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# The Effects of Post 1991 Era financial sector deregulations in Ethiopia: An Inspirational guide for agribusiness.

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**Financial institutions are the most important engines of economic growth for any economy in the world. In Ethiopia the major financial institutions operating are banks, insurance companies and micro-finance institutions. After the fall of the socialist regime in 1991the financial sector of the country witnessed a major shift of paradigm. Numerous private banks, insurances and micro financial institutions were established. Though the agriculture sector plays an important role in the Ethiopian economy it attracted a small amount of loan from banks particularly from private banks. This situation in turn inhibits the development of agribusiness sector. Sectoral distribution of loans indicated also that credit to trade sector (both domestic and international) accounted for the major part followed by industry and agriculture. In the face of various challenges in the finance sector of the country banks, insurances and MFIs have managed to increase their market share. Generally, to bring about dynamism in the finance sector and to satisfy customers, banks, insurances and MFIs should invest heavily on the development of modern electronic products and services.**

**Keywords**: Banks, MFIs, Insurance Companies, Loans, Economic Sectors

## INTRODUCTION

Financial institutions intermediate between the savers of funds and users of funds. The mere existence of surplus units and deficit units does not justify the need for financial intermediaries like banks (Bain and Howells, 2003). The differences among banks, savings and loan associations, credit unions and other financial intermediaries were primarily due to legal restrictions on their operations (Handa, 2000). They were all financial intermediaries but they differed in what was permitted and not permitted for each (Pilbeam, 2006). It is hoped that the changes now occurring will enable financial institutions to serve their customers better, strengthen the institutions by broadening and diversifying their operations and promote competition among intermediaries (Steven and Kermit, 2003).

Bank of Abyssinia was established as the first bank in 1905 based on the agreement signed between the Ethiopian government and the National Bank of Egypt, which was owned by the British. Its capital was 1 million shillings. According to the agreement, the bank was allowed to engage in commercial banking (selling share, accepting deposit and effecting payments in cheques) and to issue currency notes. The agreement prevented the establishment of any other bank in Ethiopia, thus giving monopoly right to the bank of Abyssinia. The bank, which started operation a year after its establishment agreement was signed, opened branches in Harar, Dire Dawa, Gore and Dembi- Dolo as well as well as an agency office in Gambella and a transit office in Djibouti. Apart from serving foreigners residing in Ethiopia and holding government accounts, it could not attract fully deposits from Ethiopian nationals (Lakew, 2000).

Today there are opportunities to invest in financial institutions with policies encouraging private investors to invest in the banking, MFIs and insurance companies. Although the history of private commercial banks in the country is very short, the banks have managed to contribute their part in provision of banking services and sharing the monopolies enjoyed formerly by the state owned Commercial Bank of Ethiopia. Today, in Ethiopia the lists of private commercial banks include Awash International Bank, which is the first private commercial bank in the country and others followed like Dashen Bank, United Bank,Wegagen Bank, Bank of Abyssinia, and Cooperative Bank of Oromia, Lion International Bank,Oromia International Bank, Zemen bank, Bunna International Bank, Nib Bank, Berhan International Bank and others under formation such as Addis cooperative Bank, Hawassa bank, Debub Global Bank ,Abay bank, and others under formation are included.

Apart from private commercial banks there are numerous insurance companies which are currently operational in the country such as Ethiopian Insurance Corporation, Awash Insurance Company, Africa Insurance Company., National Insurance Company of Ethiopia, United Insurance Company, Global Insurance Company, Nile Insurance Company, Nyala Insurance Company, Nib Insurance. Company, Lion Insurance Company, Ethio-Life Insurance Company, Oromia Insurance, Abay Insurance Company and Berhan insurance S.C.. On the other hand, Micro finace institutions like Oromia Credit and Saving, Amhara Credit and Saving, Dedebit Credit and Saving, Gasha Micro finance, Meklit Micro finance, Harbu Micro finance, Bussa Gonafa Micro finance and many others are functional today by providing small credit to the farmers.

The banking industry is dominated by the three state owned banks while the private commercial banks play a minimal role in the financial system of the country. However, they found that the state owned banks were comparatively inefficient relative to private banks. The combination of the closed characteristics of Ethiopia's banking sector and its non competitive market structure serves to weaken the link between financial intermediation and economic growth. (Alemayehu, 2007). Unlike modern commercial banks in the developed world, the banking sector is not developed in the least developed countries including Ethiopia's banking sector. As a result, commercial banks provide quite limited services. The banking sector faces a number of problems that hindered its proper functioning. Liquidity problems are widely seen which make the private commercial banks unable to finance big projects. As a result, this creates an imbalance between the demand for loanable fund and their supply (Wondaferahu, 2010).

**Literature Review: The Structure of Ethiopia's Financial Sector**

The financial system especially the banking sector is highly concentrated. Concentration in the market is a barrier for the presence of a well-built competition and the prevalence of excessive unutilized financial potential in the form of excess reserves and liquidity impedes efficiency of banks. This initiates the need for an immediate attention of policy makers (Muluneh, 2008).

The market structure for commercial banks in the economy is found highly concentrated especially in total assets and deposits towards public banks, especially in total assets and deposits towards public bank, especially the Commercial Bank of Ethiopia. The cost efficiency result of the banks reviewed is found comparable to the result obtained by different researchers employing the same methodology to the same institutions in other countries. Size of banks measured by total assets and branch network and age are found negatively related with efficiency while capital is found to be positively affecting efficiency of banks (ibid).

The traditional method of approaching the efficiency measurement issue of financial firms, such as banks is the financial ratio analysis .This method, however, has some major drawbacks. Managers of banks and policy maker should search alternative tools that compensate for the drawbacks in financial ratio analysis such as Data Envelopment Analysis (ADB, 2011).

It is possible to relate the need for Business Process Reengineering and the enhancement of bank performance, the target of Business Process Reengineering project is to bring radical change to business processes. Reengineering demonstrates break through thinking and aims for dramatic business results. Business Process Reengineering projects require different approaches depending on their characteristics. Practice has shown that successful reengineering efforts ultimately lead to business transformation. New product /service and customer services appear in the form of improved information flows. These enhanced options and features may produce new business opportunities .Business Process Reengineering efforts produce new products and services in addition to dramatic increases in revenue and operating savings (Mehari, 2005).

According to Lakew (2000), banks are the dominant financial institutions in the country. They account, on average, for 96% of total gross financial assets. Non-banks account only for about 4%. Financial institutions currently operating in the Ethiopian financial system comprise the central bank, commercial banks, specialized banks, insurance companies, pension fund, saving and credit cooperatives (SACCs) and Microfinance Institutions (MFIs).

The most important functions of commercial banks in the area of financial intermediation are deposit mobilization and lending activities. There has been growth in these activities in the post reform period. The annual increases in total deposits averaged 23% between 1991/92 and 1997/98.For instance, demand deposits have shown significant

**Table 1.** Loans and Advances by Economic Sectors of the banking system (in million birr)

| Economic sectors/period | 2007/08 | 2008/09 | 2009/10 | 2010/11 |
|---|---|---|---|---|
| Agriculture | 5,481.2 | 6,009.7 | 6,819.6 | 10,575.3 |
| Industry | 7,897.0 | 9,081.6 | 12,234.9 | 20,650.5 |
| Domestic Trade | 5,219.2 | 5,760.6 | 6,210. 0 | 7,261.1 |
| International Trade | 12,205.0 | 12,513.6 | 14,433.9 | 18,025.7 |
| Hotels and Tourism | 722.7 | 1,023.7 | 1,257.4 | 1,435.5 |
| Transport | 2,779.9 | 2,531.8 | 2,786.5 | 3,558.6 |

Source: NBE, 2011

increase by more than two folds from birr 3.2 million in 1992 /93 to birr 8.5 billion in 1997/98. Saving deposits have increased again by more than two folds from a record of birr 2.5 billion in 1992/93 to birr 6.2 billion in 1997/98. Time deposits increased by almost three folds during the same period from birr 315.6 million in 1992/93 to birr 1.1 billion in 1997/98 (EEA, 2002) .

Total assets of the banking system in the post-reform period grew at a rate 17.1% on average per annum (over 1991/92-1997/98). In the year 1996/97, the private banks except Awash International Bank did not add much to total assets of the banking system as would have been
expected. This has two major reasons. First, private banks are still infant in size as compared to the publicly owned ones. Second, Awash Bank Is the most dominant of the private banks and its precision from the analysis, in terms of size comparisons really matters (interestingly enough total assets of Awash bank in December 1996/97 amounted to 524.8 million birr) while total assets of Bank of Abyssinia and Dashen Bank added amount only to 519.4 million birr in June of the same year (Wondaferahu, 2010).

## MATERIALS AND METHODS

### Method of Data Collection

The study was carried out based on secondary data sources. Important data for the study were collected from different banks, microfinance Institutions and insurance companies operating in the country. Besides, crucial information was obtained from apex authority controlling the performance of financial institutions that is the National Bank of Ethiopia and also World Bank.

### Method of Data Analysis

The collected data were analyzed by using descriptive statistics. In this study descriptive analysis were chosen because of its simplicity and clarity to draw inferences.

Averages, percentages and tables were used for the analysis of the data.

## RESULTS AND DISCUSSION

### Sectoral Distribution of Loans of the Banking System in Ethiopia

The provision of loan is the major function of banks. Banks grant loans to the various sectors of the economy. Various forms of loans are there including loans of agriculture sector, trade and services loan, transport loan, manufacturing loan, import loans, export loans, Hotel and tourism, and others.

As it is obviously known among the three major financial institutions operating in Ethiopia the dominant is the banking sectors which take the lion's share in respect of loans and advances. Sectoral distribution of outstanding loans showed above in Table 1 depicts that loans to international trade took the first place from (2007/08-2010/11) followed by industry and agriculture. On the other hand, credits granted for the hotel and tourism sector is very minimal as compared to other giant sectors.

### Ownership Based Distribution of Loans of the Banking System in Ethiopia

The banking sector in the country is owned both by the private and public sectors. The major public banks include Commercial Bank of Ethiopia, Construction & Business Bank and Development Bank of Ethiopia. Although the history of private commercial banks in the country is very short, the banks have managed to contribute their part in provision of banking services and sharing the monopolies enjoyed formerly by the state owned banks. Today, in Ethiopia the lists of private commercial banks include Awash International Bank, which is the first private commercial bank in the country and others followed like Dashen Bank, United Bank, Wegagen Bank, Bank of Abyssinia, and Cooperative Bank of Oromia, Lion International Bank, Oromia International Bank, Zemen bank, Bunna International Bank, Nib Bank, Berhan International Bank and others

**Table 2**. Loans and Advances by Owners (In Million Birr)

| Lenders/periods | 2009/10 | 2010/11 |
|---|---|---|
| Public Banks | 33,394.6 | 47,924.8 |
| Commercial Bank of Ethiopia | 22,859.0 | 34,217.7 |
| Construction & Business Bank | 1,748.3 | 1,726.6 |
| Development Bank of Ethiopia | 8,787.2 | 11,980.5 |
| All Private Banks | 21,297.5 | 26,046.6 |

Source: NBE, 2011

**Table 3**. Private Banks ' Loan Composition (in percent), 2011

| Economic Sectors/Banks | BOA | Awash | Berhan | Bunna | Dashen | LIB | NIB | OIB | United |
|---|---|---|---|---|---|---|---|---|---|
| Agriculture | 0.2% | 2.2% | 0.5% | 0.0% | 2.0% | 3.0% | 4.5% | 2.2% | 0.0% |
| Manufacturing | 9.3% | 5.8% | 10.2% | 3.3% | 22.8% | 2.6% | 25.7% | 4.7% | 16.7% |
| Domestic Trade | 38.7% | 26.4% | 30.1% | 32.4% | 31.8% | 56.0% | 19.4% | 51.1% | 21.0% |
| Export | 14.5% | 21.1% | 14.5% | 7.8% | 6.1% | 4.3% | 14.2% | 15.4% | 15.1% |
| Import | 13.1% | 14.2% | 7.3% | 19.3% | 8.8% | 24.7% | 13.9% | 4.0% | 21.1% |

Source: Banks' Annual Reports

under formation such as Addis cooperative Bank, Hawassa bank, Debub Global Bank ,Abay bank, and others under formation are included. Out of the total outstanding loans disbursed the majority was provided by the three giant state banks. On the other hand, the private banks took the lesser share combined together.

It is evident in Table 2 above that the three public banks (CBE, CBB and DBE) account for 33.4 billion birr loan advanced to the various sectors of the economy in 2009/10 fiscal year, whereas the private based banks (13 banks) disbursed altogether birr 21.3 billion in the same year. In the following year also the amount of loan extended by the state owned banks exceed by far the amount disbursed by the private sector banks combined together.

## The Status of Private Banks' Commercial Lending

The agriculture sector is the mainstay of the nation in Ethiopia. Although the agriculture sector contributes 43% to the GDP of Ethiopia it gets smaller quantity of loans from Ethiopian private banks. All the private banks focused on four major areas of investment neglecting agriculture. For the private banking industry as a whole, the top four sectors to which loans are provided are Domestic Trade and Services, Exports, Manufacturing and Construction.

As it is depicted in Table 3, Nib International Bank disbursed the greatest share of total loans at (4.5 percent of loans) to agriculture while the other banks granted from 0.2 percent up to 3 percent of their total loan to the agriculture sector. However, different banks show different sector loan allocations. If we look at the specific sectors and the banks which allocate the largest share of their loans to the various sectors, we observe that: Lion International Bank provided 56 percent from its total loan to domestic trade and services, Nib International Bank gave 25.7 percent from its total loans to manufacturing sector. Dashen Bank on its part granted 31.8 percent from its total loans to domestic trade whereas Bank of Abyssinia supplied 38.7 percent of loans to domestic traders and Bunna International Bank provided 32.4 percent from its total loans to the growing domestic trade sector.

## Commercial banks' Lending to Agriculture Sector in Ethiopia

As it is repeatedly noted the agriculture sector plays a vital role in the Ethiopian economy. This sector obtains finance from commercial banks, microfinance institutions (MFIs), and cooperative societies. The agriculture sector attracted a small amount of loan out of the total loan portfolio of commercial banks in the country though the sector remains the single major contributor to the national economy. The smaller amount of loans provided to agriculture sector inhibits the development of agribusiness. Farmers' access to credit, which they need to modernize their practices, is even worsened by the excessive banking requirements to qualify for loans.

One example is the need to provide a fully backed collateral security to obtain finance from financial institutions. However, farmers normally unable to avail sufficient collateral as banks do not accept crops as collaterals. Table 4.

Lending commercial banks believe most often that the agriculture sector is a high-risk investment with high default rates on the loans supplied. Though this situation is prevailing we find that there are considerable

**Table 4.** The Status of Commercial banks' Lending to Agriculture in Ethiopia (2005-2009)

| Category | Values |
|---|---|
| Percentage of bank loans to the agricultural sector | 9.6% |
| % of loan approved and disbursed to the agriculture | 14.96% |
| % of loan to agriculture sector that has been collected | 13.12% |
| Percentage of loan outstanding | 9.66% |
| Non Performing Loan, as of June 2011 | a) Commercial Bank Ethiopia: 0.2%<br>b) Oromia Cooperative Bank: 6%<br>c) Development Bank Ethiopia: 12.8% |

Source: World Bank, 2012

**Table 5.** Branch Networks of the Banking System in Ethiopia

| | Branch networks (in number) | |
|---|---|---|
| **Banks /Years** | **2009/10** | **2010/2011** |
| Commercial Bank of Ethiopia | 209 | 417 |
| Construction & Business Bank | 32 | 34 |
| Development Bank of Ethiopia | 32 | 32 |
| Total Public Banks | 273 | 483 |
| Awash International Bank | 62 | 70 |
| Bank of Abyssinia | 47 | 57 |
| Dashen Bank | 59 | 65 |
| Wegagen Bank | 50 | 53 |
| United Bank | 42 | 50 |
| Nib International Bank | 48 | 51 |
| Cooperative Bank of Oromia | 37 | 43 |
| Lion International Bank | 22 | 30 |
| Other banks | 41 | 68 |
| Total Private banks | 408 | 487 |
| Grand Total Banks | 681 | 970 |

Source: NBE, 2011

differences in non-performing loan (NPL) rates for agricultural loans among the major commercial banks in Ethiopia. For instance, Cooperative Bank of Oromia revealed a 6 percent Non Performing Loan rate, whereas the Non Performing Loan rates of Commercial Bank of Ethiopia and Development Bank of Ethiopia stood at 0.2 percent and 12.8 percent, respectively, during the financial year 2005-2009.

**Operational Networks of the Banking System in Ethiopia**

An ever booming bank branches indicates growing market shares for the bank. Expanding operational networks of commercial banks is the major indicator of the performance of the banking system .The objective of expanding bank branches is the need to take banking services and products closer to its customers. Branch banking is much related with the investments of huge financial resources. Table 5.

In the fiscal year 2010/11 the total branch networks of commercial banks both private and public banks in the country increased to 970 from 681 in the budget year of 2009/10. A considerable expansion of operational networks of commercial banks was undertaken by Commercial Bank Ethiopia (208), followed by Bank of Abyssinia (10 branches), Oromia International Bank (9 branches), with Awash International Bank, United Bank and Lion International Bank opening 8 branches each. Due to the aggressive opening of new bank branches by Commercial Bank Ethiopia, the share of private banks branch network went down to 50 percent at the end of 2010/11 from 60 percent in the budget year of 2009/10.

**Microfinance Institutions in Ethiopia**

Micro finance institutions like Oromia Credit and Saving, Amhara Credit and Saving, Dedebit Credit and Saving, Gasha Micro finance, Meklit Micro finance, Harbu Micro finance, Bussa Gonafa Micro finance and many

**Table 6**. Microfinance Institutions Performance in Ethiopia ('000 birr)

| **Microfinance Institutions /Periods** | **2007/08** | **2008/09** | **2009/2010** | **2010/2011** |
|---|---|---|---|---|
| Total Capital | 1,339,951.5 | 1,737,402.7 | 2,375,228.0 | 2,945,970.0 |
| Saving | 1,560,971.3 | 2,098,742.1 | 2,658,962.0 | 3,779,089.0 |
| Credit | 4,474,976.8 | 4,936,135.2 | 5,824,489.0 | 6,991,986.0 |
| Total Assets | 5,340,608.7 | 6,620,630.8 | 7,958,194.0 | 10,156,387.0 |

Source: NBE, 2011

**Table 7**. Capital of Insurance Companies (in Million Birr)

| | Capitals(in million birr) | | | |
|---|---|---|---|---|
| Insurance Companies /Years | 2007/08 | 2008/09 | 2009/10 | 2010/11 |
| Ethiopian Ins. Cor. | 229.3 | 249.4 | 333.9 | 291.0 |
| Awash Ins.Com.S.C. | 51.5 | 52.9 | 93.7 | 89.0 |
| Africa Ins.Com S.C. | 46.1 | 59 | 23.4 | 81.0 |
| National Ins. Co. of Eth. | 13.4 | 14.8 | 105.2 | 27.9 |
| United Ins.Com. S.C | 56.3 | 39.3 | 20.4 | 88.0 |
| Global Ins. Com.S.C | 20.3 | 22.9 | 90.0 | 27.8 |
| Nile Ins.Com.S.C | 53.1 | 56.4 | 77.9 | 100.3 |
| Nyala Ins.Com.S.C | 56.1 | 61.6 | 102.7 | 96.3 |
| Nib Ins. Com.S.C | 45.1 | 60.3 | 77.0 | 87.4 |
| Lion Ins. Com.S.C | 10.9 | 7.1 | 13.2 | 17.3 |
| Ethio-Life Ins.Com.S.c | - | 3.3 | 4.4 | 4.9 |
| Oromia Ins.Com.S.c | - | 25.6 | 20.5 | 23.9 |
| Abay Insurance Company | - | - | - | 11.4 |
| Berhan insurance S.C | - | - | - | 9.4 |

Source: NBE, 2011

others are functional today by providing small credit to the farmers. Currently micro financing is one of the most powerful tools for combating poverty primarily by providing loan to the poor segment of the society. The number of micro financing institutions serving the poor in Ethiopia is growing from time to time. Table 6 below shows the total capital, savings, credit and total assets amount of Microfinance Institutions in Ethiopia for the period ranging from 2007/08-2010/11 budget year.

The microfinance institutions operating currently in the country are increasing in number as well as in volume of business. For instance, deposit mobilizations of microfinance institutions have increased from Birr 1.6 billion in 2007/08 to Birr 3.8 billion in 2010/11. On the other hand, credit provisions of microfinance institutions have also increased from Birr 4.5 billion in 2007/08 to Birr 7.0 billion in 2010/11.The three largest MFIs, namely Amhara, Oromia and Dedebit Credit and Savings institutions have contributed much to the growth of microfinance business. Generally, it is possible to conclude that the microfinance sector of the country is booming.

**Insurance Companies in Ethiopia**

There are numerous insurance companies which are currently operational in the country such as Ethiopian Insurance Corporation, Awash Insurance Company, Africa Insurance Company., National Insurance Company of Ethiopia, United Insurance Company, Global Insurance Company, Nile Insurance Company, Nyala Insurance Company, Nib Insurance. Company, Lion Insurance Company, Ethio-Life Insurance Company, Oromia Insurance, Abay Insurance Company and Berhan insurance S.C. Insurance industry of Ethiopia is relatively undeveloped and characterized by the sectors low penetration levels. Insurances are largely owned by the private sector in Ethiopia. There is only one state owned insurance company (Ethiopian Insurance Corporation).The following table 7 shows the capitals of both private and public banks in Ethiopia over the financial period 2007/08-2010/11.

The total capital of the state owned insurance company (Ethiopian Insurance Corporation) has increased over the years 2007/08-2009/10 from 229 million birr to 334 million birr. However, in 2010/11 fiscal year the capital of the insurance company has declined to the level of 291 million birr. The Ethiopian Insurance Corporation took the major of insurance business in the country. No private insurance company attained the total capital registered by EIC over the period under consideration. In 2007/08 budget year, United Insurance Company has registered the biggest capital among the private insurance companies understudy. On the other hand, in 2010/11 fiscal year Nile

Insurance Company's capital stood at 100 million birr being the highest capital registered as compared to other private insurance companies.

## CONCLUSIONS

Financial Institutions play a vital role in the economic growth of a nation. In the absence of modern and organized financial system a country's economy cannot ensure economic growth and development. In Ethiopia the need for banks, MFIs and insurance companies is very crucial as there are no developed security markets.

After the fall of the socialist government the new pro-capitalist regime introduced many financial liberalizations and restructuring measures to strengthen the financial sector by placing legal and regulatory frameworks. Due to the changes in the policies a number of private commercial banks, insurance companies and MFIs were established in the country sharing the former dominance of state owned financial institutions.

The participation of private sectors in the economy has brought competition in the financial sector of the country. In the future the dominance of state owned financial institutions seem to cease though still the private banks look far chasing the public banks. As it is mentioned elsewhere the government of Ethiopia gives much emphasis to agriculture sector as it is of course the mainstay of the economy. Therefore, private financial institutions should finance this priority sector by critically considering the credit worthiness of borrowers. Generally, to bring about dynamism in the finance sector and to satisfy customers, banks, insurances and MFIs should invest heavily on the development of modern electronic products and services.

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