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SCHOOL OF GRADUATE STUDIES

IMPACT OF BANKING REGULATION ON THE PERFORMANCE OF PRIVATE BANKS

BY

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DECLARATION

I, the undersigned, declare that this thesis is my original work, prepared under the guidance of Dr. Ashenafi Beyene. All sources of material used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institutions for the purpose of earning any degree.

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Name Signature

St. Mary's University, Addis Ababa **March, 2014**

ENDORSEMENT

This thesis has been submitted to St. Mary's University, School of Graduate Studies for examination with my approval as a university advisor.

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LIST OF ACRONYMS

AIB- Awash International Bank S.C

BoA- Bank of Abyssinia S.C

BRSA - Banking Regulatory and Supervisory Authority

CAP- Capital Adequacy Ratio

CBN- Central Bank of Nigeria

DB- Dashen Bank S.C

FIS- Financial Institution Supervision

LIQ- Liquidity Ratio

NBE- National Bank of Ethiopia S.C

NIB- Nib International Bank S.C

NIM- Net Interest Margin

OIB- Oromia International Bank S.C

RoA-Return on Asset

RoE- Return on Equity

SBB- Supervision of Banking Business

UB- United Bank S.C

WB- Wegagen Bank S.C

ZB- Zemen Bank S.C

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ABSTRACT

This thesis assesses the impact of Banking Regulation on the Performance of Private Banks. Qualitative methods were used to assess qualitative data collected through the utilization of a questionnaire and interviews to catch the opinion on the impacts of selected regulations on the private banks profitability and liquidity. Quantitative Analysis was used to confirm the opinions obtained using their financial statements and ratios using a panel data for ten years. The respondents were drawn from ten private banks and issued sixty (60) questionnaires and fifty four (54) were responded correctly. Their opinion was some regulations are supporting the profitability such as "The Prohibition of Foreign Nationals" and "Minimum Capital Requirement ' while others such as "Limitation on Open Foreign Currency Position of Banks" and "Limitation on Investment of Banks" are slowing down the profitability of the private banks. The "Reserve Requirement" directives are said to support the profitability and liquidity of banks, while the "NBE BILL" directive has almost outweighed all the supportive directives and are stated by most as a challenging, discriminatory and is affecting their profitability and liquidity. The panel data econometric model implies that the "Reserve Requirement" regulation positively affected liquidity and had a positive but weak impact on ROA and ROE while having a negative impact on NIM Lending cap and Bill purchase had a negative effect on the profitability indicators ROA and ROE but both did not have a statistically signflcant effect on NIM and liquidity. In general the banker's general opinion was skewed towards a negative attitude and the Banking industry is found to be highly regulated and some regulations are having negative impact on the performance of private banks. NBE should therefore revise some of the directives and shall focus on strengthening the private banks so as to make them ready for WTO accession.

Key Words. Banking Regulation, Performance, Profitability, Liquidity

CHAPTER ONE

INTRODUCTION

This chapter presents, first of all, a brief background about the study. Next it explains the objective as well as the significance of the research. Then, the methodology used, and at last, the scope and limitation of the study are presented.

1.1 Back ground of the Study

As Barth, James, Gerard and Ross (2006) exhaustively stated, the banking sector is probably the most intensely regulated sector throughout the world. This is hardly surprising. If we try to assess the reasons behind government regulation, there are several rationales that justify government intervention from the perspective of enhancing market and economic efficiencies as well as minimizing contagious effects. But the same is true if we think government intervention is driven by political and electoral interests, rather than by the desire to address market inefficiencies. The two views of government interventions obviously differ in their implications: the first one predicts a positive effect of government regulation, while the second a negative one (Luigi et al., 2007).

In addition to statutory and administrative regulatory provisions, the banking sector has been subject to widespread "informal" regulation, i.e., the government's use of its discretion, outside formalized legislation, to influence banking sector outcomes (Bonn, 2005).An efficient financial system has been regarded as a necessary pre-condition for higher growth. Propelled by this ruling paradigm, several developing countries undertook programmes for reforming their financial system.

The cost of financial system and macroeconomic instability to the general public and the government is significant. It is essential to ensure safety, soundness and stability of the banking system by having a comprehensive law for the licensing and supervision of the banking business. In Ethiopia, the National bank of Ethiopia (NBE) implements monetary policies to insure safety, soundness and stability of the banking system. Following the Monetary and Banking Proclamation of 1994 the private banking industry has been expanding in Ethiopia and a number of private banks have been established. The NBE reveals that banks increased in number from 3 in 1991 to 19 banks in 2013 both government and private banks (NBE, 2013).

Although banking regulation is vital to any country, the level of regulation has been debatable among bankers and researchers alike. Since both excessive regulation as well as inadequate regulation have their own concomitant costs, determining the optimal amount of regulation is crucial in the regulatory framework. In fact, it can be said that the crux of banking regulation is striking the balance and finding out the optimal level of regulation.

In Ethiopia, banks mostly feel that there is a high degree of regulation in the country than the optimal one. Whereas others, including the NBE, repeatedly argue the importance of the level of regulation prevailing in the country is both to the safety of the banks themselves and to the country at large. Even though the need for regulation is out of question, examining some of the regulations and affesting their impacts, if any, on the banks will be a value adding process to the banking industry.

This research therefore, assesses some of the regulations, affitude toward those regulations especially by bankers in the private banks and examine the impact of regulation on the financial performance.

1.2 Statement of the Problem

It is obvious that the operation of the financial sector does have a key impact on the economic growth and the stability of an economy. It affects long-term economic growth through its effect on the efficiency of intermediation between the savers and final borrowers of funds; through the extent to which it allows for monitoring of the users of external funds, affecting thereby the productivity of the capital employed; and through its implications on the volume of saving, which influences the future income-generating capacity of the economy. It affects the stability of the economy because of the high degree of leverage of its activities and its pivotal role in the sefflement of all transactions in the economy, so that any failure in one segment risks undermining the stability of the whole system.

Banks play an important role in economic development through mobilization of funds from within and outside the country and channelling such funds to various sectors of the economy.

Banks have reached to a point of time where, individual, company or country, cannot live without the other. This is because of their role in each step of the way and their role in government development policy through monetary actions. The business of banking has a number of attributes which, if not managed properly, has the potential to generate financial

system and macroeconomic instability. Banks in almost all countries are regulated by the Central bank even though its role varies from country to country.

Banking in Ethiopia has a one hundred years of history and modem banking has started around forty years back. Currently the banking industry is composed of sixteen (16) private and three (3) government banks with the NBE being the Central bank.

Many experts in the sector agree that the banking industry in Ethiopia is highly regulated with arguments in both sides, which some say it is an opportunity for the banks in the country to be stronger and more profitable while the others say its side effects overweigh its benefits since it has an impact in their growth, making them weaker in the international market.

In the Ethiopian banking business, the NBE issues circulars and directives which are assumed to maintain stable rate of price and exchange, foster a healthy financial system and it also undertakes such other related activities as are conducive to rapid economic development of the country. From time to time, the banks, especially the private banks, are arguing that their capacity and strength is declining from the banking regulations that are put in place while the Central bank claims that it is lack of good governance on the part of the private banks, and the performance of the banking industry in the country, in aggregate, is increasing. In addition the Central bank strongly advises the banks to make themselves ready for the entry of international banks, which the Central bank believes has been an opportunity to the existing banks to strengthen themselves in every aspect instead of rent seeking and short sightedness.

If both the Central bank and the Commercial banks agree on the importance of the banking regulation in general, their difference could only come from the level, timing, perceived or real discriminatory nature, and significance of some of the regulations, and the implementation strategies of the regulations. Therefore, to reach at a judgecious conclusion, it is worthwhile to take some regulations and check the validity of both arguments.

Other researchers have tried to show impact of a specific directive either on profitability or liquidity and were not as such conclusive to reach the level of regulation in Ethiopia. Needless to mention unless the major directives are included in the analysis, it would be very wrong to conclude the impact since one can offset the effect of the other.

In this study, therefore, affempts were made to assess selected banking sector regulations and examine their impact on bank profitability and liquidity.

1.3 Research Questions

This study primarily focuses on providing possible solutions to the following basic research questions in order to address the problem stated:

1. What are the major directives issued by NBE with a likely impact on bank profitability and liquidity?
2. How have profitability and liquidity of banks changed over years?
3. How do bankers view impact of NBE directives on profitability and liquidity?
4. What are the real impacts of NBE directives on profitability and liquidity?

1.4 Objectives of the Study

The study has the following general and specific objectives.

1.4.1 General Objective

The general objective of this research is to examine the impact of banking regulation on the performance of private banks.

1.4.2 Specific Objectives

Specifically, the objectives of the study are:

1. to evaluate the NBE directives with a likely impact on the bank profitability and liquidity risk exposure,
2. to asses the opinion of the private banks towards some part of the banking proclamation and selected NBE directives,
3. to examine the profitability and liquidity position of private banks,
4. to determine the impact of NBE directives on profitability and liquidity of private banks.

1.5 Significance of the Study

The study is believed to have the following significances.

1. Help the private banks to effectively and efficiently realize and utilize the opportunities that are entailed in the banking regulation;
2. Aid the private banks to tackle the challenges that arise from the banking regulations;
3. Give some ideas to the regulatory body so as to achieve both its supervisory role without adversely affecting the growth and performance of private banks; and

4. Serve as a reference material for those who are interested to conduct further study in the area.

1.6 Scope of the Study

The scope of this research is delimited to private banks. Even though private and state-owned banks are governed by the same NBE, because of the differences in their ownership structure and problem handling mechanisms, government banks are excluded. In addition, since some directives explicitly exclude some government banks, such situations make it difficult to put all banks in the same page for comparison.

This research is further delimited to the number and type of respondents. From the employees of ten private banks selected, only sixty bankers are selected for the questionnaire and five for interview. Also the quantitative data used is only from the nine private banks out of the sixteen using ten years maximum data. And also only selected articles from the banking proclamation and few directives by the NBE are used for the opinion survey which are expected to have direct financial impact on profitability and liquidity.

1.7 Limitation of the Study

Because of time and budget constraint, this research is delimited to the data collection tools used. The researcher employed only questionnaire and interview for collecting primary data for this study.

Also all the respondent's for the questionnaire were selected from the capital city working in private banks excluding outlying branches' employees. Even though much can be same since they are governed by the same regulation, some new opinions might be missing.

In this research, only three year data on bill purchase was used which might prohibit to yield in a robust result and more conclusive evidence on the impact of bill purchases on profitability and liquidity.

1.8 Organization of the Research Report

This research report comprises five chapters. The first chapter contains the background of the study, statement of the problem, research questions, objectives of the study, significance of the study, scope, and limitation of the study. The second chapter reveals a gap in the literature pertaining to banking regulations in the international context. The third chapter offers a detailed

description of design of the study, population and sampling techniques, the type of data, the tools/instruments of data collection employed, the procedures of data collection and the methods of data analysis used. The fourth chapter deals with the presentation of data, interpretation and analysis. The last chapter comprises three sections, which include summary of findings, conclusions, and recommendations.

CHAPTER TWO

LITERATURE REVIEW

In this chapter related literatures will be reviewed about what banking regulation is, its relevance, its types, its principles, its characteristics, its impact on profitability and liquidity. And finally empirical evidences in the maffer are presented.

Theoretical Literature

Banks operate in one of the most regulated industries, and it is not surprising that banking regulations have attracted both theoretical and empirical interest. However, the theory provides conflicting views about which regulations are the most appropriate ones and what the optimal level is. Also debates are still going on whether bank-regulatory environment is improving and making financial systems more efficient and stable or not.

2.1 Definition of Banking Regulation

Banking regulation in its strictest sense refers to the framework of laws and rules under which banks operate. Kenneth, (2000) defines it as: the banking agencies' monitoring of financial conditions at banks under their jurisdiction and to the ongoing enforcement of banking regulation and policies. Bonn,(2005) stated that banking regulation originates from microeconomic concerns over the ability of bank creditors (depositors) to monitor the risks originating on the lending side and from micro and macroeconomic concerns over the stability of the banking system in the case of a bank crisis.

Adam, (2005) argued that in addition to statutory and administrative regulatory provisions, the banking sector has been subject to widespread "informal" regulation, i.e., the government's use of its discretion, outside formalized legislation, to influence banking sector outcomes, for example to bail out insolvent banks, decide on bank mergers or maintain significant state ownership.

When we look at regulation and supervision, bank regulation typically refers to the rules that govern the behaviour of banks, whereas supervision is the oversight that takes place to ensure that banks comply with those rules (Georgios Ct al., 2010).

2.2 Why Regulation?

Although banks are operated for profit and bankers are free to make many decisions in their daily operations, banking is commonly treated as a matter of public interest. Banking laws and regulations extend to many aspects of the activities of banking, including who can open banks, what products can be offered, and how banks can expand (Kenneth, 2000).

Banking regulation is favored so as to provide stability in the banking system and meet up to its requirements of a high solvency and liquidity level (Adam, *2005;* Fatimah, 2012). The most basic reason for regulation of banking is depositor protection. (Marcia et al. 2004)

Another area in bank regulation is capital requirements. Capital requirements or regulation can be regarded as the increment of capital requirements to banking firms which will positively improve bank performance and stability. Low capital requirements could very likely lead to bank runs or failures. While increasing capital requirements might aid bank performance, opposing views have stressed on the impact of high capital requirements leading to moral hazard and high risk to banks (Fatimah, 2012).

The role bank regulators assume in protecting and insuring depositors is similar to the position any creditor or insurer takes in protecting his or her interests. Bank regulators take many similar steps in an effort to control banking risks and thereby protect depositors and ensure financial stability. Banks, for instance, are restricted to certain activities and must maintain adequate capital relative to asset and operational risks. They are also expected to maintain enough low-risk liquid securities to cover normal fluctuations in deposits. They are regularly examined, and bank supervisors will impose tighter restrictions on banks if their condition declines (Kenneth, 2000).

Commercial banks perform several valuable services to sectors of the economy. The effect of a disruption in the provision of the various services on firms, households, and the overall economy when something goes wrong in the commercial banking sector makes a case for the need to monitor performance and market value and to impose regulations that in turn affect bank performance and market value. Although regulations may be beneficial to households, firms, and the overall economy, they also impose private costs that can affect the performance and market value of commercial banks (Marcia et al., 2004).

Another goal of banking regulation is to protect consumer interests in various aspects of a banking relationship. The aforementioned regulatory objectives serve to protect consumers in a number of ways, most notably through safeguarding their deposits and promoting competitive banking services. In addition to their responsibilities for depositor protection and monetary stability, bank regulatory agencies are also responsible for promoting an efficient, competitive banking environment and preventing monopolization of banking markets (Kenneth, 2000).

In banking regulation, the objective of monetary stability has been closely linked with the goal of depositor protection. Financial crises and unintended fluctuations in the money supply have been prevented primarily by promoting confidence in banks and guaranteeing the safety of deposits.

2.3 Types of Banking Regulations

There are no defined types of banking regulations that are acceptable by all literature but various researchers have come up with their own definitions and categories. Banks in one form or another have been subject to the following non exhaustive list of regulatory provisions:

1. restrictions on branching and new entry; (Marcia et al. 2004; Bonn, 2005; James et al., 2012)
2. restrictions on pricing (interest rate controls and other controls on prices or fees) and competition; (Fatimah,2012 ; Kenneth, 2000)
3. line-of-business restrictions and regulations on ownership linkages among financial institutions; (Bonn, 2005; Fatimah,2012 ; James et al., 2012)
4. restrictions on the portfolio of assets that banks can hold (such as requirements to hold certain types of securities or requirements and/or not to hold other securities, including requirements not to hold the control of nonfinancial companies); (Bonn, 2005; Fatimah,2012)
5. compulsory deposit insurance (or informal deposit insurance, in the form of an expectation that government will bail out depositors in the event of insolvency); (Marcia et al. 2004; Bonn, 2005 ; Kenneth, 2000 ; Fatimah,2012 ; James et al., 2012)
6. capital-adequacy requirements; (Kenneth, 2000 ; Fatimah,2012 ;James et al., 2012)
7. reserve requirements (requirements to hold a certain quantity of the liabilities of the central bank); (Kenneth, 2000 ; Fatimah,2012)

8. requirements to direct credit to favored sectors or enterprises (in the form of either formal rules, or informal government pressure); (Bonn, 2005 ; Marcia et al. 2004)
9. expectations that, in the event of difficulty, banks will receive assistance in the form of "lender of last resort"; (Bonn, *2005)*
10. special rules concerning mergers (not always subject to a competition standard) or failing banks (e.g., liquidation, winding up, insolvency, composition or analogous proceedings in the banking sector); (Marcia et al. 2004 ; Fatimah,2012)
11. other rules affecting cooperation within the banking sector (e.g., with respect to payment systems). (Bonn, 2005)
12. external auditing requirements(James et al., 2012)
13. internal management/organizational requirements (James et al., 2012)
14. provisioning & accounting/information disclosure requirements(James et al., 2012)

Thus regulating banks can take different forms, such as deposit insurance scheme, capital requirements, activities restriction, mixing banking firms with nonbanking firms and many other regulatory methods. The most common methods/structures that have been studied are deposit insurance systems, activities restriction and capital requirements (Fatimah,20 12).

However, we can group these regulations in to six broader types to enhance the performance and value of commercial banks and thus maintain the viability of the banking industry. These include:

(1) entry regulations,
(2) safety and soundness regulations,
(3) credit allocation regulations,
(4) consumer protection regulations,
(5) monetary policy regulations. and
(6) efficiency and competition regulations

2.3.1 Entry Regulations

Increasing or decreasing the cost of entry into a financial sector affects the performance and market value of firms already competing in that industry. Thus, the industries heavily protected against new entrants by high direct costs (e.g., through capital contribution) and high indirect

costs (e.g., by restricting individuals who can establish commercial banks) of entry produce bigger profits for existing firms than those in which entry is relatively easy (Marcia et al., 2004).

2.3.2 Safety and Soundness Regulations

The most basic reason for regulation of banking is depositor protection because bank depositors may have more difficulty protecting their interests than customers of other types of businesses (Fatimah, 2012). To protect depositors and borrowers against the risk of commercial bank failure, regulators have developed layers of protective mechanisms. These mechanisms are intended to ensure the safety and soundness of the commercial banks and thus to maintain the credibility of the bank in the eyes of its borrowers and lenders (Bonn, 2005).

The first layer of protection is requirements encouraging commercial banks to diversify their assets. For example, banks are required not to make loans exceeding 10 percent of their own equity capital funds to any one company or borrower. The second layer of protection concerns the minimum level of capital or equity funds that the owners of a commercial bank need to contribute to the funding of its operations (Kenneth, 2000). The higher the proportion of capital contributed by owners, the greater the protection against insolvency risk to outside liability claimholders such as depositors.

The third layer of protection is the provision of guaranty funds. By protecting claimholders, when a commercial bank collapses and owners' equity or net worth is wiped out, these funds create a demand for regulation of the insured institutions to protect the funds' resource (James et al., 2012). The fourth layer of regulation is monitoring and surveillance itself (Marcia et a!., 2004). This involves on-site examination as well as a bank's production of accounting statements and reports on a timely basis for off-site evaluation (James et al., 2012).

While safety and soundness regulations help ensure that the performance and market value of a commercial bank is sufficient to maintain its viability as an ongoing concern, these regulations are not without costs for commercial banks. For example, regulators may require banks to have more equity capital than private owners believe is in their own best interests, thus, decreasing the market value of the bank. Similarly, producing the information requested by regulators is costly for commercial banks because it involves the time of managers, lawyers, and accountants. Again, the incurrence of these costs is sure to decrease the overall performance of the commercial banks or profitability (Fatimah, 2012). Pressure for such regulations arose as the public began making

financial transactions through banks, and as businesses and individuals began holding a significant portion of their funds in banks.

While depositors could conceivably make general judgments about the condition of banks, the task would still be difficult, costly, and occasionally prone to error. These facts, especially when combined with the history of depositor losses before federal deposit insurance, explain much of the public pressure for banking regulation to protect depositors (Kenneth, 2000).

Banks are comprised of functions which are based on the terms of the balance sheet items - assets (loans) and liabilities (depositors). The banks gain assets by providing and issuing bank assets to borrowers and balancing the assets through liabilities provided by depositors. The depositors provide funds that are used for issuing loans to borrowers; as such, the stakeholders of the banks are the depositors. However, when a bank run or bank failure happens, the depositors lose their funds due to insolvency of the banks, thus, one of the regulatory structure is to provide deposit insurance to depositors (Marcia et al., 2004). Deposit insurance schemes or systems have been measured as a regulatory instrument for banks as it does ensure bank performance and development (Fatimah, 2012).

2.3.3 Credit Allocation Regulations

Credit allocation regulations support lending by the commercial bank to socially important sectors such as housing, farming and small businesses. These regulations may require a commercial bank to hold a minimum amount of assets in one particular sector of the economy or, alternatively, to set maximum interest rates, prices, or fees to subsidize certain sectors (Marcia et al., 2004). In few countries, central banks require banks to direct credit to favored sectors or enterprises in the form of either formal rules, or informal government pressure (Bonn, 2005).

2.3.4 Consumer Protection Regulations

Consumer protection regulations are intended to prevent discrimination and other unfair practices in lending. Consumer protection regulations are especially concerned about the assessment of unnecessary or unfair fees and charges for bank services as well as discrimination against commercial bank customers on the basis of age, race, sex, or income (Marcia et a!., 2004).

The above mentioned regulatory objectives serve to protect consumers in a number of ways, most notably through safeguarding their deposits and promoting competitive banking services. However, there are many other ways consumers are protected in their banking activities.

Kenneth, (2000) included additional forms of protection that have been implemented through a series of legislative acts passed over the past few decades. Several basic purposes can be found in this legislation. The first is to require financial institutions to provide their customers with a meaningful disclosure of deposit and credit terms. The main intent behind such disclosures is to give customers a basis for comparing and making informed choices among different institutions and financial instruments. The disclosure acts also serve to protect borrowers from abusive practices and make them more aware of the costs and commitments in financial contracts. A second purpose of consumer protection legislation is to ensure equal treatment and equal access to credit among all financial customers. The equal treatment acts can be viewed as the financial industry's counterpart to civil rights legislation aimed at ensuring equal treatment in such areas as housing, employment, and education.

Other purposes associated with consumer protection include promoting financial privacy and preventing problems and abusive practices during credit transactions, debt collections, and reporting of personal credit histories (James et al., 2012).

Fatimah (2012) argues that consumer protection objectives are generally consistent with good banking principles. In fact, credit and deposit disclosures and informed customers should be of most benefit to bankers offering competitive services. Likewise, equal and nondiscriminatory treatment of borrowers is necessary for any banker aiming to maximize profits.

2.3.5 Monetary Policy Regulations

Another motivation for regulation concerns the special role banks play in the transmission of monetary policy from the central bank to the rest of the economy. The problem is that the central bank directly controls only the quantity of notes and coins in the economy whereas the bulk of the money supply consists of deposits. In theory, a central bank can vary the quantity of cash or outside money and directly affect a bank's reserve position as well as the amount of loans and deposits it can create without formally regulating the bank's portfolio (Kenneth, 2000).

Apart from just being concerned about individual depositors, banking regulation must also seek to provide a stable framework for making payments. With the vast volume of transactions

conducted every day by individuals and businesses, a safe and acceptable means of payment is critical to the health of an economy. In fact, it is hard to envision how a complex economic system could function and avoid serious disruptions if the multitude of daily transactions could not be completed with a high degree of certainty and safety. Ideally, bank regulation should thus keep fluctuations in business activity and problems at individual banks from interrupting the flow of transactions across the economy and threatening public confidence in the banking system (Kenneth, 2000).

Although deposit insurance has not been without cost or risk, it has provided stability in the payments system and given bank regulators greater flexibility in resolving individual bank problems. This role is further acknowledged through specific laws and regulations determining which institutions can offer deposit accounts, the level of reserves that must be held against these accounts, and the various deposit reports that must be filed.

Another policy aspect of monetary stability is supervision and regulation of the banking system (Bonn, 2005). To provide stability, banking regulation should foster the development of strong banks with adequate liquidity and should discourage banking practices that might harm depositors and disrupt the payments system (Fatimah, 2012).

2.3.6 Efficiency, Competition and Restriction Regulations

Another aspect of a good banking system is that customers are provided quality services at competitive prices. One of the purposes of bank regulation, therefore, is to create a regulatory framework that encourages efficiency and competition and ensures an adequate level of banking services throughout the economy (Bonn, 2005).

Efficiency and competition are closely linked together. In a competitive banking system, banks must operate efficiently and utilize their resources wisely if they are to keep their customers and remain in business. Without such competition, individual banks might affempt to gain higher prices for their services by restricting output or colluding with other banks. Competition is also a driving force in keeping banks innovative in their operations and in designing new services for customers (Kenneth, 2000).

A further consideration is that for resources throughout the economy to flow to activities and places where they are of greatest value, competitive standards should not differ significantly across banking markets or between banking and other industries. Thus it is imperative that the

rigorous concern for the pursuit of competition policies that has been a key element of past policies toward the financial services industry be continued. Basic principles of competition policy should be applied in financial services as should competition law, subject only to clearly justified exceptions needed for prudential reasons or other overriding public policy objectives (Bonn, 2005).

The promotion of an efficient and competitive banking system carries a number of implications for regulation. Competition and efficiency depend on the number of banks operating in a market, the freedom of other banks to enter and compete, and the ability of banks to achieve an appropriate size for serving their customers.

Banking regulation must also take an approach that does not needlessly restrict activities of commercial banks, place them at a competitive disadvantage with less regulated firms, or hinder the ability of banks to serve their customers' financial needs. Finally, regulation should foster a banking system that can adapt and evolve in response to changing economic conditions and technological advances (Kenneth, 2000).

Another bank regulation issue is activity restrictions. Kremmling (2011) explained that there are four fundamental areas of activity restrictions, which are: securities dealings, insurance business, real estate, and non-financial firms dealing. Theoretically, when banking firms deal with nonbanking activities, it will aid the regulatory framework of the bank by providing more transparency and as such, banks will not be able to take high risk, compared to banks with activity restrictions.

However, most studies have found that banking firms with less activity restrictions are not transparent in their dealings and sometimes, do not aid bank performance (Kremmling, 2011). Moreover, during the recent financial crisis in 2008, banks with activity restrictions were unable to have high risk profile compared to banking firms with dealings from real estate, securitization and insurance firms (Fatimah, 2012).

Yet the special role that banks play in the economic system implies that banks should be regulated and supervised not only to protect investors and consumers but also to ensure systemic stability. More specifically, bank regulations exist for safeguarding the industry against systemic risk, protecting consumers from excessive prices or opportunistic behaviour and finally to achieve some social objectives, including stability (Llewellyn, 1999). Last but not least,

regulation is important for the efficiency of the banking industry. In this respect, it is noticeable that whenever regulation is implemented with the aim of restricting or limiting banking activities, the banks' conduct of business and the efficiency with which they operate will be affected. This in turn could induce banks to engage in riskier activities and br to invest in ways to circumvent regulation. According to some studies, it could even ultimately affect economic growth (Georgios et al., 2010).

2.4 Principles for Banking Regulation

A striking feature of banking regulation has been the mixing up of conflicting objectives. Concerns for the safety and soundness of the system are often diluted by affempts to mobilize bank funding for worthy purposes, concern for the global competitiveness of a nation's banks, and the desire to use the industry's professional risk management. Such mixing has led to flawed regulation. There has also been a lack of clarity about what regulation is actually doing, and whether it is cost effective in addressing its objectives. The main concepts in the principles involve price stability, protection of small investors and prevention of market misconduct (Kenneth, 2000).

Just to summarize the various theoretical aspects in the principles of good banking regulation, four points are raised hereafter.

2.4.1 Safety and Soundness Focus

Banking regulation should have an unambiguous objective to safeguard the safety and soundness of the financial system in the public's best interest. The rationale for regulating banks and other financial institutions is that their failures can have a significant negative impact on the rest of the financial system and on the overall economy. One institution's problems can spill over to other institutions, for example through contractual links, through fire sales that cause asset prices to go sharply down, through information contagion taking one institution's problems as an indicator of the future of others (Fatimah, 2012). If a significant part of the banking system is affected, the financial infrastructure of the overall economy may collapse, with potentially disastrous consequences for economic activity. The worst consequences may be avoided through government intervention, but this can be extremely costly to taxpayers.

These considerations indicate that the public interest in bank safety goes significantly beyond any interests banks themselves have in managing their risk. The sometimes high quality of bank

risk management must not divert attention from recognizing the fact that the public and private interests regarding bank safety are not the same, and might be even in conflict.

One of the studies justifying the actual Basel III "numbers" (Basel, 2010) states: "The regulatory minimum is the amount of capital needed to be regarded as a viable going concern by creditors and counterparties." By this criterion, capital regulation would not be necessary: A bank that fails this criterion would not be viable because creditors and counterparties would refuse to deal with it. Good regulation should focus on the negative impact that undercapitalized banks impose on the rest of the financial system and on society when they are distressed. It is this external or "polluting" impact that the regulation should seek to limit (Anat et al., 2011).

2.4.2 Cost Effectiveness

Regulation should focus on measures that are cost effective and that do not require that supervisors know more than is feasible for them to know. This principle militates against regulations that interfere in the details of what banks do. Since supervisors are not sufficiently steeped in these details, such interference would be ineffective and costly. However, structural changes meant to reduce the size and complexity of large global banks without interfering in day to day activities can be useful for achieving the regulatory objectives (Onaran, 2011).

Cost-effectiveness considerations strongly favor capital requirements relative to other approaches. While liquidity and reserve requirements can help banks satisfy sudden withdrawals of funds by short-term creditors, they have a significant opportunity cost because they prevent funds from being used for lending. Moreover, a bank with a lot of equity that can absorb losses is likely to avert liquidity and funding difficulties, because short-term creditors have more confidence in its solvency. If solvency is not a concern, providing occasional liquidity support does not impose much cost on taxpayers. Bankers and others argue against capital regulation claiming that "equity is expensive." From the perspective of regulation, however, this objection is invalid (Kenneth, 2000).

Increases in equity funding would raise the banks' private funding costs only because government subsidies to debt would be reduced (Admati et al., 2010). Such subsidies are due to explicit or implicit guarantees and to the preferential tax treatment of debt. The private costs to the banks from reducing these subsidies would be matched and surpassed by benefits to the taxpayers and the economy. Better capitalized banks are able to absorb more losses without

needing additional funds and without contracting their lending due to financial distress and debt overhang.

Debt overhang also colors bankers' reaction to demands for recapitalization and to higher equity requirements. If recapitalization makes a bank's debt safer, this comes partly at the expense of existing shareholders, who might see the loss of subsidies or the need to bear more downside risks (rather than leave them to creditors or taxpayers) reflected in a lower stock price. This cost to shareholders, however, is outmatched by the benefits to debt holders, taxpayers, and the economy (Anat et al., 2011).

An inability to raise equity in private markets can flag a solvency concern. In this case authorities should consider whether the bank is viable or a "zombie" that should go into resolution (Onaran, 2011).

2.4.3 Addressing Distorted Incentives

It is desirable to reduce the conflict of interests between bank managers and the public with respect to risk taking by banks. Bankers seldom, if ever, face significant negative consequences when they take excessive risks that endanger the bank and the broader economy. When compensation and bonuses depend on short term performance and on measures that encourage risk taking, bankers tend to stick to ways and means that would maximize their compensation even if the bank and the economy suffer losses as a result of their investments (James et al., 2012). Regulating pay structures so that cash bonus payments are deferred and can be clawed back if losses occur is a minimum.

Tax subsidies of debt encourage excessive borrowing, which creates an additional conflict between banks' preferences regarding their funding and what is good for the public. This interferes with good banking regulation. It would be highly desirable that tax codes change to equalize the treatment of equity relative to debt funding, or even encourage more equity at least for financial institutions (Anat et al., 2011).

2.5 Characteristics of Good Banking Regulation

Because bank regulation has been extended to cover a range of goals, there is always the possibility that it might be extended to areas that are not a proper concern for public policy.

Thus, the limits of bank regulation can best be understood in terms of the things it should not try to do.

2.5.1 Banking Regulations and Government Policies Discrimination

Discriminatory intervention in banking regulation, except in cases of obvious distortions, is not desirable for several reasons. In a free society, market forces should be free to allocate credit and resources. Rules that interfere with the market are inconsistent with this principle and may have unforeseen side effects (Marcia et al., 2004). Any such intervention in banking is often likely to be futile, or nearly so, since borrowers and other customers can frequently shift their business into "favored" areas or switch to less regulated entities.

Consequently, banking regulation must be evenhanded in its effects on various groups. Regulation should not give preferential treatment or discriminate financial institutions or to their customers, and it should not favor one size or type of financial institution over another. For example, banks should not be protected from the competition of other institutions nor other institutions from bank competition. In the interest of a competitive and efficient banking system, good bank regulation should have minimal effects on credit and resource allocation decisions and should not encourage costly efforts at circumvention (Kenneth, 2000).

For good regulation to be enacted, policy makers must know what it looks like and be willing to go through the requisite political process. However, good regulation has been elusive, partly because banks and governments have developed "corruptive dependencies" (Lessig, 2011).

When political considerations enter the implementation of beneficial regulation improperly, the promotion of the public interest is compromised. To avoid this outcome, it is desirable that banking supervision should be immune from interference by the government. Subordination of supervision to the government has traditionally been justified on the grounds that taxpayer must foot the bill if banks run into difficulties. However, the symbiosis of banks and government with banks funding government favored projects and governments bailing out banks corrupts the governance of both.

Supervisory independence could perhaps break the nexus. Even then, capture of regulators or supervisors by revolving-door recruitment or by the greater sophistication and information of bank managers remains a serious concern (Lessig, 2011).

Ideally, it would be useful to allow supervisory judgment to address pro-cyclicality and prevent inefficient asset sales, or to adjust capital requirements depending on the assessed buildup of systemic risk through business and credit cycles. However, discrimination is problematic if regulators or supervisors are captured. The past decade does not provide grounds for optimism. These distortions shall only be implemented if and only if it does not impede or distort competition (Kenneth, 2000).

2.5.2 Banking Regulation Must Keep Banks From Failing

Provided insured depositors can be protected and adequate banking services can be maintained, preventing the failure of individual banks is not a primary focus of banking regulation. In cases where banks are failing, regulatory aid might serve only to protect those responsible for the bank's poor performance its management and stockholders. Furthermore, in a dynamic banking system, regulation cannot prevent all banking failures, at least not at an acceptable cost (Fotios et al., 2008). Even if failures could be prevented, the result would be to sacrifice some of the main objectives of regulation.

For example, poorly managed banks and their stockholders might have to be protected from competition and the discipline of the marketplace, thus giving them further incentives to take excessive risks and avoid corrective actions. Such protection might also leave the customers of these banks with overpriced, low-quality services. Finally, to prevent failures, regulators might have to impose tight restrictions on the entire banking industry, thus keeping well-managed banks from fully meeting the needs of their customers (James et al., 2012).

For the most part, the bank regulatory agencies have handled banking problems and failures with liffle disruption to depositors, other bank customers, and the local economy. Kenneth (2000) puts the characteristics of a good regulation as one that facilitate invention and that thinks globally so as to utilize as well as protect itself from the spillover effects of failure in another country. Through these actions, failing banks and their management and stockholders can be forced to bear the full consequences of their actions, and the deposits and many of the assets at these banks can be taken over by banks operated in a safer and more efficient manner.

2.5.3 Bank Regulations Substitute Government Decisions

Kenneth, (2000) argues that bank regulations are partly the substitute of the political environment and should be in place carefully so as not to put too much burden in the industry.

When bank examiners identify problems at banks, they may offer advice on how the problems could be corrected. The examiner is not in a position, however, to determine policy at a bank or to establish particular lending and investment practices.

Bank supervisors can often judge a banker's decisions only in retrospect. Credit decisions, for instance, might be based partly on characteristics of individual borrowers that only the lending officer understands. Also, a bank supervisor or examiner who spends only a few days or weeks in a bank cannot gather all the information available to the banker or fully comprehend all the policy decisions made in the bank. In meeting their own objectives, bank examiners and regulators must therefore be careful not to hinder banks as they serve the needs of their customers and the overall economy (Fotios et al., 2008).

2.6 Effects of Banking Regulation

2.6.1 Banking Regulation and Performance

Different studies on bank regulation provided the outcomes that relate bank regulation to bank performance and bank stability.

Kremmling (2011) sought to find out if regulating financial institutions during financial crisis will influence bank performance by taking into account, deposit insurance schemes, capital regulation and activity restrictions. His results showed that capital requirements negatively influenced the level and change in loan loss provisions during financial crisis; as such, banks with high or low capital ratios still succumbed to bank runs during financial crisis.

Activity restrictions raised the risk profile of banks severely during financial crisis; this is inevitable as banks with numerous activities from nonfinancial firms will try to gain returns from loan provisions which will be difficult to receive during financial crisis. Thus, Kremmling's (2011) findings asserted that banks' complexity can have adverse effect on regulation, which directly affects performance and stability.

Barth, (2004) tested bank regulation in a cross-country evaluation of banks by looking at the various regulatory indicators and variables that can possibly affect bank performance in different countries. These three researchers have studied bank regulation individually and co-authored books on bank regulation. Their seminal works have provided more empirical studies on bank

regulation, bank performance, bank development and corporate governance based on cros s - country emphasis.

In view of this, Barth empirically provided outcomes on bank regulation and supervision and how it affects bank development and performance. Based on their results from their studies, activity restriction was found to be negatively related to bank development and stability, compared to banks with no activity restrictions. Capital regulations were found to be positively related with bank development, when bank regulation and supervision were controlled. As such, Barth (2004) concluded that government imposition of regulation will not improve bank performance and stability, and as such, market forces ought to be allowed to regulate bank performance and development through activity diversification, premium-induced deposit insurance schemes, and relaxed capital requirements on banking firms (Fatimah,2012).

Fernandez and Gonzalez *(2005)* provide evidence to suggest that in countries with low accounting and auditing requirements, more power on official supervisory authorities may reduce risk-taking behavior from managers' perspectives. On another side, higher restrictions on bank activities can diminish the probability of a banking crisis (Georgios et al., 2010).

2.6.2 Banking Regulation and Risk

Bank regulation and supervision has been the subject of much recent debate and attention, due in large part to the global financial crisis that started in the late 2000s. A number of studies have pointed to weaknesses in regulation and supervision as one of the factors leading to the crisis. Not only did the crisis raise important questions on the appropriateness of the regulatory and supervisory approaches pursued in the run-up to the crisis, but also it prompted regulators to consider important changes in regulation and supervision.

There must be a clear and realistic account of what regulatory measures can achieve and how they promote the objective of the regulation, taking account of systemic effects. Restrictions on banks' activities can add risks and generate inefficiencies if they are not properly designed. For example, if banks are restricted to investments in a particular region, this limits their ability to reduce risk through diversification.

If reserves or equity capital are needed to satisfy regulatory requirements, they cannot actually serve as buffers (Goodhart, 2010). With capital regulation, this paradox generates a pro-cyclical mechanism where, after losses that reduce a bank's equity, assets are sold to maintain the

required capital ratio, creating downward pressure on asset prices, with potentially negative effects on other banks.

If regulation provides incentives for banks to shift risks to third parties, affention must be paid to the ability of counterparties to bear the risk. Overlooking this can give an illusion that risks are gone when they are in fact lurking elsewhere in the system (Anat et al., 2011).

Liquidity regulation should recognize that liquidity is not intrinsic to assets but may change abruptly. Treating all government bonds and even certain privately issued bonds as perfectly safe and liquid is problematic (Goodhart, 2010).

To summarize, good banking regulation focuses on promoting the public interest in financial stability, gives regulators cost effective tools, and creates an environment where regulators and supervisors have both the ability and the will to use the tools to implement and enforce the regulation (Anat et al., 2011).

2.7 Review of Empirical Literature

2.7.1 Banking Regulation and Bank Performance

While most analysts would argue for the need to enforce regulations, the question remains: What is the right benchmark to enforce regulations without jeopardizing the ability of banks to service the economy? To properly address this question, it has become necessary to thoroughly analyze the effect of banking regulations on performance.

Impact of Banking Regulation on Banks Performance in Ghana

By common consent, Ghana's banking sector had performed poorly in the past, but from the late 1980s various reforms (institutional, legal and policy reforms) have been introduced which were intended to strengthen the sector.

The financial sector reforms have largely succeeded in terms of enhancing financial development and the expansion in size and diversity of the banking sector. The enactment of the new Banking Law brought more discipline to the banking sector. The Bank of Ghana with its greater power has improved its regulatory activities as compared with the pre-financial reform period. Nevertheless, studies found some uneasiness in the banking sector about the Bank of Ghana's tardiness in reacting to specific breaches of the law by some fmancial institutions.

Since the introduction of the financial sector reforms, banks have derived considerable profit from their investments in government securities and Bank of Ghana securities. The share of private sector deposits in the banking sector portfolio declined between the two periods. The performance of the state-owned banks was found to be below that of the private banks in terms of profitability, intermediation and operations.

It is also revealed that specific policy reforms which enhanced bank performance were interest-rate liberalization, decontrol of credit allocation and the removal of non-performing assets to the Non-Performing Assets Recovery Trust. The banks identified the major measures that depressed their performance as the unified cash reserve requirement on deposits and the generally high level of reserve requirements. This tight stance was part of the fight against inflation which was a serious problem in the 1990-96 period. On the whole, bankers felt that the reforms had created a better environment for the development of the banking sector (Antwi-Asare and Addison, 2000).

Impact of Banking Regulation on Banks Performance in Turkey

Turkish banking industry has an oligopolistic structure with strictly limited entry and exit. These restrictions make the banking sector more prone to crises. Banks fragility increases with a regulator that aims to control the industry more strictly in order to eliminate the negative consequences of recent crises. The Turkish experience is exemplary in this connection. BRSA limits entry into the market and impose very strict restrictions on banks in some respects.

In this respect, regulatory structure that increases commitment and sees regulations as a contract between the state and players, both banks and consumers, may contribute positively to banking performance and increase efficiency.

The regulator binds itself by its laws and should not change them abruptly at its discretion. To this end, both the regulator and banks should provide accurate information about their activities. Regulatory commitment encourage player in the market to turn to market instead of the regulator in order to solve their problems. Opening the door to private litigation increases efficiency in the industry.

The major determinant of the efficiency of restrictions is the institutional structure. In Turkey, full deposit insurance through government ownership encouraged banks and costumers to take

excessive risks. In these cases, a strict regulation and supervision of banks tend to improve overall performance. (Ayhan, Ridvan and Fuat, Undated).

2.7.2 Banking Regulation and Liquidity Risk

Liquidity regulations for banks can be justified, like solvency regulations, by two different motives: one is to limit the risk and the extent of individual bank failures, the other is to limit the need for massive liquidity injections by the Central Bank in case of a macroeconomic shock. In normal times, the pool of marketable securities that can provide liquidity to the banks is substantial (Jean-Charles, 2008).

Impact of Banking Regulation on Banks Liquidity in US & Canada

Cash reserve requirements have been imposed in the US as early as 1820, when commercial banks were state-chartered and did not have large amounts of deposits. Reserve requirements were launched at the national level in 1863 with the passage of the National Bank Act. This Act enabled banks with a national charter to issue national bank notes and required them to hold a *25%* reserve against such notes and deposits. In 1864, this was reduced to 15% for banks located outside the largest cities. An Act of 1874 replaced reserve requirements on bank notes with a required redemption fund (banks were to deposit money equal to *5%* of the notes with the Treasury) which counted toward fulfilling reserve requirements on deposits (Christa, 2013).

Various bank runs and panics in the late 19th and early 20th centuries demonstrated that reserve requirements could not safeguard the convertibility of deposits for the entire banking system, in essence because a dollar of reserves could not concurrently meet a customer's demand for cash and also satisfy reserve requirements. To maintain stability of the financial system, the Federal Reserve System was created in 1913, Reserve Banks could act as lenders of last resort by accommodating banks' temporary liquidity needs.

Many banks struggled to maintain adequate liquidity during global fmancial crisis. Unprecedented levels of liquidity support were required from central banks in order to sustain the financial system. Even with such extensive support, a number of banks failed, were forced into mergers or required resolution. The crisis showed the importance of adequate liquidity risk measurement and management. Commercial banks were heavily exposed to maturity mismatch both through their balance sheet and off-balance sheet vehicles and through their increased reliance on repo financing. A reduction in funding liquidity **then caused significant distress. In**

response to the freezing up of the interbank market, the European Central Bank and U.S. Federal Reserve injected billions in overnight credit into the interbank market. Some banks needed extra liquidity supports (Pavla, 2010).

The recent crisis in 2008 has underlined the importance of sound bank liquidity management. In response, regulators are devising new liquidity standards with the aim of making the financial system more stable and resilient. Results suggest that profitability is improved for banks that hold some liquid assets, however, there is a point at which holding further liquid assets diminishes a banks' profitability, all else equal.

As policymakers devise new standards establishing an appropriate level of liquidity for banks, helping to ensure adequate stability for the overall financial system, the empirical results suggest they should bear in mind the trade-off between resilience to liquidity shocks and the cost of holding lower-yielding liquid assets. While holding liquid assets will make banks more resilient to liquidity shocks, thus reducing the negative externalities they might impose on other economic agents, holding too many may impose a significant cost in terms of reduced profitability. Preliminary results in this paper also suggest that Canadian banks may have needed to hold less liquid assets over the estimation period than did U.S. banks, in order to optimize profits. While this could perhaps point to favorable market perception of the regulatory framework and conservative, universal banking model in Canada, these results should be interpreted with caution due to data concerns (Etienne and Christopher, 2010).

While the United States was the epicenter of the crisis, it tested the strength and usefulness of various policy instruments. It became clear that if the crisis is a crisis of confidence, only the lender of the last resort can salvage the situation. The Federal Reserve and other central banks expanded eligible collateral beyond sovereign securities and also expanded eligible counterparties for central bank operations (BIS, 2012).

A simple, uniform liquidity ratio may be all that is needed, with the possible qualification that the Banking Supervisors could require additional liquidity for undercapitalized banks, in the spirit of the "prompt corrective action" implemented in the USA. As for macro-prudential purposes, that is anticipating what would occur in case of a large macro shock, it is probably necessary to go further, and either to require additional liquidity, or secure a credit line by the Central Bank, both based on the exposure of each individual bank to such macro shocks and

carefully monitored by the Banking Supervisors. The definition of appropriate indices of such exposures to macro shocks (possibly using stress tests and worst case scenarios) is an important empirical challenge. Similarly, some form of cost-benefit analysis of lender of last resort interventions would be useful in order to evaluate the exact costs of liquidity provision by the Central Bank, and the social cost of excessive liquidity (Jean-Charles, 2008).

Impact of Banking Regulation on Banks Liquidity in Nigeria

A key activity of the CBN is liquidity management. According to the CBN Act of 1958 and its subsequent amendments, the CBN is responsible for implementing restrictive or expansionary monetary policies in order to achieve price stability, influence interest rates, manage the growth in credit to the domestic economy and maintain the international value of the local currency. It manages Banking Sector liquidity by supplying or withdrawing liquidity from the Banking Sector which it deems to be consistent with a desired level of short-term interest rates or reserve money. It relies on the daily assessment of the liquidity conditions in the banking system, so as to determine its liquidity needs and thus, the volume of liquidity to inject or withdraw from the economy (Yesuf, 2010).

A well-funded Banking Sector is essential in order to maintain fmancial system stability and confidence in the economy. In Nigerian Banking Sector only liquidity ratio, monetary policy rate and lagged loan-to-deposit ratio are significant for predicting Banking Sector liquidity. Results suggest that during periods of economic or financial crises, deposit money banks are significantly illiquid relative to benchmarks, and geffing liquidity monetary policies right during these periods is crucial in ensuring the survival of the Banking Sector (Samuel, 2011).

Taking the above theoretical and empirical literatures presented this study examines Banking Regulation in Ethiopia and its impacts on Profitability and Liquidity gathering bankers' opinion as well as using panel data econometric model.

CHAPTER THREE
RESEARCH DESIGN AND METHODOLOGY

In this chapter the basic road map of the research, the population under consideration, the sampling technique employed, the source, the tools used for collecting the data, and the data analysis methods employed will be discussed.

3.1. Research Design

A research design is a plan or a blueprint of how to design conducting the research. The major purpose of this research is to assess the impacts of banking regulations on profitability and liquidity of Ethiopian private banks. This is mainly an explanatory study attempting to determine the effect of regulation on bank performance.

Quantitative and qualitative data were used to conduct this study. The qualitative information was gathered from the selected banks to asses which were opportunities and which were challenges and to provide possible recommendations, the researcher used both primary and secondary data as a source of data collection. The quantitative approach was applied to evaluate the financial position of banks specially those parts that are affected by the banking regulations.

Primary Data was collected by a questionnaire that was developed by the researcher on the basis of literature review and distributed for executive body and related employees in the private banks to collect qualitative data which was used to fulfil the objectives of the study. The completed questionnaires have provided useful information in such a way that the respondents may reveal their attitudes on issues relating to the banking regulations.

Finally, after all the data collected, summarized and analysed conclusion and recommendation is forwarded.

3.2. Population and Sampling Techniques

Scholars do not agree on the exact proportion of the accessible population that should form the sample size. Studies suggest that in descriptive studies ten percent of the survey population is representative enough to generalize the characteristics being observed.

In this study however ten private banks that is over *62.5* percent of the accessible population (private banks) constituted the sample size for the questionnaire while nine that is *56.25* percent has been employed for the quantitative analysis. The sampling for the quantitative analysis used

is purposive since the research used cross-sectional and at the same time panel data for the private banks using the peers. That is all the first six private banks are selected while three were selected from the second peer. The third peer group which includes the newly opened banks are excluded due to inadequate data availability. Since their business and operation is the same the researcher strongly believes all the private banks are represented by whatever the outcome from the selected ones. However ten private banks are used for questionnaire since one is included from the third peer just to assess their affitude on the banking regulation.

The study used stratified random sampling techniques for selecting respondents. Stratified sampling is used to achieve representation of the main respondents. Six questionnaires each on the average were distributed for the ten banks which made the total distributed questionnaire's to be 60. Out of the sixty questionnaires distributed, a total of *54* were returned representing a response rate of ninety percent (90%) which is enough to make generalization on the entire population since the respondents are off highly qualified professional bankers.

3.3. **Sources of Data**

The researcher used both primary and secondary data as a source of data. Primary data was collected from the banker's through questionnaires distributed among the selected samples of the target population. In addition, Primary data was obtained through an interview with selected banks based on convenience and availability. Through the collection of primary data, first-hand information was obtained about the opinions of the banker's towards the banking regulation in Ethiopia and to say whether the regulations are opportunities, challenges or both.

Secondary data was collected from annual reports and publications of the banks. The secondary data is used to obtain a verification of the attitudes whether the banking regulations had a positive or negative impact.

3.4. Tools of Data Collection

Some of the methods that can be used in gathering data in a survey are personal interviewing, telephone interviewing and self-administered surveys. In this study, primary data was collected through the utilization of questionnaires and interviews. The questionnaire was distributed to employees who are related to the issue especially around head office area and interview conducted with selected executive management of sample banks.

The secondary data sources consulted include annual reports, books, manuals and websites.

3.5. Procedures of Data Collection

The following procedures were strictly followed by the researcher to collect the data required for the study

1- Data collection tools was prepared that is questionnaire and interview questions
2- The questionnaire developed for the banker's were pilot tested to check clarity
3- Correction was made based on the feedback obtained from the pilot test session
4- The amended questionnaire was delivered by hand to the respondents at their duty stations during working hours and collected through assistant.
5- Interview session was conducted with the selected management staffs and the information obtained was compiled accordingly.

3.6. Data Analysis Methods

The data obtained through responses of questionnaires was compiled at first, and then the data was summarized, edited, coded, tabulated and analyzed. Editing was done to improve the quality of data for coding. Editing involved going through the questionnaires to see if respondents responded to questions and see if there are blank responses. Tabulation involved counting the number of cases that fall into various categories. A simple tabulation was used. Descriptive statistics data analysis method was used to analyze quantitative data where data is scored by calculating the number and percentages. Qualitative data analysis method was also employed to analyze qualitative data gathered using the interview results.

3.7. Econometric models

The quantitative methods of analysis involved were descriptive and inferential statistical analysis. These techniques describe variables in the model and also to examine the relationships between regulation and bank performance. In addition, before running panel data model, appropriate diagnostic tests were conducted.

The following four regression models were used.

Model 1 ROA = RR + LC + BP + SIZE + CAP +AGE
Model2 ROE = RR + LC + BP + SIZE + CAP +AGE
Model3 NIM = RR + LC + BP + SIZE + CAP +AGE

Model4LIQ=RR+LC+BP+SIZE+CAP+AGE

Where

- *ROA is return on assets*
- *ROE is the return on equity*
- *NIM is net interest margin*
- *LIQ is bank* ***liquidity***
- *RR is reserve requirement*
- *LC is a dummy variable for lending cap*
- *BP is a dummy variable for investment on government bonds*
- *SIZE is size of a bank*
- *CAP is capital adequacy ratio*
- *AGE is age of a bank* The dependent variables used in this study were return on equity

ROA, ROE, NIM, and LIQ to measure bank performance.

• ROA is net income after tax divided by year- average total assets at book value

- ROE is net income after tax divided by the year-average total capital at book value
- NIM is net interest income divided by total assets
- LIQ is the ratio of liquid assets to total assets

The explanatory variables used in this study were RR, LC, and BP

- RR is the reserve ratio.
- LC is a dummy variable for lending cap with a value 1 during years over which the lending cap was in effect
- BP is the ratio of banks investment in NBE bills to total assets

Three control variables were introduced to each of the four models that include SIZE, CAP and AGE

- SIZE is natural logarithm of total assets of a bank
- CAP is the ratio of shareholders equity to total assets
- AGE is age of a bank in 2014 measured by the length of time since establishment Panel

data econometric model is used to examine the impact of regulation on bank performance.

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

This chapter is organized in terms of the objectives of the study. It also presents and describes data on socio-demographic characteristics of the respondents, affitude of private banks towards the Ethiopian Banking Regulations, the impact of the Directives of the NBE on the private banks' profitability and liquidity risk experience and the impact of NBE's Directives, in order to answer those research questions and to address the objectives of the study.

Ten private banks were used to issue and distribute a total of 60 structured questionnaires. The responses yielded *54* questionnaires, resulting in a response rate of 90%.

4.1. Respondents Profile

The overall socio-demographic characteristics of the respondents to the questionnaire are summarized and presented in the table below.

Table 4.1 Respondents Gender and Age

Age Category	Gender					
	Male		Female		Total	
	Frequency	Percent	Frequency	Percent	Frequency	Percent
26-35	11	20.4	0	0	11	20.4
36 - *45*	23	42.6	3	*5.6*	26	48.1
46-55	*9*	16.7	*5*	*9.3*	14	25.9
56-65	3	5.6	0	0	3	5.6
Total	**46**	**85.2**	**8**	**14.8**	**54**	**100**

As depicted in Table 4.1 a total of 46(85.2%) were males, while 8(14.8%) were females. About half of the employees in the surveyed private banks were found to be middle-aged adults from both sexes. A total of 26(48.1%) of the sampled employees were found to be in the age category

which ranged from 36 to *45* years. Disaggregated by gender, 23(42.6%) were males and *3(5.6%)* were females. Therefore, one can deduce that there is gap in terms of age-based experience in the banking industry on the part of those workers in the private banks.

The researcher also sought to establish the highest level of education of the respondents. The findings to that were analyzed and presented as depicted in Table 4.2.

Table 4.2 Respondents Education Level

Educational Level	Frequency	Percent
Bachelor's degree	32	*59.3*
Master's degree	22	40.7
PhD degree	0	0
Total	**54**	**100**

Table 4.2 indicates the responding employees in the private banking industry achieved bachelor's degree (fifty-nine percent) and master's degree (about forty-one percent) in a specific field of study, but no sampled respondents that obtained a diploma and a PhD degree in the industry. These results of the study documented that all the respondents had educational levels beyond diploma level, especially the median typical representative of their bachelor's degree educational status achievement which was an indication of the educational movement valued trainings for delivering services and management positions at different levels in this period of the Ethiopian Banking Industry.

A duration during which the sample respondents have been working in the banking industry is illustrated in Table 4.3. A total of 29(54.1%) of the respondents were found to work in the private banks which ranged from 11 to 20 years, followed by 13(23.9%) of them who worked for at least 1 years and a maximum of 10 years. Those employees who participated in the study, on average, worked for 16.04 years in the banking industry in Ethiopia. The standard deviation and variance were calculated to 7.397 and *54.7* 16 respectively. Thus, the respondents are mostly below twenty years of experience.

Table 4.3 Respondents Experience in the Banking Industry

Duration (years) in Banking Industry	Frequency	Percent
1-10	13	23.9
11-20	29	54.1
21-30	9	16.1
31-40	3	*5.9*
Total	**54**	**100**

The respondents in the study were asked to state their duration of stay in their respective current position at the private banks. As indicated in table 4.4, the significant majority (about eighty percent) of the banks' employees were found to be incumbent of their respective offices which elapsed from 1 to *5* years. The sampled workers in the private banking industry were almost absent in having more than a decade of work experience in their current offices and are on average in their current office positions for 9 years.

Table 4.4 Respondents Experience in Current Post

Duration (years) in Current Post	Frequency	Percent
Less than 1 year	3	*5.6*
1 - 5	43	79.6
6-10	6	11.1
11-15	1	1.85
16-20	0	0
21-25	1	1.85
Total	**54**	**100**

Regarding the respondent's current job title in the banking industry, the findings of the study came up with varied job titles based on different job classifications. Table *4.5* shows that

Director as a current job title appeared to be slightly noticeable in the frequency distribution. A total of 21(about 38.9%) of the responding employees in the banks had incumbent power in their Director Position as job title. Managers and Section heads follow by 24.1% and 20.4% respectively in the respondent list.

Table 4.5 Respondents Current Job Title

Job Title	Frequency	Percent
Executive	3	*5.6*
Director	21	38.9
Deputy Director	3	*5.6*
Manager	13	24.1
Section Head	11	20.4
Officer	3	*5.6*
Total	**54**	**100**

4.2. Overview of Banking Regulation in Ethiopia

Banking regulation in Ethiopia starts from establishment of the National Bank of Ethiopia in 1963 by proclamation 206 of 1963 and began operation in January 1964. Prior to this proclamation, the Bank used to carry out dual activities, i.e. commercial banking and central banking. The proclamation raised the Bank's capital to Ethiopian dollars 10.0 million and granted broad administrative autonomy and juridical personality.

However, monetary and banking proclamation No. 99 of 1976 came into force on September 1976 to shape the Bank's role adoring to the socialist economic principle that the country adopted. Hence the Bank was allowed to participate actively in national planning, specifically financial planning, in cooperation with the concerned state organs. The Bank's supervisory area was also increased to include other financial institutions such as insurance institutions, credit cooperatives and investment-oriented banks. Moreover the proclamation introduced the new

Ethiopian currency called 'birr' in place of the former Ethiopian Dollar that ceased to be legal tender thereafter.

This proclamation was in force till the new proclamation issued in 1994 to reorganize the Bank according to the market-based economic policy so that it could foster monetary stability, a sound financial system and such other credit and exchange conditions as are conducive to the balanced growth of the economy of the country (NBE, 2013).

The banking proclamation "Licensing and Supervision of Banking Business" Proclamation No. 84/1994 was latter replaced by Banking Business Proclamation No. 592/2008. The Monetary and Banking Proclamation No. 83/1994 which established the regulatory body of banks, that is the NBE, was also revised by Proclamation No. 591/2008 is now the active proclamation in place. These proclamations jointly give the NBE the full mandate to supervise and monitor the banking business in Ethiopia. In this regard the NBE has issued various Directives and Circulars which are assumed to foster the banking business environment for the safety of the industry and the country. Some of the active directives include but not limited to are indicated in Table 4.6 below.

Table No. 4.6 List of NBE Directives

DIRECTIVE NO	DIRECTIVE DESCRIPTION
SBB-3-95	Contribution in Kind
SBB-4-95	Legal Reserve
SBB-9-95	Computation of Risk Weighted Asset
SBB- 10-95	Limitation of Accommodation
SBB-12-96	Limitation of Investment of Bank
SBB-12-96	Naming of Officer
SBB-19-96	Approval of Appointment of an Independent Auditor
SBB-2 1-97	Manner of Reporting Financial Information
SBB-26-0 1	Establishment of Special Account for Effecting Payments for Coffee Purchases From the Coffee Auction Center
SBB-27-0 1	Amendment of limitation on Open Foreign Currency Position of Banks
SBB-30-02	Limitation on Loans to Related Parties
SBB-3 1-02	Proper Operation of Current Account and Cheque
SBB-35-04	Amendment of Penalty for Non-Compliance with the Directives of National Bank of Ethiopia
SBB-40-06	Amendment of Branch Opening
SBB-43-08	Asset Classification and Provisioning(4th Replacement)
SBB-46- 10	Customer Due Diligence of Banks
SBB-47- 10	Time Limit for Reduction and/or Relinquishing Share Holdings
SBB-49-1 1	Limits on Board Remuneration and Number of Employees Who Sit on a Bank Board
SBB-50-1 1	Minimum Capital Requirement for Banks
SBB-51-11	To Authorize the Business of interest free banking
SBB-52- 12	Asset Classification and Provisioning for Development for Finance Institutions
SBB-53-12	Credit Exposures to single and related Counter Parties
SBB-54-12	Requirements for persons with Significant Influence in a Bank
SBB-55- 13	Reserve Requirement(6th Replacement)
SBB-56- 13	Requirement for Licensing and Renewal of Banking Business
FIS-01-12	Regulation of Mobile and Agent Banking Services
MFA/NBEBILLS/OO 1/2011	Establishment and Operation of NBE Bills Market
MFA/NBEBThLS/002/2013	Amendment of NBE Bill Purchase

Source: NBE, 2013

These directives tally with our literature on the types of regulation and their importance which are entry regulations, safety and soundness regulations, credit allocation regulations, consumer protection regulations, monetary policy regulations and efficiency and competition regulations (Marcia et al., 2004) which are believed to be needed for the banking industry.

4.3. Attitudes of Private Banks towards the Ethiopian Banking Regulations

In the study conducted, the researcher tried to select specific article from the banking proclamation and selected five directives which are believed to have strong impact on the operation and financial performance directly. The following are the responses on the attitude of the directives selected which include the Minimum Capital Requirement, Limitation on Open Foreign Currency Position of Banks, Reserve Requirement of Banks, Establishment and Operation of NBE Bills Market including its amendment and Limitation on Investment of Banks.

4.3.1. Prohibition of Foreign Nationals in the Banking Industry

Banking Business Proclamation No. 592/2008 Article 9 states, "Foreign nationals or organizations fully or partially owned by foreign nationals are not be allowed to open banks or branch offices or subsidiaries of foreign banks in Ethiopia or acquire the shares of Ethiopian banks". Figure 4.1 illustrates the respondents' opinions on Article 9 of the Ethiopian Banking Proclamation No. 592/2008. The output of the study showed that the employees in those private banks expressed their views on the necessity of the article. Of the fifty-four sampled respondents in the banks, *30(55.6%)* viewed Article 9 of the proclamation as "Necessary" for the function of the industry. However, twenty (20) respondents who accounted for thirty-seven percent (37%) of the total subjects in the study argued that the above-stated Article requires 'Improvement'. Very small (7.4%) of the respondents in the study were found to be in the opinion of evaluating the Article as restrictive and needs improvement.

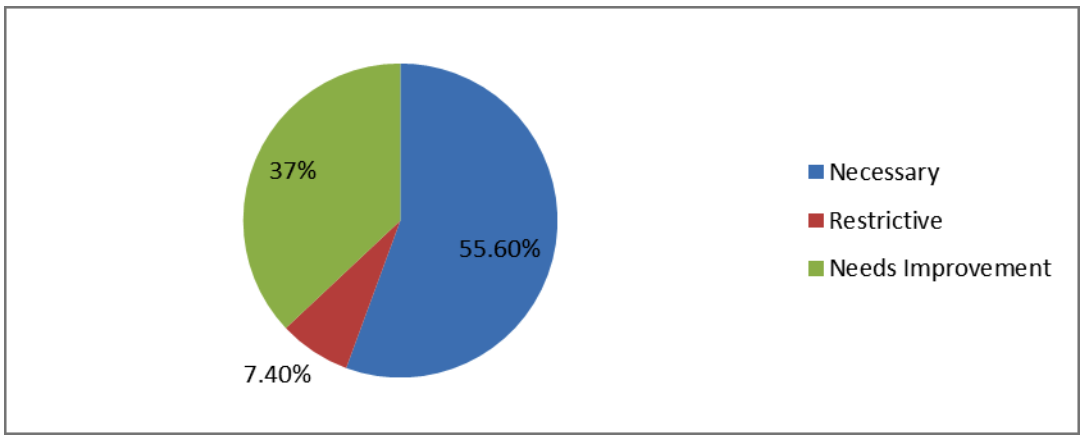

Figure 4.1 Opinion on Article 9 of the Ethiopian Banking Proclamation No. 592/2008

The Banking Business Proclamation Article 9 which supports the banks in terms of bringing about positive impact on ensuring profitability of the banks by excluding the foreign banks which will be a danger for their business due to capital, technological and innovative products differences. As shown in Table 4.7, out of the total respondents in the study, a total of 31 (about fifty-seven percent) were in the opinion of increasing the bank's profit. Surprisingly, about one-fifth (18%) of the respondents in the study strongly expressed that the Ethiopian Banking Proclamation No. 592/2008 had no impact on the banks' profitability. This means the effect of the existing Proclamation on Ethiopian banks has neither positive nor negative impact. Here, such findings may necessitate further and detail studies in a context sensitive approach as the outputs of the data analysis indicated mixed, but due attention attracting figures.

Table 4.7 Impact of the Ethiopian Banking Proclamation on Private Banks' Profitability

Impact	Frequency	Percent
It increases the bank's profit	31	*57.4*
It decreases the bank's profit	13	24.1
It doesn't have any impact	10	18.5
Total	**54**	**100.0**

Here we can say that the Article is a necessary one and also it is increasing the bank's profit and can be seen as an opportunity for the existing banks.

This tally with the literature since, heavily protected banking industry against new entrants by high indirect costs (by restricting individuals who can establish commercial banks) of entry produce bigger profits for existing firms than those in which entry is relatively easy (Marcia et al., 2004).

4.3.2. Minimum Capital Requirement

SBB 50/2011 states that "the minimum paid up capital required to obtain a banking business license shall be Birr 500 Million, which shall be fully paid in cash and deposited in a bank in the name and to the account of the bank under establishment". The researcher wanted to know about

the sample employees' affitude towards the directive. Table 4.8 depicts that the private banks show positive affitude towards the Directive which stipulates the minimum capital requirement to be ETB 500 million as paid up capital which was raised from *75* Million Bin. A total of 37(about sixty-nine percent) of the respondents were found to consider the Directive as necessary. About thirty one percent of them also confirmed that the Directive No. SBB/50/201 1 was assessed as restrictive and then needs improvement.

Table 4.8 Opinion on Directive No. SBB/50/2011: "Minimum Capital Requirement for Banks"

Opinion	**Frequency**	**Percent**
Necessary	37	*68.5*
Restrictive	9	16.7
Needs Improvement	8	14.8
Total	**54**	**100.0**

More than three-fourth (about seventy-six percent of the employees in this empirical study revealed that the impact of the Directive No. SBB/50/201 1 on the private banks could be reflected in terms of increasing their profitability. Their opinion is based on the argument that since it prohibits entry in the industry, it decreases competition and is a good base for high profit margin.

Generally, the Directive on Minimum Capital Requirement for Private Banks was conceptualized as necessary which augmented their profits as illustrated in Table 4.9.

Table 4.9 Impact of the Directive No. SBB/50/2011 on the Bank's Profitability

Type of impact	Frequency	Percent
It increases the bank's profit	41	75.9
It decreases the bank's profit	*5*	*9.3*
It doesn't have any impact on the bank's profit	8	14.8
Total	**54**	**100.0**

This tally with the literature since it heavily protects banking industry against new entrants by high direct costs through capital contribution of entry and produce bigger profits for existing firms than those in which entry is relatively easy (Marcia et al., 2004).

4.3.3.Limitation on Open Foreign Currency Position of Banks

SBB/27/2001 states that " the overall open foreign currency position of each bank at the close of each business day shall not exceed 15% of its capital". As to the question about the Directive, the data analysis documented mixed results. A total of *25(46.3%),* 19(35.2%) and 9(16.7%) of the respondents were found to be in view of the need for improvement of the Directive, expressed it as necessary, and as restrictive Directive Proclaimed by the National Bank of Ethiopia, respectively (see Table 4.10). Therefore, almost half of the sampled respondents in the study considered the Directive No. SBB/27/2001 as needs improvement. This study then highlights the need for amending the limitation that has been imposed on the banks and which, in turn, crunched their free competition for survival in the business industry at different levels. Their argument is based on the timing of business seasonality and the issue of not getting the foreign currency once surrendered to NBE after it reaches 15% when the banks are in need of the resource.

Table 4.10 Opinion on Directive No. SBB12712001, '[1]Limitation on Open Foreign Currency Position of Banks"

Type of opinion	Frequency	Percent
Necessary	19	35.2
Restrictive	9	16.7
Needs Improvement	26	48.2
Total	**54**	**100.0**

Out of those 26 respondents in the study who opted for Needs Improvement, 17(68.0%) of them stated that the percentage of holding of foreign currency in the banks in Ethiopia needs to be increased, but 9(36.0%) argued that this percentage needs to be decreased which was even more surprising. Generally, the limitation stipulated in the Directive No. SBB/27/2001 was viewed as restrictive and required improvement in the direction of increasing the amount of percentage of capital to hold more foreign currency at their possession and also introduce a way for recollecting the amount when the need arises at the private banks end.

Table 4.11 Impact of the Directive No. SBB12712001 on the Banks Profitability

Impact	Frequency	Percent
It increases the bank's profit	9	16.7
It decreases the bank's profit	38	70.4
It doesn't have any impact on the bank's profit	7	13.0
Total	**54**	**100.0**

Table 4.11 indicates that the aforementioned Directive has negative impact on the private banks' profitability. A total of 3 8(70.4%) respondents in the study confirmed that the Directive

No. SBB/27/2001 decreased the private banks' profits. Therefore, the National Bank should toil shoulder to shoulder with concerned stakeholders at different levels to sit down and to closely consult one another to revisit the discourses on the Directive No. SBB/27/2001 in affirmative maimer. Even though the NBE has the full mandate to issue any directive necessary to the country, the researcher has not come up directly with such types of regulation types in his literature review.

4.3.4. Reserve Requirement of Banks

SBB/55/2013 6th Replacement which is one of the highly amended directives ever issued by NBE states that " Any bank operating in Ethiopia shall at all times maintain its reserve account maintained at NBE *5%* of all Birr and foreign currency deposit liabilities held in the form of demand, savings and time deposits". Table 4.12 summarizes the liquidity requirements for private banks as they are stipulated in the Directive Number SBB/55/2013. Of the *54* respondents surveyed, the majority (81.5%) of them identified the necessity of the Directive. As having sound liquidity is basic and important in the banking industry, this finding of the study concurs with the general essence of it. Even though high liquidity has inverse relation with profitability, it seems that all bankers agree on the importance of having adequate reserve with different opinion on the percentage.

Table 4.12 Opinion towards SBB15512013 "Reserve Requirements for Banks"

Opinion	Frequency	Percent
Necessary	44	81.5
Restrictive	1	1.9
Needs Improvement	9	16.7
Total	**54**	**100.0**

Among those responding bankers who considered the Directive on Liquidity Requirements, 6 (11%), 2(3.7%) and only 1(1.9%) viewed the improvement in terms of the need for increment, reduction and for it to be waived in that given order.

In the study, questions are raised about types of impact the Directive Number SBB/55/2013 have on those private banks' respective liquidity status. As indicated in Table 4.13, a total of 28(about *52%)* of the respondents evaluated the Directive as the NBE's intervention to boost the banks' liquidity. Surprisingly, twenty-three respondents in the study that accounted for about forty-three percent (43%) of the total argued that the Directive SBB/55/2013 was considered as intervention which decreased the banks' liquidity which was argued since it is the sixth replacement and decreased from 15% requirement.

Table 4.13 Impact of the Directive No. SBB15512013 on the Bank's Liquidity

Type of impact	Frequency	Percent
It increases the bank's liquidity	28	51.9
It decreases the bank's liquidity	23	42.6
It doesn't have any impact on the bank's liquidity	3	*5.6*
Total	**54**	**100.0**

Table 4.14 shows that in the same vein, the findings stood at a crossroad because half of the respondents argued that this Directive has a positive effect on the private banks' profit, whereas a total of 24(44.4%) of them were found to counter-argue against the first empirical evidence.

Table 4.14 Impact of the Directive No. SBB15512013 on the Banks Profit

Types of imposition	Frequency	Percent
It increases the bank's profit	27	50.0
It decreases the bank's profit	24	44.4
It doesn't have any impact	3	*5.6*
Total	**54**	**100.0**

Of the total *54* respondents, thirty-five (about sixty-five percent) of the respondents in the study also believed the need for fair amendments on the current Reserve Directive. This was due to the belief of some banker's that *5%* is very small and the NBE needs to consider it increasing to its former position of 10%.

Also forty-three (about eighty percent) respondents in the study expressed that the implementation of this Directive did not impose any challenge on the part of the private banks and has no imposition on the private banks' existence but rather is an issue for review by NBE.

As stated in the literature, a central bank can vary the quantity of cash or outside money and directly affect a bank's reserve position as well as the amount of loans and deposits it can create without formally regulating the bank's portfolio (Kenneth, 2000). So the banker's opinion regarding the importance seems to tally with the literature while on the optimal amount still can be debatable.

4.3.5. Establishment and Operation of NBE Bills Market

Before the establishment of NBE BILLS market in 2011, Lending cap has been imposed on the private banks starting from 2009. The lending cap was not as such a directive but rather an instruction from NBE not to exceed a certain limit of loan portfolio. In this period the banks stopped lending loans even if there was liquid resource available. This was a time for sluggish performance by the banks which discouraged deposit mobilization efforts. The researcher has excluded Lending cap issue from the opinion survey and has tried to include the impact of the lending cap on the quantitative analysis since it is past matter.

In consideration of the topic under discussion, MFAINBEBILLS/001/201 1 states that "each bank shall buy bills from NBE allotted to them based on monthly plan of loans and advances equal to 27% of such disbursement". The outputs of data analysis revealed that the MFAINBEBILLS/001/201 1 Directive was considered as restrictive and required improvement as shown in Table 4.15. A total of 27(fifiy percent) of the respondents confirmed the need for the improvement of the Directive since twenty-five of the employees in the study viewed it as restrictive intervention by the National Bank of Ethiopia. However, amongst those respondents who considered the Directive to be improved, only 16(29.6%) of them stated that it was better to be waived and 11(20.4%) argued in favour of decreasing the amount of the NBE's Bills Market in the country.

Table 4.15 Opinion on MFA/NBEBILLS/OO1/2011 "Establishment and Operation of NBE Bill Market"

Response category	Frequency	Percent
Necessary	2	3.7
Restrictive	25	46.3
Needs Improvement	27	50.0
Total	**54**	**100.0**

The NBE's Directive about the Establishment and Operation of its Bills Market has been argued by the respondents as it decreased the private banks' profit and liquidity. As depicted in Table 4.16, about ninety-eight percent of the respondents stated that this Directive strongly decreases the banks' profits.

Table 4.16 Impact of the Directive No. MFAJNBEBLLLLSIOO1I2O11 on the Banks Profit

Opinion on impact	Frequency	Percent
It increases the bank's profit	1	1.9
It decreases the bank's profit	*53*	98.1
Total	**54**	**100.0**

In the same vein, Table 4.17 indicates that the same Directive has impact on the banks' liquidity. A total of *52(96.3%)* respondents surveyed viewed the Directive as the NBE's intervention in negative maimer because the document had stipulated statements which decreased the private banks' liquidity status. Therefore, the NBE had prepared and got proclaimed this Directive in 2011 which negatively affected the private banks' profitability and liquidity. The quantitative

analysis indicated that the bank's profitability was affected but the impact of the regulation was not significant on liquidity which will be presented in the next section of this chapter.

Table 4.17 Impact of the Directive No. MFAINBEBILLS/OO1/2011 on the Banks Liquidity

Impact type	Frequency	Percent
It increases the bank's liquidity	2	3.7
It decreases the bank's liquidity	52	96.3
Total	**54**	**100.0**

The above directive in addition has been amended by MFAINBEBILLS/002/2013 which further enforced that "effective January 1, 2015 total outstanding balances of short term loans shall not be less than 40% of total outstanding loans and advances of the bank". This amended directive will further increase the amount of the bill purchased by the banks by further draining the liquidity since short term loans have been defined as a one year loan.

The majority (90.7%) of the respondents labelled the Directive as restrictive and required improvement as illustrated in Table 4.18. Disaggregated by category, 26(about forty-eight percent) and also 23(about forty-three percent) of them were found to be in the primary and in the laffer categories, respectively.

Table 4.18 Opinions on Directive No. MFAINBEBILLS/002/2013

Opinion category	Frequency	Percent
Necessary	*5*	*9.3*
Restrictive	26	48.1
Needs Improvement	23	42.6
Total	**54**	**100.0**

Those sampled bankers in the selected private banks were asked about their views on the Directive specifically about "Short-Term Loans Disbursement percentage". The findings of the

study documented that 26(48.1%), 23(42.6%) and only *5(9.3%)* of those respondents considered it as restrictive, needs improvement and necessary, in that order. Out of those respondents who responded that the Directive Numbered as MFAINBEBILLS/002/2013 need improvement, the findings of the study indicated a picture which looked like the Chinese-Checkers in that about twenty-two, seventeen, and about four percent of them stated that it was beffer to be waived, required to be decreased and increased, respectively.

Thus, the amended Directive in the private banks is unfavorably restricting them and needs improvement. This can be substantiated by the empirical evidence of this study. A significant majority (about ninety-three percent) of the respondents in the study clearly expressed that the Directive was an imposition on the private banks which was found to threaten their performance. In addition to that, a total of 42(about seventy-eight percent) of the respondents argued that the same Directive imposed threat of existence on the part of the private banks.

The amended Directive is believed to decrease both the profit and the liquidity of the private banks. Table 4.19 shows that this Directive has negative impact on those banks' profits. Most of the respondents, 49(about ninety-one) argued against it because they stated that this Directive decreased those banks' profitability.

Table 4.19 Impact of Directive No. MFAINBEBILLS/002/2013 on the Bank's Profit

Impact on profit	Frequency	Percent
It increases the bank's profit	2	3.7
It decreases the bank's profit	49	90.7
It doesn't have any impact on profit	3	*5.6*
Total	**54**	**100.0**

The amended Directive of NBE BILL market has impact on the private banks' liquidity and Table 4.20 indicates that the Directive decreases the banks' liquidity.

Table 4.20 Impact of the Directive No. MFAINBEBILLS/002/2013 on Bank's Liquidity

Type of impact on liquidity	Frequency	Percent
It increases the bank's liquidity	9	16.7
It decreases the bank's liquidity	39	72.2
It doesn't have any impact on liquidity	6	11.1
Total	**54**	**100.0**

What is more problematic about the NBE Bill Market directive is that it excludes the two Government owned banks, Commercial Bank of Ethiopia and Development Bank of Ethiopia. One of the characteristics of Good Banking Regulation, as stated in the literature review, is to be non-discriminatory. In a free society, market forces should be free to allocate credit and resources. Rules that interfere with the market are inconsistent with this principle and may have unforeseen side effects.

As stated above, discriminatory intervention in banking regulation, except in cases of obvious distortions, is not desirable for several reasons. In a free society, market forces should be free to allocate credit and resources. Rules that interfere with the market are inconsistent with this principle and may have unforeseen side effects (Marcia et al., 2004). Any such intervention in banking is often likely to be futile, or nearly so, since borrowers and other customers can frequently shift their business into "favored" areas or switch to less regulated entities because of less and less liquidity position in the pockets of the private banks.

Since this is a discriminatory regulation it is expected to have severe consequences in the future in the banking industry and the country at large.

4.3.6. Limitation on Investment of Banks

5BB-12-96 is one of the oldest directives that has been issued and which is one directive that needs to be revised soon. The directive states that "No bank shall engage in insurance business but may hold up to 20% in an insurance company, Banks are prohibited from engaging directly in non-banking businesses such as agriculture, industry, and commerce, a bank's equity participation in another bank shall be subject to prior authorization by National Bank of

Ethiopia, No bank shall commit more than 20% of its net worth in real estate acquisition and development other than for own business premises without prior approval of the National Bank of Ethiopia and others.

With regard to the respondents' opinions on a Directive on Limitation of the Banks in investment, Only 21(38.9%) of the *54* employees who participated in the study reported that it was viewed as necessary, 16(29.6%) considered it as restrictive and 17(31.5%) of them argued that the Directive needs improvement. Therefore, a total of 33(61.1%) sampled respondents in the private banks viewed the Directive on Limitation of Banks' Investment as restrictive and needs improvement. This Directive generally restricts the private banks' engagement in diversification of their investment and thus it requires improvement.

Out of those 17 respondents who opted for needs improvement in this Directive, 8(14.8%) of them stated that it was beffer to be waived, 7(13.0%) argued that the limitation on the banks' investment it should be decreased, and only 2(3.7%) expressed their views on the issue in terms of increasing the limitation imposed the banks. However, the improvement of this Directive ends up with inconclusive results. Generally, the Directive Numbered as SBB/1 2/1996 needs improvement, but there is no vivid indication to which direction it should be geared whether to be open for all investments or to decrease the limitations.

Table 4.21 indicates that the Directive SBB/1 2/1996 restricts the private banks' investment endeavours and influences on their profit. Thirty-six (about sixty-seven percent) of the respondents in the study expressed that this Directive had impact on the banks' profit which could be manifested in decreasing its amount generated. Based on the empirical observations, the researcher reached at the conclusive statement of the negative impact of the Directive on those private banks' profit. Therefore, the Directive impacts on and seriously limits their profit.

Table 4.21 Impact of Directive SBB/12/1996 on the Banks Profit

Type of impact	Frequency	Percent
It increases the bank's profit	8	14.8
It decreases the bank's profit	36	66.7
It doesn't have any impact on the bank's profit	10	18.5
Total	**54**	**100.0**

The researcher, on the other hand, investigated whether the Directive SBB/12/1996 had impact on the banks' liquidity or not. The findings of the study documented that the Directive influenced their liquidity status. A total of 23(about forty-three percent) of the sample employees in the selected private banks said that the Directive had impact on their liquidity (see Table 4.22). Nevertheless, as this figure accounted for less than half of the total respondents in the study and there were mixed results; one couldn't confidently deduce the Directive decreased the banks' liquidity. On the whole, there is no clear empirical evidence on decreasing impact of the Directive SBB/12/1996 on the private banks' liquidity.

Table 4.22 Impact of the Directive SBB11211996 on the Banks Liquidity

Type of impact	Frequency	Percent
It increases the bank's liquidity	19	35.2
It decreases the bank's liquidity	23	42.6
It doesn't have any impact on the bank's liquidity	12	22.2
Total	**54**	**100.0**

Fortunately, the private banks appear to be skewed towards the safe side of the continuum. The empirical observations in the study also indicated that the Directive SBB/12/1996 was found not to impose threat for the private banks' performance (see Table 4.23). Thus, this Directive imposes no threat for the performance of those banks.

Table 4.23 Impact of the Directive SBB/12/1996 on the Banks Performance

Type of impact	Frequency	Percent
Yes, it imposes threat for the bank's performance	20	37.0
No, it doesn't impose threat for the bank's Performance	28	51.9
It doesn't have any imposition on the bank's performance	6	11.1
Total	**54**	**100.0**

As stated in the literature review, line-of-business restrictions and regulations on ownership linkages among financial institutions are among the internationally adopted banking regulations; (Bonn, 2005; Fatimah, 2012; James et al., 2012). The question here that made the banker's almost indifferent about its importance is that it is necessary but it prohibits almost all sectors that might support their performance.

4.3.7. General Attitude towards the Banking Regulations in Ethiopia

The current Ethiopian Banking Regulations on Private Banks generally were considered to be both challenges and opportunities (See Figure 4.2). Half (fifty percent) of the respondents viewed the Directive as challenges, while the remaining viewed the regulations as both.

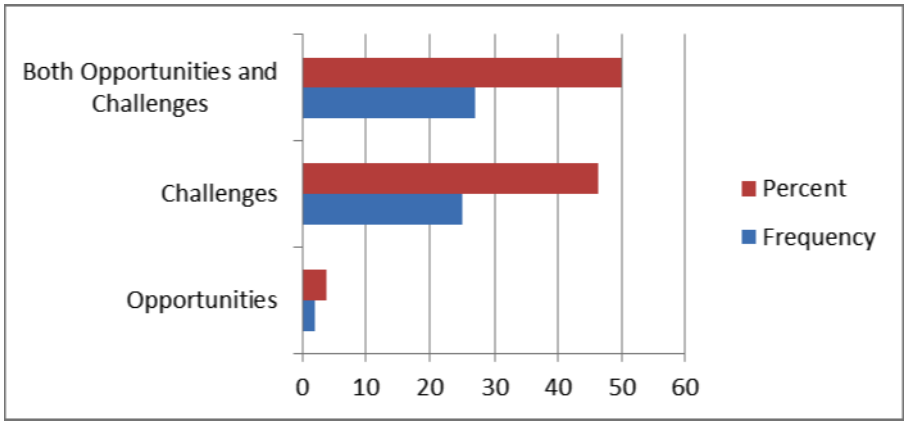

Figure 4.2 Opinions on Banking Regulations of Banks in Ethiopia

Implicitly, a total of 52(about ninety-six percent) respondents considered the Directive as challenges, whereas 29(about fifty-four percent) of them viewed it as opportunities. Therefore, one can conclude that the Directives are of more challenges for the private banks.

As depicted in Figure 4.3, the current Ethiopian Banking Regulations highly regulate the banks in Ethiopia. The significant majority (about eighty-nine percent) of the sample bankers in those private banks confirmed that the financial institutions were highly regulated by the current NBE's Regulations.

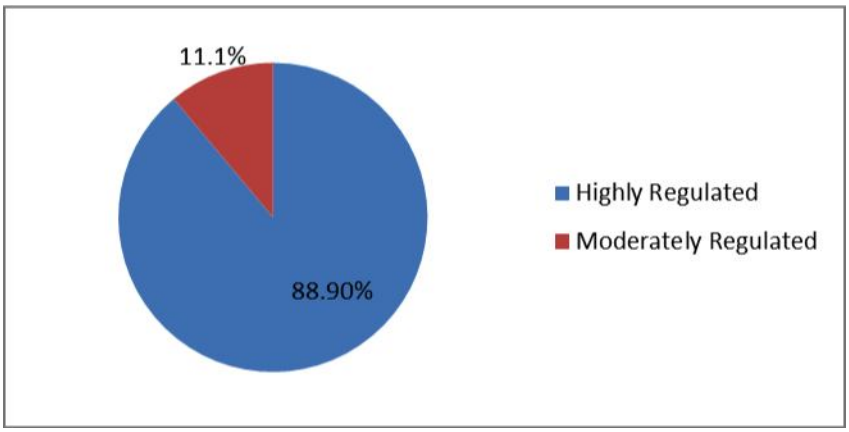

Figure 4.3 Overall Attitudes to the Ethiopian Banking Regulations by Private Banks

However, only 6(11.1%) of the respondents in the study stated that those banks were found to be moderately regulated by the current Ethiopian Banking Regulations. Thus, the current Ethiopian Banking Industry Regulations are highly imposed on the banks in the country which is believed to be above the need level.

4.4. Trends of Profitability and Liquidity of Banks

The private banks in the country are consistently arguing that their profitability and liquidity is challenged due to strict regulations of the country. Here we will try to present the actual profitability and liquidity of nine private banks from the two peers for the past ten years or from the year the banks were opened whichever comes first.

Table 4.24 Net Profit Before Tax of Sample Banks

Name of Bank	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
AIB	22.02	48.24	63.11	134.08	179.33	N/A	303.07	*350.84*	*505.08*	*530.60*	583.02
DB	36.87	*78.56*	*97.59*	185.36	259.14	*332.57*	*352.49*	*458.25*	629.89	893.26	812.93
BOA	7.64	54.44	82.04	122.92	94.98	21.91	145.40	196.34	258.38	288.58	351.47
WB	15.18	44.59	63.29	94.23	152.28	189.99	256.10	317.53	458.15	*457.90*	449.67
UB	7.41	9.42	42.89	*59.66*	86.86	125.83	133.54	247.67	322.53	*406.50*	374.16
NIB	19.34	48.72	*65.70*	79.62	105.36	158.77	219.77	285.24	344.08	389.48	378.58
ZB	-	-	-	-	-	-	(9.14)	*59.99*	121.13	123.31	123.81
OIB	-	-	-	-	-	-	(13.48)	21.51	56.69	65.16	102.15
Bunna	-	-	-	-	-	-	-	0.05	26.81	41.32	80.33

Source: Compiled from Respective Bank's Annual Reports

From the above Table 4.24 we can understand that almost all banks have an increasing profit trend in actual figure which except for few banks for few years which gives a misleading picture unless supported by appropriate ratios which will be presented in the next sections.

As for the liquidity of banks the trend is summarized and presented in the Table below using the liquidity ratio of each bank which is a result obtained dividing the liquid assets of the bank with the total liability.

Table 4.25 Liquidity Ratio of Sample Banks

Name of Bank	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
AIB	44%	41%	37%	24%	38%	N/A	50%	50%	58%	49%	46%
DB	35%	35%	32%	28%	30%	41%	53%	47%	47%	37%	34%
BOA	40%	43%	38%	30%	32%	37%	54%	52%	44%	34%	27%
WB	39%	40%	43%	33%	43%	51%	**68%**	65%	62%	41%	26%
UB	46%	50%	51%	42%	42%	50%	**60%**	62%	52%	37%	23%
NIB	27%	27%	27%	25%	32%	44%	57%	61%	61%	44%	30%
ZB							**60%**	**68%**	51%	43%	41%
OIB							**80%**	**69%**	51%	47%	39%
Bunna								81%	**69%**	37%	33%

Source: Compiled from Respective Bank's Annual Reports

From the above Table *4.25* we can generally see that their liquid asset had a consistent increase until 2008 and strong increases in 2009 and 2010. Then starting from 2011 most bank's liquidity has declined. Year 2009 and 2010 were years where lending cap was imposed while in 2011 the NBE BILL Market was introduced.

4.5. Impact of Banking Regulation on Profitability and liquidity

The quantitative analysis focuses on directives that resulted in quantifiable bank attributes obtained from the bank's financial reports. Since Prohibition of Foreign Nationals and Minimum Capital Requirement are entry barriers which their impacts cannot be indicated as the additional profit that the banks might have harvested couldn't be measured monetarily the additional profit that the banks harvested couldn't be measured. Limitation on Open Foreign Currency Position of Banks is another directive that has been active since 2001 and its impact couldn't be captured with the ten year's data that is collected in this study. As to Limitation on Investment since it is a barrier for additional earnings, which can only be expressed in terms of opportunity cost, it is not within the scope and objective of this study. Therefore, the researcher has selected the Reserve

Requirement and NBE BILL operation Directives for the quantitative analysis which can be presented in the time frame and also in terms of the objective and included the Lending cap in addition.

4.5.1. Descriptive Statistics

The data set includes banks drown from peer 1 and peer 2. From peer 1 Awash, Dashen, Abyssinia, Wegagen, United and Nib are included while Oromia International, Zemen and Bunna banks are selected from peer 2. As presented in table 4.26, with average ROE of 43% DB is the leading bank in terms of profitability while OIB is the least profitable with average ROE of only 10%. DB also leads in terms NIM while ZB is the last in the group. In terms of liquidity, OIB is the most liquid bank while DB is least liquid bank in the group. Bunna is also the most capitalized bank with a capital ratio of *25.9%* compared to DB with the lowest capital ratio of 8.69%. AIB is the oldest in the group while Buna is the youngest.

Table 4.26: Profiles of Sample Banks

Profiles of Sample Banks(Average figures)							
Name of Bank	**ROA**	**ROE**	**NIM (in millions)**	**LIQ**	**CAP**	**SIZE**	**Age (in years)**
AIB	3.3%	31.6%	189.78	44%	10.2%	*8.65*	20
DB	3.7%	42.6%	242.02	38%	8.7%	**8.87**	19
BoA	2.8%	26.0%	156.40	39%	10.7%	8.31	18
WB	4.4%	30.9%	158.77	*46%*	14.4%	8.17	17
UB	4.0%	*26.5%*	153.39	*50%*	14.6%	7.92	16
NIB	*3.5%*	*27.5%*	129.81	40%	15.2%	8.14	15
OIB	1.1%	**10.1%**	49.38	*57%*	19.3%	7.32	6
ZB	4.0%	29.4%	23.20	*53%*	15.3%	7.27	6
Buna	2.6%	11.8%	37.14	*55%*	*25.9%*	6.93	*5*

Source: Own computation based on data from each bank

Descriptive statistics in table 4.27below shows that average ROA is *3.5%* with a maximum value of *7.5%* and minimum value of -4.13%. Standard deviation that exceeds the mean suggests that variation in profitability among banks is very large. This is also confirmed by standard deviation of NIM almost as large as the average NIM. Variation among banks is also large with respect to SIZE and AGE with the oldest bank aged 19 years and youngest bank is aged just *5* years. The biggest bank has a SIZE coefficient of 9.89 compared to the smallest bank has *5.78*. All this suggests that banks in the data set do not share the same characteristics.

Table 4.27 Descriptive Statistics of Regression Variables

	Mean	**Max**	**Mi**	**Std. Dev.**
ROA	0.034361	*0.075055*	-0.041309	0.016511
ROE	0.284722	0.503232	-0.125663	0.125734
NIM	147.5119	*530.8593*	1.682096	126.1226
LIQ	0.449367	0.81	0.24	0.128914
CAP	13.64517	35.22	6.431619	*5.569978*
SIZE	8.137189	9.890766	*5.787995*	0.944222
AGE	15	20	*5*	4.775213

Source: Own computation based on data from each bank

4.5.2. Correlation Analysis

The extent of relationship among variables in the dataset can be studied by conducting a correlation analysis. As shown in Table 4.28, the three measures profitability, namely ROA,ROE and NIM are positively correlated, and this implies that the result of the regression model that involves them is likely to result in a consistent output. All the three measures of profitability are inversely correlated with liquidity, and this is consistent with the standard risk-return trade-off theory that states risk and return go hand-in-hand. The correlation between reserve requirement and ROA, ROE, NIM, and LIQ is not statistically significant.

The control variables, namely, age, capital adequacy ratio, and size are variously related to profitability and liquidity. Age of banks is positively related to profitability and liquidity, suggesting that profitability increases as banks grow older. However, older banks are less liquid compared to younger ones. This can be explained based on the fact that banks manage to control larger borrower base as they gain more experience of the market. Capital ratio is inversely related to profitability and liquidity, implying that more capital leads to lesser profit and lower loaning ability. Size, on the other hand, is positively correlated with profitability ratio and inversely related with liquidity ratio. This suggests that bigger banks are more profitable and at the same time run a higher risk of liquidity.

Table 4.28 Pearson's Correlation Matrix

	ROA	**ROE**	**NIM**	**LIQ**	**RR**	AGE	CAP
ROE	O.798877***						
NIM	O.380688***	O.408862***					
LIQ	-0.115899	0.263137**	-0.146366				
RR	0.101189	*0.00758*	*0.035468*	0.698401			
AGE	*0*.201755*	0.465218***	*0*.453468***	0.36761***	0.19345*		
CAP	0.236094**	0.527689***	-0.183012	0.508427***	0.323004***	0.61702***	
SIZE	*0.538906****	*0*.5971***	0.866331***	-0.17428	0.183455	Ø.53ØØØ.7***	-0.38399

indicates significance at 1%, 5% and 10% level respectively.

4.5.3.Panel data analysis

Diagnostic tests

Every econometric model needs to undergo diagnostic tests so that the technique of analysis that best fits the data is used. Accordingly, a Hausman test and Breusch-Pagan Lagrange multiplier (LM) test are conducted. The former is needed to decide as to whether a fixed-effect or random-effect panel data model is appropriate for each of the models while the laffer is conducted to

choose between random-effect and Ordinary Least Square (OLS). As shown in table 4.29, the Hausman Test suggests that a random-effect rather than a fixed effect is appropriate for the dataset.

Table 4.29 Hausman Test

MODEL	CHI SQR	P-VALUE	RECOMMENDED MODEL
ROA	0.78	0.9784	Random-Effect
ROE	0.23	0.9987	Random-Effect
NIM	2.11	0.8337	Random-Effect
LIQ	*0.52*	0.9915	Random-Effect

Efficiency of random-effect model should be compared with OLS, and this required Breusch-Pagan Lagrange multiplier (LM) test. As shown in Table 4.30, the result of Breusch-Pagan Lagrange multiplier (LM) test suggested that random-effect models would result in a more efficient output than OLS.

Table 4.30 Breusch-Pagan Lagrange multiplier (LM)

MODEL	CHI SQR	P-VALUE	RECOMMENDED MODEL
ROA	*26.59*	0.0000	Random Effect
ROE	3.47	0.03 12	Random Effect
NIM	1.63	0.090 8	Random Effect
LIQ	2.20	0.0692	Random Effect

4.5.4. Results of Random Effect Econometric Analysis

4.5.4.1. The Effect of Reserve Requirement, Lending Cap, and Bill Purchases on ROA

The regression analysis, as per Table No. 4.31 suggests that, controlling for capital ratio, age and size, the reserve requirement has a positive but weak impact on ROA due to lesser proportion in amount from the total deposit. On the other hand, lending cap (LC) and bill purchase (BP) has a negative effect on ROA. This may be explained based on the fact that banks are already accustomed to managing their profitability given a prevailing reserve rate, and when it increases they had to make adjustments accordingly. Besides, the change in reserve requirement is so short-lived that it did not have a strong effect on ROA. On the other hand the lending cap and bill purchases have a stronger negative effect on ROA perhaps due to its bigger magnitude and the fact that both were in effect for a more extended period.

Table 4.31 Regression Result for ROA Model

ROA	Coef.	Std. Err.	z	P>IzI
pp	.0009655**	.000447	2.16	0.031
LC	-.0205316***	.0074184	-2.77	0.006
BP	-.0205594**	.0093853	-2.19	0.028
SIZE	.0187733***	.0041316	4 . 54	0.000
CAP	-.0004204	.0003685	-1.14	0.254
AGE	-.0019034**	.0009476	-2.01	0.045
cons	-.0789266	.0267042	-2 .96	0.003

R2 =0.34

***,**,* indicates significance at 1%, 5% and 10% level respectively.

4.5.4.2. The Effect of Reserve Requirement, Lending Cap, and Bill Purchases on ROE

Reserve ratio, lending cap, and bill purchase have the same effect on ROE as on ROA, except that the effects are a bit stronger on ROE. As shown on Table 4.32, reserve ratio has a positive but very weak effect on ROE while lending cap and bill purchase have a negative impact on ROE. Size, on the other hand, has a positive effect on profitability measured using ROE, implying that the bigger a bank grows the more profitable it becomes.

Table 4.32 Regression Result for ROE model

ROE	Coef.	Std. Err.	z	P>|z|
pp	.0072947**	.0033401	2.18	0.029
LC	-.1416737***	0553351	-2.56	0.010
BP	-.148426**	0698799	-2 .12	0.034
SIZE	.1094791***	.0307399	3.56	0.000
C P	-.0048621*	.0027267	-1.78	0.075
AGE	-.0057589	.0063817	-0.90	0.367
_cons	-.4217553	1938698	-2.18	0.030

R2 =0.51

***,**,* indicates significance at 1%, 5% and 10% level respectively.

4.5.4.3. The Effect of Reserve Requirement, Lending Cap, and Bill Purchases on NIM

As shown on table 4.33, in contrast to the previous results, reserve requirement has a negative impact on NIIM, suggesting that increase in reserve ratio led to decline in NIIM. Unlike its effect on ROA and ROE, increase in reserve requirement decreases NIIM, and this can be explained based on the fact that banks affempt to offset decrease in interest income by non-interest income that becomes part of net profit but not NIM. Contrary to our expectation, lending cap and bill purchase both do not have a statistically significant effect on NIM. All the control variables do not have a statistically significant effect on NIM, implying that NIM is size, age and capital

invariant. Also the NIM model is found to be weak since 76% is explained by other variables that are not included in the study.

Table 4.33 Regression result for NIM model

NIM	Coef.	Std. Err.	z	P>IzI
RR	-.0012051	.0002991	-4.03	0.000
LC	.0076366	.0049681	1.54	0.124
BP	-.0002262	.0062911	-0.04	0.971
SIZE	.0026234	.0027704	0.95	0.344
CAP	.0002735	.0002478	1.10	0.270
AGE	.0004452	.0006907	0.64	0.519
_cons	.0072324	.018339	0.39	0.693

R2 =0.24

***,**,* indicates significance at 1%, 5% and 10% level respectively.

4.5.4.4. The Effect of Reserve Requirement, Lending Cap, and Bill Purchases on LIQ

As shown in Table 4.34, reserve ratio positively affects liquidity of banks because a higher ratio leads to a higher reserve that would be kept as part of liquid assets of a bank. This, in turn, enhances liquidity position of a bank. Lending cap and bill purchase, on the other hand, are found to have no statistically significant effect on liquidity. Size has a negative effect on liquidity sugge sting that bigger banks keep relatively smaller amount of liquid assets compared to smaller banks due to the fact that they have a wider client base. Capital ratio, on the other hand, has a positive impact on liquidity, implying that funds raised from shareholders are used to boost liquidity.

Table 4.34 Regression result for LIQ model

LIQ	Coef.	Std. Err.	z	P>IzI
RRI	.02072 19***	002988	6.93	0.000
LC	-.0260493	.0491132	-0.53	0.596
BP	-.8753439	.5620224	-1.56	0.119
SIZE	-.0576367	.0269952	-2 .14	0.033
CAP	.0044966*	0023594	1.91	0.057
AGE	.0054594	0048503	1.13	0.260
cons	.5494221	1657312	3.32	0.001

R^2 =0.66

***,**,* indicates significance at 1%, 5% and 10% level respectively.

To sum up the analysis, Reserve Requirement Regulation has relatively positive impact on profitability and liquidity while NBE Bill and Lending cap had negative effect on profitability while week effect on liquidity surprisingly. But even with this quantitative result it is the strong belief of the private banks, Banking Regulation in Ethiopia is high and also resents to being challenges instead of opportunities.

CHAPTER FiVE
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This chapter is concerned with the highlights of the study findings and conclusions that are derived from the data analysis and discussions. Recommendations are provided at the end based on the findings and conclusions drawn from the study.

5.1 Summary of Major Findings

As per the discussion, analysis and data interpretation undertaken in the previous chapter, the following are the summary of major findings derived;

+ Prohibition of Foreign Nationals in the Banking Industry by the banking proclamation has been supported by the banks in terms of bringing about positive impact on ensuring profitability of the banks by excluding the foreign banks which will be a danger for their business operations due to capacity, technological and innovative products differences. This can be considered as an opportunity for the existing banks to exploit the market to themselves only.
+ Minimum Capital Requirement Directive has been found to consider the Directive as necessary since it prohibits entry in the industry; it decreases competition and is a good base for high profit margin. This has been considered as opportunity again by many banks while as restrictive for some especially those that are newly operational and still have not yet reached the minimum capital.
+ Limitation on Open Foreign Currency Position of Banks Directive has been found to consider the Directive as restrictive and required improvement in the direction of increasing the amount of percentage of capital to hold more foreign currency at their possession. The argument is based on its negative impact on the private banks' performance, the timing of business seasonality and the issue of not geffing the foreign currency once surrendered to NBE after it reaches 15% when the banks are in need of the resource.
+ Reserve Requirement of Banks Directive has been found to consider the Directive as necessary having sound liquidity is basic and important in the banking industry. It is considered as intervention which decreased the banks' liquidity which was argued since it is the sixth replacement and decreased from 15% in years back to a 5% requirement

currently. Some still argue it is small and needs even to be increased for the safety of the industry but is an opportunity till then.

+ The regression analysis suggests that, controlling for capital ratio, age and size, the reserve requirement regulations positively affects liquidity and a positive but weak impact on ROA and ROE while having a negative impact on NIM. Reserve requirement positively affects liquidity of banks because a higher ratio leads to a higher reserve that would be kept as part of liquid assets of a bank.
+ Establishment and Operation of NBE Bills Market Directive was considered as restrictive and required improvement and has been argued by the respondents as it decreased the private banks' profit and liquidity. And what is more was even the amended directive in the matter has even made the stress more strong on the profitability and the liquidity. Majority of the banker's expressed that the Directive was an imposition on the private banks which was found to threaten to their profitability and liquidity and unless it is amended it will also be a threat for their existence. Since it specifically excludes the two giant state banks, Commercial Bank of Ethiopia and Development Bank of Ethiopia, the directive was argued to be discriminatory which fails to be a good banking regulation characteristic. This regulation is above all is weighted to be challenging and is the lively proof of undue banking regulation in Ethiopia.
+ On the other hand, the regression analysis suggested accordingly to the opinions of the banks that lending cap and bill purchase have a negative effect on the profitability indicators ROA and ROE. However lending cap and bill purchase both did not have a statistically significant effect on NIM and liquidity as opposed to the opinion of the banks.
+ Limitation on Investment of Banks the private banks viewed the Directive as restrictive and needs improvement and had impacts on and seriously limiting their profit with both arguments on the impacts on liquidity.
+ Half of the private banks feel that the prevailing banking regulations are full of challenges while equal half argued it is made of both. Almost none argued that it is opportunities majored. But still majority felt the regulation is excessive and needs to loosen up for the greater good.

5.2 Conclusions

The research has tried to triangulate the opinions of the private banks with the actual impacts of some directives on profitability and liquidity. The bank's general opinion was skewed towards a negative attitude towards the banking regulations in Ethiopia. Even though some regulations are favouring the existing banks such as "The Prohibition of Foreign Nationals" and "Minimum Capital Requirement" by barring entry in to the industry others such as "Limitation on Open Foreign Currency Position of Banks" are slowing down the performance of the private banks. While the "Reserve Requirement" amendments are favouring the profitability and liquidity of banks "Limitation on Investment of Banks" is an old directive which hinders harvesting of potential market other than the banking business in the economy.

The opinion towards the Bill market was rather harsh and was not supported by any literature that the researcher has come up with. This directive has almost out weighted all the supportive directives and is stated by most as a challenging and discriminatory.

The panel data analysis yielded in a mixed result. While reserve requirement has a very weak positive effect on ROA and ROE, lending cap and bill purchase have a consistently negative effect on the two variables. However, the effect of reserve requirement on NIM is just the opposite. The reserve requirement has a negative effect on profitability measured using NIM. However, it has a very weak positive effect on ROA and ROE. This can be explained based on the ground that effect of reserve requirement is directly felt by reducing NIIM, and banks oftentimes offset lost interest income by generating non-interest income. The reserve requirement has a positive effect on liquidity, suggesting that banks increase their stock of liquid assets as they maintain additional reserve.

The lending cap and bill purchase have a negative impact on profitability. However, contrary to a claim by bankers in the country, lending cap and bill purchases are found to have no statistically significant effect on liquidity.

Even though we cannot strongly conclude that all Banking Regulation in Ethiopia have negative impact on the performance of private banks, we can deduce that some of the banking regulations are causes for poor performance of private banks which can be justified by the real impacts as well as the opportunity costs that the banks has incurred.

5.3 Recommendations

Ethiopia is among the fastly growing economies in Africa and needs to be supported by strong and vibrant banks which can fulfil the demands of the economy at large. This without a doubt has to be monitored by an optimal banking regulation in order to assure the safety and soundness of the financial system. The country has applied for WTO and is expected to open the doors for foreign banks after 2015 G.C. This calls for the Ethiopian Private Banks to be stronger and competitive until the door is fully open for the foreign banks which cannot be avoided but rather delayed.

Therefore the Central Bank shall adopt directives that can gear the banks to a stronger state instead of focusing only on control and monitoring regulations such as increasing the legal reserve that banks should retain from their profit so as to be more stronger. Directives that are old and need revision, such as "Limitation on Investment" shall be revised to benefit not only the banks but also the other sectors in the economy. Existing Directives that are believed to have negative effect on performance, such as NBE BILL market, shall be revised soon so as to build their capacity at the required level. This can be done either by decreasing the bill amount or by the introduction of priority sector lending directive. Also the NBE should work on its image and monitoring mechanisms since most private banks are with negative attitude even with positive regulations.

In this study, only three year data on bill purchase was used, and hence future studies should attempt to investigate the impact of bill purchases on liquidity by including data for a longer period. In so doing it is likely to yield in a more robust result, and hence more conclusive evidence on the impact of bill purchases on profitability and liquidity.

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Annex - 1

St Mary's University

School of Graduate Studies

MBA Programme

Dear Respondent,

Thank you for taking your time in filling this questionnaire. This questionnaire will be used as part of data to be used in the research **"Impact of Banking Regulation on Performance of Private Banks"** which is a partial requirement in obtaining Masters in Business Administration.

This study is purely an academic research. All your responses are confidential and no need to write your name. Your genuine response is highly valuable to conduct the study and to reach in to legitimate results. I hereby request you to fill this questionnaire and give back to me to the earliest time possible. Thank you again for your willingness, effort and precious time.

Part I

1. Gender

Male **Female**

2. WhatisyourAgeGroup?

Under 26 **26 to 35** **36 to 45** **46 to 55** **56 to 65** **66 or older**

3. What is your highest level of Education?

College Diploma **Bachelor's degree** **Master's degree**

Doctorate degree or Professional degree

4. How long have you worked in the banking industry?

Years

5. How long have you been working on the current position?

Years

6. What is your Job Title?

_____

Part II

1. The Ethiopian Banking Proclamation No. 592/2008 Article 9 prohibits ownership of private banks by foreigners both at shareholder and bank or branch level. How do you see this directive? **Necessary** **Restrictive** **Needs improvement**

1.1 What do you think of its impact on Profit?

It increases the bank's profit **It doesn't have any impact**

1.2 What do you think of its impact on liquidity?

It increases the bank's liquidity _____ **It decreases the bank's liquidity** ____ **It doesn't have any impact**

2. Directive No SBB/50/2011"Minimum Capital Requirement for Banks" states that any one bank need to have Birr 500 mill as paid up capital to obtain banking license. How do you see this directive?

Necessary_____ **Restrictive** **Needs improvement**

2.1 If you believe it needs improvement what will be your opinion?

It needs to be increased **It needs to be decreased** **It better be waived**

It increases the bank's profit _____**It decreases the bank's profit impact**

2.3 What do you think of its impact on liquidity?

It increases the bank's liquidity **It decreases the bank's liquidity** **impact**

2.2 What do you think of its impact on profitability?

It doesn't have any

It doesn't have any

3. Directive No SBB/27/2001 "Amendment of limitation on Open Foreign Currency Position of Banks" States that the overall open foreign currency position of each bank shall not be above 15% of the bank's total capital at any given day. How do you see this directive?

Necessary **Restrictive** **Needs improvement**

3.1 If you believe it needs improvement what will be your opinion?

It needs to be **increased** **It needs to be decreased** **It better be waived**

3.2 What do you think of its impact on profitability?

It increases the bank's profit impact **It decreases the bank's profit** **It doesn't have any**

3.3 What do you think of its impact on liquidity?

It increases the bank's liquidity **It decreases the bank's liquidity** **It doesn't have any impact**

4. Directive No SBB 55/2013 "Liquidity Requirement (6th Replacement)" states banks are required to hold 5% of their total deposit mobilized at the NBE reserve account. How do you see this directive?

Necessary **Restrictive** **Needs improvement**

4.1 If you believe it needs improvement what will be your opinion?

It needs to be increased **It needs to be decreased** **It better be waived**

4.2 What do you think of its impact on liquidity?

It increases the bank's liquidity impact **It decreases the bank's liquidity**

4.3 Does it impose threat of existence? **It doesn't have any**

Yes it does **No it doesn't** **It doesn't have any impact**

4.4 What do you think of its impact on Profit?

It increases the bank's profit ____ **It decreases the bank's profit** **It doesn't have any impact**

4.5 As stated above, the current directive on liquidity is the 6th replacement. Do you believe the amendments are fair as compared to the need?

Yes I do **No I don't** **I can't say**

5. Directive No MFA/NBEBILLS/OO1/2011"Establishment & Operation of NBE Bills market" states that from each loan disbursement, 27% shall be allocated for purchase of NBE bill with a maturity period of five years. How do you see this directive?

Necessary **Restrictive** **Needs improvement**

5.1 If you believe it needs improvement what will be your opinion?

It needs to be increased **It needs to be decreased** **It better be waived**

5.2 What do you think of its impact on Profit?

It increases the bank's profit **It decreases the bank's profit** **It doesn't have any impact**

5.3 What do you think of its impact on liquidity?

It increases the bank's liquidity **It decreases the bank's liquidity** **doesn't have any impact**

5.4 Does it impose threat of existence?

Yes it does **No it doesn't** **It doesn't have any impact**

6. Directive No MFA/NBEBILLS/002/2013 states that short term loans disbursement in any bank shall be a minimum 40% of total loans disbursed at any given time. How do you see this directive?

Necessary **Restrictive** **Needs improvement**

6.1 If you believe it needs improvement what will be your opinion?

It needs to be increased **It needs to be decreased** **It better be waived**

6.2 What do you think of its impact on Profit?

It increases the bank's profit **It decreases the bank's profit** **It doesn't have any impact**

6.3 What do you think of its impact on liquidity?

It increases the bank's liquidity **It decreases the bank's liquidity** **It doesn't have any impact**

7. Directive No. SBB/12/1996 "Limitation on Investment of Banks" states that Banks are prohibited from engaging directly in non-banking businesses such as agriculture, industry, and commerce. How do you see this directive?

Necessary **Restrictive** **Needs improvement**

7.1 If you believe it needs improvement what will be your opinion?

It needs to be increased **It needs to be decreased** **It better be**

7.2 What do you think of its impact on Profit?

It increases the bank's profit **It doesn't have any impact**

7.3 What do you think of its impact on liquidity?

It decreases the bank's liquidity **doesn't have any**

It decreases the bank's profit

It increases the bank's liquidity

impact

7.4 What do you think of its impact on overall performance?

It imposes threat on performance ____ It doesn't imposes threat on perf. ____ It doesn't have any impact

8. In your opinion, are most of the banking regulations in Ethiopia to private banks are

Opportunities m **Challenges** **Both**

9. On the **overall what is your opinion about** the **banking regulation in Ethiopia?**

Highly Regulated **Moderately Regulated** **Less Regulated**

Use the space below if you want to add related information on the subject matter.

Thank You for your time.

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Email: antenehsd@yahoo.com

III A

Asset Structure

For Selected Private Banks

In millions of Birr

Name of Bank	Description	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
AIB	Liquid Assets	745.82	**884.38**	1,027.03	789.00	1,624.63	-	3,186.78	4,042.55	5,637.31	5,645.10	7,261.93
	Loans and Advances	760.76	1,068.60	1,453.40	2,354.98	2,402.60	-	2,563.99	2,997.38	3,841.55	5,355.72	7,532.30
	Fixed Assets	40.65	44.37	51.81	63.84	93.19	-	147.16	227.12	257.43	327.07	476.27
	Other Assets	282.98	381.64	457.57	475.24	**662.64**	**-**	1,234.64	1,755.95	1,353.14	1,797.33	2,513.42
	Total Assets	**1,830.21**	**2,378.99**	**2,989.81**	**3,683.06**	**4,783.06**	**-**	**7,132.57**	**9,022.99**	**11,089.43**	**13,125.22**	**17,783.92**
Dashen	Liquid Assets	**649.86**	871.38	1,020.26	1,149.88	1,670.89	2,915.51	4,702.81	5,255.36	6,225.75	5,774.62	6,060.93
	Loans and Advances	1,217.87	1,627.37	2,160.63	3,080.26	3,889.00	4,291.70	4,349.25	4,938.74	6,093.87	7,949.37	8,663.25
	Fixed Assets	25.91	39.30	45.79	60.01	89.15	93.85	109.74	**164.88**	194.13	262.06	318.90
	Other Assets	97.83	138.57	193.13	255.85	390.37	538.78	570.78	1,994.41	2,101.05	3,534.00	4,704.09
	Total Assets	**1,991.47**	**2,676.62**	**3,419.81**	**4,546.00**	**6,039.41**	**7,839.84**	**9,732.58**	**12,353.39**	**14,614.80**	**17,520.04**	**19,747.17**
BOA	Liquid Assets	506.94	**628.06**	758.87	781.22	1,021.90	1,442.65	2,696.29	2,962.00	2,895.91	2,523.11	2,420.18
	Loans and Advances	747.16	889.37	1,172.97	1,901.47	2,197.34	2,566.58	2,442.75	2,919.69	3,205.21	3,797.31	4,608.53
	Fixed Assets	12.70	18.51	34.80	37.18	41.31	65.47	76.00	76.12	**86.08**	95.56	264.78
	Other Assets	155.70	115.89	264.09	294.21	317.41	195.25	261.59	321.72	1,090.36	1,823.54	2,631.58
	Total Assets	**1,422.50**	**1,651.84**	**2,230.72**	**3,014.08**	**3,577.96**	**4,269.95**	**5,476.63**	**6,279.54**	**7,277.56**	**8,239.52**	**9,925.07**

N.B: Due to change in Accounting period, Financial Statement of **AIB** for **2008 is consolidated in 2009.**

Asset Structure

For Selected Private Banks

In millions of Birr

Liquid Assets			1,319.81	1,803.40	2,915.55	3,035.72	4,141.09	2,790.87	2,228.38
Loans and Advances		1,516.84	2,060.61	2,207.93	1,983.75	2,375.63	2,777.88	3,478.97	4,585.11
	889.08	**1,140.14**	**1,615.65**	**2,259.54**	**3,480.28**	**4,124.89**	**5,118.31**	**5,741.94**	**8,060.95**	**8,347.16**	**10,393.80**
					1,385.71	1 2,485.62	1 3,274.75	1 3,559.25	1 2,862.66	1 4,894.67	
Loans and Advances			1,367.88	1,809.90	2,086.52	2,518.28	3,186.20	3,990.14	4,623.20
	674.41	**1,072.94**	**1,599.58**	**2,182.74**	**3,250.28**	**4,652.44**	**5,896.23**	**7,725.44**	**8,786.86**	**9,977.68**
					1,332.69	1 2,334.56	1 3,068.08	1 3,644.17	1 2,980.68	1 2,254.85	
Liquid Assets									
Loans and Advances	756.47	1,085.71	1,418.05	1,755.83	2,033.79	2,118.06	2,446.83	2,652.42	3,608.33	4,429.32
	1,015.65	**1,396.09**	**1,909.27**	**2,027.02**	**2,606.60**	**3,650.11**	**4,806.51**	**5,970.51**	**7,111.80**	**8,275.70**	**9,144.55**

For Selected Private Banks

In millions of Birr

Appendix-B

Liability Structure
For Selected Private Banks

In millions of Birr

Name of Bank	Description	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
AIB	Total Deposits		1,346.32	1,732.76	2,212.88	2,721.30	3,419.20	4,962.41	6,105.94	7,743.77	9,204.36	12,545.21
	Demand Deposit	-	282.18	340.80	499.06	578.08		1,132.93	1,383.09	2,014.01	2,158.29	3,289.69
	Saving Deposit					697.94		3,648.93	4,660.89	5,647.60	6,565.01	8,505.56
	Time Deposit	9 93.37	1,296.85	1,623.11	2,022.05	2,426.41		180.54	61.96	82.16	481.06	749.96
	Other Liabilities	70.77	95.11	90.71	121.17	294.85		1,408.86	1,957.70	2,009.16	2,270.23	3,172.50
	Total Liabilities	**1,676.01**	**2,181.95**	**2,748.63**	**3,341.30**	**4,300.53**	**-**	**6,371.27**	**8,063.64**	**9,752.93**	**11,474.59**	**15,717.71**
Dashen	Total Deposits	1,621.39	2,177.74	2,833.01	3,691.60	4,860.55	4 66.33	6,151.52	7,925.21	10,144.55	11,841.23	14,065.60	15,851.26
	Demand Deposit		623.23	793.031,039.09		1,360.93	1	1,616.81	2,189.75	2,715.40	3,408.06	4,392.72	4,265.72
	Saving Deposit	,056.33	1,447.76	1,897.05	2,343.24	2,842.85				3,841.93	5,033.51	6,730.377,797.45	**8,888.84**
	Time Deposit	– 98.73	106.75	142.93	309.27	656.77				10,577.45			
	Other Liabilities	– 241.20	326.76	343.92	468.54	634.38	692.78			701.95	698.78635.72	784.04	1,008.09
	Total Liabilities	**1,862.59**	**1 2,504.50**	**1 3,176.93**	**1 4,160.14**	**1 5,494.93**	1 **7,109.24**	1 **8,823.89**	1 **11,230.04**	1 **13,218.38**	1 **15,692.15**	1 **17,701.48**
BOA	Total Deposits		1,076.17	1,275.19				1,627.63	2,177.00	2,721.33	3,477.77	4,494.19	5,138.85
	Demand Deposit		6,075.26					6,771.25	8,496.15				
	Saving Deposit	– 206.97	223.01	333.28	403.00	511.06	785.25	1,211.31	1,219.36	1,591.37	1,630.50	2,058.34	
	Time Deposit	– 719.04	936.68					1,183.26	1,548.00	1,898.10	2,411.50	3,049.75	3,783.28
	Other Liabilities	150.17		115.50	111.10	226.00	312.17	281.02	233.13	136.20	61.03	217.03	
	Total Liabilities	197.62		184.27	349.87	435.00	453.89	372.10	463.21	555.20	541.57	561.67	
		1,273.79	**1,459.47**	**1,977.49**	**2,612.00**	**3,175.21**	**3,849.87**	**4,957.40**	**5,694.05**		**6,616.83**	**7,332.92**	

N.B: Due to change in Accounting period, Financial Statement **of AIB** for **2008 is consolidated in 2009.**

Cont...Appendix-B

Liability Structure
For Selected Private Banks

In millions of Birr

Name of Bank	Description	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Wegagen	Total Deposits	703.55	875.65	1 1,288.42	1,778.42	2,723.63	2,966.33	3,728.38	3,922.81	5,957.47	5,758.18	7,550.86
	Demand Deposit	250.78	374.71	590.17	724.72	1,209.51	1,191.00	1,870.21	1,770.34	3,116.93	2,296.81	3,032.79
	I Saving Deposit	273.75	350.86	518.33	723.44	803.53	1,095.42	1,517.98	1,960.46	2,529.44	3,195.54	3,986.93
	Time Deposit	179.02	150.08	179.92	330.26	710.59	679.91	340.19	192.01	311.11	265.83	531.14
	Other Liabilities	91.60	135.74	147.02	226.46	353.45	553.11	553.51	767.41	766.11	984.84	1,012.53
	Total Liabilities	**795.15**	**1,011.39**	**1,435.44**	**2,004.88**	**3,077.08**	**3,519.44**	**4,281.89**	**4,690.22**	**6,723.58**	**6,743.02**	**8,563.39**
United	Demand Deposit	287.46	532.69	**865.16**	1,292.76	1,680.77	2,443.35	3,615.74	4,724.85	6,065.83	6,757.52	8,063.49
	Saving Deposit	78.13	177.57	305.72	403.63	524.61	776.11	1,241.04	1,660.37	2,289.26	2,102.44	2,261.49
	Time Deposit	167.01	272.67	395.58	**680.80**	849.15	1,353.17	1,977.53	2,841.30	3,571.97	4,160.22	5,133.10
	Other Liabilities	42.32	82.45	**163.86**	208.33	307.01	314.07	397.17	223.18	204.60	494.86	**668.90**
		90.94	45.53	82.89	115.45	142.24	339.06	516.72	533.82	758.25	927.63	713.04
	Total Liabilities	**378.40**	**578.22**	**948.05**	**1,408.21**	**1,823.01**	**2,782.41**	**4,132.46**	**5,258.67**	**6,824.08**	**7,685.14**	**8,776.53**
NIB	Total Deposits	588.11	832.33	1,224.17	1,451.78	1,878.93	2,469.93	3,296.39	4,127.19	5,157.40	5,838.13	6,655.21
	Demand Deposit	151.80	229.24	292.41	327.31	422.95	670.98	1,031.73	1,308.87	1,801.80	2,018.57	2,123.66
	Saving Deposit	336.38	492.87	709.44	836.59	1,084.63	1,436.58	1,995.52	2,517.19	3,137.26	3,476.58	3,980.68
	Time Deposit	99.93	110.22	222.32	**287.88**	371.35	362.37	269.15	301.13	218.34	342.98	550.87
	Total Liabilities	**890.77**	**1,223.47**	**1,686.30**	**1,742.01**	**2,181.45**	**3,051.99**	**4,077.68**	**5,054.00**	**5,941.05**	**6,747.75**	**7,478.61**

Cont...Appendix-B

Other Liabilities	302.66	391.14	462.13	290.23	302.52	582.06	781.29	926.81	783.65	909.63	823.40

Cont...Appendix-B

Description	2003	2009	2010	2011	2012	2013
Total Deposits	-	277.85	6 88.02	1,162.56	1,792.88	2,505.53
Demand Deposit	-	40.54	1-	256.64	395.19	626.35
Time **Deposit**		96.65	8.37	731.76		
Other Liabilities		140.66	**3-**	174.16		
Total Liabilities		94.24	**8.86**	210.64	320.76 1 250.07	
		11.36 1 372.08 1 897.03 1 1,373.20 1 2,113.64 1 2,755.59				
Total Deposits		189.50	820.93	1,526.32	2,117.30	3,050.44
Demand Deposit		90.70	212.70	599.92	814.86	1,216.40
Saving Deposit		79.83	318.76	643.01	968.52	1,525.54
Time Deposit		18.97	289.47	283.38	333.92	308.50
Other Liabilities		29.58	85.63	139.50	232.41	313.19
Total Liabilities		**219.08**	**906.56**	**1,665.82**	**2,349.71**	**3,363.63**
Total Deposits			239.26	491.32	903.31	1,547.61
Demand Deposit			72.54	117.82	273.71	566.12
Saving Deposit			86.72	233.50	444.94	755.44
Time Deposit			80.00	140.00	184.65	226.05
Other Liabilities			71.75	57.62	174.71	205.94
Total Liabilities			**311.01 1 548.93 1 1,078.02 1 1,753.55**			

Liability Structure

For Selected Private Banks

In millions of Birr

Appendix-C

Capital Structure

For Selected Private Banks

In millions of Birr

Name of Bank	Description	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
AIB	Paid Up	116.74	135.66	158.44	200.00	282.30	-	445.48	550.00	734.07	912.25	1,170.38
	Retained Earnings	37.44	61.38	82.73	141.76	200.23	-	315.82	409.35	602.43	738.38	895.84
	Total Capital	**154.18**	**197.04**	**241.17**	**341.76**	**482.53**	**-**	**761.30**	**959.35**	**1,336.50**	**1,650.63**	**2,066.22**
Dashen	Paid Up	75.00	100.00	100.00	156.19	282.21	453.99	528.51	591.86	698.71	703.79	737.21
	Retained Earnings	53.88	72.15	142.89	229.68	262.26	276.62	380.18	531.49	697.69	1,124.10	1,308.48
	Total Capital	**128.88**	**172.15**	**242.89**	**385.87**	**544.47**	**730.61**	**908.69**	**1,123.35**	**1,396.40**	**1,827.89**	**2,045.70**
BOA	Paid Up	-	137.24	165.73	265.00	265.00	312.57	313.14	315.00	315.00	478.90	577.03
	Retained Earnings	148.71	55.13	87.50	137.00	137.75	107.51	206.09	270.49	345.76	427.70	530.61
	Total Capital	**148.71**	**192.37**	**253.23**	**402.00**	**402.75**	**420.08**	**519.23**	**585.49**	**660.76**	**906.59**	**1,107.64**
Wegagen	Paid Up	76.95	87.79	110.99	147.61	233.14	370.83	517.62	633.17	779.32	952.94	1,575.92
	Retained Earnings	17.41	40.94	69.12	107.06	170.07	234.62	318.80	418.56	558.02	651.19	255.04
	Total Capital	**94.36**	**128.73**	**180.11**	**254.67**	**403.21**	**605.45**	**836.41**	**1,051.73**	**1,337.34**	**1,604.13**	**1,830.96**

N.B: Due to change in Accounting period, Financial Statement of AIB for 2008 is consolidated in 2009.

Capital Structure

For Selected Private Banks

In millions of Birr

Name of Bank	Description	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
	Paid Up	83.00	84.95	87.66	130.83	259.33	330.28	355.20	373.19	523.30	580.94	600.00
United	Retained Earnings	8.39	11.24	37.21	60.52	100.41	137.59	164.77	264.37	378.06	520.77	601.15
	Total Capital	**91.39**	**96.19**	**124.87**	**191.35**	**359.73**	**467.87**	**519.97**	**637.55**	**901.36**	**1,101.72**	**1,201.15**
	Paid Up	105.20	129.09	160.00	200.00	307.60	425.56	488.42	585.64	717.02	959.81	**999.40**
NIB	Retained Earnings	19.70	43.56	**62.96**	85.02	117.54	172.56	240.40	330.86	453.74	568.14	**666.53**
	Total Capital	**124.90**	**172.65**	**222.96**	**285.02**	**425.15**	**598.12**	**728.82**	**916.51**	**1,170.76**	**1,527.95**	**1,665.93**
	Paid Up						93.67	**99.66**	120.58	149.58	149.58	343.81
ZEMEN	Retained Earnings						-	(9.14)	38.02	91.13	131.02	149.67
	Total Capital						**93.67**	**90.52**	**158.59**	**240.71**	**280.60**	**493.49**
	Paid Up						-	115.48	197.29	235.21	374.55	439.13
OIB	Retained Earnings						-	(8.20)	14.72	60.80	63.13	108.47
	Total Capital						**-**	**107.28**	**212.01**	**296.02**	**437.68**	**547.60**
	Paid Up						-	-	169.05	213.36	252.51	307.64
BUNNA	Retained Earnings						-	-	0.05	19.07	34.50	67.25
	Total Capital						**-**	**-**	**169.10**	**232.43**	**287.01**	**374.89**

Appendix-D

Establishment Date
For Selected Private Banks

2	Dashen Bank	1995 G.C.
4	WegagenBank	1997G.C.
6	Nib International Bank	1999 G.C.
7	Zemen Bank	2008 G.C.
9	Burma International Bank	2009 G.C.