ST. MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

POTENTIAL EFFECTS OF FORIGN BANK ENTRY ON FINANCIAL INDUSTRY OF ETHIOPIA

(FROM PERSPECTIVE OF SELECTED BANK PROFESIONALS)

BY ROBEL ABEBE

MAY 2024

ADDIS ABABA, ETHIOPIA

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DECLARATION

I, the undersigned, declare that this thesis is my original work, prepared under the guidance. of Mohamed seid (PhD). All sources of materials 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 institution for the purpose of earning any degree.

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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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Advisor Signature

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POTENTIAL EFFECTS OF FORIGN BANK ENTRY ON FINANCIAL INDUSTRY OF ETHIOPIA

ABSTRACT

The financial industry of Ethiopia has a long story of existence, both in foreign, private and government ownership and participation. Currently the industry is once again being exposed to foreign investors. This paper studies the potential effects based on the prospect of bank professionals. Quantitative research design and descriptive models are used on this paper. the researcher uses secondary data from balance sheets of the local banks and primary data sources from local bank senior employees and foreign bank representative offices. the study identifies the effects on the finance sector to be rather positive regarding technological advancement, low cost of credit and assurance of excelled service and points out risk of capital outflow and weak financial security of the domestic finance system to be potential risks to be faced accordingly. The study also forwards recommendations to the NBE and local banks the mechanism to overcome the negative effects based on the experience of other nation, and to use the positive opportunities relentlessly.

CHAPTER ONE

1.INTRODUCTION

The first banking business agreement that was reached in 1905 between Emperor Minilik II and Mr. Ma Gillivray, representative of the British owned National Bank of Egypt marked the introduction of modern banking in Ethiopia. Following the agreement, the first bank called Bank of Abyssinia was inaugurated in Feb.16, 1906 by the Emperor. The Bank was totally managed by the Egyptian National Bank and the following rights and concessions were agreed upon the establishment of Bank of Abyssinia: IN 1931 Bank of Abyssinia was legally replaced by Bank of Ethiopia shortly after Emperor Haile Selassie came to power.

The new Bank, Bank of Ethiopia, was a purely Ethiopian institution and was the first indigenous bank in Africa and established by an official decree on August 29, 1931 with capital of £750,000. Bank of Egypt was willing to abandon it's on cessionary rights in return for a payment of Pound Sterling 40,000 and the transfer of ownership took place very smoothly and the offices and personnel of the Bank of Abyssinia including its manager, Mr. Collier, being retained by the new Bank. Ethiopian government owned 60 percent of the total shares of the Bank and all transactions were subject to scrutiny by its Minister of Finance, Bank of Ethiopia took over the commercial activities of the Bank of Abyssinia and was authorized to issue notes and coins.

The National Bank of Ethiopia with more power and duties started its operation in January 1964. Following the incorporation as a share company on December 16, 1963 as per proclamation No.207/1955 of October 1963, Commercial Bank of Ethiopia took over the commercial banking activities of the former State Bank of Ethiopia. It started operation on January 1,1964 with a capital of Eth. Birr 20 million. In the new Commercial Bank of Ethiopia, in contrast with the former State Bank of Ethiopia, all employees were Ethiopians.

Following the declaration of socialism in 1974 the government extended its control over the whole economy and nationalized all large corporations. Organizational setups were taken to create stronger institutions by merging those that perform similar functions. Accordingly, the three private owned banks, Addis Ababa Bank, Banco di Roma and Banco di Napoli Merged in 1976 to form the second largest Bank in Ethiopia called Addis Bank with a capital of Eth. birr 20 million and had a staff of 480 and 34 branches. Before the merger, the foreign participation of these banks was first nationalized in early 1975. Then Addis Bank and Commercial Bank of Ethiopia .SC. Were merged by proclamation No.184 of August 2, 1980 to form the sole commercial bank in the country till the establishment of private commercial banks in 1994.

The Commercial Bank of Ethiopia commenced its operation with a capital of Birr 65 million, 128 branches and 3,633 employees. The Savings and Mortgage Corporation and Imperial Saving and Home Ownership Public Association were also merged to form the Housing 17NOV2022 and Saving Bank with working capital of Birr 6.0 million and all rights, privileges, assets and liabilities were transferred by proclamation No.60, 1975 to the new bank.

Proclamation No.99 of 1976 brought into existence the Agricultural and Industrial Bank, which was formed in 1970 as a 100 percent state ownership, was brought under the umbrella of the National Bank of Ethiopia. Then it was reestablished by proclamation No. 158 of 1979 as a public finance agency possessing judicial personality and named Agricultural and Industrial Development Bank (AIDB). It was entrusted with the financing of the economic development of the agricultural, industrial, and other sectors of the national economy extending credits of medium and long-term nature as well as short-term agricultural production loans. The financial sector that the socialist oriented government left behind constituted only 3 banks and each enjoying monopoly in its respective market.

Following the demise of the Dergue regime in 1991 that ruled the country for 17 years under the rule of command economy, the EPRDF declared a liberal economy system. In line with this, Monetary and Banking proclamation of 1994 established the national bank of Ethiopia as a judicial entity, separated from the government and outlined its main function. Monetary and Banking Proclamation No.83/1994 and the Licensing and Supervision of Banking Business No.84/1994 laid down the legal basis for investment in the banking sector. Consequently, shortly after the proclamation the first private bank, Awash International Bank was established in 1994 by 486 shareholders and by 1998 the authorized capital of the Bank reached Birr 50.0 million. Dashen Bank was established on September 20,1995 as a share company with an authorized and subscribed capital of Birr 50.0 million. 131 shareholders with subscribed and authorized capital of 25.0 million and 50 million founded bank of Abyssinia.

HITORY OF FORIGN BANKS IN ETHIOPIA

Agreement that was reached in 1905 between Emperor Minilik II and Mr.Ma Gillivray, representative of the British owned National Bank of Egypt marked the introduction of modern banking in Ethiopia. Following the agreement, the first bank called Bank of Abysinia was inaugurated in Feb.16, 1906 by the Emperor. The Bank was totally managed by the Egyptian National Bank and the following rights and concessions were agreed upon the establishment of Bank of Abyssinia.

The capital of the Bank was agreed to be Pound Sterling 500,000 and one-fifth was subscribed and the rest was to be obtained by selling shares in some important cities such as London, Paris and New York. The Bank was given full rights to issue bank notes and monitor coins which were to be legal tender and all the profits there from a ruing to the bank and freely exchangeable against gold and silver on cover by the Bank as well as to establish silver coins and abolish the Maria Theresa. Land was given to the Bank free of charges & permitted to build offices and warehouses. Government and public funds were to be deposited with the bank and all payments to be made by checks. The government promised not to allow any bank to be established in the country within the 50-year concession period.

Within the first fifteen years of its operation, Bank of Abyssinia opened branches in different areas of the country. In 1906 a branch in Harar (Eastern Ethiopia) was opened at the same time of the inauguration of Bank of Abyssinia in Addis Ababa. Another at Dire Dawa was opened two years later and at Gore in 1912 and at Dessie and Djibouti in 1920. Mac Gillivray, the then representative and negotiator of Bank of Egypt, was appointed to be the governor of the new bank and he was succeeded by H Goldie, Miles Backhouse, and CS Collier were in change from 1919 until the Bank’s liquidation in 1931.

The society at that time being new for the banking service, Bank of Abyssinia had faced difficulty of familiarizing the public with it. It had also need to meet considerable cost of installation and the costly journeys by its administrative personnel. As a result, despite its monopolistic position, the Bank earned no profit until 1914. Profits were recorded in 1919, 1920 and from 1924 onwards.

Generally, in its short period of existence, Bank of Abyssinia had been carrying out limited business such as keeping government accounts, some export financing and undertaking various tasks for the government. Moreover, the Bank faced enormous pressure for being inefficient and purely profit motivated and reached an agreement to abandon its operation and be liquidated in order to disengage banking from foreign control and to make the institution responsible to Ethiopia's credit needs. Thus by 1931 Bank of Abyssinia was legally replaced by Bank of Ethiopia shortly after Emperor Haile Selassie came to power.

The new Bank, Bank of Ethiopia, was a purely Ethiopian institution and was the first indigenous bank in Africa and established by an official decree on August 29, 1931 with capital of £750,000. Bank of Egypt was willing to abandon its on cessionary rights in return for a payment of Pound Sterling 40,000 and the transfer of ownership took place very smoothly and the offices and personnel of the Bank Of Abyssinia including its manager, Mr. Collier, being retained by the new Bank. Ethiopian government owned 60 percent of the total shares of the Bank and all transactions were subject to scrutiny by its Minister of Finance.

Bank of Ethiopia took over the commercial activities of the Bank of Abysinia and was authorized to issue notes and coins. The Bank with branches in Dire Dawa, Gore, Dessie, Debre Tabor, Harar, agency in Gambella and a transit office in Djibouti continued successfully until the Italian invasion in 1935. During the invasion, the Italians established branches of their main Banks namely Banca d'Italia, Banco di Roma, Banco di Napoli and Banca Nazionale del lavoro and started operation in the main towns of Ethiopia. However, they all ceased operation soon after liberation except Banco di Roma and Banco di Napoli which remained in Asmara. In 1941 another foreign bank, Barclays Bank, came to Ethiopia with the British troops and organized banking services in Addis Ababa, until its withdrawal in 1943. Then on 15th April 1943, the State Bank of Ethiopia commenced full operation after 8 months of preparatory activities. It acted as the central Bank of Ethiopia and had a power to issue bank notes and coins as the agent of the Ministry of Finance. In 1945 and 1949 the Bank was granted the sole right of issuing currency and deal in foreign currency. The Bank also functioned as the principal commercial bank in the country and engaged in all commercial banking activities.

The State Bank of Ethiopia had established 21 branches including a branch in Khartoum, Sudan and a transit office on Djibouti until it ceased to exist by bank proclamation issued on December, 1963. Then the Ethiopian Monetary and Banking law that came into force in 1963 separated the function of commercial and central banking creating National Bank of Ethiopia and commercial Bank of Ethiopia. Moreover it allowed foreign banks to operate in Ethiopia limiting their maximum ownership to be 49 percent while the remaining balance should be owned by Ethiopians.

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There were two other banks in operation namely Banco di Roma S. . and Bank o di Napoli S.C. that later reapplied for license according to the new proclamation each having a paidup capital of Eth. Birr 2 million.

The first privately owned bank, Addis Ababa Bank share company, was established on Ethiopians initiative and started operation in 1964 with a capital of 2 million in association with National and Grindlay Bank, London which had 40 percent of the total share. In 1968, the original capital of the Bank rose to 5.0 million and until it ceased operation, it had 300 staff at 26 branches.

There were other financial institutions operating in the country like the Imperial Savings and Home Ownership public Association (ISHOPA) which specialized in providing loans for the construction of residential houses and to individuals under the guarantee of their savings. There was also the Saving and Mortgage Corporation of Ethiopia whose aims and duties were to accept savings and trust deposits account and provide loans for the construction, repair and improvement of residential houses, commercial and industrial buildings and carry out all activities related to mortgage operations. On the other hand, there was a bank called Agricultural Bank that provides loan for the agricultural and other relevant projects established in 1945. But in 1951 the Investment Bank of Ethiopia replaced it. In 1965, the name of the bank once again hanged to Ethiopian Investment Corporation Share Company and the capital raised to Eth. Birr 20 million, which was fully paid up. However, proclamation No.55 of 1970 established the Agricultural and Industrial Development Bank Share Company by taking over the asset and liability of the former Development Bank and Investment Corporation of Ethiopia.

Following the declaration of socialism in 1974 the government extended its control over the whole economy and nationalized all large corporations. Organizational setups were taken in order to create stronger institutions by merging those that perform similar functions. Accordingly, the three private owned banks, Addis Ababa Bank, Banco di Roma and Banco di Napoli Merged in 1976 to form the second largest Bank in Ethiopia called Addis Bank with a capital of Eth. birr 20 million and had a staff of 480 and 34 branches.

PREVIOUS THEORETICAL AND EMPIRICAL FINDINGS

In many less developed countries (LDCs), inefficient domestic banks and a lack of competition among lenders result in high borrowing costs and limited financial access for many firms. More developed countries, such as the U.S., Japan, and those in the European community, argue that LDCs should allow foreign banks to enter into their economies. By increasing competition, foreign bank entry may increase the supply of credit and improve efficiency. However, banking theories that incorporate information asymmetries demonstrate that greater competition among banks may reduce some firms' access to credit (Petersen and Rajan, 1995). Moreover, the high cost of acquiring information about local firms may limit foreign banks to 'cream-skimming', where they lend only to the most profitable local firms (Dell'Arricia and Marquez, 2004; Sengupta, 2007) and adversely affect both domestic banks and the firms that rely upon them (Gormley, 2007). These competing theories naturally lead to the question does foreign bank entry improve credit access for domestic firms, and if so, which firms? Moreover, do these changes in the credit market affect the performance of domestic firms? The growing trend among LDCs to allow greater foreign bank entry and the degree of entry that typically occurs suggests that the answers may have important implications for financial policy in these economies. To answer these questions, this paper studies the experience of other countries with comparable economic development and ownership of sound of financial institutions as of Ethiopia.

Theory and empirical evidence have been debatable on the effects of foreign bank entry on entrepreneurship. In theory, foreign bank entry could significantly reduce the cost of credit by bringing capital, technical skills, and product innovation to host countries, which increases competition and leads to improvements in the efficiency of the banking sector, ultimately benefitting customers of the banking system, including small and new enterprises. It is conceivable, however, that fierce competition with foreign banks for funding or relationships could threaten the survival of local banks and thus lead to reduced access to finance for many borrowers, especially if foreign banks concentrate on the top and selected segments of the market.

Empirical research examining the effects of foreign bank entry on the cost of funds has generally supported the view that foreign bank entry lowers the cost of credit and improves access to credit for less politically connected borrowers (Clarke et al. 2006, Giannetti and Ongena 2009, 2012, Bruno and Hauswald 2013, Claessens and van Horen 2014). Some studies, however, find negative associations between foreign bank presence and financial system performance (Detragiache, Gupta and Tressel 2008, Beck and Martinez Peria 2010, Gormley 2010, Mian, 2006) although this may be attributable to omitted variables bias. For example, Cull and Martinez Peria (2008) show that the negative association between the foreign bank market share and the level of financial depth can result from the fact that countries relax bank entry barriers after financial crises.

1.2 STATEMNET OF THE PROBLEM

In many regions of the world different studies have been conducted aiming to anticipate the Effects of foreign banks on the local banking industry. In return to that, nations improve their policy within the national bank and amend their prerequisites to join the local markets to a higher standard to minimize unwanted effects.

Effects of foreign bank entry tend to depend on variables, which are the modes of entry, economic development of the country, the behavior of the local market.

The mode of entry might be full-fledged or by buying shares of domestic bank. One way or the other if the banks have a dominant presence or a weak presence dictate their potential Effect. banks may benefit from regional specialization because they acquire specific knowledge. Therefore, when already active in a specific region, foreign banks are more likely to expand in that same region. when foreign banks are less (more) important in terms of numbers, they tend to play a less (more) important part in financial intermediation. This suggests that when less important in terms of numbers, foreign banks are more niche players. And conversely, when dominant in numbers, foreign banks tend to focus on large operations.

The economic development of the host nation also dictates the Effect being positive or negative. the entry of foreign banks is generally thought to have favorable effects on the development of host banking systems, including through increased credit extension, some studies find more ambiguous results. Some show that foreign banks “cherry pick” borrowers (Detragiache, Gupta, and Tressel, 2008; Beck and Martinez Peria, 2007). This can undermine overall access to financial services, since cherry picking worsens the remaining credit pool, and lower financial development, especially in low-income countries where relationship lending is important. Indeed, Detragiache, Tressel and Gupta (2008) show the presence of foreign banks in low-income countries to be associated with less credit being extended. Meanwhile in developed nation foreign bank entry is limited but it has been found that foreign banks has negligible Effect on credit provisioning and extension.

The behavior of the local market in relation with the international market also dictates the Effect. Meaning if the local market has a relatively higher import trade than export the foreign banks might lure the importers by providing foreign currency and term loans on demand. Hence the import export balance of the host nation determines the effect to be positive or negative.

Concerning the title of this study, many Ethiopian researchers have put forward their findings and point of views. Mekonnen hurrisa (2015) on his paper *Potential Effects of Opening the Ethiopian Banking Sector to Foreign Banks* concludes The key findings revealed that if foreign banks were entered in the country, the domestic banks would be benefited in all the four dimensions such as potential benefit, potential efficiency, macro-economic and social indicators and potential costs. Even though his study was all dependent on mere collection of theoretical ideas and answers from financial industry workers and institutions. He has not done any empirical evidences and his adopted model for testing the effects numerically was not clear.

Noah yoseph (2019) on his paper *what motivates foreign banks entry in low-income sub Saharan countries* discuss a nice points of views but as the title speaks he does not give emphasis to the Effects of their entry.

Yonas mekonnen hamdu kedir and wolde Michael shibiru (2015) in their article review *financial soundness of Ethiopian banks* have discussed how to measure the stability of the local industry with a CAMELmodel and international standards set by the Basel accord on Basel Committee on Banking Supervision (BCBS). Even though they did not articulate the economical Effects if foreign banks on the soundness of the local industry.

Hence the centripetal agenda of this research topic is to articulate the potential Effects of foreign bank entry on local banks depending on comments given by professionals of the banking industry and proving the common idea with empirical evidence.

1.3 Research questions

- What are the main effects of foreign bank entry on domestic bank performance?
- What positive and negative effects are to be faced by local firms?
- Can domestic banks compete with foreign banks in current capabilities?

1.4 Objectives

1.4.1 General objectives

The main of the study is to find out the main Effect of foreign bank entry based on the current financial stability of local banks and economic progress of our nation.

1.4.2 Specific objective

- To identify the main effects of foreign bank entry on domestic banks
- To investigate the overall effect on the local firms
- To find out the level of readiness of local banks to the opening of the market

1.5 Significance of the study

This paper will support the local banks by providing set of facts to expect during the opening of the market to the international competitors. Also gives a brief prediction on the changes expected due to opening of the sector for foreign competitors. Hopefully other researchers could use this paper as an input for their future studies.

1.6 Scope and Limitations of the study

The study will be organized by taking financial statements and balance sheets of local banks who has been running for above 10 years in the industry. And the questionnaires are distributed for professionals in the capital which Is due to headquarters of local banks mostly dewel in the inner city. Other than local bank officials and professionals, foreign bank office representatives are part of this study.

CHAPTER TWO

Literature review

2.1 Theoretical literature

The history of the banking sector in Ethiopia goes back to the year 1905 when the first banks of Abyssinia establish. This bank is owned by British-owned national bank of Egypt (Harvey, 1994). As its early establishment of banks in Ethiopia the growth is very slow compare to other developed countries (BekezelaNcube,na). Even the capital base for the banking industry increases at this time, the Ethiopian banking industry is still very small even by African standard suggesting the need for further efforts to enhance financial intermediation in the country (NBE report, 2009/2010).

When we go back to the year 1963 the most part (51%) of the banking sector in Ethiopia is occupied by foreigner (Harvey, 1994). But especially in the Derg regime the policy will not allow foreign banks to involve. At recent time bank in Ethiopia is in its high growth rate as the government is allowing new private banks to establish. Concerning the policy, foreign banks not allowed participating in the banking industry.

At current time, there are 19 banks in operation, and 33 micro finance institutions. From 19 banks in operation 16 are private banks and the rest 3 are state owned banks. As reported by access capital in 2010 from the financial institutions that are involved the main leader is the banking sector. Banks take the higher percentage compared to insurance and micro finance institution. In 2008 Ethiopian banking industry cover 91.5% of the total asset share of the financial institution and the recent 8.5% is covered by insurance and micro finance institution1. As such the financial regulators & Central banks have devoted much effort to monitoring & regulating the banking industry.

Performance of banks in Ethiopia as stated by many researchers is in good position when compared to other African countries as well as when compared to some European countries in some aspect. Ethiopian banks are on the way of increasing in growth, profit, and dividends. Mostly the private banks in Ethiopia get their main revenue from collecting deposit, loan providing and foreign exchange (Access capital, 2010).By the end of June 2011, the sector had capital and reserves of 12,321 billion Br while having a loan portfolio of 21,385 billion Br with 23.7pc capital adequacy ratio (CAR) that was remained same from 2009 figure, (Addis fortune, 2010).

According to the economic rule of capitalism, one might think increased competition in turn increases the bargaining power of the consumers which in turn will bring better service with lower relative cost. Strong foreign bank participation will enhance competition and increase efficiency of the banking sector through implementing new management practices and information technologies. They stimulate innovation and facilitate broader access to financial services, which in turn will increase aggregate lending, growth, and stability (Moreno and Villar, 2005). Also, evidence exists of better-quality financial intermediation, e.g., lower loan-loss provisioning with more foreign entry (Martinez-Peria and Mody, 2004).

Likely several factors are behind these effects of foreign banks, such as the introduction of new, more diverse products, greater use of up-to date technologies, and know-how spillovers (e.g., as people learn new skills from foreign banks, they migrate over time to domestic banks). In addition, foreign banks likely pressured governments to improve regulation and supervision, increase transparency, and more generally catalyze domestic reform (Levine 1996, Dobson, 2005, and Mishkin, 2006).

How ever recent studies made by IMF and other researchers indicate the above statement highly depend on the host nation economic conditions. The effects of the entry of foreign banks on development and efficiency appear to depend though on some conditions. Limited general development and barriers can hinder the effectiveness of foreign banks (Garcia-Herrero and Martinez Peria, 2005; Demirguc-Kunt, Laeven and Levine, 2004). Also, the relative size of foreign banks' presence seems to matter. With more limited entry (as a share of the total host banking system), fewer spillovers seem to arise, suggesting some threshold effect (Claessens and Lee, 2003).

While the entry of foreign banks is generally thought to have favorable effects on the development of host banking systems, including through increased credit extension, some studies find more ambiguous results. Some show that foreign banks “cherry pick” borrowers (Detragiache, Gupta, and Tressel, 2008; Beck and Martinez Peria, 2007). This can undermine overall access to financial services, since cherry picking worsens the remaining credit pool, and lower financial development, especially in low-income countries where relationship lending is important.

Another concern is that the domestic authorities will lose control over the banking system, if foreign banks have too strong presence. International banks are able to engage in complex cross border financial transactions, which are sometimes difficult to monitor by either the host or the home country supervisors (Roldos, 2001). Moreover, the regulatory institutions in the home country may have negative affect the decisions of foreign banks to lend, merge or acquire in the host environment (Peek and Rosengren, 2000). A related issue is the inability of domestic banks to compete with the high performing international banks. Foreign bank entry may lead to lowering the interest margins, further weakening of domestic players and bankruptcies (Peek and Rosengren, 2000).

2.2 Reasons to enter the market

Ethiopian government even though have not made clear the modes that foreign banks could enter the market, the foreign banks will enter either by buying shares or with full-fledged mode. As they are profitable organizations their aim is to mobilize deposits and create a credit availability. A foreign bank is a bank with a business existence outside its nation of origin, for no less than one branch or subsidiary. Branches are entities that work as a bank yet don't have a different legal status and are part of the same legal entity as the (foreign) parent bank. Conversely, subsidiaries are separate legal entities that might be completely possessed, or dominant part claimed by a bank in another country. Subsidiaries may themselves possess subsidiaries in another country. Alongside branches and subsidiaries, banks can likewise open a representative office. While agent workplaces are commonly precluded from performing any banking activity, they offer the open door for banks to encourage associations between the parent bank and financial business outside the home country.

The main reasons they enter the Ethiopian market are summarized here with theories. more important explanation for developing countries is the existence of host country opportunities Banks enters other, non-saturated and less developed, less efficient markets where they enjoy comparative advantages – higher quality services, better risk management tools etc. Such markets often offer good profit and growth prospects typically; these markets also entail risks do not present in developed countries. Therefore, the entry decision is influenced by other factors, such as the development of market infrastructure standards of regulation and supervision, and political risk. Often foreign banks are attracted by tax relieves and other regulatory exemptions. (Clarke 2001.)

Defensive expansion hypothesis. This claims that multinational banks follow their clients abroad (either their trade or investment). Information about the client is one of the main assets of banks. There is, however, no external market for this information i.e. markets where banks could sell this knowledge. Hence, they must follow their client if they do not want to lose them. Often the motivation behind following the client is not so much to earn more profit but rather to avoid loss at existing locations On the other hand, it is also in the interest of the clients, who must bear the transaction costs of changing banks. Although defensive expansion is found to have strong explanatory power in more developed countries, it only provides a partial explanation.

other hypotheses such as regulatory Effect, home market sophistication, etc. Banks who follow their clients might restrict their activity to their existing client base, but they can also create a beachhead (Williams 1997, 2002) and try to acquire new clients or enter into other market segments in the host country. Their relative performance and Effect on the domestic banking sector is largely determined by which strategy they follow.

Internalization theory, originating in the pioneering work of Coase (1937). The theory has focused primarily on explaining which parameters would stimulate firms to expand across borders, and on entry mode choice. More recent internalization theory extensions have focused on establishing linkages with strategic management perspectives on the MNE, and on describing differentiated network MNEs (Peter J. Buckley et al., 2017).

The eclectic theory has been developed by John Dunning in a series of publications (Dunning 1980, 1981, 1988, 1992). There are three factors that determine the international activities of multinational enterprises (MNEs). These are ownership (O) advantages, location (L) advantages, and internalization (I) advantages. Therefore, the Dunning eclectic theory is also known as the OLI paradigm. The OLI theory clarifies outward FDI. It suggests that MNEs develop competitive O advantages at home and then transfer these abroad to particular countries (depending on L advantages) through FDI, which enables the MNE to internalize the O advantages.

2.3 How foreign banks enter

There are various hypotheses to explain why banks expand their activity abroad. The first such theory introduced into the literature by Williams (1997, 2002) is called the defensive expansion hypothesis. This claims that multinational banks follow their clients abroad (either their trade or investment). Information about the client is one of the main assets of banks. There is, however, no external market for this information i.e. markets where banks could sell this knowledge. Hence, they have to follow their client if they do not want to lose them. Often the motivation behind following the client is not so much to earn more profit but rather to avoid loss at existing locations On the other hand, it is also in the interest of the clients, who must bear the transaction costs of changing banks. Although defensive expansion is found to have strong explanatory power in more developed countries, it only provides a partial explanation. Williams refers to

other hypotheses such as regulatory Effect, home market sophistication, etc. Banks who follow their clients might restrict their activity to their existing client base, but they can also create a beachhead (Williams 1997, 2002) and try to acquire new clients or enter into other market segments in the host country. Their relative performance and Effect on the domestic banking sector is largely determined by which strategy they follow.

In developing countries, the defensive expansion hypothesis is suggested to have even less importance and the underlying motivation is also rather different. Whereas in developed countries banks' primarily motive is to keep existing clients, here the need for effective monitoring becomes more important. Financial markets are less developed and mature; the only way to ensure effective monitoring is physical presence. Delegation of monitoring is not an option (Sergio L. Shmuket, et al, 2004)

An alternative and more important explanation for developing countries is the existence of host country opportunities Banks enters other, non-saturated and less developed, less efficient markets where they enjoy comparative advantages – higher quality services, better risk management tools etc. Such markets often offer good profit and growth prospects typically; these markets also entail risks do not present in developed countries. Therefore, the entry decision is influenced by other factors, such as the development of market infrastructure standards of regulation and supervision, and political risk. Often foreign banks are attracted by tax relieves and other regulatory exemptions. (Clarke 2001).

In addition to the aforementioned "pull" factors, there are other factors, which "push" banks abroad Amongst others, Clarke et al. mentions deregulation in the home country (which, for example, pushed Spanish banks to enter Latin American markets) as well as the size and efficiency of the entering bank (Clarke et al, 2001).

2.4 forms of entry

With a growing understanding of foreign market and a more developed network of relationships with local financial institutions, some banks subsequently increased the range of their operations by adding local customers. Following this pattern, foreign banks would first establish representative offices. At a later stage, they would open branches and, eventually, establish subsidiaries (Inwon 2004).

The major forms of foreign banks entry are

I. Representative offices

Representative offices are generally prohibited from performing any banking operations. They do, offer opportunities for contracts with the parent bank and its clients concerning a variety of commercial and financial business that relates to the foreign market. Frequently, the representative office of foreign banks also negotiate associations with local banks. It offers the banks a minimal cost entry mode, enabling them to build up their brands without having any capital costs identified with setting up a branch or subsidiary. This activity gives a specific bit of advantage when the entry value on the local market has yet to be proven or the regulatory frameworks have a degree of uncertainty.

A foreign bank representative office is the most restricted type of organization and the less expensive one. Still, it can't play out any sort of activity. That is the reason it is for the most part utilized for exploring business opportunities from a foreign country. (Nicoleta Hurduc et al., 2011)

II. Foreign branches and Bank subsidiaries

A foreign branch is an overseas office a bank incorporated in a foreign country and constitutes a higher level of commitment than the representative office. Foreign branch offices are typically involved in a wholesale banking.

Bank subsidiaries are separately incorporated from the parent bank, whose financial commitment to the subsidiary consist of the capital invested. Subsidiaries are usually involved in retail banking markets. However, in some countries such as the United Kingdom, subsidiaries are often involved in wholesale investment banking operations.

Foreign banks can enter host countries by forming branches or subsidiaries. The choice to enter by branch or subsidiary is to an enormous degree driven by regulatory requirements in Africa, while other contemplations, for example, differences in tax rates, seem secondary. However, even where the option of branching is available, branching requirements often do not differ substantially from requirements for establishing a subsidiary. For example, in Kenya regulations establish similar minimum capital requirements for branches and subsidiaries, thus eliminating a key reason (lower set-up costs) for establishing a branch rather than a subsidiary. The decision to enter by branch or subsidiary can also be driven by the business model pursued by a foreign bank. Foreign banks that aim to serve a narrow corporate clientele or are reluctant to invest sizeable capital as long as the size of their cross-border activity in the relevant market is uncertain, may find the branch model more attractive. In contrast, foreign banks with the intent to establish a more broad-based retail operation may find the subsidiary model that provides for the host-country operation to be run as an independent bank, including with separate liquidity and capital buffers, and with its own management, board, and committees, more suitable. (Thorseten Beck et al., 2014)

III. Offshore banks

Offshore banks are engaged in banking business but in foreign currency only. They accept deposits from foreign banks or non bank companies or entities and make loan to them in foreign currencies.

IV. Joint venture and affiliate relationships.

Establishing affiliated relationship or participating in a joint venture can be another way to engage into foreign expansion. This usually involves taking minority tasks in local entries and the level of involvement into management of the local banks by the foreign banks. (Inwon Song 2004). Foreign banks can enter host countries by merging or acquiring the operation of an existing financial institution, or by establishing a presence from scratch (greenfield investment).

The reasons behind choosing one mode over the other often depend on various factors, including the degree of difficulty of obtaining a new banking license, whether any suitable banking operations can be acquired, and whether banks intend to establish a retail-focused presence or enter to follow existing corporate customers. Acquiring the operations of an existing financial institution can often give relatively quick and easy access to extensive operations; however, it is not without challenges, such as combining different corporate cultures. On the other hand, banks have also reported significant start-up costs and long break-even periods from entering a host country in the form of greenfield investment. (Thorseten Beck et al., 2014). According to Hryckiewicz (2010), the main way in acquisition has been largely led by the privatization of state-owned banks and the rescue of struggling domestic financial institutions.

2.5 overall immediate effects

improve the quality and availability of financial services in the domestic financial market by increasing bank competition and enabling the application of more modern banking skills and technology. Most local banks are not yet even close to digital filing systems let alone serving with digital products. Even though there is a spark in some private banks and they have a culture of using digital technology and providing savings and credit access to their customers its overall performance is relatively lower than most east African nations. In 2019, e-commerce revenues grew by an average of 24 percent in sub-Saharan Africa. About one-quarter of the region’s population were active, online-paying customers in 2019, compared with at least half the population in all other regions and 90 percent in advanced economies.

Foreign banks serve to stimulate the development of the underlying bank supervisory and legal framework. As it is obvious the host nation would be able to participate in the big leagues of world bank and IMF due to their strict financial security requirements, which are to be adjusted due to the entry of the foreign bank. It also enhances a country's access to international capital. The international capital markets would be relatively accessible since the international banks can minimize the transaction costs.

2.6 Empirical evidence

Empirical studies proved that foreign banks rather provide net benefits to emerging market in host countries in terms of stability. However, patterns of financial markets vary from country to country and for some countries too much presence of foreign banks from a single country may have negative Effect if the banking operations are not geographically diversified (Clarke at al. 2001).

In transitional developing countries there is a particular large need for financial and banking services, both for short and long operation. This is due to the great need for restructuring and privatization to adopt the economy to the new conditions of an open market economy. Foreign banks much better equipped to provide the needed services than domestic banks and that the recent development of global, multinational banking services provide a great opportunity for transitional economies, by bringing them into expedite the transition and encourage higher levels of economic growth (Michael and Gur, 2002).

It is generally accepted that foreign banks can contribute to efficiency and economic growth of emerging markets. Foreign banks can bring transitional economies to the entire package of services needed for restructuring. As Reininger, et al, (2001) and World Bank (2001) in Michael and Gur(2002), findings foreign banks contribute for Short and long term intermediary savings and channeling recourse, Mobilization of household saving and channeling recourse, training and assistance in financial management, Proper risk assessment and evaluation, risk transformation and risk sharing, Supervising the proper corporate management of enterprise, Monitoring the performance of loans and repayment schedule, Lobbying for and helping to introduce the proper regulatory regime for the entire banking sector, Reduce transaction costs and improving information. In addition to their knowledge and experience, foreign banks bring with them trust, by both households and business, that is based on their record reputation in their home countries and in the global economy. Trust and reputation are gravelly missing in the local financial sector, and this severely hinders their ability to fulfill their mission (Michael and Gur, 2002). A study in Russian Banking Sector, (World Bank, 2001 in Michael and Gur,

2002) has argued that "trust cannot be reborn without an intensive initial involvement and setting the norms of foreign banks". All these can increase savings, or at least trusting them to the banks, raise the level of investment and will allocate investment funds in a more efficient way throughout the economy.

If we consider the case of Kenya, In December 2013Kenya has 43 banks, with 1,313 branches and accounting for about two thirds of the financial system's assets. In terms of shareholding, the Central Bank identifies 14 banks with foreign ownership, accounting for 32.2% of net assets in 2012. The Central Bank also identifies 6 banks with state ownership accounting for 24.8.% of net assets in 2012, with the government having majority ownership in three of these, which account for 4.2% of net total assets (Consolidated Bank; Development Bank of Kenya; and the National Bank of Kenya,(Kenya Bank Supervisor annually Report 2014) The remaining 20 are local private banks, accounting for 43.0% of the banking sector's net assets. Hence Kenya's banking system is dominated by local private banks and foreign banks.

Oloo(2013) proposes a number of indicators to identify the different strengths and weaknesses of Kenyan banks and provides data on individual banks, which we aggregate into the various ownership components, weighted by the value of assets in 2012. These include the rates of return on assets and capital, cost of funds, efficiency ratio and the ratio of non-performing loans.

The performance of commercial banks in Kenya by ownership

	Foreign banks	State owned banks	Majority state owned	Local private banks	All banks
Return on assets					
2009	3.6	2.8	3.7	3.8	3.6
2010	4.7	3.7	4.2	4.8	4.6
2011	4.7	4.1	3.1	4.8	4.7
2012	5.2	4.1	1.4	4.8	4.9
Return on capital					

2009	36.7	30	27.2	30.3	32.3
2010	46.1	23.4	30.8	46.6	40.7
2011	50.6	44.9	27.6	50.4	49.1
2012	51.9	38	12.7	50.9	48
Average cost of fund					
2009	3	2.7	3.5	4	3.4
2010	2.2	2.1	2.9	3.4	2.7
2011	2.5	2.3	3.8	3.8	3
2012	4.9	5.3	7.6	7	6
Efficiency ratio					
2009	53.1	66.4	64.4	58.8	60
2010	47.1	61.4	58	51.6	53.6
2011	45.8	56.8	63.1	51.6	52
2012	50.7	57	74.8	52	53.9
Non- Performing Loans to advances ratio					
2009	4.5	9.7	10.1	6.4	6.7
2010	3.6	6.4	6.6	5.1	5
2011	2.7	4.4	6.5	3.7	3.6
2012	2.4	5.2	8.8	3.6	3.7

2.7 Measurements of financial soundness

There are different measurements of bank performance that are used by different countries. The international framework that is set by the bank for international settlement in the Basel accord is used as a base in most countries to evaluate the financial performance of their banks. This framework set as to the extent in which banks should acquire capital at least 8% of their risk weighted asset. Similarly, National Bank of Ethiopia set it standard as the same to the Basel committee agreement made in the year 1982.Accordingly, the researchers tests whether banks in Ethiopia meet the directive set with respect to financial performance in general and check their financial health to identify the strength and weakness of the banks and to give identical views to strength the banking sector. For evaluating bank health, the research, select CAMEL framework.

CAMEL framework was firstly developed by the Basel committee to measure the financial performance of different financial institution. As far as the researcher's knowledge there are no research that is done to check the health of banks by using CAMEL framework in Ethiopia. CAMEL framework is an abbreviation stand for capital adequacy, Asset quality, Management quality, Earning Ability and Liquidity position. Financial institutions provide service as intermediaries of financial markets.

A well-functioning financial institution will sustain a countries economic development and play a great role in reduction of poverty. But the mal functioning of the banking system can be extremely costly to the real economy. Financial institutions are responsible for transferring funds from investors to companies in need of those funds. One of the major participants in the financial institution is the banking industry.

Banks serve as backbone to the financial sector, which facilitate the proper utilization of financial resources of a country (Dang, 2011). As Bank is one of the participants and major key player in the financial institution, it needs a continuous assessment by its supervisory and management (Saidov, 2011). That is why financial regulators and central banks devotes much effort to monitoring & regulating the banking industry. In the region of sub-Saharan Africa, country like Ethiopia has banks involved as financial intermediaries.

"CAMEL rating has become a concise and indispensable tool for examiners and regulators". This rating ensures a bank's healthy conditions by reviewing different aspects of a bank based on variety of information sources such as financial statement, funding sources, macroeconomic data, budget, and cash flow (Dang, 2011). Nevertheless, Hirtle and Lopez in 1999, p. stress that the bank's CAMEL rating is highly confidential, and only exposed to the bank's senior management for projecting the business strategies, and to appropriate supervisory staff.

CAMEL framework has five components, capital adequacy, Asset quality, management quality, Earning ability and Liquidity position. Capital Adequacy Capital adequacy or sometimes regulatory capital is determined how well banks or other depository institution can have enough capital equal to their asset to sustain operational losses and to show if whether those institution are not participating in investment that increase risk to default.

The capital structure of banks is highly regulated. This is because capital plays a crucial role in reducing the number of bank failures and losses to depositors when a bank fails as highly leveraged firms are likely to take excessive risk to maximize shareholder value at the expense of finance providers (Olweny and Shipo, 2011). Capital adequacy for this study has been analyzed using two ratios. The first one is by applying capital adequacy ratio, which is measured by capital to risk weighted asset and the second measurement is by using leverage ratio.

The asset quality is one of the major factors that will affect the health of banks. The quality of asset held by an individual bank has an Effect to the performance of the bank. Exposure of credit risk, trends of nonperforming loan, bank borrower profitability health, will determine the heath of the asset quality of the bank (Baral, 2005). In addition to assessing trends in classified assets, delinquent loans, and credit concentrations, the asset quality component rating considers management's ability to underwrite and administer credits in a prudent and sound manner (Ilhomovic, 2009). To evaluate asset quality, the study uses two financial ratios. This is loan loss provision to total loan and loan loss provision to total asset.

Management Quality Measuring of management quality is subjective by its nature. As such Sound management is a key to bank performance but is difficult to measure. It is primarily a qualitative factor applicable to individual institutions. Several indicators, however, can jointly serve as an indicator of management soundness. Expenses ratio, earning per employee, cost per loan, average loan size and cost per unit of money lent can be used as a proxy of the management quality (Baral, 2005). For this study the researcher selects two ways to measure management performance this are operating expense ratio and interest expense ratio.

Liquidity position Liquidity is defined as the capacity of financial institutions to finance increases in their assets and comply with their liabilities as these mature. Siegel, (2007) defines liquidity as the ability of a firm to meet its short-term obligation. management of banks can concretely manage their liquidity risk in several dimensions in the way, such as where it is exactly performed in the organization, how liquidity is measured and monitored, what measures banks can take to prevent or tackle a liquidity shortage, etc. Following overview of the banking industry's practices is based on a survey conducted at several banks in each EU country (Miguel, et al, 2006).

Earning ability Earning ability indicate the ability of the banks in generating revenue by using the asset, shareholders equity and using the proportion of gross income. To assess the earnings performance of a bank, it will be helpful to look at a variety of ratios and measures: these include: (1) return on assets (ROA) (2) return on equity (ROE) and profit margin (PM).

ROA	Net income/ Average total asset
ROE	Net income/ Average shareholder equity
Capital adequacy	Capital/Risk weighted Asset
Asset Quality	Loan loss provision/ Total Asset
Management Quality	Total non-Interest Income/ Total non-Interest expense
Earning quality	Net income After tax & Provision/ (Interest income + Non-Interest income)
Liquidity position	Liquid Asset / Total deposit

CHAPTER THREE

3.1 Research methodology

The current situation in Ethiopia, there is an escalating number of banks to take advantage of the currency demand, and observing the untapped market, according to world bank survey on 2021, in 2018/19 about 30.5 percent of adults (18 years of age and older) had an account at a formal financial institution, up from 21.8 percent in 2015/16. However, this research is mainly focused on the established banks, banks which have more than 10 years of experience. This is because these banks will have the financial statements needed to examine their financial soundness and forecast effects on them as well.

According to NBE There are Five top performing banks by collecting resources and with higher profit margins. They are the primary subject of the study, as much of the data is collected from these five institutions. The paper will focus on them.

In addition, the study will include two immerging banks established on 2022gc. From these two banks one of them shall be a full-fledged interest free bank. This is because the Islamic banks tend to work depending on unique business principle, that is they don’t have interest given for a savings account plus variety of investment products are available. Taking those reasons in to account they might have a different approach to compete with foreign banks.

Foreign bank representative offices are also another subject for the study. The KCB Group, Deutsche Bank, Commerzbank, Bank of Africa, Ziraat Bank, Equity Group Holdings, the Export-Import Bank of India, Equity Bank, the European Investment Bank, and Standard Bank, among others, have opened representative offices. Even the South Korean Exim Bank has a representative office in Ethiopia.

Based on the type of the research, its central point being financial stability and foreign entry, the suitable type of method happens to be quantitative research with descriptive approach. This way the paper could answer the questions and objectives. cross-sectional design was employed for a data collected and analyzed more than one case at a single time.

3.2 data collection and sources

The paper mainly uses primary data sources from personnel and professionals working on the above institutions. Secondary source data are financial statements of local banks and statistics from previous studies on foreign bank entry. Standard questionnaire and open ended interview was given to employees and personnel who work closely to this matter of work to be more specific IBD, credit, corporate managers and commercial bank controlling department.

Respondents were given questionnaires with open and close ended questions that contain statements directly related to the current stability of the bank and the outcome and change on stability after different variables are changed due to foreign bank entry.

3.3 sampling design and procedures

This study employed random and purposive sampling techniques in order to select the required size. Regarding the bank professionals the sampling is purposive and deliberate in selecting employees working on INTERNATIONAL BANKING and CREDIT.

Regarding the EEA, EPRI and PEAA higher officials are going to be samples randomly. Regarding representative office its planned to have a random sampling.

3.3.1 sample size determination

There are several approaches to determining the sample size of a study. The sample of this research was calculated by using Yamane (1973) formula (as sited in Glenn, 1992) . The formula is shown as bellow:

$$n=N/(1+N(e))^2$$

Where:

n = sample size required

N = number of people in the population

e = allowable error

3.4 data collecting and analyzing procedures.

The first step, to collect a data by getting permission from concerned authorities in those banks sector and professional association as well as research institution by submitting the support letters written by Accounting and Finance Department. Because of the wideness of the study area, five professional enumerators with knowledge of data collection system were involved. Among those lists of banks and firms, the researcher used all samples which were included in the study. And in this study data was collected by using pre-designed format or questionnaire in English version by giving the necessary consent for respondents. All data were collected from bank branch manager, In fact, as per the researcher believe bank branch managers are suitable candidates for answering the questionnaire. Because most of those concerned bodies were making financial decisions and knowing more about government financial policy and could easily respond to the questionnaire.

Once the data was collected the researcher continues to analyze them by five steps. Identification, collection, cleaning, analysis and interpretation. This process is useful to transform large amounts of data into meaningful insights (Mishra & alok, 2011).

3.5 ethical considerations

According to Bhandari, (2022) noted that a researcher must adhere to principles of ethics, before collecting data from respondents. Voluntary engagement, informed consent, anonymity, confidentiality, potential for harm, and results communication are among these principles. Therefore, while carrying out the study, an ethical value must be considered.

In this study, the researcher described the purpose of distributing the questionnaire to the respondents. This was done to ensure that the respondents gave their informed consent to participate in the study. Furthermore, this assured cooperation from the respondents and helped to avoid any skepticism on the part of the study subjects. The secondary data that was used in the study was obtained from Bank of Abyssinia's annual reports and website, which are available to the public.

CHAPTER FOUR

DATA ANALYSIS

In this part, the researcher has tried to analyze the raw data collected from the field of the study. In the survey, a total number of one hundred thirty-four questionnaires' have been distributed in the selected private and government Banks as well as other organizations; out of which, one hundred twenty-three or 91.79% were collected and analyzed, whereas the rest 8.21% were not returned or invalid.

S.NO	Bank name	Number of branches in capital city	Selected size
1	Bank of Abyssinia	380	45
2	Bunna bank	120	45
3	Awash bank	450	45
4	NBE		1

Table 4.1

the survey embodied with three main sections. They are:

- Potential effect of foreign banks entry on the financial performance of local commercial banks
- Benefit of foreign banks entry
- How far the domestic banks are ready to compete with foreign banks.

4.1 Information about respondents

The general information gives the organizations the respondent come from, their level of qualification and gender mix. Accordingly, as presented in table 4.2, all of the respondents are from Private commercial Banks and NBE and representative office offices.

Regarding the education level concern 41.6% respondents have master's degree and above whilst 56.4% study participants have got bachelor's degree, whereas 3% of the study participants are not willing to give a proper answer for this specific question. Moreover, 69% of the respondents are males and the rest 31% are female. As the research uses purposive selection of respondents the questions and interview was given to employees and personnel who work closely to this matter of work to be more specific IBD, credit, corporate managers and commercial bank controlling department.

4.2 Effects of foreign bank entry on financial stability

The survey respondents were asked the question that whether the foreign banks accelerate the country's economic growth or not. Large majority respondent that is positive to this questionnaire. 75.6 % of the respondents have the opinion that foreign banks would have a positive Effect for the acceleration of economic growth, whereas the other 23.2 % oppose the opinion. Moreover, one respondent, i.e., 1.2 %, did not give the valid answer. (Fig4.1)

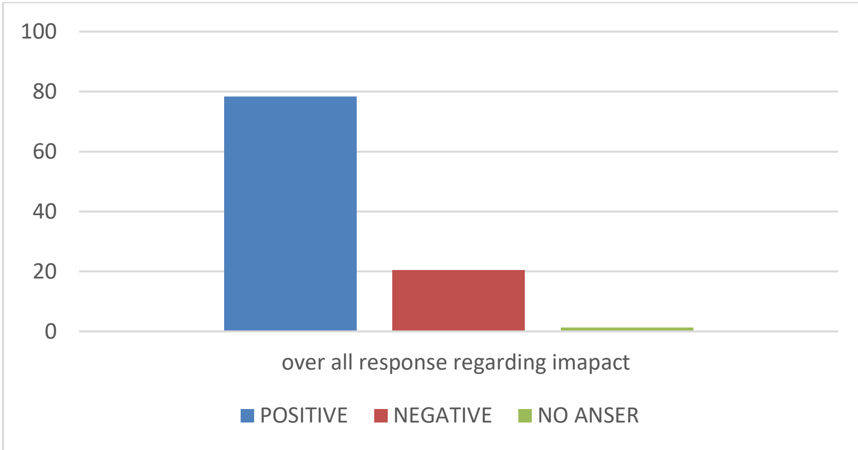


Fig 4.1: foreign banks accelerate the country's economic growth Source: Own survey, 2023

If foreign bank entry is permitted, 40.4% of respondents believed that the economic stability will be attained and gross domestic product (GDP) can be growing, while 34.6 % of respondents informed that the chance may attract more foreign currency and investor to invest in the country. Moreover, 3.3%ofthe respondents, believed, it may create employment opportunity for the society also help he industry to be more modern.

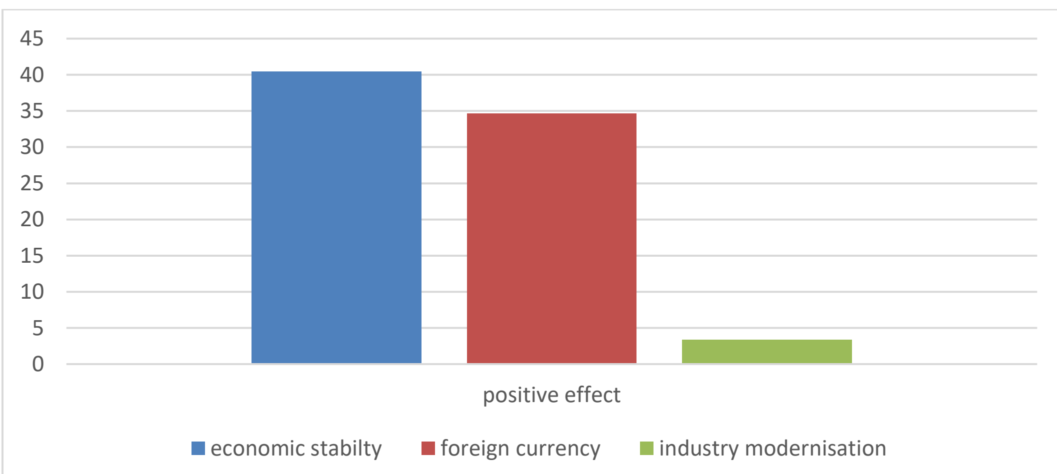


Fig 4.2 effect on ecconomy and banking sector

On the contrast respondents those arguing against the entry of foreign banks for economic growth, constituted 9.1%.As their opinion if those banks entered in the country, the gross domestic product (GDP) will be affected negatively while also out flowing of foreign currency due to financial crisis is a huge risk, 8.1 % of the respondents respond that it may affect the investment activity of the country because foreign banks might create an overly competitive market which would only benefit big firms. Around, 3.3% of the respondent believed that the entry of foreign banks would have been the causes of inflation (Figure 4.3).

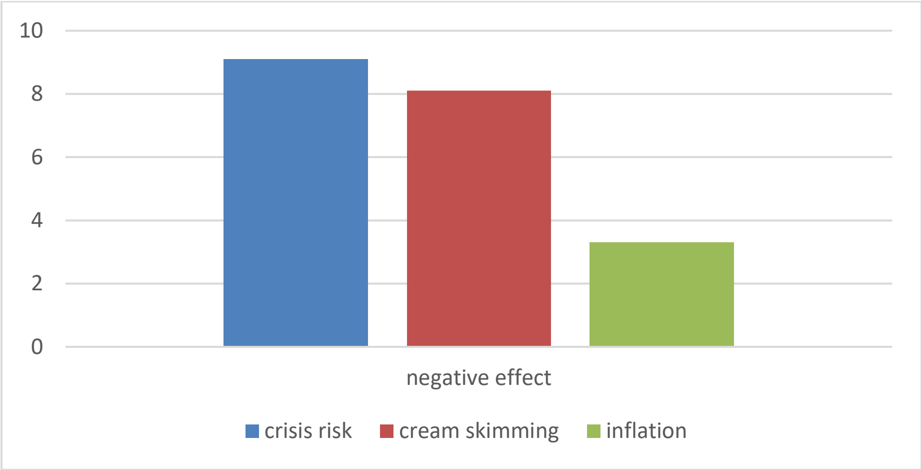


Fig 4.3 negative Effect on economy and sector

4.3 Earning ability of banks.

To increase the earning shares and management quality of the banks from the industry 35.9% of respondent think revising the credit interest is mandatory. While the rest 42.3% believes commissions and miscellaneous incomes need to be raised for services given. The rest 21.8% believe salary and non-interest expenses should be controlled in addition to the two factors mentioned earlier.

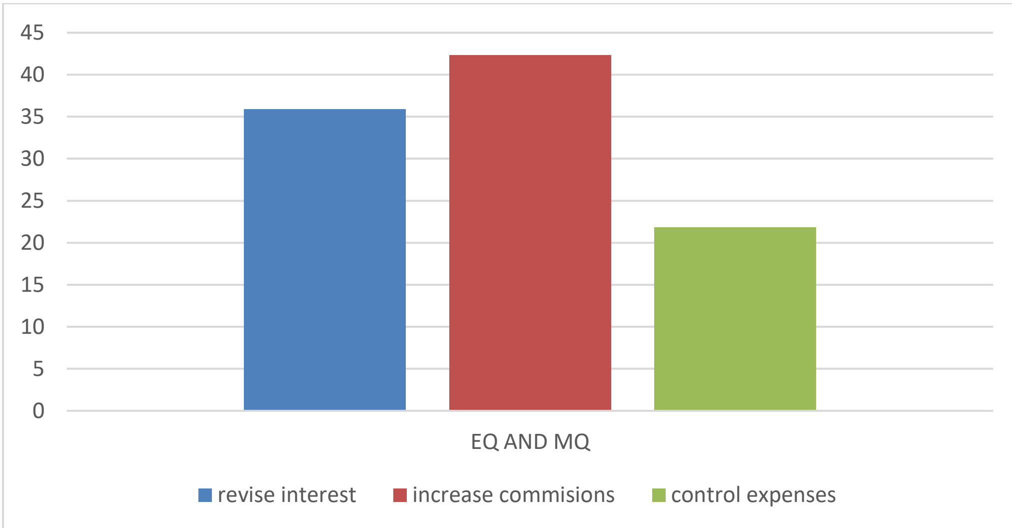


Fig 4.4 earning quality of banks

4.4 capital adequacy ratio.

the respondents viewed the Effect on capital adequacy from different angles, 78.1% believes aggressive deposit attraction and mobilization is key to overcome the problem, while the 12.8% believe controlling credit and investment shares are vital the rest 3.8% say they need to issue new shares to overcome temporary shorthand on total capital.

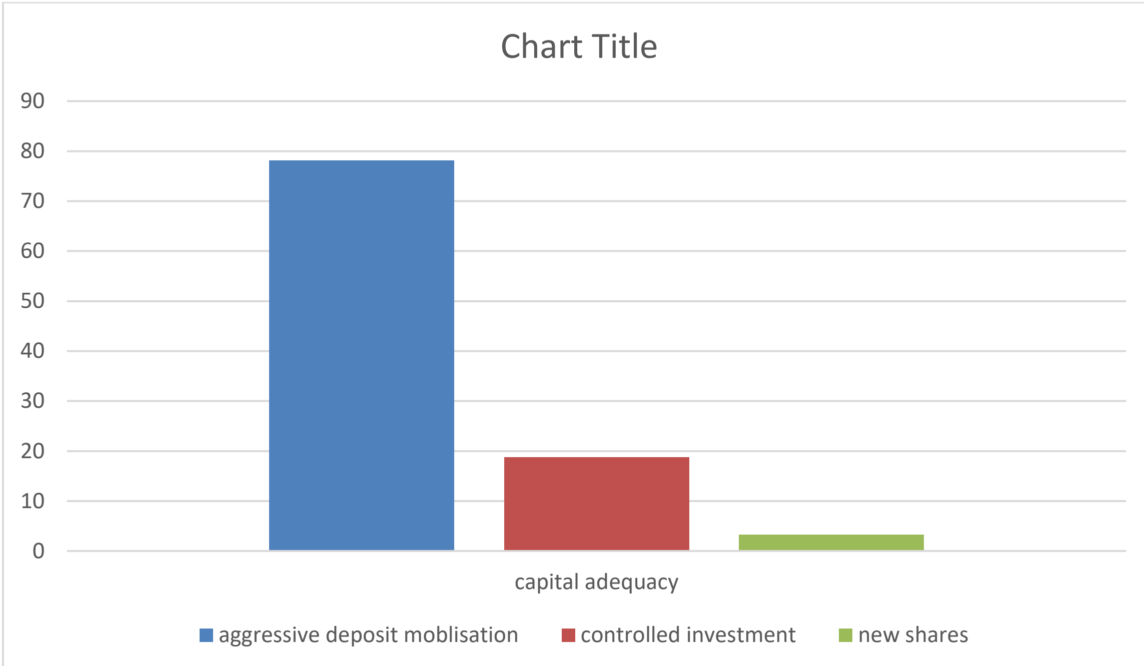


Fig 4.5 capital adequacy of local banks

4.5 ROE AND ROA

From the survey to increase ROA 54.7% of respondents believed Effect on ROA can be averted by providing credit for developed industries to get valuable collaterals assets in other words, managing loan portfolios. The other 26.2% reduce operational costs by automating and digitalizing banking operation, which in turn is investment for the coming technological shift. The rest 19.1 % believes effective interest rate management is the key in to increase profitability by strategically pricing loans and deposit interest.

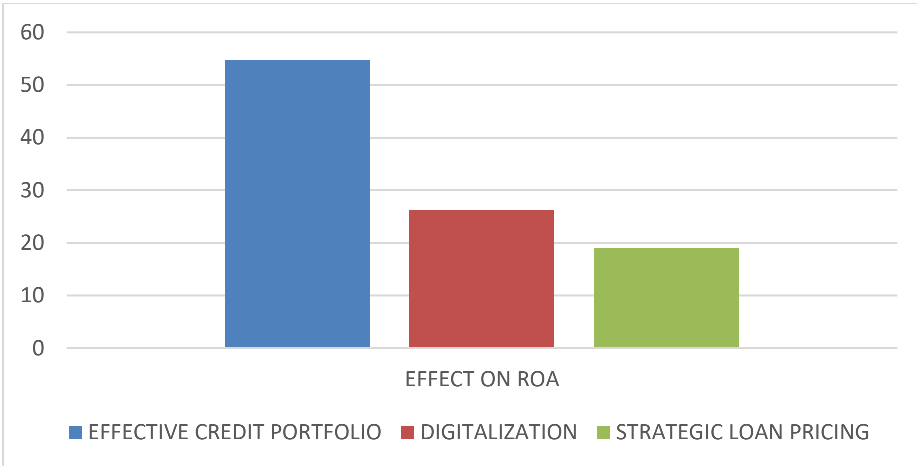


Fig 4.6 effect on ROA

Meanwhile, the respondents gave an interesting view towards averting the effect on ROE. One of the common responses was optimizing the capital structure, this was shared by 71.6% of respondents. Mitigating the interest income reliance and maximize the fee-based incomes, in addition investing on digital products to create new revenue stream, this response was shared by 15.3% of the respondents. Effective interest management (net interest margin) comprises the rest 13.1% of the responses.

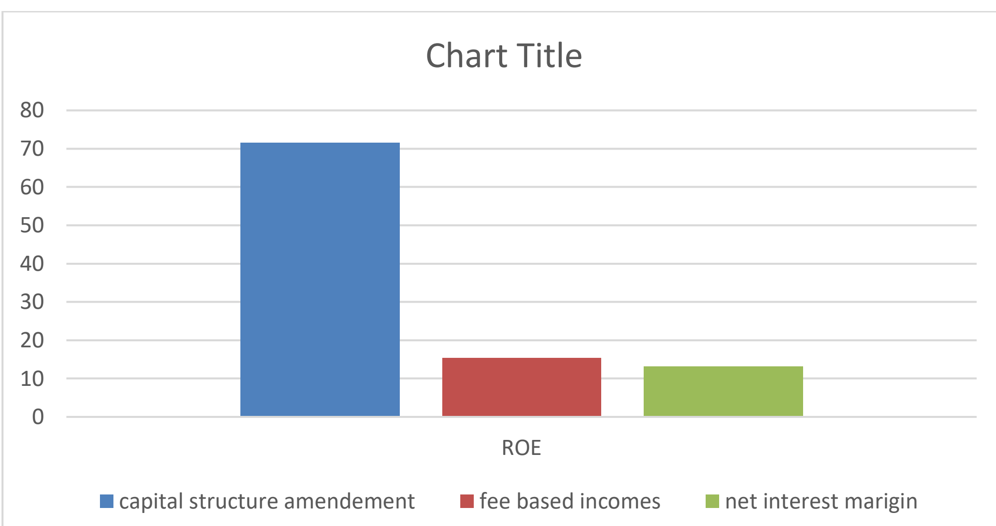
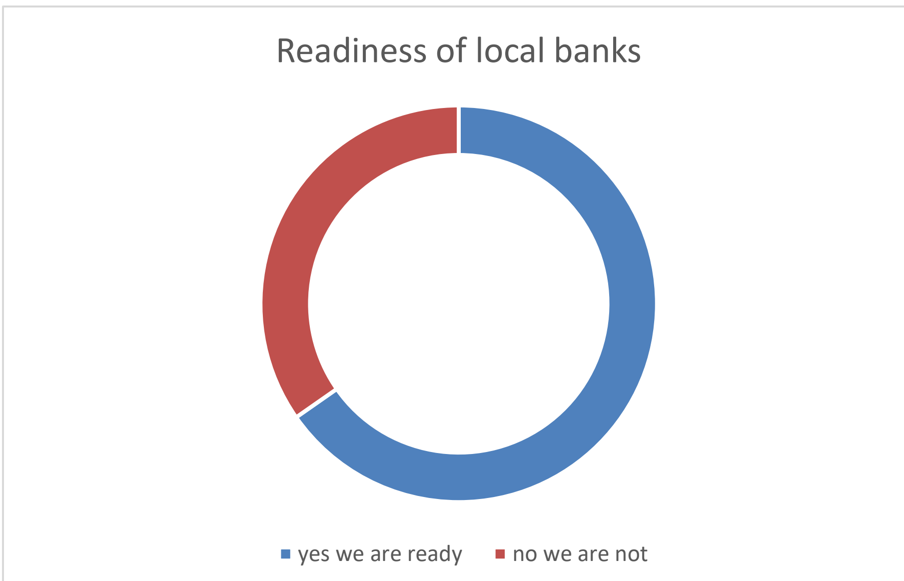


FIG 4.7 EFFECT ON ROE

4.6 readiness of the economy and domestic banks to compete with foreign banks.

According to 65.3% respondents' points of view, domestic banks were ready to compete with foreign how far they advanced in technology and modern management system. However,34.7% of the study participant opposes the above respondentresponse.



4.8 REDINESS OF LOCAL BANKS

4.6.1 arguments behind respondents

Although respondents who agree the market ready for foreign investment, they have different point of view and argument which is summarized below.

A. Improve Quality Service in the Financial Sector
most of the respondent, 26%, convinced that if foreign banks entered, they have a stronger tendency to improve the quality of the sector.

B. More Credit Supply can be Offered.

Regarding to the credit supply, most of the respondents, 35.9%, strongly agreed with the foreign banks are capable to supply more credits.

C. Higher Efficiency will be Obtained and customer satisfaction.

More respondents, 11.5% agreed with the statement which is said foreign banks entry will benefit the domestic banks to obtain higher efficiency,

D. Competition Will be Enhanced.

Different literatures state that higher competitions among domestic and foreign bank. Accordingly, respondent was asked whether competition will be enhanced if foreign banks were permitted, and the response comprises with 8.6% of the total response.

E. Modern Technology and digitally equipped Banking System

18.0% of the study participants agreed with if foreign banks were invited in the country, they may transfer modern technology and introduce new banking system.

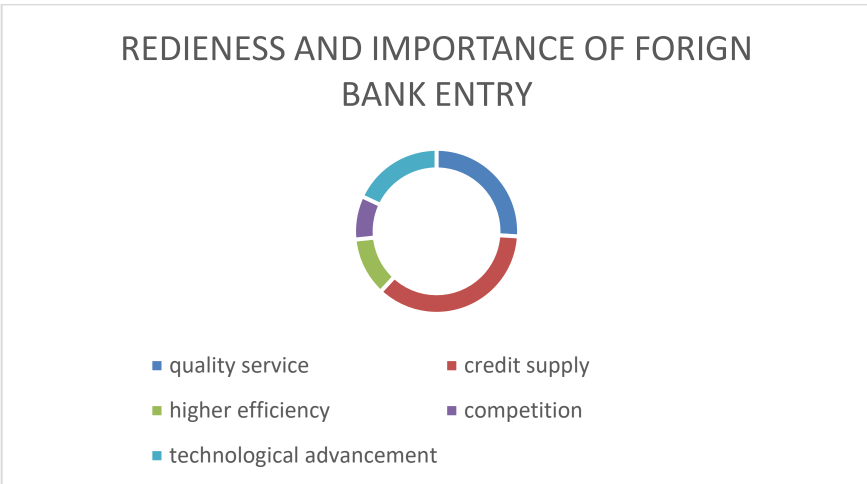


Fig 4.9 importance of foreign bank

On the other hand, the remaining 34.7% of respondents apposed for the following reasons.

A. Domestic Banking as an infant industry becomes less Competitive.

As the respondent response indicates, 32.2% of the study participants agreed to the opinion on the inquiries which state domestic banking as an infant industry becomes less computation.

B. Foreign Bank Retains Credit to Small firms.

According to 31.3% respondents' points of view foreign banks retains credit to small firms,

C. Lack of Domestic Strong Supervisory Body

Regarding to the lack of domestic stronger supervisory body 36.5%respondents agreed in it should be strengthened on legal and technological framework.

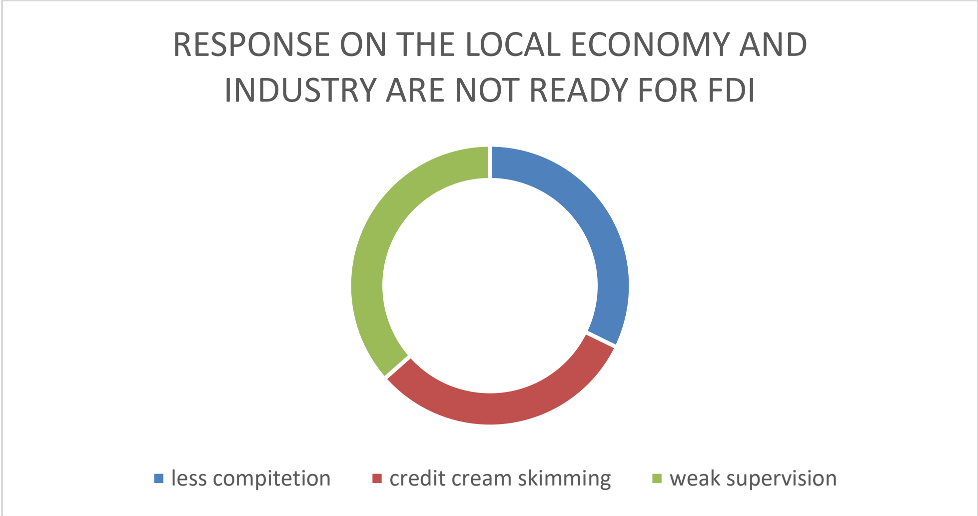


Fig 4.10 importance of foreign bank

4.7 suitable mode of entry

for the questions asked regarding the preferred mode of entry by foreign banks, 89% of local bank employees pointed out joint venture would create a win-win environment for both local and foreign markets. The rest say it will continue to operate on subsidiary level for it's the next close step for representative offices.

Meanwhile foreign bank representatives narrate it all depends on the policy of the host country. Given that the Ethiopian market Is not probably going to open full autonomy for foreign investors in this specific industry its most likely to be joined with joint ventures. By collaborating and making strategic partnership foreign banks leverage their entry to the host country.

4.8 Interview

this summery report summarizes key findings from discussions with NBE office correspondents regarding foreign banking investments. The interview is meant to compliment the questionnaire assessing similar themes. The main topics raised are discussed below with simple words.

1. how much of a total bank share is allowed to be purchased by foreign bank if the foreign bank choses to invest by joint ventures?

Foreign investors or any firm can buy a share from a local bank up to 49% of the total shares. This regulation aims to maintain the control of the domestic investors over the banking industry, and at the same time to balance the benefits of foreign investors. As the banking sector is back bone of the nation's economy it's a duty to keep it responsive to the need of the national economy. The reason behind the regulation which is restricted the foreign ownership on 49% is to keep the balance between maintaining domestic control on the finance sector and attracting foreign investment simultaneously.

Currently there are several foreign investors in Ethiopian banking sector like development bank of China which owns 5% share in cbe, Dutch development bank which owns 12.4% share in dashen bank, commercial bank of Dubai owning 20% stake in Oromia bank. Even though there is disclosable information about amendment to 49/50 policy approach which could be favorable to other foreign investors in the current state the running stakeholders have no remarkable Effect on the industry.

2. what are the legal formalities foreign banks must comply to participate in the market?

   There is actually a guideline and formality to comply if foreign bank are allowed to participate in the market and own a bank with higher than 49% stake.
   The first thing is licensing and a policy framework prepared for them to invest and operate needs to be issued and approved by responsible organ of the government. Then application process licensing will follow.
   Secondly there is at least ETB500 million paid up capital and equity contribution for branching services and ETB100 million for subsidiary investment in the current pre request of formality.
   Thirdly after the commence on delivering service the need to sell 25% of the shares to local investors. After all its important to underline all the taxation, prudential regulation, foreign currency regulations and scope of operation will be all regulated closely and same as the domestic banks.

3. What is the policy towards the permeability of foreign transaction is foreign banks are to be allowed to operate?

There is a purpose to transaction control of local and foreign banks and that is to protect the financial system from risk and maintain financial stability. For this purpose, commercial banks are obliged to send reports periodically other than that our office makes on time inspection and audits to verify they are complying with the rules and regulation. There is no disclosed information about the technological security and controlling level of our nation in contrast to the developed world since the foreign banks are bringing superior technology as a nation we need to comprehend to the current state of security. But we can improvise series of regulation to control foreign banks.

Foreign exchange is one mechanism, we can impose restriction on the amount of foreign currency they inject the market and suck from the market. Including the amount to hold and transfer abroad.

On the hand we can control the capital flowing through these banking channels in and out of the country. Including portfolio investment and repatriation of profit. Even though export and import payment process can be eased and brings our nation one step close to global economic arena, there is a downside to the foreign banks because their scope of operation can be limited due to the restriction on foreign exchange and capital flow.

Chapter five

Conclusion and Recommendation

5.1. Conclusion

This thesis has reviewed various theoretical and empirical literatures on Potential Effect of foreign banks in the case of developing transition countries. The main analysis of this paper is divided into two parts. The first part has provided the findings of the survey results which private and government banks participants had responded supplementing the literature whether the positive potential Effects of foreign banks entry outweigh the associated risks in Ethiopian banking sector. The second view is to examine whether financial development causes economic growth and analyze the effect of foreign banks entry in Ethiopian banking industry.

As this study intended particularly to explore the benefits and risks of foreign banks entry, it has provided its conclusion and recommendation assuming that foreign banks are willing to enter Ethiopian's banking business. Banks as financial intermediaries are considered as an important element for growth in developing countries.

The respondents comprise branch manager of the selected banks, higher official of Professional association and higher official of the National Bank of Ethiopia. They have a deep knowledge to point out how foreign bank entry will affect the domestic banking industry and can list the best remedial action to be made.

First, majorities of the respondents agreed that foreign bank entry will accelerate the country's economic growth and due to this, the most positively affected macroeconomic parameters are Gross domestic product and Investment. On another points respondents believe that foreign bank entry will improve financial regulation, introduce other financial activities like investment banking activities and attract a foreign direct investment.

Second, the survey respondents agree that foreign bank entry is necessary in the country's banking sector to adopt the modern banking system as well as modern technology. Majority of the respondents prefer that types of foreign bank permitted to enter should be the one which is more specialized banks that have more knowledge in stock market and investment banking and also the time of enters should be in the long- term period

Third, Majorities of the respondent accept working with foreign banks would help the domestic bank more dynamic and competent. Additionally at the result of foreign bank entry, respondents agree that the quality service in the financial sector will be improved; more credit supply will be offered than before. They accept that the banking sector service will more be efficient that will result in enhancing customer satisfaction. Again, they agree that competition among banking will be more, but they refuse that foreign bank entry will bring better economic stability.

Fourth, survey respondents agree that foreign bank entry will reduce cost and retain credit to small firms like microfinance. They also agree that in the current situation, domestic banking cannot compete with foreign due modern management and advanced technology. Respondents accept that domestic banks sector has lack of strong supervisory body to protect the sector from any financial crises relating to foreign bank entry.

Finally, Majorities of the respondents agree that domestic banking sectors ready and accept foreign banks smoothly compete with them. They also prefer that the form foreign entry should be in the form Joint Ventures. This form of foreign bank can control the expected cash outflow and minimize the financial risk. Additional, respondents accept that as the number bank increased population bank ratio will be reduced and also the demand for foreign exchange will solve. Respondents believe that foreign bank entry will facilitate consumer credit and mortgage and lending rate will be lower. Some respondents find out that a “close door” policy started in Ethiopia ever since 15th century, when Ethiopia prohibited no entry in Ethiopia for 150 years. It has many adverse effect on the progress of the country still now. They suggested that entry of foreign banks will bring the real competition, real growth and development, real life and real society.

From data analyses, researcher concluded that foreign bank permit to enter in the county will benefit the domestic bank by improving the quality service and Efficiency as well as enhance Customer satisfaction, then economic potential of the country would be improved, Additionally, different macroeconomic and social indicators show that the country would be benefited by lowering bank lending, minimizing the demand for foreign exchange, if the foreign bank were permitted.

5.2. Recommendation

As seen in detail, financial development through its capacity increases investment and enhance economic growth. In Ethiopia, the appropriate mode of foreign banks entry can be seen in two different perspectives. From the strength of controlling capacity aspect of the central bank, subsidiaries and joint venture might be preferred. But from the risk minimization point of view, branches are the preferred organizational forms. It is because in the case of losses depositors have the right to claim from the parent office of the branch and large parent offices are strong enough to absorb these possible losses.

However, this study taking the county's economic situation into account, recommends that allowing specialized foreign banks which have more knowledge in stock market , investment banking and which has a willing to finance the agricultural sectors, small , medium and large scale industries .

On the other hand, it is more than twenty year that free market economy was implemented, but the government didn't amend the investment limitation on foreign banks entry. The government should adopt from the neighboring country like Kenya and Egypt administer more than ten foreign bank for a long period and have rich experiences how to run their financial institution and supervise their operate . The researcher therefore, recommends the government need to concentrate on:- • Issue prudent (careful) financial system regulations and building of the central bank's professionals with adequate exposures to best practices of other countries central banks.

5.3. Further Research

In comparing with the potential benefits of foreign banks entry with its associated risks, the findings of this study have indicated that the potential benefit outweighs the associated risks. Accordingly, allowing specialized banks that have more knowledge in micro financing and lending to the agricultural sectors, medium and large sector industries in the form of joint venture is recommended to enter in to the country's banking business.

Furthermore, a suggestion to further research need to concentrate on the appropriate modes of entry, the specific types and size of foreign banks to be allowed in the Ethiopians banking sector.

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APPENDICES

ANNEX

St marys University

College of business and economics

Department business administration

This is organization study conducting for supporting the researcher senior essay paper. The research name is ROBEL ABEBE, I' am attending my higher education at St marys University, the department of business administration. This study is aims to get information about the Effects of foreign bank entry on financial institutions. The gathered information will be kept secret and be used mainly for the researcher academic purpose not evaluating your commitment and take same measure. You can answer your questionnaire by any local language and English. I hope you will give your kind cooperation by frankly responding to this questionnaire.

Instruction

- To maintain confidentiality, please do not write your name or sign anywhere in the questionnaire. Unless you want to be quoted on the paper.
- Give your response to all the statement found in the questionnaire.

Section one

For local bank staffs only

1. How do you describe the financial stability of your organization based on liquidity, earning capacity, management quality and capital adequacy?

2. How do you describe the financial stability of the overall banking industry in Ethiopia?

3. If you are working in the banking sector
   3.1 what is your liquidity position as a bank?

   3.2 Depending on your banks earning ability as a bank what kind of Effect do expect from foreign bank entry?
   - ☐ Getting Higher interest income from credit
   - ☐ By getting Higher commissions and miscellaneous noninterest incomes from services provided.
   - ☐ Lower non-interest expenses like salary, bonus, provident funds

3.3 Depending on your banks management quality as a bank what kind of Effect do expect from foreign bank entry?
- ☐ Increment noninterest incomes like service charges, fees, and commissions.
- ☐ Minimalization of noninterest expenses like salary, allowance and other expenses
- ☐ Interest increment on credit service takers

3.4 Depending on your bank's capital adequacy ratio as a bank what kind of Effect do expect from foreign bank entry? Please try to write any type of shocks the bank could incur when foreign banks inter the market.
- ☐ Our bank could increase its capital by retaining its profit from further investment.
- ☐ Our bank could sell more newly issued shares to increase its paid capital.

3.5 What type of change on asset quality of your bank is expected during entry of foreign banks?

3.6 Depending on your ROA and ROE indication what major strategy do you have to increase these ratios to a better quality to stay compete with foreign banks?
- ☐ Apply more service charge to increase non-interest incomes and increase the net income of the bank.
- ☐ Provide credit for developed industries to collect higher interest and hold valuable collateral.
- ☐ Provide recuring small digital loans to collect more from interest.
- ☐ Provide opportunities for share holders to buy more shares and increase their shares.
- ☐ Increase resource mobilaization with non-increasing manpower to decrease expenses.

4. Do you think your bank is ready to be competitive on product, credit, and customer service aspects against foreign bank?

Section two

For representative office staffs only

5. If you work in representative office, do you believe the Ethiopian market is feasible investment for your bank?
   - ☐ Yes, because only 50% of the society is banked.
   - ☐ Yes, because the current products in the market are so poor.
   - ☐ Yes, because the the current service quality standard in the market is too poor.
   - ☐ No, because most money is circulating outside the banking system.
   - ☐ No, because the controlling system of NBE is tighter to provide innovative banking systems.

   (please do explain your opinion elaborately if you have any)

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6. If you work in a representative office which mode of entry is suitable for your bank, if your bank is allowed to operate financially?
   - ☐ Subsidiary
   - ☐ branch banking
   - ☐ offshore banking
   - ☐ joint venture

	ROA (%)	ROE (%)	CAPITAL ADEQUECY (%)	ASSET QUALITY (%)	EARNNING QUALITY (%)	MGT QUALITY (%)
BANK OF ABYSSINIA	3.145	25.19	7.9	71.13	24.2	16
AWASH BANK	2	19.8	9.85	75	24	75.8
BUNNA BANK	2.6	21.2	16.88		19.4	42.37

Source 2023/24 budget year financial statements