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Financial Performance Analysis:
The Case of Bank of Abyssinia
Versus Other Private Commercial Banks in Ethiopia

BY:

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Declaration

I, **LEMMA NIGUSSIE ZERGAW**, here by declare that the thesis entitled “**Financial Performance Analysis: The case study of bank of Abyssinia versus other private commercial banks in Ethiopia**”, submitted by me to the award of the Degree of **MBA** in **Finance** to Mekelle University at Mekelle, is original work and it hasn't been presented for the award of any other Degree, Diploma, Fellowship or other similar titles of any other university or institution.

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Certification

This is to certify that this thesis entitled “**Financial Performance Analysis: The Case of Bank of Abyssinia versus other Private Commercial Banks**” submitted in partial fulfillment of the requirements for the award of the degree of MBA., in Financial Management, to the College of Business and Economics, Mekelle University, through the Department of Management, done by **Mr. Lemma Nigussie Zergaw, Id.No.CBE/PR/0007/01** is an authentic work carried out by him under my guidance. The matter embodied in this project work has not been submitted earlier for award of any degree or diploma to the best of my knowledge and belief.

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Date_____

Dedication

I have dedicated this project to my mother, **W/ro Muluwork Yigezu**, who has laid the foundation of my life, my sister **Shewaye Zergaw**, my wife **Albasework Aschenaki** and my lovely daughter **Nuhamin Lemma**.

Abstract

This study entitled 'Financial Performance Analysis' was conducted on Bank of Abyssinia. Both the trend and comparative financial performance analysis approaches were used. Five years audited financial reports from 2005 to 2009 of the private commercial banks were taken for analysis purpose. So far, most researches have tried to assess the growth of private banks relative to state-owned banks in terms of asset ownership and loan granting ability. But this paper has tried to assess whether the private commercial banks are financially sound or not by specifically considering only the private commercial banks and by taking Bank of Abyssinia as a case study.

The objective of the study is to evaluate the financial performance of Bank of Abyssinia by analyzing its past five year's performance trend and comparing the financial performance of the bank with other private commercial banks operating in Ethiopia (United Bank, Wegagen Bank and Nib International Bank). Financial ratios were considered to measure the credit quality, liquidity, efficiency and profitability as well as sustainability (financial and operating) of the private commercial banks.

In both the financial performance analysis approaches i.e., the trend and comparative analysis, Bank of Abyssinia's financial performance showed that weak performance has been reported continuously in all the financial ratios (Profitability, Liquidity, Risk and Solvency Efficiency and credit quality) taken for analyzing the financial performance.

Key words: Profitability, Liquidity, Risk and Solvency, Efficiency

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Acronyms

BOA=Bank of Abyssinia

UB=United Bank

WB=Wegagen Bank

NIB=Nib International Bank

ROA=Return on Asset

ROE=Return on Equity

NIM=Net Interest Margin

IT=Information Technology

CROA=Cash Return on Assets

PER=Profit to Expense Ratio

NITA=Non-interest Income to Total Asset

ROD=Return on Deposit

LDR=Loan to Deposit Ratio

LAR=Loan to Asset Ratio

DER=Debt to Equity Ratio

DTAR=Debt to Total Asset Ratio

EMR=Equity Multiplier Ratio

AUR=Asset Utilization Ratio

IER=Income to Expense Ratio

OER=Operating Efficiency Ratio

L/C=Letter of Credit

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“How can I repay the lord for his goodness to me?” pls.115:12 NIV.

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Chapter I: Introduction

1.1. Background of the Study

A commercial bank is a type of financial intermediary and a type of bank. Commercial banking is also known as business banking. It is a bank that provides checking accounts, savings accounts, and money market accounts and that accepts time deposits. (B. Fabozzi, 2003)

Commercial banks play a vital role in the economy for two reasons: they provide a major source of financial intermediation and their checkable deposit liability represent the bulk of the nation's money stock. Evaluating their overall performance and monitoring their financial condition is important to depositors, owners, potential investors, managers and of course regulators. Currently financial ratios are often used to measure the overall financial soundness of a bank and the quality of its management. (Y. Piyu, 2004)

Beyond their traditional role in project finance transactions, commercial banks are developing new roles in providing advisory services; construction financing; inter mediation to permanent long-term fixed-rate financing; commodity, currency, and interest rate risk management; foreign tax absorption; and working capital financing for projects throughout the world. Looked at separately, the development of these roles is a response to increasing competition both among commercial banks and between commercial banks and other institutional lenders and intermediaries to meet an explosion of worldwide project finance needs. Commercial banks differ considerably in their ability to provide such services. (The Financier, May 1995).

The emergence of banks owned by the local private sector began in the mid-1970 in Africa. Financial markets in Africa in the period since independence have been dominated by foreign and government-owned commercial banks. But deficiencies in financial intermediation provided an opportunity for local private investors to enter financial markets, especially in those countries where the domestic private sector was relatively well developed, such as Kenya and Nigeria. (The Financier, May 1995).

Financial resource like any other economic resources is believed to be the critical input in any country's development endeavor. This resource is considered to be one of the most critical factors impeding the socio-economic development of countries like Ethiopia. The vast majority of Ethiopians are still deprived of the capacity to participate in the wealth creation of the nation due to the extreme shortage of the resource as well as the obstacles in the legal framework of access to it. Improving access to financial services is an important development tool, because it helps in creating employment opportunities for the unemployed and increases their income and consumption, which would in the final analysis reduce poverty. (S. Arega, 2007)

Access to financial services to the poor also facilitates economic growth by easing liquidity constraints in production, by providing capital to start-up new enterprises or adopt new technologies, and by helping producers to assume production risk. Moreover, the transformation from subsistence to a more commercially driven economy requires capital formation and increased demand for working capital. To secure such objectives managing the financial resources of any company in the most efficient and effective way is compulsory. The Ethiopian economy has been state controlled through a series of industrial development plans since the Imperial Government of Haile Selassie. It was managed as a Soviet-style centrally planned economy under a socialist government from 1976-1991. (K. Kozo, 2007).

The post-1991 government led a transition to a more market-based system. Although state control has been reduced and domestic and foreign (private) investment promoted, the state still plays a dominant role in the economy today. Ethiopia's financial sector remains closed and is much less developed than its neighbors. Ethiopia has no capital market and very limited informal investing in shares of private companies. A series of financial sector reforms has been introduced since 1994, when private banks were allowed to be re-established. But the three large state-owned banks continue to dominate the market in terms of capital, deposits and assets. The current government is committed to alleviating poverty through private sector development and through integrating Ethiopia into the global economy. (K. Kozo, 2007).

For the purpose of a bank's financial analysis, it is important to use a consistent framework for developing its performance indicators. The analytical framework normally used in this process is a set of financial accounts. Financial statements are therefore the starting point of bank financial appraisal. (A. M. Santomero, 1997).

Banks' performance monitoring, analysis and control needs special analysis in respect to their operation and performance results from the viewpoint of different audiences, like investors/owners, regulators, customers/clients, and management themselves.(A. August,2002)

The problem of banking and financial system soundness has become more important in all countries over the recent years. The financial sector, and especially the banking system, is vulnerable to systemic crises which has led to the creation of costly safety nets, as depositor insurance schemes with well-known moral hazard problem. It is argued that there is increasing evidence that banks are "black boxes" due to the weak transparency and banks' unwillingness to disclose information (Hyytinen, 2003).

This paper had focused in examining the financial performance of bank of Abyssinia versus other private commercial banks in Ethiopia using both the trend and comparative analysis approaches of financial performance.

1.2 Statement of the Problem

Performance of financial institutions is relevant from the policy point of view because as finance-growth literature suggests, if banks become better-functioning entities, it is expected to be reflected in strengthening capital buffer, safety and soundness of the financial systems. (M. Joseph, 2007)

Efficiency estimates are leading indicators, as such, efficiency measurement of individual banks is an important research activity carried out by the central bank of the country in order to identify the effects of deregulation, merger, market structure as well as their scale and scope of activity. Segmenting the industry into different strategic groups can help the banks position themselves and take long-term overhauling of their delivery design process. (M. Joseph, 2007)

Several studies have found that the performance of private banks is typically better than state-owned banks. The total assets and return on assets (ROA) of Ethiopian state-owned and private banks from 1998 to 2006 shows that the share of assets of private banks grew from 6.4 percent in 1998 to 30.4 percent in 2006. This in turn implies that the share of state-owned banks

significantly declined. Note, however, that the values of total assets increased from 1998 to 2006 for both state-owned and private banks. This suggests that the Ethiopian banking sector has grown rapidly. (L. Porta, 2002)

The growth of private banks has been much faster than state-owned banks, although more than two-thirds of assets are still held by state-owned banks. It is also an evident that private banks show generally better performance than state-owned banks. In seven out of nine years, private banks had higher ROA than state-owned banks. (K. Kozo, 2007).

Thus, the purpose of this project is to analyze the financial performance of private commercial banks in Ethiopia to reinforce the previous works. So far, most researches have tried to assess the growth of private banks relative to state-owned banks in terms of asset ownership and loan granting ability. But this paper has tried to assess whether the private commercial banks are financially sound or not by specifically taking only the private commercial banks.

As to the Bank of Abyssinia (BOA) there was no information related to the financial performance of the company. Hence, this becomes the basis of the study and the researcher has tried to analyze the financial performance of the bank by considering its past performance using the trend analysis and by comparing it with other private commercial banks using the comparative financial performance analysis approach.

1.3 Objectives of the Study

1.3.1 General Objective:

The **general objective** of the study is to compare the financial performance of Bank of Abyssinia with other private commercial banks operating in Ethiopia.

1.3.2 Specific Objectives:

The **specific objectives** of the study are:

- 1) To assess the trend financial performance of Bank of Abyssinia (BOA) for the last five years.

- 2) To evaluate the operating profitability of Bank of Abyssinia (BOA)
- 3) To analyze the financial sustainability of Bank of Abyssinia (BOA)
- 4) To compare the financial performance of Bank of Abyssinia (BOA) versus the other private commercial banks average for the last five years.
- 5) To give recommendations for the stakeholders of the banking sector.

1.4 Research Questions

1. What looks like the financial performance of BOA for the last five years?
2. How profitable is BOA?
3. How sustainable are the private commercial banks financially?
4. What looks like the financial performance of BOA versus the other private commercial banks?

1.5 Significance of the Study

Financial statement analysis is important to boards, managers, payers, lenders, and others who make judgments about the financial health of organizations. One widely accepted method of assessing financial statements is ratio analysis, which uses data from the balance sheet and income statement to produce values that have easily interpreted financial meaning. (H. P. George, 2005)

Since it revolves around one of the popular issues of current business scenario, the financial aspect, the following are the expected significances of the study.

- It provides some insight about the financial performance analysis approaches of private commercial banks.
- It has identified the strong and weak sides of the private commercial institutions concerning their finance management.

- It also provides significant information related to the sector for those individuals who are interested to join the business as well as for those who are in the policy making responsibility.
- It has tried to give appropriate recommendations to the concerned companies so that it will help them to reassess their current practices.

1.6 Scope and Limitation of the Study

In conducting detail researches on financial performance, it is compulsory to have much more time, adequate information, expertise knowledge, etc. This study focuses on one company, Bank of Abyssinia, and it has analyzed the financial performance of the bank by using both the trend and comparative approaches. The study has considered only those private commercial banks which were established before the year 2005.

There are different types of financial analysis methods like fund flow analysis, ratio analysis, common size statements analysis, cost-volume-profit analysis, profitability of capital and leverage analysis, etc. But this study has focused on only the financial ratio analysis and presented the trend changes on the different ratios but it did not analyze the causes for these changes in detail.

Even though there are a number of important determinant variables which have significant influence on the financial performance of any company like political affairs, inflation, economy, management philosophy, etc, they were not considered in this study.

The researcher could not get any standardized data from the National bank of Ethiopia that can be used as a bench mark in making comparison analysis .Moreover, time and financial constraints were also the important limitations of the study.

1.7 Organization of the Paper

The organization of this study takes the following form: The first chapter is introductory which consists of background of the study, statement of the research problem, objectives of the study, research methodology, significance of the study and scope and limitation of the study. The second chapter provides the related summary of literature review on the financial performance

analysis. Chapter three presented data source and methodology; chapter four is devoted to analysis of data and discussion based on data collected; finally, chapter five concludes the study and provides relevant recommendation.

Chapter II: Literature Review

2.1 Theoretical review

2.1.1 Factors that affect banks performance

Researchers in banking and finance have indicated that bank performance is related to internal and external factors. The internal factors relate to banks' characteristics and external factors are described as the economic and legal environment (Athanasoglou, 2008).

1. Internal Factors

Internal factors refer to those factors which are internal to the banking sector which have significant influence on the performance of the any bank. Some of the internal factors are insiders' abuse, weak corporate governance, management of the bank etc.

Insiders Abuse

The government owned bank suffered from frequent changes in board membership and many appointments were made based on political affiliation rather than expertise consideration. Consequent upon this, board members saw themselves as representative, of political parties in sharing the national cake emanating thereof and thus, ascribed their loyalty to the party members rather than the proper running of the bank itself. On the side of the privately-owned banks, shareholders constituted a problem. According to Olufon (1992), the owner-managers regarded banking as an extension of their operations by appointing their relatives or friends to key positions instead of relying solely on professional managers. Thus, their appointees were mere loyalists who cared for the interest of their masters rather than the business itself. Shareholders quarrels and boardroom squabbles were common among the banks that management attention deviated in favor of unnecessary squabbles.

Weak Corporate Governance

As a result of the insiders abuse of recruiting inexperienced and incompetent personnel to hold key positions in the bank, deterioration of management culture and weak internal control system instigated by the squabbles among the high rank management decision making team, and non compliance with laws and prudential standards, mismanagement seemed to play a major role in bank failure in any country. Bank losses increased and management resorted to hiding the losses in order to buy time and remain in control.

Management of the Bank

Jensen and Meckling (1976) propose that an inverse monotonic relation should exist between the owner-manager's control and agency costs, and that, as ownership increases, there is increased incentive for the owner-manager to maximize the value of the firm.

2. External Factors

The external factors are those factors which are outside the banking sector but whose changes have its own impact on the performance of any bank. These include changes in government policies, changes in the economy, and changes in rates by central banks, inflation, etc.

Change in Government Policies

Banks in most economies are the principal depositories of the public's financial savings, the nerve centre of the payment system, the vessel endowed with the ability of money creation and allocation of financial resources and conduit through which monetary and credit policies are implemented. The success of monetary policy, to a large extent, depends on the health of the banking institutions through which the policies are implemented. As a result of this central role of banks in the economy, their activities have to be kept under surveillance to ensure that they operate within the law in line with safe and sound banking practices so that the economy will not be jeopardized. Hence, governments generally legislate to influence and/or directly control banks' activities to suit the developmental objectives of the economy. (<http://eurojournals.com>)

The Economy

The health of the global economy has a fundamental influence on banks performance because it is ultimately responsible for driving company profits. Broadly speaking if the economy is growing, company profits will be improved and vice versa.

Changes in Rates by Central Banks

Looking at the changing scenario, central banks keep on changing rates like cash reserve ratio, interest rate, etc. These rates have a direct relation with the bank's performance. Thus, a change in these rates or even a speculation change in these rates will affect banks performance a lot.

Inflation

Economists will generally argue that more information is better. Having a central bank more fully communicate its objectives, its assessment of economic conditions, and the expected effects of its policy actions will enhance social welfare, because agents will be better able to align their decisions with those of the central bank and the economy will adjust more smoothly.

As Woodford (2005) argues, monetary policy is more effective when it is expected, since better information on the part of financial markets about central bank actions and intentions implies that the change in the policy rate required to achieve the desired outcome can be much more modest when expected future rates also move.

2.1.2 Definitions of Important Terms

A **bank** is a financial institution that accepts deposits and channels those deposits into lending activities. Banks primarily provide financial services to customers while enriching investors. Government restrictions on financial activities by banks vary over time and location. Banks are important players in financial markets and offer services such as investment funds and loans. (<http://www.investorwords.com/401/bank.html>)

A **financial statement** is written report which quantitatively describes the financial health of a company. This includes an income statement and balance sheet, and often also includes a cash flow statement. Financial statements are usually compiled on a quarterly and annual basis. (http://www.investorwords.com/1957/financial_statement.html)

A **balance sheet** is a quantitative summary of a company's financial condition at a specific point in time, including assets, liabilities and net worth. The first part of a balance sheet shows all the productive assets accompany owns, and the second part shows all the financing methods.

An **income statement**, also referred as profit and loss statement (P&L), earnings statement, operating statement or statement of operations, is a company's financial statement that indicates how the revenue (money received from the sale of products and services before expenses are taken out, also known as the "top line") is transformed into the net income (the result after all revenues and expenses have been accounted for, also known as the "bottom line"). It displays the revenues recognized for a specific period, and the cost and expenses charged against these revenues, including write-offs (e.g., depreciation and amortization of various assets) and taxes. (http://www.investorwords.com/1957/financial_statement.html)

Statements of retained earnings show changes in a company's or an organization's retained earnings over a specific period of time. These statements show the beginning and final balance of retained earnings, as well as any adjustments to the balance that occur during the reporting period. This information is sometimes included as part of the balance sheet or it may be combined with an income statement. However, it is frequently provided as a completely separate statement. (http://www.investorwords.com/1957/financial_statement.html)

2.1.3 Important Concepts

2.1.3.1 Financial Statement Analysis

A careful review of a bank's financial statements can highlight the key factors that should be considered before making a trading or investing decision. Investors need to have a good understanding of the business cycle and the yield curve - both have a major impact on the economic performance of banks. Interest rate risk and credit risk are the primary factors to consider as a bank's financial performance follows the yield curve. Financial statement analysis is important to boards, managers, payers, lenders, and others who make judgments about the financial health of organizations. One widely accepted method of assessing financial statements is ratio analysis, which uses data from the balance sheet and

income statement to produce values that have easily interpreted financial meaning. (H. P. George, 2005)

The purpose of financial statement analysis is to examine past and current financial data so that a company's performance and financial position can be evaluated and future risks and potential can be estimated. Financial statement analysis can yield valuable information about trends and relationships, the quality of a company's earnings, and the strengths and weaknesses of its financial position. (W. J. Charles, 2003)

Financial statement analysis begins with establishing the objective(s) of the analysis. For example, is the analysis undertaken to provide a basis for granting credit or making an investment? After the objective of the analysis is established, the data is accumulated from the financial statements and from other sources. The results of the analysis are summarized and interpreted. Conclusions are reached and a report is made to the person(s) for whom the analysis was undertaken. (W. J. Charles, 2003)

2.1.3.2 Types of Financial Analysis

The problem of banking and financial system soundness has become more important in all countries over the recent years. The financial sector, and especially the banking system, is vulnerable to systemic crises which has led to the creation of costly safety nets, as depositor insurance schemes with well-known moral hazard problem. It is argued that there is increasing evidence that banks are “black boxes” due to the weak transparency and banks’ unwillingness to disclose information. (Hyytinen, 2003).

Horizontal Analysis

When an analyst compares financial information for two or more years for a single company, the process is referred to as horizontal analysis, since the analyst is reading across the page to compare any single line item, such as sales revenues. In addition to comparing dollar amounts, the analyst computes percentage changes from year to year for all financial statement balances, such as cash and inventory. Alternatively, in comparing financial statements for a number of years, the analyst may prefer to use a variation of horizontal analysis called trend analysis. Trend analysis involves calculating each year's financial statement balances as percentages of the first

year, also known as the base year. When expressed as percentages, the base year figures are always 100 percent, and percentage changes from the base year can be determined. (Hyytinen, 2003).

Vertical Analysis

When using vertical analysis, the analyst calculates each item on a single financial statement as a percentage of a total. The term vertical analysis applies because each year's figures are listed vertically on a financial statement. The total used by the analyst on the income statement is net sales revenue, while on the balance sheet it is total assets. This approach to financial statement analysis, also known as component percentages, produces common-size financial statements. Common-size balance sheets and income statements can be more easily compared, whether across the years for a single company or across different companies. (Hyytinen, 2003).

Ratio Analysis

Ratio analysis enables the analyst to compare items on a single financial statement or to examine the relationships between items on two financial statements. After calculating ratios for each year's financial data, the analyst can then examine trends for the company across years. Since ratios adjust for size, using this analytical tool facilitates inter company as well as intra company comparisons.

2.1.3.3 Role of Financial Analysis

Financial analysis today is performed by various users of financial statements. Investors and Management perform the financial analysis to understand how profitably or productively the assets of the company are used. Lenders and Suppliers of goods look for the ability of the firm to repay the dues on time. For instance, as a deposit holder of a Bank, you would be interested in liquidity of the Bank and would expect the Bank to pay you the amount when you need.

Customers would like to know the long-term solvency of the Bank to get continued support. For example, as a borrower, you would like your bank to be healthy and profitable since you will be depending on the Bank for your future needs. Of course, employees would be interested in the profitability as well as liquidity of the bank. (<http://vpatras.blogspot.com/>)

Financial managers not only prepare financial statements but also analyze the same to get further insight on the performance of the Organization. They need to examine the organization from the perspective of several users so that they can follow the needs of them and satisfy several stakeholders. Sometimes, profitability might be affected when the managers try to satisfy the needs of various stakeholders but if you focus too much on profitability, it might affect the organization in other ways. For instance, we would expect that our deposit holders need liquidity. If we plan for more liquidity, it might affect profitability. (<http://vpatras.blogspot.com/>)

On the other hand, if we continue to have low liquidity, we may not get funds or we need to pay more interest to attract funds. While financial analysis is often used for evaluating current or historical performance, management uses the input of such analysis for future planning exercise. For instance, in preparing budgets, the inputs of financial analysis are extensively used. Financial analysis provides linkage between operating activities and funding activities. Normally, top management sets the goal and operational managers then determine the level of operations required to achieve the goal. It would be difficult to increase the level of operations without any investments unless there is a huge idle capacity. Thus increased activity demands more addition to assets and this in turn puts a demand for capital. The first step in this process is to know how much of additional assets we need and how much of capital we need to mobilize from various sources. (<http://vpatras.blogspot.com/>)

Financial analysis, which provides historical linkage between various financial components, is useful. Suppose the top management fixes a goal to increase the net income by another twenty percent for the coming year. Using profit to sales linkage, we can estimate additional turnover required to achieve the goal. Once we know additional turnover, it is possible for us to assess how much of additional assets are required (fixed and current assets in the case of manufacturing companies) and then additional funds that are required to buy the assets. Thus financial analysis is a prerequisite for financial planning. (<http://vpatras.blogspot.com/>)

2.1.3.4 Users of Financial Statements

There are different kinds of users of financial statements. The users of financial statements may be inside or outside the business. They are classified and detailed as follows:

1. Internal Users

The internal users are the individuals who have direct bearing with the organization and include the following. (contactus@mapsoftworld.com)

Managers and Owners

For the smooth operation of the organization the managers and owners need the financial reports essential to make business decisions. So as to provide a more comprehensive view of the financial position of an organization, financial analysis is performed with the information supplied in the financial statements. The financial statement is used to formulate contractual terms between the company and other organizations. A variable of the financial statement like the current debt to equity ratio is important in deciding the amount of long term capital that would be required to be raised. The financial statements of other companies can also provide investment solutions to different companies. Sometimes it becomes difficult to decide the right field in which financial resources may be channelized. In such situations the financial statements of other companies provide the appropriate guideline. (contactus@mapsoftworld.com)

Employees

The financial reports or the financial statements are of immense use to the employees of the company for making collective bargaining agreements. Such statements are used for discussing matters of promotion, rankings and salary hike. (contactus@mapsoftworld.com)

2. External Users

Institutional Investors

The external users are basically the investors who use the financial statements to assess the financial strength of a company. This would help them to make logical investment decisions.

Financial Institutions

The financial statements are also used by the different financial institutions like banks and other lending institutions to decide whether to help the company with working capital or to issue debt security to them. (contactus@mapsoftworld.com)

Government

The financial statements of different companies are also used by the government to analyze whether the tax paid by them is accurate and is in line with their financial strength.

Customers

The relationship between a firm and its customers can extend over many years. In some cases, these relationships take the form of legal obligations associated with guarantees, warranties, or deferred benefits. In other cases, the long-term association is based on continued attention to customer service. (contactus@mapsoftworld.com)

Financial Ratios

A financial ratio (or accounting ratio) is a relative magnitude of two selected numerical values taken from an enterprise's financial statements. Often used in accounting, there are many standard ratios used to try to evaluate the overall financial condition of a corporation or other organization. Financial ratios may be used by managers within a firm, by current and potential shareholders (owners) of a firm, and by a firm's creditors. (www.netmba.com/finance/ratios/)

2.1.3.5 Types of Financial Ratios Analysis

2.1.2.5.1 Profitability Ratios

Every firm is most concerned with its profitability. One of the most frequently used tools of financial ratio analysis is profitability ratios which are used to determine the company's bottom line. Profitability measures are important to company managers and owners alike. If a small business has outside investors who have put their own money into the company, the primary owner certainly has to show profitability to those equity investors. (http://www.investopedia.com/terms/p/profitabilityratios.asp)

1. Return on Assets (ROA)

The Return on Assets ratio is an important profitability ratio because it measures the efficiency with which the company is managing its investment in assets and using them to generate profit. It measures the amount of profit earned relative to the firm's level of investment in total assets. The return on assets ratio is related to the asset management category of financial ratios. (<http://www.investopedia.com/terms/p/profitabilityratios.asp>)

2. Return on Equity (ROE)

The Return on Equity ratio is perhaps the most important of all the financial ratios to investors in the company. It measures the return on the money the investors have put into the company. This is the ratio potential investors look at when deciding whether or not to invest in the company (<http://www.investopedia.com/terms/p/profitabilityratios.asp>)

3. Profit to Expenses Ratio (PER)

It measures the operating profitability of the bank with regards to its total operating expenses. The ratio measures the amount of operating profit earned for each dollar of operating expense. The ratio indicates to what extent bank is efficient in controlling its operating expenses. A higher profit to expense ratio means bank is cost efficient and is making higher profits. (<http://www.investopedia.com/terms/p/profitabilityratios.asp>)

4. Net Interest Margin (NIM)

Analysts focus on Net Interest Margin (NIM) ratio because small changes in a bank's lending margin can translate into large bottom line changes. The higher the ratio the cheaper the funding or the higher the margin the bank is obtaining. A bank's net interest margin is a key performance measure that drives ROA. Net interest income is the difference between interest income and interest expense. It is the gross margin on a bank's lending and investment activities. (<http://www.investopedia.com/terms/p/profitabilityratios.asp>)

5. Non interest Income to Total Assets (NITA)

Non interest Income to Total Assets (NITA) is an indicator of the operational performance. It indicates the proportion of fees and other income in respect of total assets of banks. This ratio is used as a measure of profitability indicator.

6. Return on Deposit (ROD)

To most financial analysts, Return on Deposit is one of the best measures of bank profitability performance. This ratio reflects the ability of bank management to utilize the customers' deposits in order to generate profits. (<http://www.investopedia.com/terms/p/profitabilityratios.asp>)

2.1.2.5.2 Liquidity ratios

Liquidity ratios attempt to measure a company's ability to pay off its short-term debt obligations. This is done by comparing a company's most liquid assets to short-term liabilities. The higher liquidity ratios mean bank has larger margin of safety and ability to cover its short-term obligations. Because saving accounts and transaction deposits can be withdrawn at any time, there is high liquidity risk for both the banks and other depository institutions. In general, the greater the coverage of liquid assets to short-term liabilities the better as it is a clear signal that a company can pay its debts that are coming due in the near future and still fund its ongoing operations. On the other hand, a company with a low coverage rate should raise a red flag for investors as it may be a sign that the company will have difficulty meeting running its operations, as well as meeting its obligations. Measures of bank liquidity include Loan to Deposit Ratio (LDR and Loan to Asset Ratio (LAR). (www.investopedia.com)

1. Loan to Deposit Ratio (LDR)

This refers to the amount of a bank's loans divided by the amount of its deposits at any given time. The higher the ratio, the more the bank is relying on borrowed funds, which are generally more costly than most types of deposits. Bank with low LDR is considered to have excessive liquidity, potentially lower profits, and hence less risk as compared to the bank with high LDR. (www.investopedia.com)

2. Loans to Assets ratio (LAR)

The loan to assets ratio measures the total loans outstanding as a percentage of total assets. The higher this ratio indicates a bank is loaned up and its liquidity is low. The higher the ratio, the more risky a bank may be to higher defaults. (www.investopedia.com)

2.1.2.5.3 Risk and solvency ratios

One of many ratios used to measure a company's ability to meet long-term obligations. The solvency ratio measures the size of a company's after-tax income; excluding non-cash depreciation expenses, as compared to the firm's total debt obligations. It provides a measurement of how likely a company will be to continue meeting its debt obligations. (<http://www.fimarkets.com/pagesen/solvency-ratio-mcdonough-cooke.htm>)

Acceptable solvency ratios will vary from industry to industry, but as a general rule of thumb, a solvency ratio of greater than twenty percent is considered financially healthy. Generally speaking, the lower a company's solvency ratio, the greater the probability that the company will default on its debt obligations.

1. Debt-Equity Ratio (DER)

The Debt to Equity Ratio measures how much money a company should safely be able to borrow over long periods of time. It does this by comparing the company's total debt (including short term and long term obligations) and dividing it by the amount of owner's equity.

This ratio indicates how much the company is leveraged (in debt) by comparing what is owed to what is owned. A high debt to equity ratio could indicate that the company may be over-leveraged, and should look for ways to reduce its debt.

Equity and debt are two key figures on a financial statement, and lenders or investors often use the relationship of these two figures to evaluate risk. The ratio of your business' equity to its long-term debt provides a window into how strong its finances are. Equity will include goods and property your business owns, plus any claims it has against other entities. Debts will include both current and long-term liabilities. (<http://www.fimarkets.com/pagesen/solvency-ratio-mcdonough-cooke.htm>)

2. Debt to Total Assets Ratio (DTAR)

The debt to asset ratio is the percentage of total debt financing the firm uses as compared to the percentage of the firm's total assets. It helps you see how much of your assets are financed using debt financing.

The lower the Debt to Asset Ratio, the better, as companies with high amounts of debt introduce more risk. You certainly want to look very hard at companies that have more Total Liabilities than Total Assets, as this is a precarious position for a company to be in. Depending on the industry of the company, you might expect the company to have two or three times as many assets as liabilities. Anything less than this might be a signal that the company is running into trouble. (<http://www.fimarkets.com/pagesen/solvency-ratio-mcdonough-cooke.htm>)

3. Equity Multiplier (EM)

A measure of financial leverage calculated as Total Assets/Total Stockholders' Equity. Like all debt management ratios, the equity multiplier is a way of examining how a company uses debt to finance its assets. It is also known as the financial leverage ratio or leverage ratio.

In other words, this ratio shows a company's total assets per dollar of stockholders' equity. A higher equity multiplier indicates higher financial leverage, which means the company is relying more on debt to finance its assets. (<http://www.fimarkets.com/pagesen/solvency-ratio-mcdonough-cooke.htm>)

2.1.2.5.4 Efficiency Ratios

The efficiency ratios and other ratios are key ratios to understanding financial statements. Our ratio calculation spreadsheets reduce time and effort in calculating decision making ratios. They reduce risk for lenders and investors and enable owners, managers and consultants to increase productivity and business profits. (<http://kbr.dnb.com/help/ratios/efficiency-ratios.htm>)

1. Asset Utilization Ratio (AUR)

How effectively the bank is utilizing all of its assets is measured by assets utilization ratio. The bank is presumably said to using its assets effectively in generating total revenues if the AU ratio is high. If the ratio of AU is low, the bank is not using its assets to their capacity and should either increase total revenues or dispose of some of the assets. (<http://kbr.dnb.com/help/ratios/efficiency-ratios.htm>)

2. Income Expense Ratio (IER)

This is the most commonly and widely used ratio in the banking sector to assess the managerial efficiency in generating total income vis-à-vis controlling its operating expenses. Income to

expense is the ratio that measures amount of income earned per dollar of operating expense. High income expense ratio is preferred over lower one as this indicates the ability and efficiency of the bank in generating more total income in comparison to its total operating expenses. (<http://kbr.dnb.com/help/ratios/efficiency-ratios.htm>)

3. Operating Efficiency Ratio (OER)

It measures managerial efficiency in generating operating revenues and controlling its operating expenses. In other words, how efficient is the bank in its operations unlike income expense ratio, which measures the amount of income earned per dollar of operating expense, operating efficiency is the ratio that measures the amount of operating expense per dollar of operating revenue. Lower operating expense is preferred over higher operating expense as lower it indicates that operating expenses are lower than operating revenues. (<http://kbr.dnb.com/help/ratios/efficiency-ratios.htm>)

2.1.2.6 Limitations of Ratio Analysis

Ratio analysis is useful, but analysts should be aware of these problems and make adjustments as necessary. Ratios analysis conducted in a mechanical, unthinking manner is dangerous, but if used intelligently and with good judgment, it can provide useful insights into the firm's operations. The following are some of the limitations of ratio analysis. (<http://www.kutenk.com/tag/limitations-ratio-analysis>)

Different Accounting Policies

The choices of accounting policies may distort inter company comparisons. Example some firm may allow valuation of assets to be based on either revalued amount or at depreciated historical cost. The business may opt not to revalue its asset because by doing so the depreciation charge is going to be high and will result in lower profit.

Creative Accounting

The businesses apply creative accounting in trying to show the better financial performance or position which can be misleading to the users of financial accounting.

Ratios are not Definitive Measures

Ratios need to be interpreted carefully. They can provide clues to the company's performance or financial situation. But on their own, they cannot show whether performance is good or bad. Ratios require some quantitative information for an informed analysis to be made.

Financial statements contain summarized information.

Ratios are based on financial statements which are summaries of the accounting records. Through the summarization some important information may be left out which could have been of relevance to the users of accounts. The ratios are based on the summarized year end information which may not be a true reflection of the overall year's results.

Interpretation of the Ratio

It is difficult to generalize about whether a particular ratio is 'good' or 'bad'. For example a high current ratio may indicate a strong liquidity position, which is good or excessive cash which is bad. Similarly non current assets turnover ratio may denote either a firm that uses its assets efficiently or one that is under capitalized and cannot afford to buy enough assets.

Price Changes

Inflation renders comparisons of results over time misleading as financial figures will not be within the same levels of purchasing power. Changes in results over time may show as if the enterprise has improved its performance and position when in fact after adjusting for inflationary changes it will show the different picture.

Technology Changes

When comparing performance over time, there is a need to consider the changes in technology. The movement in performance should be in line with the changes in technology. For ratios to be more meaningful the enterprise should compare its results with another of the same level of technology as this will be a good basis measurement of efficiency.

Different Financial and Business Risk Profile

No two companies are the same, even when they are competitors in the same industry or market. Using ratios to compare one company with another could provide misleading information. Businesses may be within the same industry but having different financial and business risk. One

company may be able to obtain bank loans at reduced rates and may show high gearing levels while as another may not be successful in obtaining cheap rates and it may show that it is operating at low gearing level. To an uninformed analyst he may feel like company two is better when in fact its low gearing level is because it can not be able to secure further funding.

Impact of Government Influence

Selective applications of government incentives to various companies may also distort inter company comparison. One company may be given a tax holiday while the other within the same line of business not, comparing the performance of these two enterprises may be misleading.

Window Dressing

These are techniques applied by an entity in order to show a strong financial position. This can improve the current and quick ratios and make the balance sheet look good. However the improvement was strictly window dressing as a week later the balance sheet is at its old position.

2.2 Empirical Review

Kaminsky and Reinhart (1999) argued that indicators of business failures and nonperforming loans are also usually available only at low frequencies, if at all; the latter are also made less informative by banks desire to hide their problems for as long as possible. This means that it is needed to use as fully and complexly as possible all available financial information from the official financial statements of banks for making financial analysis of banks' performance.

(Sundararajan, 2002) argued that relaying too heavily on just a few indicators of bank profitability can be misleading. While ROA, ROE, and interest margin (and non interest expenses) to gross income remain the key measures, they should ideally be supplemented by the analysis of other operating ratios.

Jahangir, Shill and Haque (2007) stated that the traditional measure of profitability through stockholder's equity is quite different in banking industry from any other sector of business, where loan-to-deposit ratio works as a very good indicator of banks' profitability as it depicts the status of asset-liability management of banks. But banks' risk is not only associated with this asset liability management but also related to growth opportunity. Smooth growth ensures higher future returns to holders and there lies the profitability which means not only current profits but

future returns as well. So, market size and market concentration index along with return to equity and loan-to-deposit ratio grab the attention of analyzing the banks' profitability.

Chowdhury (2002) observed that the banking industry of Bangladesh is a mixed one comprising nationalized, private and foreign commercial banks. Many efforts have been made to explain the performance of these banks. Understanding the performance of banks requires knowledge about the profitability and the relationships between variables like market size, bank's risk and bank's market size with profitability. Indeed, the performance evaluation of commercial banks is especially important today because of the fierce competition. The banking industry is experiencing major transition for the last two decades. It is becoming imperative for banks to endure the pressure arising from both internal and external factors and prove to be profitable.

Bhatt & Ghosh (1992), observed that the profitability of commercial banks depend on several factors some of them are endogenous and some exogenous. The endogenous factors represent control of expenditure, expansion of banking business, timely recovery of loans and productivity. The exogenous factors consist of direct investments such as SLR (Statutory Liquidity Ratio), CRR (Cash Reserve Ratio) and directed credit programs such as region wise, population wise guidelines on lending to priority sectors. The regulated and restricted regime in the operation of banking system in terms of investment, credit allocation, branch expansion, interest rate determination and internal management eroded the productivity and profitability of commercial banks.

According to Al-Shamrarni and Salirni (1998) profitability ratio especially return on equity (ROE) signals the earning capability of the organization. They also suggest that higher return on equity (ROE) ratio is appreciable as it is the primary indicator of bank's profitability and functional efficiency.

Hossain and Bhuiyan (1990) stated that there is no universally accepted operational definition of performance measures. In broad sense performance level of an enterprise can be measured by the extent of its organizational effectiveness. In the context of services rendered towards public the performance of an organization can be viewed as the extent to which its work is carried out within established specifications for goods and services produced, to the general satisfaction of

the clientele served, within given cost and time constraints, and in such a manner as to support or contribute to the achievement of the organization objectives.

Spathis, and Doumpos, 2002 investigated the effectiveness of Greek banks based on their assets size. They used in their study a multi criteria methodology to classify Greek banks according to the return and operation factors, and to show the differences of the banks profitability and efficiency between small and large banks

Bateswar and Ajay (2007) have made a review on the performance of banking sector in India during post reform period. A comparative appraisal of banks have been undertaken on the basis of seven indicators of performance namely, Net profit , Credit to deposit ratio (C/D) , Market Share, Business per Employee, Return on Assets, Capital Adequacy Ratio and Non performing Asset to Net Advances. The paper reveals that public sector banks have improved considerably and their performance was now comparable with other banks. Yet, they were lagging behind in trust areas such as business per employee, asset quality, and non performing asset to net advances, and capital adequacy.

Suyanto (2007) has evaluated inter bank performance of Bank Muamalat Indonesia in profitability, liquidity, risk and solvency, and community involvement for the period 2000 – 2004. Financial ratios (Return on Asset, Return to Equity, Profit Expense Ratio, Non Net Interest Margin Cash to Deposit Ratio, Loan to Deposit Ratio, capital Adequacy Ratio, Debt to Asset Ratio and Non performing loan to Total Loan Ratio) were applied in measuring these performances. The study found that the Bank Muamalat Indonesia (BMI) relatively had more profit and commitment to community development but had less liquidity compared to the conventional banks.

Chapter III: Data Source and Methodology

3.1 Research Methodology

3.1.1 Study Design

This study entitled ‘Financial Performance Analysis’ was conducted on Bank of Abyssinia. Both the trend and comparative financial performance analysis approaches were used. Five years audited financial reports from 2005 to 2009 of the private commercial banks were taken for analysis purpose.

To select the banks which are used for comparative analysis purpose, purposive sampling method was used. Year of establishment, amount of capital reserve and number of branches were taken as a criterion for selecting these private commercial banks for analysis purpose. Based on this criterion, three other private commercial banks in addition to Bank of Abyssinia, i.e. Wegagen Bank, United Bank and Nib International Bank (NIB) were selected.

The profitability ratios, liquidity ratios, risk and solvency ratios, efficiency ratios and credit quality ratios which are appropriate to evaluate bank performance were used in the study.

3.1.2 Data Collection Methods and Tools

The data used for this study were both primary and secondary sources. The audited annual financial reports of the private commercial banks, literature from various books, journals, news papers, magazines, reports of the National Bank of Ethiopia and various web sites were used as a source of secondary data. In addition, interviews with the concerned managers were conducted.

3.1.3 Method of Data Analysis

In any research undertaking, the methodology to be followed is determined by the nature of the problem statement or more specifically by the research objectives. Here in this study the analysis consists of data of five years, from 2005 to 2009 and comparison was done among each year between the chosen banks. Five years audited annual financial reports of the private commercial banks were taken for analysis purpose.

A trend and comparative appraisal of financial ratios and changes in growth were considered to measure the credit quality, liquidity, efficiency and profitability as well as sustainability (financial and operating) of the private commercial banks. In some cases, the analyzed information is presented by using graphs, tables and diagrams which are appropriate to explain the findings.

3.2 Background of the Banking Industry in Ethiopia

February 15, 1906 marked the beginning of banking in Ethiopia when the first Bank of Abyssinia was inaugurated by Emperor Menelik II. It was a private bank whose shares were sold in Addis Ababa, New York, Paris, London, and Vienna. One of the first projects financed by the bank was the Franco-Ethiopian railway which reached Addis Ababa in 1917. In 1931, Emperor Haile Selassie introduced reforms into the banking system and the Bank of Abyssinia became the Bank of Ethiopia, a fully government-owned bank providing central and commercial banking services. The Italian invasion in 1935 brought the demise of one of the earliest initiatives in African banking. During the Italian occupation, Italian banks were active in Ethiopia. (NBE, 2007)

On April 15, 1943, the State Bank of Ethiopia became the central bank and was active until 1963. The National Bank of Ethiopia was established in 1963 by Proclamation 206 of 1963 and began operation in January 1964. (NBE, 2007)

Prior to this proclamation, the Bank carried out dual activities, i.e. commercial banking and central banking. The proclamation raised the Bank's capital to ten million Ethiopian dollars and granted broad administrative autonomy and juridical personality. Following the proclamation the National Bank of Ethiopia was entrusted with the following responsibilities:

- To regulate the supply, availability and cost of money and credit.
- To manage and administer the country's international reserves.
- To license and supervise banks and hold commercial banks reserves and lend money to them.
- To supervise loans of commercial banks and regulate interest rates.
- To issue paper money and coins.

- To act as an agent of the Government.
- To fix and control the foreign exchange rates.

However, monetary and banking proclamation No. 99 of 1976 came into force on September 1976 to shape the Bank's role according to the socialist economic Principle that the country adopted. Hence the Bank was allowed to participate actively in national planning, specifically financial planning, in cooperation with the concerned state organs. The Bank's supervisory area was also increased to include other financial institutions such as insurance institutions, credit cooperatives and investment-oriented banks. Moreover the proclamation introduced the new 'Ethiopian Birr' in place of the former Ethiopian Dollar that ceased to be legal tender. (NBE, 2007)

This proclamation was in force till the new proclamation issued in 1994 to reorganize the Bank according to the market-based economic policy so that it could foster monetary stability, a sound financial system and such other credit and exchange conditions as are conducive to the balanced growth of the economy of the country. Accordingly the following are some of the powers and duties vested in the Bank by proclamation 83/1994. (NBE, 2007)

3.2.1 Organizational Profile of BOA

On 15 February 1996, ninety years to the day following the establishment of the first Bank of Abyssinia, a new privately-owned bank with this historic name, but otherwise not connected with the older bank, came into existence. (www.bankofabyssinia.com)

The subscribed capital of the new Bank of Abyssinia (BOA) was Birr 25 million and its authorized capital Birr 50 million, with 131 shareholders, all Ethiopian.

3.2.1.1 Vision, Mission, Values

Vision Statement

As Abyssinia was one of the earliest civilizations in ancient times and as Abyssinia Bank was the first bank in the history of Ethiopia, Bank of Abyssinia shall be a standard bearer in the banking industry in Ethiopia and an international player capable of being compared favorably with the best institution in its class world wide. (www.bankofabyssinia.com)

Mission Statement

BOA's mission is to provide domestic and international banking services through innovative utilization of technology, human and other resources, and be recognized as quality focused, results oriented, financially sound and socially responsible bank. (www.bankofabyssinia.com)

Values Statement

- Uncompromised Integrity, Honesty, Loyalty, and Ethical Standards. Integrity, honesty, loyalty, and ethical standards are paramount to the Bank's interest. We constantly work to make them part of the social architecture of the Bank.
- Dedication to Customer Satisfaction. We care for the customer so as to make Bank of Abyssinia his/her first choice.
- Enduring Commitment to Quality and Innovation. BOA shall provide superior services to the best satisfaction of its customers which shall continually include generation of new products and alternative services.
- Commitment to Employees Satisfaction. BOA provides its employees a conducive and transparent working environment where they receive fair treatment and equal opportunity in the area of training, promotion, compensation as well as clearly defined individual duty and responsibility that will ensure superior performance.
- Social Responsibility. Bank of Abyssinia is a socially responsible corporate citizen and always operates mindful of this responsibility.

3.2.1.2 Types of Services provided

BOA currently offers the following standard services:

- ✓ Current (checking) Accounts
- ✓ Savings Accounts
- ✓ Time Deposits
- ✓ NR/NT Accounts
- ✓ Overdraft Facilities
- ✓ Term Loans

- ✓ Merchandise Loans
- ✓ Letters of Credit

3.2.1.3 Key facts about the bank

- ✓ BOA currently has 1,301 shareholders, all private individuals or institutions in the private sector.
- ✓ BOA's branches are expanding. Currently we have 24 branches in Addis and 24 in the regions (Awassa, Bahir Dar, Gondar, Mekelle, Jimma, Nazareth, Dire Dawa, Debre Brehan, Dilla, Debre Markos, Bishoftu, Dessie, Arba-Minch, Motta, Teppi, Debere-Tabor, Hossaena, Sahsemene, Alemgenna, Harrar, Hagere Mariam, Modjo, Humera, and Chagni).
- ✓ BOA is a very competitive Bank. It has won four consecutive tenders for banking services. All commercial banks participated in these bids. BOA is the only commercial bank which provides on-site services to diplomatic missions.
- ✓ In every branch, we have a listening post which keeps us close to our customers. Our suggestion box! We open each of these every Friday and listen to customers' concerns (and, yes, to their compliments too). And we act promptly on each suggestion or complaint!!

3.2.1.4 Services for the Diaspora

Ethiopians living abroad can open:

- **A Checking Account:** It is a non-interest bearing account. Withdrawals from the account are unlimited. Monthly bank statement will be sent to customers regularly.
- **A Savings Account:** Deposits and withdrawals are made using the Bank's form. It is an interest bearing account. Deposits and withdrawals are shown in a saving passbook that is kept with the customer. This type of account may not be convenient for an account holder living abroad unless he/she arranges the account to be operated through another person holding power of attorney.
- **A Special Saving Account:** It can be operated using special check. It is an interest bearing account. Saving passbook is not required for special saving account but monthly

bank statements will be sent regularly to the account holder. The frequency of withdrawals from the account is limited, say, up to four times per month.

- **A Non-Interest Bearing Account in Foreign Currency** will, in future, be allowed for Ethiopians living abroad. The terms and conditions under which such an account is to be allowed are yet to be prepared by the supervising body, National Bank of Ethiopia.

Chapter IV: Discussion and Analysis

In this chapter the results of the financial performance analysis are presented. The analysis is made from the audited financial statements of the private commercial banks. Five consecutive fiscal years audited balance sheet and income statement were taken from the banks considered in the study.

Trend analysis of Bank of Abyssinia's performance which includes the profitability ratios (return on asset, return on equity, net interest margin, profit to expense ratio, non-interest income to total asset), liquidity ratios (loan to deposit ratio and loan to total asset ratio), risk and solvency ratios (debt to equity ratio, debt to total asset and equity multiplier), efficiency ratios (asset utilization, income to expense, and operating efficiency) and credit quality ratios (equity to loan, equity to total asset, non-performing loan to total loan) are presented consequently.

Then the comparative financial analysis of Bank of Abyssinia versus other private banks in Ethiopia using the ratios explained above will be presented. The respective ratios of the bank are compared with the average ratios of the four banks (BOA, UB, WB and NIB) taken for the study.

4.1. Trend Analysis of BOA

4.1.1 Profitability Ratios

Every firm is most concerned with its profitability. One of the most frequently used tools of financial ratio analysis is profitability ratios which are used to determine the company's bottom line. Profitability measures are important to company managers and owners alike. If a small business has outside investors who have put their own money into the company, the primary owner certainly has to show profitability to those equity investors.

Suyanto (2007) has evaluated inter bank performance of Bank Muamalat Indonesia in profitability, liquidity, risk and solvency, and community involvement for the period 2000 – 2004. Financial ratios (Return on Asset, Return to Equity, Profit Expense Ratio, Non Net Interest Margin, Cash to Deposit Ratio, Loan to Deposit Ratio, capital Adequacy Ratio, Debt to Asset Ratio and Non performing loan to Total Loan Ratio) were applied in measuring these performances. The study found that the Bank Muamalat Indonesia (BMI) relatively had more

profit and commitment to community development but had less liquidity compared to the conventional banks. BMI does not show (statistically) any difference in risk performance with the conventional banks.

1. Return on Asset Ratio (ROA)

The Return on Assets ratio is an important profitability ratio because it measures the efficiency with which the company is managing its investment in assets and using them to generate profit. It measures the amount of profit earned relative to the firm's level of investment in total assets. The return on assets ratio is related to the asset management category of financial ratios. The higher the percentage, the better it will be, because that means the company is doing a good job using its assets to generate profits.

The calculation for the return on assets ratio is:

$$\text{ROA} = \text{Net Income} / \text{Total Assets}$$

Table 4.1 Return on Asset Ratio

| <i>particulars</i> | Fiscal Year | | | | |
|--------------------|--------------------|---------------|---------------|---------------|---------------|
| | 2005 | 2006 | 2007 | 2008 | 2009 |
| Net income | 61,055,643 | 87,279,946 | 66,300,800 | 16,655,459 | 100,367,944 |
| Total asset | 2,230,722,739 | 3,014,059,680 | 3,577,964,010 | 4,269,946,935 | 5,476,625,540 |
| ROA-Ratio | 0.03 | 0.03 | 0.02 | 0.01 | 0.02 |

Source: researcher computation from financial statement of BOA

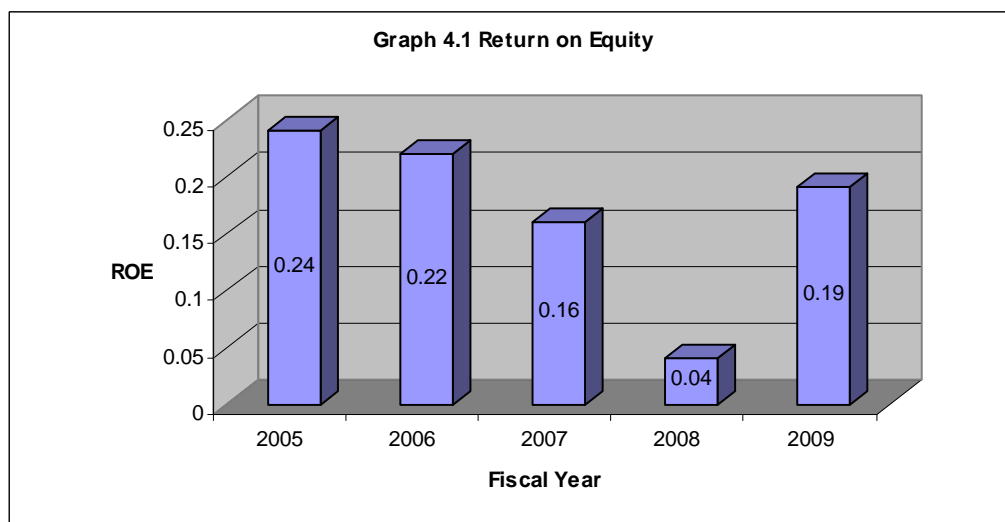
As it can be seen from the above Table 4.1, the return on asset of Bank of Abyssinia has shown declining trend from 2006 to 2007 and reached the lowest level in the year 2008 which was around one percent and in 2009 it has reached two percent. This implies that the assets of the bank are contributing only a little amount for the total profit of the bank, in the fiscal years 2005 and 2006 only three percent of the total profit was fetched from the bank's assets and in 2008 it

has been declined only to one percent. The management of the bank is not using the assets to generate higher profit which implies that most of the assets of the bank are put idle with out any contribution for the profit of the company. The reasons for these were the continuous increment of expenses like provision for doubtful loans and advances which shows almost four times change from 2007 to 2008 (i.e.,46,756,843 in 2007 and 142,771,341 in 2008), salaries and benefits and administrative costs.

2. Return on Equity Ratio (ROE)

It measures the return on the money the investors have put into the company. This is the ratio potential investors look at when deciding whether or not to invest in the company. The return on equity ratio measures how much the shareholders earned for their investment in the company. The higher the ratio percentage, the more efficient management is in utilizing its equity base and the better return is to investors.

According to Al-Shamrnari and Salirni (1998) profitability ratio especially return on equity (ROE) signals the earning capability of the organization. They also suggest that higher return on equity (ROE) ratio is appreciable as it is the primary indicator of bank's profitability and functional efficiency.



Source: researcher computation from financial statement of BOA

As it is depicted on Graph 4.1 above, the return on equity of Bank of Abyssinia has shown the maximum figure in the year 2005 which was around 24 percent and then it follows a declining

trend. In the year 2008, it has declined to the lowest point which was around 4 percent. The return on equity of the bank has shown improvement in the fiscal year 2009 and it has grown to around 19 percent. This implies that the investors of the bank were getting 24 cents for each one Birr investment they have made in the fiscal year 2005 and it has shown a declining trend till 2008 and it reached at the point where investors have enjoyed only four cents for each one birr investment they have made in the fiscal year 2008. As it can be seen from the financial statement of the bank, the reasons for these fluctuations were the less proportion of growth observed in the owners equity and the continuous reduction on the net income of the bank.

3. Profit to Expense Ratio (PER)

It measures the operating profitability of the bank with regards to its total operating expenses. The ratio measures the amount of operating profit earned for each dollar of operating expense. The ratio indicates to what extent the bank is efficient in controlling its operating expenses. A higher profit to expense ratio means the bank is cost efficient and is making higher profits.

It is calculated as:

$$\text{PER} = \text{Profit before tax} / \text{Operating Expenses}$$

Table 4.2 Profit to Expense Ratio

| <i>particulars</i> | Fiscal Year | | | | |
|--------------------|--------------------|-------------|-------------|-------------|-------------|
| | 2005 | 2006 | 2007 | 2008 | 2009 |
| Profit before tax | 82,040,574 | 122,921,543 | 94,980,332 | 21,907,426 | 145,399,775 |
| Operating expense | 36,683,611 | 56,745,638 | 111,216,547 | 232,135,062 | 147,346,454 |
| PER-Ratio | 2.24 | 2.17 | 0.85 | 0.09 | 0.99 |

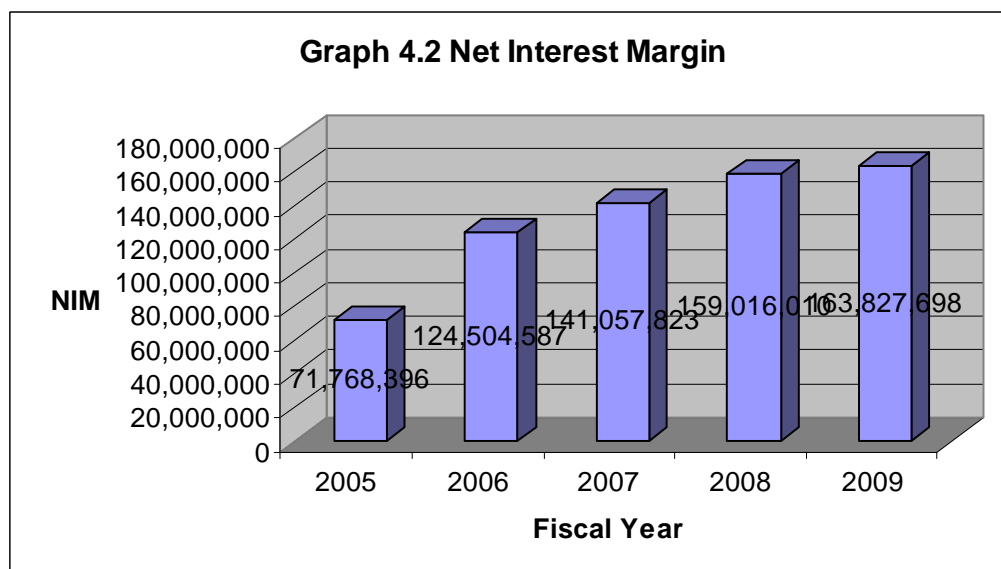
Source: researcher computation from financial statement of BOA

As it can be observed from Table 4.2 above, Profit to expense ratio of Bank of Abyssinia was 2.24 in 2005, which means for every one birr expense the bank incurred; it has generated a profit

of around 2 birr and 24 cents. In the succeeding fiscal years the bank's profit to expense ratio has shown a declining trend. In the fiscal year 2008, Bank of Abyssinia has earned the lowest profit in which it has fetched only 9 cents for its one birr expense it has incurred. This ratio showed that there is an increasing trend in the expenses of the bank but a decreasing trend in the revenue of the bank. As it can be seen from the financial statement of the bank there is a continuous increment in the expense of the bank, for instance from the fiscal year 2005 to 2008 the expense has grown by more than hundred percent but such progress was not observed in the profit of the company. Therefore, these are the causes for the continuous decline in the profit to expense ratio.

4. Net Interest Margin (NIM)

Analysts focus on Net Interest Margin (NIM) ratio because small changes in a bank's lending margin can translate into large bottom line changes. The higher the ratio the cheaper the funding or the higher the margin the bank is obtaining. A bank's net interest margin is a key performance measure that drives ROA. Net interest income is the difference between interest income and interest expense. It is the gross margin on a bank's lending and investment activities. It is calculated as: **$NIM = \text{interest income} - \text{interest expense}$**



Source: researcher computation from financial statement of BOA

As it has been shown in graph 4.2 above, the net interest margin of Bank of Abyssinia has shown a continuous improvement from the fiscal year 2005 to 2009. This implies that the bank's deposit

is showing progress (from 1,627,627,080 in the fiscal year 2005 to 4,494,186,427 in the fiscal year 2009) and the bank has used this deposit to grant loans for its customers, this in turn maximizes the net interest income of the company. As it can be seen from the financial statement of the bank, the loan has shown growth from 1,172,965,585 birr in 2005 to around birr 2,442,747,456 in the fiscal year 2009 by showing more than hundred percent growth.

5. Non-interest Income to Asset Ratio (NIAR)

Non interest Income to Assets (NITA) is an indicator of the operational performance. It indicates the proportion of fees and other income in respect of total assets of banks. This ratio is used as a measure of profitability indicator.

It is calculated as:

$$\text{NITA} = \text{total non interest income} / \text{total asset}$$

Table 4.3 Non-interest Income to Asset Ratio

| <i>particulars</i> | Fiscal Year | | | | |
|---------------------------|--------------------|---------------|---------------|---------------|---------------|
| | 2005 | 2006 | 2007 | 2008 | 2009 |
| Total non-interest income | 46,955,789 | 55,162,594 | 65,139,056 | 95,026,478 | 128,918,531 |
| Total asset | 2,230,722,739 | 3,014,059,680 | 3,577,964,010 | 4,269,946,935 | 5,476,625,540 |
| NITA-ratio | 0.02 | 0.02 | 0.02 | 0.02 | 0.02 |

Source: researcher computation from financial statement of BOA,

As it can be seen from the above Table 4.3, the non-interest income to asset ratio of Bank of Abyssinia has shown a constant trend from the fiscal year 2005 to 2009 which was about 0.02, this implies that in all the fiscal years the non-interest income accounts only 2 percent of the total assets of the company. It can be also said that even though the total asset of the bank has shown continuous growth, the total non interest income has also grown in proportionate amount, which

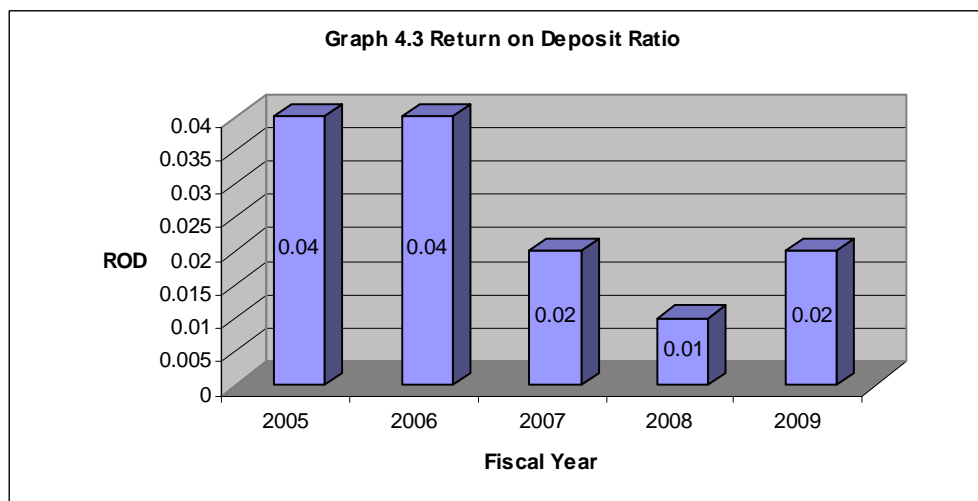
means the bank has equal proportion of non-interest income to its total assets at each fiscal year. The total non-interest income shows almost equal proportion of growth each year with the total asset of the bank.

6. Return on Deposit (ROD)

To most financial analysts, Return on Deposit is one of the best measures of bank profitability performance. This ratio reflects the bank management ability to utilize the customers' deposits in order to generate profits.

It is calculated as:

$$\text{ROD} = \text{Net Profit after Tax} / \text{Total Deposit}$$



Source: researcher computation from financial statement of BOA

As it has been indicated in graph 4.3 above, the return on deposit ratio of Bank of Abyssinia was the same in 2005 and 2006 which was around 4 percent. In 2008, it has declined to one percent. This implies that four percent of the bank's profit was generated from the deposit of customers in the fiscal year 2005 and 2006; two percent both in the fiscal years 2007 and 2009 and in the year 2008 it has declined to two percent. This was because of the fact that the net income the bank is getting was showing declining trend (for instance, the net income has declined from birr 87,279,946 in the fiscal year 2006 to birr 16,655,459 in the fiscal year 2008) and the contribution to this net income from the deposit of customers of the bank has also declined in huge amount.

4.1.2 Liquidity Ratios

Liquidity ratios attempt to measure a company's ability to pay off its short-term debt obligations. This is done by comparing a company's most liquid assets to short-term liabilities. The higher liquidity ratios mean the bank has larger margin of safety and ability to cover its short-term obligations. Because saving accounts and transaction deposits can be withdrawn at any time, there is high liquidity risk for both the banks and other depository institutions.

1. Loan to Deposit Ratio

This refers to the amount of a bank's loans divided by the amount of its deposits at any given time. The higher the ratio, the more the bank is relying on borrowed funds, which are generally more costly than most types of deposits. Bank with low LDR is considered to have excessive liquidity, potentially lower profits, and hence less risk as compared to the bank with high LDR.

It is calculated as:

$$\text{LDR} = \text{Loan} / \text{Deposit}$$

Table 4.4 Loan to Deposit Ratio

| <i>particulars</i> | Fiscal Year | | | | |
|--------------------|--------------------|---------------|---------------|---------------|---------------|
| | 2005 | 2006 | 2007 | 2008 | 2009 |
| Total loan | 1,172,968,585 | 1,901,466,545 | 2,197,341,801 | 2,566,577,377 | 2,442,747,456 |
| Total deposit | 1,627,627,080 | 2,176,885,481 | 2,721,327,589 | 3,477,767,008 | 4,494,186,427 |
| LD-ratio | 0.72 | 0.87 | 0.81 | 0.74 | 0.54 |

Source: researcher computation from financial statement of BOA

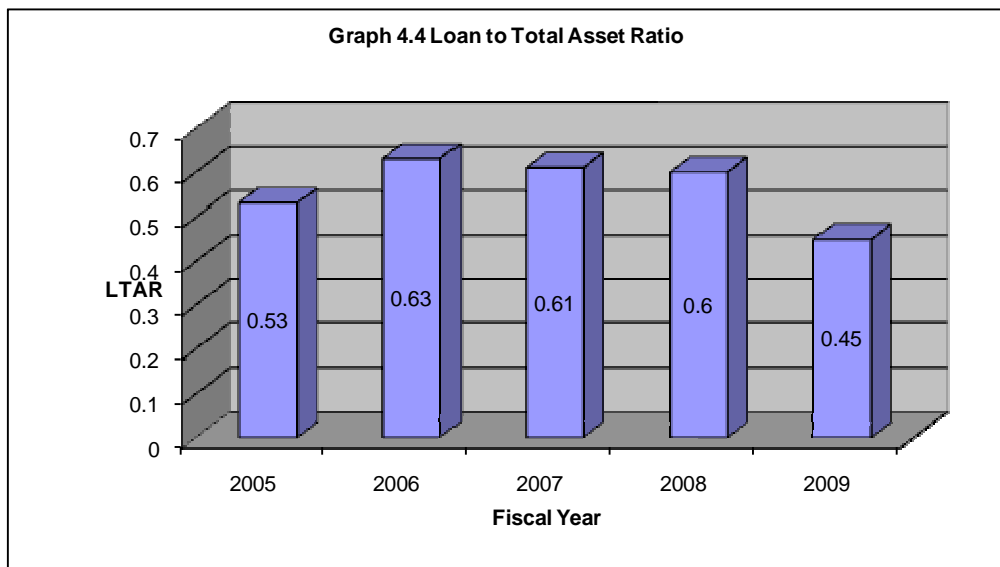
As it can be seen from Table 4.4 above, the loan to deposit ratio of Bank of Abyssinia has reached its maximum peak in the year 2006 which was around 87 percent which implies the bank has granted eight-seven percent of its deposits as a loan to its customers and only thirteen percent

was kept in the bank, this shows that although the bank was generating interest income from the loan granted, the bank may face liquidity risk because customers may withdraw their saving account and transaction deposits at any time. In 2009, it has reached to 54 percent which shows the banks conservative measures taken to grant loan to customers. This was because the loan that was granted to the bank's customers has shown declining trend comparing the previous year 2008 but the deposit of the bank has increased by about 22.6 percent.

2. Loan to Asset Ratio

The loan to assets ratio measures the total loans outstanding as a percentage of total assets. The higher this ratio indicates a bank is loaned up and its liquidity is low. The higher the ratio, the more risky a bank may be to higher defaults. This figure is determined as follows:

$$\text{Loans to Assets} = \text{Loan} / \text{Total Asset}$$



Source: researcher computation from financial statement of BOA

As it can be seen from graph 4.4 above, the loan to asset ratio of Bank of Abyssinia has shown irregular trend. In the fiscal year 2006, it was around 63 percent and in the fiscal year 2009 it has declined to around 45 percent which implies that the total loan granted to the bank's customers accounts about 63 percent of the total asset in the fiscal year 2006 and 45 percent in 2009. As it

can be seen from the financial statement of Bank of Abyssinia although the loan granted to its customers has shown growth, the total asset has also increased continuously between the fiscal years 2005 to 2009 (from a total asset of 2,230,722,739 in the fiscal year 2005 to a total asset of 5,476,625,540 in 2009).

4.1.3 Risk and Solvency Ratios

Acceptable solvency ratios will vary from industry to industry, but as a general rule of thumb, a solvency ratio of greater than twenty percent is considered financially healthy. Generally speaking, the lower a company's solvency ratio, the greater the probability that the company will default on its debt obligations.

For a bank, debt consists essentially of sight deposits. The financial assets are the loans granted. After all, the purpose of a bank is to distribute loans!

A bank's solvency therefore consists of its ability to fulfill the withdrawal demands of its depositors. And that is where the regulatory authorities come in to ensure that bank are indeed capable of meeting their obligations. This is a matter that affects the economic stability of an entire country. Debt-Equity Ratio (DER), Debt to Total Assets Ratio (DTAR), and Equity Multiplier (EM) are the most important measures used to gauge risk and solvency of a bank.

1. Debt to Equity Ratio

This ratio indicates how much the company is leveraged (in debt) by comparing what is owed to what is owned. A high debt to equity ratio could indicate that the company may be over-leveraged, and should look for ways to reduce its debt.

Equity and debt are two key figures on a financial statement, and lenders or investors often use the relationship of these two figures to evaluate risk. The ratio of your business' equity to its long-term debt provides a window into how strong its finances are. Equity will include goods and property your business owns, plus any claims it has against other entities. Debts will include both current and long-term liabilities.

It is calculated:

$$\text{DER} = \text{Total liabilities} / \text{share holders' equity}$$

Table 4.5 Debt to Equity Ratio

| <i>particulars</i> | Fiscal Year | | | | |
|----------------------|--------------------|---------------|---------------|---------------|---------------|
| | 2005 | 2006 | 2007 | 2008 | 2009 |
| Total liabilities | 1,977,494,722 | 2,612,436,106 | 3,175,212,704 | 3,849,866,780 | 4,957,396,033 |
| Shareholders' equity | 253,228,017 | 401,623,574 | 402,751,306 | 420,080,155 | 519,229,507 |
| DER-Ratio | 7.81 | 6.50 | 7.88 | 9.16 | 9.55 |

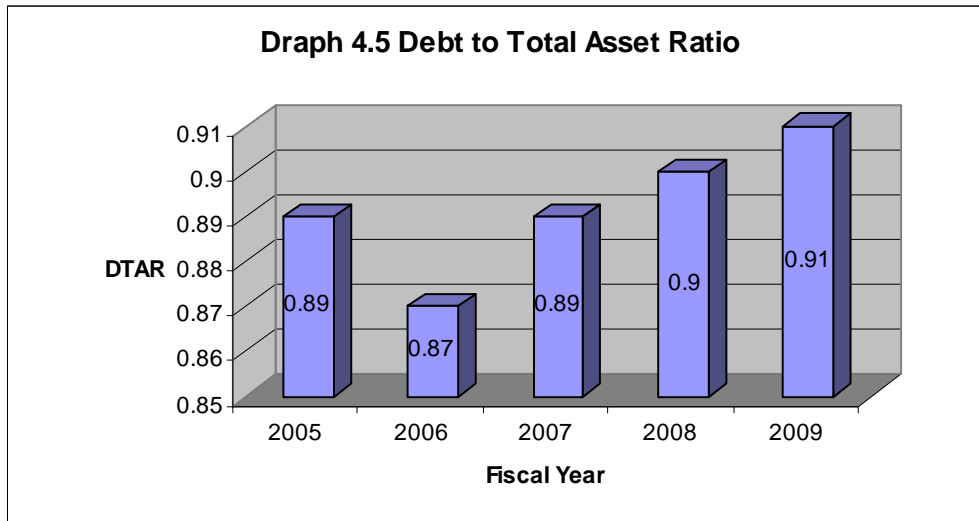
Source: researcher computation from financial statement of BOA

As it has been shown in table 4.5 above, debt to equity ratio of Bank of Abyssinia was having the highest ratios in 2008 and 2009 which were 9.16 and 9.55 respectively which means creditors of BOA has provided about 9.2 Birr in 2008 and almost 9.6 Birr in 2009 in financing for every one Birr contribution by owners. As it can be observed from the financial statement of the bank, the total liability of the bank has grown by 76 percent from the fiscal year 2005 to 2006, by 82 percent from 2006 to 2007 and by 64 percent from 2007 to 2009 but the growth of the total shareholders equity is by 64 percent from 2005 to 2006, only by 0.1 percent from 2006 to 2007 and by 19 percent from 2008 to 2009. This implies that the bank is highly dependent on the fund generated from creditors or it is highly leveraged. The bank's management should take serious measures in making important adjustments so as to rectify the problem.

2. Debt to Total Asset Ratio

The debt to asset ratio is the percentage of total debt financing the firm uses as compared to the percentage of the firm's total assets. It helps you see how much of your assets are financed using debt financing.

The lower the Debt to Asset Ratio, the better, as companies with high amounts of debt introduce more risk. You certainly want to look very hard at companies that have more Total Liabilities than Total Assets, as this is a precarious position for a company to be in. Depending on the industry of the company, you might expect the company to have two or three times as many assets as liabilities. Anything less than this might be a signal that the company is running into trouble.



Source: researcher computation from financial statement of BOA

As it is shown in the Graph 4.5 above, in the year 2009, the debt to total asset ratio of the Bank of Abyssinia was around 0.91. The bank was having the same debt to total asset ratio in the fiscal years 2005 and 2007 which was around 0.89; and 0.87 and 0.90 debt to total asset ratio was reported in the fiscal years 2006 and 2008 respectively. This implies that from the bank's total assets, 89 percent of the assets were financed by the fund generated from the creditors in the fiscal year 2005, 87 percent in 2006, 89 percent in 2007, 90 percent in the fiscal year 2008 and 91 percent in the fiscal year 2009. As it can be seen from the financial statement of Bank of Abyssinia the proportion of creditors contribution to the bank's total assets is showing continuous upward trend and this implies that the bank's performance is showing a declining trend i.e., the bank is highly dependent on the fund granted from creditors. Therefore, the bank's management should appraise the causes in detail and take corrective measures.

3. Equity Multiplier Ratio

A measure of financial leverage calculated as Total Assets/Total Stockholders' Equity. Like all debt management ratios, the equity multiplier is a way of examining how a company uses debt to finance its assets. It is also known as the financial leverage ratio or leverage ratio.

In other words, this ratio shows a company's total assets per dollar of stockholders' equity. A higher equity multiplier indicates higher financial leverage, which means the company is relying more on debt to finance its assets.

It is calculated as:

$$\text{EM} = \text{Total Assets} / \text{Total Stockholders' Equity}$$

Table 4.6 Equity Multiplier Ratio

| <i>particulars</i> | Fiscal Year | | | | |
|----------------------------|--------------------|---------------|---------------|---------------|---------------|
| | 2005 | 2006 | 2007 | 2008 | 2009 |
| Total assets | 2,230,722,739 | 3,014,059,680 | 3,577,964,010 | 4,269,946,935 | 5,476,625,540 |
| Total shareholders' equity | 253,228,017 | 410,623,574 | 402,751,306 | 420,080,155 | 519,229,507 |
| EM-Ratio | 8.81 | 7.50 | 8.88 | 10.16 | 10.55 |

Source: researcher computation from financial statement of BOA

As it can be seen from the above Table 4.6, the equity multiplier ratio of Bank of Abyssinia has shown continuous growth starting from 2006 to 2009. It has grown from 7.50 in 2006 to 10.55 in 2009 which implies the bank's total assets has been continuously financed by creditors of the bank in huge amount or the contribution of the bank's owners is getting lesser and lesser. In other words the creditors are highly investing in the assets of the company which implies the bank is becoming highly leveraged. For instance, in the fiscal year 2005, for owners each one birr contribution, the creditors of the bank are contributing around Birr eight and eighty-one cents, this grows to almost to Birr ten and Birr eleven in the fiscal years 2008 and 2009. This shows that the management of the bank has to work hard in reducing the debt amount through maximizing the bank's profit, increasing the efficiency of the workers, and using the idle assets in generating profits, etc.

4.1.4 Efficiency Ratios

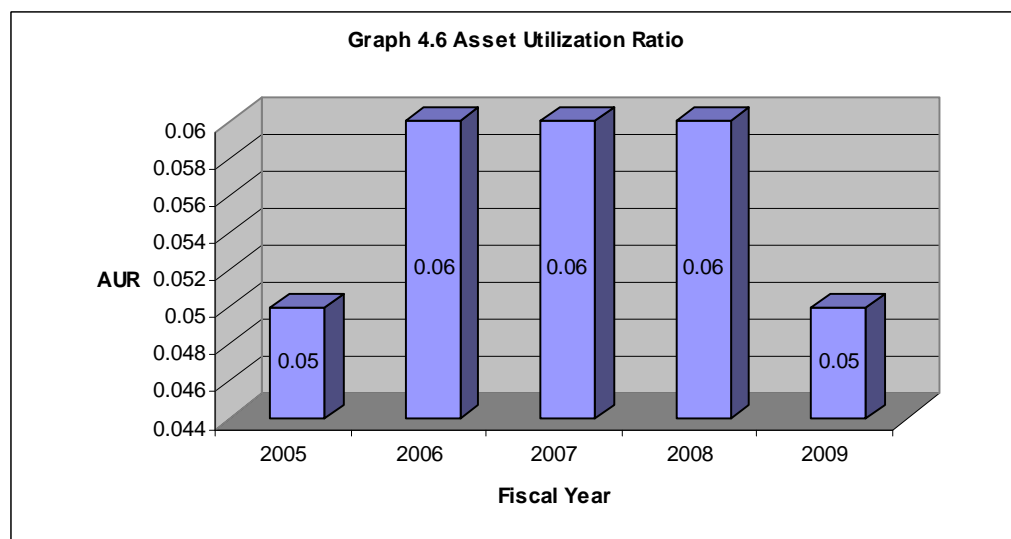
The efficiency ratios and other ratios are key ratios to understanding financial statements. Our ratio calculation spreadsheets reduce time and effort in calculating decision making ratios. They reduce risk for lenders and investors and enable owners, managers and consultants to increase productivity and business profits.

1. Asset Utilization Ratio

How effectively the bank is utilizing all of its assets is measured by assets utilization ratio. The bank is presumably said to using its assets effectively in generating total revenues if the AU ratio is high. If the ratio of AU is low, the bank is not using its assets to their capacity and should either increase total revenues or dispose of some of the assets.

It is calculated as:

$$\text{AUR} = \text{Total Revenue} / \text{Total Asset}$$



Source: researcher computation from financial statement of BOA

As it has been indicated in graph 4.6 above, asset utilization ratio of Bank of Abyssinia has showed constant trend from the fiscal year 2006 to 2008 which was around six percent. In 2005 and 2009 it was having an asset utilization ratio of five percent, from the total profit the company has generated the assets were contributed only six percent (in the fiscal years 2005 and 2009) and five percent (in the fiscal years 2006 to 2008). This implies that even though the total asset

proportion was increasing from year to year ,the contribution of the assets to the total profit of the bank is not showing progress which implies that there are assets which are contributing nothing for the profit of the company. Therefore, the management of the bank has to make those assets which are idle to contribute for the profit of the company, if is not possible to do so the idle assets have to be disposed off and reinvesting the fund in other profitable investments.

2. Income to Expense Ratio

This is the most commonly and widely used ratio in the banking sector to assess the managerial efficiency in generating total income vis-à-vis controlling its operating expenses. Income to expense is the ratio that measures amount of income earned per dollar of operating expense. High income expense ratio is preferred over lower one as this indicates the ability and efficiency of the bank in generating more total income in comparison to its total operating expenses.

It is calculated as:

$$\text{IER} = \text{Total income} / \text{Total Operating Expenses}$$

Table 4.7 Income to Expense Ratio

| <i>particulars</i> | Fiscal Year | | | | |
|-------------------------|--------------------|-------------|-------------|-------------|-------------|
| | 2005 | 2006 | 2007 | 2008 | 2009 |
| Total income | 118,724,185 | 179,667,181 | 206,196,879 | 254,042,488 | 292,746,229 |
| Total operating expense | 36,683,611 | 56,745,638 | 111,216,547 | 232,135,062 | 147,346,454 |
| IER-Ratio | 3.24 | 3.17 | 1.85 | 1.09 | 1.99 |

Source: researcher computation from financial statement of BOA

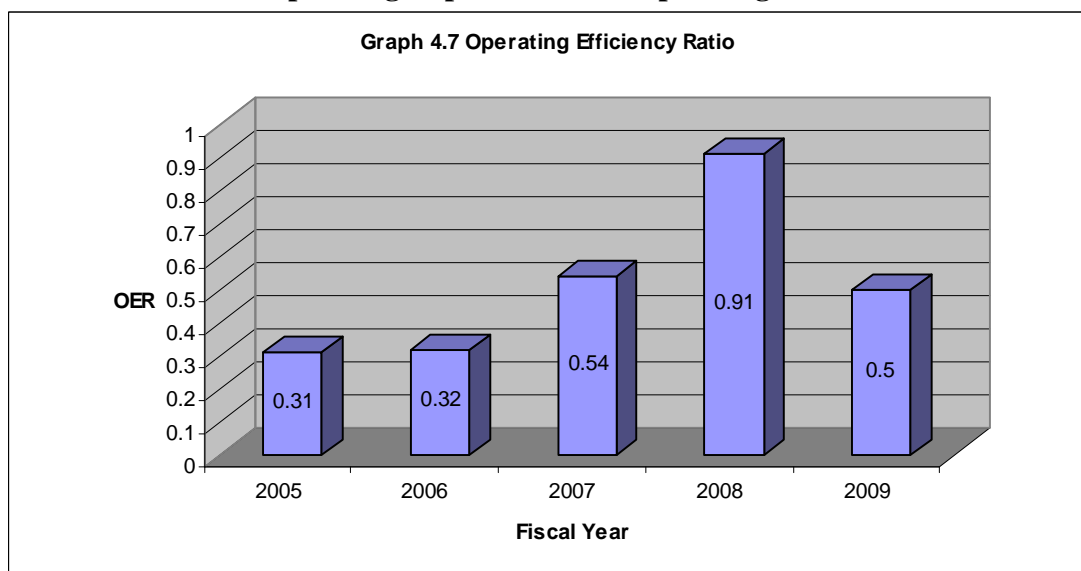
As it can be observed from table 4.7 above, the income to expense ratio of the bank has shown a declining trend from the fiscal year 2005 to 2008 continuously, this implies that the bank's expenses are showing an upward trend continuously but the total income was following the reverse path or the total income that was generated from a single dollar of expense is declining. For instance, the total expense of the bank has grown by more than four hundred percent (From

Birr 36,683,611 to Birr147, 346,454) in the fiscal year 2009 than it was seen in the fiscal year 2005 but the total income of the bank was grown only by two hundred percent (from Birr 118,724,185 to Birr 292,746,229) in the fiscal year 2009 than it was observed in the fiscal year 2005. In the fiscal year 2005, the income to expense ratio of the bank was 3.24 and it has reached 1.09 in 2009 which implies that the bank has generated Birr 3.24 and Birr 1.09 on each of the single dollar expense it has incurred. It again showed increment to 1.99 in 2009 fiscal year. Generally, the management of the bank in reducing costs and maximizing the total income is shown a weaker effort. Therefore, the bank management has to assess the causes for these problems critically and should take serious measures in controlling the total expense and maximizing the total income of the company.

3. Operating Efficiency Ratio

It measures managerial efficiency in generating operating revenues and controlling its operating expenses. In other words, how efficient is the bank in its operations unlike income to expense ratio, which measures the amount of income earned per dollar of operating expense, operating efficiency is the ratio that measures the amount of operating expense per dollar of operating revenue. Lower operating expense is preferred over higher operating expense as lower expense indicates that operating expenses are lower than operating revenues. It is calculated as:

$$\text{OER} = \text{Total Operating Expenses} / \text{Total Operating Revenue}$$



Source: researcher computation from financial statement of BOA

As it has been seen in Graph 4.7 above, Bank of Abyssinia's operating efficiency ratio has shown an increasing trend from the year 2005 to 2008 which implies the amount of expense incurred on each dollar of revenue is increasing. For instance, in the fiscal year 2005, the bank has incurred only Thirty-one cents on each of one Birr revenue it has enjoyed but it has grown to Fifty-four cents in 2007, Ninety-one cents in the fiscal year 2008. As it can be seen from the financial statement of the bank, the efficiency of the bank's management in controlling costs is showing a declining trend, whose consequence is reducing the total revenue. Therefore, the management should take appropriate measures to improve the performance of the bank i.e., they should seriously work in reducing expenses and maximizing costs.

4.1.5 Credit Quality Ratios

One of the most important sources of income for commercial bank is the issuing of loans. However, when a commercial bank makes loans it is exposed to risks, because banks operate in asymmetric information. The principal risk it faces is the risk of defaulting interest payment or the principal or both interest and loans. Thus, loan performance measures bank's risk associated with loans created by bank. In other words, it measures the quality of loans. The greater is the amount of loan and interest in default, the higher is a risk for a bank, and the bank is going to be rated as poor. The following three financial measures are used for measuring the credit quality of commercial banks.

1. Equity to Total Asset Ratio (ETAR)

Equity to Asset ratio measures equity capital as a percentage of total assets. It provides percentage protection afforded by banks to their investment in asset. It measures the overall shock absorbing capacity of a bank for potential loan asset losses. The higher the ratio of EQTA, the greater is the capacity for a bank to sustain the assets losses.

It is calculated as:

$$\text{ETAR} = \text{Total Equity} / \text{Total Asset}$$

Table 4.8 Equity to Total Asset Ratio

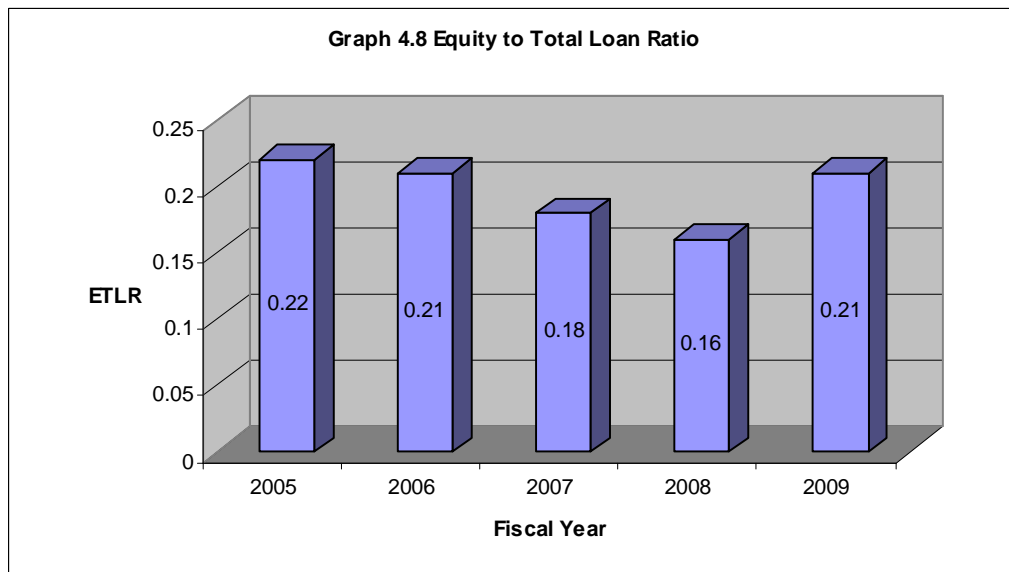
| particulars | year | | | | |
|--------------|---------------|---------------|---------------|---------------|---------------|
| | 2005 | 2006 | 2007 | 2008 | 2009 |
| Total Equity | 253,228,017 | 401,623,574 | 402,751,306 | 420,080,155 | 519,229,509 |
| Total Asset | 2,230,722,739 | 3,014,059,680 | 3,577,964,010 | 4,269,946,935 | 5,476,625,540 |
| ETA-Ratio | 0.11 | 0.13 | 0.11 | 0.10 | 0.09 |

Source: researcher computation from financial statement of BOA

As it has been indicated in Table 4.8 above, the equity to total asset ratio of Bank of Abyssinia is showing almost a constant rate of equity to total asset ratio each year. In the fiscal years 2005 and 2007 it was around eleven percent, thirteen percent in 2006, ten and nine percent in the fiscal years 2008 and 2009 respectively which implies the overall shock absorbing capacity of a bank is showing little progress from year to year. For instance, the owners are contributed only eleven cents for each one Birr potential loan asset losses of the company in the fiscal years 2005 and 2007 and it has shown no progress in the consecutive years rather it is declined to ten percent in 2008 and nine percent in 2009. This implies that the bank's total assets have been continuously financed by creditors of the bank in huge amount or the contribution of the banks owners is getting lesser and lesser. Therefore, the management of the bank has to take important measures to maximize the owners' contribution in the proportion of the total asset of the bank.

2. Equity to Loan Ratio (EQL)

Equity to loan ratio measures equity capital as a percentage of total loans. It provides equity as a cushion (protection) available to absorb loan losses. The higher the equity to loan ratio, the higher it will be the capacity for a bank in absorbing loan losses.



Source: researcher computation from financial statement of BOA

As it has been indicated in graph 4.8 above, the equity to total loan ratio of Bank of Abyssinia has shown a declining trend from the fiscal year 2005 to 2008, this implies that the proportion of the total share holders' equity of the company to the total loan of the bank is getting lower and lower. This in turn shows that the bank is granting huge amount of loan to its customers and if in case the bank faces risk of loan repayment, the proportion of the owners in resisting the shock of loss is lower i.e. the company will be in a position to face bankruptcy. For instance, the loan of the bank that was granted to its customers has grown from Birr 1,172,968,585 in the fiscal year 2005 to Birr 2,442,747,456 in the fiscal year 2009, it has grown by more than hundred percent but the total equity did not show such amount of changes (it has grown by only about Birr 250 million from the fiscal year 2005 to 2009). This indicates that the bank did not take measures to maximize shareholders equity. Therefore, the bank management has to work to maximize the total shareholders equity and to use strict techniques of credit management to appraise customers' position before granting loans.

3. Non Performing Loans to Total Loan Ratio (NPTLR)

Non performing loan to total loan ratio is one of the most important criteria to assess the quality of loans or asset of a commercial bank. It measures the percentage of gross loans which are

doubtful in banks' portfolio. The lower the ratio of non performing loan to total loan ratio, the better is the asset/credit performance for the commercial bank.

To measure banks' creditworthiness and risk exposures is a complicated issue and it is not easy to interpret banks' accounting data. (Kaminsky and Reinhart,1999) argued that indicators of business failures and nonperforming loans are also usually available only at low frequencies, if at all; the latter are also made less informative by banks desire to hide their problems for as long as possible. This means that it is needed to use as fully and complexly as possible all available financial information from the official financial statements of banks for making financial analysis of banks' performance.

Table 4.9 Non Performing Loan to Total Loan Ratio

| particulars | year | | | | |
|----------------------------|---------------|---------------|---------------|---------------|---------------|
| | 2005 | 2006 | 2007 | 2008 | 2009 |
| Non performing Loan | 2,505,971 | 4,159,280 | 46,756,843 | 142,771,341 | 15,641,598 |
| Total Loan | 1,172,968,585 | 1,901,466,545 | 2,197,341,801 | 2,566,577,377 | 2,442,747,456 |
| NPLTL-Ratio | 0.002 | 0.002 | 0.02 | 0.06 | 0.006 |

Source: researcher computation from financial statement of BOA

As it can be observed from Table 4.9 above, the total non-performing loan to total loan ratio of Bank of Abyssinia shows that the bank's non-performing loan is showing an increasing trend from the fiscal year 2005 to 2009. In the fiscal year 2005, from the total loan granted to its customers around 0.4 percent was reported as non-performing loan, in 2007 it has grown to two percent, in 2008 still it has grown to six percent and in the fiscal year 2009 it has improved to about 0.6 percent. This implies that the bank's performance was showing an irregular trend. For instance, in the year 2005, the loan that was left uncollectible was only 0.4 percent (about Birr 4,159,280 out of Birr 1,172,968,585) but in 2008 it has grown to six percent (about Birr 142,771,341 out of Birr 2,566,577,377) which implies that the bank has granted huge amount of

loan to customers with out using appropriate credit appraisal techniques. Therefore, the management has to follow critical credit appraisal techniques before granting loan to its customers.

4.2 Comparative Analysis of Bank of Abyssinia with Other Private Commercial

Banks

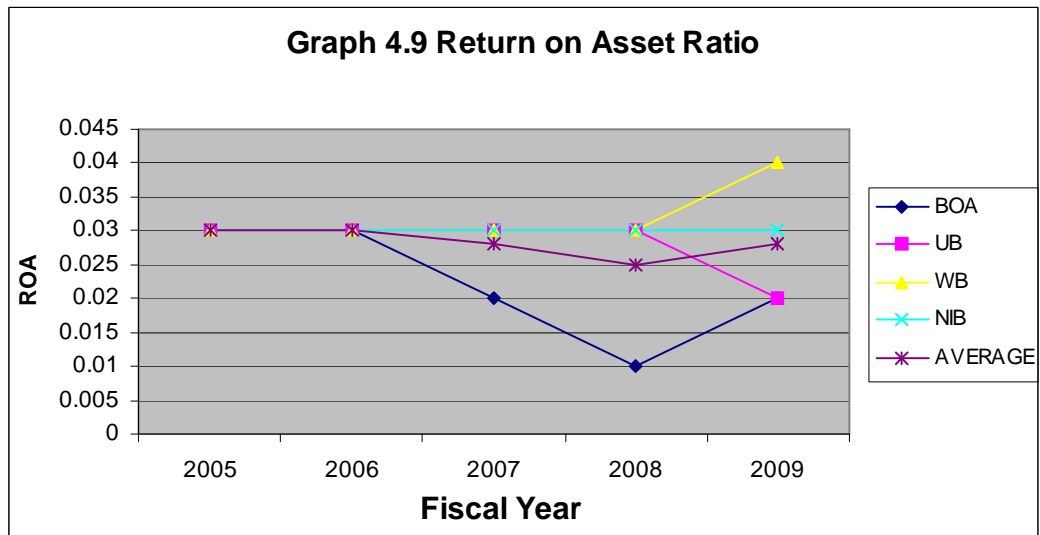
In this section, the financial performance of Bank of Abyssinia in comparison with the financial performance of other private commercial banks in Ethiopia is presented. Those banks which were established before the fiscal year 2005, with almost similar number of branches and total capital reserve are selected for comparison purpose. Based on these criteria; the banks which were taken for comparison purpose are United Bank Share Company, Wegagen Bank Share Company, and Nib International Bank Share Company. The name of the banks, number of branches, total capital and date of establishment are presented here under.

| Name of the bank | Established in (G.C) | Number of branches | Total capital (in 2009) |
|------------------|----------------------|--------------------|-------------------------|
| AIB Sc. Company | 1994 | 60 | 750,000,000 |
| DB Sc. Company | 1995 | 55 | 909,000,000 |
| WB Sc. Company | 1997 | 50 | 532,000,000 |
| BOA Sc. Company | 1996 | 47 | 519,229,507 |
| UB Sc. Company | 1998 | 41 | 519,974,509 |
| NIB Sc. Company | 1999 | 45 | 728,823,558 |

Source: NBE and the banks' financial statements

4.2.1 Profitability Ratios

1. Return on Asset Ratio



Source: researcher computation from financial statement of the banks

As it has been in Graph 4.9 above, all the private commercial banks have shown the same return on asset ratio in 2005 and 2006 which was around three percent which implies the total asset of the banks has contributed only three percent of the banks' profit. From 2007 to 2009, Bank of Abyssinia has scored lower ratio than the average of all the private commercial banks. As it was already explained this was caused as a result of the continuous increment observed in the bank's expenses (especially in the provisions for doubtful loans and advances) and declining trend in the profit of the bank. Wegagen bank has shown the highest return on asset ratio in 2009 which was around four percent.

2. Return on Equity

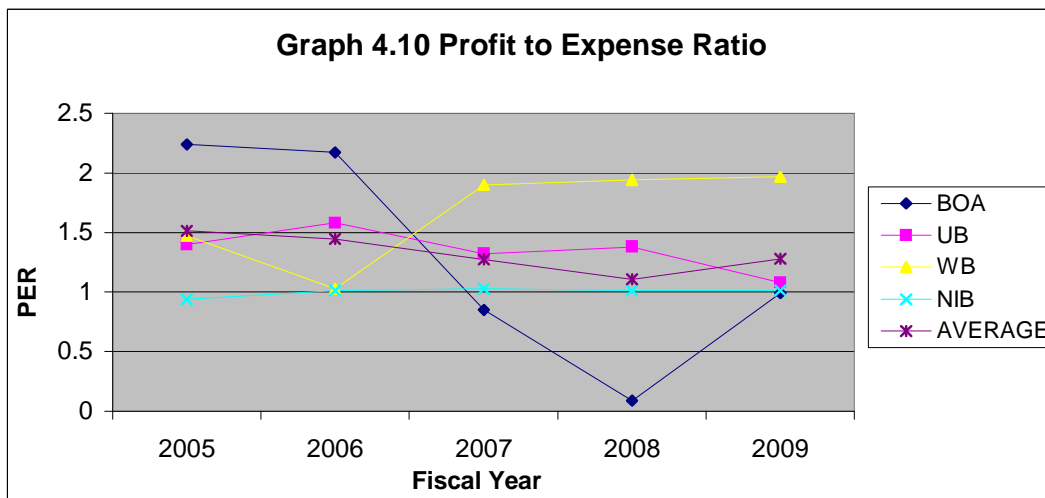
Table 4.10 Return on Equity

| year | Commercial banks | | | | average |
|------|------------------|------|------|------|---------|
| | BOA | UB | WB | NIB | |
| 2005 | 0.24 | 0.25 | 0.26 | 0.21 | 0.240 |
| 2006 | 0.22 | 0.23 | 0.28 | 0.20 | 0.233 |
| 2007 | 0.16 | 0.18 | 0.28 | 0.18 | 0.200 |
| 2008 | 0.04 | 0.19 | 0.23 | 0.19 | 0.163 |
| 2009 | 0.19 | 0.18 | 0.22 | 0.21 | 0.200 |

Source: researcher computation from financial statement of the banks

As it can be seen from the above Table 4.10, Bank of Abyssinia's return on equity ratio has shown the lowest figure in all the fiscal years from 2005 to 2009 when it is compared with the average of private commercial banks return on equity ratio which implies that the total share holders equity of the bank is contributing a lower amount for the total profit of the bank. For instance, in the fiscal year 2005, about 24 percent of the total profit was generated from the equity of the bank; 22 percent in 2006, but in the fiscal year 2008, only four percent of the total profit was generated from the equity of the bank. Wegagen bank has shown the highest return on equity ratio in 2006 which was 28 percent and the lowest return on equity ratio by Bank of Abyssinia in 2008 which was four percent.

3. Profit to Expense Ratio



Source: researcher computation from financial statement of the banks

From the Graph 4.10 above, in the fiscal years 2005 and 2006, Bank of Abyssinia has reported a higher profit to expense ratio than the average profit to expense ratio of the private commercial banks which was around Birr 2.24 and 2.17 respectively, this implies that from each one birr expense the bank has incurred, it has enjoyed a profit of Birr two and twenty-four cents in the fiscal year 2005 and Birr two and seventeen cents in 2007. From the fiscal years 2007 to 2009, a lesser profit to expense ratio was seen in Bank of Abyssinia. This shows that when comparing the bank with the other private commercial banks in terms of controlling costs and maximizing profits, its management has performed weaker and needs to make corrective measurements especially in controlling costs and improving profits.

4. Net Interest Margin

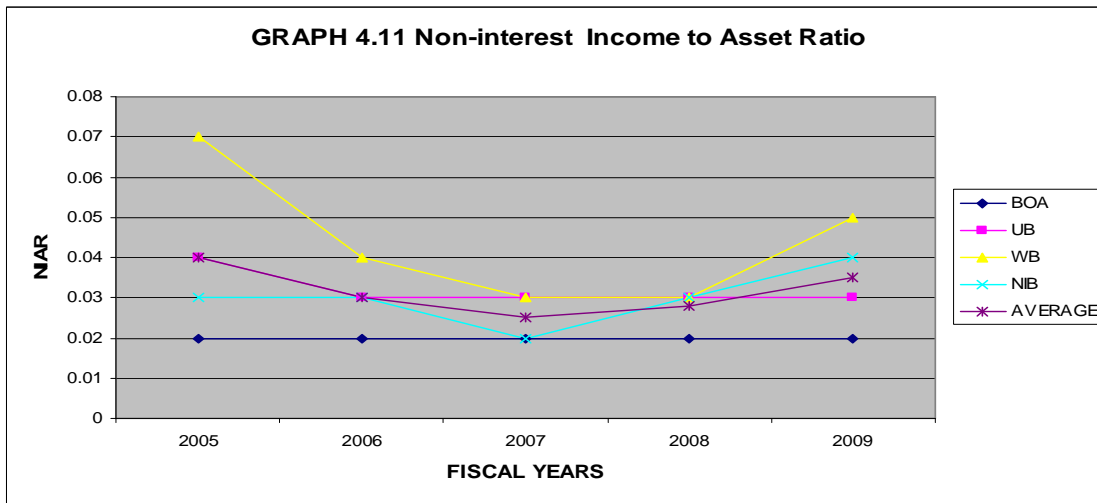
Table 4.11 Net Interest Margin

| year | Commercial banks | | | | average |
|------|------------------|-------------|-------------|-------------|-------------|
| | BOA | UB | WB | NIB | |
| 2005 | 71,768,396 | 28,507,850 | 58,397,888 | 59,065,964 | 54,435,025 |
| 2006 | 124,504,587 | 42,716,890 | 85,000,000 | 73,093,026 | 81,328,626 |
| 2007 | 141,057,823 | 82,569,642 | 129,729,134 | 105,152,759 | 114,627,340 |
| 2008 | 159,016,010 | 108,303,969 | 148,565,012 | 147,780,386 | 140,916,344 |
| 2009 | 163,827,698 | 122,411,144 | 150,085,783 | 178,477,545 | 153,700,543 |

Source: researcher computation from financial statement of the banks

As it has been shown in Table 4.11 above, Bank of Abyssinia has shown the highest net interest margin in all the fiscal years from 2005 to 2009, even the net interest margin of the bank was much greater than the average rate of all the private commercial banks taken for comparison purpose. As it can be seen from the financial statements of the banks (see from appendix), Bank of Abyssinia has granted huge amount of loan comparing it with the loans granted by the other private commercial banks taken for analysis purpose, which in turn enables the bank to generate high amount of net interest income. But on the contrary, extending huge amount of loan implies that the bank's credit policy is not strict and the bank does not use critical credit appraisal techniques and the management has to take cautions in granting loans.

5. Non-interest Income to Asset Ratio



Source: researcher computation from financial statement of the banks

As it can be seen from Graph 4.11 above, a constant trend of 0.02 (two percent) non-interest income to total asset ratio was registered by Bank of Abyssinia from the fiscal year 2005 to 2009 which was lesser than the average ratio of the private commercial banks in all the fiscal years considered in the study which means only two percent of the total non-interest income has been generated from the total assets of the bank. This implies that even though the total asset of the bank has shown continuous growth, the total non interest income has also grown in proportionate amount, which means the bank has equal proportion of growth of non-interest income to its total assets at each fiscal year. As it can be seen from the financial statement of the banks, from all the private commercial banks considered for analysis purpose, Wegagen bank has shown better performance which was more than the rate reported by the other banks.

6. Return on Deposit Ratio

Table 4.12 Return on Deposit Ratio

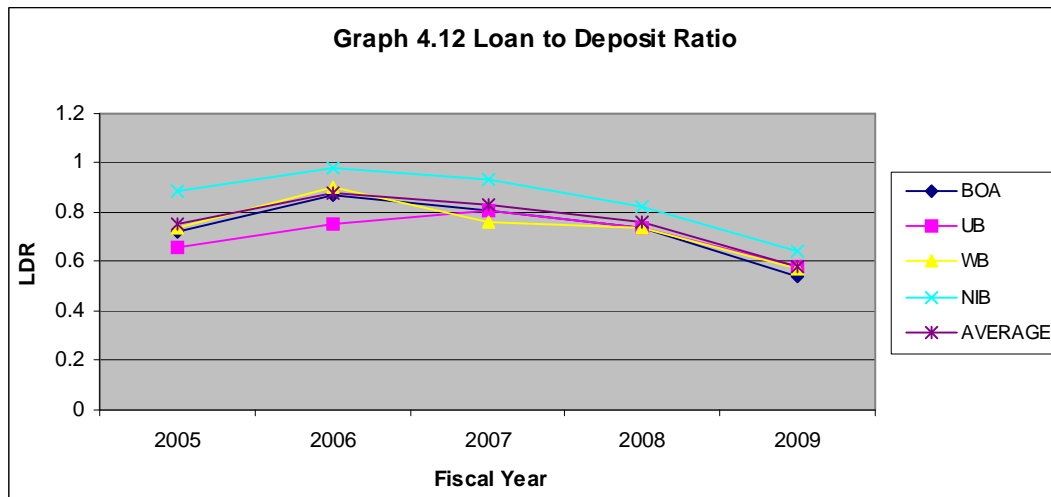
| year | Commercial banks | | | | average |
|------|------------------|------|------|------|---------|
| | BOA | UB | WB | NIB | |
| 2005 | 0.04 | 0.04 | 0.04 | 0.04 | 0.040 |
| 2006 | 0.04 | 0.03 | 0.04 | 0.04 | 0.038 |
| 2007 | 0.02 | 0.04 | 0.04 | 0.04 | 0.035 |
| 2008 | 0.01 | 0.04 | 0.05 | 0.05 | 0.038 |
| 2009 | 0.02 | 0.03 | 0.05 | 0.05 | 0.038 |

Source: researcher computation from financial statement of the banks

As it is depicted in Table 4.12 above, a lower return on deposit ratio was reported by Bank of Abyssinia in 2008 which was around one percent when comparing with the average return on deposit ratio of the private commercial banks which implies the contribution of deposits of the bank to its profit before tax was only one percent. This shows that the bank is not using customers' deposits to generate income or it has investing it in non profitable investment. In all the fiscal years considered, the return on deposit ratio of the bank was the lowest of all the other private commercial banks considered in the study except in the fiscal year 2005. Therefore; the bank management has to verify the causes in detail and has to take corrective actions. From all the private commercial banks, Wegagen bank and Nib International Bank have shown better performance.

4.2.2 Liquidity Ratio

1. Loan to Deposit Ratio



Source: researcher computation from financial statement of the banks

As it can be seen from Graph 4.12 above, when the loan to deposit ratio of Bank of Abyssinia was compared with the average loan deposit ratio of the other private commercial banks, it has shown better performance than United Bank and lesser performance than Nib International Bank. The loan to deposit ratio of Bank of Abyssinia has reached its maximum peak in the year 2006 which was around 87 percent which implies the bank has granted eight-seven percent of its deposits as a loan to its customers and only thirteen percent was kept in the bank, this shows that although the bank was generating interest income from the loan granted, the bank may face liquidity risk because customers may withdraw their saving account and transaction deposits at any time. Nib international bank has granted 98 percent of the deposits as loan to its customers in the fiscal year 2006 and 93 percent in 2007.

2. Loan to Asset Ratio

The loan to assets ratio measures the total loans outstanding as a percentage of total assets. The higher this ratio indicates a bank is loaned up and its liquidity is low. The higher the ratio, the more risky a bank may be to higher defaults.

Table 4.13 Loan to Asset Ratio

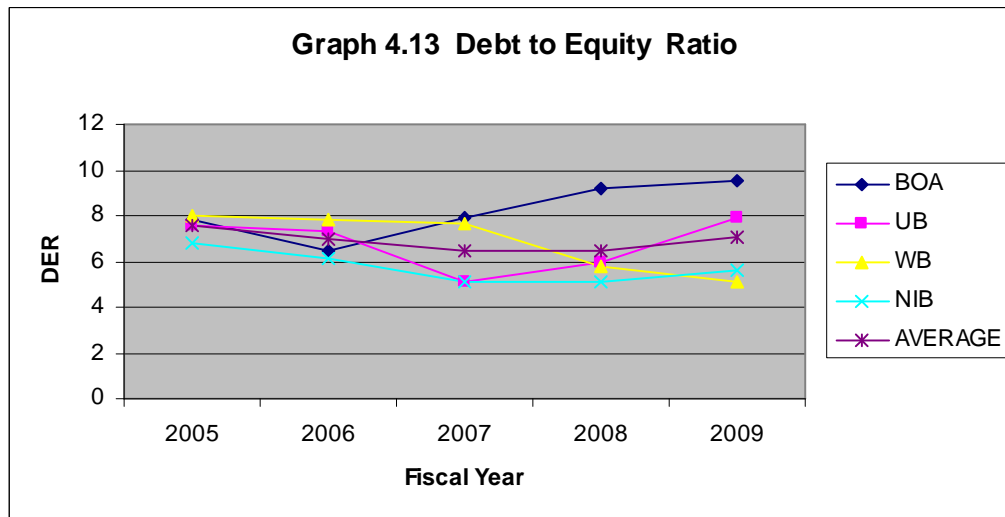
| <i>year</i> | <i>Commercial banks</i> | | | | average |
|-------------|-------------------------|------|------|------|----------------|
| | BOA | UB | WB | NIB | |
| 2005 | 0.53 | 0.53 | 0.59 | 0.63 | 0.570 |
| 2006 | 0.63 | 0.61 | 0.71 | 0.70 | 0.663 |
| 2007 | 0.61 | 0.63 | 0.59 | 0.67 | 0.625 |
| 2008 | 0.60 | 0.56 | 0.54 | 0.56 | 0.565 |
| 2009 | 0.45 | 0.49 | 0.41 | 0.44 | 0.448 |

Source: researcher computation from financial statement of the banks

As it is indicated in Table 4.13 above, Bank of Abyssinia's loan to total asset ratio has shown a better figure from the fiscal year 2005 to 2007 in which the total loan to total asset ratio was lesser than the average total loan to total asset ratio of the other private commercial banks. The total loan of the bank was accounting only 53 percent of the total assets in 2005, it has grown to 63 percent in 2006 and 61 percent in 2007; these ratios showed the bank's better performance comparing it with the other private commercial banks considered in the study. In 2008 and 2009 the loan to total asset ratio of Bank of Abyssinia has declined comparing it with the average loan to total asset ratio of the private commercial banks taken for comparison purpose, 60 percent in 2008 and 45 percent in the fiscal year 2009.

4.2.3 Risk and Solvency Ratios

1. Debt to Equity Ratio



Source: researcher computation from financial statement of the banks

As it has been shown in Graph 4.13 above, the debt to equity ratio of Bank of Abyssinia has shown a lower rate than the average debt to equity ratio of the other private commercial banks except in the fiscal year 2006. In the fiscal year 2008 and 2009, the debt to equity ratio of bank of Abyssinia was 9.16 and 9.55 respectively which implies for every one birr contribution by the owners, creditors of the bank has contributed almost birr nine in 2008 and birr ten in 2009. This shows that the bank is highly dependent on borrowed funds, which in turn reminds the bank management to search ways to maximize the contribution of share holders. From all the private commercial banks Nib International Bank has reported better performance.

2. Debt to Total Asset Ratio

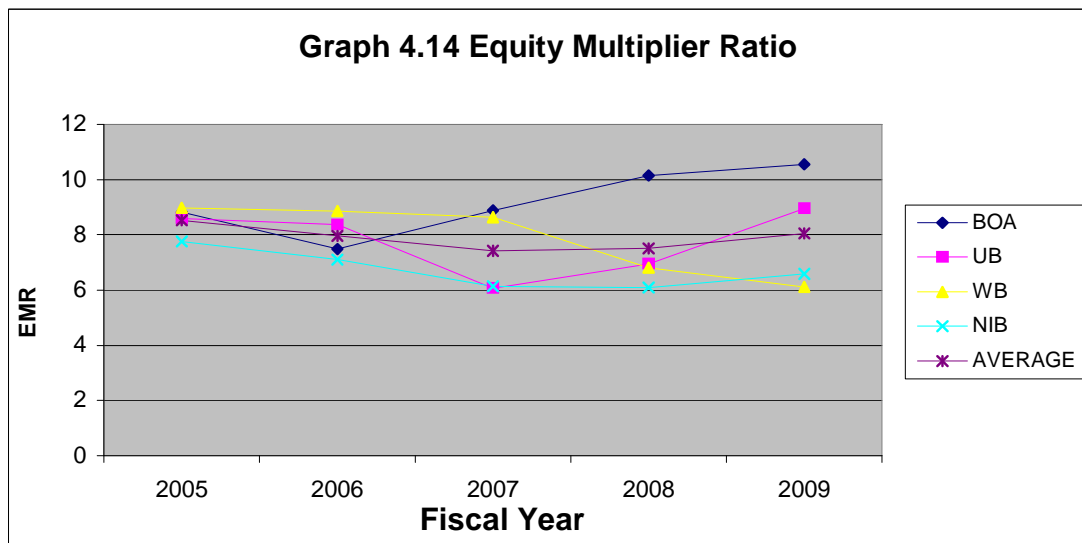
Table 4.14 Debt to Total Asset Ratio

| year | Commercial banks | | | | average |
|------|------------------|------|------|------|---------|
| | BOA | UB | WB | NIB | |
| 2005 | 0.89 | 0.88 | 0.89 | 0.87 | 0.883 |
| 2006 | 0.87 | 0.88 | 0.89 | 0.86 | 0.875 |
| 2007 | 0.89 | 0.84 | 0.88 | 0.84 | 0.863 |
| 2008 | 0.90 | 0.86 | 0.85 | 0.84 | 0.863 |
| 2009 | 0.91 | 0.89 | 0.84 | 0.85 | 0.873 |

Source: researcher computation from financial statement of the banks

As it can be seen from the Table 4.14 above, although all the private commercial banks have reported relatively closed figures, Bank of Abyssinia's debt to total asset ratio showed the lowest rate than the average ratio of the private commercial banks. For instance, in the fiscal years 2008 and 2009 the debt to total asset ratio of the bank was 0.90 and 0.91 respectively, which implies that from all the total assets of the company almost 90 percent in the fiscal year 2008 and 91 percent in 2009 of the assets have been already financed by funds generated from creditors. As it has been already explained, this is an indication of the bank's high dependence on borrowed capital.

3. Equity Multiplier Ratio



Source: researcher computation from financial statement of the banks

As it has been indicated in Graph 4.14 above, when comparing the average equity multiplier ratio of the private commercial banks with that of Bank of Abyssinia's equity multiplier ratio, Bank of Abyssinia has still showed the lowest performance. For instance, in the fiscal years 2008 and 2009 the bank's equity multiplier ratios were 10.16 and 10.55 respectively which implies for every one Birr contribution by the owners the creditors of the bank have contributed Birr ten in the fiscal year 2008 and almost Birr eleven in 2009 and this in turn implies that the company is suffering from high amount of debt. Nib International Bank has shown the best performance of all the other private commercial banks considered for the study.

4.2.4 Efficiency Ratio

1. Asset Utilization Ratio

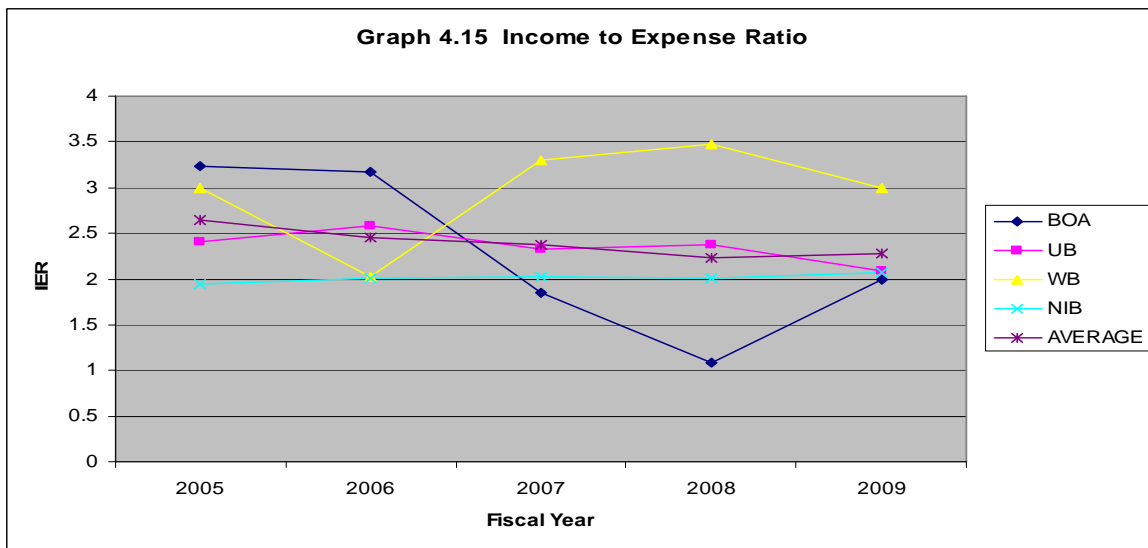
Table 4.15 Asset Utilization Ratio

| year | Commercial banks | | | | Average |
|------|------------------|------|------|------|---------|
| | BOA | UB | WB | NIB | |
| 2005 | 0.05 | 0.07 | 0.08 | 0.08 | 0.070 |
| 2006 | 0.06 | 0.06 | 0.08 | 0.08 | 0.070 |
| 2007 | 0.06 | 0.07 | 0.08 | 0.08 | 0.073 |
| 2008 | 0.06 | 0.07 | 0.08 | 0.09 | 0.075 |
| 2009 | 0.05 | 0.06 | 0.08 | 0.09 | 0.070 |

Source: researcher computation from financial statement of the banks

As it is depicted in Table 4.15 above, when comparing the average asset utilization ratio of the private commercial banks with that of Bank of Abyssinia's asset utilization ratio, Bank of Abyssinia has still showed the lowest performance. In the fiscal years 2006 to 2008, only six percent of the total profit was generated from the assets of the company which is much lesser than the average ratio of the private commercial banks and only five percent of the total profit of the bank was generated from the total assets of the bank in the fiscal years 2005 and 2008. This shows that the bank is not using its assets to contribute more to the profit of the bank or there are idle assets which are bringing nothing to the bank's profit. Nib International Bank has shown the best performance of all the other private commercial banks considered.

2. Income to Expense Ratio



Source: researcher computation from financial statement of the banks

As it can be seen from Graph 4.15 above, in the fiscal years 2005 and 2006, Bank of Abyssinia has shown the highest performance than the other private commercial banks with an income to expense ratio of 3.24 and 3.17 respectively. This implies that for every Birr one expense the bank has incurred, it has generated a profit of almost Birr 3 and 24 cents in the fiscal year 2005 and almost Birr 3 in 2006 which shows the efficiency of management in maximizing profit. From the fiscal year 2007 to 2009, Bank of Abyssinia has showed that it has performed lesser than the average income to expense ratio of the other private commercial banks considered in the study.

3. Operating Efficiency Ratio

Table 4.16 Operating Efficiency Ratio

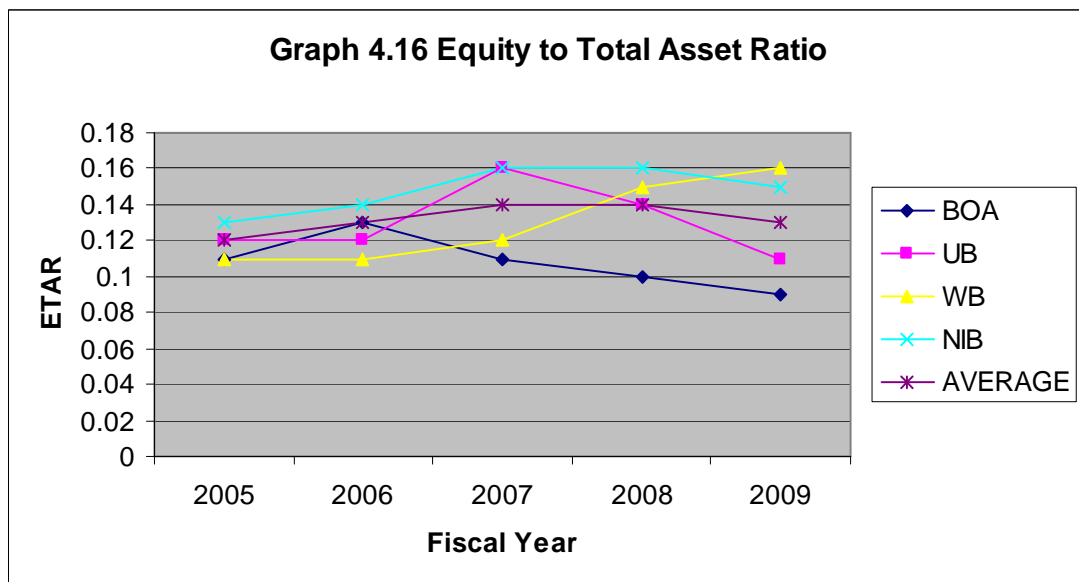
| year | Commercial banks | | | | Average |
|------|------------------|------|------|------|---------|
| | BOA | UB | WB | NIB | |
| 2005 | 0.31 | 0.42 | 0.33 | 0.52 | 0.395 |
| 2006 | 0.32 | 0.39 | 0.49 | 0.50 | 0.425 |
| 2007 | 0.54 | 0.43 | 0.30 | 0.49 | 0.440 |
| 2008 | 0.91 | 0.42 | 0.29 | 0.50 | 0.530 |
| 2009 | 0.50 | 0.48 | 0.33 | 0.48 | 0.448 |

Source: researcher computation from financial statement of the banks

As it has been depicted in Table 4.16 above, when the performance of bank of Abyssinia is compared with the other private commercial banks' operating efficiency ratio, 2005 and 2006 fiscal years were marked by better performance of the bank. It has incurred lower expenses for the revenues it has generated; an expense of 0.32 cents per an income of Birr one generated in the fiscal year 2005 and only an expense of 0.31 cents in 2006. From 2007 onwards its performance showed a declining trend and it has even shown the lowest effort in 2009 by having an operating efficiency ratio of 0.91, incurring 91 cents on each Birr one of revenue. From all the private commercial banks considered in the study, Wegagen bank has showed the best performance by controlling the costs of the company and maximizing its profits.

4.2.5 Credit Quality Ratios

1. Equity to Total Asset Ratio (EQTA)



Source: researcher computation from financial statement of the banks

As it can be seen from Graph 4.16 above, the equity to total asset ratio of Bank of Abyssinia is shown a declining trend from the fiscal year 2006 to 2009. In the fiscal year 2005 it was around 11 percent i.e. from the total asset of the company the owners of the bank are contributing only 11 percent and the rest 89 percent is financed by creditors. This figure has grown to 13 percent in 2006, and it has again declined to 10 and 9 percent in the fiscal years 2008 and 2009 respectively which implies that the overall shock absorbing capacity of the bank is showing almost no progress from year to year. This indirectly implies that the bank's shareholders capital is not showing significant growth and the bank is dependent more on creditors.

2. Equity to Loan Ratio (ELR)

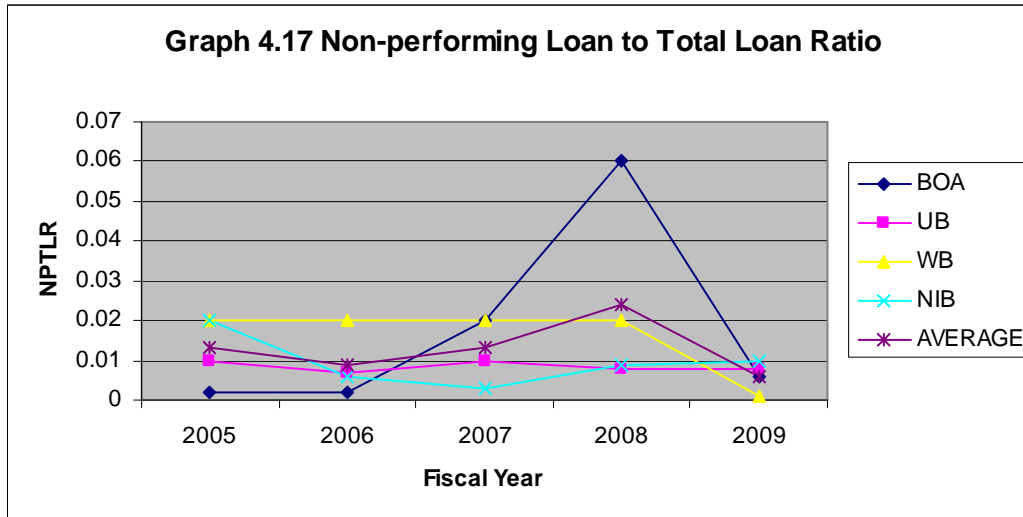
Table 4.17 Equity to Loan Ratio

| year | Commercial banks | | | | Average |
|------|------------------|------|------|------|---------|
| | BOA | UB | WB | NIB | |
| 2005 | 0.22 | 0.22 | 0.19 | 0.21 | 0.21 |
| 2006 | 0.21 | 0.20 | 0.16 | 0.20 | 0.19 |
| 2007 | 0.18 | 0.26 | 0.20 | 0.24 | 0.22 |
| 2008 | 0.16 | 0.26 | 0.27 | 0.29 | 0.25 |
| 2009 | 0.21 | 0.25 | 0.40 | 0.34 | 0.30 |

Source: researcher computation from financial statement of the banks

From Table 4.17 above, the equity to total loan ratio of Bank of Abyssinia has shown a declining trend from the fiscal year 2005 to 2008 (0.22 in the fiscal year 2005 to 0.16 in the year 2008), which means from the total loan granted to borrowers of the bank the owners have contributed only 22 percent in the fiscal year 2005 and 16 percent in 2008. This implies that the proportion of the total share holders' equity of the company to the total loan of the bank is getting lower and lower. This in turn shows that the bank is granting huge amount of loan to its customers and if in case the bank faces risk of loan repayment, the proportion that the owners will contribute in resisting the shock of loss is lower which on the other hand shows the company's potential exposure to the possibility of bankruptcy.

3. Non Performing Loans to Total Loan Ratio (NPTLR)



Source: researcher computation from financial statement of the banks

As it has been depicted in Graph 4.17 above, the non-performing loan of Bank of Abyssinia has shown the best performance in the fiscal years 2005 and 2006 with a ratio of 0.002 which implies that from the total loan granted to the bank's lenders only 0.2 percent (Birr 2,505,971 out of Birr 1,172,968,585 in 2005 and Birr 4,159,280 out of Birr 1,901,466,545 in 2006) were left uncollected. As it can be seen from the financial statement of the bank, from the fiscal year 2007 onwards the performance of the bank has shown a downward trend; with a ratio of 0.02 in 2007, 0.06 in 2008 and 0.006 in 2009. These periods were marked by the lowest performance of the bank in collecting the loan granted to lenders of the bank. Especially in the fiscal year 2008, the bank has failed to collect birr 142,771,341 (which was around 6 percent) of the total loan granted at this period which is the highest figure when it is even compared with the average ratio of non-performing loan to total loan ratio of the private commercial banks considered in the study.

Chapter v: Conclusions and Recommendations

This chapter which is entitled as conclusion and recommendation is designed to present the conclusions made from the discussion and analysis part of the study and it then provides some recommendations.

5.1 Conclusions

- The return on asset of the Bank of Abyssinia has shown a declining trend each year from the fiscal year 2006 to 2008. In the fiscal year 2008, it has reached the minimum level which was around two percent. When the bank's return on asset has been compared with the other private commercial banks, its performance was showing the lowest rate comparing it with the average return on asset ratio of the banks considered in the study.
- Bank of Abyssinia has reported the maximum return on equity in the fiscal year 2005. From the fiscal year 2006 onwards the return on equity of the bank has declined continuously and in the fiscal year 2008 it has reached the lowest rate which was around 4 percent. When the bank's return on equity was compared with the average of the private commercial banks performance, it was having the lowest rate of all the other banks considered in the study.
- Profit to expense ratio of Bank of Abyssinia was showing the maximum rate in the fiscal years 2005 and 2006 which was around 2.24 and 2.17 respectively. These rates were even the highest rates when compared them with the average profit to expense ratio of the private commercial banks. Starting from the fiscal year 2007 to 2009 the profit to expense ratio has shown declining trend which was lesser than the average profit to expense ratio.
- Bank of Abyssinia has shown a constant rate of non-interest income to total asset ratio from the fiscal year 2005 to 2009 which was around 0.02. This rate was the lowest rate

comparing it with the average non-interest income to total asset ratio of the private commercial banks.

- The same rate of return on deposit was reported by Bank of Abyssinia which was around 0.04 in the consecutive fiscal years of 2005 and 2006. The minimum rate was shown in 2008. From 2007 to 2009 the return deposit ratio of the bank was lower than the average rate of the private commercial banks.
- In the fiscal years 2005 to 2007 Bank of Abyssinia has reported a better rate in the total loan to total asset ratio comparing it with the average ratio of the private commercial banks. Less performance in this ratio was seen in the consecutive years, 2008 to 2009.
- The debt to equity ratio of Bank of Abyssinia has shown the lowest rate in all the fiscal years starting from 2005 to 2009. In 2009 the bank's debt to equity ratio has reached the lowest level which was around 9.55.
- Debt to total asset ratio of Bank of Abyssinia was the same in the fiscal years 2005 and 2007. The bank has reported the lowest rate in 2009. Comparing it with the average rate of the private commercial banks, weak performance has been reported by Bank of Abyssinia.
- The equity multiplier of Bank of Abyssinia has shown continuous improvement from the fiscal year 2005 to 2009. But when it is compared with the average rate of the private commercial bank, the bank's performance was the lowest.
- The same asset utilization ratios in the fiscal years 2006 to 2008 was reported by the Bank of Abyssinia. Lower rate of performance was reported by the bank in all the fiscal years when it is compared with the average rate of the private commercial banks.

- The income to expense ratio of the Bank of Abyssinia has shown a declining trend from 2005 to 2008. But in 2005 and 2006 the bank's performance was better than the performance of the other private commercial banks. From 2007 onwards the bank's performance has shown a declining trend.
- The operating efficiency ratios of Bank of Abyssinia were remarked by an increasing trend in 2005 and 2006. From 2007 to 2009 the performance of the bank has shown a declining trend when it was compared with the average operating efficiency ratio of the other private commercial banks.
- The proportion of non-performing loan to total loan of bank of Abyssinia has shown a declined trend from the fiscal year 2006 to 2009 which implies that the bank's credit management is becoming weaker and weaker or the bank is not appraising the quality of borrowers and the increment of doubtful loan left uncollectible.
- From all the measurements used in the study to analyze the financial performance of Bank of Abyssinia (both the trend and comparative financial performance analysis approaches), it can be concluded that the bank's financial performance is declining from one fiscal year to the other in all the study periods considered in the paper (2005 to 2009), which implies the bank's future sustainability is under question.

5.2 Recommendations

- The profitability ratios (return on asset, return on equity, return on deposit, income expense ratio, non-interest income to asset ratio) of bank of Abyssinia have shown a declining trend in all the study periods (from the fiscal year 2005 to 2009). This implies that the performance of the bank became weaker and weaker. In order to improve its profitability the management of bank of Abyssinia has to reduce the proportion of non-performing loan to total loan, search for less costly capital sources, dispose off the assets which are not contributing for the profitability of the bank, and work to maximize the overall profits of the bank through investing in profitable investments.

- Bank of Abyssinia's liquidity ratio showed a fluctuating trend. From 2005 to 2006, it has grown by 15 percent but from the fiscal year 2006 to 2009, this ratio has shown a declining trend which implies that the bank has started to retain most of its deposits. This in turn shows that the bank has much unproductive cash in the store, which is costly since continuous interest rate will be paid on this idle cash. This had its own impact on the overall profitability of the bank. Therefore, the bank management has to work to retain optimum amount of cash and granting the excess amount to borrowers of the bank as a loan or investing it in other profitable investments.
- The risk and solvency ratios (debt to equity ratio, debt to total asset ratio and equity multiplier ratio) of bank of Abyssinia have shown a continuous growth. This implies that the bank has becoming more and more dependent on funds from creditors of the company; this is very risky for the overall sustainability of the bank. Therefore, the bank's management has to work to maximize the amount of owners' equity, and has to search for other sources of cash (like selling shares), etc so that the performance of the bank can be improved.
- The efficiency ratios of the bank (asset utilization ratio, income to expense ratio, and operating efficiency ratio) have shown that the bank's performance is deteriorating from year to year. This was because the costs of the bank were increasing from time to time but the revenues of the bank were following the reverse trend. Therefore, the bank's management has to work to reduce the costs (for instance, reduce the expense incurred for the proportion of non-performing loans to total loan and other administrative expense) and maximize the revenues of the bank by reducing the expense per dollar of the revenues generated.
- The credit quality of bank of Abyssinia has shown that the bank's performance is becoming weaker and weaker from time to time. This implies that the bank's performance in collecting its loan granted to its borrowers is becoming lesser which in turn increases

the expenses of the bank (because interest has to be paid on deposits) and this makes the bank to be more dependent on creditors to cover other administrative and operational costs. Therefore, the bank's management has to work to reduce the proportion of non-performing loan to total asset ratio and to maximize the proportion of owners' equity of the company.

- Since the number of banks is increasing from time to time, it is important to have a responsible centralized body which can provide enough information about the sector to interested parties like academicians, researchers, analysts, etc. But in Ethiopia there is no centralized party which can provide the needed information recently. Therefore, the concerned parties (may be National Bank of Ethiopia or Ministry of Finance) have to establish such type of responsible body to facilitate fast information flow concerning the sector.
- Financial performance analysis is a useful tool to know the financial health of any company. This is done by either analyzing the past financial performance trend of the company or comparing its performance to the performance of other similar companies. To compare one company's performance to the performance of the other, a standard benchmark is needed, but there is no settled standard against which comparison can be made in Ethiopia. Therefore, the concerned party, central bank of Ethiopia, has to take this responsibility and should settle a benchmark that can be used as a standard.
- Even though there are a number of important determinant variables which have significant influence on the financial performance of any company such as political affairs, inflation, economy, management philosophy, etc, they were not considered in this study. Therefore, further research works should be done in this area by considering all these variables.

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Appendix

BANK OF ABYSSINIA SHARE COMPANY

BALANCE SHEET

AS AT 30 JUNE,

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|--|----------------------|----------------------|----------------------|----------------------|----------------------|
| ASSETS | | | | | |
| Cash and Bank Balances | | | | | |
| Cash on hand | 109,500,832 | 101,106,090 | 128,155,838 | 325,464,779 | 612,145,892 |
| Deposits with Local Commercial Banks | 15,773,899 | 5,068,762 | 428,828 | 1,464,888 | 15,628,916 |
| Deposits with Foreign Banks | 193,235,775 | 203,021,312 | 260,260,211 | 294,932,194 | 374,929,138 |
| Reserve Account with NBE | 80,017,347 | 99,017,347 | 130,017,347 | 445,017,347 | 605,017,346 |
| Other Accounts with NBE | <u>360,337,637</u> | <u>372,994,734</u> | <u>822,003,597</u> | <u>375,767,206</u> | <u>1,088,572,508</u> |
| | 758,865,490 | 781,208,245 | 822,003,597 | 1,442,646,414 | 2,696,293,802 |
| Items in course of collection from other banks | 75,739,464 | 99,371,516 | 119,367,091 | 101,102,831 | 131,298,130 |
| Deposits and Prepayments | 3,984,886 | 5,151,392 | 9,184,928 | 10,435,575 | 10,591,683 |
| Loans and Advances to Customers | 1,172,968,585 | 1,901,466,545 | 2,197,341,801 | 2,566,577,377 | 2,442,747,456 |
| Other Assets | 13,837,763 | 9,356,072 | 7,047,312 | 83,213,659 | 118,055,094 |
| Customers' Liabilities on L/C | <u>173,517,858</u> | <u>180,332,154</u> | <u>181,807,580</u> | ----- | ----- |
| | 2,198,914,046 | 2,976,885,924 | 3,536,652,309 | 2,761,329,442 | 2,702,692,363 |
| Intangible fixed Assets | 1,020,748 | 846,477 | 672,206 | - | 1,153,004 |
| Tangible fixed Asset | <u>30,787,945</u> | <u>36,327,279</u> | <u>40,639,495</u> | <u>65,473,144</u> | <u>75,998,395</u> |
| TOTAL ASSETS | 2,230,722,739 | 3,014,059,680 | 3,577,964,010 | 4,269,946,935 | 5,476,625,540 |
| LIABILITIES | | | | | |
| Deposits | | | | | |
| Demand Deposits | 333,275,052 | 403,275,052 | 511,058,029 | 785,253,055 | 1,211,306,002 |
| Savings Deposits | 1,183,255,052 | 1,548,299,795 | 1,898,101,450 | 2,411,495,128 | 3,049,747,076 |
| Fixed time Deposits | <u>111,096,783</u> | <u>225,357,313</u> | <u>312,168,110</u> | <u>281,018,825</u> | <u>233,133,349</u> |
| | 1,627,627,080 | 2,176,885,481 | 2,721,327,589 | 3,477,767,008 | 4,494,186,427 |
| Margins held on L/C | 36,889,148 | 45,447,427 | 34,703,482 | 76,834,074 | 89,332,936 |
| Other liabilities | 118,476,315 | 172,866,461 | 208,919,138 | 287,933,943 | 328,909,679 |
| Provision for tax | 20,984,321 | 36,904,583 | 28,454,915 | 7,331,755 | 44,966,991 |
| Bank's liabilities on L/C | <u>173,517,858</u> | <u>180,332,154</u> | <u>181,807,580</u> | <u>76,834,074</u> | <u>89,332,936</u> |
| TOTAL LIABILITIES | 1,977,494,722 | 2,612,436,106 | 3,175,212,704 | 3,849,866,780 | 4,957,396,033 |
| CAPITAL AND RESERVES | | | | | |
| Paid-up capital | 165,726,575 | 264,713,109 | 265,000,000 | 312,571,450 | 313,141,425 |
| Share premium | - | - | - | 2,827,540 | 2,827,540 |
| Legal reserve | 36,203,274 | 58,023,261 | 74,598,461 | 78,762,326 | 103,854,312 |
| Special reserve | 5,506,436 | 13,427,245 | 13,427,245 | 13,427,245 | 29,918,839 |
| Retained earnings | <u>45,791,732</u> | <u>65,459,959</u> | <u>49,725,600</u> | <u>12,491,594</u> | <u>73,487,391</u> |
| | 253,228,017 | 401,623,574 | 402,751,306 | 420,080,155 | 519,229,507 |
| Total Liabilities and Shareholders Fund | 2,230,722,739 | 3,014,059,680 | 3,577,964,010 | 4,269,946,935 | 5,476,625,540 |

Source: Financial Statement of BOA from 2005 to 2009

UNITED BANK SHARE COMPANY
BALANCE SHEET
AT 30 JUNE,

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|--------------------------------------|----------------------|----------------------|----------------------|----------------------|----------------------|
| ASSETS | | | | | |
| Cash and bank balances | 484,382,029 | 592,675,420 | 757,713,731 | 1,385,712,083 | 2,485,621,432 |
| Loans and advances | 570,025,059 | 974,949,418 | 1,367,883,083 | 1,809,902,837 | 2,086,516,735 |
| Other assets | 6,757,045 | 17,440,479 | 24,235,873 | 18,945,191 | 36,221,539 |
| Deferred charges | 1,042,996 | 917,154 | 1,041,530 | 1,544,003 | 1,325,320 |
| Investment | - | - | 320,000 | 320,000 | 506,000 |
| Fixed assets | 10,725,125 | 13,586,332 | 31,549,592 | 33,857,202 | 42,251,974 |
| TOTAL ASSETS | 1,072,932,254 | 1,599,568,803 | 2,182,743,809 | 3,250,281,316 | 4,652,443,000 |
| LIABILITIES | | | | | |
| Deposits from customers | 746,432,689 | 1,220,580,816 | 1,541,089,453 | 2,324,388,261 | 3,381,837,372 |
| Deposits from institutions | 118,735,542 | 72,178,991 | 139,680,126 | 118,963,649 | 233,914,724 |
| Other liabilities | 42,129,282 | 51,960,005 | 85,258,458 | 142,400,869 | 182,933,109 |
| Margin held on L/C | 28,795,152 | 47,534,159 | 34,395,684 | 161,861,101 | 293,825,226 |
| Profit tax payable | <u>11,963,204</u> | <u>15,955,194</u> | <u>22,585,753</u> | <u>34,795,499</u> | <u>39,958,060</u> |
| TOTAL LIABILITIES | 948,055,869 | 1,408,209,165 | 1,823,009,474 | 2,782,409,379 | 4,132,468,491 |
| CAPITAL AND RESERVES | | | | | |
| Paid-up capital | 87,664,950 | 130,834,967 | 259,326,669 | 330,277,074 | 355,202,724 |
| Share premium | 130,676 | 1,595,547 | 9,057,087 | 5,278,954 | 7,019,008 |
| Legal reserve | 13,803,181 | 24,724,204 | 40,792,802 | 63,551,864 | 86,948,104 |
| Retained earnings | <u>23,277,578</u> | <u>34,204,920</u> | <u>50,557,777</u> | <u>68,764,045</u> | <u>70,804,673</u> |
| | 124,876,385 | 191,359,638 | 359,734,335 | 467,871,937 | 519,974,509 |
| TOTAL LIABILITIES AND CAPITAL | 1,072,932,254 | 1,599,568,803 | 2,182,743,809 | 3,250,281,316 | 4,652,443,000 |

Source: Financial Statement of UB from 2005 to 2009

WEGAGEN BANK SHARE BANK
BALANCE SHEET
AT 30 JUNE,

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|--------------------------------------|----------------------|----------------------|----------------------|----------------------|----------------------|
| ASSETS | | | | | |
| Cash and balances with banks | 619,515,948 | 661,000,000 | 1,319,806,130 | 1,803,396,676 | 2,915,000,000 |
| Loans and advances | 951,028,332 | 1,516,000,000 | 2,060,606,572 | 2,207,928,130 | 1,984,000,000 |
| Other assets | 21,733,898 | - | 43,711,990 | 45,989,232 | - |
| Deferred charges | 2,351,713 | - | 597,068 | 815,801 | - |
| Fixed assets | <u>21,022,695</u> | <u>25,000,000</u> | <u>49,464,353</u> | <u>56,391,267</u> | <u>58,000,000</u> |
| Total Assets | 1,615,652,586 | 2,259,000,000 | 3,480,280,390 | 4,124,891,893 | 5,118,000,000 |
| LIABILITIES | | | | | |
| Deposits from customers | 1,230,004,473 | - | 2,236,538,813 | 2,567,876,386 | - |
| Deposits from institutions | 58,444,599 | - | 487,087,044 | 398,453,771 | - |
| Demand deposits | - | 725,000,000 | | | 1,870,000,000 |
| Savings deposits | - | 723,000,000 | | | 1,518,000,000 |
| Fixed deposits | - | 330,000,000 | | | 340,000,000 |
| Other liabilities | 88,756,525 | 118,000,000 | 153,783,036 | 228,878,979 | 264,000,000 |
| Margin held on L/C | 42,683,699 | 85,000,000 | 144,467,640 | 260,159,917 | 214,000,000 |
| Provision for profit tax | 15,583,530 | 23,000,000 | 41,305,813 | 51,153,448 | 75,000,000 |
| Leasehold land payable | - | - | 13,892,078 | 12,920,604 | - |
| Total liabilities | 1,435,472,826 | 2,004,000,000 | 3,077,074,424 | 3,519,443,105 | 4,281,000,000 |
| CAPITAL AND RESERVES | | | | | |
| Paid-up capital | 110,994,000 | 151,000,000 | 233,139,000 | 370,825,000 | 532,000,000 |
| Share premium | 1,683,200 | - | 5,241,450 | 9,679,450 | - |
| Legal reserve | 28,162,621 | 46,000,000 | 73,622,138 | 108,331,515 | 153,000,000 |
| Special reserve | 3,557,722 | 5,000,000 | 7,972,089 | 12,484,693 | 16,000,000 |
| Retained earnings | <u>35,782,217</u> | <u>53,000,000</u> | <u>83,231,289</u> | <u>104,128,130</u> | <u>135,000,000</u> |
| | <u>1,615,652,586</u> | <u>255,000,000</u> | <u>403,205,966</u> | <u>605,448,788</u> | <u>836,000,000</u> |
| TOTAL CAPITAL AND LIABILITIES | 1,615,652,586 | 2,259,000,000 | 3,480,280,390 | 4,124,891,893 | 5,118,000,000 |

Source: Financial Statement of WB from 2005 to 2009

NIB INTERNATIONAL BANK SHARE COMPANY
BALANCE SHEET
AS AT JUNE,

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|--------------------------------------|----------------------|----------------------|----------------------|----------------------|----------------------|
| ASSETS | | | | | |
| Cash and bank balances | | | | | |
| Cash on hand | 138,129,044 | 110,843,536 | 146,874,312 | 341,295,450 | 1,026,241,659 |
| Reserve account with NBE | 54,917,075 | 62,916,920 | 80,916,920 | 317,916,920 | 412,916,920 |
| Payment account with NBE | 42,806,914 | 30,549,825 | 197,758,297 | 402,171,911 | 493,347,150 |
| Deposit with local banks | 27,677,144 | 22,778,504 | 20,604,640 | 93,725,297 | 189,093,330 |
| Deposit with foreign banks | <u>200,099,342</u> | <u>207,761,791</u> | <u>248,908,693</u> | <u>177,576,042</u> | <u>212,960,066</u> |
| | 463,629,519 | 434,850,576 | 695,062,862 | 1,332,685,620 | 2,334,559,125 |
| Other assets | 169,978,292 | 140,729,956 | 111,303,896 | 238,108,548 | 293,884,214 |
| Investment in shares | 2,400,000 | 2,434,000 | 2,653,000 | 2,652,500 | 3,778,500 |
| Loans and advances | 1,085,710,775 | 1,418,048,098 | 1,755,831,156 | 2,033,788,606 | 2,118,055,100 |
| Fixed assets | <u>10,185,168</u> | <u>30,957,098</u> | <u>41,746,558</u> | <u>42,875,885</u> | <u>56,230,088</u> |
| TOTAL ASSETS | 1,731,903,754 | 2,027,020,081 | 2,606,596,372 | 3,650,111,159 | 4,806,507,027 |
| LIABILITIES | | | | | |
| Deposits | | | | | |
| Demand deposits | 292,413,467 | 327,306,953 | 422,953,177 | 670,979,595 | 1,031,726,983 |
| Savings deposits | 709,440,657 | 836,589,389 | 1,084,627,147 | 1,436,580,753 | 1,995,516,308 |
| Fixed deposits | <u>222,322,642</u> | <u>287,875,543</u> | <u>871,354,235</u> | <u>362,370,955</u> | <u>269,146,679</u> |
| | 1,224,176,766 | 1,451,771,885 | 1,878,934,559 | 2,469,931,303 | 3,296,389,970 |
| Margins held on L/C | 50,116,556 | 55,787,380 | 49,871,589 | 162,822,443 | 200,646,985 |
| Other liabilities | 214,676,882 | 211,366,186 | 222,912,510 | 373,500,276 | 514,936,300 |
| Provision for tax | 19,970,404 | 23,074,286 | 29,731,593 | 45,732,463 | 65,710,214 |
| TOTAL LIABILITIES | 1,508,940,608 | 1,741,999,737 | 2,181,450,251 | 3,051,986,485 | 4,077,683,469 |
| CAPITAL AND RESERVES | | | | | |
| Share capital | 160,000,000 | 200,000,000 | 297,573,500 | 416,901,000 | 487,129,000 |
| Share premium | - | - | 10,030,900 | 8,663,900 | 1,293,700 |
| Legal reserve | 29,883,586 | 44,048,978 | 62,954,884 | 91,214,596 | 129,729,210 |
| Special reserve | 600,000 | 700,000 | 800,000 | 900,000 | 1,000,000 |
| Profit and loss account | <u>32,479,560</u> | <u>40,271,366</u> | <u>53,786,837</u> | <u>80,445,178</u> | <u>109,671,648</u> |
| | 222,963,146 | 285,020,344 | 425,146,121 | 598,124,674 | 728,823,558 |
| TOTAL CAPITAL AND LIABILITIES | 1,731,903,754 | 2,027,020,081 | 2,606,596,372 | 3,650,111,159 | 4,806,507,027 |

Source: Financial Statement of NIB from 2005 to 2009

**BANK OF ABYSSINIA
PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 30 JUNE,**

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|--------------------|--------------------|--------------------|--------------------|--------------------|
| INCOME | | | | | |
| Interest income | 104,677,146 | 165,275,931 | 201,548,788 | 252,419,524 | 275,894,414 |
| Less: interest expense | <u>32,908,750</u> | <u>40,771,344</u> | <u>60,490,965</u> | <u>93,403,514</u> | <u>112,066,716</u> |
| Net interest income | 71,768,396 | 124,504,587 | 141,057,823 | 159,016,010 | 163,827,698 |
| Provision no longer required | 11,531,638 | 444,770 | - | - | - |
| Gain on fluctuation of exchange rates | 16,631,389 | 25,790,857 | 33,795,470 | 52,999,000 | 68,580,780 |
| Service charges-foreign and local | 9,708,058 | 13,663,773 | 14,757,678 | 19,260,650 | 22,468,433 |
| Commission earned | 4,165,335 | 7,311,719 | 8,161,545 | 11,768,831 | 13,381,401 |
| Other income | <u>4,919,369</u> | <u>7,951,475</u> | <u>8,424,363</u> | <u>10,997,997</u> | <u>24,487,917</u> |
| | 118,724,185 | 179,667,181 | 206,196,879 | 254,042,488 | 292,746,229 |
| EXPENSES | | | | | |
| Salaries and benefits | 12,863,552 | 26,104,024 | 31,730,478 | 45,260,827 | 65,908,915 |
| General and administration | 17,852,583 | 22,853,201 | 29,841,319 | 42,672,401 | 65,306,729 |
| Board of directors' fees | 3,391,505 | 3,548,779 | 2,787,907 | 236,400 | 255,473 |
| Audit fee | 70,000 | 80,354 | 100,000 | 120,119 | 93,765 |
| Provision for other receivables | 2,505,971 | 4,159,280 | - | 1,073,974 | 139,974 |
| Provision for doubtful loans & advances | <u>2,505,971</u> | <u>4,159,280</u> | <u>46,756,843</u> | <u>142,771,341</u> | <u>15,641,598</u> |
| | 36,683,611 | 56,745,638 | 111,216,547 | 232,135,062 | 147,346,454 |
| Profit before tax | 82,040,574 | 122,921,543 | 94,980,332 | 21,907,426 | 145,399,775 |
| Less: provision for tax | 20,984,931 | 36,905,600 | 28,456,730 | 7,333,668 | 45,031,831 |
| Prior period adjustments | - | <u>1,264,003</u> | <u>222,802</u> | <u>2,081,701</u> | - |
| Net profit after tax | 61,055,643 | 87,279,946 | 66,300,800 | 16,655,459 | 100,367,944 |
| Transfer to legal reserve | <u>15,263,911</u> | <u>21,819,987</u> | <u>16,575,200</u> | <u>4,163,865</u> | <u>25,091,986</u> |
| | 45,791,732 | 65,459,959 | 49,725,600 | 12,491,594 | 75,275,958 |
| Retained earnings brought forward | 28,682,784 | 45,791,732 | 65,459,959 | 49,725,600 | 12,491,594 |
| Less: transfer to special reserve | - | 7,920,809 | - | - | 12,491,594 |
| Dividends paid | 28,682,784 | 37,870,923 | 65,459,959 | - | 12,491,594 |
| Less: directors' share on profit | - | - | - | - | 1,788,567 |
| Retained earnings carried forward | 45,791,732 | 65,459,959 | 49,725,600 | 12,491,594 | 73,487,391 |
| Earning per share | | | | | |
| (par value of Birr 25) | 10.08 | 10.76 | 6.25 | 1.45 | 8.02 |
| Earnings per Birr 100 shares | 40.32 | 43.02 | 25.02 | 5.79 | 32.09 |

Source: Financial Statement of BOA from 2005 to 2009

**UNITED BANK SHARE COMPANY
INCOME STATEMENT
FOR THE YEAR ENDED 30 JUNE,**

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|-------------------|-------------------|--------------------|--------------------|--------------------|
| INCOME | | | | | |
| Interest income | 45,955,806 | 71,269,924 | 122,146,169 | 171,133,540 | 210,075,178 |
| Less :interest expense | <u>17,447,956</u> | <u>28,553,034</u> | <u>39,576,527</u> | <u>62,829,571</u> | <u>87,664,034</u> |
| Net interest income | 28,507,850 | 42,716,890 | 82,569,642 | 108,303,969 | 122,411,144 |
| Net fees and commission income | 19,643,120 | 25,388,260 | 26,605,012 | 40,268,128 | 56,186,560 |
| Net gains from dealings in foreign currencies | 23,630,994 | 26,824,029 | 40,380,801 | 59,408,716 | 72,867,127 |
| Other income | <u>1,635,821</u> | <u>2,578,691</u> | <u>2,973,824</u> | <u>8,842,052</u> | <u>5,813,492</u> |
| Net operating income | 73,417,785 | 97,507,870 | 152,529,279 | 216,822,865 | 257,278,323 |
| Provision for doubtful loans and advances | 7,119,714 | 6,391,600 | 13,269,166 | 13,584,580 | 16,700,000 |
| Net interest and other income after provision for doubtful loans and advances | 66,298,071 | 91,116,270 | 139,260,113 | 203,238,285 | 240,578,323 |
| EXPENSES | | | | | |
| Salaries and benefits | 9,587,021 | 13,859,278 | 22,891,653 | 34,346,397 | 54,677,915 |
| General and administration expenses | 12,553,252 | 15,863,386 | 26,973,539 | 39,481,316 | 48,681,455 |
| Directors' fee | 1,211,012 | 1,689,653 | 2,464,778 | 3,473,324 | 3,561,936 |
| Audit fee | <u>58,121</u> | <u>58,121</u> | <u>70,000</u> | <u>105,500</u> | <u>114,000</u> |
| | 23,409,406 | 31,470,438 | 52,399,970 | 77,406,537 | 107,035,306 |
| Profit before taxation | 42,409,406 | 59,645,832 | 86,860,143 | 125,831,748 | 133,543,017 |
| Provision for taxation | <u>11,968,355</u> | <u>15,961,742</u> | <u>22,585,753</u> | <u>34,795,499</u> | <u>39,958,060</u> |
| Net profit after taxation | 30,920,310 | 43,684,090 | 64,274,390 | 91,036,249 | 93,584,957 |
| Legal reserve | <u>7,730,077</u> | <u>10,921,023</u> | <u>16,068,598</u> | <u>22,759,062</u> | <u>23,396,240</u> |
| Net profit after tax and legal reserve | 23,190,233 | 32,763,067 | 48,205,792 | 68,277,187 | 70,188,717 |
| Earning per share of Birr 100 | 34.73 | 41.60 | 35.87 | 29.51 | 27.06 |

Source: Financial Statement of UB from 2005 to 2009

WEGAGEN BANK SHARE COMPANY
INCOME STATEMENT
FOR THE YEAR ENDED 30 JUNE,

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|--|--------------------------|--------------------------|--------------------------|--------------------------|-------------------------|
| INCOME | | | | | |
| Interest income | 79,913,317 | 120,000,000 | 185,021,035 | 238,242,127 | 233,543,954 |
| Less: interest expense | <u>21,515,429</u> | <u>35,000,000</u> | <u>55,291,901</u> | <u>89,677,115</u> | <u>83,458,171</u> |
| Net interest income | 58,397,888 | 85,000,000 | 129,729,134 | 148,565,012 | 150,085,783 |
| Commission, fees and charges | 39,176,276 | 52,000,000 | 66,633,394 | 90,625,922 | 90,186,237 |
| Net gains from dealing in foreign currencies | 29,370,387 | 46,500,000 | 66,689,701 | 98,687,993 | 139,694,032 |
| Other operating income | 1,280,673 | 1,500,000 | 1,704,659 | 2,686,487 | 8,815,418 |
| Net operating income | 128,225,224 | 185,000,000 | 264,756,888 | 340,565,414 | 368,781,470 |
| Provision for doubtful loans and advances | 19,082,579 | 29,000,000 | 32,109,500 | 50,183,892 | - |
| Provision for doubtful debts other than loans and advances | <u>2,899,757</u> | - | <u>47,675</u> | <u>2,285,574</u> | <u>2,901,000</u> |
| | <u>21,982,336</u> | <u>29,000,000</u> | <u>32,157,175</u> | <u>52,469,466</u> | <u>2,901,000</u> |
| Net interest and other income | 106,242,888 | 157,000,000 | 232,599,713 | 288,095,948 | 385,880,470 |
| OPERATING EXPENSES | | | | | |
| Salaries and benefits | 20,070,095 | 31,000,000 | 38,902,832 | 50,348,419 | 74,344,643 |
| General administration expenses | 22,655,141 | 31,000,000 | 36,213,750 | 43,097,034 | 49,701,732 |
| Directors' fee | 124,500 | - | 5,098,766 | 4,495,435 | 5,652,543 |
| Audit fee | <u>100,000</u> | - | <u>103,500</u> | <u>164,105</u> | <u>80,098</u> |
| Total operating expense | <u>42,949,736</u> | <u>62,000,000</u> | <u>80,318,848</u> | <u>98,104,993</u> | <u>129,779,016</u> |
| Net profit before tax | 63,293,152 | 95,000,000 | 152,280,865 | 189,990,955 | 256,101,454 |
| Provision for profit tax | <u>15,583,530</u> | <u>23,000,000</u> | <u>41,305,813</u> | <u>51,153,448</u> | <u>75,499,105</u> |
| Net profit after tax | 47,709,622 | 72,000,000 | 110,975,052 | 138,837,507 | 180,602,349 |
| Legal reserve | <u>11,927,405</u> | <u>18,000,000</u> | <u>27,743,763</u> | <u>34,709,377</u> | <u>45,150,587</u> |
| Net profit after tax and legal reserve | 35,782,217 | 54,000,000 | 83,231,289 | 104,128,130 | 135,451,762 |
| Earning per share of Birr 1000 | 478 | 497 | 573 | 449 | 389 |

Source: Financial Statement of WB from 2005 to 2009

**NIB INTERNATIONAL BANK
PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 30 JUNE,**

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|---------------------------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| INCOME | | | | | |
| Interest income | 82,954,648 | 106,187,449 | 147,290,760 | 209,998,084 | 253,590,455 |
| Commission and service charges | 23,428,070 | 24,851,943 | 26,955,828 | 48,275,800 | 90,192,623 |
| Gain on foreign currency transactions | 28,259,538 | 25,242,049 | 29,607,784 | 55,076,142 | 77,259,553 |
| Other income | <u>1,238,075</u> | <u>1,862,518</u> | <u>3,646,585</u> | <u>3,232,348</u> | <u>4,973,798</u> |
| | 135,880,331 | 158,143,959 | 207,500,957 | 316,582,374 | 426,016,429 |
| EXPENSES | | | | | |
| Interest expense | 23,888,684 | 33,094,423 | 42,138,001 | 62,217,698 | 75,112,910 |
| Salaries and benefits | 11,544,374 | 16,856,138 | 24,628,932 | 35,548,133 | 53,471,759 |
| Administrative and general expenses | 16,498,112 | 19,320,379 | 30,305,106 | 40,906,582 | 54,151,280 |
| Provision for doubtful debts | 18,184,058 | 9,170,090 | 4,993,195 | 19,035,151 | 23,391,813 |
| Audit fee | <u>69,000</u> | <u>80,500</u> | <u>80,500</u> | <u>103,500</u> | <u>120,000</u> |
| | 70,184,228 | 78,521,530 | 102,145,734 | 157,811,064 | 206,247,762 |
| Net profit before taxation | 65,696,103 | 79,622,429 | 105,355,223 | 158,771,310 | 219,768,667 |
| Provision for taxation | <u>19,970,404</u> | <u>23,074,286</u> | <u>29,731,593</u> | <u>45,732,463</u> | <u>65,710,214</u> |
| Net profit after taxation | 45,725,699 | 56,548,143 | 75,623,630 | 113,038,847 | 154,058,453 |
| Prior year adjustment | - | 113,424 | - | - | - |
| Less: transfer to legal reserve | 11,431,425 | 14,165,392 | 18,905,907 | 28,259,712 | 38,514,613 |
| Less: directors' allowance | 1,714,714 | 2,124,809 | 2,830,886 | 4,233,957 | 5,772,192 |
| Less: transfer to special reserve | 100,000 | 100,000 | 100,000 | 100,000 | 100,000 |
| Surplus for year balance | 24,606,930 | 32,479,560 | 53,786,837 | 80,445,178 | 109,671,648 |
| Dividend paid | <u>24,606,930</u> | <u>32,479,560</u> | <u>40,271,366</u> | <u>53,786,837</u> | <u>80,445,178</u> |
| Balance, 30 June | 32,479,560 | 40,271,366 | 53,786,837 | 80,445,178 | 109,671,648 |
| Earning per share | 160 | 161 | 160 | 161 | 170 |

Source: Financial Statement of NIB from 2005 to 2009

Interview Schedule

The interview was conducted with the management of Bank of Abyssinia to have an understanding about the company and the causes for the fluctuations seen in the different financial ratios. The researcher has raised questions concerning the issues here under.

- General information ;
 - vision, mission and values of the bank
 - number of branches
 - total capital reserve
 - type of services provided

- Causes for fluctuations of the financial ratios of the company
- Credit policy of the company:
- Efficiency of the workers
- Current status of the bank