

Access of Financial Service: Supply Side Barriers in the Banking Industry of Ethiopia

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Abstract
This paper reviews the financial access to the broad population in Ethiopia and analyses the main barriers of providing financial service particularly the banking products to the broad adult population in Ethiopia. The study focused on the supply side barriers which are transaction costs, lack of adopting information technology and the regulatory framework in which the financial systems operate. Indeed, Improving access of financial service such as saving, credit facilities, insurance, remittance etc to the broad adult population through formal financial institutions is playing most essential role in reducing poverty in developing country to help them invest in productive assets and it's the source of income for the dependent household at the time the income earner became sick or unable to work. Ethiopia is one of the developing sub-Saharan African countries around 90 percent of the population excluded from formal financial institutions.
Keywords: Financial access, Supply side barriers, Information technology, Regulatory framework, banking industry.

1. Introduction

Improving access of financial service such as saving, credit facilities, insurance, remittance etc to the broad adult population through formal financial institutions plays the most essential role in reducing poverty on developing country. Indeed, adequate financial access particularly for the rural and poor people helps them to invest in productive assets and the source of income for the dependent household at the time the income earner became sick or unable to work. Despite the fact that, micro-finance institutions plays indispensable roles to address the rural and poor people financial needs in developing countries, still majority of the rural populations in developing countries are excluded from formal financial service.

According to Center for Financial Inclusion survey report 2013, currently 2.7 billion working age adult population excluded from formal financial service globally. Certainly in Sub-Saharan African countries, only 24 percent of adult have bank account. The reason behind this can be formal financial institutions in Africa have not typically seen much profit in delivering financial service to the majority of the poor and rural adult population due to high transaction cost of delivering the service because these people living in remote areas beyond the reach of bank branches. To solve this problem, some African countries use Mobile banking service in addition to banking branches to reach majority of the rural adult population. However, many commercial banks and micro-finance institutions in Africa are not yet adopt Mobile banking and other advanced information technology.

Among the challenges faced by the financial sector in developing countries that hinder the delivery of financial products using advanced information technologies are: underdeveloped telecommunications infrastructure and lacks of adequate capital and innovations by the financial institutions.

To bring full financial access, Center for financial inclusion is launched in 2008. To achieve this objective, many stakeholders involved. Among them, financial institutions are the main players. Hence, financial institutions should build their capacity in order to provide financial service to the broad adult population with affordable cost.

Ethiopia is one of the developing African country 83 percent of the population live in the rural area and their income is mainly depend on agricultural sector. Even if, financial sector in Ethiopia showed remarkable growth after the liberalization of financial sector to private ownership since 1994, financial access still less than 10 percent (Center for financial inclusion report 2013).

Financial system in Ethiopia is not addressing the demand of the majority of the population, particularly the rural poor people. According to center for financial inclusion, the reason behind this broadly divided in to two: supply side barriers and demand side barriers. The supply side barriers defined as the transaction cost, lack of adopting information technologies and the regulatory framework in which the financial system operate. Whereas the demand sides are restrain the capacity of individuals to access available service.

Inability of the financial institution (banking industry) adopting advanced information technology to deliver the financial service with least cost and the most efficient ways and the regulatory framework are the main challenges. Thus, the study focused on the supply side barriers of the banking industry of Ethiopia.

2. Related literature review

2.1. Key Indicators of Financial Access

Key financial access indictors are developed by IMF and World Bank to appraise the performance of countries in respective of financial inclusion. Accordingly, three key dimensions of financial inclusions are measured:

- Access to financial services;
- Usage of financial services; and
- Quality and delivery of financial service.

According to the study of Department for International Development (DFID), There are two major approaches to deliver the financial service:

Additive Approach, which primarily targeting existing, banked customers, and offer the service through Internet, ATM and mobile channels as an additional channel, along with the bank branches. This approach is greater convenient for the existing clients (particularly urban populations who have relatively financial service access but limited access via advanced information technologies).

Transformational Approach, which intentionally reach out to markets beyond the existing banked groups, through a service offering which meets the known needs of the unbanked groups. In this approach the target customer are majority of rural adult population who haven't financial access due to the high transaction cost of delivering the service through banking branches.

2.2. Kenya Banking Industry practice

Banking industry in Kenya is relatively developed. Hence, the practice would be importance lesson for Ethiopians banking industry as well as others developing countries. The financial sector in Kenya is fully liberalized. The central bank of Kenya regulates the banking industry by the banking Act. The Banking Act of Kenya defines banking, collecting deposit from the public and repay on demand or at the expiry of a fixed period or after notice, accepting from members of the public of money on current account and payment and acceptance of checks and the employing of money held on deposit or on current account or any part of it by lending, investment or in any other manner for the account and the risk of the person so employing the money.

Currently, Kenya has 43 licensed commercial banks. Among these, 31 are locally owned and 12 are foreign owned. Citibank, Habib bank, standard chartered and Barclays Bank are the major foreign-owned financial institutions. Kenyan government has a significant stake in three commercial banks[1]. The remaining local commercial banks are largely family owned. All financial institutions including commercial banks are highly regulated by Central Bank of Kenya. The financial sector particularly the banking industry is highly innovative due to high competition in the sector. In fact competition is one of the driving forces for innovation of financial products that fit for each customer and find the right and efficient delivery channels to deliver these products as well as to maximize profit.

2.3. Trends of Mobile and Internet Banking in Kenya

With the emerging wave of information driven economy, the banking industry in the world has inevitably found itself unable to resist technological indulgence. Due to the emerging of information technology business, Kenyan banking industry has led to a boom in development of mobile banking laying down a strong base for low cost banking, and growth of mobile phone use in rural Kenya.

In 2009, Standard Chartered launched its mobile banking in seven African markets, among these, Kenyan market it offers a number of services on a unique, user-friendly platform called Unstructured Supplementary Services Data (USSD) and is only available on GSM carrier networks which enable customers to access banking in real time, anywhere in the world, through their mobile phones. The platform is a convenient menu-driven application that is not dependent on specific customer handsets and does not need to be downloaded. Another foreign bank, Barclays bank's m-banking platform is known as 'hello money' it allows customers to carry their bank in their mobile and access banking services anytime/anywhere on the move. Unlike other players in the sector this is all for free.

Co-operative bank pioneered mobile banking way back in 2004 by enabling customers to access their accounts and transact using their mobile phones. It offers services such as balance enquiries, mini-statements, SMS alerts on credit and debit transactions to an account, pay utility bills and funds transfer.

A couple of study shows that the general macroeconomic impacts of the mobile phone penetration in the developing countries are having a critical mass effect than developed countries. One well-known study found that while mobile phones in less developed countries are playing the same crucial role that fixed telephony played in richer countries in the 1970s and 1980s, and that a rise of ten mobile phones per 100 people boosts GDP growth by 0.6% (Waverman, Meschi & Fuss 2005). Another reported that the impact of mobile phone penetration is positively linked to Foreign Direct Investment (FDI). This impact has grown more significant in

[1] Kenya Commercial bank, Development bank of Kenya and Cooperative bank of Kenya

recent years, with a 1% increase in mobile penetration rates associated with 0.5-0.6% higher rates of FDI and GDP (Williams 2005).

3. Financial System in Ethiopia

Currently in Ethiopia, there are 19 commercial banks, 3 of them are state owned[1]. State owned banks are having the lion share interims of capital and asset structure. Foreign financial institutions are not allowed to enter in to the financial system of the country; the financial sector is not explicitly show the positive or negative consequence of financial globalization. The reason behind this isolation could be fear the risk of financial globalization (liberalization) that will lead unable to easily control the economy and the domestic financial sector is not competitive with the foreign financial institutions. Of course, this isolation adversely affects the development of the financial system in the country.

Since the liberalization of financial sector in 1994, a number of domestic commercial banks, others financial institutions like Micro-finance institutions, insurance companies, government owed Pension Fund and saving and credit cooperatives established in Ethiopia. Although, saving and credit cooperatives are relatively larger in number than formal financial institutions, their capacity and accessibility to provide financial products is still very low.

The government owned Pension Fund provides long term compulsory contractual saving product providing financial service for only for public sector employees. While, in 2011 Ethiopian government established the private employees pension fund agency to serve private sector employees. Other than these, there are no other financial institutions that specialize in provision of contractual savings products to the general public.

Commercial Banks in Ethiopia commonly provide traditional financial products (saving and credit). Saving products includes demand saving and time deposit. While, a credit product includes: short, medium and long-term loans. All of these products are not trade in the secondary market[2] because; there is no secondary market that enable securitization of loans[3].

The financial system in Ethiopia is underdeveloped. This adversely affects the adequacy and the level of financial access population the broad adult population. the recent study of world bank concerning the accessibility of financial system depict that, only around 10 percent of the populations in Ethiopia have account in formal financial institutions (world bank,2013).

The distribution of accounts in financial institutions, commercial Banks contribute large proportion (60%) of total accounts followed by Micro-finance institutions (32%) the reset, 2% is others financial institutions (government owned pension fund, credit and saving cooperatives etc). The accessibility of these financial services for rural and poor people is limited due to the fact that:

- **Low Geographic and Demographic Penetration**: Those rural people want to use financial service must travel very long distance by foot. Since, most commercial banks branches are usually found on the main cities of the region. In addition, all commercial banks headquarter are found in Addis Ababa their branches are highly concentrated in this city too (33%).

  Indeed branch expansion is the main activity uses by commercial banks to address the need for the majority of the population and to mobilize saving from the general public. Accordingly, during the quarter ended December 2013, 172 additional commercial banks branches were opened. Thus, total number of branches grew to 2,015 at the end of December 2013. Among these, state owned commercial banks had 957 (47.49%), while private banks owned 1058 (52.51%). The total number of population to bank branches (penetration) reached to 42,680 against 52,805 of last year same period. Region[4]wise, in the capital city (Addis Ababa) accounted for 33.00% of total branches, followed by Oromia region (27.74%) and the remaining regions together (39.24%) (NBE, 2013).

According to the financial access survey conducted by the IMF from the year 2004 up to 2013, the financial access is measured by variables, geographical outreach, uses of financial service and volumes of account. Accordingly, regarding geographical outreach, micro-finance institutions in Ethiopia are many in number than the commercial banks, reached to 32 and 19 as of 2013 respectively. However, the total number of commercial banks branch is far greater than micro-finance institutions, 2015 and 1224 respectively as of 2013. Commercial bank branches per 1000 Km.sq reached to 2.05 in 2013, grown on average by 78 percent. While the bank branch per 100 000 adult populations is reached to 3.80 in 2013 grown on average by 71 percent (FAS,

[1] Commercial Bank of Ethiopia(CBE),Development Bank of Ethiopia (DBE) and Construction and Business Bank(CBB)
[2] A market where investors purchase securities or assets from other investors, rather than from issuing companies themselves.
[3] The process through which an issuer creates a financial instrument by combining other financial assets and then marketing different tiers of the repackaged instruments to investors.
[4] There are 9 regional states and 2 city administration in Ethiopia. The total number of population live on these regions are 90 million, the highest population lives in two regions; Oromia(34%) Amhara (24%).

2013).

Another measurement variable used by the financial access survey is, use of financial service. Thus, number of depositors in commercial banks and microfinance institutions were take in to consideration. The total numbers of depositors in commercial banks and micro finance institutions are 9,287,300 and 3, 033,560 respectively. Where as, the number of borrowers in commercial banks are less than microfinance institutions, 112,650 and 3,485,520 respectively. Therefore in Ethiopia, commonly, microfinance institutions give credit facility for the majority of the public than the commercial banks. Besides, most of the adult population in Ethiopia use banking service for the purpose of deposit rather than borrowing (depositors of commercial bank per 1000 adults reached to 160.25, whereas borrows from commercial banks reached to 2.8 in the same year with the same measurement).

Volume of accounts, which is outstanding deposit and loan in commercial banks reached to 28.80 percent and 15.25 percent of GDP respectively in 2013 (FAS,3013).

Recently, the state owned bank particularly, Commercial Bank of Ethiopia (CBE) aggressively expand its branch in most parts the country as a result of financial inclusion policy stated on the growth and transformation plan by the central government. The bank lunched full fledge internet and Mobile banking through 74 branches of CBE that have been connected with the Integrated banking solutions called Core Banking. This new system works on any tool that can support an Internet browser and has been emulating experiences from European and Asian banks that have an anti-hacking and anti E-theft system, a rigorous authentication method for customers as well as building a formidable Information Technology Architecture. According to the bank, this service will serve around 100,000 clients in urban areas of Ethiopia (Capital, 2013). However, the connivance of the service is still not fulfilling the needs of majority of rural population. Branch based banking service is not cost effective to deliver banking service to rural population due to high transaction cost. Therefore private commercial banks focused opening branches only in urban and relatively rich population areas. Advanced information technology enable to deliver the banking service for rural population with least cost where telecom infrastructure is adequate on rural areas. However, commercial banks in Ethiopia that use these technologies is very few in number, Only four banks uses Internet and Mobile banking[1]on a pilot based and seven commercial banks[2] uses Automated Teller Machine (ATM). Now a total of 400 ATM service has been installed throughout the country. Majority (200) of this service is found in the capital city (NBE 2012).

- **Affordability:** the minimum amount needed to open account in the commercial banks is 50 Ethiopian Birr[3]. This amount is mostly might not be affordable for a small farm landholder living on the rural area of the country. Indeed most small farmers living in rural region are excluded in the eyes of mainstream banks even for deposit products. Moreover, commercial banks are unable to extending credit facility to such farmers due to high requirement of collateral. The most common financial service affordable for the rural and poor people is remittance and payment service. In fact, commercial banks provide credit facility only to urban rich who have capacity to offer collateral with estimated value at a minimum adequate to cover the risk of default.

3.1. Information Communication Technology infrastructure in Ethiopia

Ethiopia has Africa's largest big telecoms monopoly. Since 2002, Ethiopian Telecommunication Corporation widens the service from the existing fixed telephone line in to mobile phone service and internet service for majority of the urban region of the country by investing huge telecom infrastructure. However, the telecom access is limited to the urban population and some of the semi rural region of the country. In addition, the poor service quality not yet resolved. Due to absences of competition in telecom sector, the service is not expand in to majority of the region and also the service charge is relatively high compared to eastern African countries. Consequently, the service penetration is relatively very low compared to others African countries. For instance, Mobile-phone penetration in the country which averages 70% of the population anywhere in Africa is closer to 25% in Ethiopia. A paltry 2.5% of Ethiopians have access to the internet, compared with 40% in neighboring Kenya (Economist, 2013).

3.2. Regulatory Framework in the Financial Sector

Financial sector in Ethiopia is highly regulated by the National Bank of Ethiopia (NBE) under the proclamation No.84/1994 for the last 20 years. Since the liberalization of financial sector, National Bank of Ethiopia (NBE) has made numerous reforms in the banking industry. The main objective of this reform is to ensure the safety

[1] Commercial Bank of Ethiopia (CBE),Dashin Bank (DB),United Bank (UB) and Wagagen Bank(WB)
[2] Commercial bank of Ethiopia (CBE), Dashin bank (DB),United bank (UB),Awash bank (AB),Wagagen bank (WB), Abysinya bank (BOA) and Nib bank (NB)
[3] 1USD equal to 20.50 Ethiopian Birr

and soundness of financial sector and stimulating economic growth of the country. Though, this reform sometimes adversely affects the expansion and the competition of banking industry. Thus, this proclamation limits the participation of foreign investors, according to the licensing directive of NBE, only Ethiopian nationalities participate in the financial sector. Hence, the market is dominated by state owned banks and limited domestic investors. The asset share of sate owned banks reached 88 percent which are the highest in East Africa which adversely affect competition in the sector (NBE 2012).

3.3. Enabling Environment to Use Mobile Banking
Although, the application of advanced information technology like Mobile, ATM and internet banking is limited and infant stage in Ethiopian banking industry, recently it shows remarkable progress. For instance; mobile phone penetration in 2012 was reached to 24 percent which was 17 percent before one year ago (Freedom House, 2012). Meanwhile the use of internet service in mobile phone device is increasingly particularly in semi-urban areas. This infrastructure enables possible to expand mobile and internet banking service to the existing mobile and internet service access areas.

3.4. Regulatory Framework for adopting Mobile Banking
Regulatory authority, National Bank of Ethiopia (NBE) issued directive No. FIS.01/2012. This directive creates a conducive business environment in the banking industry by setting minimum standard for risk management and customer protection on the delivery of mobile banking service. This directive has positive influence in the banking business to promote mobile banking business in the country.

3.5. Mobile and Internet Banking (E-Banking) Challenge
Currently, the challenges faced to fully adaptation of electronic banking system in Ethiopia are:

- Low level of internet penetration and poorly developed telecommunication infrastructure. Hence telecom infrastructure in most of the rural areas of the country has underdeveloped. Indeed, small businesses are highly concentrated on this region.
- Low literacy rate is another serious obstacle. E-banking system requires easily reading and writing text messages and understanding of basic ICT languages.
- The cost of Internet access relative to per capita income in Ethiopia is relatively high compared to other east African countries. Low cost of internet and mobile air time are the critical factor for smoothly doing internet and mobile business.
- Continuous power interruption: Lack of reliable power supply is a key challenge for smoothly running e-banking in Ethiopia.
- Resistance to changes in technology among customers and staff due to:
  - ✓ Lack of awareness on the use and benefits of advanced information technologies
  - ✓ risk averse mentality by the customers and stuff
  - ✓ Lack of trained personnel in the banking industry

4. Conclusions
On this study, I explained and analysis the main challenge in the banking industry in respect of its access to the broad adult population in Ethiopia and reviewed the experience of expanding financial access in other African countries particularly Kenyans banking industry. The current status of financial access is evaluated in terms of the adaptation of information technology particularly Mobile and ATM banking other than the expansion of branch. Thus the main shortcomings in the banking industry, the regulatory framework in the financial sector and the telecom infrastructure were identified. Likewise,

- ➢ Commercial banks should invest for adopting f information technology that automating the banking system and access majority of unbanked population with lest cost.
- ➢ Policymaker in the financial sector which is National Bank of Ethiopia should understand creating conducive business environments for financial innovation to take place, and efforts to ensure consumer protection and financial capability. Adopting comprehensive policies at the country level that respond the supply-side barriers and most effective in fostering financial inclusion.
- ➢ Public awareness should be created by the stakeholders in the banking industry on the use of Information Communication Technology (ICT), on the application of mobile and internet banking
- ➢ Ongoing efforts on the expansion of mobile phone infrastructure and expansion of ICT by Ethiopian Telecom should be encouraged and continues.
- ➢ In the long run, Ethiopian government should consider the liberalization of the telecom industry to enhance efficiency and competition within the sector.
- ➢ Ethiopian government should consider the liberalization of the financial sector for foreign bank entry to enhance the introduction of modern technology as well as the transfer of skill and knowledge in the

banking industry.
- The current telecom infrastructure quality should be drastically improved.

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