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Financial Performance Analysis of Privately Owned Commercial Banks in Ethiopia

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Abstract
Ethiopian banking history, in its modern sense began towards the end of the reign of Emperor Menilek II. Currently, there are eighteen banks in Ethiopia; two of them owned by government the remaining are private. Financial performance analysis intends to enable to make decision and to regulate profit distribution. Various studies conducted on bank performance have focused on individual bank; the measurements they were used, time period coverage and some other include the macroeconomic variables. However, this study only covers banks which privately owned and which had operated for eleven years from 2005-2015. The objectives of the study were to investigate the performance of privately owned commercial banks in Ethiopia for the period 2005-2015. This paper uses a descriptive method for analysis of financial information by using ratio analysis and Pearson correlation was used to show the relationship between the performance measurement. The researcher used four types of performance measurement; profitability performance, liquidity performance, debt management and credit performance. Based on the findings the overall profitability performance of privately owned banks was in good condition. Banks liquidity to meet its financial obligation in a timely manner was in a good condition for the measurement of LADST and NLTA but net loan locked in to non-liquid asset of the banks was high. Therefore, the bank should improve this to meet their financial obligation. All privately owned commercial banks in Ethiopia use huge amounts of debt to finance their asset. This has positive implications of the banks because the main source of finance and liabilities of the banks are deposit from customers. The Pearson correlation result indicates banks LADST negatively correlated with ROA and ROE. Generally, the financial performance of privately owned commercial banks seems better from period to period. There was variation in their performance.
Keywords: Financial Performance; private banks in Ethiopia

1. Introduction

Commercial banks play a vital role in the economic resource allocation of countries. For sustainable intermediation function, banks need to be profitable. Good financial performance rewards the shareholders for their investment. On the other hand, poor banking performance can lead to banking failure and crisis which have negative repercussions on the economic growth (Vincent et al ,2013). Financial analysis is the most widely method for determining an organization's strength and weakness. (James Van Horne 1971). Ratio analysis is not merely the calculation of a given ratio. More important is the interpretation of the value. A meaningful basis for comparison is needed to answer such questions as, "is it too high or too low?" and "is it good or bad? " In this regard comparative ratio analysis helps to identify and quantify company's strength and weaknesses, evaluate its financial position, and understand the risk that may take. The other way of comparison the ratio can be made through, Cross-sectional analysis, Industrial analysis, Time series or Trend analysis. (Brigham ,Ehrhardt 13 Ed). Generally, the aim of the study was to investigate the performance of privately owned commercial banks in Ethiopia for the period 2005- 2015.

Ethiopian banking history, in its modern sense began towards the end of the reign of Emperor Menilek II. This period witnessed the establishment when the agreement reached in 1905 between Minilik II and Mr. Ma Gillivray representative of the British owned National Bank of Egypt marked the introduction of modern banking in Ethiopia (Dr.Richard Pankhurst, 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. Following the declaration of socialism in 1974 the government extended its control over the whole economy and nationalized all large corporations. Following the Dergue regime, 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. Consequently shortly after the proclamation the first private bank, Awash International Bank was established in 1994. Currently, there are eighteen banks two of them owned by government that is Commercial bank of Ethiopia and Development bank of Ethiopia the rest of them owned by private (National Bank of Ethiopia).

Financial performance analysis intends to enable to make decision and to regulate profit distribution. These include business enterprise, its owners, its creditors and all others parties who have an economic stake in its financial strength and profitability of the business enterprise (Keown, Martin et. Al 10th Ed). There are different ways of using ratio analysis information both within and outside and among different type of users. This diversity reflects the fact that financial analysis information plays an important role in much type of decisions. (Brigham, Houston 13th Ed). Most studies on bank performance has focused on single bank performance, the methodology they were used, time period coverage were limited to five to six years and some other include the macroeconomic variables (Mulugeta and Asmare,2015 Vincent,2013 and Mabwe and Robert,2010). However, this study only covers banks which privately owned and which had financial statement of eleven years that is from 2005-2015. From all private banks which fulfill this information were limited to seven. Although, this study were used to evaluate the financial performance of banks by using different ratio which includes Credit Performance, Liquidity performance and Profitability Performance

2. Objectives of the study

The main objectives of the study were to investigate the performance of privately owned commercial banks in Ethiopia for the period 2005- 2015. The Specific objectives of the study were to;

- Evaluate profitability performance of private banks
- Measure the liquidity performance of those banks.
- Assess the credit quality of the banks

3. Methodology and Data

In an attempt to meet the research purposes, a quantitative research was used for this study. The reasons for selecting this method is the study used secondary financial data and statistical tools like descriptive (ratio analysis) and correlation coefficient also used for analyzing the data. The study was used annual financial reports of seven privately owned banks in Ethiopia during the period of 2005-2015. In Ethiopia now there are 18 banks (before Construction and Business bank merged with Commercial bank of Ethiopia there number was 19). From this number commercial bank of Ethiopia and development bank of Ethiopia are state owned banks, the rest are privately owned banks. The researcher took the private banks which operated for the last eleven years. For achieving the objective of the study ratio analysis and the Pearson correlation were used to examine the relationships between financial performance ratios. The STATA software was used to analyze data.

4. Data analysis and interpretation

This section analyzes the financial performance of privately owned banks in Ethiopia by classifying in to three section, the first section analyze the profitability of the bank, the second section analyze the liquidity of the end the final is credit performance of the bank.

4.1 Profitability Performance

The most common measure of bank performance is profitability. Profitability Ratios attempt to measure the firm's success in generating income. These ratios reflect the combined effects of the firm's asset and debt management. It is measured by using Return on Asset and Return on Equity.

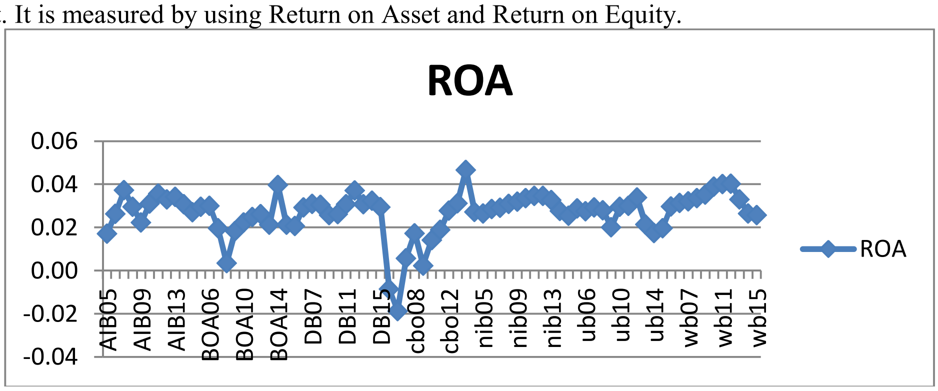

Figure1: Return on Asset

Whereas, AIS= Awash International Bank, BOA= Bank of Abyssinia, DB= Dashen Bank, CBO= Cooperative Bank of Oromia, NIB= Nib Bank, UB= United Bank and WB= Wogagen Bank.

The first one is Return on Asset ratio (ROA). This ratio indicates how much net income is generated per Br. of assets. The higher the ROA, the more the profitable the bank. As shown on the above figure the highest return on asset was in the year 2014 that is 0.05 by CBO. This means that for each Br. Invested in asset the return on investment is 0.05 cents. This amount is the highest of all private banks. But the ROA of this bank which result loss in the year 2005 and 2006 by -0.01 and -0.02 respectively, which is the only loss that ever seen in these years of operation. Overall as indicted below in the table the average ROA of the banks were positive; which indicate for each Br. investment in asset on average they earn 0.03 cents.

Table1: The Overall Return on Asset

	Mean	Minimum	Maximum
ROA	0.03	-0.02	0.05

The other measurement of profitability is ROE. ROE is the most important indicator of a bank's profitability and growth potential. It is the rate of return to shareholders or owner of the banks or the percentage return on each Br. of equity invested in the bank. As indicated below in Figure the ROE of banks in fluctuate for each period. The smallest amount result was occurred in the 2005 and 2006 that is -0.01 and -0.03 respectively.

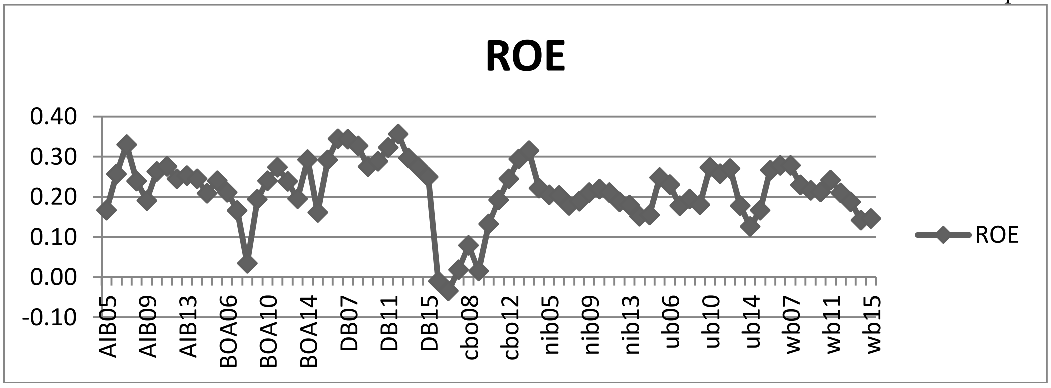

Figure 2: Return on Equity

Whereas, AIS= Awash International Bank, BOA= Bank of Abyssinia, DB= Dashen Bank, CBO= Cooperative Bank of Oromia, NIB= Nib Bank, UB= United Bank and WB= Wogagen Bank.

As indicated below in the table, banks earn for each Br. Investment in the equity maximum of 0.36 cents and on average 0.21 cents.

Table2: The overall Return on Equity

	Mean	Minimum	Maximum
ROE	0.21	-0.03	0.36

4.2 Liquidity performance

Liquidity indicates the ability of the bank to meet its financial obligations in a timely and effective manner (Michael C et.al 13ed). Financial liabilities are attracted through retail and wholesale distribution channels. Retail generated funding is considered less interest elastic and more reliable than deposits attracted from wholesale distribution channels**.** Liquidity is measured using liquid asset to customer deposit and short-term borrowed funds, Net loans to total assets and net loans to total deposits and short-term borrowings.

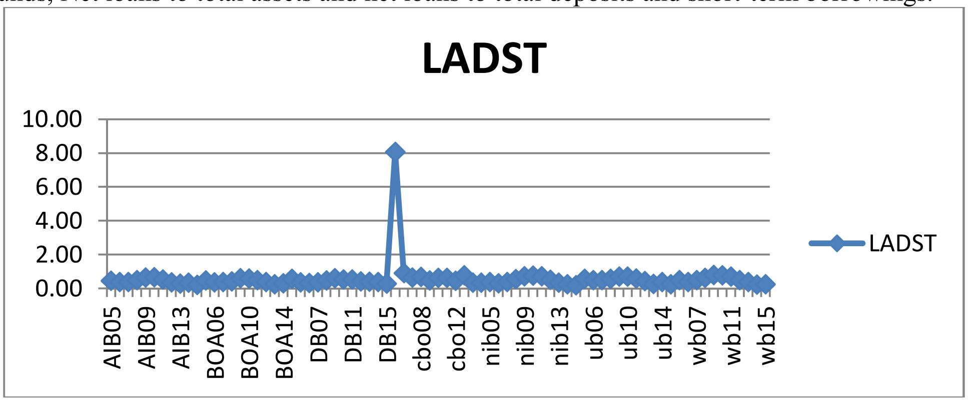

Figure 4: Liquid Asset to Customer Deposit and Short-Term Borrowed Funds

Whereas, AIS= Awash International Bank, BOA= Bank of Abyssinia, DB= Dashen Bank, CBO= Cooperative Bank of Oromia, NIB= Nib Bank, UB= United Bank and WB= Wogagen Bank.

The first ratio to measure the liquidity of private banks in Ethiopia is liquid asset to customer deposit and short-term borrowed funds. This ratio indicates the percentage of short-term obligations that could be met with the bank's liquid assets in the case of sudden withdrawals. So, as indicated on the above figure except in the year 2006 CBO's LADST raised to 8.07 the other banks including CBO has operated in good LADST because the ratio indicated that below one that means they have sufficient amount of liquid asset if sudden withdrawals happen by their customers.

Additionally, when it measured in the overall performance of LADST of privately owned banks in Ethiopia their average LADST ratio is 0.57 this means that they one Br. for each 0.57 short term obligation. So, they can cover their short term obligation easily.

Table4: The overall liquid asset to customer deposit and short-term borrowed funds

	Mean	Minimum	Maximum
LADST	0.57	0.18	8.07

The second measurement of liquidity of the banks is the Net loans to total assets. This measures the percentage of assets that is tied up in loans. The higher the ratio, the less liquid the bank is. As shown below in the figure all banks assets which is tied up in loans is between 30 to 60 percent. This result varies year to year except CBO in the year 2005, which has a minimum amount of NLTA percentage that is 20%. This result is low in amount because this bank (CBO) started it operation in 29 October 2004 so its loan amount is little in amount as compared to the current period.

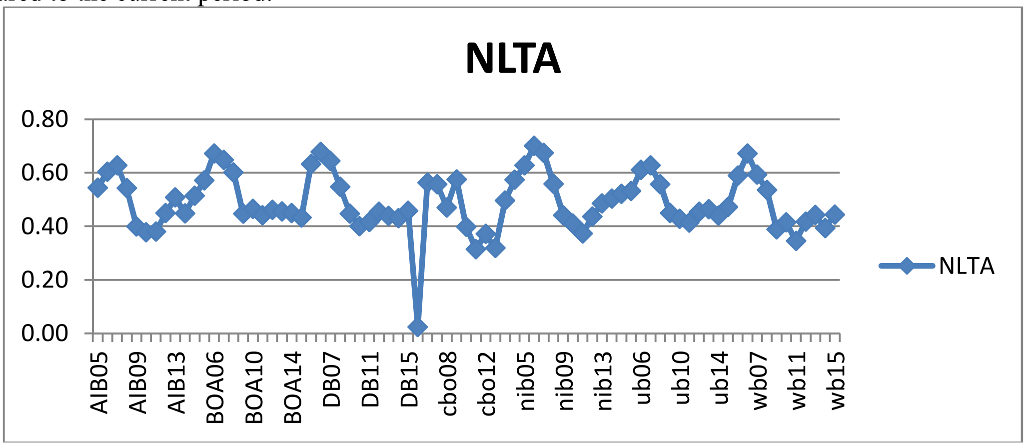

Figure 5: Net loans to total assets

Whereas, AIS= Awash International Bank, BOA= Bank of Abyssinia, DB= Dashen Bank, CBO= Cooperative Bank of Oromia, NIB= Nib Bank, UB= United Bank and WB= Wogagen Bank.

Table5: Net loans to total assets

	Mean	Minimum	Maximum
NLTA	0.49	0.02	0.70

As indicated in the above table the minimum percentage of assets that attached in loans was 20 percent and the average is 49 percent, which is good as compared to the maximum amount which 70 percent.

The third measurement is that the researcher used to measure the liquidity was net loans to total deposits and short-term borrowings**.** This ratio indicates the percentage of the total deposits locked into non-liquid assets. A high figure denotes lower liquidity.

As noted below in the Figure, NLDST of the banks was in between 40 to 60 percent that specify, private banks net loans was locked into non liquid asset. Nevertheless, in the 2005 and 2006 CBO's NLDST indicate 20 and 106 percent respectively, which was abnormal amount. Although, this amount was became normal starting from the year 2007.

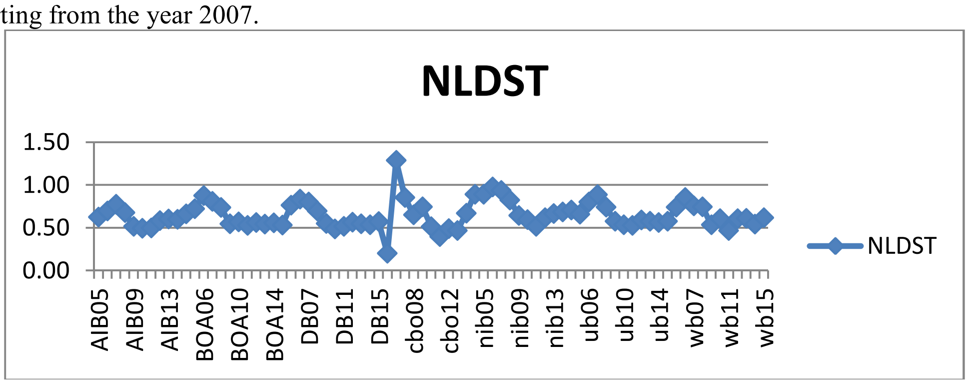

Figure 6: net loans to total deposits and short-term borrowings

Whereas, AIS= Awash International Bank, BOA= Bank of Abyssinia, DB= Dashen Bank, CBO= Cooperative Bank of Oromia, NIB= Nib Bank, UB= United Bank and WB= Wogagen Bank.

Table 6: net loans to total deposits and short-term borrowings

	Mean	Minimum	Maximum
NLDST	0.65	0.20	1.29

As indicated in the above table, NLDST of the banks mean was 65 percent, which means 35 percent of the net loan locked in to liquid asset. This result indicates that if the sudden withdrawal by customer happed almost banks have insufficient amount of liquid asset to meet the required amount of customer needs.

4.3 Credit Performance

Credit performance evaluates the risks associated with the bank's asset portfolio that is the quality of loans issued by the bank. While it is expected that banks would bear some bad loans and losses in their lending activities, one of the key objectives of the bank is to minimize such losses. This ratio indicates the proportion of the total portfolio that has been set aside but not charged off. It is a reserve for losses expressed as a percentage of total loans.

The Figure below shows the LRGL ratio. As shown below BOA reserved the maximum loan loss from its gross loan about 10 percent in the year 2009, this means that from the loan that provided by BOA almost 10 percent is nonperforming. Although, some banks do not held reserve for loan doubtful for some years that make the minimum amount is zero.

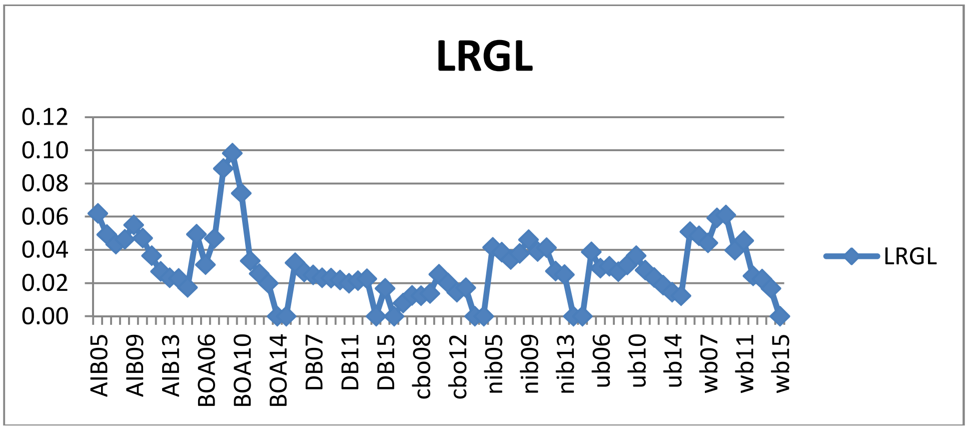

Figure 7: The overall Loan loss reserve to gross loans (LRGL)

Whereas, AIS= Awash International Bank, BOA= Bank of Abyssinia, DB= Dashen Bank, CBO= Cooperative Bank of Oromia, NIB= Nib Bank, UB= United Bank and WB= Wogagen Bank.

Table 7: The Overall Loan loss reserve to gross loans (LRGL)

	Mean	Minimum	Maximum
LRGL	0.03	0.10	0.00

As indicated above in the table, privately owned commercial banks in Ethiopia, their average Loan loss reserve or nonperforming loan was 3 percent. However, the credit performance of privately owned commercial banks was in excellent position for past eleven years that is from 2005- 2015.

4.4 Debt Management

Debt Management Ratios attempt to measure the firm's use of Financial Leverage and ability to avoid financial distress in the long run. These ratios are also known as Long-Term Solvency Ratios. To examine debt management of privately owned commercial banks the researcher used two type of ratio that is debt ratio (total debt to total asset) and debt to equity ratio.

Debt ratio

This ratio measures how the firm is financed. The ratio of total liabilities to total assets is called the debt ratio. It measures the percentage of funds provided by current liabilities and long-term debt.

Below the Figure shows the banks DR for the year 2005-2015. As shown in the Figure the banks DR except NIB bank in the year 2005 and 2006 financed its asset about 85 and 60 percent respectively from owners. The other banks financed their asset from loan from eighty to ninety percent.

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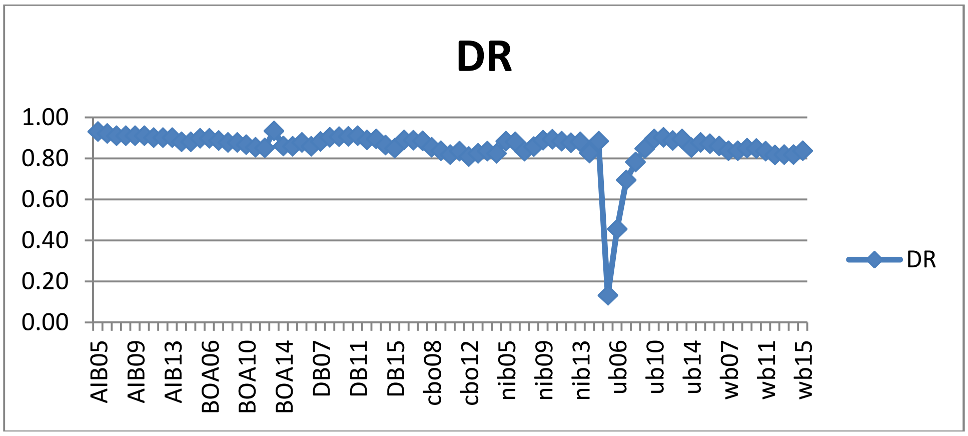

Figure 8: Debt Ratio (DR)

Whereas, AIS= Awash International Bank, BOA= Bank of Abyssinia, DB= Dashen Bank, CBO= Cooperative Bank of Oromia, NIB= Nib Bank, UB= United Bank and WB= Wogagen Bank.

Table 8: The Overall DR

	Mean	Minimum	Maximum
DR	0.85	0.13	0.93

As indicated on above table the industry average of DR of privately owned banks was 85 percent. It means that the source finance for banks almost 85 percent comes from the depositor or creditors, and the other fund was comes from owners.

Pearson Correlation

To investigate all the relationships between profitability of performance banks and other measurements the Pearson correlation were used. The result of the Pearson Correlation is summarized in table 9 below and each relationship is discussed under the table.

Table 9: Pearson correlation

	ROA	ROE	LADST	NLTA	NLDST	LRGL	DR
ROA	1.0000						
ROE	0.7856	1.0000					
LADST	-0.4169	-0.3489	1.0000				
NLTA	0.0612	0.1209	-0.5465	1.0000			
NLDST	-0.1644	-0.1621	-0.3419	0.8622	1.0000		
LRGL	0.0598	0.1053	-0.1115	0.2245	0.0714	1.0000	
DR	-0.0554	0.0083	0.0264	-0.1022	-0.0975	0.0307	1.0000

As indicated from the above table the relationship between variables that use to measure the financial performance of private banks LADST negatively correlated with ROA and ROE. This shows when the LADST ratio increases the ROA and ROE decreases. In other way LADST ratio shows the percentage of short term obligations that could be met with the bank's liquid assets in the case of sudden withdrawals so, if LADST increases or customer withdrawal increase the ROE and ROE will decrease. On the other hand NLDST ratio highly correlated with NLTA as compared to other ratios. ROA is negatively related with LADST, NLDST and DR. The result indicates that when ROA LADST, NLDST and DR decrease the ROA of the banks increase and vice versa.

5. Conclusion

The objectives of the study were to investigate the performance of privately owned commercial banks in Ethiopia for the period 2005- 2015. The researcher used four types of performance measurement the first one is profitability performance, secondly liquidity performance, debt management the fourth one was credit performance.

The most common measure of bank performance is profitability. Profitability is measured using Return on Asset, Return on Equity and Expense (total cost of bank) per income. ROA of privately owned banks are in better condition for the past eleven years except in the years of 2005 and 2006 by CBO incurred loss.

ROE is the most important indicator of a bank's profitability and growth potential. It is the rate of return to shareholders or owner of the banks or the percentage return on each Br. of equity invested in the bank. The banks ROE positive and its progress improved from year and they the maximum of 0.36.

Liquidity indicates the ability of the bank to meet its financial obligations in a timely and effective manner. The researcher used three different measurement of liquidity LADST,NLTA and NLDST. So, as indicated except in the year 2006 CBO's LADST raised to 8.07 the other banks including CBO has operated in good LADST because the ratio indicated that below one that means they have sufficient amount of liquid asset if sudden withdrawals happen by their customers.

The other measurement of liquidity of the banks is the Net loans to total assets. This measures the percentage of assets that is tied up in loans. The result varies year to year except CBO in the year 2005, which has a minimum amount of NLTA percentage that is 20%. The last measurement is that the researcher used to measure the liquidity was net loans to total deposits and short-term borrowings**.** As noted in the analysis, NLDST of the banks was in between 40 to 60 percent that indicates, private banks net loans was locked into non liquid asset. Nevertheless, in the 2005 and 2006 CBO's NLDST indicate 20 and 106 percent respectively, which was unusual amount. Although, this amount was became normal starting from the year 2007.

Credit performance evaluates the risks associated with the bank's asset portfolio that is the quality of loans issued by the bank. This ratio indicates the proportion of the total portfolio that has been set aside but not charged off. It is a reserve for losses expressed as a percentage of total loans. The result shows except BOA reserved the maximum loan loss from its gross loan about 10 percent in the year 2009. Although, some banks do not held reserve for loan doubtful for some years that make the minimum amount is zero. However, the credit performance of privately owned commercial banks was in excellent position for past eleven years that is from 2005- 2015.

Debt Management Ratios attempt to measure the firm's use of Financial Leverage and ability to avoid financial distress in the long run. The first measurement of debt management ratio is DR, it measures the percentage of funds provided by current liabilities and long-term debt. The privately owned commercial bank in Ethiopia finance their asset on average 85 percent from depositor or creditor the remaining fund was invested by owners.

Based on the literature survey and the findings of this research, the researcher recommended that:

- Based on the findings the overall profitability performance of privately owned banks was in good condition. This is appreciable performance of the banks and it recommended that to keep their performance for the remaining life of the banks.
- Profitability is measured using Return on Asset, Return on Equity and Expense (total cost of bank) per income. Based on the finding the banks' profitability was fluctuated for the last eleven years, so the banks should improve their profitability to increase with the industry average.
- Based on the result the banks liquidity to meet its financial obligation in a timely manner was in a good condition for the measurement of LADST and NLTA but net loan locked in to non-liquid asset of the banks was high so, the bank should improve this to meet the their financial obligation.
- The credit performance (non-performing reserve) of privately owned banks in Ethiopia was in good condition so, the bank should keep this performance to increase their profitability.
- Based on the analysis made on privately owned commercial banks in Ethiopia, all of them use huge amounts of debt to finance their asset. This has positive implications of the banks because the main source of finance and liabilities of the banks are deposit from customers. Therefore, it is recommended that to keep and to continue this performance.
- Generally, the financial performance of privately owned commercial banks seems better from period to period. There was variation in their performance. Thus the researcher recommend that the management (board of Directors) of banks to work on increasing the overall financial performance to become a good competitor in the ever banking industry.

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