Djibouti continued successfully until the Italian invasion in 1935. During the invasion, the Italians established branches of their main Banks namely Banca d'Italia, Banco di Roma, Banco di Napoli and Banca Nazionale del lavoro and started operation in the main towns of Ethiopia. However, they all ceased operation soon after liberation except Banco di Roma and Banco di Napoli which remained in Asmara. In 1941 another foreign bank, Barclays Bank, came to Ethiopia with the British troops and organized banking services in Addis Ababa, until its withdrawal in 1943. The State Bank of Ethiopia had established 21 branches including a branch in Khartoum, Sudan and a transit office on Djibouti until it ceased to exist by bank proclamation issued on December, 1963. Then the Ethiopian Monetary and Banking law that came into force in 1963 separated the function of commercial and central banking creating National Bank of Ethiopia and commercial Bank of Ethiopia. Moreover it allowed foreign banks to operate in Ethiopia limiting their maximum ownership to be 49 percent while the remaining balance should be owned by Ethiopians (Tassew 2015).

Following the financial liberalization measures taken by a number of countries since 1990s, foreign bank participation has increased in developing countries (Gezae 2015).

The Federal Democratic Republic of Ethiopia has implemented market oriented economic policy reform in which financial sector liberalization was one of policy change made in 1992. As a result, the year 1994 brought new and bright beginning to the banking sector in the country for the re-establishment of private commercial banks with Monetary and Banking Proclamation No 83/1994 and Licensing and Supervision of Banking Business Proclamation No.84/1994 that laid down the legal basis which allowed private sectors to engage in banking business. Moreover, the Proclamations provided additional powers and duties to the National Bank of Ethiopia to license, supervise and properly regulate both the already existing three state owned banks, the newly entrant private banks and other financial institutions operating in the country (Raba 2017). Ethiopia is different compared to its East African neighbours (Uganda, Kenya, and Tanzania) and other developing countries that have not still opened its door for banking sector for foreign bank participation. Ethiopian banking industry remains closed from the impact of globalization. Although Ethiopian policy makers understand the potential importance of financial liberalization, it is believed that liberalization may result loss of control over the economy and even may not be economically beneficial (Tassew 2015).

Since the time of establishment of this government different financial reforms were done including allowing the organization of private banks. Currently, there are seventeen private banks running their business in the country in collaboration with state owned banks. However, since this days the government does not allow foreign banks to enter to the country as well as do not want to open the financial sector to foreign participation and competition. Although, some say it would be good since it may bring different opportunities and advantages for the country in terms of technology, capital flow and global exposure, however, others say not, due to the different problems they may bring to the country like instability and crises; hence, in line with this the purpose of this research is to undertake assessment on the opportunity and challenge of foreign bank entry in Ethiopia.

1.2.Statement of the Problem

According to Senbet & Otchere (2008), as cited in (Legesse 2012), among the developing nations Africa is the only place in the world where private capital investment is exceeded by flow of development assistance. This is mainly because of the lack of well organize and

developed financial markets and poor economic policies and institutions, where Ethiopia is one of them. Financial markets are vital part of an economy making it possible for industry, trade and commerce to flourish without any obstacle in terms of financial resources; furthermore, financial markets also assist the role of the private sector in the economy by providing the required financial resources, diversified investment options and liquidity functions (Legesse 2012). In support of these, a number of studies argue that the entry of foreign banks have positive effect on the performance of host country banks (Demirgüç-Kunt *et al*. 1998; Barajas *et al* 2000; Denizer 2000; Lensink and Hermes 2003). On the other hand, according to Demirgüç-Kunt *et al*. (1998) liberalizing restrictions on foreign bank entry accelerated the efficiency of the domestic banking sector and thereby contributed to long-run economic growth.

Ethiopia's financial sector remains closed and is much less developed than its neighbors. Ethiopia has no capital market and very limited informal investing in shares of private companies. A series of financial sector reforms has been introduced since 1994, when private banks were allowed to be re-established. But the state-owned banks continue to dominate the market in terms of capital, deposits and assets. The current government is committed to alleviating poverty through private sector development and through integrating Ethiopia into the global economy. However, the government does not at this time seem prepared to privatize large state-owned banks, allow for private ownership of land, or open the financial sector to foreign participation and competition (Kiyota *et al*. 2007). Despite the efforts made by the government of Ethiopia in liberalizing the financial sector, the overall contributions of financial liberalization to major economic factors as well as the bidirectional effect between the variables remain a mystery (Mohammed 2016). Nonetheless, liberalization helps fore the integration of a country's local financial system with international financial markets and institutions which can lead to large benefits, particularly to the development of the financial system. This integration typically requires that governments liberalize the domestic financial sector and the capital account; Integration takes place when liberalized economies experience an increase in cross-country capital movement, including an active participation of local borrowers and lenders in international markets and a widespread use of international financial intermediaries (Schmukler 2004). Furthermore, according to Mohammed (2010), cited on Legesse (2012), there are more than 60,000 shareholders in Ethiopia where there is no market for share trading and retarding implying that there is high share illiquidity. If this illiquidity persists, the existing shareholders

tend to frustrate and new shareholders will be discouraged to get into share company business which in effect hinders the growth of investment and private sector involvement in the Economy.

Although, there were considerable amounts of debate on this issue, considering the above mentioned problems the argument is inclined to allowing foreign financial market would make a country more beneficial; however, due to its natural complication creating such situations and opening the door to international financial market is not as such easy task due to political, economic, and social factors. Furthermore, while Ethiopia's financial sector has not been studied to any great extent, the benefits of financial sector liberalization for developing countries have been widely investigated, with conclusions suggesting that there may be significant positive effects involved. Despite all these arguments, the empirical evidence with respect to the effects of foreign bank presence on domestic bank behaviour in Ethiopian is insufficient as there are only very few (Amanuel 2008; Tassew 2015; Mohammed 2016; Raba 2017) studies that has been conducted in the Ethiopian context to ascertain this. Therefore, the purpose of this study is to investigate the opportunities and challenges of foreign banks entry in to Ethiopia, from the perspective of the domestic country and from the eyes of the end users, local banks, regulatory body, and foreign Banks which are eyeing to cash into the opportunity presented.

1.3.Objective of the Study

1.3.1. General objectives

The main objective of the study is to investigate the opportunities and challenges of liberalizing the banking sector in Ethiopia.

1.3.2. Specific objectives

More specifically the study aims at providing insight on the following critical points;

- ✓ Identify the different opportunities that the banks would bring
- ✓ To identify the challenges to foreign banks entry to domestic banks.
- ✓ To assess the effects of foreign banks entry on regulatory body
- ✓ To identify foreign bank mode of entry, if allowed to enter in Ethiopia

1.4.Significance of the Study

The first beneficial of this study would be the government, the government may be interested in finding out how the foreign banks that operate in Ethiopia whether it has negative or positive impact on the local banks and welfare of the country. It might help them in making policies to regulate new entrants into the Ethiopian market as they would be aware of the benefits or challenges it may pose to the local banks. Furthermore, this study draws in the perspective of the various stakeholders involved on the topic and tries to give insight to local banks, regulatory bodies and other stakeholders of what is about to come in the future. The findings of the study might also be used by management body in the banking industry to make accurate decisions towards how to approach the financial markets as they would be aware of the impact that other entrants bring on the banking environment. They may also understand the benefits and drawbacks that will be brought by the entrant of foreign banks in the domestic market. Apart from this, future researchers and scholars may use the study as a source of reference for further research on the same area and it will be important for documenting the research findings for further reference.

1.5.Scope and Limitation of the Study

The focus of this study basically is analyzing only the challenges and opportunities of foreign bank entrance in Ethiopian case only; specifically, the research scope is limited to assessing the problems and prospects of liberalizing financial sectors with a special emphasis on banking sector in terms of its influence on domestic banks efficiency and performance. In addition to this, the research doesn't consider all the financial institutions and sectors; it is limited only to banks.

1.6.Organization of the Study

Generally the thesis organized in five chapters. The first chapter covered the introductory part including problem statement, objective and significance of the study, and scope and limitation of the study. Chapter two deals with a review of related literatures; Chapter three present a general background of methodology. Chapter four explains how the data was analyzed and interpreted. The fifth and last chapter provides a conclusion and recommendations for the future.

CHAPTER TWO

LITERATURE REVIEW

In this section we aim to highlight the possible benefits and drawbacks of foreign bank entry in Ethiopian economy. In this way we strive to identify the channels through which foreign bank entry may have positive or negative effect; accordingly, this chapter incorporates two main sub-topics, the theoretical and empirical backgrounds.

2.1. Theoretical Background

In the past, governments in many developing countries often saw multinational enterprises (MNEs) as part of the development problem, due to assertions of exploitation of the environment and of the labor force. At present, MNEs are seen as part of the development solution for several reasons. The attitude towards inward foreign direct investment (FDI) has changed considerably over the last couple of decades, as most countries have liberalized their policies to attract investments from foreign multinational corporations (MNCs). On the expectation that foreign MNCs will raise employment, exports, or tax revenue, or that some of the knowledge brought by the foreign companies may spill over to the host country's domestic firms, governments across the world have lowered various entry barriers and opened up new sectors to foreign investment. According to the comparative advantage theory, the banks that enjoy a comparative a comparative advantage in the banking industry will offer more competitive financial products, and will therefore be more competitive in international markets. Furthermore, banks engage in foreign entry to increase the bank's profitability, within an acceptable risk profile and risk diversification goals (Mucheru 2011). According to Focarelli & Pozzolo (2000) banks prefer to have subsidiaries in countries where expected profits are larger, owing to higher expected economic growth and the prospect of reducing the local banks inefficiency.

Rugman (1981) argued that the internalization theory can be applied to multinational banks, and concluded that the reasons for internalization include low marginal costs, market intelligence advantages, the information provided by the headquarters in the home country, reputation, regulations(e.g. deposit insurance and foreign exchange regulations), transactions costs , growth and risk reduction. Cho (1986) developed a growth model of multinational banks using eclectic paradigm, and empirically verified that the banks‟ scale of operations in the home country,

differences in loan interest rates, the market size of the host country are the main factors that facilitate the growth of multinational banks in host country. Furthermore, several researchers and financial experts (Greenwood & Smith 1997; Levine 1997; Levine 1999; Levine, Loayza, & Beck 2000) have confirmed the role of banks in the growth process (Arun & Truner 2002). Beck and Levine (2004), Rousseau and Wachtel (2000), Levine (1998) have found that both banks and stock market are essential elements for economic growth of a country. The effects of the entry of foreign banks on development and efficiency appear to depend though on some conditions. Limited general development and barriers can hinder the effectiveness of foreign banks (Garcia-Herrero and Martinez Peria 2005; Demirguc-Kunt Laeven and Levine 2004).

With more limited entry (as a share of the total host banking system), fewer spillovers seem to arise, suggesting some threshold effect (Claessens and Lee 2003). In terms of individual bank characteristics, it seems that larger foreign banks are associated with greater effects on access to financial services for small and medium-sized enterprises, perhaps as they are more committed to the market, while smaller banks are more niche players (Clarke *et al.* 2001). Furthermore, the health of both the home and the local host bank operation seem to matter, with healthier banks showing better credit growth

Banks play a key role in improving economic efficiency by channeling funds from resource surplus unit to those with better productive investment opportunities. Banks also play key role in trade and payment system by significantly reducing transaction costs and increasing convenience (NCA 2006) cited on (Eshete *et al*. 2013). In less monetized countries, like Ethiopia, whilst financial sector is dominated by banking industry, effective and efficient functioning of the latter has significant role in accelerating economic growth. To enhance the role of banks in an economy, competition is an important driving force; without competition, it is improbable to bring about efficiency and foster financial sector development. In other words, insufficient competition may result in substantial social losses on account of higher price, higher transaction cost, lower credit supply, lack of innovation and poor service quality. Although competition has a positive effect on efficiency and economic growth, there are certain characteristics that may indicate restrictions on banking. In the absence of proper information processing (where the problem is eminent in less developed economies), banking industry is more vulnerable to instability relative to other industries, owing to the existence of short term liability versus long

term assets and the presence of highly leveraged firms and banks that have an incentive to engage in risky behavior (Northcott 2004).

Intensive competition may lead to excessive risk taking by banks, which would result in deterioration of the quality of banks' lending portfolio and balance sheets. If banks suffer deterioration in their balance sheets and so have a substantial contraction in their capital, they will have fewer resources to lend, hence a decline in investment spending, and slower economic activity. If the deterioration in bank balance sheets is severe enough, banks will start to fail, and fear can spread from one bank to another. Depositors, fearing for the safety of their deposits and not knowing the quality of banks' loan portfolios, withdraw their deposits to the point that multiple bank failures occur, whose ultimate consequence would be severe contraction in economic activity. This suggests the need for some degree of market power in achieving stability and efficient allocation of resources in banking industry (Padoda 2000).

2.2.Effects of Foreign Bank Entry

2.2.1.1. Credit Availability

Financial integration allows capital to flow from capital-abundant countries, where expected returns are low, to capital-scarce countries, where expected returns are high (Obstfeld & Rogoff 1995). Capital inflows may foster growth by increasing the amount of funding available to domestic projects. More in general, in countries with underdeveloped financial systems like the Eastern European economies, financial integration should increase the supply of finance and thus expand the national financial system of these countries. In this respect, financial integration is expected to spur faster growth across the board (Rajan & Zingales 1998). The beneficiaries of financial market integration may well depend on the nature of the capital flows. Wider availability of funds decreases the interest rate and the ensuing decrease in the cost of capital should abet all firms (Giannetti & Ongena 2005).

2.2.1.2. Sounder Lending Practices

The ownership structure of domestic banks often leads to lending practices that are far from sound. Local governments and shareholders of non-financial companies often control domestic

banks in developing countries. State or corporate control may give rise to conflicts of interests with pernicious effects on financial stability. Furthermore, Opening the domestic financial sector to foreign competition helps to mitigate these conflicts of interests. Domestic firms typically do not control foreign banks. While foreign governments own some foreign banks and these banks may be driven by political motives when lending to their respective home constituencies, these foreign state-owned banks are also naturally unencumbered by any domestic ownership ties and political motivations in making lending decisions (Giannetti & Ongena 2005). Foreign banks are likely to shun businesses created during the transition years, because often these firms were mere conduits to strip assets from the government. There is actually evidence that domestic, in particular state-owned, banks favored transition businesses and in the process of privatization made large loans to potential entrepreneurs to enable them to tender and acquire firms (Simonson 2001). Furthermore, according to Song (2004), foreign bank presence may contribute to the stability of available lending by diversifying the capital and funding bases. In all but a few countries, domestic banks have difficulty in diversifying because their lending is concentrated in the home country. In contrast, foreign banks tend to have more diversified portfolios and also usually have access to sources of funds from all over the world through their branching network. This diversification contributes to economies of scale and scope in the domestic market.

2.2.1.3. Competition, Stability, and Dynamic Effects in the Banking System

According to Crystal *et al.* (2002), in developing countries, foreign bank entry may stabilize the financial system. First, foreign banks have sounder lending practices and accumulate fewer bad loans. In addition foreign banks may be more resilient to negative shocks because of their direct access to foreign savings. On the other hand, foreign banks may introduce more volatility in lending because they can more easily find alternative investment opportunities (Morgan & Strahan 2003). However, the latter effect is likely to be second order in emerging markets that are generally exposed to significantly larger shocks than the foreign banks' home countries. Consistently, de Haas & Lelyveld (2003) find no evidence of increased instability following foreign bank entry for a set of transition countries. To the extent that foreign bank entry actually reduces concentration, fewer, not more, banking crises should ensue (Beck & Levine 2004). Furthermore, the mode of foreign bank entry may also determine its effects on local financing. It

is well known that if foreign banks enter through mergers and acquisitions, they have the potential to harm small local firms borrowing from the domestic target bank. Berger & Udell (1996) find that as domestic banks grow through consolidation, they tend to reduce the supply of loans to small businesses, in particular when the acquirer previously focused on large-firm lending. In general, foreign bank entry may foster competition, efficiency, and stability, in which case firm growth and financing should increase across the board. On the other hand, small firm growth and financing may be negatively affected if foreign banks enter. In that case the net effect will also depend on the dynamic response by other competing banks (Giannetti & Ongena 2005).

2.2.1.4. Enhancing Banking Market Competition and Efficiency

Empirical evidence shows that greater foreign bank ownership indeed reduces the profitability and overall expenses of domestically owned banks. These results suggest that foreign bank entry leads to greater efficiency in the functioning of national banking markets, with positive welfare implications for banking customers. The relaxation of restrictions on foreign bank entry may similarly reduce domestic banking profits and force domestic banks to cut costs, but with positive overall welfare implications for the domestic economy (Song 2004). There was a clear push for the foreign banks as they indicated an improvement in efficiency. Foreign banks were allowed to open branches in India as fully owned or as subsidiaries. They were also permitted to enter into joint ventures with private banks for merchant banking or investment banking (Sharda 2014). Furthermore, In particular, it can play an important role in development efforts, including: supplementing domestic savings, employment generation and growth, integration into the global economy, transfer of modern technologies, enhancement of efficiency, and raising skills of local manpower (Mucheru 2011).

2.2.2. Challenges of Foreign Bank Entry

2.2.2.1. Likelihood of Bringing Instability

It is argued that foreign banks will be more likely to shift their funds to more attractive markets during a crisis if their parents are weak. There are two related issues here: (i) whether the presence of foreign banks makes systemic banking crises more or less likely to occur, for example, by providing an additional avenue for capital flight, and (ii) whether there is a tendency

for foreign banks to "cut and run" during a crisis. On the other hand, foreign banks can contribute to the stability of the domestic financial system, for example, if depositors shift their deposits to foreign banks from their risky local banks rather than engaging in a capital flight (Song 2004). Levine (1999) concluded that greater foreign bank participation was a stabilizing factor in a crisis situation.63 In contrast, in their empirical studies on the links between foreign banks and stability in emerging market banking system, on the other hand Mathieson & Roldos (2001) draw no firm conclusion on whether foreign banks provide emerging market banking sectors more stability and lessen credit volatility. With regard to the foreign banks' lending tendency in a crisis situation, some empirical studies argue that a bank's soundness and not ownership, as such, is the critical element in the growth and volatility of bank credit

2.1.1.1. Challenge the Performance and Weakening Domestic Banks

The main argument against an early market entry of foreign banks is the risk that domestic financial institutions would not be able to withstand increased competitive pressure and might even risk facing bankruptcy. Such banking failures might have spillover effects on other banks and could possibly endanger stability in the financial market If domestic banks fall under the "too big to fail" category and thus require some support, suppressing competition from new entrants can be an inexpensive form of support. Restricting bank entry is a way of providing a hidden subsidy to the existing industry and temporarily avoiding the costs of restructuring the financial sector. Such delays also bear a social cost, since inefficient banks will continue to misallocate resources (Song 2004).

2.2.3. Forms of Foreign Bank Entry and Form of Organization

Empirical evidence shows that in emerging markets, foreign banks are more profitable and more efficient than domestic banks (Bonin *et al*. 2005), while being less profitable in more developed countries (Demirguc-Kunt and Huizinga 2001). These contrasting findings heat the debate as to what extent foreign bank entry benefits customers. Traditional industrial organization literature predicts that bank entry leads to more competition which should ultimately help borrowers. Indeed, foreign bank presence in emerging countries increases access to loans, especially for large and transparent firms (Mian 2006). Differences in information distribution (*soft* versus *hard* information) between domestic and foreign banks may however obstruct a likewise impact

on lending to small and more opaque firms (Dell'Ariccia and Marquez 2004). These firms are often captured by their domestic bank and barred from foreign lending.

Each host country determines the types of foreign bank operations it will permit. Desired forms of entry may vary from bank to bank and from country to country, depending upon business-strategy considerations and host country-laws and banking structures(Song 2004) . Banks initially extended their services abroad in order to assist their home-country customers with international transactions. With a growing understanding of foreign markets and a more developed network of relationships with local financial institutions, some banks subsequently increased the range of their operations by adding local customers. Following this pattern, foreign banks would first establish representative offices. At a later stage, they would open branches and, eventually, establish subsidiaries (Amanuel 2008). Today, the actual pattern of foreign bank entry depends on a wider range of factors. In particular, the profit opportunities in the destination market have become a key factor in determining the pattern of foreign bank entry. As a result, forms of foreign participation have become more varied, including full acquisition, targeted purchases of specific activities, joint ventures, alliances with local banks, and outsourcing of administrative and financial services.

a) Representative Offices

A representative office is the most limited but most easily established organizational form. It does not engage in attracting deposits and extending loans, but is generally established to test the possibility of further involvement (Goldberg 1992). In theory, representatives have little more than a public relations function and are used in situations where regulations are present or profit opportunities are low because of low income per capita (TerWengel 1995). An agency is a more costly form of foreign banking operation than a representative office and may be warranted if banks engage in very substantial export servicing and subsequent heavy involvement in the foreign exchange market (Heinkel and Levi 1992; and Tschoegl 2002). Representation with an agency also allows a bank to make commercial loans, although business related to consumer loans or deposits is not permitted (Goldberg 1992).

Representative offices are generally prohibited from performing any banking operations. They do, however, offer opportunities for contracts with the parent bank and its clients concerning a

variety of commercial and financial business that relates to the foreign market. In terms of market readiness of foreign banks entry, All participants (except foreign bank representative's) agreed that the necessary capital , human resource , banking technology and basic infrastructure does not enable the local banks to compete with foreign banks at this stage and it will take several years to have all of the above important components ready; while foreign bank representatives argue that the market is asking for their entry and that their entry will facilitate the completion of above mentioned components (Tassew 2015). According to Song (2004),
Banks initially extended their services abroad in order to assist their home-country customers with international transactions. With a growing understanding of foreign markets and a more developed network of relationships with local financial institutions, some banks subsequently increased the range of their operations by adding local customers. Following this pattern, foreign banks would first establish representative offices. At a later stage, they would open branches and, eventually, establish subsidiaries. Setting up trading relations with domestic banks, by establishing representative offices or branches in order to secure their presence in the new markets and to monitor the new markets successfully (Charalambos 2007).

b) Foreign Branch

A foreign branch constitutes a higher level of commitment than a representative office or agency. The crucial difference between a foreign branch and a foreign subsidiary is that, legally, a branch is a unity with its parent and a subsidiary is an independent legal entity. Other differences between branch and subsidiary regard supervision, risk and performance. While home country supervisors supervise branches, local supervisory authorities supervise subsidiaries. Subsidiaries are subject to local lending limits associated with the level of their capital, while for branches no local lending limits are involved as from a consolidated point of view, they rely on the capital of the foreign parent (Naaborg 2007). Foreign branch is an overseas office of a bank incorporated in a foreign country and constitutes a higher level of commitment than a representative office. Foreign bank branches are typically involved in wholesale banking. Other countries follow a "*single-entity"* doctrine and consider a bank and its foreign branches as a whole and give an equal treatment to all creditors wherever their domicile (IMF 1998). For example, the Canadian and American legislations allow the authorities to "separate" the branch from its parent company and use the assets in order to cover the liabilities under the host country regulations. Although

Canadian and American laws grant the authorities the right to seize the assets of a branch of a bank that is being liquidated abroad, it is not clear what will happen when the home country regulator or a third party seeks to challenge such actions, especially in a country characterized by the single entity doctrine (U.K.) in which a branch cannot be separated from its parent bank (Cárdenas *et al*. 2002).

Based on a real option approach, Gulamhussen (2004) argues that banks use scale to rationally manage risk in their foreign market entry decision under uncertainty. Banks set up small-scale offices to get a foothold and large-scale offices to seek new customers and compete in foreign markets. Goldberg and Johnson (1990) pose that US banks wanting to expand with large operations should do so in countries with less restrictive regulation, high levels of FDI by US companies, large relative foreign trade, and lower levels of GNP per capita and domestic deposits (Naaborg 2007).

c) Bank Subsidiaries

Bank subsidiaries' are separately incorporated from the parent bank, whose financial commitment to the subsidiary consists of the capital invested. Subsidiaries are usually involved in retail banking markets. However, in some countries such as the United Kingdom, subsidiaries are often involved in wholesale investment banking operations. It is noteworthy that foreign bank entry through openings of branches (foreign bank subsidiaries have only rarely been established), which had been the most important organizational form of foreign entry until 1997, began to slow substantially from 1998, following its strong increase during the three consecutive years from 1995 to 1997 (Kim 2005).

d) Establishing an Affiliate Relationship or Participating in a Joint venture

This can be another way to engage in foreign expansion. This usually involves taking minority stakes in local entities, and the level of involvement in the management of the local banks by the foreign bank is normally low. The joint ventures modes are formed by more than one firm. They generally have a financial interest and a board membership. A joint venture is an arrangement where the firm is required to share equity and control of the venture with a partner from the host country. This entry mode requires lower investment compare to the other modes available. As a result out of this, it provides risk, return and control commensurate to the extent of equity

participation of the investing firm (Taylor *et al*. 2001). Much of the modernization and privatization initiatives in Albania are due to the international organizations, which has entered into the Albanian market mostly through joint venture. Those who mostly have used this type of entry mode belong to the telecommunication sector. Foreign companies have used home companies' know - how and experience to make a successful entry strategy in this market (Këllezi 2013). The preference of affiliates and subsidiaries can be easily interpreted from the need of the financial institutions to offer specialized banking services to their corporate customers while at the same time a careful monitoring of the market and supervision of the trade is achieved. In addition, banks being companies from a neighboring country enter into the emerging markets of host country, merely by having acquired the local banks and by establishing subsidiaries in these countries (Charalambos 2007).

2.2.3.1.Out Look of Current and Future of Banking Sector in Ethiopia

Ethiopia enjoyed positive development of real GDP for the period during 1998-2008, except the fiscal year 2002/03. Comparing the first and second half of the decade, the recent five years, in terms of GDP, has shown significant progress an average growth of 11.78 per year. However, in both period agriculture constituted the lion share compared to other sectors contribution (Amanuel 2008).

Over the past decade, Ethiopia has achieved impressive economic growth averaging close to 11 percent annually (World Bank 2013). The development of a vibrant and active private banking system that complements existing public sector work is considered important to Ethiopia's economic progress by a range of experts, including the World Bank, the African Development Bank (AFDB), and the International Monetary Fund (IMF). These bodies view the expansion of the private banking system in a prudent and controlled manner as key to the success of Ethiopia's "Growth and Transformation Plan (GTP)," an ambitious five-year development plan launched in 2010 to assist the country in reaching "middle income" status (Keatinge 2014:14).

Compared to most countries, Ethiopia has taken a cautious approach towards the liberalization of its banking industry. For all intents and purposes, its industry is closed and generally less developed than its regional peers. The industry comprises one state-owned development bank and 18 commercial banks, two of which are state-owned, including the dominant Commercial

Bank of Ethiopia (CBE), with assets accounting for approximately 70 percent of the industry's total holdings (IMF 2013). The banking industry's nonperforming loan ratio is commendably low, and profitability is good, but the dominance of public sector banking certainly restricts financial intermediation and economic growth. It contrasts with regional and international peer countries where banking industries have a much higher share of private sector and foreign participation (World Bank 2014).

According to Gezae (2015), the last ten years have seen some improvement in the works of various participants of the banking sector in Ethiopia. The government and the National Bank of Ethiopia have followed a step-by-step approach in transforming the sector, not a big bang one. For instance the entry of foreign players is still prohibited. The introduction of new technological solutions such as the CORE-Banking system has improved customer service. Some gaps however remain such as lack of an inter-bank interest rate benchmark, absence of an active secondary market for debt and equity instruments and the money market. Besides, the exchange rate regime is also still a managed float system. On the whole, the cumulative effect of the developments since the deregulation in 1991 can be considered a good move particularly with respect to the emergence of new banks and the automation of banks in providing real time banking products and services and enormous change in the outreach of bank branches.

The structure of the banking sector is unique on account of the dominance of state-owned banks, which control two-thirds of the local banking sector and which the government uses to set the desired levels of lending (such as investment in specific sectors and government projects to boost economic growth). This is contrary to the trend elsewhere in Africa, where private sector banks dominate the banking sector and drive economic growth via credit to the private sector. The loan book for the Ethiopian banking sector grew by a compound annual growth rate of 20.4% in the past six years to ETB151.28bn in 2013 (USD7.81bn) on the back of significant credit disbursement by public sector banks. The CBE alone accounts for over 52% of the industry loan book, while collectively the three public banks account for over 68% of outstanding credit to the economy. The top five banks (CBE, DBE, Awash, Dashen, and United Bank) collectively account for over 82% of outstanding credit. This makes the Ethiopian banking sector highly concentrated banking sector in Africa (Ecobank. 2014).

By comparing the level of access to financial services in a neighbouring country such as Kenya, it can be deduced that there is considerable room for expansion of these services in Ethiopia. Kenya has 5.2 commercial bank branches and 9.5 ATMs per 100,000 adults, in contrast with Ethiopia's 2.0 and 0.3, respectively (World Bank 2014). This lack of financial access extends to Ethiopian businesses. The 2012 Ethiopia Enterprise Survey highlights access to finance as the major developmental constraint for small (38 percent of those surveyed) and medium-sized (30 percent) businesses. This compares to a sub-Saharan African average of 21 percent and 15 percent, respectively (Ibid). This situation is compounded by the government's direction, via the CBE, to focus lending and investment to public enterprises generally and the regulatory requirement that a substantial portion of private sector banking already limited lending capacity be used to purchase NBE bills equivalent to 27 percent of any new loan disbursements, thus removing the possibility of investing or lending these funds (Keatinge 2014).

Legitimate concerns have been expressed about allowing domestic banking expansion and the increased entry of foreign capital into Ethiopia. Such measures could result in destabilizing disruption caused by "hot money" flows and skewed allocation of credit toward more-attractive borrowers, such as larger industrial companies that already have access to bank lending, rather than smaller-scale enterprises (Kiyota *et al.* 2007). Yet, controlled development and expansion of private sector banking, including the admission of foreign capital and operators, can deliver meaningful benefits to a country such as Ethiopia. These benefits may include improvements in the overall efficiency of the sector, the transfer of skills for employers and regulators, and greater financial stability by reducing the need for cross-border flows. Thus, although mismanaged financial development can lead to financial crises, forming policies that promote successful financial development can greatly improve the environment for economic growth (Mishkin 2007). The lack of domestic savings opportunities provided by private banks and the limited available access to bank credit for small businesses dramatically restricts economic growth potential. Public sector banks will inevitably lead investment in key developmental projects such as those involving infrastructure, but broad-based development is required in order to create sustainable economic growth, and this investment typically comes from private sector banks as their deposit base grows. Expanding the banking system will create greater savings opportunities that will in turn boost funding via savings. The alternative is a country's heavy reliance on external sources, private or official value transfers such as remittances, and external borrowing.

None of these approaches is within a nation's control, and thus all are unreliable. In contrast, a developed domestic savings market can be controlled and managed within a country and create a much more stable base from which investment can be made. Thus far, as the recipient of significant private and official value transfers, Ethiopia has relied less than many of its peers on external borrowing. This is a strength for the country that should be preserved if at all possible, and development of a private sector banking–led savings market will be key to maintaining this national advantage (Keatinge 2014).

2.3.Empirical Review

Legesse (2012) examine the environmental foundation for establishing financial markets in Ethiopia; identify the potential challenges and opportunities. His emphasis was identify the roles that financial markets can play in expediting Ethiopian economy, the environmental factors that need to be analyzed the current situation of Ethiopia in terms of each factor. He used secondary data sources basically and employed both qualitative and quantitative features. The findings of the study are presumed to be of paramount importance in providing input information for policy makers towards establishing financial markets in Ethiopia. As a way forward the Government of Ethiopia need to take timely actions to further investigate the environmental situation to establish financial markets, appreciate the potential opportunities and make preparations towards addressing the direct challenges.

Raba (2017) analyze the prospects and challenges of foreign bank entry in Ethiopia using a descriptive statistic. The finding of the study shows that foreign bank entry in Ethiopia could introduce new banking technologies, financial innovation and promote financial development. In addition, it enhances access to international capital and may precipitate the overseas expansion of domestic banks and greater integration of Ethiopian banks into international financial systems, which may enable them to provide a broader range of services, particularly to larger local firms with international operations. On the other hand, the stiff competition with foreign banks may threaten the survival of domestic banks that may lead them to incur high cost in the short run and decline in profit. In addition, it may; bring shocks from other country, destabilize domestic credit and may serve more productive sectors only. He also recommend that allowing foreign bank

entry in Ethiopia step by step is advantageous with extensive capacity building to all stakeholders and implementation of modern banking technologies.

Kiyota *et al*. (2007) analyze the issues of financial sector liberalization in Ethiopia, with reference in particular to the Ethiopian banking sector. The finding of their study indicates that, they identify two factors that may constrain Ethiopia's financial development. One is the closed nature of the Ethiopian financial sector in which there are no foreign banks, a non-competitive market structure, and strong capital controls in place. The other is the dominant role of state-owned banks. Our observations suggest that the Ethiopian economy would benefit from financial sector liberalization, especially from the entry of foreign banks and the associated privatization of state-owned banks.

Cho (1990) has studied about foreign banking presence and banking market concentration on banks in Indonesia; he has found that foreign bank presence in Indonesia contributed to increased competition in the banking market. The most comprehensive study on the efficiency and competition effects of foreign bank presence is studied by Claessens *et al*. (2001). By having a large data set containing individual bank accounting information of domestic banks in 80 countries for the period 1988-1995, they found that the increased presence of foreign banks is associated with reductions of profitability, non-interest income and overall expenses of domestic banks.

Denizer (2000) analysis the effects of foreign bank presence on domestic banks in Turkey. His empirical results explain that net interest rate margins, returns on assets and overhead expenses of domestic banks decrease after foreign banks have entered to the market. These findings support the idea that foreign banks put spirited pressure on the domestic banks in Turkey, despite the fact that these foreign banks had a market share of only between 3.5 and 5 per cent during the period 1970-1997. Barajas, Salazar and Steiner (2000) found out the same study focusing on the Colombian banking system and using individual bank accounting data for the 1985-1998 periods. Their studies explain that foreign banks presence totally increases competition in the domestic banking system as evidenced by reduced intermediation spreads. Foreign bank presence is also associated yet with a deterioration of reported loan quality among domestic banks. Molina (2010 page10) however, administrative costs of domestic banks rise, probably due to the fact that these banks should upgrade their performance because of increased

competitive strain. Thus, on the whole foreign bank presence seems to be associated with an increase of costs for the domestic banking system in Colombia.

Lensink and Hermes (2003) studied on the short-term effects of foreign bank presence on domestic bank performance, using data of 990 banks for the period 1990- 1996. The paper investigates the short-term effects of foreign bank entry on the behaviour of the local banking sector. They argue that these effects are dependent on the level of economic development of the host country and showed that in the lower levels of economic development foreign bank entry is generally associated with higher costs and margins for domestic banks. At higher levels of economic development the effects appear to be less clear: foreign bank entry is either associated with a fall of costs, profits and margins of domestic banks, or is not associated with changes in these domestic bank variables.

2.4.Literature Gap

The literature mentions several arguments why foreign bank presence (Cho, 1990; Stiglitz 1994; Levine, 1996; Buch, 1997; Berger and Hannan, 1998) may influence domestic bank performance.

First, the presence of foreign banks may stimulate domestic banks to reduce costs and increase efficiency of existing financial services through competition. In the presence of foreign banks domestic banks are pressured to improve the quality of their services to retain their market shares. Secondly, foreign banks presence could lead to positive spill-over effects. To begin with, foreign banks may introduce new financial services. The introduction of these services may motivate domestic banks to develop such new services, improving the efficiency of financial intermediation of the domestic financial system. Thirdly, foreign banks may increase the quality of human capital in the domestic banking system in a several ways. To begin with, if foreign banks import high-skilled man powers of bank managers to work together with in their foreign branches, local employees/bankers may learn from the practices of these foreign bank managers.

There is also experience of the impact of foreign bank's participation in dissimilar countries. A significant issue for emerging market economies is if the entry of foreign banks contribute to the banking system' s stability and being a stable source of credit or not, especially in periods of

crisis. Mathieson and Roldos (2001) have discussed two related issues: whether the presence of foreign banks make systematic banking crises, more or less likely to occur, and whether there is a tendency for foreign banks to “cut and run” during a crisis. In general, it has been recommended that foreign banks provide stable source of credit because the branches and the subsidiaries of large international banks can draw on their parents (which is typically hold more diversified portfolios) for additional funding.

The local studies conducted in this area include Getnet (2010) who investigated investment limitations in and by banks in Ethiopia. Abreham (2008) showed that if foreign banks allowed operating the survey respondents demonstrate an affirmative impact on domestic banking efficiency. However, foreign banks are expected to exert and adverse effect on performance and possible exposing the sector to crises. In addition to the above mentioned studies, different investigations have been made on foreign banking (Amanuel 2008; Legesse 2012; Eshete *et al.* 2013; Gezae 2015; Mohammed 2016; Raba 2017). study on foreign banking in Ethiopian case can be seen from two different points of view, the first view was analyzing the sector from the points of view of analyzing its effect on pure financial sector of the country; the second point of view was looking the issue of foreign banking as a determining factor for the development of banking sector and Ethiopian economy as a whole. most of the prior research on the entrepreneurial teams of academic spin-offs from research institutes has focused on the developmental issue. The effects of foreign banking on the development and performance of local banking industry and national economy which have been analyzed mainly on mixed type of research approach; thus, further qualitative empirical studies are needed. In this context, therefore, the theoretical approach must be extended from the point of view of investigate the challenges and opportunities of foreign banks entry in Ethiopia. Hence, this study believed to address this gap.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1. Research Design and Approach

The study employed a qualitative approach and generated qualitative data. The qualitative approach is adopted to get more insight and generate explanations about the opportunities and challenges of foreign bank entry. In terms of time frame, the study adopted across-sectional research design in which data from the subjects were collected in a snap shot in April 2017. As a matter of fact, this research is conducted to analyze the extent of the challenges and opportunities of foreign banks entrance in Ethiopia; hence, it follows exploratory research design. According to Bhattacherjee (2012), exploratory research is often conducted in new areas of inquiry, where the goals of the research are: to scope out the magnitude or extent of a particular phenomenon, problem, or behavior, to generate some initial ideas (or "hunches") about that phenomenon, or to test the feasibility of undertaking a more extensive study regarding that phenomenon.

3.2.Population and Sampling Design

The target populations of this study are professionals and expertise of financial sector specifically 22 individuals who are engaged in the banking industry for long period of time, Hence, for the purpose of selecting the sample the researcher used purposive sampling, in which the right respondent was selected purposely. The purposive sampling is selected by some arbitrary method because it is known to be representative of the total population, or it is known that it will produce well matched groups. The idea is to pick out the sample in relation to some criterion, which is considered important for the particular study. This method is appropriate when the study places special emphasis upon the control of certain specific variables (Singh 2006). To purposefully select participants or sites (or documents or visual material) means that qualitative researchers select individuals who will best help them understand the research problem and the research questions. Furthermore, purposeful sampling, collection of open-ended data, analysis of text or pictures, representation of information in figures and tables, and personal interpretation of the findings all inform qualitative methods (Creswell 2014). Therefore, using purposive sampling the research made in depth interview with national bank officials, private bank experts, foreign representative bank officials, MOFED and EEA.

3.3.Data Collection Procedure

Both primary and secondary data were gathered. Since the issue needs only the argument and comments of professionals and individuals who had expertise in the sector, only selected professionals and stakeholders were included in the interview. Primary data are collected from different stake holder's including regulatory bodies of banks using in-depth interviews and key informant interviews. The key informants were the senior professional bankers who had long years of experience. The data collected from the interview participants would have their perspective in the research topic and theoretical assumptions stated in the literature reviews. Secondary data were collected from different publications such as previous researchers, journals, and different financial books. Furthermore, the data collection instruments were developed by the researcher. The questions were open ended questions and the questions were classified into 4 categories as per the relevance to the participant.

The Interview questions categories are the following:

I. National Bank of Ethiopia officers and experts
II. Local banks employee experts(Commercial Bank of Ethiopia, Dashen Bank, Awash International Bank).
III. Foreign representative banks officials
IV. Other financial sectors stake holders such as MoFED, EEA

3.4.Method of Data Analysis

The study has utilized qualitative data analysis techniques. Qualitative analysis is the analysis of qualitative data such as text data from interview transcripts (Bhattacherjee 2012). Hence, the qualitative data has been analysed by using content analysis technique. By which the data is organized in line with the research objectives. Furthermore, the data was categorized and analysed by using analytical method through aligning with the research objectives to the findings obtained from the collected data.

CHAPER FOUR

DATA ANALYSIS AND PRESENTATION

Since this study follows a qualitative approach the data was collected basically using interview which was administered by the researcher, and the questions are directly concerned about opportunities and challenges of allowing foreign bank entry in Ethiopia. As a matter of fact the researcher understood that respondents has given their response as per required and most of them reflect their opinion that helped me get in-depth and pertinent information from a variety of professionals. As the respondents were purposely selected based on their qualification, experience on policy making, macroeconomic policy management and financial regulation, they expressed their suggestion on what should be done and not regarding foreign bank entry into the country. Accordingly, in this part in following the respondent’s characteristics both the opportunities and challenges of foreign bank entry in Ethiopia would be discussed respectively.

4.1. Characteristics of Respondents

All of the interviewed respondents of this particular study were a graduate of recognized university ranged in the age between 30 and 40 years of age and they have long experience in the banking industry, hence, possibly to say they have vast knowledge and skills. The respondents have worked in the bank industry for a period of between 6 to 10 years, this gave an edge on the know-how of how the banks operate and the effects they have on the banking sector as a whole. The study being done from the top management of the bank made them appropriate to objectively answer the questions that were presented to them as they had the necessary knowledge on the topic under study and were well versed with the banking sector.

4.2.Opportunities of Foreign Bank Entry in Ethiopia

The evidence that foreign bank do not merely follow home country customers abroad. They also go abroad to pursue local profited opportunities, especially in developing economies. In this Section we aim to highlight the possible benefits of foreign bank entry, in particular for Ethiopian economies. In this way we strive to identify the different advantages these banks brought to the countries, the main issue that the researcher explores in the rest of the paper. Accordingly, the different opportunities of foreign banking in Ethiopia are discussed below.

4.2.1. Improving Financial System Infrastructure

With regard to the financial system infrastructure the interviewed respondents replied that it will be good if foreign banks enter in to the country because they bring advanced way of financial system since they have huge experience in the sector; in addition they argue that if the foreign banks starts to run here they also push technological advancement, this is because their financial system may need more advanced computer technologies so that new firms or the government itself starts to work on it to stabilize the system. In line with this, Raba (2017) argue that foreign bank participation improves the country's financial system infrastructure such as good banking practice, and know-how, financial regulation, managerial and supervisory skills to international best practice. Furthermore, according to Levine, (1996), foreign bank encourages the upgrading of additional institutions such as accounting, auditing and rating firms, thereby improving the quality and flow of information about firms and banks. Amanuel, (2008), also argues that foreign bank with better practice and know-how spillover the trained to domestic financial sector to fill the gap in the development. Supporting this foreign banks could make improvement in the financial sector includes accounting and transparency, financial regulation, and through the increased presence such supporting agents as rating agencies, auditors and credit bureaus. Furthermore, in support of this argument Gopalan & Pajan, (2010), said that foreign bank presence may create pressures for local banking authorities to enhance and eventually harmonize regulatory and supervisory procedures and standards and the overall financial infrastructure to international best practice implying that foreign bank involvement in banking business in Ethiopia would improve the country's financial system infrastructure from present status.

4.2.2. Enhance Credit Access

The results of the analysis indicates majority of the interviewed experts agreed that allowing the foreign banks help to have enough credit to emerge small scale enterprises as well as large investors although the effectiveness of the credit is in question. Furthermore, according to the respondent the entry by foreign banks will further skew credit allocation towards large-scale industrial, real estate and service enterprises (including trade) and away from agriculture, small-scale and cottage/micro enterprises (sectors which are the priorities for the government's development strategy). The respondents also contend that foreign banks will concentrate lending in major urban centres using foreign funds, contributing little towards the development of rural

banking. According to Cárdenas *et al.* (2002), small and medium sized firms play a major role in emerging markets economies especially in developed countries as they represent around 90 percent of the total firm's population and generate a large share of employment and value added in the economy. These firms are also significant sources of innovation. Access to credit is crucial for small business survival, and a key supplier of credit to SMEs is the commercial banking system. Banks may play an even greater role in emerging market economies in which they are the main financial intermediaries. The widely held view is that foreign banks generate positive effects for the host countries in which they establish a local presence. Foreign banks unambiguously stimulate the performance of financially constrained firms even after controlling for credit to the industrial sector by domestic banks (Bruno & Hauswald 2012).

Giannetti & Ongena (2005), also argues that since all firms borrow from banks, the benefits of foreign bank entry may well be more evenly distributed. Foreign bank presence fostering the development of the banking system widens the availability of credit and relaxes firm capital constraints also for small and young firms. Foreign bank presence may thus have pervasive positive effects on a country's level of entrepreneurial activity. The presence of foreign banks are generally agreed to increase the amount of funding available for domestic projects by facilitating capital inflows. Foreign banks are often better equipped and more experienced than local banks in the handling of international finance and financial instruments which require an international network (Song 2004).

4.2.3. Increase Competition and Efficiency

Regarding competition and efficiency the analysis indicates that, respondents argue that competition by itself create efficiency, according to them as the number of banks increased in the market the competition is going to be high, which leads to banks to use their maximum in terms of resource such as human, material, technology, and etc. And ultimately this leads to efficiency. Furthermore, when foreign banks get a permission to enter in to local market, they come with high technology, skilled man power, and more experience, good will and high foreign currency capacity which lead to efficiency of the banking sector in the host market. This is because domestic banks are forced to compete with more efficient foreign banks and because of skills and technology level improvement.

According to Zhao (2009), there are two point of views concerning the advantages of foreign bank entrance regarding competition and efficiency. The first view is that the foreign banks access can improve the efficiency of the banking system. It is believed that the entrance can promote the efficiency directly or indirectly through competition effect and the spill over effect. In theory, there are three ways in affecting the banking efficiency of the host country. Firstly, market competition can improve the banking operation. Secondly, the technology transfer of organization and management can improve the efficiency. Finally, the standardization and improvement of banking industry environment is taking an important part as well. The second point of view is that the impact of efficiency caused by foreign banks entering is uncertainty because the influence depends on the number of foreign banks, the capacity of demonstration and transmission, and the initial conditions of the host country financial opening up and the situation of native supervision. The core idea of the uncertainty theory is that the efficiency improvement of local banks in emerging countries is affected by other factors like initial conditions and path dependence

According to Cárdenas *et al*. (2002), foreign bank presence may also foster efficiency and development of domestic financial markets by increasing the number of financial products available to local customers through imported technologies and know-how. It is also worth mentioning that recent research on competition in the banking industry highlights the presence of foreign owned institutions as a mitigating factor of the possible negative effects of increased market concentration. Moreover, foreign banks make domestic banks improve their performance levels this is greatly seen by having products that customized banking products, improved customer relations that put the banks at a better marketing position with their clients as they feel appreciated and recognized (Mucheru 2011). It is frequently asserted that foreign bank entry renders national banking markets more competitive and, thereby, can force domestic banks to start operating more efficiently. Foreign banks may well introduce competitive pressures that would benefit both savers and lenders (Song 2004). Furthermore, In support of the issue that the advantages of foreign bank entry most of the studies are indicating that the entry of foreign banks plays an active role in promoting the efficiency of the host country's banking sector through the market competition (Classens and Glaessener 1998; Claessens and Klingebiel, 1999; Cárdenas *et al*. 2002; Zhao 2009; Raba 2017).

4.2.4. Develop the Financial Market & Foreign Currency

The analysis of this study indicates in Ethiopia the problem of foreign currency is not uncommon; the existence of foreign banks may solve such problems, according to some of the experts if there is enough stock of hard currency there will be more imports which create good competition in the market which finally made the consumer beneficial with competitive low commodity price. In line with this, Amanuel (2008), explained that regarding the trade balance of Ethiopia there still exist a wider gap between the import and export of goods, which recently resulted in the increase in rate of foreign exchange. In turn, this resulted in the reduction of importable items from abroad. It is in this situation that, some big companies were observed to face shortage of foreign currency. He further contended that the entrance of foreign banks increase the sock of hard currencies which in turn bust the importable items, upon which the government collect the tax on the imported items.

The existence of foreign banks would be good for the development and promotion of foreign exchange market (Zhao 2009). Furthermore, the entry of foreign banks will assist in the development of financial markets. For example, foreign banks that lack a branch network to guarantee deposit financing of their activities are more likely to turn to the interbank market. Foreign banks can also contribute to bringing professional expertise to the local foreign currency markets. Foreign bank branches are sometimes willing to undertake the obligations of "market makers" if they are authorized foreign exchange dealers. They can contribute to both the level of competition and professional expertise of the market (Song 2004). Furthermore, according to Mucheru (2011), foreign banks investment in the banking sector can solve various major problems of a country like financial insecurity, incompetent management, capitalization problem, altering the financial market environment and technical progress in the foreign market. It also helps in handling problems relating to innovative financial products and nonperforming assets. Banking sector as a whole has benefited from the globalization of the financial market due to more developed IT systems, better management techniques and a wide range of products and experience that the foreign banks bring to the host country; because globalization of capital market has added speed to the international trade in the country. Without finances one cannot expect any trade to take place either domestic or international (Mucheru 2011).

4.3. Challenges of Foreign Banks Entry in Ethiopia

The banking system is often said to act as the nervous system of an economy. Banks play a central role in the allocation of financial resources and manage most financial transactions. Because they are leveraged institutions, banks are inherently vulnerable to runs. Under certain conditions, the failure of a single bank can prompt depositors to flee from otherwise sound institutions and precipitate a collapse of the system. Therefore, opening the banking sector to foreign capital is a delicate operation that involves more complicated policy considerations than the opening of other service or goods sectors (Martinez-Diaz 2007). Foreign banks entry could have a number of complications for the host country, accordingly, the major challenges and threats of foreign banks entry in Ethiopian context is discussed below.

4.3.1. Weakening and Challenge the Performances of Domestic Banks

Literally people respond this answer if somebody asked what would happen if the foreign banks join the local financial market. The findings of this study contend that majority of the banks would be out of market within short period of time, according to the respondents this is due to very low capital of the banks compared to the international banks, some of the expert key informants replied that even the capital of all private banks together couldn't compete with a single international banks. Apart from the huge capital this foreign international banks have very exhaustive marketing experience which could make the local banks empty hand. In support of this Amanuel (2008), argues that the development of a viable domestic banking sector will be threatened by foreign banks, because they have more capital, more experience, and better reputations. They argue that the Ethiopian financial sector is too young and inexperienced to compete (the infant industry argument). Furthermore, according to Martinez-Diaz (2007), foreign ownership of the banking sector is neither a straightforward cure for weak banking systems nor the neocolonial invasion feared by nationalist politicians. Foreign capital can be leveraged to strengthen the banking sectors of developing and transition economies, but how the opening process is managed is crucial. In addition to this, Song (2004), also argues that the main argument against an early market entry of foreign banks is the risk that domestic financial institutions would not be able to withstand increased competitive pressure and might even risk

facing bankruptcy. Such banking failures might have spillover effects on other banks and could possibly endanger stability in the financial market. According to Raba (2017), foreign bank entry has some adverse effect especially in the case of developing countries. Many evidences show foreign banks have more capital, experiences and better reputation compared with local banks. On the other hand, the banking sector in Ethiopia is relatively undeveloped and till infant in terms of capital bases, assets, skilled man power, modern banking technologies compared with foreign banks. Allowing foreign bank entry in this situation may threaten the survival of local banks.

4.3.2. Threat of Bringing Instability

When the economy is at its steady there would be stable flow of credit, according to the key informant of bank experts sometime when the economy is unstable, instead of making some adjustment and contribute to the stability of the economy in the host country these foreign banks make a capital flow to another station or country where there is good economic transaction in which exacerbate the problem of the economic situation. In support of this Clarke *et al.* (2003), said that foreign banks could increase instability if they reduce their exposure during financial crises. Furthermore, according to Li *et al*. (2015), the fear was that foreign banks would crowd out domestic banks, and also that foreign banks would be under the control of their parent corporations rather than responsive to host country monetary authorities, and this would be a source of financial instability for the host country. Foreign bank may decrease the stability of aggregate domestic bank credit by withdrawing or transferring funds from local markets in the face of crises either in host or home country (Raba 2017). Furthermore, during an economic crisis in the host country, foreign-controlled banks will behave in a way that mitigates or exacerbates the shock. Because their parent institution is based abroad, a foreign bank should be able to inject liquidity into the banking system even when domestic banks are embroiled in the crisis and are forced to cut back their lending. Foreign banks could, in theory, act as lenders of last resort. Yet, because foreign banks operate their subsidiaries in the context of a global strategy, sometimes the parent institution may make decisions that are good for the parent but bad for the branch or subsidiary in the host country (Martinez-Diaz 2007). It is also argued that the presence of foreign banks may not necessarily yield a more stable source of credit to

domestic borrowers because foreign banks can, at times, shift funds abruptly from one market to another for risk management purposes (Song 2004).

4.3.3. Possibility of Loss of Control over Foreign-Owned Banks

When foreign banks arrive to the host country, even though governments feel it understand the pros and cons of that foreign investment, however, sometimes these multinational financial corporations have multiple ways to control the host countries financial system if something is not seems worth good for them. Furthermore, the respondents also argues that some of the international banks control half of the world countries, hence, their vast experience, very strong capital, high skilled man power, technology advancement together with their political dominancy may definitely lead to lose the control of this banks, because in some instances these banks may brought something very new technology and system which could not understand easily by the local financial authorities. According to Cárdenas *et al*. (2002), international banks might also engage in regulatory arbitrage seizing differences in regulations around the world. Host country regulators may be overwhelmed by the complexities associated with the supervision of large and complex financial institutions, understanding new products and operations and by difficulties to achieve effective coordination with their counterparts located in home or other host countries. Conflicts of interests among parent companies and their subsidiaries may arise from management actions on the host country- seeking to pursue solely the interests of the former. An often-voiced concern recently is that the regulatory authority may have a diminished ability to engage in moral suasion or undertake enforcement of bank regulations when dealing with foreign international banks more focused on expected financial returns and profits and less sensitive to domestic goals promulgated by the regulator (Kim 2005).

4.3.4. Crisis Diversification

Banks are not always being successful; sometimes they get in to troubles, in some instances they even may not recover. Especially for those banks who are involved only in domestic markets that have small capital comparatively, however, according to the respondents this may not worry sometimes the international banks since they are diversified their market in internationally. But there are some cases when these multinational banks got bankruptcy in some countries that may challenge their overall capital, in such case they import the shocks from their home country or from other country they operate. According to Martinez-Diaz (2007), even though foreign-controlled banks face lower default risk by virtue of their globally diversified portfolios and lower funding costs, there is the possibility of reverse contagion the risk that foreign banks may act as transmission belts for economic shocks from the home to the host country. Multinational bank lending tends to be influenced by the home country business cycle (Martinez Peria *et al.* 2002). According to Cull & Martinez Peria (2010), foreign banks may import shocks from other countries into host countries in case of crises. Multinational banks have branches or subsidiaries in different countries. As a result, they may bring shocks from their home country or other country they operate (Raba 2017).

4.4.How the Banks should Join the Local Market

According to Giannetti & Ongena (2005), the mode of foreign bank entry may determine its effects on local financing. It is well known that if foreign banks enter through mergers and acquisitions, they have the potential to harm small local firms borrowing from the domestic target bank. In undertaking liberalization, it may be important to give particular attention to the mode of entry and time frame so that the Ethiopian banking sector can enhance the quality of governance and develop its institutional framework, thereby providing insurance against financial crises. For example, government officials may choose to limit the degree of foreign ownership for a specified period of time in an effort to help domestic firms to prepare for future competition and enhance the quality of governance. Similarly, adjustment measures and regulatory monitoring of foreign bank branches, subsidiaries, and green field investments are essential in permitting foreign financial FDI (Kiyota *et al*. 2007).

The finding of this study articulate in two options, according to the experts the first option was allowing full liberalization with very strict monitoring system, just in some instances one of the allowed banks seems to violate the regulations immediate actions should be taken; the second option was the mode of entry should be done gradually, the full ownership should be given to the banks after certain period of time, some of the experts also put specific figures like the full ownership should be allowed after seven or eight years. One of the reasons they deliver for this was if just in case something is happen it would be easy to control the banks before they cause damage on the economy; since the foreign banks work globally their effect may affect the host country. The second reason they justify was it would help the government to understand these foreign bank systems and their technologies. In support of this Tassew (2015), argues that the mode of entry of foreign banks should be a step by step process whereby arrangements such us joint ventures and minority stakes and gradual increase are promoted and full ownership mode of entry is regulated at the starting phase. The impact of foreign bank penetration on the domestic banking sector depends on its mode, the underlying motivation, and the scope of their activity. If banks enter the market to follow their clients, they are not expected to outperform domestic banks or have a substantial impact on the entire banking industry. On the other hand, when banks enter a range of market niches to exploit their comparative advantages they are sure to trigger competitive pressure on domestic banks. However, this effect may be limited to the market segment in which they are present. It may also happen that foreign entrants provide new, previously non-existent services in the host country, which contributes to better services, but does not exert competitive pressure on their domestic peers (Mérő & Valentinyi 2003).

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1. Conclusion

On this research we have started with the topic of foreign banks entry in Ethiopia: possibility, opportunities, risks and mitigations. The research focused on four objectives in line with the topic and started by exploring the theoretical frameworks and other lessons learnt from other countries in relation to the topic. The research has used qualitative data collection method where by the opinion of experts in relation to research objective has been collected in the form of in-depth interview. The research participants have been selected from the various stakeholders of the topic ranging from the regulatory body, local banks, foreign representative banks and other stakeholder's in the subject. After the data collection process is completed, the data's have been analysed in line with the four objectives that the research aims to address.

Based on the research analysis and findings since foreign banks have advanced technology and financial systems, their entrance may improve the existing financial infrastructure of the country; in addition to this since the country is in striving to transform its economy from agriculture to industry many of the established whether small scale or large scale firms need working capital, hence such foreign banks could provide enough credit access. Apart from this where ever, where there is enough and fair competition the efficiency of the firms would increase since the incompetent one would be out of the market, hence, the entrance of the foreign banks may encourage the competency and efficiency of local banks. For a country like Ethiopia whose majority of the commodities are imported having enough sock of hard currency is very essential; moreover, most of the raw materials that we use for the manufacturing companies are imported from abroad, since, this all are true, allowing those foreign banks to join the market may probably solve the countries common problem of foreign currency. The entry of foreign banks will facilitate the economic activities and growth of the financial sector in to international standards. However, allowing these banks may not always have advantages, it has its own disadvantage also, unless care is taken these international banks may swallow the local banks within short period of time and make them out of market; furthermore, since they are internationally working organizations they are not always successful, hence their crises in another edge of the world may affect the host country's economy. Apart from these, due to their

advanced technology and unknown base, once they control the country's financial system they may be out of control of the government; the inability to regulate and manage the foreign banks might lead to malpractices by foreign banks that will harm the finical industry

5.2.Recommendation

The different pros and cons of foreign banking in Ethiopia is discussed so far, in line with the finding of this study the researcher forward the following suggestions for different stakeholders in which he believed that should be done in the future.

Local Banks

- Domestic banks should have to increase their capital at least at level of making them competent with international banks
- Domestic banks should have ethical and high quality human capital through delivering task oriented international standard training and development and improve corporate good governance. Increasing their capital and lowering non performing loans and introducing world class products like mobile banking and expanding use of international Standard Automated Teller Machines interims of quality and quantity should be one of the focus of banks to compute with world class banks.
- Domestic banks should consider the challenges arising from foreign bank entry and prepare themselves accordingly by increasing number of customers, branch expansion and technological advancements
- Domestic Banks should set up strategic plans for methods of handling foreign banks entry, which might also include various forms of partnerships

Regulatory Body

- National bank of Ethiopia should develop an internationally competitive human resource capacity through strategic training and development, conducting seminars and conferences and share experiences from successful African and other experienced countries if there is need financial liberalization and compete with them
- The capital requirements of local banks should be increased in order to strengthen the banks capacity to be risk resilient and expand their services to untapped areas.
- Bank products which are highly exposed to risk such as speculative investments should be restricted at the beginning of financial liberalization.
- New regulatory frameworks need to integrate the perspective of the different stakeholders and in line with international banking standards.
- NBE should be alert in its due diligence of foreign banks to identify banks with potentially suspicious reputations and with risk prone banking practices.
- There needs to be strict regulations especially when it comes to outflow of funds for foreign banks to minimize the risks associated to unexpected capital flight.
- The mode of entry of foreign banks should be a step by step process whereby an arrangement such us joint ventures and minority stakes and gradual increase are promoted and full ownership mode of entry is regulated at the starting phase.
- The regulatory framework should be revised as to meet interest of the banks to compete in the international standards.
- The regulatory framework should be devised in a way that addresses the challenges associated with the entry of foreign banks entry.
- NBE should Setup a strict and limit monetary policy. Example, limit the amount of high capital outflows that might be occur during economic downturn in the parent country, through bilateral negotiations with trading countries and banks.

For Further Research

This research paper is expected at paving the way for further work, and the researcher would like to suggest the concerned stakeholder mainly the national bank of Ethiopia, Local banks

which are operating in Ethiopia and foreign banks who are interested to operate in Ethiopia should conduct comprehensive research which is aligned with their specific objective

And I hope the findings and conclusions generated from this study will serve as a stepping stone for further research.

REFERENCE

Alfaro, L., Calomiris, C.W. & Beck, T., 2015. *Foreign Bank Entry and Entrepreneurship*,

Amanuel, A., 2008. *Is Ethiopia Ready To Accept Foreign Banks ?* Addis Ababa.

Beck, T., A.D.-K. & Levine, R., 2004. *Bank Concentration and Crises*,

Berger, A.N. & Udell, G.F., 1996. *Universal Banking and the Future of Small Business Lending, in A. Saunders, and W. Ingo, eds.: Financial System Design: The Case for Universal Banking*,

Bhattacherjee, A., 2012. *Social Science Research: Principles, Methods, and Practices*,

Bruno, V. & Hauswald, R., 2012. *The Real Effect of Foreign Banks*,

Cárdenas, J., Graf, J.P. & Dogherty, P.O., 2002. *Foreign banks entry in emerging market economies : a host country perspective .*,

Charalambos, S., 2007. *The entry strategy choices (internationalization patterns) of foreign banks in South Eastern European countries : The case of Greek banks*,

Clarke, G. et al., 2001. *Foreign bank entry - experience, implications for developing countries, and agenda for further research,*

Clarke, G. et al., 2003. Foreign Bank Entry : Experience , Implications for Developing Economies , and Agenda for Further Research. , 18(1), pp.25–59.

Creswell, J.W., 2014. *Research design : qualitative, quantitative, and mixed methods approaches* 4th ed.,

Crystal, J.S., Dages, B.G. & Goldberg, L.S., 2002. Has Foreign Bank Entry Led to Sounder Banks in Latin America?,. *Current Issues in Economics and Finance*.

Cull, R. & Martinez Peria, M., 2010. *Foreign Bank Participation in Developing Countries; What Do we Know about the Drivers and Consequences of this Phenomenon?*,

Demirgüç-Kunt, A., Levine, R. & Min, H.., 1998. Opening to foreign banks: Issues of stability, efficiency, and growth. In *The Implications of Globalization of World Financial Markets*. Seoul: Bank of Korea.

Ecobank., 2014. *Ethiopia: Banking sector liberalisation can lift growth*,

Eshete, Z.S., Tesome, K.W. & Abebe, T.K., 2013. Competition in Ethiopian Banking Industry. *African Journal of Economics*, 1(5), pp.176–190.

Focarelli, D. & Pozzolo, A., 2000. *The determinants of cross-border bank shareholdings: An analysis with the bank-level data from OECD countries. Federal Reserve Bank of Chicago*,

Gezae, A., 2015. *Determinants of Banking Sector Development in Ethiopia*. Addis Ababa.

Giannetti, M. & Ongena, S., 2005. *FINANCIAL INTEGRATION AND ENTREPRENEURIAL*

ACTIVITY: EVIDENCE FROM FOREIGN BANK ENTRY IN EMERGING MARKETS,

Gopalan, S. & Pajan, S., 2010. Financial sector De-Regulation in Emerging Asia: Focus on Foreign Bank Entry. *The Journal of World Investment and Trade*.

de Haas, R. & Lelyveld, I., 2003. *Foreign Banks and Credit Stability in Central and Eastern Europe*,

International Monetary Fund (IMF), 2013. *The Federal Democratic Republic of Ethiopia: 2013 Article IV Consultation,*

Keatinge, T., 2014. *The Role of Public and Private Sector Banking in Ethiopia ' s Future Economic Growth*,

Këllezi, J., 2013. Strategies of Entry Modes : The Case of Greek Banks Entering the Albanian Market. *Academic Journal of Interdisciplinary Studies*, 2(2), pp.321–326.

Kim, H.E., 2005. *Domestic Financial Liberalization , Stabilizing Effects of Foreign Bank Entry , and Challenges to Bank Supervision : The Korean Experience*,

Kiyota, K., Peitsch, B. & Stern, R., 2007. *The Case for Financial Sector Liberalization in Ethiopia*,

Kiyota, K., Peitsch, B. & Stern, R.M., 2007. *The Case for Financial Sector Liberalization in Ethiopia* *,

Legesse, T., 2012. Establishing financial markets in Ethiopia: the environmental foundation, challenges and opportunities. *JBAS*, 4(1), pp.1–45.

Levine, R., 1999. *Foreign Bank Entry and Capital Control Liberalization: Effects on Growth and Stability*,

Levine, R., 1996. Foreign Banks, Financial Development, and Economic Growth.

Li, R. et al., 2015. *Consequences of China ' s Opening to Foreign Banks*,

Martinez-Diaz, L., 2007. *BANKING SECTOR OPENING: POLICY QUESTIONS AND LESSONS FOR DEVELOPING COUNTRIES*,

Mathieson, D.J. & Roldos, J., 2001. The Role of Foreign Banks in Emerging Markets,". In *paper presented at the third Annual Financial Markets and Development*.

Mérő, K. & Valentinyi, M.E., 2003. *No Title*,

Mishkin, F.S., 2007. Is Financial Globalization Beneficial? *Journal of Money, Credit and Banking*, 39(2), p.3.

Mohammed, O., 2016. *THE EFFECT OF FINANCIAL LIBERALIZATION ON ECONOMIC DEVELOPMENT IN ETHIOPIA*.

Morgan, D.P. & Strahan, P.E., 2003. *Foreign Bank Entry and Business Volatility: Evidence from*

US States and Other Countries,

Mucheru, R.W., 2011. *THE FINANCIAL ROLE PLAYED BY FOREIGN BANKS IN THE DOMESTIC BANKING SECTOR : A CASE STUDY OF BARCLAYS BANK OF KENYA*. University of Nairobi.

Naaborg, I., 2007. *Foreign bank entry and performance with a focus on Central and Eastern Europe*,

NCA, 2006. *Competition in Nordic Retail Banking*,

Northcott, C., 2004. *Competition in Banking: A review of Literature*,

Obstfeld, M. & Rogoff, K., 1995. *Foundation of International Macroeconomics*,

Padoda, S., 2000. *Competition Among Banks: Good or bad?*, Frankfurt.

Raba, G., 2017. Prospects and Challenges of Foreign Bank Entry in Ethiopia. *THE INTERNATIONAL JOURNAL OF BUSINESS & MANAGEMENT*, 5(1), pp.123–132.

Rajan, R.G. & Zingales, L., 1998. Financial Dependence and Growth. *American Economic Review*.

Rugman, A.M., 1981. *Multinational banking and the theory of internalization: Inside the multinationals*, New York: Columbia University Press.

Schmukler, S.L., 2004. *Benefits and Risks of Financial Globalization : Challenges for Developing Countries*,

Senbet, L. & Otchere, I., 2008. African Stock Markets. In *High- Level Seminar Organized by the IMF Institute in Collaboration with the Joint African Institute*. Tunis, Tunisia.

Sharda, G., 2014. *Impact of Foreign Banks on the Indian Economy*,

Simonson, D.G., 2001. Foreign Bank Influence in the Czech Republic. In *Foreign Participation in Financial Systems in Developing Countries*.

Singh, Y.K., 2006. *Fundamental of Research Methodology and Statistics*, Age International (P) Ltd.

Song, I., 2004. *Foreign Bank Supervision and Challenges to Emerging Market Supervisors*,

Tassew, T., 2015. *Foreign Banks Entry in Ethiopia: Possibility, Opportunity, Threats and Mitigations*. Jimma Universty.

Taylor, C.R., Osland, G.E. & Zou, S., 2001. Selecting International Modes of Entry and Expansion. *Marketing Intelligence & Planning*.

World Bank, 2014. *Ethiopia Economic Update II*,

World Bank, 2013. *Ethiopia Economic Update II: Laying the Foundation for Achieving Middle Income Status*,

Zhao, L., 2009. *The motivation and impact on the foreign banks entrance in China*. Lund University.

Interview questions for experts

- ✓ What will be the effects of financial liberalization on foreign currency deposit?
- ✓ Does foreign bank entry skew credit allocation towards large scale industrial real estate, service enterprises, agriculture, small scale firms?
- ✓ Does financial liberalization have positive effects on the efficiency of the banking sector.
- ✓ Do you think the development of a viable domestic banking sector will be threaten by foreign banks because they have more capital, more experience, better reputations?
- ✓ what will be the impacts of foreign banks entry on the macro economy of the host country in terms of trade ,finance?
- ✓ do you think that The entry of foreign banks may have positive effects on employment and wages?
- ✓ Will foreign banks entry Enhances competition among financial institutions/banks in terms of setting deposit rate ,interest rate ,service quality and develops a greater diversity of financial institutions ?
- ✓ What will be the impact of foreign banks on Domestic banks performance in terms of attracting qualified staffs, reducing local banks and reducing local banks total growth asset?

Interview questions for regulatory body

- ✓ does foreign bank entry allow Market Forces to Determine Interest Rates as well as the Value of the Ethiopian Birr (ETB)?
- ✓ does foreign bank entry Upgrade the Regulatory and Supervisory Capacity of the National Bank of Ethiopia (NBE) ?
- ✓ what will be the challenges of regulatory body while permitting foreign bank entry in terms of regulation?
- ✓ do foreign banks entry improve bank supervision through regulatory spill over ?
- ✓ Do you think if foreign banks enter to the country, will the NBE able to regulate and supervise foreign banks effectively?
- ✓ What is the reason for closing doors o f foreign banks?
- ✓ Is there possibility to open foreign banks in the future?

Interview questions for representative of foreign banks

- ✓ What will be the foreign banks mode of entry? Is it full acquisition, targeted purchases of specific activities, joint ventures, alliances with local banks, and outsourcing of administrative and financial services?
- ✓ Does the infrastructure of the host country is the challenge for foreign banks in terms of road net work , electric access?
- ✓ What will be the impact of economic crises of domestic country on foreign banks?
- ✓ Will the culture be the challenges for foreign banks?
- ✓ Will the culture be the factor ?
- ✓ If there is permission to join, are you ready to join?
- ✓ Is there other positive issue to say?
- ✓ Is there negative issue to say?