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POTENTIAL EFFECTS OF OPENING THE ETHIOPIAN

BANKING SECTOR TO FOREIGN BANKs

By

MekonnenHurisa

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Potential Effects of Opening the Ethiopian Banking Sector to Foreign Banks

by

Mekonnen Hurisa

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STATEMENT OF CERTIFICATION

Addis Ababa University

School of Graduate Studies

This is to certify that the thesis prepared by Mekonnen Hurisa, entitled: **Potential Effects of Opening the Ethiopian Banking Sector to Foreign Bank** and submitted in partial fulfillment of the requirements for the Degree of Master of Science (Accounting and Finance) complies with the regulations of the University and meets the accepted standards with respect to originality and quality.

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STATEMENT OF DECLARATION

I declare that this thesis is my original work and has not been presented for a degree in this or any other university and that all sources of materials used for this thesis have been duly acknowledged.

Name: **Mekonnen Hurisa**

Signature ____________________________

Date _________________________________

This thesis has been submitted for examination with my approval as university advisor.

Name ________________________________

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Date _________________________________

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Abstract

In theory, foreign bank entry could significantly reduce the cost of credit by bringing capital, technical skills, and product innovation to host countries, which increases competition and leads to improvements in the efficiency of the banking sector, ultimately benefitting customers of the banking system, including small and new enterprises. The main objective of this study is to evaluate the potential impact of foreign bank entry in Ethiopian banking sector and analyses how far the domestic banking sectors are ready to compete with the new technology and modern management system. The quantitative research method was adopted to collect data based on the pre-design survey questionnaires and the result of 134 survey questionnaires were distributed and the analysis done using descriptive statistics like graphical presentation, average, standard deviation, frequency, percentage etc. A cross-sectional design was employed for a data collected and analyzed more than one case at a single time. Only quantitative research approach was also implemented. Out of the total respondents, the indicate samples were selected under the consideration of both purposive and random sampling techniques. The key findings revealed that if foreign banks were entered in the country, the domestic banks would be benefited in all the four dimensions such as potential benefit, potential efficiency, macro-economic and social indicators and potential costs. Therefore, the permeation of foreign bank would improve the domestic banks economic potential, additionally different macroeconomic and social indicators show that the country would be benefited if the foreign bank were permitted. Finally the government should adopt from neighboring country like Kenya and Egypt , those have a long period of experience in supervising foreign bank and revise the investment proclamation that prohibited Foreign bank entry.

Key words: Foreign Bank, Entry, Macro-economic indicators, Domestic Bank,

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Acronyms

ANB	Arab National Bank
CBE	Commercial Bank of Ethiopia
EPRI	Ethiopian Policy Research Institute
EEA	Ethiopian Economics Association
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
HSBC	Hong Kong and Shanghai Banking Corporation
NBE	National Bank of Ethiopia
EPAAA	Ethiopian Professional Accountant and Auditors Association
SME	Small and Medium Sized Enterprise
WTO	World Trade Organization

Chapter One

1. Introduction

1.1. Background of the Study

The effects of foreign bank entry have been controversial in both theory and empirical research. On the one hand, removing entry barriers that limit foreign bank entry should reduce the costs of external finance for bank-dependent borrowers by allowing banks to diversify, and allowing banks with low costs of raising capital in one country to redeploy that capital in countries with higher indigenous costs of capital. This logic suggests that countries that impose barriers on foreign bank entry should see lower rates of business formation for small and medium-sized enterprises. On the other hand, some researchers (Bruno and Valentina, 2014)worry that foreign banks focus mostly on incumbent and wealthy firms and may push domestic banks out of the market as the result of their superior efficiency (Alfaro, Beck & Calomiris, 2015).

Alfaro, Beck & Calomiris (2015) states that from a public policy standpoint it is also crucial to recognize that there is more to foreign bank entry barriers than legal prohibitions on entry or severe charter restrictions that apply only to foreign banks. Foreign bank entry can also be impeded when political and legal environments favor local bankers, such as when the legal system fails to protect the rights of arms-length creditors, which favors bank lending to “insiders.” If the legal system provides little protection to arms-length lenders, then domestic banks linked to firms through crony networks that control both the firms and the banks may be advantaged in their ability to lend.

The last three decades have seen a rapid but unequal increase in foreign bank entry across the globe. The former transition economies of Central and Eastern Europe have experienced some of the biggest changes, with foreign bank participation rising as high as 90 percent, while Western Europe has seen a much slower increase, which occurred only after the establishment of the Euro. Several Latin American countries, including Mexico, lowered entry barriers and saw rapid increases in foreign bank participation. At the same time, many Asian countries continue to show

a relatively small share of international bank lending. One of the most interesting new twists in foreign banking has been the increased diversity of foreign banks' countries of origin. In recent years, partly in response to troubles at home, banks from the U.S. and Western Europe have shrunk in importance in many developing countries. At the same time, multi-national banks from emerging market countries especially those headquartered nearby have increased their role. In Sub-Saharan Africa, for example, banks from South Africa, Nigeria, Morocco and Kenya have increased their participation across the African continent. (Alfaro, Beck & Calomiris, 2015)

Theory and empirical evidence have been ambiguous on the effects of foreign bank entry on entrepreneurship. In theory, foreign bank entry could significantly reduce the cost of credit by bringing capital, technical skills, and product innovation to host countries, which increases competition and leads to improvements in the efficiency of the banking sector, ultimately benefitting customers of the banking system, including small and new enterprises. It is conceivable, however, that fierce competition with foreign banks for funding or relationships could threaten the survival of local banks and thus lead to reduced access to finance for many borrowers, especially if foreign banks concentrate on the top and selected segments of the market. Empirical research examining the effects of foreign bank entry on the cost of funds has generally supported the view that foreign bank entry lowers the cost of credit and improves access to credit for less politically connected borrowers (Clarke et al. 2006, Giannetti and Ongena 2009, 2012, Bruno and Hauswald 2013, Claessens and van Horen 2014). Some studies, however, find negative associations between foreign bank presence and financial system performance (Detragiache, Gupta and Tressel 2008, Beck and Martinez Peria 2010, Gormley 2010, Mian, 2006) although this may be attributable to omitted variables bias. For example, Cull and Martinez Peria (2008) show that the negative association between the foreign bank market share and the level of financial depth can result from the fact that countries relax bank entry barriers after financial crises.

The nexus among foreign bank entry, entrepreneurship, and economic growth has received relatively little attention. Voluminous theoretical and empirical work has shown the importance of firm entry and entrepreneurship for economic development, and also the importance of well-

developed and efficient financial systems for promoting entrepreneurship (Kerr and Nanda, 2009).

Nevertheless, we know little about how recent shifts in foreign bank entry have affected access to credit for new entrepreneurs, especially in developing economies. Some research has suggested that foreign banks tend to "skim the cream" of the credit markets into which they enter, focusing mainly on wealthy consumers and established firms (Clarke, Cull, Martinez Peria, and Sanchez 2005, Beck and Martinez Peria 2010, Beck and Brown 2015). Foreign banks may do so, because, they have an advantage in the cost of raising capital, but may suffer a disadvantage in their ability to understand the nuances of local laws and production methods, which may make it harder for them to fund small and medium-sized enterprises (SMEs). Even if they have trouble competing in lending to SMEs, foreign bank entry still may benefit SMEs by competing for the business of large firms, and thereby encouraging domestic banks to shift more of their lending to SMEs. That is especially possible if foreign entry is associated with greater competition and a reduction in "connected" lending (domestic lending to connected borrowers), as Mian (2006) and Giannetti and Ongena (2009, 2012) find is true. Furthermore, according to the Clarke et al. (2006) findings, the self-reported financing obstacles of 3,000 firms in 35 developing and transition economies decline with foreign banks' share of the banking system, and this holds for all size categories of firms.

Evidence of past challenges for foreign bank lending to SMEs may be less relevant today, given the recent improvements in institutions that protect creditors' rights, and given the recent importance of foreign bank entrants from other developing economies. Several countries have improved their legal frameworks for lending by improving laws governing collateralization of assets, or by adding or improving new credit registries that make it easier to monitor the pledging of assets as collateral (Campello and Larrain 2015, Calomiris et al. 2015). New foreign bank entrants from nearby countries may behave differently in their lending to SMEs than foreign lenders from developed economies. Banks headquartered in nearby economies with similar economic, legal, and political profiles may be better able to overcome the challenges that normally limit SME lending by foreign banks headquartered in developed economies (Mian, 2006; Claessens and Van Horen, 2014).

Main 2006, Claessens and Van Horen et al, 2014 gauges that the role of foreign banks in fostering new business formation (the measure of entrepreneurship) using a unique firm-level database covering 36 manufacturing industries around the world. Importantly, by focusing on the differential effects of foreign bank entry for business formation across various industries they are able to mitigate identification concerns that arise in cross-country regressions. Cross-country regressions assessing the effect of foreign bank entry on business formation suffer from endogeneity biases associated with omitted variables (country characteristics that happen to be correlated with both foreign bank entry and domestic business formation) and reverse causality

To address these biases, we explore the differential effect that foreign bank entry has on entry rates across different industries, making use of theories that predict differential sensitivities of business formation to foreign bank credit supply increases across different industries. Specifically, the researcher gauges the differential effect of foreign bank entry on business formation rates across industries either with (a) different needs for external finance or with (b) input structures that are more differentiated, therefore, giving rise to more complex production processes and supplier-buyer relationships dominated by asymmetric information and agency problems (Main 2006, Claessens and Van Horen , et al 2014)

Similarly, foreign bank entry may differentially affect SMEs operating in industries with different production processes. Foreign banks may find it easier to lend to SMEs when production processes and supply chains are simpler, or where there is less reason for concerns about supplier-buyer agency problems, as this might require less investment in costly relationship building with borrowers. If foreign banks are more effective in overcoming information asymmetries for SMEs operating in industries with lower agency conflicts, then greater foreign bank entry should result in lower business formation rates in industries with less standardized inputs. Alternatively, if foreign banks are more effective in overcoming information asymmetries in industries with higher potential agency conflicts, we should see that greater foreign bank entry results in higher business formation rates in industries with less standardized inputs.(Main 2006, Claessens and Van Horen , et al 2014)

1.2. Statement of the Problem

Many countries have encouraged inflows of capital by disseminating restriction and controls on capital out flows, deregulation domestic financial markets, liberalizing restriction on foreign direct investment(FDI) and improving their economic environment and prospect through the introduction of market oriented reform.

The benefits of increased foreign participation in the banking sectors are discussed by W.C Gruben (1999), that foreign banks entry was generally associated with a lower incidence of a local banking crisis.

In the post 1991, various economic reforms have been implemented in Ethiopia to encourage foreign direct investment (FDI), in the non-financial sector, while at the same time the country's investment law prohibits foreigners to invest in the financial sector including the banking sector. One of the government aims through this economic reform program was to encourage foreign direct investment to participate widely in the rehabilitation and reconstruction efforts of the country. However, investment Proclamation No.280/2002, in banking sector were reserved to the public sector and later through proclamation No. 84/1994(TGE, 1994 b) to private domestic investment in the banking sector, but closed for foreign investor. So, what is the rationale behind the investment law of the banking sector which prohibits foreign nationals to undertake banking business in Ethiopia, while the country is encouraging FDI on the other sector? However, the Ethiopian government has reflected strong hesitation to open the county's banking sector to foreign banks (Proclaim. No.15 (1992) and 37/1996. In this prospect, the key issue has been to identify the policy prerequisites that may allow the country to exploit the gain while minimizing the risks associated with opening foreign banks to operate in the domestic banking sector.

In order to fill the research gap two researches paper on this related titles are taken as the bench mark. The first one is the research made by Getnet (January 2010) on "*Investment Limitation in and by banks in Ethiopia*". Getnet mainly focus on the theoretical part of restriction on Foreign Direct Investment(FDI) related to banking sector and try to explain the negative effect

on the national economy and point out that scholars have different view regarding the impact of FDI. He did not conduct any survey to analyze the effect of investment limitation in banking sector and his research does not fully address the problem. The second one is the research made by Abreham (June 15, 2009) on "*Is Ethiopia Ready to Accept Foreign Banks?*" Abreham tried to collect primary data from individuals working in financial institution. It is not clear as to how he selected the respondent .the 100 respondent may not be appropriate for the issue at hand if only random sampling is used .He concluded that, liberalization of domestic financial sector followed by the stock market and capital account liberalization to be the order needed to be followed to tap the benefit of foreign banks as well as latest technology should be adopted by the domestic bank before permitting the foreign bank entry.

Accordingly, this research was focused on selected respondent from appropriate associations such as Ethiopian Economic Association (EEA), Ethiopian Professional Accountant and Auditor Association (EPAAA) and members from Ethiopian policy research institute (EPRI), in addition to Financial Institution (Banking Sector)

1.3. Research Question

- **I.** What are the potential benefits or risks of foreign bank entry on the financial performance of local Commercial banks?
- **II.** What are the benefits and risks if foreign bank are permitted to enter the local banking Industry?
- **III.** Are domestic banks ready to compete against foreign Bank?
- **IV.** Is there any condition that encourage foreign bank to enter the domestic banking sector in Ethiopia?

1.4. Objectives

1.4.1. General objective

The main objective of this study is to evaluate the potential effect of foreign bank entry in Ethiopian banking sector and analyses how far the domestic banking sectors are ready to compete with the new technology and modern management system.

1.4.2. Specific Objective

- To investigate the potential effect of foreign banks entry on the financial performance of domestic banking sectors ;
- To investigate the readiness factor for the domestic banks in order to make a level playing field with their foreign competition.

1.5. Significant of the Study

Issue of allowing or prohibiting foreign bank entry into Ethiopian financial market is a subject of debates among both academic and practitioners. Ethiopia in its endeavor to attract Foreign Direct Investment(FDI)and economic development wants to open up to the global economy, to the extent of seeking admission / accession to World Trade Organization(WTO). Ethiopia at the same time protects its domestic nascent financial markets, whether this policy is theoretically supported and also practically advantageous needs to be investigated .This research was a contribution to the ongoing debate and partly also provoke further considerations

1.6. Scope and limitation of the study

Theoretical, it is known that research needs to incorporate different variables; the researcher scope is limited to the four dimension bank efficiency measurements. Moreover, the study focused on private and government banks as well as related Professional association and government policy research Institute. With respect to geographical location the study specifically focus on Commercial banks in Addis Ababa branches of the sampled banks due the fund and time constraints.

1.7. Organization of the study

This research paper is organized in five chapters. : Chapter one provides the general introduction about the whole report. Chapter two describes the review of related literature. Chapter three provides detail description of the methodology's employed by the researcher. Chapter four contains data presentation, analysis and interpretation. Finally, the last chapter includes the total work of the researcher and gives relevant recommendation based on finding.

Chapter Two

2. Literature Review

2.1. Theoretical Literature

For emerging economies it is a very sensitive issue to open up domestic banking market to foreign entry. On the one hand, foreign banks can play a crucial role in a weaken economy; and on the other, foreign exposure of domestic financial system may imply significant risks. To estimate the benefits and the costs of foreign bank entry it is important to know how foreign banks behave during a banking crisis. A key question is, if foreign banks will be able to stabilize the financial turmoil by providing additional credit (Peek and Rosengren, 2000). Table 2.1 presents a short overview of the potential benefits and costs of foreign banks for the host country.

Table 2.1: Benefits and costs of foreign bank presence

Benefits	Costs
source of new capital	**no attachment to domestic borrowers**
"safe haven"	**loss of control**
efficiency and innovation	**exposure to home country effects**
growth and stability	**domestic banks' bankruptcies**

Source: (Peek and Rosengren 2000)

Foreign banks are regarded as an important source of new capital for recapitalizing deteriorated banking system in the presence or aftermath adverse domestic shock, e.g. crisis. Banks with only domestic operations are expected to depend stronger on domestic economic situation, while global banks can diversify risk in different markets and their performance is much more stable. Furthermore, foreign bank penetration may attract capital inflows from foreign nonblank companies, as well as prevent from capital flight by domestic investors during crises. In this case they serve as an alternative "safe haven" helping the host country to overcome liquidity problems and unfavorable exchange rate movements (Peek and Rosengren, 2000).

Strong foreign bank participation will enhance competition and increase efficiency of the banking sector through implementing new management practices and information technologies. They stimulate innovation and facilitate broader access to financial services, which in turn will increase aggregate lending, growth and stability (Moreno and Villar, 2005).

However, foreign banks will not have an attachment to domestic borrowers as they can diversify among different regions and choose where to cut operations. This preference for the borrowers in the home country plays an important role when host and home country shocks are correlated and financing is scarce at a time when is most demanded (Peek and Rosengren, 2000). This highly important issue regarding the behavior of foreign banks during crisis periods explains the limited foreign bank entry in Asia, where foreign banks have "cut and run" after the 1997 crises (Roldos, 2001). A question emerges, whether foreign banks with local presence will maintain their local operations, while foreign banks engaged in cross-border lending are more likely to pull off the market.

Another concern is that the domestic authorities will lose control over the banking system, if foreign banks have too strong presence. International banks are able to engage in complex cross-border financial transactions, which are sometimes difficult to monitor by either the host or the home country supervisors (Roldos, 2001). Moreover, the regulatory institutions in the home country may affect negatively the decisions of foreign banks to lend, merge or acquire in the host environment (Peek and Rosengren, 2000). A related issue is the inability of domestic banks to compete with the high performing international banks. Foreign bank entry may lead to lowering the interest margins, further weakening of domestic players and bankruptcies (Peek and Rosengren, 2000). While foreign banks *skim off the cream* creditworthy borrowers the most risky contracts are left over for the less efficient domestic banks (Uiboupin, 2005). If the foreign share reaches a certain threshold, these foreign banks will have to finance less efficient projects, so the relationship with regard to efficiency may be hump-shaped (Eller et al, 2006). Asymmetric information will make it more difficult for foreign banks to estimate the risk of their operations in the host country and it is expected that foreign banks will generally reduce the availability of credit to small firms (Roldos, 2001).

Taking such universal and transparent environment gives a clear advantage to local banks that can rely much better on connections, insider networks, discretion and corruption. This is why most foreign banks considering moving into TEs or should be interested in effective supervision on their operation as well. Delays in legislation and enforcement partially explain the relative late arrival of the foreign banks to most TEs (Michael and Gur, 2002).

A decision to encourage the banks to step in thus forces the government to expedite the formation of the minimum necessary legal environment, which is of course an added bonus when foreign banks became a natural lobby in favor of continuous tightening of regulatory regime (Michael and Gur, 2002). This is definitely true with respect to the protection of creditors and improvement of corporate governance of enterprises; however, most likely that an efficient legal environment and supervision for the banking sectors itself. Only in this way they can hope to overcome the advantage of the domestic banks. In general, the dominance of the domestic banks may lead to a vicious circle that leads, as it has in a number of countries to financial crises.

In the literature it is also indicated that, following clients, (home-host country economic integration), opportunity in host country and host country regulations are the most common factors that draw foreign banks to enter into a host country's banking sector. Various studies have found a positive and significant correlation between the follow of banks foreign direct investment (FDI) and the extent of integration between home and host countries (George, *et al*, 2001).

In developing countries, foreign entrant faces relatively less effective domestic computation. Developing host counties therefore, might offer substantial profit opportunities in financial services. In that sense foreign penetration in banking might proceed and perhaps help bringing about, entry of non financial sector firms. Classens, et al, (2002), also provide support for the notion that foreign banks are attracted by profitable opportunities in host countries. They find greater entry where the expected rate of economic growth is higher and banking system is on average less efficient. Therefore, foreign banks are more likely to enter in to host countries with

better prospects for growth and where local banks have higher average costs, lower net interest margins, less charge offs, and higher cash fellows.

The effect of host country regulations on foreign entry are straight forward, such restrictions limit computations and protect inefficient domestic banks (George, *et al*, 2001b).As indicated by, George, *et al*, (2001b), the general indications are that foreign banks enter developing countries for some different reasons than they enter developed ones. In particular the fellows of the customer motivation seems less important for developing countries, which suggest that foreign banks are genuinely in exploiting opportunities in the host country. More recent economic analysis, on the motivating factor for entry has found that the share of foreign banks is a function of some of the general factors, including banking net margins profitability, country credit worthiness, political stability, and fundamental factors (Claessens and Jonk-Kun, 2003). Whatever the factor which draw foreign banks to enter into the developing countries banking sector, the main concern of this paper is to explore the major advantages and disadvantages of foreign banks, assuming that foreign banks are willing to participate in the host domestic banking system.

In theory, there are different ways through which financial globalization can lead to in the financial sector infrastructure. First, financial globalization can improvements lead to a greater competition in the provision of funds, which can generate efficiency gains. Second, the adoption of international accounting standards can increase transparency. Third, the introduction of international financial intermediaries would push the financial sector towards the international frontier. Fourth, Stulz (1999) argues that financial globalization improves corporate governance; new shareholders and potential bidders can lead to a closer monitoring of management. Fifth, Crockett (2000) claims that, the increase in the technical capabilities for engaging in precision financing results in a growing completeness of local and global markets. Sixth, Stiglitz (2000) argues that the stringent market discipline imposed by financial globalization has consequences not only on the macro-economy, but also on the business environment and other institutional factors

Foreign bank entry is another way through which financial globalization can improve the financial infrastructure of developing countries. Mishkin (2003) argues that foreign banks enhance financial development for at least three main reasons. First foreign banks have more diversified portfolios as they have access to sources of funds foreign banks have more diversified portfolios as they have access to sources of funds from all over the world, what means that they are exposed to less risk and are less affected by negative shocks to the home country economy. Second, foreign entry can lead to the adoption of best practices in the banking industry, particularly in risk management but also in management techniques, what leads to a more efficient banking sector. Third, if foreign banks dominate the banking sector, governments are less likely to bail out banks when they have solvency problems. A lower likelihood of bailouts encourages a more prudent behavior by banking institutions, an increased discipline, and a reduction in moral hazard. The World Bank (2001)

2.2. History of Banking in Ethiopia

The first Commercial bank of Ethiopia, Bank of Abyssinia, was established in Feb.16 1906 under a50-year franchise agreement reached between Emperor Minilik II and Mr. Ma Gillivary. The bank was totally managed by the British owned National Bank of Egypt representative and its capital was agreed to be Pound Sterling 500,000 and one-fifth was subscribed and the rest was to be obtained by selling shares in some important cities such as London, Paris and New York. The bank was given full right to issue bank notes and monitor coins which were to be legal tender and all the profits there from a ruling to the bank and freely exchangeable against gold and silver on cover by the bank as well as to establish silver coins and abolish the Maria-Theresa.(National Bank of Ethiopian Bulletin and online)

Bank of Ethiopia took over the commercial activities of the Abyssinia and was authorized to issue notes and coins. The Bank with branches in Dire Dawa, Gore, Dessie, Debre Tabor, Harar, Agency in Gambella and transit office in Djibouti continued successfully until the Italian invasion in 1935. During the invasion, the Italians established branches of their main banks namely Bancad' Italia, Banco di Roma, Banco di Napoli and Banco Nazionale Dellavoro and started operation in the main towns of Ethiopia. However, they all ceased operation soon after

liberation except Banco di Roma and Banco di Napoli which remained in Asmara. In 1941 another foreign bank, Barclays bank came to Ethiopia with the British troops and organized banking services in Addis Ababa, until its withdrawal in 1943. Then on 15th April 1943, the State Bank of Ethiopia commenced full operation after 8 months of preparatory activities. It acted as the Central Bank of Ethiopia and had a power to issue bank notes and coins as the agent of the Ministry of Finance. In 1945 and 1949 the Bank was granted the sole right of issuing currency and deal in foreign currency. The Bank had established 21 branches including a branch in Khartoum, Sudan and a transit office on Djibouti until it ceased to exist by proclamation issued on December, 1963. Then the Ethiopian Monetary and banking law that came into force in1963 separated the function of commercial and central banking creating National Bank of Ethiopia and Commercial bank of Ethiopia. Moreover, it allowed foreign banks to operate in Ethiopia limiting their maximum ownership to be 49 percent while the remaining balance should be owned by Ethiopians.(NBE Bulletin and online)

The National Bank of Ethiopia with more power and duties started its operation in January 1964. Following the incorporation as a share company on December 16, 1963 as per proclamation No.207/1955 of October 1963, Commercial Bank of Ethiopia took over the commercial banking activities of the former state Bank of Ethiopia. It started operation on January 1, 1964 with a capital of Birr 20 million. (NBE Bulletin and online)

The first privately owned bank, Addis Ababa Bank shares Company, was established on Ethiopians initiative and started operation in 1964 with a capital of Birr 2 million in association with National and Grindlay Bank, London which had 40 percent of the total share. In 1968, the original capital of the bank rose to Birr 5 million and until it ceased operation, it had 300 staff at 26 branches.(NBE Bulletin and online)

Following the declaration of Socialism in 1974 the government extended its control over the whole economy and nationalized all large Corporations. Organizational setups were taken in order to create stronger institutions by merging those that perform similar functions. Accordingly, the three private owned banks, Addis Ababa Bank, Banco di Roma and Banco di Napoli merged in 1976 to form the second largest bank in Ethiopia called Addis Bank with a

Capital of Birr20million and had a staff of 480 and 34 branches. Before the merger, the foreign participation of these banks was first nationalized in 1975. Then Addis Banks and Commercial Bank of Ethiopia S.C were merged by proclamation No.184 of August 2, 1980 to form the sole commercial bank in the country till establishment of private commercial banks in 1994. The Commercial bank of Ethiopia commenced its operation with a capital of Birr 65 million, 128 branches and 3633 employees. The saving and mortgage corporations and Imperial Saving and Home Ownership Public Association were also merger to form the Housing and Saving Bank with working Capital of Birr 6million and all rights, privileges, assets and liabilities were transferred by proclamation No. 60, 1975 to the new bank (NBE Bulletin and online).

The financial sector that the socialist oriented government left behind was constituted only by 3 banks; and each enjoying monopoly in its respective market. The following was the structure of the sector at the end of the era

- The National Bank of Ethiopia(NBE)
- The Commercial Bank of Ethiopia(CBE)
- Agricultural and Industrial Development Bank(AIDB)

Following the change in the economic policy, financial sector reform also took place. Monetary and banking proclamation of 1994 established the National Bank of Ethiopia as judicial entity, separated from the government and outlined its main functions. So, monetary and Banking Proclamation No.83/1994, and the licensing and supervision of banking Business No.84/1994 laid down the legal basis for investment in the banking sector consequently (NBE Bulletin and Directors).In that regard currently, there are 19 Banks in the country as mention below (Table.2.2).

Table2.2 List of Banks in Ethiopia

S. No.	Bank Name	Year Established	No. of Branch on June 2016
1	National Bank of Ethiopia	1931	Central Bank
2	Commercial Bank of Ethiopia	1963	1153
3	Development Bank of Ethiopia	1970	110
4	Awash International Bank	1994	245
5	Abay Bank S.C	2010	116
6	Addis International bank	2011	245
7	Bank of Abyssinia	1996	176
8	Berhan International Bank	2010	88
9	Bunna International Bank	2009	105
10	Cooperative Bank of Oromia(S.C)	2005	184
11	Dashen Bank	2003	118
12	Debub Global bank	2012	28
13	Enat Bank	2013	20
14	Lion International bank	2006	121
15	Nib International Bank	1999	155
16	Oromia International Bank	2008	210
17	United Bank	1998	144
18	Wegagen Bank	1997	161
19	Zemen Bank	2009	13
	Total		**3190**

Source: **NBE (online list of Banks in Ethiopia on June, 2016)**

2.2.1. Risks and net effects of globalization

Although financial globalization has several potential benefits, financial globalization can also carry some risks. The recent stream of financial crises and contagion after countries liberalized their financial systems and became integrated with world financial markets, might lead some to suggest that globalization generates financial volatility and crises (Sergio L. Shmuket, June 2004)

Even though domestic factors tend to be key determinants of crises, there are different channels through which financial globalization can be related to crises. First, when a country liberalizes its financial system it becomes subject to market discipline exercised by both foreign and domestic investors. When an economy is closed, only domestic investors monitor the economy and react

to unsound fundamentals. In open economies, the joint force of domestic and foreign investors might generate a crisis when fundamentals deteriorate. This might prompt countries to try to achieve sound fundamentals, though this might take a long time Furthermore, .investors might overreact, being over-optimistic in good times and over-pessimistic in bad ones, not necessarily disciplining countries. Therefore, small changes in fundamentals or even news can trigger sharp changes in investors' appetite for risk. (Sergio L. Shmuket, et al, 2004)

Second, globalization can also lead to crises if there are imperfections in international financial markets. The imperfections in financial markets can generate bubbles, herding behavior, speculative attacks, and crashes among other things. Imperfections in international capital markets can lead to crises even in countries with sound fundamentals. For example, if investors believe that the exchange rate is unsustainable they might speculate against the currency, what can lead to a self-fulfilling balance of payments crisis regardless of market fundamentals. This is largely illustrated in the literature following Obstfeld (1986). Imperfections can also deteriorate fundamentals. For example, moral hazard can lead to over borrowing syndromes when economies are liberalized and there are implicit government guarantees, increasing the likelihood of crises, as argued in McKinnon and Pill (1997)

Third, globalization can lead to crises due to the importance of external factors even in countries with sound fundamentals and even in the absence of imperfections in international capital markets If a country becomes dependent on foreign capital, sudden shifts in foreign capital flows can create financing difficulties and economic down turns. These shifts do not necessarily depend on country fundamentals. Calvo, Leiderman, and Reinhart (1996) argue that external factors are important determinants of capital flows to developing countries. In particular, they find that world interest rates were a significant determinant of capital inflows into Asia and Latin America during the 1990s. Economic cyclical movements in developed countries, a global drive towards diversification of investments in major financial centers, and regional effects tend to be other important global factors

Fourth, financial globalization can also lead to financial crises through contagion, namely by shocks that are transmitted across countries. Three broad channels of contagion have been

identified in the literature: real links, financial links, and herding behavior or "unexplained high correlations." Real links have been usually associated with trade links. When two countries trade among themselves or if they compete in the same external markets, a devaluation of the exchange rate in one country deteriorates the other country's competitive advantage. As a consequence, both countries will likely end up devaluing their currencies to re-balance their external sectors. Financial links exist when two economies are connected through the international financial system. One example of financial links is when leveraged institutions face margin calls. When the value of their collateral falls, due to a negative shock in one country, leveraged companies need to increase their reserves. Therefore, they sell part of their valuable holdings on the countries that are still unaffected by the initial shock. This mechanism propagates the shock to other economies .Finally; financial markets might transmit shocks across countries due to herding behavior or panics. At the root of this herding behavior is asymmetric information. Information is costly so investors remain uniformed. Therefore, investors try to infer future price changes based on how other markets are reacting. In this context, a change in Thailand's asset prices might be useful information about future changes in Indonesia or Brazil's asset prices. Additionally, in the context of asymmetric information, what the other market participants are doing might convey information that each uniformed investor does not have. This type of reaction leads to herding behavior, panics, and "irrational exuberance."(Sergio L. Shmuket, et al, June 2004)

2.2.2. Why do foreign Banks Enter?

There are various hypotheses to explain why banks expand their activity abroad. The first such theory introduced into the literature by Williams (1997, 2002) is called the defensive expansion hypothesis. This claims that multinational banks follow their clients abroad (either their trade or investment). Information about the client is one of the main assets of banks. There is, however, no external market for this information i.e. markets where banks could sell this knowledge. Hence, they have to follow their client if they do not want to lose them. Often the motivation behind following the client is not so much to earn more profit but rather to avoid loss at existing locations On the other hand, it is also in the interest of the clients, who must bear the transaction costs of changing banks. Although defensive expansion is found to have strong explanatory power in more developed countries, it only provides a partial explanation. Williams refers to

other hypotheses such as regulatory impact, home market sophistication, etc. Banks who follow their clients might restrict their activity to their existing client base, but they can also create a beachhead (Williams 1997, 2002) and try to acquire new clients or enter into other market segments in the host country. Their relative performance and impact on the domestic banking sector is largely determined by which strategy they follow.

In developing countries the defensive expansion hypothesis is suggested to have even less importance and the underlying motivation is also rather different. Whereas in developed countries banks' primarily motive is to keep existing clients, here the need for effective monitoring becomes more important. Financial markets are less developed and mature; the only way to ensure effective monitoring is physical presence. Delegation of monitoring is not an option (Sergio L. Shmuket, et al, 2004)

An alternative and more important explanation for developing countries is the existence of host country opportunities Banks enters other, non-saturated and less developed, less efficient markets where they enjoy comparative advantages – higher quality services, better risk management tools etc. Such markets often offer good profit and growth prospects typically; these markets also entail risks not present in developed countries. Therefore, the entry decision is influenced by other factors, such as the development of market infrastructure standards of regulation and supervision, and political risk. Often foreign banks are attracted by tax relieves and other regulatory exemptions. (Clarke 2001).

In addition to the aforementioned "pull" factors, there are other factors, which "push" banks abroad Amongst others, Clarke et al. mentions deregulation in the home country (which, for example, pushed Spanish banks to enter Latin American markets) as well as the size and efficiency of the entering bank (Clarke et al, 2001).

2.2.3. Why do countries open up their Markets?

Typically, the opening up of home markets is part of a broader liberalization process. In addition, it is often driven by the need for capital and also for expertise during privatization or following a banking crisis. It is regarded as an important way of importing knowledge and enhancing competition (Magyar Nemzeti Bank, November 2003)

The decision on opening up is based on thorough consideration of its costs and benefits. Benefits cited in relation to developing countries are numerous. It is expected that foreign banks contribute to building a more efficient and resilient financial system by introducing and spreading technology, providing new services and products, raising standards and practices, by exerting competitive pressure on domestic banks and increasing the efficiency of resource allocation. Increased competition lowers the cost of intermediation and leads to cheaper credit for borrowers (Haas and Lelyveld February 2003). It can even lead to stronger regulation and supervision

.During turbulent times, foreign banks can also provide a "safe haven" for depositors and a stable source of funds compared to domestic banks (Peek and Rosengren December 2002). Foreign banks might attract other foreign investors in the non-bank sector. On the cost side, Hindley 2003 for example summarizes the counterarguments under the headings of economic and regulatory. Among the former ones are the followings domestic banks need time to mature (the so-called infant industry argument) newcomers can engage in cherry picking; in contrast to existing banks they do not have bad loans, and hence a level playing field is not ensured have bad loans, and hence a level playing field is not ensured; a lack of commitment to the local economy might cause capital flight on the other hand, there are fears that regulators cannot control foreign banks properly. Others add to this list (Claessen February 2013) the loss of monetary autonomy and increased volatility of capital flows. There are also concerns that foreign banks ignore certain markets segment (SMEs) or propagate shocks originating from their home country.

2.2.4. Foreign banks' impact on domestic banking systems

Many studies have examined the consequences of foreign bank ownership on domestic banking systems. Before the crisis, the general consensus was that the benefits of foreign banks greatly outweigh costs in many dimensions (Clarke, Cull, Martinez Peria and Sanchez, 2003, Claessens, 2006 and Chopra, 2007). Since the global financial crisis there has been some revision of this view. This section reviews ideas put forward in the literature and provides some new evidence on the local market banks under two headings: access to financial services and financial stability.

2.2.4.1. Access to financial services

In general, studies (Claessens, Demirguc-Kunt, and Huizinga, 2001 and later studies, e.g., Mian, 2003,Berger, Clarke, Cull, Klapper and Udell, 2005) have found that greater foreign bank presence coincides with lower overall costs of financial intermediation (measured by, among others, margins, spreads and overheads). Also, evidence exists of better quality financial intermediation with more foreign entry, e.g., lower loan-loss provisioning and better economic performance of borrowers (Martinez Peria and Mody, 2004). A number of factors are thought to be behind these effects. First, foreign bank presence can increase competition in the host country. Second, the entry of foreign banks can lead to the introduction of new, more diverse products, greater use of up-to-date technologies, and know-how. In addition, foreign banks can pressure governments to improve regulation and supervision, increase transparency, and more generally catalyze domestic reform (Levine 1996 and Mishkin, 2007).

However, the literature also shows that these effects tend to depend on some conditions. For example, limited general development and entry barriers seem to hinder the effectiveness of foreign banks (Garcia Herrero and Martinez Peria, 2007; Demirguc-Kunt, Laeven and Levine, 2004). Also, the relative size of foreign banks' presence appears to matter: with more limited entry (as a share of the total host banking system), fewer spillovers arise, suggesting the existence of a threshold effect (Claessens and Lee, 2003).Furthermore, as shown in the previous section, important interplays exist between host country characteristics, the distance of the home country to the host country and foreign banks' performance in the local market.

.In terms of access to financial services, greater foreign bank presence seems to help, although here results depend (even) more on individual bank characteristics. Clarke, Cull and Martinez Peria (2002) find that foreign bank entry improves financing conditions for enterprises of all sizes, although larger firms benefit more. Beck, Demirgüç-Kunt and Maksimovic (2004) and Berger, Hasan and Klapper (2004) instead conclude that a larger foreign presence leads to a greater availability of credit to SMEs. Brown Ongena, Popov and Yesin (2011), on the other hand, find evidence of greater access to finance for more transparent firms when more foreign banks are present in a country. Giannetti and Ongena (2012) show that large and foreign firms are more likely to have a relationship with a foreign bank, while small firms tend to be served by private domestic banks. In addition, they find that an increase in foreign bank presence increases the probability that a firm gets access to bank loans, which holds for all types of firms.

The extent to which foreign banks contribute on net to access to finance and financial sector development thus remains debated. Although some studies have looked at the relationship between private credit and foreign bank ownership, surprisingly little is known under what conditions foreign ownership positively relates to private credit and when negatively. Some suggest that foreign banks "cherry pick" borrowers. If this is the case, foreign bank presence can undermine access to financial services as it worsens the remaining credit pool available for domestic banks, lowering overall financial sector development. This could be especially so in low-income countries where relationship lending is important. Indeed, the results in the previous section are indicative of some cherry-picking behavior among foreign banks in these types of countries. Furthermore, especially examining the relationship between foreign bank presence and financial sector development, Detragiache, Gupta and Tressel (2008) show that greater presence of foreign banks in low income countries indeed is associated with less credit being extended. However, Cull and Martinez Peria (2011) show that this relationship disappears, or even reverses once crisis induced acquisition of (distressed) banks by foreigners is accounted for.

While providing interesting new insights, these studies only accounted for some of the heterogeneity found among foreign banks. Therefore in a recent paper, Claessens and Van Horen (2013a) re-examine the relationship between foreign bank presence and levels of private credit to explore in more detail how country characteristics affect this relationship. Following the

methodology of Detragiache, Gupta and Tressel (2008), they use cross-country regressions over a sample of 111 countries; a sample that is much more diverse than that of Detragiache, Gupta and Tressel (2008), since it represent all levels of development, not just low-income countries.

The results of Claessens and Van Horen (2013a) indicate that several host country characteristics, not only the general development of the country, seem to matter .They find for the whole sample a negative relation between foreign bank presence and growth in private credit to GDP. However, when splitting the sample across income groups, they find no statistically significant relationship between private credit and foreign bank presence for emerging markets and high-income countries. For the group of developing countries, on the other hand, they find a negative relationship, in line with the findings of Detragiache, Gupta and Tressel (2008). A one standard deviation increase in foreign presence is associated with a decline in private credit of 5 percentage points for this group of countries (compared to a mean private credit to GDP ratio of 20 percent). However, splitting the sample across other dimension, the authors find that foreign banks' negative impact on credit also occurs when foreign banks have a limited market share, when enforcing contracts is costly, and when credit information is limited available. These results are very much in line with the previous section and suggest that in certain types of markets foreign banks are more likely to be niche players that cherry-pick their customers. This benefits their own profitability, but negatively affects credit provision to the private sector as a whole

2.2.4.2. Financial Stability

The role of foreign banks with respect to lending stability has been a topic high on the policy and research agenda since the start of the global financial crisis. As a starting point, it is important to realize that foreign banks can offer valuable diversification services and can absorb shocks occurring in the host market. Several papers have highlighted how foreign banks can enhance financial stability when crises occur in the host country. Studying crisis episodes in (mainly) emerging markets and developing countries several studies show that due to support of the parent banks, foreign affiliates do not need to rein in their credit supply during a financial crisis in the host country, while domestic banks do have to contract their lending (see, among others, Crystal, Dages and Goldberg, 2001; De Haas and Van Lelyveld,2006, 2010).

At the same time, and especially after the recent crisis, concerns have been raised that foreign banks can be a source of contagion. When faced with capital or funding shocks at home, foreign banks might withdraw from cross-border banking activities to redirect lending at home. This can translate in a reduction in capital that parents lend to their foreign affiliates, which in turn can have a negative impaction the supply of credit by these affiliates in the host market. The seminal studies of Peek and Rosengren(1997, 2000) show indeed that (funding) shocks to parent banks can be transmitted to their foreign subsidiaries with negative consequences for their lending. Schnabel (2012), on the other hand, shows that the negative liquidity shock resulting from the Russian default led international banks to reduce lending to both domestic and foreign-owned Peruvian banks, which in turn reduced lending to Peruvian firms. However, although parent banks did reduce their lending to Peruvian banks in general, they continued to support their own Peruvian affiliates.

Findings of recent studies focusing specifically on the recent global financial crisis suggest that at the height of the crisis global banks were transmitting shocks across borders through their affiliates. De Haas and Lelyveld (2013), for example, compare foreign banks with large domestic banks and find that the former group on average contracted their lending more. De Haas, Korniyenko, Loukoianova and Pivovarsky (2011) find similar results for a sample of Eastern European countries. Popov and Udell (2012) show that if banks in the vicinity of the firm were experiencing distress at the onset of the global financial crisis, the likelihood of a firm being credit constrained increased. This transmission of bank distress to firm access to credit also took place when shocks occurred to the balance sheet of the parents of the foreign owned subsidiaries.

Other recent studies suggest, however, that also with respect to financial stability one cannot look at foreign subsidiaries as one homogeneous group. Cull and Martinez Peria (2012) show that in Eastern Europe, loan growth by foreign banks fell more than that of domestic private banks during the crisis, but that in Latin America foreign banks did not contract their loans at a faster pace. The distinction between the two continents seems to be driven by the fact that foreign banks in Latin America were mostly funded through a domestic deposit base with most of the lending denominated in domestic currency, in part forced by regulatory requirements. This

allowed them to maintain lending even when parent banks were hit by a funding shock. Furthermore, Cetorelli and Goldberg (2012) show that global banks actively manage their inter-office positions: when faced with a funding shock, they tend to reallocate capital within the holding towards "important" subsidiaries. While they do not study the lending behavior of subsidiaries, their results do suggest that some affiliates might be forced to curb lending due to a reduction in funding from the parent, whereas other affiliates do not feel this pressure or might even be in a better position compared to domestic banks to continue to extent credit.

It is therefore insightful to investigate under which conditions funding shocks to parent banks negatively affected local lending by subsidiaries during the global financial crisis and when not. Using the extensive database on bank ownership of Claessens and Van Horen (2013) allows us to not only compare many domestic and foreign banks active in various regions, but also the behavior of different types of foreign banks in different types of host countries. Specifically, we examine how differences in levels of development, relative market share, distance between home and host country and having access to local deposits affected the stability of lending of foreign banks during the global financial crisis.

2.2.5. Forms of Foreign Banks Entry

The increasing foreign banks entry is one of the most striking developments in the banking system in the transition economies. It is found that, on average foreign owned banks account for more than half of the total number of banks in 2000 and hold more than two thirds of total banks assets in most transition economies (Ilko Naaborg et al 2003). However, the importance of foreign banks varies a lot among countries. The different parts of foreign banks entry depend on a wider range of factors. In particular the profit opportunities in the destination market has become a key factor in the determining the pattern of foreign bank entry. As a result, forms of foreign banking participation has become more varied, including full acquisition, targeted purchases of specific activities, joint ventures, alliances with local banks, and outsourcing of administrative and financial services. The desired forms of entry may vary from banks to bank and from country to country, depending upon the business strategy considerations and host country laws and banking structure. Banks initially extend their service abroad in order to assist their home country customers with international transaction.

With a growing understanding of foreign market and a more developed network of relationships with local financial institutions, some banks subsequently increased the range of their operations by adding local customers. Following this pattern, foreign banks would first establish representative offices. At a later stage, they would open branches and, eventually, establish subsidiaries (Inwon 2004).

The major forms of foreign banks entry are:-

I. Representative offices

Representative offices are generally prohibited from performing any banking operations. They do, offer opportunities for contracts with the parent bank and its clients concerning a variety of commercial and financial business that relates to the foreign market.

II. Foreign branches

A foreign branch is an overseas office a bank incorporated in a foreign country and constitutes a higher level of commitment than the representative office. Foreign branch offices are typically involved in a wholesale banking.

III. Bank subsidiaries

Bank subsidiaries are separately incorporated from the parent bank, whose financial commitment to the subsidiary consist of the capital invested. Subsidiaries are usually involved in retail banking markets. However, in some countries such as the United Kingdom, subsidiaries are often involved in wholesale investment banking operations.

IV. Offshore banks

Offshore banks are engaged in banking business but in foreign currency only. They accept deposits from foreign banks or non bank companies or entities and make loan to them in foreign currencies.

V. Joint venture and affiliate relationships.

Establishing affiliated relationship or participating in a joint venture can be another way to engage into foreign expansion. This usually involves taking minority tasks in local entries and the level of involvement in to management of the local banks by the foreign banks.(Inwon Song 2004)

2.3. Empirical Evidence

2.3.1. International Evidence

Empirical studies proved that foreign banks rather provide net benefits to emerging market in host countries in terms of stability. However, patterns of financial markets vary from country to country and for some countries too much presence of foreign banks from a single country may have negative impact if the banking operations are not geographically diversified (Clarke at al. 2001).

In transitional developing countries there is a particular large need for financial and banking services, both for short and long operation. This is due to the great need for restructuring and privatization to adopt the economy to the new conditions of an open market economy. Foreign banks much better equipped to provide the needed services than domestic banks and that the recent development of global, multinational banking services provide a great opportunity for transitional economies, by bringing them into expedite the transition and encourage higher levels of economic growth (Michael and Gur, 2002).

It is generally accepted that foreign banks can contribute to efficiency and economic growth of emerging markets. In particular foreign banks can bring transitional economies to the entire package of services needed for restructuring. As Reininger, et al, (2001) and World Bank (2001) in Michael and Gur(2002), findings foreign banks contribute for:-

- Short and long term intermediary savings and channeling recourse;
- Mobilization of household saving and channeling recourse;
- Advise, training and assistance in financial management;

- Proper risk assessment and evaluation, risk transformation and risk sharing;
- Supervising the proper corporate management of enterprise;
- Monitoring the performance of loans and repayment schedule;
- Lobbying for and helping to introduce the proper regulatory regime for the entire banking sector;
- Reduce transaction costs and improving information.

In addition to their knowledge and experience, foreign banks bring with them trust, by both households and business, that is based on their record reputation in their home countries and in the global economy. Trust and reputation are gravelly missing in the local financial sector and this severely hinders their ability to fulfill their mission (Michael and Gur, 2002). A study in Russian Banking Sector, (World Bank, 2001 in Michael and Gur, 2002) has argued that, "trust cannot be reborn without an intensive initial involvement and setting the norms of foreign banks". All these can increase savings, or at least trusting them to the banks, raise the level of investment and will allocate investment funds in a more efficient way throughout the economy.

Finally, foreign banks bring with them the lifeline of the global economy, investment recourses, potential entrepreneurs and investors for other industries, and networking links foreign trade.
This section shows the relevant experience and lesson of three countries. The experiences of these countries are taken due to their economies and financial liberation as well their banking sector activated after a long period of the government monopoly. These are:

I. Turkey

Denizer (2000) analyzed the effects foreign bank presence on domestic banks in Turkey. He noted that the entry of foreign banks lead to a decrease of net interest rate margins and returns on assets. However, on the flip side domestic banks noted increased overhead expenses. This is despite the fact that foreign banks controlled a market share between 3.5 and 5 percent during the period 1970 and 1997. The findings could support the idea that foreign banks exert competitive pressure on the domestic banks.

II. Colombian

Barajasetal.(2000) analyzed the Colombian banking system and using individual bank accounting data for the year 1985 to 1998. The study shows that foreign bank presence generally increases competition in the domestic banking system as evidenced by reduced intermediations spreads. On the other side of the coin, they observed deterioration of loan quality on domestic banks as a result of foreign banks entry. In order to catch up with foreign banks, domestic banks experienced increased overheads because the need to upgrade the operations with advanced technologies.

III. Kenya

In December 2013Kenya has 43 banks, with 1,313 branches and accounting for about two thirds of the financial system's assets. In terms of shareholding, the Central Bank identifies 14 banks with foreign ownership, accounting for 32.2% of net assets in 2012. The Central Bank also identifies 6 banks with state ownership accounting for 24.8.% of net assets in 2012, with the government having majority ownership in three of these, which account for 4.2% of net total assets (Consolidated Bank; Development Bank of Kenya; and the National Bank of Kenya,(Kenya Bank Supervisor annually Report 2014) The remaining 20 are local private banks, accounting for 43.0% of the banking sector's net assets. Hence Kenya's banking system is dominated by local private banks and foreign banks.

Oloo(2013) proposes a number of indicators to identify the different strengths and weaknesses of Kenyan banks and provides data on individual banks, which we aggregate into the various ownership components, weighted by the value of assets in 2012. These include the rates of return on assets and capital; cost of funds, efficiency ratio and the ratio of non-performing loans (Table2.2)

Table 2.2: The performance of commercial banks in Kenya by ownership

	Foreign Banks	Banks with stat-ownership	Banks with majority stat-ownership	Local private Banks	All Banks
	Return on Assets %[A]				
2009	3.6	2.8	3.7	3.8	3.6
2010	4.7	3.7	4.2	4.8	4.6
2011	4.7	4.1	3.1	4.8	4.7
2012	5.2	4.1	1.4	4.8	4.9
	Return on Capital %[B]				
2009	36.7	30	27.2	30.3	32.3
2010	46.1	23.4	30.8	46.6	40.7
2011	50.6	44.9	27.6	50.4	49.1
2012	51.9	38.0	12.7	50.9	48.0
	Average cost of Funds %[C]				
2009	3	2.7	3.5	4	3.4
2010	2.2	2.1	2.9	3.4	2.7
2011	2.5	2.3	3.8	3.8	3
2012	4.9	5.3	7.6	7	6
	Efficiency Ratio %[D]				
2009	53.1	66.4	64.4	58.8	60
2010	47.1	61.4	58	51.6	53.6
2011	45.8	56.8	63.1	51.6	52
2012	50.7	57.0	74.8	52	53.9
	Non- Performing Loans to advances ratio%[E]				
2009	4.5	9.7	10.1	6.4	6.7
2010	3.6	6.4	6.6	5.1	5
2011	2.7	4.4	6.5	3.7	3.6
2012	2.4	5.2	8.8	3.6	3.7

Source:(*Kenya Bank Supervisor annually Report 2014)*

A- Return on Assets (ROA) is the Ration of profits before tax to average total assets (at beginning and end of the year). A higher ratio is desirable

B- Return on Capital (ROC) is measured as the return to the average core capital (at the beginning and end of the year). A higher ratio is desirable

C- The ability of a bank to acquire external funding cheaply to boost its investment is a critical measure. There are two main sources of funds for bank: (a) deposits from customers; and (b) borrowed funds. This ratio therefore is a measure of how cheaply, or expensively these funds have been acquired. It reflects the ease with which a bank is able to secure such funds. A lower rate is desirable

D- The efficiency ratio is measured by taking the total operating expenses, which include the bank's overheads and weighting them against the total operating income. A lower is desirable

E- Non-performing loans are the single most important threat that a bank can face. To assess its magnitude, it is weighted against the total portfolio of all loans and advances that the bank has extended a higher ratio which is a reflection of imprudent lending practice and poor credit management. A low ratio is therefore desirable

As a result, the foreign banks have done as well as local private banks with both having an average rate of return on assets of 4.6% over 2009 to 2012, ahead of banks with state ownership(3.7%) and state-owned banks (3.1%). The poor performance of the latter is attributed to poor legacy in the past of poor governance and massive interference by the state in their management. The same pattern is repeated in the other indicators. Foreign banks have on average done slightly better on the rate of return on core capital (46.3%) over 2009-2012 when compared to local private banks (44.6%), ahead of banks with state ownership and major state ownership, 4.1% and 24.6%, respectively. Foreign banks also have the lowest cost of funds (index of 3.2%) together with banks with state ownerships (index of 3.1% and 4.5%, respectively) and local private banks (index 4.6%). Moreover, those foreign banks are the most efficient with an average score of 49.1% Slightly ahead of local private banks (score of 53.5%), with banks with state ownership the least efficient (scores of 60.4% and 65.1%, respectively). Finally, foreign banks have the least non-performing loans ratio average 3.3% over the year 2009-2012, followed by local private banks (4.7%) and banks with state ownership (6.4% and 8.0%, respectively).

It is therefore apparent that foreign banks largely behave like local private banks except that they have cheaper sources of finance due to their reputation capital. They are also very diverse so that it is difficult to generalize their behavior. For example those banks include (i) the traditional multinational banks from Europe and USA (Barclays, Citibank, Habib A.Z. Zurich and Standard); (ii) banks from Asia and the Middle East, such as Bank of Baroda, Bank of India, Gulf African Bank, Habib Bank and Diamond Trust Bank, the last two from Pakistan and owned by the Aga Khan Fund for Economic Development; (iii) pan-African banks (Bank of Africa, United Bank of Africa; and Ecobank); and (iv) Islamic banks (First Community Bank licensed in 2007 with some shareholding from Tanzania and Gulf African Bank licensed in 2008). K-Rep Bank was incorporated as a commercial bank in 1999, from microfinance NGO and has largely maintained the microfinance banking model.

According to World Bank (2013), most foreign banks have dedicated units serving SMEs. There are however a few exceptions such as Citibank which is focused on corporate and high-end clients, and hence do not lend to SMEs. Oloo (2013) also simulates the cost of provision of banking services to SMEs from customers' perspective. In the first scenario, he considers a small business firm, with a turnover of $ 60,000 (at the exchange rate of Ksh 84.5 per US dollar in 2012). He assumes the annual cost of opening and maintaining a business current account to require six 50-leaf cheque books, 48 customer withdraws, 48 bankers cheques, 24 standing orders, charges for 600 transactions and 12 ledger fees. In the second scenario, he considers a medium-sized business enterprise with a turnover of $ 6 million per year. He assumes the annual cost of opening and maintaining a business current account requires twelve 50-leaf cheque books, 96 customers withdraws, 96 bankers cheques, 96 standing orders, charges for 6,000 transactions and 12 ledger fees.

Oloo, et al (2013) derives the following total costs of operating the accounts by type of bank ownership. The results show that local private banks have the lowest costs to SMEs, followed by foreign banks and then banks with state ownership.(Table 2.3)

Table2.3: Simulated cost of banking services to SMES

	Small firm US$	**Medium-sized firm, US$**
Foreign banks	795.50	1751.00
Banks with state ownership	825.30	1902.00
Banks with majority state ownership	800.60	1835.30
Local private banks	733.00	1667.70

Source:(Oloo, 2013)

2.3.2. Local Evidence

The Ethiopian government continues by law to prohibit the entry of foreign banks to the country. Barriers to entry in the banking sector reinforce inefficient state-owned enterprises by shielding them from competition. The government's concern is that if foreign banks were to be allowed to operate in Ethiopia, it may lose of control over the economy. This position is based on the infant industry argument. Prohibiting foreign bank entry at this time would prevent the domestic banks

from being weakened because of unfair competition from foreign banks (Admassu B.&Asayehgn D.2014).

Two important questions must be answered when examining the issue of foreign bank entry to Ethiopia. First, will foreign banks invest in Ethiopia if the government reverses its stand and permits their entry? Second, once foreign banks start operations in Ethiopia will they be assets or liabilities to the country? The answer to the first question is an unqualified "yes" since Ethiopia presents a huge potential for bank profits for a number of reasons.(Admassu B.&Asayehgn D. April 2014).

To begin with, foreign banks have a number of advantages compared to domestic banks. By servicing client's active in more than one country, they can achieve benefits from spreading best-practice policies and procedures. Second, they may be able to diversify risk better, allowing them to undertake higher risk, but also with potentially higher returns on investments. Third, foreign banks have advantages in the form of more diversified funding sources, including having access to external liquidity from their parent banks, which may lower their funding costs. Finally, by being larger they may achieve other scale advantages such as utilizing more advanced and sophisticated risk assessment models to give them a competitive edge over fragile Ethiopian banks.

At the same time, foreign banks are likely to incur additional costs and face more obstacles when compared to domestic banks. They may have less information compared to local banks on how to do business in the host country, putting them at a disadvantage, at least until they have been in the country for some time. Moreover, foreign banks might be exposed to discrimination by individual customers. Additionally, diseconomies might arise because of an institutional environment that is culturally different. However, these costs remain a small fraction of the huge revenue benefits they are likely to generate by operating in the host country. Aghion and Howitt(1998),(as referred by Admassu and Asayehgn (2014)) successful foreign banks that have learned to work in a competitive environment with demanding customers in their home countries have learned to innovate, pursue new business segments, and adjust to changing circumstances. Greater competition in their home countries can lead to more efficient operations

in Ethiopia. Gregorian and Manole (2006) and Berger, Hansen and Zhou (2009) ,(as referred by Admassu and Asayehgn(2014)) after examining the role of foreign banks in developing countries have found that foreign banks outperform domestic banks.

The current state of development of the financial sector in Ethiopia is also a factor that could have a favorable impact on the profitability of foreign banks. In Ethiopia, where a large part of the population does not yet have access to banking services, it is easier for foreign banks to gain market share and therefore likely easier to make a higher profit".

Finally, according to Berger and Humphrey (1997), size has been found to be an important factor for explaining performance of any bank. By being comparatively larger, foreign banks may achieve other scale advantages; for example they may afford more advanced and sophisticated risk assessment models giving them superior risk management skills.

When studying foreign banks in developing countries, Claessens, Demirguc-and Huizinga (2001) point out that in a country like Ethiopia where the banking sector is inefficient, banking practices are outmoded, and credit is not allocated on commercial criteria, foreign banks may be able to reap higher profits than domestic banks. Similarly Mico, Panizza and Yanez (2007) find that foreign banks do tend to have higher profits than domestic banks in developing countries. Also, Gregorian and Manole (2006) have found that foreign banks outperform domestic banks. The answer to the first question of whether or not foreign banks will be willing to invest in Ethiopia's an affirmative "yes" because it will be profitable for them to do so and globally competitive banks will seek to exploit the profit potential to their advantages.

Foreign banks will be an asset since they will promote competitiveness and efficiency in the banking sector. However, as far as the current government of Ethiopia is concerned, foreign banks are viewed as a liability to the country. As a consequence, entry of foreign banks is prohibited. The government's rationale is based on the infant industry argument as follows: first, since the banking sector in Ethiopia is young it will not be able to compete with more mature foreign banks that have more capital, professionally qualified and seasoned managers and employees, and better reputations. (Admassu B.&Asayehgn D. April 2014).

Second, there is evidence in the literature about the association between financial liberalization and banking crises. Such studies include Williamson and Mahar (1998), Kaminsky and Reinhart (1999), Demirguc-Kunt and Detragiache (2001), Weller (2001), Eichengreen and Arteta (2002) and Noy (2004),Demirguc-Kunt and Detragiache (2001) find that financial liberalization is strongly and positively correlated with the probability of a subsequent banking crisis. This is especially true in a country like Ethiopia where the institutional environment is weak. Weller (2001) finds that a banking crisis becomes more likely after domestic financial liberalization. Noy (2004) considers interactions between domestic liberalization and supervision and concludes that banking crises occur as a result of weak supervision after liberalization.

Third, since foreign banks, if allowed to operate in Ethiopia, are likely to engage in cream skimming behavior, preferring large scale operators for clients, such as commercial agriculture, big industrial, real estate and service establishments. They inevitably will skew credit allocation in favor of these very large and established enterprises. Fourth, foreign banks may concentrate on lending rather than mobilizing of savings.(Admassu B.&Asayehgn D. April 2014).

Finally, the government believes that at present Ethiopia is poorly endowed with the financial experts to design and operate the regulatory and institutional structures needed to supervise the banking sector. Although assistance from IMF/World Bank can help redress the shortage, the ultimate success of banking reform ambitions will stand or fall by Ethiopia itself. Ethiopia continues to experience a significant brain drain begun in 1974 and does not have the capability to effectively oversee the operations of foreign banks at this time.(Admassu B.&Asayehgn D. April 2014).

The infant industry argument seems to be an excuse for a concern held by some Ethiopian government officials. According to them, since foreign banks serve as conduits for inward and outward flows they would facilitate the outflow of capital whenever they felt that a banking crisis was about to emerge. An outflow of capital could develop into full-blown economic crises leading to political instability. The government does not want to take chances and lose control. Demirguc-Kunt and Detragiache (1998),(as referred by Admassu B.&Asayehgn, (2014))banking

crises tend to erupt when the macroeconomic environment is weak, particularly when growth is low and inflation is high. Since, Ethiopia's economy is characterized by low growth and high inflation, the danger of political instability remains real.

Contrary to the government's view, the potential benefits that can result from opening the sector for foreign direct investment remain substantial. First, foreign bank participation may have the potential for a positive impact on the efficiency of the Ethiopian banking sector. Competition demands that domestic banks continuously upgrade their skill and technology levels to stay in business. Second, entry of foreign banks may improve bank regulation and supervision. According to Goldberg (2007) the entry of foreign banks in emerging markets that are healthier than domestic banks implicitly allows the introduction of stronger and more prudent regulation, increasing the soundness of the local banking sector. Third, the entry of foreign banks to Ethiopia will strengthen the financial sector and may have a positive impact on economic growth. Demirguc-Kunt, Levine and Min (1998), Mattoo, Rathindran, and Subramanian (2006),(as referred by Admassu and Asayehgn (2014)) have found a positive correlation between financial sector openness and economic growth. Also, Beck et al. (2004), Levine, Loayza and Beck (2000),LaPorta (2002), Lopez-Silanes, and Shlefer(2002) concluded that an increase in bank concentration was an obstacle in obtaining financing for growth.

Ethiopia financial sector remains closed and is much less developed than its neighbors. Ethiopian 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-establish. 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. Hoverer, the government does not at this time seem prepared to privatize large state- owned enterprises(or bank) , allow for private ownership of land or open the financial sector to foreign participation and competition(Kiyota, Peitsch& M Stern August 17,2007)

Kiyota, Peitsch and M Stern et al (August 17, 2007) point out that some important potential benefits of liberalization and qualification is taken into account. Such as

- Financial liberalization may have positive effects on efficiency of the banking sector in the host market. This is because domestic banks are forced to compete with more efficient foreign banks and skills and technology levels improve.
- The entry of foreign banks through financial liberalization may improve bank supervision through regulatory spillover. They quoted that, according to Goldberg (2007 p.10):" The entry of Foreign banks in emerging markets that are healthier than domestic banks insurance against Financial crises"

2.4. Conclusion and Research Gap

The effect of foreign bank entry has been a controversial in both theory and empirical literature. In theory literature foreign bank entry could significantly reduce the cost of credit by bring capital, technical skills, and product innovation to host countries which increase competition and leads to improvement in efficiency of the banking sector, while empirical literature examine the effect of foreign bank entry on the cost of funds has generally supported the view that foreign banking entry lowers the cost of credit.

Overall, the available empirical literature appears to conclude that foreign bank presence has effect on the performance of the domestic banking system through increased competition .It is less clear to what extent this competition leads to improved efficiency. However, at least one study (Cho, 1990) reports increasing cost for banks after foreign bank entry. Another study shows (Lensink and Herms, 2003) that in the short -run costs may go up, depending on the level of economic development of the recipient country. This seems to suggest that there may be a trade –off in terms of benefits and cost for domestic banks from foreign presence. This study will examine the potential impact of foreign banks entry on the financial performance of local commercial banks and the forgone opportunity in Ethiopia.

Chapter Three

3. Research Methodology

This chapter deals with the research design and method in a systematic way to accomplish the research objectives or to solve the research problem. The purpose of this study is to evaluate the potential effect of foreign bank entry in Ethiopian banking sector

3.1. Study Setting

The study were conducted based on the data gathered from banks and other related sectors such as the Ethiopian Economic Association (EEA), Ethiopian Policy Research Institute (EPRI) and Professional Ethiopian Accountant and Auditor Association (PEAA). As of June 2016 there are 19 banks in Ethiopian including NBE that was registered under National Bank of Ethiopia. Therefore, out of the total number of entire population the researcher decided were15 (i.e.10 from Private Bank, two from Govern Banks and 3 from others sector) sample institutions were selected only at Addis Ababa level

3.2. Research Design

In order to describe the raison topic title experimental or longitudinal designs were not suitable but cross-sectional design capable to do so. A cross-sectional design was employed for a data collected and analyzed more than one case at a single time.

3.3. Research Method/Approach

There are three common approaches to conduct a research project in the area of business and financial studies, namely: quantitative, qualitative and mixed research approaches. In order to attain the objective of the study and answer the research questions. The researcher adopted only the quantitative research approach. With quantitative approach, the researcher primarily formulates inquiries which were going to answer the research question. Then follow collected a data on pre specified instrument that yield statistical data. When someone uses the

word quantitative or describe quantitative dissertations, he/she will draw a quantitative research methods or statistical analysis techniques. Quantitative research takes a particular approach to theory, answering research questions and/or hypotheses, setting up a research strategy, making conclusions from results, and so forth (Creswell 2003).

3.4. Research Strategy

Research strategies help researchers to provide data that can answer the research questions or achieve the research objectives. There are many types of research strategies, depending on the types of data that the researcher want to collect and analyze, such as experiment, survey, case study, action research and grounded theory. However, this study employed survey strategy because the data collected from as such kinds of strategy can be used to suggest a possible explanation about the raisin issues.

3.5. Data Sources and Collection Method

3.5.1. Data Source

Data are collected from Bank employees/Officers, (all licensed Banks) members of Professional association related to the field(Ethiopian Economic association –EEA,) (Ethiopian Professional of Accountant and Auditor-EPAAA) .In addition higher official Ethiopian Policy Research Institution (EPRI) were also included.

3.5.2. Study Population

All selected banks, Ethiopian Policy Research Institute and professional associations (EEA&EPAAA) employees those participated in this study were considered as a study population in Addis Ababa.

3.6. Study units

All selected Bank Manager, higher official of the NBE, higher official of EPRI and higher official of EEA and higher official of EPAAA were the last study participants. Total number of study units are 813(from Bank sector 810 , three from others)

3.7. Sample Design and Procedure

From the total population the researcher collected data from the sample selected banks registered under National Bank of Ethiopia, professional Associations (EEA&EPAAA) and Ethiopian Policy Research Institution (EPRI) in Addis Ababa.

3.8. Data Collection Instrument and Administration

Here the researcher used primary data which was collected from the sample selected of banks and other sector like professional associations (EEA&EPAAA) and Ethiopian Policy research institute (EPRI) in Addis Ababa using a pre -designed questioners.

3.9. Sampling procedures

3.9.1. Sampling procedure

This study employed random and purposive sampling techniques in order to select the required size. Primarily, due to the limited resource, the researcher purposively selects banks those were found in Addis Ababa. According to the data obtained from National Bank of Ethiopia, on June, 2016, 19 banks were registered and worked in Ethiopia including the NBE. All those bank main offices and their branches were found in Addis; that was why Addis was selected purposely. Then, randomly select 10from private bank and two from government purposely selected from Govern (NBE& CBE) banks found in the country. Jointly, the study included three purposely selected concerned professional associations (EPAAA and EEA) and research institution (EPRI).

3.9.2. Sampling Frame

The sampling frame of this study was 19 private and government Banks that was listed on National Bank of Ethiopia yearly bulletin and online source and two professional Association as well as Ethiopian policy Development Research Institute.

3.9.3. Sample Size Determination

There are several approaches to determining the sample size of a study. The sample of this research was calculated by using Yamane (1973) formula (as sited in Glenn, 1992)[1]. The formula is shown as bellow:

$$n = \frac{N}{1 + N(e)^2}$$

Where:

n = sample size required

N = number of people in the population

e = allowable error

From the selected 15 banks found in Addis, there are 810 branches (table-3.1) and allowable error assumed to be (e=8%). From them by the above given formula:

$$n = \frac{810}{1 + 810(0.08)^2}$$

n = 131

Therefore, from the total target population of 810 bank branches and main offices, 131 of them, 16.2% of the target population, was selected randomly. Then, from each bank, only one respondent (the manager or focal person) filled the questionnaire. In addition, from the selected three institutes (EEA, EDRI and PEAAA) include respondent, one for each. So, the total sample size will be 134. The below table indicate how the sample size distribute as per the size of the branches those banks have (Table3.1)

[1] Glenn D. Israel, 1992. *Determining sample size*. University of Florida, USA. 17

Table3.1. List of Bank and Branches selected for the Study

S. No	Name	# of branches in Addis	The selected size
1	Awash International Bank	122	20
2	Addis International	32	5
3	Wegagen Bank	72	12
4	United Bank	81	13
5	Cooperative Bank	54	8
6	Zemen Bank	1	1
7	Berhan International	10	2
8	Bunna international	54	8
9	Dashen Bank	108	17
10	Abay Bank	30	5
11	Commercial Bank of Eth(CBE)	245	39
12	National Bank of Ethiopia	1	1
	Total	**810**	**131**

3.10. Data Collection Procedures

The first step, to collect a data by getting permission from concerned authorities in those banks sector and professional association as well as research institution by submitting the support letters written by Accounting and Finance Department. Basically, for the data collection process, professional data collectors were engaged. Because of the wideness of the study area, five professional enumerators with knowledge of data collection system were involved. Among those lists of banks and firms, the researcher used all samples which were included in the study. And in this study data was collected by using pre-designed format or questionnaire in English version by giving the necessary consent for respondents. All data were collected from bank branch manager, higher official of the National Bank of Ethiopia, higher official of professional associations. In fact as per the researcher believe bank branch managers, higher official of the National Bank of

Ethiopia and higher official Professional Association and Ethiopian Development Research Institute were suitable candidates for answering the questionnaire. Because most of those concerned bodies were making financial decisions and knowing more about government financial policy and could easily respond to the questionnaire.

3.11. Method of Data Analysis

After the data were collected, data processing was carried out. The raw data were converted into suitable form for analysis and interpretation. This was achieved through sequences of activities including editing, coding, entry, and tabulation. The objectives were to check the completeness, internal consistency and appropriateness of the answers to each of the questions.

Descriptive statistics such as frequency distribution, measures of central tendency and measures of dispersions (mean, standard deviation, percentage, frequency etc.) were used to provide details regarding the statements in the questionnaire.

3.12. Reliability

Reliability is concerned whether the procedures of data collection and analysis will generate the same results on other occasions or will other observers make similar observations and arrive at conclusions from the raw data.

In order to measure the consistency of the questionnaire and the overall reliability of constructs that it is measuring, a reliability test was carried out based on Cronbach's Alpha coefficient. Cronbach's Alpha can be interpreted as like a correlation coefficient; its coefficient range lay on the value from 0 to 1. A reliability coefficient (alpha) is higher than or equal to 0.7 considered as acceptable reliability. That means the targeted questions raised in the questionnaires are capable to answer the objective of the study.

Therefore, the reliability test accomplished that all the items of the pilot questionnaire has been reliable since the scores of the test was higher than 0.7 as in the table 3.2. Hence, the responses

generated for all of the variables' used in this research were reliable enough for the data analysis (Table.3.2)

Table 3.2: RELIABILITY STATISTICS

Cronbach's Alpha	N of Items
0.82	32

Source: Computation based on data from author's field work, 2017

3.13. Scale used for Analysis

The following criteria, as shown below, are used to express the degree of mean values based on the criteria to scale rating of class interval (Table3.3).

Table 3.3: Likert scale threshold

Range	Degree
1.25 --- 1.99	Most favourable (true to a very extent true)
2.00 --- 2.74	Favourable (True to a high extent)
2.75 --- 3.49	Average (True to a moderate extent)
3.50 --- 4.24	Unfavourable (true to a high extent)
4.25 --- 4.99	Most unfavourable (true to a very high extent)

Source: Evannyakwara (2013) and reformed by user

Chapter Four

4. Data Analysis and Finding

In this part, the researcher has tried to analyze the row data collected from the field of the study. In the survey, a total number of one hundred thirty four questionnaires' have been distributed in the selected private and government Banks as well as other organizations; out of which, one hundred twenty three or 91.79% were collected and analyzed, whereas, the rest 8.21% were not returned or invalid(Table 4.1).

Table 4.1: The expected and actual Responses

S. No	Name	Expected data	Collected data	Percentage
1	Awash International Bank	20	18	90
2	Addis International	5	5	11
3	Wegagen Bank	12	12	100
4	United Bank	13	13	100
5	Cooperative Bank	8	7	87
6	Zemen Bank	1	0	0.0
7	Berhan International	2	2	100
8	Bunna international	8	7	87.5
9	Dashen Bank	17	16	94.1
10	Abay Bank	5	5	100
11	Commercial Bank of Eth(CBE)	39	35	90
12	National Bank of Ethiopia	1	1	100
13	EEA	**1**	**1**	**100**
14	PEAAA	**1**	**1**	**100**
15	EDI	**1**	**0**	**0.00**
	Total	**134**	**123**	**91.79**

Source: Own survey, 2017

The survey embodied with four main sections. They are:

- General information of respondent

- Potential effect of foreign banks entry on the financial performance of local commercial banks
- Benefit of foreign banks entry
- How far the domestic banks are ready to compete with foreign banks

Some ordinary scaling issued for the Likert scale questions, except for the general information about the respondent. The scaling range starting from 1 to 5; which helps to indicate the degree of agreement or disagreement about the potential impact of foreign banks. The number 1 refers to 'Strongly agree", 2. "Agree", 3. "Neither agree nor disagree", 4. "Disagree"5." Strongly disagree".

4.1. General Information about the respondent

The general information gives the organizations the respondent come from, their level of qualification and gender mix. Accordingly, as presented in table 4.2, 69.1% of respondents are from Private commercial Banks, 28.5% from Commercial Bank of Ethiopia, 0.8% from National Banks of Ethiopia and 1.6% from Professional Association.

Regarding the education level concern35.8% respondents have Master Degree and above whilst 62.6%study participants have got Bachelor degree, whereas, 1.6% of the study participants are not willing to give a proper answer for this specific question. Moreover, 74.80% of the respondents are males and the rest 25.20% are females.

Table 4.2: Background of the respondents

Variables		Frequency	%
Organizations currently the respondents attend	NBE	1	0.8
	CBE	35	28.5
	Private Banks	85	69.1
	EEA, PEAAA, EPRI	2	1.6
Sex of the respondent	Male	92	74.8
	Female	31	25.2
Educational level of the respondent	BSc/BA	77	62.6
	MSc/MB/A	44	35.8
	Not responded	2	1.6

Source: Own survey, 2017

4.2. Potential effect of foreign banks entry on financial performance of local Commercial banks

The survey respondents were asked the question that whether the foreign banks accelerate the country's economic growth or not. Large majority respondent that is positive to this questionnaire. 82.9% of the respondents have the opinion that foreign banks would have a positive impact for the acceleration of economic growth, whereas the other 16.3% oppose the opinion. Moreover, one respondent, i.e., 0.8%, did not give the right answer. (Fig4.1)

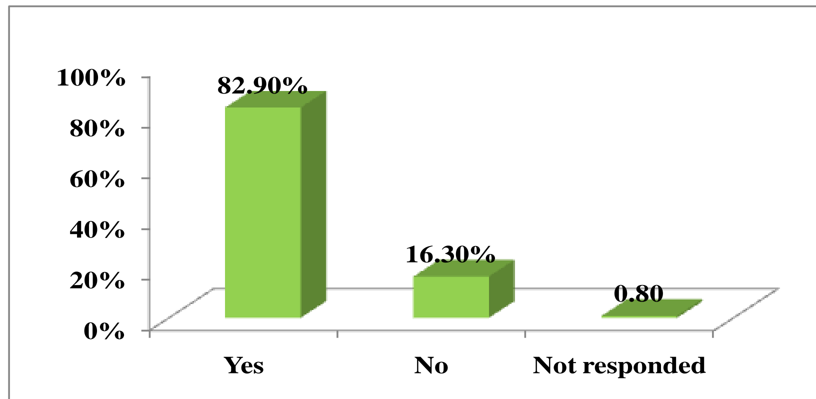

Fig 4.1: **foreign banks accelerate the country's economic growth**

Source: Own survey, 2017

If foreign bank entry is permitted, 42.3% of respondents believed that the gross domestic product (GDP) can be growing, while, 37.4% of respondents informed that the chance may attract more investor to invest in the country. Moreover, 3.3%ofthe respondents, believed, it may create employment opportunity for the society (Figure 4.2).

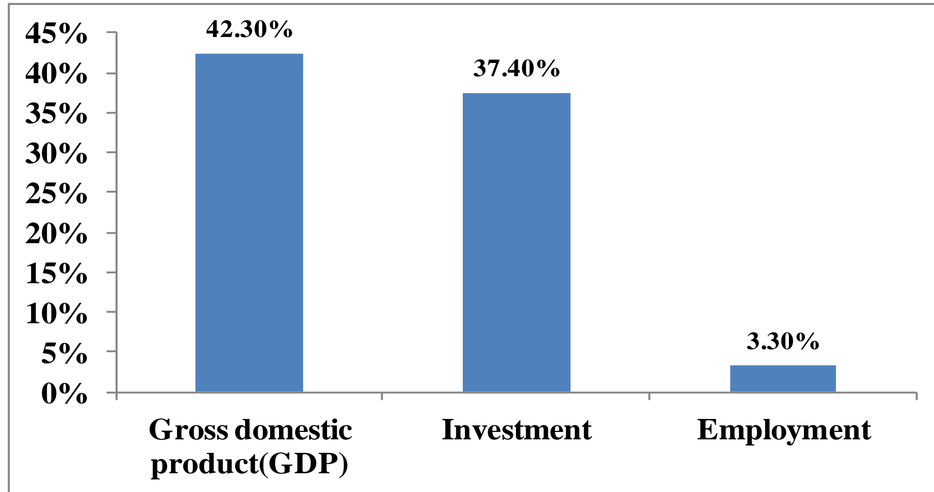

Fig 4.2: Macroeconomic parameter affected positively

Source: Own survey, 2017

On the contrast respondents those arguing against the entry of foreign banks for economic growth, constituted 4.1%.As their opinion if those banks entered in the country, the gross domestic product (GDP) will be affected negatively while, 8.9% of the respondents respond that it may affect the investment activity of the country. Around, 3.3% of the respondent believed that the entry of foreign banks would have been the causes of inflation (Figure 4.3).

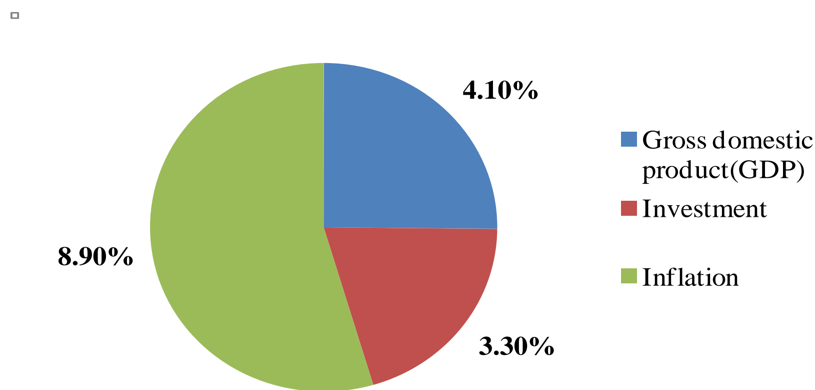

Fig 4.3: Macroeconomic parameter that will be affected negatively

Source: Own survey, 2017

4.3. How do Foreign Bank enhance the efficiency of Domestic Banks?

The respondents have pointed out that if foreign banks are allowed to operate with current condition, the potential efficiency reform to the general economy will be to:

A.Improve Financial Regulation

As presented in table4.3, majority of the respondent, 74.8% feel that entry of foreign banks will improve financial regulation in the country. This is supported by 41.5% who agree and 33.3% who strongly agree with statement. 16.2%, of the respondent remain neutral about the statement , that is they are not sure whether it really improve the financial regulation of the country. 5.7% and 3.3% of the respondent disagree and strongly disagree respectively, with the statement. Therefore 9% of the respondent has the opinion that entry of foreign banks will not improve financial regulation in Ethiopia.

B.Introduce other Financial Activities

Moreover, most of the respondents, 60.2%, pointed out that foreign bank can introduce other financial activities, likewise, the next highest responds, 33.33%,agreed with those collies opinion on the possible benefit. But 3.3%, of the respondents are neutral to give a judgment either to say foreign banks introduce other financial activity or not. In other way round, equal numbers, 1.6%,of the study participants strongly and partially disagreed with foreign banks entrance association with the introduction of other finical activities (Table 4.3).

C.Attract a foreign Direct Investment

About 47.2% of the survey respondents have the same highest opinion about the entrance of foreign banks attract a foreign direct investment, 44.7% of the respondents also have a concurrent idea with the above respondent. But, each 1.6% respondents strongly and partially contradicted the above arguers. As these respondents believe the presence or absence of foreign

banks doesn't affect the foreign direct investment. However, the rest 4.9% respondents were neither agree nor fro of the two parties opinion (Table 4.3).

D.Enhance the Overall Stability

On the statement whether permitting foreign banks entry would improve the overall stability of the domestic banking sector , the respondents have shown mixed results. Considerable percentage of respondent 29.3% are not sure about its effect on stability (neutral), while 21.1% and 28.5% strongly agree and agree, respectively and 16.3% and 4.9% disagree and strongly disagree. The overall result shows that 49.6% of the respondent fill it will bring about stability while the remaining either are not sure or feel it does not contribute to stability at all (Table 4.3).

Table 4.3: **How do Foreign Bank enhance the efficiency of Domestic Banks**

Quality items	Strongly Agree	Agree	Neutral	Disagree	strongly disagree	N
Improve Financial Regulation	41 (33.3%)	51 (41.5%)	20 (16.2%)	7 (5.7%)	4 (3.3%)	123
Introduce other Financial Activities	74 (60.2%)	41 (33.3%)	4 (3.3%)	2 (1.6%)	2 (1.6%)	123
Attract a foreign Direct Investment	58 (47.2%)	55 (44.7%)	6 (4.9%)	2 (1.6%)	2 (1.6%)	123
Enhance the Overall Stability	26 (21.1%)	35 (28.5%)	36 (29.3%)	20 (16.3%)	6 (4.9%)	123

Source: Own survey, 2017

4.4. Necessity of Foreign Banks Entry in Ethiopian Banking Sector

Most respondents, 78.9%, point out that foreign bank entry is necessary in Ethiopian banking sectors, while, 21.1% of the respondents oppose the necessity of foreign bank entry in the domestic banking sector (Fig 4.4).

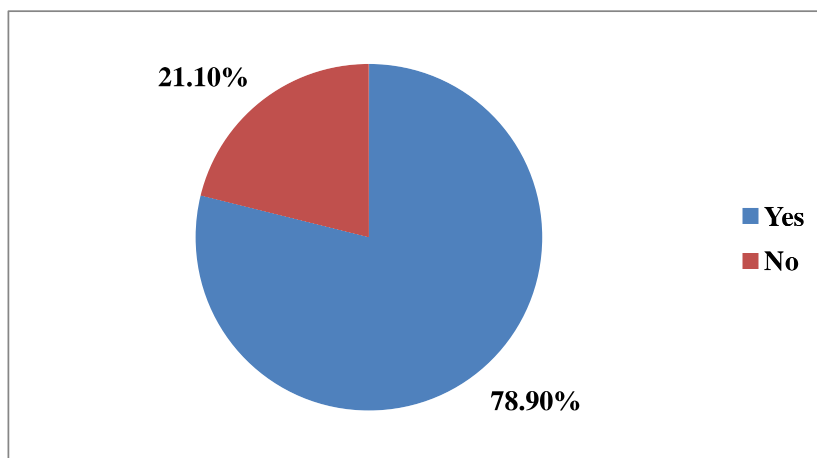

Fig 4.4: Necessity of foreign banks entry

Source: Own survey, 2017

Jointly,50.4% of the respondents prefer that the appropriate time of foreign bank entry should be in the long term period(from5-20 years),while, 21.1% of the respondent prefer the short term period(from 1-5 years). Amicably, according to 4.9% of the respondents believe those banks would have entered before 15 years, during the previous regime, whilst, due to the2.4% respondents point of view, the banks entrance period may determine by the strengthening of current domestic banks performance(Table 4.3).

Table 4.4a: **Appropriate time for foreign bank entry into the county**

	Frequency	Percent
In the past fifteen years (after the transitional government	6	4.9
In the short term period(from 1-5 years)	26	21.1
In the long term period (from 5-20 years)	62	50.4
If others please specify	3	2.4
Missing System	26	21.1
Total	**123**	**100.0**

Source: Own survey, 2017

In other way round, among the respondents who oppose the foreign bank entry, 17.1% of them mention that foreign bank can weaken the domestic banking sector while only 4.1% of them suggest that there will be capital out fellow (foreign shortage) (Table 4.4b).

Table 4.4b: The possible disadvantages of foreign banks entry in the country's banking activities

	Frequency	Percent
Weakening of domestic banking sector	21	17.1
Capital outflow(foreign shortage)	5	4.1
Total	26	21.1
Missing System	97	78.9
Total	**123**	**100.0**

Source: Own survey, 2017

4.5. Type of Foreign Bank Entry Expected

Most respondents,35.0%, prefer a type of foreign would be permitted should be the one which was more specialized and have a knowledge in stock market as well investment banks. Likewise, 34.1% of the respondents prefer a foreign banks those have a multinational character like HSBC, Citibank, ANB, etc and the rest30.9% of the respondent prefer large, globally operating banks (Table4.5).

Table 4.5: Type of foreign banks entry Expected

	Frequency	Percent
Large, globally operating	38	30.9
Multinational banks (such as HSBC, Citibank, ANB etc.)	42	34.1
More specialized banks that have more knowledge in stock market, investment banking	43	35.0
Total	**123**	**100.0**

Source: Own survey, 2017

4.6. Foreign Bank Helps the Domestic bank to become more dynamic

Most respondents, 83.7%, point out that foreign bank helps Ethiopian banking sectors, while, 16.3% of the respondents oppose the idea (Fig 4.5).

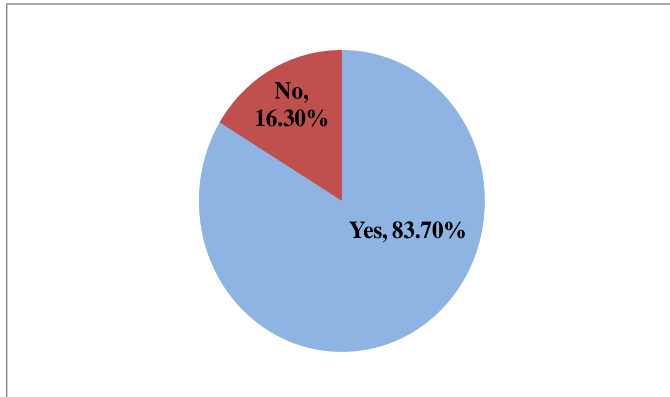

Fig 4.5: Foreign banks help the domestic banks to become more dynamic

Source: Own survey, 2017

4.7. Benefits of Foreign Bank Entry

Different literature in transition countries states that the foreign bank entry has its own benefits and risks. Accordingly, respondents were asked to rate the potential benefit of foreign bank entry. Hence foreign banks will,

A. Improve Quality Service in the Financial Sector

As the result reveled in the table below, the majority of the respondent, 56.9%, convinced that if those banks were entered, they have a stronger tendency to improve the quality of the domestic banks.Likewise,36.9%, of the study participants agreed with this opinion. Other2.4%respondents hold to say any, i.e., neither agrees nor disagrees about their tendency. In contrast 4.1% respondents disagreed with the above respondents' opinion. For more detail information look at the table below (Table 4.6):

B. More Credit Supply can be Offered

Regarding to the credit supply, most of the respondents, 43.9%, strongly agreed with the foreign banks capably to supply more credits. Similarly, 36.9% of the respondents support those collies opinion. However, 5.7% of the respondents oppose the above opponents idea; as their believe

getting of more credit supply never associated with the banks type. Similarly, 0.8% of the study participants strongly support the later respondents' idea. The remaining 13.0% respondents reserved themselves from any suggestion on the credit supply (Table 4.6)

C. Higher Efficiency will be Obtained

More respondents, 54.5% strongly agreed with the statement which is said "foreign banks entry will benefit the domestic banks to obtain higher efficiency," and 35.8% of other respondents also share the mined of the above respondents' idea. But, 5.7% of the study participants were against the above argument. Meanwhile, the remaining respondents, 4.1%,are not decided (Table 4.6).

D. Competition Will be Enhanced

Different literatures state that there will higher competitions among domestic and foreign bank. Accordingly, respondent were asked whether competition will be enhanced if foreign banks were permitted and the responds with scaling of "strongly agree" were 44.7% while "agree" were 39.8%. The remaining were "neither agree nor disagree" and Disagree" 9.8% and 5.7% respectively (Table4.6).

E. Modern Technology and New Banking System will be Introduced

The study also want to see the perception level respondents about modern technology and foreign banks interaction; as a result 61.0% of the study participants strongly agreed with if foreign banks were invited in the country, they may transfer modern technology and introduce new banking system. Similarly, 30.1% respondents agreed with this idea, whereas, 3.3% of the study participants disagreed with this opinion. But, the rest 5.7% respondents neither agreed nor disagree with the two arguers' idea (Table 4.6).

F. Foreign Bank will Bring about Better Economic Stability

Majorities of the respondents, 44.0%, are positively responded and some other, 35.0%, are not in a position to express their opinion that foreign bank will bring a better economic stability if it

were permitted to entry the domestic banking sector. Accordingly 21.2% of the respondents not accept this argument rather the types of banks there are other factors those can trigger the economic stability of banks (Table 4.6).

G. Foreign Bank Enhanced Customer Satisfaction as Result of Higher Efficiency

The below table illustrated that opinions of respondents about the foreign banks enhanced customer satisfaction with the higher efficiency, 50.4%strongly agreed and 33.3%agreedby the argument, whereas, 11.4%of the respondents undecided whether this is true or not. In contrast 4.9%of the study participants disagreed by the argument (Table 4.6).

Table 4.6: **Benefits of Foreign Bank Entry**

Quality items	Strongly Agree	Agree	Neutral	Disagree	strongly disagree	N
Improve Quality Service in the Financial Sector	70 (56.9%)	45 (36.6%)	3 (2.4%)	5 (4.1%)	0 (0.0%)	123
More Credit Supply can be Offered	54 (43.9%)	45 (36.6%)	16 (13.0%)	7 (5.7%)	1 (0.8%)	123
Higher Efficiency will be Obtained	67 (54.5%)	44 (35.8%)	5 (4.1%)	7 (5.7%)	0 (0.0%)	123
Competition Will be Enhanced	55 (44.7%)	49 (39.8%)	12 (9.8%)	7 (5.7%)	0 (0.0%)	123
Modern Technology and new banking system will be introduced	75 (61.0%)	37 (30.1%)	7 (5.7%)	4 (3.3%)	0 (0.0%)	123
Foreign Bank will Bring about Better Economic Stability	27 (22.0%)	27 (22.0%)	43 (35.0)	21 (17.1%)	5 (4.1%)	123
Foreign Bank Enhanced Customer Satisfaction as Result of Higher Efficiency	62 (50.4%)	41 (33.3%)	14 (11.4%)	6 (4.9%)	0 (0.0)	123

Source: Own survey, 2017

4.8. Potential cost of Foreign Bank Entry

A. Foreign Banks May reduce Costs

Survey respondents were asked to rate potential costs of foreign bank entry if they were permitting to the countries current situation and their responds as scaling of strongly Agree, 21.1%, and agree 41.5%, whilst, 23.6% of the respondents neither agree nor disagree. However, 10.6%, of the study participants disagree and the rest 3.2% of the respondent strongly disagrees. For more detail information please look at the table below (Table 4.7).

B. Domestic Banking as an infant industry becomes less Competitive

As the respondent response indicates, 32.5% of the study participants strongly agreed, 31.7% agree and the 28.5% shows undecided to the opinion inquiries which state domestic banking as an infant industry becomes less computation. In contrast 7.3% of the study participants disagreed with the above opponents' argument (Table;4.7).

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C. Foreign Bank Retains Credit to Small firms

According to 39.0% respondents points of view foreign banks retains credit to small firms, 15.4% of the other respondents strongly agreed those respondents opinion. However, 20.3% of the study participant opposes the above respondent response, 1.6% of the respondents also do the same. Moreover, 23.6% of the study participants detain to support or against the above opinion (Table: 4.7).

D. Lack of Domestic Strong Supervisory Body

Regarding to the lack of domestic stronger supervisory body 41.5%respondents agreed in its strength, similarly, 23.6%,respondents expresses their dissatisfaction. About 18.7% of the respondents neither agreed nor disagreed about the issues the above respondents arguing. In contrast 12.2% of the respondents never suspected the non existence of strong supervisory body; the same as 4.0% respondents support this idea strongly (Table: 4.7).

E. **Foreign Bank will Reduce Market share of the Domestic Bank**

Survey respondents were asked to rate potential costs of foreign bank entry if they were permitting to the countries current situation and their responds as scaling of strongly Agree, 21.1%, and agree 41.5%, whilst, 23.6% of the respondents neither agree nor disagree. However, 10.6%, of the study participants disagree and the rest 3.2% of the respondent strongly disagrees. For more detail information please look at the table below (Table 4.7).

Table 4.7: Potential cost of foreign bank entry to the Ethiopian current situation

Quality items	**Strongly**	**Agree**	**Neutral**	**Disagree**	**strongly disagree**	**N**
Foreign Banks May reduce Costs	26 (21.1%)	51 (41.5%)	29 (23.6%)	13 (10.6%)	6 (3.2%)	123
Domestic Banking as an infant industry becomes less Competitive	40 (33.5%)	39 (31.7%)	35 (28.5%)	9 (7.3%)	0 (0.0%)	123
Foreign Bank Retains Credit to Small firms	19 (15.4%)	48 (39.0%)	29 (23.6%)	25 (20.3%)	2 (1.6%)	123
Lack of Domestic Strong Supervisory Body	29 (23.6%)	51 (41.5%)	23 (18.7%)	15 (12.2%)	5 (4.0%)	123
Foreign bank will reduce Domestic market share	31 (25.2%)	36 (29.3%)	29 (23.6%)	20 (16.3%)	7 (5.7%)	123

Source: Own survey, 2017

4.9. Domestic Banks Ready to Compete With Foreign Banks

According to 71.5% respondents' points of view, domestic banks were ready to compute with foreign how far they advanced in technology and modern management system. However, 28.5.8%, of the study participant opposes the above respondent response (Table.4.8).

Table :4.8 **Domestic Bank Ready to compute with Foreign Bank**

	Frequency	**Percent**
Yes	88	71.5
No	35	28.5
Total	**123**	**100**

Source: Own survey, 2017

Furthermore, 28.5% of the respondents prefer a Joint Venture form of bank penetration and the next respondents 25.2% that prefer branch form while the remaining 15.4 % of responder choose subsidiary and 2.4% of the respondents prefer representative Office (Fig:4.6)

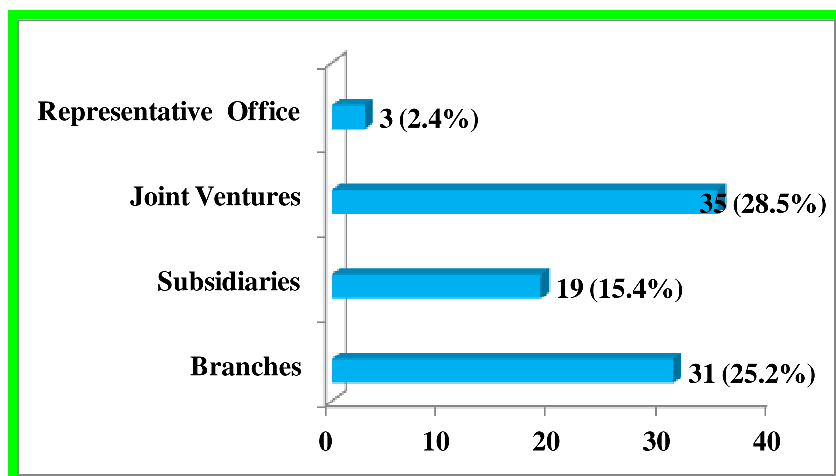

Fig.**4.6. Form of foreign bank penetration**
Source: Own survey, 2017

On other way round, the study respondents were asked if they oppose that foreign bank will not rush to the country without any precondition that should be fulfilled.

Accordingly.15.4% of respondent believe that financial sector should be liberalized, while 11.4 % of the respondents suggest that introduce practicable financial system regulation and strength the central banks capacity and only two respondents or(1.6%) suggest that there is a need for political and economic stability (Fig:4.7)

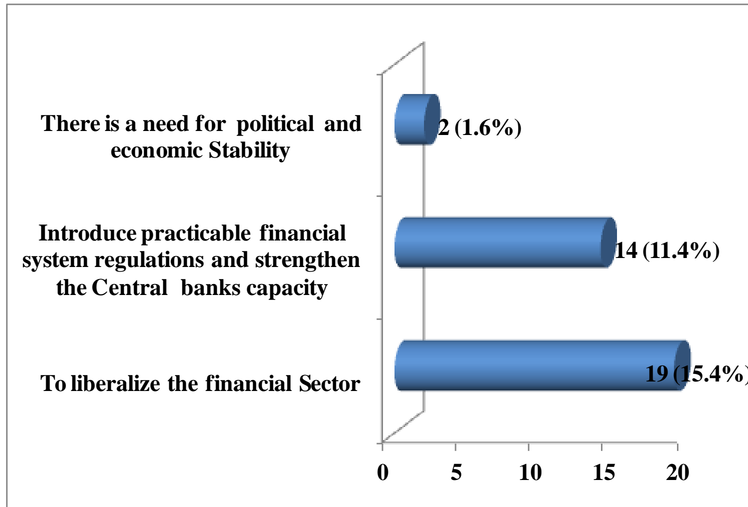

Fig.**4.7 Precondition for Foreign Bank Entry**
Source: Own survey, 2017

4.10. Macroeconomic and Social Indicator If foreign Banks Enter the Ethiopia Market

A. To Reduce the Population bank Ratio

Respondents were asked to rate macroeconomic and social indicator if foreign bank were permitted and their responds as Scaling of Strongly agree, 26.8%, Agree, 25.2%, while 19.5% of the respondents were Neither agree nor Disagree, However 15.4% of the study participants Disagree and the rest 7.3% of the respondents strongly Disagree.(Table4.9)

B. To Demand for Foreign Exchange

Majorities of the respondents believe that the demand for foreign exchange will be minimized if foreign bank entry is permitted , with the scaling of 35% Strongly agree and48% agree while 4.1% of the survey respondents were disagree and the remaining 13% of the respondents were neither disagree nor agree(Table4.9)

C. **To Speed up the Investment Reform**

The survey respondents responds as Scaling of 39% were strongly agree, 40.7% agree, while 6.3% of the respondents were disagree and 0.08% were strongly disagree and the remaining 12.2% were Neither Agree nor Disagree (Table:4.9).

D. **To Lower Bank Lending Rate**

As the respondent response indicates 21.1% of the study participants strongly agree, 39% agree and the 20.3% shows undecided to the opinion inquiries which state foreign bank entry will lower bank Lending rate. In contrast 15.4% of the study participant disagrees with the above opponent argument (Table4.9).

E. **To Facilitate Consumer Credit and Mortgage**

Survey respondents were asked to rate macroeconomic and social indicators if foreign bank were permitted their responds as scaling of strongly Agree, 33.33%, and agree 44.7%, whilst, 17.9% of the respondents neither agree nor disagree. However, 3.3%, of the study participants disagree and the rest 0.08% of the respondent strongly disagrees. For more detail information please look at the table below (Table 4.9)

Table:4.9: **Macroeconomic & Social Indicator**

Quality items	**Strongly Agree**	**Agree**	**Neutral**	**Disagree**	**strongly disagree**	**N**
To reduce the population to bank Ratio	33 (26.8%)	31 (25.2%)	31 (25.2%)	19 (15.4%)	9 (7.3%)	123
To demand for foreign exchange	43 (35%)	59 (48%)	16 (13%)	5 (4.1%)	0 (0.0%)	123
To speed up the investment reform	48 (39%)	50 (40.7%)	20 (16.3%)	4 (3.3%)	1 (0.08%)	123
To lower bank lending rate	26 (21.1%)	48 (39%)	25 (20.3%)	19 (15.4%)	5 (4.1%)	123
To facilitate consumer credit and mortgage	41 (33.3%)	55 (44.7%)	22 (17.9%)	4 (3.3%)	1 (0.8%)	123

Source: Own survey, 2017

4.11. Analysis of the relative important of the four potential Effect dimensions of opening the Ethiopian Banking Sector to Foreign Banks

In here the study analyze the perception level of respondents if foreign banks were entered in Ethiopian what benefit or lose domestic banks have got with the consideration of four dimensional measurement.

The table below provides a summary of the rankings for the four dimensions of perception level of the respondents about foreign bank entrance advantage or disadvantage over the domestic banks.

- In regards to the potential effect, the most important dimension to which highest average score 1.7877 was assigned to benefits of foreign bank for the Ethiopian current situation. It scored highest potential efficiency value in this study as the respondent perception level. This suggests that if foreign banks permit to enter in the country, the domestic banks will potentially benefited by obtaining the modern management skill as well as new Banking system and adoption of the new technology.

- The potential efficiency reform to the general economy dimension has an average score of 1.9356 as shown in the table below. It is the second highest weighted score that assigned by the respondents. This indicates that the economic potential efficiency of the domestic bank will be improved if foreign bank entry were permitted.

- MESI is the third important dimension, has an average of 2.0801 which indicates that the demand for foreign exchange will be minimized , investment reform will be speed up and lastly the lending rate will be lower if foreign bank entry were permitted

- The last attributes are potential cost to the country current situation which has lest important of the four dimensions. Infect, the study result indicated that its average score is 2.2825 which is still below the median threshold. That is, this domain is still having higher score

even if it is the least factor compared with the other. So, potential cost of service in the domestic bank will be improved if foreign bank entry were permitted (Table 4.10).

Table 4.10: The relative importance of each of the four dimensions

	N	Minimum	Maximum	Mean	Std. Deviation	Rank
Potential efficiency reform to the general economy	123	1.00	5.00	1.9356	.72702	2
Potential benefits of foreign Bank for the Ethiopian current situation	123	1.00	4.00	1.7877	.66581	1
Potential costs to the Ethiopian current situation	123	1.00	4.00	2.2825	.74296	4
ME_SI	123	1.00	4.00	2.0801	.70522	3

Chapter Five

5. Conclusion and Recommendation

5.1. Conclusion

This thesis has reviewed various theoretical and empirical literatures on Potential impact of foreign banks in the case of developing transition countries in particular. The main analysis of this paper is divided into two parts. The first part has provided the findings of the survey results which private and government banks as well as professional association (EEA& PEAAA) participants had responded supplementing the literature whether the positive potential impacts of foreign banks entry outweighs the associated risks in Ethiopian banking sector. The second view is to examine whether financial development causes economic growth using the SPSS 16 analyze the effect of foreign banks entry in Ethiopian banking industry..

As this study intended particularly to explore the benefits and risks of foreign banks entry, it has provided its conclusion and recommendation assuming that foreign banks are willing to enter into Ethiopian's banking business. Banks as financial intermediaries are considered as an important element for growth in developing countries.

The respondents comprise branch manager of the selected banks, higher official of Professional association and higher official of the National Bank of Ethiopia. They have a deep knowledge to point out how fare foreign bank entry will affect the domestic banking industry and can list the best remedial action to be made

First , majorities of the respondents agreed that foreign bank entry will accelerate the country's economic growth and due to this , the most positively affected macroeconomic parameters are Gross domestic product and Investment. On another points respondents believe that foreign bank entry will improve financial regulation, introduce other financial activities like investment banking activities and attract a foreign direct investment. The response is mixed 49.6% support while 50.4 % oppose or neutral.

Second, the survey respondents agree that foreign bank entry is necessary in the country's banking sector to adopt the modern banking system as well as modern technology. Majority of the respondents prefer that types of foreign bank permitted to enter should be the one which is more specialized banks that have more knowledge in stock market and investment banking and also the time of enters should be in the long- term period(from5-20).

Third, Majorities of the respondent accept working with foreign banks would help the domestic bank more dynamic and competent. Additionally at the result of foreign bank entry, respondents agree that the quality service in the financial sector will be improved; more credit supply will be offered than before. They accept that the banking sector service will more be efficient that will result in enhancing customer satisfaction. Again they agree that competition among banking will be more, but they refuse that foreign bank entry will bring better economic stability.

Fourth, survey respondents agree that foreign bank entry will reduce cost and retain credit to small firms like microfinance. They also agree that in the current situation, domestic banking cannot compete with foreign due modern management and advanced technology. Respondents accept that domestic banks sector has lack of strong supervisory body to protect the sector from any financial crises relating to foreign bank entry.

Finally, Majorities of the respondents agree that domestic banking sectors ready and accept foreign banks smoothly compete with them. They also prefer that the form foreign entry should be in the form Joint Ventures. This form of foreign bank can control the expected cash outflow and minimize the financial risk. Additional, respondents accept that as the number bank increased population bank ratio will be reduced and also the demand for foreign exchange will solve. Respondent believe that foreign bank entry will facilitate consumer credit and mortgage and lending rate will be lower. Some respondent find out that a "close door" policy started in Ethiopia ever since 15th century, when Ethiopia prohibited no entry in Ethiopia for 150 years .It has many adverse effect on the progress of the country still now. They suggested that entry of foreign banks will brought the real competition, real growth and development, real life and real society.

From data analyses, researcher concluded that foreign bank permit to enter in the county will benefit the domestic bank by improving the quality service and Efficiency as well as enhance Customer satisfaction, then economic potential of the country would be improved, Additionally, different macroeconomic and social indicators show that the country would be benefited by lowering bank lending, minimizing the demand for foreign exchange, if the foreign bank were permitted.

5.2. Recommendation

As seen in detail, financial development through its capacity increases investment and enhance economic growth. In Ethiopia, the appropriate mode of foreign banks entry can be seen in two different perspectives. From the strength of controlling capacity aspect of the central bank, subsidiaries and joint venture might be preferred. But from the risk minimization point of view, branches are the preferred organizational forms. It is because in the case of losses depositors have the right to claim from the parent office of the branch and large parent offices are strong enough to absorb these possible losses.

However, this study taking the county's economic situation into account, recommends that allowing specialized foreign banks which have more knowledge in stock market , investment banking and which has a willing to finance the agricultural sectors, small , medium and large scale industries .

On the other hand it is more than twenty year that free market economy was implemented, but the government didn't amend the investment limitation on foreign banks entry. The government should adopt from the neighboring country like Kenya and Egypt administer more than ten foreign bank for a long period and have rich experiences how to run their financial institution and supervise their operate . The researcher therefore, recommends the government need to concentrate on:-

- Issue prudent (careful) financial system regulations and building of the central bank's professionals with adequate exposures to best practices of other countries central banks.

- Improve the efficiency of the financial system through modern technology training of the domestic bank higher official and appropriate regulatory and policy reform in order to promote faster economic growth. .

5.3. Further Research

In comparing with the potential benefits of foreign banks entry with its associated risks, the findings of this study have indicated that the potential benefit outweighs the associated risks. Accordingly, allowing specialized banks that have more knowledge in micro financing and lending to the agricultural sectors, medium and large sector industries in the form of joint venture is recommended to enter in to the country's banking business.

Furthermore, a suggestion to further research need to concentrate on the appropriate modes of entry, the specific types and size of foreign banks to be allowed in the Ethiopians banking sector.

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Annex I

Addis Ababa University

College ofBusiness and Economics

Department of Accounting and Finance

Masters of Science in Accounting and Finance

Title:-Potential Effects of Opening the Ethiopian Banking Sector to Foreign Bank

Hello. My name is **MEKONNEN HURISA**. I am a student of Addis Ababa University, College of Business and Economics in the Department ofAccounting and Finance. My colleagues and I are conducting a survey in the title of Potential effects of Opening the Ethiopian Banking Sector to Foreign Banking. We would very much appreciate your participation in this project. This information will help the researcher to fetch your opinion about raisin topic. The survey usually takes between 12 and 30 minutes to complete. . Whatever information you provide will be kept strictly confidential, and will not be shared with anyone other than members of our survey team.

Thank you for your sharing your precious time to complete this survey

Section I

1. General information of Respondent

Please read each questionnaire carefully and answer using the given space. Your answer should be truthful. Your name may not be provided, but specify the type of your organization, your level of education in the given Space.

101. What is the organization currently you worked?

1. National Bank of Eth ☐ 2. Government Bank ☐

3. Private Bank ☐ 4. Others (EEA, PEAAA,EPRI) ☐

102.Sex of the respondent

1. Male ☐ 2. Female ☐

103. Educational level of the respondent

1. Master degree and above 3. Diploma

2. Bachelor degree 4. Other please specify_______

Section II

2. Potential effect of foreign banks entry on the financial performance of local commercial banks

201. If foreign banks are allowed to operate in Ethiopia's banking sector, in your opinion willforeign banks accelerate the country's economic growth?

1. Yes ☐ 2. No ☐

202. If your answer to question no. 201 is "***Yes***"**,** please indicate which macroeconomic parameters will be affected positively.

1. Gross domestic product(GDP) ☐
2. Investment ☐
3. Employment ☐
4.If others please specify________________

203. If your answer to question no.201 is ***"No",*** please, indicate which macroeconomic parameters will be affected negatively.

1. Gross domestic product(GDP) ☐
2. Investment ☐
3. Inflation ☐
4. If others please specify__________________

204. Literature in different transition countries reveals that foreign banks enhance the efficiency of domestic banks. How would you rank the following potential efficiency reform to the general economy, if foreign banks are allowed to operate with current conditions?

	1.Strongly agree	2. Agree	3. Neither agree nor	4. Disagree	5. Strongly disagree
a. Improve financial regulation					
b. Introduce other financial activities					
c. Attract a foreign direct investment					
d. Enhance the overall stability					

Section III

3. Benefit of ForeignBanks Entry

301. You, as an Ethiopian, do you think that foreign bank entry is necessary in Ethiopian'sbanking sector?

1. Yes ☐ 2. No ☐

302. If your answer forquestion no.301.is "***Yes",*** what would be the appropriate time for foreign bank entry into the county?

1. In the past fifteen years (after the transitional government ☐
2. In the short term period(from 1-5 years) ☐
3. In the long term period (from 5-20 years) ☐
4. If others please specify________________________

303. If your answer to question no 301 is "***No",*** what would be the possible disadvantages of foreign banks entry in the country's banking activities?

1. Weakening of domestic banking sector ☐
2. Capital out fellow(foreign shortage) ☐
3. Unemployment through automated banking system ☐
4. 4.If others please specify____________________________

304. And also, as your opinion, what type of foreign banks should be welcomed?

1. Large, globally operating ☐
2. Multinationalbanks(such as HSBC, Citibank, ANB etc.) ☐
3. More specialized banks that have more knowledge in stock market, investment banking ☐
4. If others please specify__________________________

305. What do you think, the possible benefits if foreign banks are allowed to operate in Ethiopian's banking sector?

1. Quality of service ☐
2. Availability of more credit supply ☐
3. Higher efficiency ☐
4. Competition ☐
5. If others please specify_________________

306. Will working with foreign banks helps the domestic banks become more dynamic?

1. Yes ☐ 2. No ☐

307. Different literature in transition countries reveals the benefits and risks of foreign banks. How would you rate the potential benefit to the Ethiopia current situation, if foreign banks are allowed to operate?

	1.Strongly agree	2.Agree	3.Neither agree nor disagree	4.Disagree	5.Strongly disagree
a. There will be improved quality service in the financial sector					
b. More credit supply can be offered					
c. Higher efficiency will be obtained					
d. Competition will be enhanced					
e.Modern technology &New Banking system will be introduced					
f.Will bring about better economicstability					
g.Enhanced customer satisfaction as result of higher efficiency					

308. How would you rate the potential costs to the Ethiopia current situation, if foreign banks are allowed to operate?

	1. Strongly agree	2. Agree	3. Neither agree nor disagree	4. Disagree	5. Strongly disagree
a. Foreign banks may reduce costs					
b. Domestic Banking as an infant industry becomes less competitive					
c. Retains credit to small firms					
d. Lack of domestic strong supervisory body					
e. Reduce market share of the domestic bank					
f. Other please specifies					

Section IV

4. How far the Domestic Banks are ready to compete with foreign banks

401. If the country's economic policy allows foreign banks entry, do you think that foreign banks will rush to Ethiopian banking sector?

1. Yes ☐ 2. No. ☐

402. If your answer to question No 401 is "***No***", what preconditions need to be fulfilled to attract foreign banks in Ethiopia?

1.To liberalize the financial Sector ☐

2.Introduce practicable financial system regulations and strengthen the Central banks capacity ☐

3. There is a need for political and economic Stability ☐

4.Establishment of Capital/ money market ☐

5.If other please specify___________________________

403. If your answer to question No.401 is "**Yes,**" Which form of foreign bank penetration is the most useful for the country's economic development?

1. Branches ☐
2. Subsidiaries ☐

3.Joint Ventures ☐

4. Representative Office ☐

5.If others please specify___________________

404. As your opinion is the following macroeconomic and social indicators call foreign banks enter the Ethiopia market ?

Indicators	1.Strongly agree	2.Ag ree	3. Neither agree nor disagree	4. Disagree	5.Strongly disagree
a. To reduce the population to bank ratio					
b. To demand for foreign exchange					
c. To speed up the investment reform					
d. To lower bank lending rate					
e. To facilitate consumer credit and mortgage					
f. Other please specifies					