PERFORMANCE EVALUATION OF BANKING SECTOR AND ITS IMPACT ON SUSTAINABLE DEVELOPMENT OF ETHIOPIA ECONOMY

Dr. P. Raja Babu[1], Dr. Mahesharan[2], Dr. Surya Prakash[3], Dil Gasa[4]
[1,2,3,4] Professor, Department of Accounting & Finance, Bule Hora University, Ethiopia

ABSTRACT

The banking sector in Ethiopia has been playing a predominant role in the development of an economy. After 1990, many banks enter this sector for their existence and bringing a new dynamism for providing enormous services to vulnerable groups for expanding financial inclusion. The role of commercial banks is very important for increasing customer deposits, providing loans enhancement of trading activities (Berhane Ghebray, 2014). This study has focused on the present performance of both public and private banks through scientific tools such as ROA, ROE, LDR, CDR, CAR, IETTL and NIM for measuring their performance and to give appropriate suggestions for providing quality of services for sustainable development of an economy.

Keywords
Financial ratio analysis, public sector, private sector, descriptive analysis

Article Received: 10 August 2020, Revised: 25 October 2020, Accepted: 18 November 2020

Introduction

The role of commercial banks is very important and it is the backbone for the development of a country. The vibrant performance of the banking sector in the future can discharge of nation and international financial crisis **(Tobias and Themba 2011)**. Bank performance has been considered by depositors, shareholders, creditors will focus on the performance of the bank **(European Central Bank, 2010)**. The European Central Bank report, 2010, defined sustainability of bank depends on performance and capacity of the bank, and its efficient financial system is reducing transaction cost **McKinnon (1973) and Levine (1997)**; (Gupta, 2015) (Sathye, 2005) (Shankar, 2007). The banking sector is the mediator and mobilizing the funds from savers to users and it is the foundation of the economic **(Schumpeter, 1934).** Performances of commercial banks are examined by the central bank for resolving their problems. Investors need to sell or buy their stocks in banks; the central bank to evaluate the performance of commercial banks and determine for achieving their outcomes.

Commercial Banks in Ethiopia: There are three players' banks, insurance and microfinance institutions are playing a major role in Ethiopia. The mixed banking system has been following in Ethiopia i.e., private and public sector banks. The total number of banks are in Ethiopia 18, 2 (Commercial Bank of Ethiopia and Development of Bank of Ethiopia) are public sector and 16 are private sector. In Ethiopia, there was no involvement of foreign banks. The financial markets have been playing by domestic and private and state-owned banks. The total share capital 39.9% is having private banks, 51.1% and 9% are having both CBE and DBE respectively. The number of branches in Ethiopia was 4757. Out of these public sector banks are 68.8% and 35.3% of branches are located in Addis Ababa. In Ethiopia, the branch bank ratio was 1: 20,286 people by the end of 2018 (NBE, 2018). By the end of 2019, the contribution of private banks in loan collection 58.8% rest of the percentage by the public banks whereas deposit collection for all the commercial banks has reached 816.2 billion. Out of total deposits, CBE contribution is 60.8%.

Review of Literature: Most of the studies were conducted in either private or public sectors in different countries. Earlier literature reviewed bank performance evaluation in US, European markets and developing countries **(Yeh, 1996; Webb, 2003, 2003; Lacewell, 2003; Halkos and Salamouris, 2004; Dev and Rao, 2006). Omran (2007)** enlightened performance evaluation of commercial banks in Egypt for the period of pre & post-privatization. Few of studies indicated that the ownership structure and its type, government regulations, mergers and market structure on efficiency have been influencing the performance of a bank (**Lin and Sum, 2012); Rahman and Rejab (2015);** (**Berger and Humphrey, 1997**); **Ben Naceur and Goaied (2008).** Other studies enlightened the dynamic effects of ownership, assets management, operational efficiency of commercial banks have been influencing the performance of the bank **(Tarawneh, 2006). Kapur and Gualu (2012); Hsiao et al. (2010).** The overall studies are saying private sector banks are better than the public sector **(Gupta and Sundram, 2015); Sathye, 2005; Shankar and Sanyal, 2007; Chaudhary and Sharma, 2011; Waleed et al, 2015**.

The Problem of the Study: Performance evaluations of the banks are very essential for decision-making for users of managers, regulatory agencies, creditors, potential investors, etc. Banks are working as an intermediary between savers and users and it has a functioning healthy role for the development of an economy. The financial performance of the bank is very important for the effective function of the financial environment **(Athanasoglou, 2008)**. But, the present status of the banking sector characterised by low competition, operational inefficiency and there was capital inadequacy **(Flamini, C., Valentina C., McDonald, G., Liliana, S. (2009); (Lelissa, 2007).** The number of banks Ethiopia has been increasing significantly in Ethiopia. Hence, this study aimed at evaluating the performance of public and private sector banks, to find out their competition and return on equity on the development of an economy.

Objective of the Study

- To evaluate the performance of public and private sector banks in Ethiopia
- To analyse the relationship between the public and private sector between 2011 and 2017
- To give appropriate suggestions for improving the financial performance of commercial banks in Ethiopia

Hypothesis

H01: There is no relationship between the state-owned sector and the private sector

H02: There is no impact between ROE and the growth rate of an economy.

The methodology of the Study: This study is completely based on audited financial reports. Descriptive statistical methods are used for summarizing and to give a static picture of both sectors. For analysing the data used some yardsticks in performance evaluation of both public and private sector banks were employed. These yardsticks: Return on Assets (ROA), Return on Equity (ROE), Loan to deposit ratio (LDR), Cash to deposit ratio (CDR), Capital Adequacy ratio (CAR), net interest margin ratio (NIM), Expenses to income ratio (EIR), Interest expense to total loan (IETTL) and Operating efficiency ratio (OER). The financial ratios are indicators to compare the financial position of the banks **(Moscalu and Vintila, 2012; Dang, 2011).**

Table: 1 shows the average financial ratios of the commercial banks in Ethiopia between 2011 and 2017 (Ratios in %)

Sl. No.	Ratios	Two Public Sector Banks (CBE & DBE)	Sixteen Private Sector Banks	Total Industry
1	ROA	2.79	2.66	2.725
2	CAR	5.54	16.29	10.915
3	ROE	62.69	18.37	40.53
4	LDR	45.89	59.80	52.845
5	CDR	20.07	38.04	29.055
6	IETTL	3.68	4.67	4.175
7	EIR	27.49	51.50	39.495

8	NIM	3.45	3.47	3.46

(Sources from annual reports)

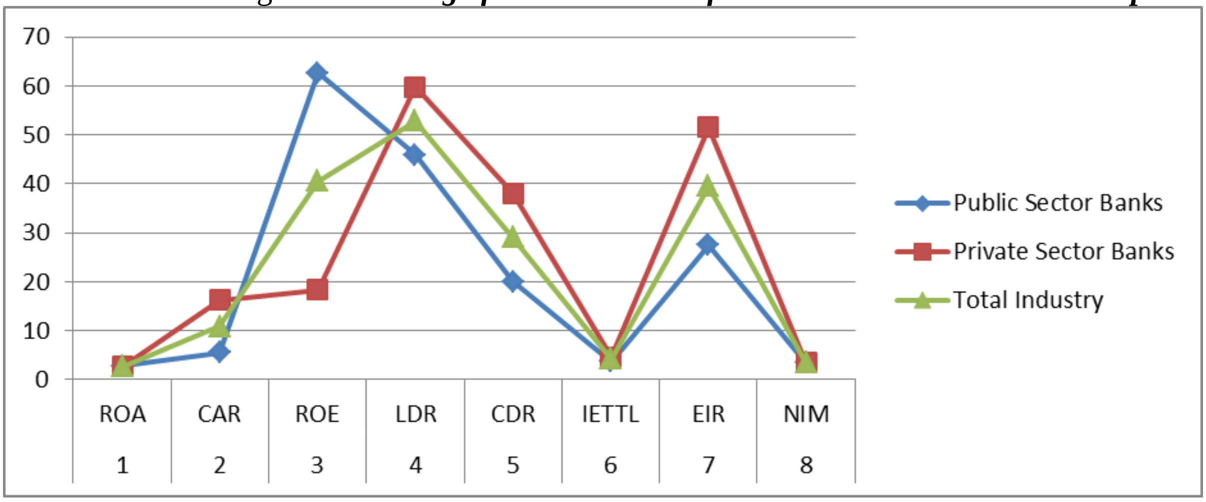
The above table represents the information about financial ratios of the commercial banks both public and private sector during the period of 2011-2017. It is indicated that the return on assets reflects optimum use of bank assets for generating profits. It is computed as the relationship between net profits after tax to total assets. The average ROA of public-owned banks is 2.79% whereas the private banks recorded 2.66% during 2011-17. The capital adequacy ratio is shown as 5.54% in state-owned banks but the high capital adequacy ratio is having private banks which were 16.29%.

The Returns on Equity refers to returns (after expenses and tax) to shareholders on their investment **(Van Home 2005).** The higher ROE means better managerial performance **(Ross, Westerfiled, and Jaffe 2005)**. It is the benefit of equity shareholders using debt with the benefit of financial leverage. It can be calculated as the relation between net profits after tax to shareholders' equity. The ROE of public banks is 62.69% but private banks are having low equity returns i.e., 18.37%.

The Cash to deposit ratio is the liquid assets of the banks. High CDR indicates that a bank is related more liquid than the lower CDR percentage of the bank. It is measured as mathematical relation between cash to deposits. The CDR is more in private banks than state-owned banks which are 38.04% and 20.07% respectively.

It is the ratio the income measures on operating expenses. A higher IER is preferred than a lower one. An expense to income ratio is very higher for private banks than state-owned banks which are 51.50% and 27.49% respectively. Net interest margin is the difference between income and interest expenses. The margin is higher it is the benefit of the organization. The study period for both the banks is the almost same.

Figure: 01 ***average financial ratios of the commercial banks in Ethiopia***



CDR of Commercial Banks in Ethiopia

Table: 04 indicates the CDR of state-owned and private sector banks During 2011-17 (Ratio in %)

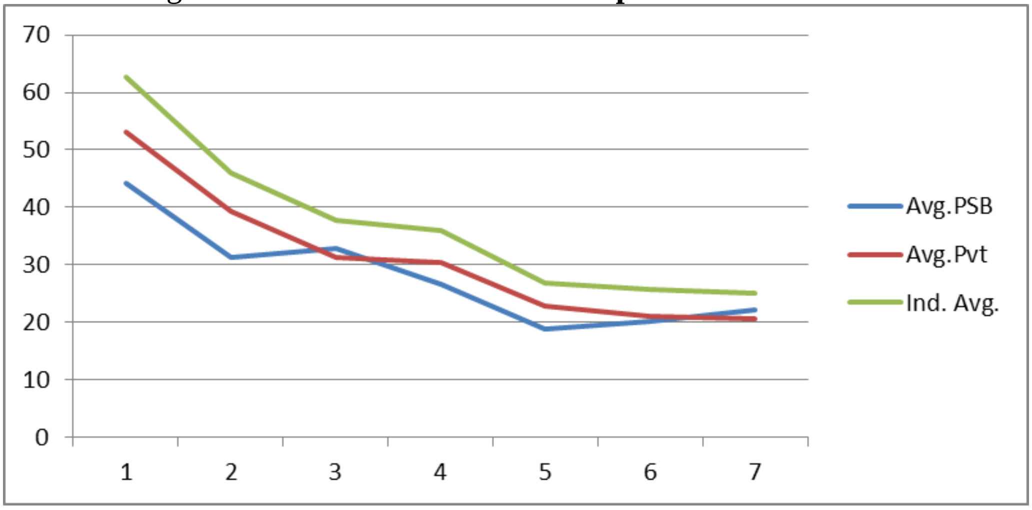
Year	Avg. CDR PSB	Avg. CDR Pvt SB	Ind. Avg.	Total Ind.
2011	44.135	53.17	62.59	938.9
2012	31.29	39.21	45.99	689.9
2013	32.76	31.18	37.63	564.4
2014	26.55	30.45	36.02	540.2
2015	18.85	22.81	26.84	402.7
2016	20.12	21	25.75	386.2

2017	22.045	20.62	24.93	374

(Sources from annual reports)

Corr	0.954372771		
Std Dev	8.918075478	11.7872	
Var	79.53207024	138.9381	
T. test			
t-Test: Paired Two Sample for Means			
	44.135	*53.165*	
Mean	25.26916667	27.54367	
Variance	34.42368417	54.19099	
Observations	6	6	
Pearson Correlation	0.8688029		
Hypothesized Mean Difference	0		

Figure:02 **CDR of state-owned and private sector banks**



The above analysis stated that there is a strong relationship between the sector i.e., 0.953. The standard deviation is very higher for the private sector than state-owned banks there was a lot of variation in CDR between the years. The average cash to deposits ratio is very high for private sector banks than public sector banks because the total numbers of banks are sixteen so that they are maintaining more than the required cash balances. The null hypothesis is rejected.

Table-05 shows Banking Sector Return on Equity and GDP growth rate during the period 2010-2018 (In Percentage)

Year	BANK ROE	GDP
2010	31.34	12.6
2011	33.9118	11.2
2012	35.5587	8.6
2013	52.5281	10.6
2014	45.7504	10.4
2015	42.426	9.4
2016	43.268	8
2017	37.8828	9.6
2018	25.2075	6.8
2019		8.4

2020		2.1

The above analysis presents to find the relationship between ROE and the Growth of an economy. The average ROE 38.65% during 2010-18 whereas the growth rate of Ethiopia is 9.6%. There is no relationship between the variable because the Pearson correlation is 0.19. It is very low. The variance between the years is having very higher ROE i.e., 68.166 whereas in growth rate the variance is very low 3.0711. The ‘p’ value of the t. test indicates more than 0.05 i.e., 2.5. It is indicated that there is no impact on the performance of banks towards sustainable development of the Ethiopian economy.

SUMMARY OUTPUT									
Regression Statistics									
Multiple R	0.1955								
R Square	0.0382								
Adjusted R Square	-0.0992								
Standard Error	8.6560								
Observations	9								
ANOVA									
	df	*SS*	*MS*	*F*	*Sig F*				
Regression	1	20.847	20.847	0.278	0.614				
Residual	7	524.487	74.927						
Total	8	545.334							
	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	29.728	17.164	1.732	0.127	10.859	70.315	10.859	70.315
X Variable 1	0.921	1.746	0.527	0.614	-3.208	5.051	-3.208	5.051

Table-5 highlights the impact of commercial banks on the Ethiopian economy. It is indicated that the ‘R^2 value 0.0382 and the ‘p’ is more than 0.05. It means that there is no impact on the sustainable development of an economy. Hence, there is no impact of ROE on the sustainable development of an economy.

Conclusion:

The study aims performance evaluation, to find out the relationship and the impact of the banking sector on the development of an economy. The performances of both the banks are evaluated during 2011-17 using eight indicators for evaluating both sector performances. The ROE is very higher for state-owned banks than private sector banks whereas CAR and EIR have been maintaining higher by private sector banks to public sector banks. The relationship between public and private sector banks is correlating each one competitively, but the private sector banks are having a higher risk than public sector banks due to the CDR variation is very higher between the years. There is a significant relationship between the sectors so the null hypothesis is rejected means there is competitiveness between the sectors. Finally, this study aims to find out the impact of ROE of the banking sector on the growth of the Ethiopian economy. The result of regression analysis indicates that there is no impact of ROE on the growth of the economy during 2010-18. The analysis showed that the r^2 value 0.0382 (38.2%) and the 'p' value is 0.614. Hence, the null hypothesis is accepted.

Recommendations:

This study mainly focused on the performance evaluation of public and private sector banks during 2011-17. Management of both sectors should concentrate on improving their return on assets. Particularly, the private sector banks should improve returns on equity for the benefit of their shareholders.

The management of public banks should focus on capital adequacy, interest expense to total loan ratio, net interest margin and loan deposit ratio compare to private banks. At the same time, the private banks should be maintained optimum funds to meet their requirements. Otherwise, it is the burden of the bank to meet unnecessary expenses.

References

[1] Am., F. (2010). Beyond, RoE: How to Measure Bank Performance Frankfurt am Main. Germany: European Central Bank.

[2] Athanasoglou, P. B. (2008). Bank-specific, Industry-specific and Macroeconomic Determinants of Bank, Profitability. Journal of International Financial, Markets, Institutions and Money, 121-136.

[3] Barth JR, C. G. (2004). Bank Regulation and Supervision: What Works Best? Journal of Financial Intermediation, 205-248.

[4] Dev, A. a. (2006). Performance Measurement in Financial Institutions in an ERM Framework: A Practitioner Guide. Risk Books.

[5] Ethiopia, N. B. (2018). Annual Report. Adis Ababa.

[6] Flamini, V. V. (2009). The Determinants of Commercial Bank Profitability in Sub-Saharan Africa. IMF Working Paper.

[7] Ghebray, B. (2014). Performance Evaluation of Commercial Banks. Addis Ababa, Ethiopia: Annual Report of Zemen Bank.

[8] Gupta, A. A. (2015). Comparative Study of Public and Private Sector Banks in India: An Empirical Analysis. International Journal of Applied Research, 895-901.

[9] Halkos, G. a. (2004). Efficiency measurement of the Greek Commercial Banks with the use of financial ratios: a data envelope analysis approach. Management Accounting Research, 201-224.

[10] Hsiao, H. C.-H. (2010). First Financial Restructuring and Operating Efficiency: Evidence from Taiwanese Commercial Banks. Journal of Finance and Accountancy, 12-30.

[11] Lacewell, S. K. (2003). Do Efficient Institutions Score WEll Using Ratio Analysis? An Examination of Commercial Banks in the 1990s. Journal of Commercial Banking and Finance, 17-33.

[12] Lin, J. -C. (2012). Bank Ownership and Performance in Taiwan: Do Politics Matter? Journal of Finance and Accountancy, 12-30.

[13] Mckinnon, R. (1973). Money and Capital in Economic Growth: Views and Agenda. Journal of Economic Literature, 688-726.

[14] Moscalu, M. A. (2012). Business Failure, Risk Analysis Using Financial Ratios. Procedia. Social and Behavioral Science, 728-732.

[15] Omran, M. (2007). Privatization, State Ownership and Bank Performance in Egypt. World Development, 714-733.

[16] Rahman, N. a. (2015). Ownership Structure and Bank Performance. Journal of Economics, Business and Management, 483-488.

[17] Ross, S. W. (2005). Corporate Finance. New Delhi: McGraw-Hill Inc.,.

[18] Ross, S. W. (2005). Fundamentals of Financial Management. Pearson.

[19] Sathye, M. (2005). Privatization, Performance, and Efficiency: A Study of Indian Banks. Vikalpa, 7-16.

[20] Schumpeter, J. (1934). The Theory of Economic Development. Cambridge: Harvard University Press.

[21] Shankar, R. a. (2007). What Drives Bank Performance? An Analysis for the Post Reform Period in India. The World Bank Working Paper.

[22] Shipho, T. O. (2011). Effects of Banking Sectoral Factors on the Profitability of Commercial Banks in Kenya. Economics and Finance Review, 1-30.

[23] T.B., L. (2007). The Impact of Financial, Liberalization on the Ownership, Market Structure, and Performance of the Ethiopian Banking, Industry. Ph.D Thesis, 12-30.

[24] Tarawneh, M. (2006). A Comparison of Financial Performance in the Banking Sector: Some Evidence from Omani Commercial Banks. International Research Journal of Finance and Economics, 103-112.

[25] Van Horne, J. a. (2005). Business Failure, Risk Analysis Using Financial Ratios. Pearson.

[26] Webb, R. (2003). Levels of efficiency in UK retail banks: aDEA Window Analysis. International Journal of the Economics of Business, 305-322.

[27] Yeh, Q. (1996). The Application of Data Envelopment Analysis in Conjunction with Financial Ratios for Bank Performance Evaluation. Journal of the Operational Research Society, 980-988.