ADDIS ABABA UNIVERSITY
SCHOOL OF GRADUATE STUDIES
MBA PROGRAM

PROJECT WORK ON

RISK MANAGEMENT IN COMMERCIAL BANKS IN ETHIOPIA (A CASE STUDY OF THE COMMERCIAL BANK OF ETHIOPIA)

IN PARCIAL FULFILLMENT OF THE REQUIREMENT FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION

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MARCH 2007

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Acknowledgment

First, I would like to express my special gratitude to my advisor, professor G.K. Murthy, for his unreserved support and advice from the start to the end of this study.

My father, the late Ato Wedaje Jijo, has been the cause for all the good things that have happened to me. It is only because of his guidance and support that I am where I am today. May God rest his soul in peace. I am also extremely indebted to Ato Kabeta Barkessa, my Supervisor at CBE, for his invaluable assistance and encouragement during the course of my study.

Without the typing skills of Sosina Tessema and Meskerem Behailu, this paper would not have been so professionally presented. I am grateful for all their work with my drafts. Finally, I would like to thank my family, relatives and friends for all the help and encouragement that they have been extending to me.

Thank you all.

ACRONYMS AND ABBREVIATIONS

CBE – COMMERCIAL BANK OF ETHIOPIA

NBE – NATIONAL BANK OF ETHIOPIA

NPL – NON-PERFORMING LOANS

PLL – PROVISION FOR LOAN LOSSES

DBE – DEVELOPMENT BANK OF ETHIOPIA

CBB – CONSTRUCTION AND BUSINESS BANK

AIB – AWASH INTERNATIONAL BANK

DB – DASHEN BANK

BOA – BANK OF ABYSSINIA

WB – WEGAGEN BANK

UB – UNITED BANK

NIB – NIB INTERNATIONAL BANK

OCB – OROMIA COOPERATIVE BANK

ESL – EMERGENCY STAFF LOAN

DTS – DOMESTIC TRADE AND SERVICES

AIDB – AGRICULTURAL AND INDUSTRIAL DEVELOPMENT BANK

MFI – MICRO FINANCE INSTITUTIONS

CSA – CENTRAL STATISTICAL AUTHORITY

IMF – INTERNATIONAL MONETARY FUND

BOM – BOARD OF MANAGEMENT

ALD – ADVANCES IN LEGAL DEPARTMENT

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Chapter I

Introduction

1.1. Background

Banking, if we equate it with money lending, is perhaps as old as civilization itself (Vaswani, 1973). Modern banking, however, is something radically different from mere lending. It is far more sophisticated and complicated. Banks are the custodians of the community's money as well as the suppliers of its liquidity. For those bank customers who seldom borrow, the depository function may be the most important. Commercial banks also provide flexibility and mobility to the money supply by providing the mechanism through which money payments can be most speedily and efficiently carried out. Commercial banks participate with other institutions in the process of accumulating and investing real savings and perform a number of other incidental functions. Banking institutions today form the heart of the financial structure of any country, whether it is developed or developing.

As discussed above, one of the primary tasks of banks in an economy is to mobilize saving and direct them into productive channels. However, in a developing country like Ethiopia where people are not in the habit of depositing their saving with banks, the task of creating and spreading the banking habit and of mobilizing the country's resources becomes a challenging one. It is true that finance cannot take the place of real resources.[1] But it is not lack of resources alone that retards or hinders the process of economic development. An equally important cause is the lack of effective utilization of available resources. It is here that banks play a crucial role because they act as a bridge between those who require finance (which enables them to acquire the necessary resources) and those who have finance (in the form of savings) but are unable to make an

[1] Vaswani,T.A.(1973). 'Indian Banking System', Lalvani Publishing House, Bombay, pp 4

effective and productive use of it. Banks thus become an instrument of a more efficient use of available savings.

As mobilizers of resources of the economy, as dispensers and distributors of these resources for productive purposes among different channels of the economy and finally as creators of money (in the form of bank deposit), banks not only occupy an important place in the economic structure of a country but they also play an effective role in its growth.

1.2. The Banking Sector in Ethiopia

Ethiopia is characterized by the absence of strong effective demand for bank credit (Astatke, 2002). However, following the economic reform program of 1992 that set out favorable macro-economic conditions, the private sector's involvement in investment activities has increased dramatically. Expansion of the private sector through the bond or equity market cannot be thought of, as both bond and equity markets are non-existent in the country. As a result, the private sector is highly dependent upon bank credit for financing both investment and working capital requirements.

Due to the economic reform program of 1992, the private sector has been expanding by taking the lion's share in bringing a higher growth to the country's economy. A witness to this fact is the large number of new and privately owned projects that have commenced operation. Such an expansion of the private sector cannot be thought to materialize without the involvement of the banking sector. In this regard, the banking sector has a paramount role in mobilizing idle funds from the general public and in reallocating the funds thus mobilized to sound and viable projects for financing their physical investment and working capital requirement.

The major lending bank in the country has been the Commercial Bank of Ethiopia (CBE). Over the years, the share of CBE in the provision of bank credit has never been below 56 percent out of the total credit the banking sector provides every year. The CBE is involved in the provision of credit to almost all sectors of the economy such as public enterprises, cooperatives, private firms and state owned and private banks.

Table 1.1. Loans and advances by lender bank (expressed as a percent of total bank loans)

(In Percent)

Lender bank	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
CBE	82.1	79.4	75.4	71.1	71.5	65.1	68.7	67.6	64.8	66.4	56.4
DBE	11.2	14.2	14.5	18.2	17.3	20.5	17.1	17.3	15.9	11.2	14.3
CBB	6.7	6.4	6.8	5.9	3.8	4.1	3.2	3.4	2.6	2.3	3.1
AIB			1.9	2.3	2.1	3.0	2.5	2.9	3.9	4.1	5.3
Dashen Bank			1.2	1.5	2.2	2.8	2.9	3.8	4.9	6.4	7.6
Bank of Abysinia			0.2	0.5	1.8	2.6	2.8	2.5	2.8	3.5	4.2
Wegagen Bank			0.0	0.5	1.0	1.4	1.5	1.7	2.0	2.3	3.4
United Bank					0.3	0.5	0.5	0.7	1.0	1.1	1.8
NIB International Bank							0.8	0.1	2.0	2.7	3.9
OCB											
Total	100	100	100	100	100	100	100	100	100	100	100

Source: NBE annual reports and own calculations.

Like any bank in a developing economy, the lender banks in Ethiopia are likely to face chronic problems that may slow down their active participation in supporting the development process of the economy. The major problem, among others, is a higher rate of non-performing loans (NPLs) in the books of banks in Ethiopia.

Table 1.2. NPLs ratio of the banking sector

YEAR	NPL RATIO (%)	Response rate for this data	
		No. of banks responded	Rate
2000	25.6	4	44.4%
2001	24.6	4	44.4%
2002	50.3	5	55.6%
2003	42.6	7	77.8%
2004	31.4	7	77.8%

Source: Endalkachew Mihret, 2005, unprinted material.

The existence of these significant amounts of NPLs is largely believed to be because of lack of adequate risk management techniques in place. This issue has become a leading agendum in the banking sector and has made most lender banks to be more cautious in assessing the creditworthiness of borrowers. This study hence attempts to assess the risk management practices in the banking industry.

Statement of the Problem

Market failure in credit markets emanates from two basic sources (Astatke, 2002). These are:

1. The absence of profitable (effective) demand for credit, and
2. Inability of lenders to make proper need and risk assessments in the process of providing credit

The absence of profitable demand reflects the specific needs of the borrower as well as the nature of alternative sources of funds and is a reflection of the low level of development of the investing community. The second problem, which is the focus of this paper, on the other hand reflects failure of banks to determine both effective demand for funds from borrowers and the variability in expected return as a measure of the banks' risk. The major risk banks must measure, monitor, and manage is credit, or default risk, which is the uncertainty, associated with borrowers' loan repayments.

Before the 1990s, a few dominant banks controlled the Ethiopian market and these banks were not under pressure to innovate, change or compete. The 1990s, however, witnessed a change in the status quo in the banking field. Many external factors played a role in altering the nature, the scope, and most especially, the risks of banking. Although the changes to banking in Ethiopia as a whole have been numerous, perhaps the most important has been an increase in risk. Risk, though it can be defined in many ways and can take many forms, is central to the banking business. Since the 1990s, Ethiopian banks have been exposed to new types of risks with different characteristics and magnitudes from those dealt with in the earlier days of banking. Some of these risks have come from the markets themselves and others have been fuelled by competition.

All these realities are making all interested parties to be curious about what the bank is doing to deal with all these developments. The basic questions to be addressed in the research include:

- ➔ What was the risk management practice of the bank before the financial reform of the 1990s?
- ➔ What are the specific changes to banking that have led the bank to be exposed to new types of risks following the reform?
- ➔ What are the credit risk management practices of the bank these days?
- ➔ What are the problems and challenges with regard to the bank's credit risk management endeavors?

Objective of the Study

This study has a general objective of assessing the credit risk management practices and the associated problems and challenges of the Commercial Bank of Ethiopia. In doing so, the study will try to see the practices before and after the reform in the mid 1990s. Under this general objective, the study will have the following specific objectives:

- ➔ To assess the risk management practice of the bank before the financial reform and see the changes that have led the bank to be exposed to new types of risks
- ➔ To review the current risk measurement and control techniques being practiced

- To identify problems and challenges that the bank is facing in managing credit risk and
- To draw conclusions and put forward policy recommendations based on the findings of the study

Significance of the Study

There is no sufficient local literature on risk management in general and credit risk management in particular. However, an efficient credit risk management system is the determining factor for success in this ever-changing business environment. Banks need to predict scientifically the exact level of risk they are going to assume by entering into a contract in availing credit to the public.

The current study will help to enrich local literature on the subject matter. Future researchers will also be familiarized with the conceptualization of credit risk and its management.

Scope and Limitation of the Study

The basic exposures banks face arise from credit risk, interest rate risk, and liquidity risk. The largest banks and financial holding companies face this formidable trio plus foreign exchange risk and, in general, market risk. However, as the majority of the banks' assets are held in the form of loan and as the major risk the Ethiopian banks must measure, monitor, and manage is credit risk, the study will focus only on credit risk management.

Currently, there are three public, six privately owned and one cooperative bank in the Ethiopian banking industry. It would have been much better if the study could have focused on all the banks in the country. However, because of cost and time constraints the study will focus only on the risk management practices of the Commercial Bank of Ethiopia.

Data Source and Methodology

A case study research method is used to conduct this research. Broadly, two kinds of cross sectional data sets are collected for this study. The first set comprises data of primary type. This data set is collected from the credit staff of the CBE by way of an interview. The interviewees include branch managers, branch credit section heads, relationship managers at the head office, and managers and senior staff working at the credit risk management department of the bank. The branch staffs interviewed are selected from a total of 30 Grade 3 and Grade 4 branches in Addis Ababa. Out of the total of 83 employees who fulfilled the criteria, 26 of them are selected randomly for the interview. Missing information is made complete from the individual borrowers' files at the disposal of the CBE. Stratified sampling was adopted in selecting 30 of the loan files from the total of 5,601 loan files found in Addis Ababa. The five strata formed for the sampling purpose are:

- ➔ Domestic trade and services loans
- ➔ Agricultural loans
- ➔ Building and Construction loans
- ➔ Manufacturing loans and
- ➔ International trade loans

The second set of data is collected from the publications of both the CBE and NBE (National Bank of Ethiopia).

Data Analysis

The method of data analysis is both descriptive and analytical. Data collected from secondary sources are processed by classifying and tabulating them. Ratios and growth rates are calculated and are briefly explained. For this purpose, graphs and tables are used.

Organization of the Study

The study is structured to have four chapters. The first chapter comprises the general introduction and the research approach. Chapter two reviews relevant literature. Detailed analyses of the data collected in the area of credit risk management practices of the bank are given in chapter three of the study. Chapter four summarizes the research, draws conclusions, and forwards some recommendations.

CHAPTER II

Litrature Review

Banks play a particularly critical role in an economy. They provide a place where individuals and businesses can invest their funds to earn interest and redeploy these funds by making loans. In this regard, banks are remarkably similar to other financial intermediaries which also acquire funds from individuals and businesses and pass on these funds to other individuals and businesses. As to the definition of 'banking', Cade (1997) takes it simply to comprise the core activities of licensed banks, more or less anywhere, such as:

- Intermediation (taking deposits and lending money)
- Disintermediation (relinquishing the intermediary debtor/creditor position, whilst retaining a 'broker' role)
- Collection and payment system, money transmission
- Foreign exchange, foreign trade services
- Participation in the money and capital markets

Koch (1995) states that banks promote investments by providing facilities for moblizing savings and appropriate instruments with which such funds can be channelled into productive investments, without which neither economic growth nor development can take place smoothly and efficiently. In the process of performing these functions, banks come to hold the single largest proportion of an economy's financial resources and correspondingly account for a similar lion share of the credit that propels the engine of growth and development (Adewunmi, 1992). It has often been said that credit is the lifeblood of an economy.

Commercial banks extend credit to different types of borrowers for many differnt purposes. For most customers, bank credit is the primary source of available debt financing and for banks, good loans are the most profitable assets[1]. Banks derive their income primarily from lending and investment and, to a lesser extent, from fees and charges received for services rendered. With regard to bank income, Crosse (1992) states that income from loans constitutes more than 60% of the total. Banks also use loans to cross-sell other fee-generating services. According to Koch loans are the dominant asset in most banks portfolios, comprising from 50 to 70 percent of total assets.

Principles and Factors Governing Lending

Two important principles govern a bank's lending activities (Brown C., Mallet D., and Taylor M., 1993). The first is the principle of stewardship. The bank is lending (and thus putting at risk) depositors' money; management must therefore excercise a high degree of prudence and integrity. The second principle is that a bank must make reasonable level of return on its lending to cover its costs and to reward its shareholders for the risk that they have taken in standing behind the depositors. Striking an acceptable balance between these two principles is the art of good lending and the essence of sound banking.

According to Brown et al, the factors taken into account by bankers in seeking to achieve these balances include the quality of the borrower, the purpose of the loan, the amount of the loan, the duration of the loan, the means by which the loan will be repaid, the value and quality of any available security, and policy constraints. These factors will have some influence on a bank's willingness to lend, but they will form only a part of the bank's loan portfolio management strategy. This strategy should, at the very least, establish and provide for the monitoring of the following matters[2].

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[1] Koch T.W.,(1995), 'Bank Management'. The Dryden Press, USA, 3rd Ed. pp 630

[2] Brown et al, (1993), 'Banks: An Industry Accounting & Auditing Guide', Page Bros Ltd, Norwich, pp 221

- The types of loan that the bank is willing to make;
- The geographical constraints within which the bank will lend;
- The maximum exposures to individual borrowers, groups of connected borrowers and industry sectors;
- The maximum maturity mismatches that are acceptable;
- The basis upon which loan interest is to be determined; and
- The absolute limit on the aggregate of its loans necessary to preserve the proper relationship between lending and capital resources.

Lender banks are directly concerned about borrowers repaying their loans on a timely basis so that the value of the bank can be maximized. To protect their own interests and the wealth of bank shareholders, banks need to investigate and monitor the activities of would-be and existing borrowers. In addition, lenders have a fiduciary responsibility to thier depositors to conduct their businesses in a safe and sound manner. In this context, banks serve as 'delegated monitors' for their creditors (e.g. depositor)[3]. Most suppliers of funds to banks do not have the time nor the skill to evaluate the creditworthiness of existing and would-be borrowers, and must, in effect, delegate banks to do this investigation for them with the understanding that bank regulators are in turn watching the banks.

The Risk Management Challenges to Bankers

Consider the following statements about risk management. First Walter Wriston[4], the former chairman of Citicorp said:

> *The fact is that bankers are in the business of managing risk. Pure and simple that is the business of banking.*

A decade or so later. The Economist[5] said:

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[3] The theory of banks as delegated monitors comes from Diamond (1984), as cited in Sinkey, J. (2002), Commercial Bank Financial Management in the Financial –Services Industry, Pearson Education Inc., 6th Ed., PP 307

[4] Cited in Sinkey J. (2002), Commercial Bank Financial Management in the Financial- Services Industry, PearsonEducation Inc., 6th Ed., pp253

Risk management is perhaps the central topic of the 1990s among managers of financial institutions and their regulators.

And the following is from Allianz Group[6]. Europe's leading global insurer and provider of financial services:

To us risk management means thinking the unthinkable to prevent risk turning into loss.

Finally, consider the words of Laurence H.Meyer[7], a member of the Board of Governors of the Federal Reserve System of America, made on June 1, 2000, before the risk management planning conference:

> *[Risk management focuses] on the largest and most complex organizations because that is where the greatest change in the art has, and will, occur in response to real needs. Because complexity is the driving force requiring better risk management tools and practices, these new techniques will spread to smaller organizations as needed. But less complex and even traditional organizations are being affected by the* changing technology; credit scoring and participations in securitization are two examples.

Several different courses of action are open to a banker faced with a particular source of risk. According to Cade (1997), these courses of action include:

- avoiding it, if in prospect
- accepting and retaining it on an economically justifiable basis
- increasing, reducing or eliminating it by executive actions
- reducing it by diversification within a portfolio of risks.
- Hedging it artificially – i.e. counter balancing and neutralising it, to a degree, by the use of derivative instruments.
- Liquidating it by transfer without recourse to another party.

Which of these solutions is appropriate depends on the type of risk and the particular circumstances.

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[5] Ibid pp253
[6] Ibid pp253
[7] Ibid pp253

As with any investment, extending loans to businesses and individuals involves taking risks to earn high returns. The most obvious risk in banking is credit risk; the possiblity that loans will not be repaid or that borrowers will go into default with consequent loss to the bank. Many factors can lead to loan defaults. An entire indstry, such as manufacturing, agriculture or real estate, can decline because of general economic events. Firm-specific problems may arise from changing technology, labor strikes, shifts in consumer preference, or bad management. Some borrowers may also resort to willful defaults.

Few bankers ever knowingly make poor loans[8]. It is what occurs after a loan is made that causes it to deteriorate in quality. Such adverse circumstances may sometimes be foreseen, as when obvious credit weaknesses are overlooked or ignored[9]. However, many of these adverse circumstances are unforeseeable. In this regard, Crosse (1962) argues that one cannot extend credit successfully on the premise of a major economic downturn in the foreseable future. He also says that one cannot predict the impact of war or threats of war on the economy; one cannot even predict, very far ahead, changes in consmer demand which may affect the business of a borrower or even the business of an entire community. These risks to the quality of bank credit are ever present.

Taking risks can almost be said to be the business of bank management[10]. A bank that is run on the principle of avoidiing all risks, or as many of them as possible, will be a stagnant institution and will not adequately serve the legitmate credit needs of its community. On the other hand, a bank which takes excessive risks or, what is more likely, takes them without knowing the extent of them, or even that they exist at all, will inevitably run into

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[8] Crosse H.D., (1962), 'Management Policies for Commercial Banks', Printice Hall Inc., New Jersey, pp 37.
[9] Ibid PP 37
[10] Ibid 37

difficulty. Particularly in times of expanding business activities some of the risks of banking may be obscured beneath the general economic prosperity and banks may seem to take large risks; however, the seeds of unwise banking will sprout inevitably into losses[11].

Calvo & Kumar (1994) in their study identified four factors that restrain banks from making potentially more profitable loans to the enterprise sector. These factors are:

- Limited information about enterprises' current performance,
- Considerable uncertainity about their future prospects,
- Lack of expertise in evaluating risk and
- Pressure from the government to improve the quality of bank asset portfolio.

Calvo and Kumar also showed that these factors lead to low credit to the private sector thereby creating a vicious cycle of low output, low enterprise profits, high fiscal deficits, and again low credit to enterprises.

Catao (1997) shares Calvo's and Kumar's view in that banks' perception of a higher lending risk (due to information asymmetry) has an important bearing on the sluggish pace of credit to the private sector.

On the other hand, Bass(1991) argues that banks have become more active risk takers and managers, they have become more astute product innovators and, on the negative side, they have occasionaly made unwise business decisions for the sake of earnings, market penetration, reputation and so on. He further argues that this has led to their being exposed to defaults (and losses) on a variety of instruments and markets. There is no doubt, he says, that the risks facing banks today are significantly greater and more complex and far more destructive if not fully understood.

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[11] Ibid 37

The financial crisis that hit the East Asian Countries in 1997 revealed substantial vulnerabilities in the financial sector. It turned out that most financial institutions had a large amount of non-performing loans, which were the result of poor risk management and excessive lending to some parts of the real sector. In fact, a large number of financial institutions were insolvent and susequently had to be either financially supported, merged or liquidated (Laeven, 1999). According to Laeven, poor risk management was caused by weak corporate governance and limited investment in risk management technology. Excessive lending was caused to a large extent by extensive cross-ownership of banks and companies, weak enforcement of banking regulations and government directed lending.[12] Sinkey (2002) has also stated that the majority of U.S bank failures, including those in the 1980s, can be traced to problems associated with credit risk, and frequently with credit risk linked to fraud and insider abuse. On the other side of the coin, successful banks have been able to avoid serious problems with credit risk, reflecting greater ability to control the lending fuction in terms of quality growth (Sinkey, 2002).

Defaults may occur as a result of continued or sudden financial deterioration leading to forced or voluntary bankruptcy. In certain cases defaults may also occur because a counterparty willfully elects to cease performance under a contract. And the end results of these defaults are losses. In this regard, Sacks & Crawford (1991) pointed out that in anticipation of some borrowers' defaulting, banks set aside part of thier earnings, through an expense account called provision for loan losses (PLL), to attempt to cover such contingencies. In effect, a bank earmarks capital or earnings (the PLL expense provision) for expected future loan losses.

No loan is entirely without risk. Every loan, no matter how well it is secured, and no matter who is the borrower, has the potential to generate loss for the

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[12] Laeven L. (1999), 'Risk and Efficiency in East Asian Banks', Policy Research Working Paper No. 2255, pp 2

lender. It is the degree of risk to which a loan is susceptible and the probability of loss that vary. Hence, banks need to exercise an efficient risk management process which would lessen potential losses. According to Banks (1993), risk management process is divided into three separate stages, identification, measurement and management. The risk identification phase seems obvious but can often be very difficult, since it is important to recognize and classify all risks likely to be encountered. Any risk which is wrongly identified or not identified at all will lead to incomplete or negative results. Banks says it is during this stage that the less obvious, and hidden, risks must be captured.

Once identified, risks must be measured.[13] This is also often a challenging task and any mismeasurement of identified risks can lead to negative results. Measurement can be especially difficult when dealing with everchanging environment. According to Banks, much of the business of banking requires risk measuremnt in ever-changing conditions and this can lead to complications when dealing with the future value of volatile variables. It is during this phase that a bank is required to develop risk measurement techniques and apply them to its portfolio. The most important goal of the measurement process is to develop a measure conservative enough to ensure that a bank is able to have a reasonably certain idea of the risks it is assuming but not so conservative that potentially good business is driven away.[14]

After risks have been identified and measured, a bank will have to elect whether or not it wants to engage in a particular transaction with a particular client. In a banking environment such a decision is generally based on a number of elements, including credit quality, amount of risk, return on the transaction, maturity of the transaction and motivation for the transaction.[15]

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[13] Banks E. (1993), 'Volatility and Credit Risk in the Capital Markets', Macmillan Publishers Ltd., Basingstok pp20
[14] Ibid PP20
[15] Ibid PP20

If a bank chooses not to transact business with a particular client, there is no further work to be done, since no risk will be assumed by the bank.

Management's credit philosophy determines how much risk the bank will take and in what form. Under the lable *credit culture*, banks evidence large differences in how they make loans. According to Koch (1995), credit culture refers to the fundamental principles that underlie lending activity and how management analyzes risk. Credit culture, overtly or implicitly, embodies the psychology and beliefs of a bank's management. In most of the litratures, strong credit culture is taken as the first requirement for success in managing credit risk. Cade (1997), for example, states that in a strong credit culture, top management will have good understanding of: the trade-off between risk and reward, the concept of expected loss, the required rate of return; the economic limits of sustainable growth; and the principles of portfolio management.

Koch expressed that sound credit culture requires comprehensive and coherent written credit policies, and no condoning of habitual disparities between policy and practice. In this regard, Koch has documented elements of a strong credit culture that encourages management to maintain asset quality as follows:

Exhibit 2.1. Twenty Essentials of Good Banking Fostered by a Strong Credit Culture

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1. Commitment to excellence.
2. Philosophical framework for day-to-day decision making.
3. Sound value system that will cope with change.
4. Uniform approach to risk-taking that provides stability and consistence.
5. Development of a common credit language.
6. Historical perspective on the bank's credit experience.

7. Bank comes first and ahead of every profit center.
8. Candor and good communication at all levels.
9. Awareness of every transaction's effect on the bank.
10. A portfolio with integrity and an appreciation of what properly belongs in it.
11. Accountability for decisions and actions.
12. Long-term view as well as a short-term view.
13. Respect for credit basics.
14. Reconciliation of market practice with common sense.
15. Use of independent judgement and not the herd instinct.
16. Constant mindfulness of the bank's risk taking parameters.
17. Realistic approach to markets and budgeting.
18. An understannding of what the bank expects and the reasons behind its policies.
19. Credit system with early warning capabilities.
20. Appreciation that in risk-taking there are no surprises, only ignorance.

Source: Koch T., Bank Management, 1995, PP 634

Most of the elements in exhibit 2.1 above address the systematic approach to risk taking that forces loan officers to concentrate on long-term performance, consider a wide range of possible outcomes, and be accountable for actual earnings and loss performance. Sinkey (2002) also states that bank's credit culture is an integral part of its lending function, either explicitly or implicitly. He further explains that credit culture includes such factors as organizational design, reporting arrangements, communication practices, and incentive schemes for lending officers.

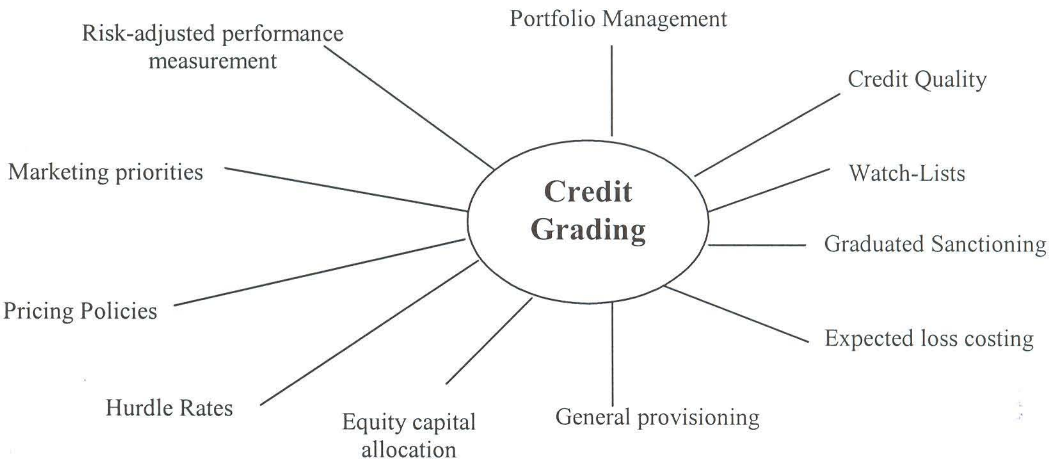
Credit Grading

As rating systems gained growing acceptance in national and international markets, banks began to cross-compare, to develop and to integrate the statistically-based theories of credit grading, portfolio management, and risk and reward that hold sway today. According to Cade (1997) credit grading provides an analytical framework dedicated to the calculation of expected and unexpected loss. He also says that credit grading furnishes an economic discipline in the credit area for meeting the canons of risk/reward management namely:

- Costing the business (expected loss)
- General provisioning (expected loss)
- Equity capital planning and allocation (unexpected loss)
- Setting hurdle rates, business selection and rejection, marketing appetite
- Pricing policy
- Risk-adjusted performance measurement

At a very practical level, grading provides a master scale on which to plot credit quality and migration between grades, and hence to devise strategies for improvement. The lower grades can be accorded watch-list status, with prescribed policies for safeguarding the bank's position. The figure below summarizes the potential gains from a credit grading system. Cade concludes that the credit grading technique promises something of a renaissance for many banks, but realisation of the full benefits may require several years of intensive effort.

Fig 2.1 Credit Grading as the Hub of Portfolio Management



Source: Cade E., Managing Banking Risks (1997), PP 118.

The Role of Collateral in Credit Risk Management

The basic policy of commercial bank lending is that money loaned in whatever form should flow back to the bank as the transaction being financed is consummated. The term of repayment, in other words should be related to the form and nature of the transaction being financed and a definite repayment program should be established with respect to every loan, no matter how well secured. Sinkey (2002) states this principle in such a way that a sound bank loan should be collectible from the anticipated income or profits of the borrower rather than from the liquidation of any collateral that may be pledged. He further states that whenever a bank has to foreclose and sell collateral it demonstrates thereby that the extension of credit was unsound in the first place, even though the bank incurs no loss. When a bank forecloses and sells a collateral, the borrower usually does lose and the community may suffer as well.[16] The later fact becomes

[16] Sinkey J. (2002), 'Commercial Bank Financial Management in the Financial-Services Industry', Pearson Education Inc., 6th Ed., PP 275.

abundantly clear if many banks are forced to liquidate numerous loans and, in the process of disposing of collateral, depress the market sharply, thus effectively destroying existing values in the entire community.

According to Crosse (1962), the proper function of collateral is to minimize the risk of loss to the bank in the event the income or profits of the borrower fail to materialize in sufficient quantity to repay the loan for reasons which neither the bank nor the borrower can forsee. He also argues that in most cases capacity to pay, if properly measured, is better security than collateral. Bankers usually try to obtain a lien on some asset of the borrower to support a loan whenever possible. In this regard, Crosse argues that there is nothing wrong with such policy if it does not lead to overreliance on security to the neglect of the more important credit considerations.

With respect to business loans, the real sigificance of collateral or other protective arrangements lies in the fact that such devices enable bank management to make economically desirable loans, or to work out weak credit situations, when such action would not be entirely safe without security. Many loans to small or new enterprises or to businesses that are expanding rapidly could not be justified on the basis of credit worthiness alone.[17] Longer-term loans to the most credit worthy of borrowers also require additional protection because of the greater risk involved in the time factor alone.

Banks can lower the risk of loss on a loan by requiring backup support beyond normal cash flow. This, according to Koch (1995), can take the form of assets held by the borrower or an explicit guarantee by a related firm or key individual. Collateral is the security a bank has in assets owned and pledged by the borrower against a debt in the event of defaults.[18]

[17] Ibid

[18] Ibid PP275

Banks look to collateral as a secondary source of repayment when primary cash flows are insufficient to meet debt service requirements. Banks select collateral that retains its value over the business cycle. Receivables and inventory are preferred because of thier liquidity; plant, equipment, and real estate are also valuable. Gelos and Werner (1999) explicityly assesssed the role of collateral; i.e., using the value of real estate (land and buildings) as a proxy for collateralizable assets in a credit supply function and found a strong relationship between them. According to thier article, the heavy reliance of banks on collateral in lending decisions emanates from their poor state of evaluation and monitoring capacities coupled with prevailing legal and enforcement problems.

Cade (1997) argues that lending without properly identified means of repayment, other than realization of the security taken, is vulgarly known as 'pawn broking'. It is not the safe bet it is sometimes taken to be, but is a high risk area; the more so when the security also forms the purpose of the advance (e.g. property development, acquisition finance, equipment purchase).[19]

Credit Analysis

Once a customer requests a loan, bank officers analyze all available information to determine whether the loan meets the bank's risk return objectives. Credit analysis is essentially default risk analysis, in which a loan officer attempts to evaluate a borrower's ability and willingness to repay. Compton (1985) identified three distinct areas of commercial risk analysis related to the following questions:

1. What risks are inherent in the operations of the business?
2. What have managers done or failed to do in mitigating those risks?

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[19] Cade E.,(1997), 'Managing Banking Risks', Woodhead Publishing Limited, Abington, PP80.

3. How can a lender strucuture and control its own risks in supplying funds?

According to Compton the first question forces the credit analyst to generate a list of factors that indicate what could harm a borrower's ability to repay. The second recognizes that repayment is largely a function of decisions made by a borrower. The last question forces the analyst to specify how risks can be controlled so the bank can structure an acceptable loan agreement.

Traditionally, key risk factors have been classified according to the five Cs of credit: Character, Capital, Capacity, Conditions, and Collateral. Koch (1995) defines the five Cs as follows:

- **Character:** Refers to the borrower's honesty and trustworthiness.
- **Capital:** Refers to the borrower's wealth position, measured by financial soundness and market standing.
- **Capacity:** Involves both the borrower's legal standing and management's expertise in maintaining operations so the firm or individual can repay its debt obligations.
- **Conditions:** Refers to the economic environment or industry-specific supply, production, and distribution factors influencing a firm's operations.
- **Collateral:** Is the lender's secondary source of repayment or security in the case of default.

Golden and Walker (1993), on the other hand, identified the five Cs of bad credit, representing things to guard against in order to help prevent problems. These include Complacency, Carelessness, Communication Breakdown, Contingencies, and Competition. According to these authors complacency refers to the tendency to assume that because things were good in the past they will be good in the future. Common examples are an overreliance on guarantors, reported net worth, or past loan repayment success because it's always worked out in the past. Carelessness involves poor underwriting, typically evidenced by inadequate loan documentation, a lack of current financial information or other pertinent information in the credit files, and a lack of protective covenants in the loan agreement.[20] Each of these makes it difficult to monitor a borrower's progress and identify problems before they are unmanageable. Loan problems often arise when a bank's credit objectives and policies are not clearly communicated.[21] Management should articulate and enforce loan policies, and loan officers should make management aware of specific problems with existing loans as soon as they appear. Contingencies refers to lenders' tendency to play down or ignore circumstances in which a loan might default.[22] The focus is on trying to make a deal work rather than identifying downside risk. Finally, they said that competition involves following competitors' behavior rather than maintaining the bank's own credit standards.

Koch (1995) also states that the purpose of credit analysis is to identify and define the lender's risk in making a loan. He says there is a four-stage process for evaluating the financial aspects of commercial loans:

1. Overview of management and operations
2. Financial ratio analysis
3. Cash flow analysis
4. Financial projections

On the other hand, Sinkey (2002) explains credit analysis as the evaluation of the financial history and financial statements of credit applicants, designed to assess credit worthiness. He states that the purpose of credit analysis is threefold:

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[20] Sam Golden and Harry Walker, as Cited on Koch T., (1995), 'Bank Management'. The Dryden Press, USA, pp 636.

[21] Ibid PP636

[22] Ibid

1. Determine the financial strenth of the borrower
2. Estimate the probability of full repayment
3. Determine whether collateral or a co-signer is needed to secure the loan.

According to Sinkey, a fast changing economy requires commercial lenders and analysts to apply fundamental skills to complex and new situations. Credit analysis focuses on the strength and weaknesses of a business, its managment, and the industry and environment in which it operates. The objective of credit analysis is to integrate these analyses to make judgement about past and future financial performance and to decide about repayment ability. From the point of view of Sinkey, the four pillars of credit analysis are:

1. Cash flow
2. Assessment of management
3. Forecasting
4. Business and competitive environment

Sinkey states that the other area that has to be stressed in managing credit risk is the importance of setting and adhering to credit limits. He says banks have to set limits by customer, georgraphic region and industry sector. Koch has also expressed that excessive credit exposure to one or more customers, regions or industries is dangerous because of the risk of default contagion between companies in the same region or industry. Concentration occurs when an institution's portfolio contains an excessive level of credit to a single counterparty, a group of associated counterparties, a geographic region, one type of credit facility or a class of security.

Compton (1985) also argues that excessive concentration renders an institution vulnerable to adverse changes in the area in which the credit is concentrated and to security impairment. Cole (1992) has also pointed out that sound and prudent portfolio management involves the minimization of concentration risk by developing and implementing policies and procedures to ensure the diversification of the credit portfolio.

Credit Review and Monitoring Risks

Loan review effort is directed at reducing credit risk as well as handling problem loans and liquidating assets of failed borrowers. Effective credit management separates loan review from credit analysis, execution, and administration. According to Koch (1995), the review process can be divided into two functions: monitoring the performance of existing loans and handling problem loans. He says loan review personnel audit current loans to verify that the borrower's financial condition is acceptable, loan documentation is in place, and pricing meets return objectives. If a borrower has violated any loan covenant, the loan is in default. The bank can then force the borrower to correct the violation, or it can call the loan. Koch states that calling a loan is normally a last resort and done only when the borrower does not voluntarily correct the problem and he also argues that such a practice allows the bank to request full payment before repayment prospects worsen.

The problem is much more serious when the borrower's financial condition deteriorates. These loans are classified as problem loans and require special treatment. In many cases, banks have to modify the terms of the loan agreement to increase the probability of full repayment. Modifications include defering interest and principal payments, lengthening maturities, and liquidating unnecessary assets (Koch, 1995). Banks often request additional collateral or gurantees and ask borrowers to contribute additional capital. Banks use loan workout specialists at this point because they are liquidation oriented and are frequently involved in intense negotiations.

Banks rarely lose money solely because the initial decision to lend was wrong. Even where there are greater risks than the banks recognized, they only cause a loss after giving warning signs. Donaldson (1986) argues that more banks lose money because they do not monitor their borrowers properly, and fail to recognize warnings early enough, than for almost any other reason. Early recognition of the warning signs gives the chance to study the problem, decide on its main causes, prospects of dealing with them and how likely they are to prove fatal.

Early recognition of a company's weakness does not happen in a vacuum. In this regard, Donaldson has pointed out that banks must instil a certain frame of mind in their people and must have systems for monitoring all credits, even those they believe to be healthy. Many fail to recognize that the prime purpose is to identify weakness; to montor recognized problems, while important, is still closing the stable door after the horse has bolted (Donaldson, 1986). Naturally a borrwer in difficulty needs close watching. But the main need is to review all borrowers and to highlight, early, names whose quality is deteriorating.

Non-Performing Loans and Provisions for Doubtful Loans

Banks usually classify their loan portfolios according to the likelihood of repayment of loans that are granted to customers. Most banks classify loans and advances into the catagories of 'Pass', 'Special Mention' or 'Non-Performing'. In Ethiopia, a loan is classified as non-performing when principal and/or interest is due and uncollected for 90 days or more beyond the scheduled payment date or maturity.[23] Non-performing loans are further classified as 'Substandard', 'Doubtful', and 'Loss'. Interest income cannot be accounted for all Non-performing loans and such loans will remain classified until servicing of the account is satisfactory. The following table

[23] NBE, Licensing & Supervision of Banking Business; Directive No. SBB/32/2002

shows the classification of loans and advances mainly based on NBE's Directive No. SBB/32/2002 (Sub articles 6.1.1. to 9.1.5)

Table 2.1 NBE's Loan Classification

Loan Classificaiton (Status)	Description
Pass	Loan or advance in this category is any loan or advance, or portion thereof, which is fully secured, both as to principal and interest, by cash or cash-substitutes, regardless of past due status or other adverse credit factors.
Special mention	Any loan or advance past due 30 days or more, but less than 90 days shall be classified as Special Mention.
Substandard	Non-Performing loans or advances past due 90 days or more but less than 180 days shall, at a minimum, be classified as substandard.
Doubfull	Non-perfoming loans or advances past due 180 days or more but less than 360 days shall be classified, at a minimum, as doubtful
Loss	Non-performing loans or advanes past due 360 days or more shall be classified as loss.

Source: NBE Directive No. SBB/32/2002.

Table 2.2 shows minimum provision percentages that banks have to put aside against the outstanding principal amount of each loan or advance classified in the above table. These are the revised provisions put in place effective January 2004 by the NBE's Directive No. SBB/32/2002.

Table 2.2 NBE's Provision Requirements for Doubful Loans.

Loan Classification	Brief Description	Provision
Pass	High paying capacity of the borrower, no matter what the past due status is	1%
Special mention	30 days or more but <90 days	3%
Substandard	90 days or more but <180 days	20%
Doubtful	180 days or more but<360 days	50%
Loss	360 days or more	100%

Source:NBE Directive No. SBB/32/2002

Lessons from the Asian Crisis

Since exposure to credit risk cotinues to be the leading source of problems in banks worldwide, banks and thier supervisors should be able to draw useful lessons from past experiences. Delhaise(1998) divided the causes of the Southeast Asian Crisis in to two: the panic and fundamentals. On the panic side are such things as nervous lending and betting against thier own currency (aggressive purchase of USD for fear of devaluation) and on the fundametals side are such things as microeconomic performance, corruption, poor regulation and poor governance, etc. Therefore, he says, regulators have to recurrently ensure that there is a safeguard against deteriorations.

Giancarlo C., Paulo P. and Nouriel R. (1997) also believed that the extent and the depth of the 1997/98 crisis should not be attributed only to the deterioration in fundamentals (macro economic peformance) but also to the panic on the part of domestic and international investors, somewhat reinforced by the faulty policy response of the International Monetary Fund (IMF). As reported in the following table, the pre-crisis share of non-performing loans as a proportion of total lending (NPLs ratio) ranged from the smallest level of 3% for Hong Kong to the highest level of 14% for China and Philippines.

Table 2.3. Non- Performng Loans (as proprtion of total lending in 1996)

Korea	8%	China	14%
Thailand	13%	Philippines	14%
Indonesia	13%	Taiwan	4%
Hong Kong	3%	Singapore	4%
Malaysia	10%		

Source: Giancarlo C.,Paulo P., and Nouriel R.,1997

Based on this NPL range, Giancarlo et al concluded that countries with relatively less NPLs ratio are also vulnerable to financial crisis by what is known as regional contagion effect. Accordig to thier study, even if NPLs are the major source, they are not an altogether cause of finanical crisis; there were also other pockets of the crises in addition to the NPLs in Southeash Asian Countries.

Principles of Credit Risk Management – The Basel Committee[24]

The Basel Committee promotes sound practices for managing credit risk. In line with this objective, the Committee has outlined principls of credit risk management which are mainly applicable to the business of lending and it believes that banks should have a keen awareness of the need to identify,

[24] The Basel Committee was established at the end of 1974 comprising of members from Belgium, Canada, France, Germany, Italy, Japan Luxemburg, the Netherlands, Spain, Sweden, Switzerland, United Kingdom and United States. Countries are represented by their central bank. The Committee formulates broad supervisory standards and guidelines and recommends statements of best practice in the expectation that individual authorities will take steps to implement them through detailed arrangements – statutory or other wise – which are best suited to their own national systems.

measure, monitor and control credit risk as well as to determine that they hold adequate capital against these risks and that they are adequately compensated for risks incurred.

Although specific credit risk management practices may differ among banks depending upon the nature and complexity of their credit activities, a comprehensive credit risk management program will address the following four areas of credit risk management identified by the Committee.

A. Establishing an appropriate crdit risk environment
B. Operating under a sound credit granting process;
C. Maintaining an appropriate credit administration, measurement and monitoring process; and
D. Ensuring adequate controls over credit risk

A. Establishing an appropriate credit risk environment

Principle 1: The board of directors should have responsibility for approving and periodically (at least annually) reviewing the credit risk strategy and significant credit risk policies of the bank. The strategy should reflect the bank's tolerance for risk and the level of profitability the bank expects to achieve for incurring various credit risks.

Principle 2: Senior management should have responsibility for implementing the credit risk strategy approved by the board of directors and for developing policies and procedures for identifying, measuring, monitoring and controlling credit risk. Such policies and procedures should address credit risk in all of the bank's activities and at both the individual credit and portfolio levels.

Principle 3: Banks should identify and manage credit risk inherent in all products and activities. Banks should ensure that the risks of products and actitivities new to them are subject to adequate risk management procedure and controls before being introduced or undertaken, and approved in advance by the board of directors or its appropriate committee.

B. Operating under a sound credit granting process

Principle 4: Banks must operate within sound, well-defined credit-granting criteria. These criteria should include a clear indication of the bank's target market and a thorough understanding of the borrower or counterparty, as well as the purpose and structure of the credit, and its source of repayment.

Principle 5: Banks should establish overall credit limits at the level of individual borrowers and counterparties, and groups of connected counterparties that aggregate in a comparable and meaningful manner different types of exposures, both in the banking and trading book and on and off the balance sheet.

Principle 6: Banks should have a clearly-established process in place for aproving new credits as well as the amendment, renewal and re-financing of existing credits.

Principle 7: All extensions of credit must be made on an arm's-length basis. In particular, credit to related companies and individuals must be authorized on an exception basis, monitored with particular care and other appropriate steps taken to control or mitigage the risks of non-arm's length lending.

C. Maintaining an appropriate credit administration, measurement and monitoring process

Principle 8: Banks should have in place a system for the ongoing administration of their various credit risk-bearing portfolios.

Principle 9: Banks must have in place a system for monitoring the condition of individual credits, including determining the adequacy of provisions and reserves.

Principle 10: Banks are encouraged to develop and utilize an internal risk rating system in managing credit risk. The rating system should be consistent with the nature, size and complexity of a bank's activities.

Principle 11: Banks must have information systems and analytical techniques that enable management to measure the credit risk inherent in all on-and off-balance sheet activities. The management information system should provide adequate inforamtion on the composition of the credit portfolio, including identification of any concentrations of risk.

Principle 12: Banks must have in place a system for monitoring the overall composition and quality of the credit portoflio.

Principle 13: Banks should take into consideration potential future changes in economic conditions when assessing individual credits and thier credit portfolios, and should assess their credit risk exposures under stressful conditions.

D. Ensuring adequate conrols over credit risk

Principle 14: Banks must establish a system of independent, ongoing assessment of the bank's credit risk management processes and the results of such reviews should be communicated directly to the board of directors and senior management.

Principle 15: Banks must ensure that the credit-granting function is being properly managed and that credit exposures are within levels consistent with prudential standards and internal limits. Banks should establish and enforce internal controls and other practices to ensure that exceptions to policies, procedures ad limits are reported in a timely manner to the appropriate level of management for action.

Principle 16: Banks must have a system in place for early remedial action on deteriorating credits, managing problem credits and similar workout situations.

E. The Role of Supervisors

Principle 17: Supervisors should require that banks have an effective system in place to identify, measure, monitor and control credit risk as part of an overall approach to risk managment. Supervisors should conduct an independent evaluation of a bank's strategies, policies, procedures and practices related to the granting of credit and the ongoing management of the portfolio. Supervisors should consider setting prudential limits to restrict bank exposures to single borrowers or groups of connected counterparties.

CHAPTER III

3.1. Banking in Ethiopia

3.1.1. Before 1974

The bank of Abyssinia, set up in 1905, was the first bank to appear in Ethiopia. It was originally given a fifty year concession, with certain exclusive banking privileges, and it acted as banker to the government, engaged in finance of foreign trade, and issued bank notes in 1914 - 15. The next bank to arrive on the scene was the banque de l'Indochine, which, in 1915, was given permission to open a branch in Addis Ababa. In 1931, however, to bring banking more under national control, the government bought out the Bank of Abyssinia and established, in its place, the Bank of Ethiopia, in which the government took a majority of shares. Among its many activities, the new bank issued thaler notes fully backed by specie.

The Italian invasion unfortunately brought the life of the Bank of Ethiopia to an early end, and during the occupation banking services were provided by branches of several Italian banks, of which only the Banco di Roma and the Banco di Napoli survived the liberation of 1941. For a brief interlude between 1941 and 1943 Barclays Bank provided services, particularly for British troops. After the victory over fascist Italy, the State Bank of Ethiopia was established by the Imperial Charter issued in August 1942. the State Bank of Ethiopia became operational in 1943, with 43 employees and two branches. This government owned enterprise was originally intended to be a commercial bank, but it was soon given central banking functions in addition, including the issue of currency, the control of foreign exchange reserves, and acting as banker to the government.

One effect of the occupation and subsequent period of liberation had been to create monetary confusion and to destroy all semblance of a banking system. It was therefore eminently practical to place the initial task of monetary and banking reconstruction in the hands of one management. Indeed the state bank performed this task very effectively and, in the twenty years of its life, it developed a substantial volume of deposits of all types, along with the counterpart loans, discounts, and investments; and it opened as many as twenty-one branches. In addition, it was responsible for the first public issue of government bonds. But its very success made the separation of central and commercial banking functions the more desirable. This separation was achieved by the Banking Proclamation of 1963, which created, by charter, the National Bank of Ethiopia and the Commercial Bank of Ethiopia to take over from the State Bank the central banking and commercial banking functions respectively.

The 1963 law allowed for other commercial banks to operate, including foreign banks provided they were 51% owned by Ethiopians. The biggest of these was the Addis Ababa Bank, which was 40% owned by Grindlays Bank (British-owned) and had 26 branches by 1975. There were also two foreign commercial banks: the Banco di Roma and the Banco di Napoli, with eight and one branches respectively as of 1975. In addition to the commercial banks, the government established two development banks, both 100% government owned. The Agricultural and Industrial Development Bank (AIDB) was set up in 1970, taking over two earlier development banks: the Development Bank of Ethiopia and the Ethiopian Investment Corporation, which had been established in 1963 as the Investment Bank of Ethiopia. The Housing and Saving Bank was created in 1975 out of a merger between two earlier housing finance institutions created in 1962 and 1965.

3.1.2. Between 1974-1991

After the fall of the imperial government in 1974, Dergue nationalized the relatively small private commercial banks and concentrated them into the

Commercial Bank of Ethiopia. By doing so the socialist government completely owned the banking system. During the command system that lasted for about 17 years, CBE had been the sole commercial bank in Ethiopia and a mere instrument of the central planning. During that time, the practice of banking has changed fundamentally. The banks' large customers became public enterprises (annex 6) and the banks were instructed to lend to them in support of the government's development plans (Harvey, 1998). The banks were not able to refuse to implement these instructions on the basis of commercial lending criteria.

3.1.3. After 1991

After the dawn fall of the Dergue in 1991, a new banking proclamation has been enacted in 1994; and this proclamation created several new opportunities for the private sector to be involved in the banking sector. This made the government owned banks to relinquish their monopoly position in the country's banking industry. After this period, the government owned banks had to go through several changes to cope with the environmental turbulence created by the country's policy redirection. At the end of 2004/05, the number of banks in Ethiopia reached ten, of which three are government owned and the rest are all owned privately. Details of the banks in Ethiopia along with their capital and branch network for the years 2003/04 and 2004/05 is depicted on Table 3.1. At the time of writing this project, a bank, Lion International Bank, has been under formation, which would raise the number of banks to eleven.

Table 3.1. Capital and Branch Network of the Banking System

(Branches in number and capital in million Birr)

Banks	Branch Network				Capital in Million Birr		Branch Network		Capital in Million Birr	
	2004/05				2004/05		2003/04		2003/04	
	Regions	Addis Ababa	Total	% Share	Total Capital	% Share	Total	% Share	Total Capital	% Share
1. Public Banks										
CBE	138	36	174	44.7	1,427	40.9	172	48	1495.4	47.4
CBB	15	11	26	6.7	115	3.3	21	5.9	87.9	2.8
DBE	31	1	32	8.2	437	12.5	32	8.9	524.4	16.6
Total Public Banks	**184**	**48**	**232**	**59.6**	**1979**	**56.8**	**225**	**62.8**	**2107.7**	**66.8**
2. Private Banks										
AIB	14	19	33	8.5	225	6.5	31	8.7	177.5	5.6
DB	15	18	33	8.5	324	9.3	31	8.7	229.9	7.3
BOA	10	12	22	5.7	269	7.7	19	5.3	208.6	6.6
WB	19	10	29	7.5	187	5.4	25	7.0	145.6	4.6
UB	4	13	17	4.4	125	3.6	14	3.9	96.1	3.0
NIB	3	14	17	4.4	265	7.6	13	3.6	189.5	6.0
CBO	6	-	6	1.5	112	3.2				
Total Private Banks	**51**	**67**	**157**	**40.4**	**1507**	**43.2**	**133**	**37.2**	**1047.2**	**33.2**
Total Banks	**235**	**115**	**389**	**100**	**3486**	**100**	**358**	**100**	**3154.9**	**100**

Source: NBE Annual Reports

3.2. Lending Activity of the Banking Sector

Until the time that the 1994 banking proclamation was put in place, credit was entirely provided by the three state owned banks; namely the CBE, DBE and CBB. Moreover, as both the DBE and CBB were rendering specialized services the fate of working capital financing of business firms and state owned enterprises was in the hands of the CBE. But following the 1994 banking proclamation, a number of privately owned commercial banks entered to the market and started to play their role in the industry.

In the Ethiopian banking system, loans and advances constitute the largest part of the total assets of the banks. As discussed in chapter 2, this also holds true for many banking systems around the world. The percentage of total loans and advances to the aggregate assets of Ethiopian banks has been between 41 and 66% over the last six years as shown below.

Table 3.2. Selected Balance Sheet Items of the Banking Sector

(In Million Birr)

Description	2005	2004	2003	2002	2001	2000
Total Assets	70,744	55,677	47,271	41,526	37,641	30,956
Total Loans & Advances	29,107	31,598	28,399	26,432	24,977	19,680
Loans as percent of total assets	41%	57%	60%	64%	66%	64%
Provision for doubtful loans	2426	3,133	3,562	3,091	2,607	2,017
As percent of total loans & advances	8%	10%	13%	12%	10%	10%
Capital & Reserve	3,486	3,020	2,519	1,982	2,332	2,188

Source: NBE Annual Reports & Own Calculations

As can be seen from the above table, the total capital of the banking system reached Birr 3,486 million at the end of June 2005, of which Birr 1979 million (56.8 percent) was held by the three government owned banks.

Though their share has been declining gradually, public banks have the lion's share of the total outstanding loans in the industry.

The total outstanding loan of the public banks has never been below 73% in the period under review. The Commercial Bank of Ethiopia, the largest public bank in the country, accounted for about 56.6% of the total outstanding loans of the banking system as of June 30, 2005. However, it is worth to note that the share of the CBE in outstanding loans has declined from 65.1% in 1999/2000 to 56.6% in 2004/2005. Unlike the CBE, the share of the private banks in outstanding loans went up from 10.3 % in 1999/2000 to 26.2 % in 2004/2005.

Table 3.3. Outstanding Loans and Advances of the Ethiopian Banking Industry

(In million Birr)

Lender Bank	2004/05	2003/04	2002/03	2001/02	2000/01	1999/00
CBE	16,420.8	20,978.4	18,399.7	17,856.4	17,184.8	12,774.8
DBE	4,094.9	3,529.0	4,543.1	4,441.2	4,264.8	4,021.4
CBB	899.1	741.5	731.3	760.1	796.1	803.1
Total (A)	**21,414.8**	**25,248.9**	**23,674.1**	**23,057.7**	**22,245.7**	**17,599.3**
Market Share	73.8%	79.9%	83.4%	87.2%	89.1%	89.7%
AIB	1,524.8	1,283.5	1,116.1	775.4	615.6	596.7
DB	2,218.5	1,979.7	1,378.3	1,012.1	723.5	552.6
BOA	1,217.5	1,121.0	788.5	672.1	687.3	507.4
WB	1,002.3	737.9	570.9	402.4	363.7	283.3
UB	513.2	360.1	290.5	188.3	130.6	81.7
NIB	1,135.4	866.4	580.6	324.1	210.3	NA
CBO	NA	NA	NA	NA	NA	NA
Total (B)	**7,611.7**	**6,348.6**	**4,724.9**	**3,374.4**	**2,731.0**	**2,021.7**
Market Share	26.2%	20.1%	16.6%	12.8%	10.9%	10.3%
Total (A+B)	**29,026.5**	**31,597.5**	**28,399.0**	**26,432.1**	**24,976.7**	**19,621.0**

Source: Annual & Quarterly Reports of NBE and Own Calculations.

3.3. Lending at the Commercial Bank of Ethiopia

The Commercial Bank of Ethiopia has the following credit products.

I. Overdraft

An overdraft is a form of credit facility by which a customer may be allowed to draw beyond the deposits of his/her/its current account for the sole purpose of the day-to-day operational needs of a viable, ongoing business. An overdraft is an open credit facility for an unlimited period of time though the bank has the right to evaluate the performance of the overdraft facility for six months, or one year, for further utilization.

II. Overdrawal

An overdrawal is a temporary facility that grants a customer the license to draw a specified amount of fund over and above the overdraft limit in order to meet unexpected cash shortage. For the borrower to be eligible for overdrawal financing, his or her credit risk grade must be grade 1 or grade 2.

III. Term Loan

A term loan is a loan granted to customers to be repaid within a specific period of time with interest. The loan is repaid in a lump sum on maturity, or in monthly, quarterly, semi-annual or annual installments, depending on the nature of the business and its cash flow. Term loans can be divided into short-term loans, medium and long-term loans.

Special Provision on Term Loans

A. Agricultural Term Loan

An agricultural term-loan is a loan granted to alleviate the financial constraints of the agricultural sector in the form of an agricultural input loan for the purchase of agricultural machinery, working capital finance and investment finance to large and modern commercial farms.

B. Syndicate Loans

A syndicate loan is a form of term loan that is provided by and shared between the CBE and other banks due to the volume of the fund and the magnitude of the risk involved.

C. Loan for the Privatization of Public Enterprises

A privatization loan is a form of term loan that is provided by the bank to partially cover the cost of the acquisition of a public enterprise to be privatized.

D. Loans for Small Scale Enterprises

A small-scale enterprises loan is a loan provided to small-scale enterprises mainly in the form of short to medium term loan that is repayable within a specific period of time with interest. Small-scale enterprises are those businesses with a paid-up capital of more than Birr 20,000 and up to 500,000 but excluding high-tech establishments.

E. Loan to Micro Financing Institutions

An MFIs loan is a loan availed to the MFIs mainly in the form of term loans that are repayable within a specific period of time with a negotiable interest rate.

F. Mortgage Loans

A mortgage loan is a loan extended to alleviate the financial constraints of the housing construction sector in the form of medium and long term loans for the purchase/construction of residential and business buildings.

G. Motor Vehicle Loans

A motor vehicle loan is a loan extended in the form of a term loan for the purchase of motor vehicles, and is aimed at alleviating the financial constraints of the transport sector as well as of other business sectors.

IV. Merchandise Loan

A merchandise loan is a short-term credit facility provided by the bank against which the merchandize or documentary evidence (Railway Receipt, Warehouse Receipt and Airway Bills) is held as a pledge or collateral for the loan.

V. Letter of Credit

A letter of credit is a credit instrument issued by the bank at the request of an importer through which the bank commits itself to a payment undertaking to an applicant (importer) to pay a seller (exporter) a given amount of money upon presentation of specified documents representing the supply of goods within specific time limits, the documents conforming to the terms and conditions agreed by the importer and exporter.

VI. Revolving Export Credit

A revolving export credit facility is an advance extended to exporters upon presentation of acceptable export documents, except a bill of lading.

VII. Pre-shipment Export Credit

Pre-shipment export credit is a loan extended to non-coffee exporters against 80% guarantee of NBE for purchase of raw materials, processing them and converting them into finished goods, transporting them, warehousing the goods and packing them until such time as the goods are shipped.

VIII. Advance on Export Bills

Advance on export bills is a post shipment export credit extended to exporters, upon presentation of all relevant export documents, to bridge the gap between the shipment of goods and the realization of proceeds.

IX. Bank Letter of Guarantee

A letter of guarantee issued by a bank is a written promise by the bank to compensate (pay a sum of money) to the beneficiary (local or foreign) in the event that the obligor fails to honor his/her/its obligations in accordance with the terms and conditions of the guarantee/agreement/contract.

3.4. Income from Loans

The bank derives much of its income primarily from the loans it grants and the other sources of its income include commission and other incomes. In the last eleven years, except for the year 2004/05, interest income took the lion's share of the total income. As can be seen form table 3.4 below, interest income has always been above 50 percent of the bank's income except in 2004/05. In the last eleven years, the average percentage share of interest income to the total income of the bank has been 66.8%.

As loans are the major sources of its income, the bank has to properly manage the risk associated with lending for failing to manage those risks properly could lead to huge losses.

Table 3.4. Summary of Income Accounts

(In Thousand Birr)

Particulars	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	Average	% Share
Interest Income	681,696	924,092	836,424	812,710	875,510	997,770	987,010	586,969	670,029	680,341	645,755	790,755	66.82%
Commission Earned	70,047	92,611	73,550	77,280	79,162	76,165	94,570	95,477	97,695	126,442	171,856	95,896	8.10%
Other Income	156,794	126,936	201,996	109,391	275,620	246,112	261,573	322,945	533,753	457,937	571,846	296,809	25.08%
Total Income	908,537	1,143,639	1,111,970	999,381	1,230,292	1,320,047	1,343,153	1,005,391	1,301,477	1,264,720	1,389,457	1,183,460	100.00%
Percentage of Interest Income to Total Income	75.03%	80.80%	75.22%	81.32%	71.16%	75.59%	73.48%	58.38%	51.48%	53.79%	46.48%	66.82	

Source: CBE Annual Reports and Data from Statistical Services.

3.5. Organs involved in Credit Risk Management

The credit risk management department is principally in charge of overseeing the overall credit risk management of the bank. This involves initiating new credit policies and procedures, periodically revising the credit policies and procedures and enforcing the existing ones, ensuring that loans are processed in accordance with the credit policies and procedures, and forwarding credit proposals for credit decisions. The department is organized under the Finance and Accounting Main Department, which is in charge of planning, coordinating and monitoring the overall credit-risk management function of the bank. The credit risk and portfolio management unit is also organized under the credit risk management department to handle many of the risk management functions of the bank.

The Board of Management (BOM) and the President are bodies on top of the organizational structure that are involved in credit risk management issues. The BOM attends to the overall strategic credit and risk management issues of the bank. It approves credit policies and oversees the overall credit and risk management of the bank. The president is responsible for issuing credit procedures and guidelines in line with the credit policy and ensuring their proper execution. The president is also responsible for obtaining appropriate feedback reports from the Credit Risk Management Department on loan status and on the overall credit management performance, and taking remedial actions on irregularities. (The organizational structure is annexed)

3.6. Credit Risk Management Practices

3.6.1. The Practice during the Pre-reform period

As noted in section 3.1.2, during the socialist period the Commercial Bank of Ethiopia (CBE) and the other government banks were obliged to lend to public enterprises according to government instructions. The CBE could not refuse credit in the circumstances, regardless of whether its credit assessment was positive or negative. This practice could have led to large-scale accumulation of bad debts, extensive fraud and insolvency. But CBE didn't face these problems for a number of reasons. First and probably most fundamentally, during most of the socialist period the majority of public enterprises made a profit and were therefore able to service their debts (Eshetu Chole, 1994).

To a considerable extent, the ability of public enterprises to service their loans was assured by their receiving sufficient allocations of scare foreign exchange to remain viable (Harvey, 1998). Review of the files of the then borrower public enterprises showed that public enterprises made losses and were not able to service their debt during the years 1989 and 1990. The reason stated for making those losses was the worsening foreign exchange shortage of that time. Though the public enterprises were failing to pay their debt, the then financial statements of the CBE revealed that the bank made no provisions against lending to these enterprises. In practice, the CBE clearly expected the government to carry any unrecovered losses eventually. There was therefore a line of defense in the CBE's lending to parastatals, namely, that it expected to be compensated for the cost of any bad debts resulting from the lending it had been instructed to undertake.

There was certain logic in such procedures, in that the banks, all government-owned, were part of the public sector. As a consequence, the allocation of expenses, such as parastatal inability to pay debt, was to some extent a matter of accounting procedures. Bank deposits were considered as an additional resource to finance public sector activities, with the possibility of latter repayment; the government-owned commercial bank was simply a convenient transmission mechanism, rather than a source of independent decision-making on the allocation of resources.

Most unusually, however, the files reviewed showed that the CBE continued to undertake credit analysis of lending decisions according to the commercial criteria, even though the majority of its lending was to public enterprises and it was not able to refuse government instructions to lend where that analysis was negative. The management of commercial banking was therefore apparently a rather unusual mixture of continued attention to commercial criteria, combined with submission to the demands of central planning in making loans to public enterprises. Between 1981 and 1993, lending to the private sector was only between 30 and 40% of total loans and advances (Annex 6).

It should, however, be noted that the risk of lending to parastatals was somewhat reduced because the deposits of public enterprises were very roughly as large as, and frequently larger than, the loans outstanding (Annex 12). Collectively, therefore, public enterprises did not threaten the solvency of the CBE. Of course, individual public enterprises with deposits greater than borrowings would not necessarily cover the defaults of other public enterprises.

3.6.2. The Post-reform Period

After the downfall of the Dergue, the CBE remained in 100% government ownership, but it was given greater autonomy in lending decisions, especially from September 1994. It also acquired its own Board of Directors. Even before these institutional changes, there was a sharp increase in loans and advances, with a major shift to lending to the private sector (Annex 6). This sharp increase in lending came after a prolonged period of stagnation: From 1981 to 1989 the amount of CBE's loans and advances remained constant in real terms, and then fell by 0.4% in the three years to 1992.

Table 3.5 Loans & Advances of CBE in Real Terms

(In Million Birr)

Year	Public Enterprises	Co-operatives	Private & Individuals	Total
1981	626 (63%)	3 (0%)	366 (37%)	995
1989	898 (70%)	22 (2%)	366 (28%)	1286
1992	858 (67%)	22 (2%)	401 (31%)	1281
1993	1,493 (60%)	33 (1%)	976 (39%)	2502
1994	1,617 (52%)	66 (2%)	1425 (46%)	3108

Source: CBE Statistical Service & Own Calculations
Note: Numbers in brackets are percentages of total lending in that year.

After 1992, the real value of lending to public enterprises rose by 88% in two years, but lending to the private sector rose even faster, more than tripling. The share of the private sector increased, therefore, from 31% to 46% of total lending.

Such a rapid rate of increase in lending could have endangered the quality of the bank's loan portfolio. In this particular case, the bank also had to cope with a major shift in the structure of its lending, and therefore with the criteria for making loans. Years of lending to public enterprises on government instructions, with an implicit government guarantee, could also be expected to have reduced the bank's knowledge and experience of lending. There was also a change in the lending environment. During the socialist period, central allocation of foreign exchange acted as a substitute for assessing the viability of borrowers. Liberalization of foreign exchange allocation, however, made assessment of the quality of loan applications more difficult, requiring different skills. Moreover, the bank was highly liquid despite the rapid increase in loans and advances in the period since 1992 (Annex 12). In 1994 for example, loans were only 41% of total deposits (compared with 25% two years earlier). The liquidity ratio (liquid assets as a percentage of demand deposits) was 88% compared with a formal requirement of 15%. This excess liquidity gave the bank scope to continue rapidly increasing its lending, especially to the private sector, for several more years.

Overall, the CBE came to be at risk of expanding its lending to the private sector faster than it used to lend. In fact, if one has to criticize the bank, it should be on the side of pursuing a more relaxed lending policy, particularly during the initial years of the policy reform period during which overall business risk is believed to have increased, largely because of the abrupt open up of the economy for competition. One visible outcome of the reform program was that it has changed the composition and customer base of the bank, away from public enterprises and other government agencies towards the private sector. The share of the private sectors both in terms of deposits and outstanding loans has substantially exceeded the public enterprises and government agencies since the reform days.

Credit Deployment

The trend of outstanding loans and advances of the CBE after the financial reform in 1994 shows that a significant increase in total loans and advances has been registered following the onset of the reform. The total outstanding loans and advances have grown from Birr 4.877 billion in June 1995 to Birr 9.556 billion in June 2005 showing a 96% increase over the last 11 years. When we see the rate at which total loans and advances has been growing, we come to realize that the rate of growth has been significantly high during the years immediately after the reform. In 1996 for example, total loans and advances of the bank increased by 40% when compared to the outstanding balance of the year 1995. The capacity of any bank to control the quality of its lending could be endangered by such a large increase over a short period. As we see it in the sections to follow, the aggressive lending tendency of the CBE immediately after the reform years had a huge impact on the quality of its loans and advances.

Table 3.6. Outstanding Balances of Loans and Advances

(In Thousand Birr)

Year	Agricultrue	Manufacturing	Domestic Trade & Service	Foreign Trade	Building & Const.	Personal & ESL	Financial Inst.	Co-Fin. Of Projects	I.F.A.D	Total Loans & Advances	Growth Rate (%)
1995 June	162,835	451,065	2,157,574	1,551,482	306,399	12,833	179,483	55,571		4,877,242	
1996 June	210,526	578,202	3,014,389	2,029,417	350,618	14,737	527,600	93,987	2,628	6,822,104	40%
1997 June	326,804	711,878	3,396,524	2,373,401	428,411	15,807	540,876	148,242	6,111	7,948,054	17%
1998 June	345,630	790,576	3,459,113	2,657,440	419,305	17,732	496,672	597,288	6,636	8,790,392	11%
1999 June	439,443	891,104	3,204,514	2,901,832	639,595	19,105	554,803	871,710	7,739	9,529,845	8%
2000 June	467,360	900,360	3,548,589	2,822,932	680,963	20,080	676,906	973,357	8,429	10,098,976	6%
2001 June	454,724	1,036,013	3,460,621	2,785,453	912,066	22,566	564,322	1,039,858	7,918	10,283,541	2%
2002 June	549,168	1,074,857	3,001,400	2,758,056	729,119	24,316	517,656	1,032,989	8,213	9,695,774	-6%
2003 June	482,931	1,092,721	2,602,363	1,923,521	733,830	31,100	456,550	1,031,309	6,677	8,361,002	-14%
2004 June	476,285	1,103,792	3,060,624	2,342,387	688,490	43,379	414,151	453	5,407	8,134,968	-11%
2005 June	1,023,242	1,233,263	3,496,567	2,871,770	547,262	44,130	340,188			9,556,422	28%
Total	4,938,948	9,863,831	34,402,278	27,017,691	5,747,568	265,785	5,269,207	5,844,764	59,758	93,409,830	
Average	448,995	896,712	3,127,480	2,456,154	574,757	24,162	479,019	584,476	6,640	8,598,395	
% Share	5%	10%	36%	29%	7%	0%	6%	7%	0%	100%	

Source: CBE statistical service and own calculations.

The above data clearly shows that the increases in total loans & advances have continued until the year 2001. However, the subsequent three years witnessed a decline in the outstanding balances of loans. There were many reasons for the decline. Drought was prevalent in a number of areas in the country and as a result agricultural production in the fiscal years 2001/02 & 2002/03 was not so good. Even before the occurrence of the drought, the 2000/01 good weather conditions that resulted in a bumper harvest of agricultural produces and products had brought about a substantial price fall in the grain market, adversely affecting growers and traders. The unprecedented plummeting of the price of coffee on the world market continued unchecked during those years and caused a considerable decline in coffee exports. The negative developments in the domestic economy were also exacerbated by the unhealthy situation in the global economy. The terrorist attacks that took place on September 11, 2001 in America aggravated the weakening trend of the world economy and that, directly or indirectly, had a negative effect of a considerable degree on the Ethiopian economy. As a result the bank's credit customers became less capable of repaying their bank debts.

In addition to the national and global adverse developments, the aggressive lending tendency of the bank in the preceding years had resulted in the piling up of NPLs. In fact, the surge in NPLs became the major cause for the decline in outstanding loans as the bank focused in collecting the unhealthy loans than on fresh loan disbursements (Annex 7). At the end of the fiscal year 2002/2003, for example, the rate of the NPLs of the bank had reached 53%[1]. The outstanding loans as at the end of 2003/04 amounted to Birr 8.1 billion, lower than the preceding year, largely due to the bank's commitment to focusing on quality and catering to corporate loans. Besides the poor performance of the economy during those years, the stringent requirements for credit extension and the ever-stiffening competition had also their contribution in the reduction of the outstanding loans. This decline has not been limited only to the outstanding balances of loans and advances. The number of accounts for loans & advances has also been declining accordingly.

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[1] CBE Newsletter, September 2006, vol. 2, issue 4, pp1

Table 3.7. Number of Accounts in Loans & Advances by Economic Sector

(In number)

SECTORS	Jun-95	Jun-96	Jun-97	Jun-98	Jun-99	Jun-00	Jun-01	Jun-02	Jun-03	Jun-04	Jun-05
Agriculture	2,049	2,560	2,580	2,740	2,834	3,301	2,963	3,163	3,519	3,746	5,085
Manufacturing	988	698	784	674	637	633	584	356	310	287	275
Domestic Trade & Services	22,545	26,886	25,799	22,801	18,934	13,408	6,911	5,339	4,282	3,929	3,975
International Trade	745	680	738	756	604	600	679	441	388	323	360
Building and Construction	572	571	411	337	337	356	225	172	161	114	112
Personal & ESL	5,530	4,852	4,895	4,962	4,964	5,171	6,232	6,278	6,554	6,914	6,955
IFAD		40	105	64	26	89	141	384	294	288	
Financial Institution		4	4	4	5	6	6	6	6	6	4
Co-Finance of Projects		3	4	5	7	7	7	6	6	6	
ALD+LIR	2,707	2,786	3,623	4,768	5,662	9,287	13,753	14,333	13,664	13,362	12,772
TOTAL	**35,136**	**39,080**	**38,943**	**37,111**	**34,010**	**32,858**	**31,501**	**30,478**	**29,184**	**28,975**	**29,538**
Growth Rates, (%)		**11%**	**0%**	**-5%**	**-8%**	**-3%**	**-4%**	**-3%**	**-4%**	**-1%**	**2%**

Source: CBE Statistical Service

The sectoral breakdown of outstanding loans and advances shows that almost all sectors have registered an increase in outstanding loans except some declines during the years when the economy was in trouble (2002 & 2003). However, the rate at which loans to the trade sector (Domestic and Foreign) have been growing is much significant when compared to the rest of the sectors.

As can be seen from Table 3.6, a significant proportion of the loan portfolio is comprised of trade loans. They together represented 54 to 76% of the total outstanding loans and advances during the years between 1995 and 2005. Such exposures could have negative consequences unless their ever growing proportion is given due attention. In the last six years, for example, the bank had two large exposures, each representing more than 50% of the capital base of the bank. Portfolio management is included in the policy with the objective of having a balanced portfolio of credit spread over different industry sectors, group exposures, geographical areas, maturities and products. In relation to the various industrial sectors, the bank's policy states that the bank's credit commitments to anyone sector should not exceed 40% of the total commitments. When we see the exposure of the bank by splitting the trade sector into domestic trade and foreign trade, they remain the two large exposures of the bank. Of course, when seen individually, the exposure of the two sectors falls within the stated limit set by the bank.

Loans and Advances by Ownership

When looking at the trend of loans by ownership, it is evident that loans to the private sector by far exceeded the loans granted to that of the public sector. This is a reflection of the economic policy which encourages the private sector to have a significant role in the economy.

Table 3.8. Outstanding Balances of Term Loans & Overdraft by Ownership

(In Thousand Birr)

Year	Term Loan (Incl. Mdse & ALD)					Overdraft (Incl. Advances)					Grand Total	Growth Rates, (%) (for Grand Total)
	Private & Indv.	Pub. Ent. & Age	Co-operatives	Total	Growth Rates (%) (Total T/Ls & Mdse)	Private & Ind.	Pub. Ent. & Age.	Co-operatives	Total	Growth Rates (%) (Total O/D & Adv.)		
1995	1,972,064	356,263	107,584	**2,435,911**		1,023,823	1,417,347	161	**2,441,331**		**4,877,242**	
1996	3,017,727	984,490	98,408	**4,100,625**	68%	1,821,784	891,130	8,565	**2,721,479**	11%	**6,822,104**	40%
1997	3,622,183	914,941	119,333	**4,656,457**	14%	2,090,031	1,198,619	2,944	**3,291,594**	21%	**7,948,051**	17%
1998	4,047,562	887,339	111,391	**5,046,292**	8%	2,655,056	1,086,079	2,964	**3,744,099**	14%	**8,790,391**	11%
1999	4,267,276	881,747	314,247	**5,463,270**	8%	3,200,333	863,875	2,368	**4,066,576**	9%	**9,529,846**	8%
2000	4,872,957	1,079,740	298,541	**6,251,238**	14%	2,900,462	947,278		**3,847,740**	-5%	**10,098,978**	6%
2001	5,213,793	789,215	256,292	**6,259,300**	0%	3,079,573	944,668		**4,924,241**	28%	**11,183,541**	11%
2002	4,893,453	1,031,533	298,416	**6,223,402**	-1%	2,536,760	935,610		**3,472,370**	-29%	**9,695,772**	-13%
2003	4,946,816	894,530	283,891	**6,125,237**	-2%	1,687,226	548,538		**2,235,764**	-36%	**8,361,001**	-14%
2004	3,907,952	1,758,822	323,641	**5,990,415**	-2%	1,482,231	662,087	225	**2,144,543**	-4%	**8,134,958**	-3%
2005	3,817,839	2,572,243	899,274	**7,289,356**	22%	1,530,949	736,117		**2,267,066**	6%	**9,556,422**	17%
Total	**44,579,622**	**12,150,863**	**3,111,018**	**59,841,503**		**24,908,228**	**10,231,348**	**17,227**	**35,156,803**		**94,998,306**	
Average	**4,052,693**	**1,104,624**	**282,820**	**5,440,137**		**2,264,384**	**930,123**	**2,871**	**3,196,073**		**8,636,210**	
% Share-1	**74.5%**	**20.31%**	**5.20%**	**100.00%**		**70.85%**	**29.10%**	**0.09%**	**100.04%**			

Source: CBE statistical service and own calculations

Table 3.8. shows that outstanding loans of the private sector have been growing at a faster rate until the year 2001 while loans to the public sector remained stagnant. In 1995, for example, loans to the private sector have been 61 percent of the total outstanding loans. But as of June 2001, the share of loans to the private sector reached 82 percent of the total outstanding loans. In absolute terms, loans to the private sector had reached Birr 9.2 billion while loans to the public sector was only Birr 1.7 billion. However, after 2001, loans to the private sector have started to decline and at the end of June 2005 it was only 5.3 billion whereas the public sector's share has gone up to Birr 3.3 billion. Exposure limits to a single counterparty and related parties are set by NBE (Directive No. SBB/29/02 and SBB/30/02 respectively). The directive for a single borrower limit states that the aggregate loan or extension of credit by a bank to any one borrower shall at no time exceed 25% of the total capital of the bank. According to the directive on loan limit to related parties, the sum of the outstanding balances of loans extended to one related party should not exceed 15% of the total capital of the bank and the sum of outstanding balances of loans extended to all related parties should not exceed 35% of the total capital of the bank.

Disbursement by Ownership

Loan disbursement by ownership shows that the private sector had the largest share in all the years reviewed. In recent years, however, disbursement to both cooperatives and the public sector has increased significantly. The increase in disbursement to cooperatives may show the bank's desire to finance less risky businesses as many of the loans to cooperatives are granted against government guarantees. During the years 2000/01, 2001/02 and 2002/03, the total disbursement of the bank has been declining owing to the weak economic and business conditions and partly by the stringent credit decision procedures and tight regulation in extending new loans. Of course, the tight regulation of the NBE were the result of the soaring NPLs of banks.

Table 3.9. Term Loan Disbursment By Ownership

(In Thousand Birr)

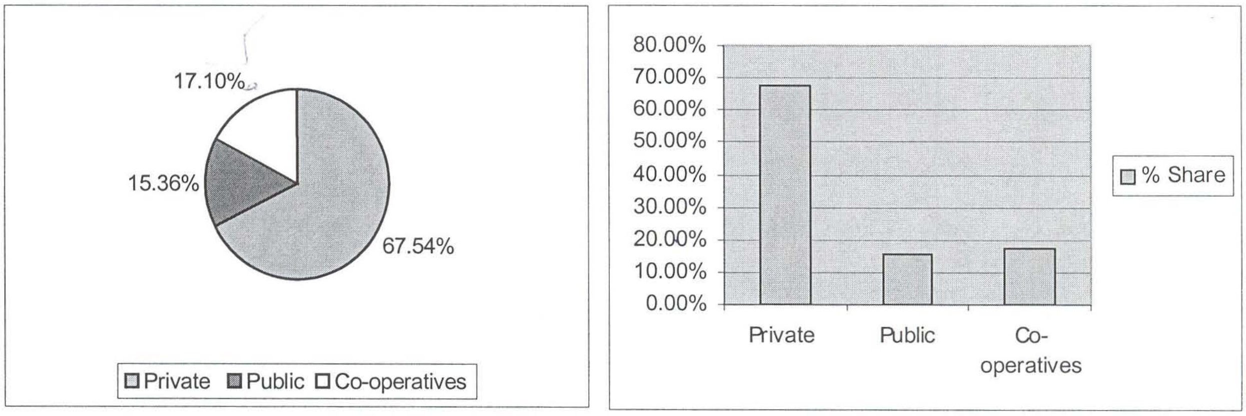
Year	DISBURSED				
	Private	Public	Co-operatives	Total	Growth Rates (%)
1994/95	2,443,383	200,652	282,203	**2,926,238**	
1995/96	2,552,377	639,310	231,474	**3,423,161**	17%
1996/97	2,350,407	210,303	232,155	**2,792,865**	-18%
1997/98	1,873,954	125,894	300,500	**2,300,348**	-18%
1998/99	1,950,139	222,793	590,797	**2,763,729**	20%
1999/00	2,067,019	236,146	626,206	**2,929,371**	6%
2000/01	1,696,203	135,507	408,302	**2,240,012**	-24%
2001/02	1,069,519	139,080	457,223	**1,665,822**	-26%
2002/03	1,129,269	170,395	314,467	**1,614,131**	-3%
2003/04	1,085,880	1,093,137	400,438	**2,579,455**	60%
2004/05	1,508,071	1,312,690	1,151,437	**3,972,198**	54%
Total	**19,726,221**	**4,485,907**	**4,995,202**	**29,207,330**	
Average	**1,793,293**	**407,810**	**454,109**	**2,655,212**	
% Share	**67.54%**	**15.36%**	**17.10%**	**100.00%**	

Source: CBE statistical service

Note: Disbursement figures do not include overdrafts

On average 67.5 percent of the total loans disbursed over the last eleven years has been the share of the private sector. The shares of cooperatives and public enterprises has been 17.1 and 15.4 percent respectively.

Figure 1: Average Loan Disbursement by Ownership



Disbursement by Economic Sector

Table 3.10 clearly shows that disbursement to the trade sector, both domestic and foreign, has dominated in all the years. On average, the share of domestic and foreign trade sectors in disbursed loans have been 43 and 20% respectively in the period under review. As can be seen from the table, disbursement to the trade sector is followed by agriculture and manufacturing sectors respectively.

Table 3.10. Term Loan Disbursement By Economic Sector

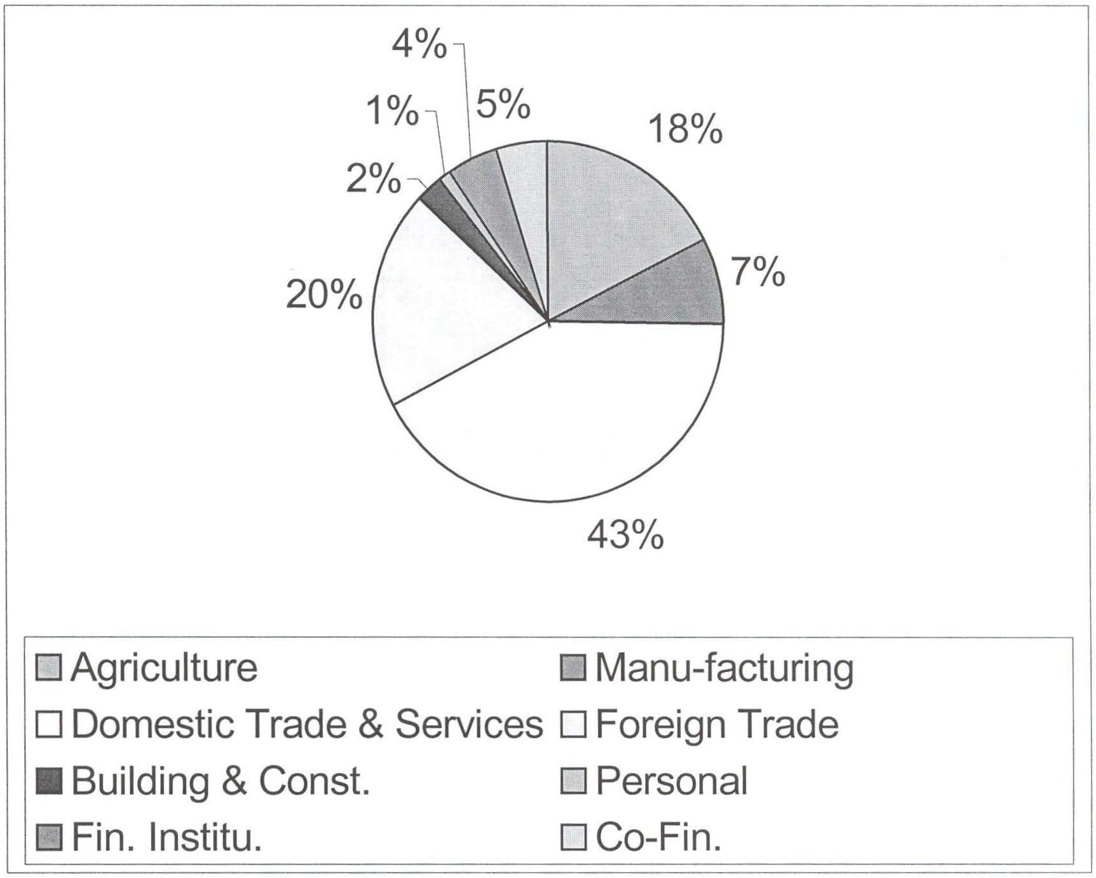
(In Thousand Birr)

Year	Agri-culture	Manu-facturing	Domestic Trade & Services	Foreign Trade	Building & Const.	Personal	Fin. Institu.	Co-Fin.	Total
1994/95	298,797	137,146	2,074,918	255,702	19,038	32,209	85,000	23,428	2,926,238
1995/96	317,489	292,546	1,968,061	538,324	29,853	35,259	182,000	59,629	3,423,161
1996/97	325,128	161,084	1,669,287	466,791	22,930	33,982	60,000	53,663	2,792,865
1997/98	341,226	135,335	1,056,613	329,424	39,732	32,404		365,614	2,300,348
1998/99	554,006	249,793	826,741	496,116	260,783	39,530	100,002	236,757	2,763,728
1999/00	517,320	295,330	1,075,908	617,385	80,263	32,605	200,000	110,560	2,929,371
2000/01	522,221	284,109	730,766	520,258	77,190	25,974		79,494	2,240,012
2001/02	508,642	142,644	435,199	519,694	33,185	26,457			1,665,821
2002/03	346,740	273,294	594,412	232,260	127,443	39,982			1,614,131
2003/04	447,046	189,809	1,130,478	714,021	42,327	55,775			2,579,456
2004/05	1,140,038	227,631	1,218,410	1,311,054	32,680	42,386			3,972,199
Total	5,318,653	2,388,721	12,780,793	6,001,029	765,424	396,563	627,002	929,145	29,207,330
Average	483,514	217,156	1,161,890	545,548	69,584	36,051	125,400	132,735	2,655,212
% Share	18%	7%	43%	20%	2%	1%	4%	5%	

Source: CBE statistical service

The pie chart drawn based on the average disbursements made to each sector in the last eleven years reveal the extent to which the trade sector has been dominant. The chart shows that all the rest of the sectors have a total share of only 37 percent.

Figure 2: Average Loan Disbursement by Economic Sector



Collection by Ownership and Economic Sector

As can be seen from table 3.11, in all the years, collection from the private sector has been very significant as it has been the case in loan disbursements. Collection from the trade sector has also been dominant over the years under review. On average collection from the domestic and foreign trade sectors has been 45.32 and 21.27% respectively and in total they represented around 67% of the collection from all the economic sectors.

Table 3.11. Collection by Ownership and Economic Sector

(In Thousand Birr)

Year	BY OWNERSHIP					BY ECONOMIC SECTOR								
	Private	Public	Co-operatives	Total	Growth Rates (%)	Agriculture	Manu-facturing	Domestic Trade & Services	Foreign Trade	Building & Const.	Personal	Fin. Institu.	Co-Fin.	Total
1994/95	1,517,067	283,506	239,389	**2,039,962**		214,142	254,814	1,267,585	255,653	13,910	32,510	884	464	**2,039,962**
1995/96	1,928,102	275,053	279,899	**2,483,054**	22%	295,384	220,893	1,484,232	433,780	14,358	32,751		1,656	**2,483,054**
1996/97	2,174,252	241,595	243,974	**2,659,821**	7%	259,569	184,659	1,657,407	452,058	22,135	32,462	50,669	863	**2,659,822**
1997/98	1,799,014	151,161	262,585	**2,212,760**	-17%	281,971	152,283	1,275,151	401,530	27,288	31,572	40,819	2,246	**2,212,860**
1998/99	1,703,017	273,719	549,615	**2,526,351**	14%	385,608	172,041	1,288,707	548,237	35,450	40,969	33,503	21,835	**2,526,350**
1999/00	1,661,654	267,071	536,266	**2,464,991**	-2%	520,909	328,329	932,192	416,784	80,925	30,225	116,519	39,109	**2,464,992**
2000/01	1,530,506	382,536	742,053	**2,655,095**	8%	580,248	167,432	1,009,244	583,121	62,556	24,024	146,138	82,333	**2,655,096**
2001/02	1,484,049	160,051	461,945	**2,106,045**	-21%	456,011	192,029	835,673	419,622	95,089	24,549	55,484	27,587	**2,106,044**
2002/03	1,709,410	216,677	320,569	**2,246,656**	7%	461,754	208,063	736,495	483,728	123,044	31,860	118,310	83,402	**2,246,656**
2003/04	1,455,980	396,248	425,392	**2,277,620**	1%	466,029	151,299	701,491	685,857	77,461	44,486	62,531	88,466	**2,277,620**
2004/05	1,877,036	643,186	586,512	**3,106,734**	36%	676,970	204,579	948,887	1,014,425	123,630	43,938	93,855	459	**3,106,743**
Total	**18,840,087**	**3,290,803**	**4,648,199**	**26,779,089**		**4,598,595**	**2,236,421**	**12,137,064**	**5,694,795**	**675,846**	**369,346**	**718,712**	**348,420**	**26,779,199**
Average	**1,712,735**	**299,164**	**422,564**	**2,434,463**		**418,054**	**203,311**	**1,103,369**	**517,709**	**61,441**	**33,577**	**71,871**	**31,675**	**2,434,473**
% Share	**70.35%**	**12.29%**	**17.36%**	**100.00%**		**17.17%**	**8.35%**	**45.32%**	**21.27%**	**2.52%**	**1.38%**	**2.95%**	**1.30%**	

Source: CBE statistical service

3.7. Credit Risk Grading Procedure

It is widely believed that credit risk ratings are important tools for monitoring and controlling the quality of individual credits in particular and the total portfolio in general. Believing that an internal credit risk grading system would help it detect potential or actual deterioration in credit quality, the bank introduced a comprehensive credit risk grading procedure back in 2004. Since then, the procedure is being used to differentiate the degree of risk in the different credit exposures of the bank. In line with this a five point grading/classification system has been put in place and this grading system classifies the risk in each customer from Grade 1 – lowest risk to Grade 5 – highest risk.

Objectives

The objectives of the credit grading system include:

i. To standardize the risk identification and management of the bank's loan portfolio
ii. To specify the criteria attaching to each risk grade
iii. To ensure a uniform bank approach to risk identification and management
iv. To identify development of early warning signals and to take remedial action on time;
v. To enhance monitoring and controlling of the qualities of individual credits as well as total portfolio.
vi. To assist decision making at all levels in the bank; and
vii. To enable lending officers to focus on better quality clients

Grading Process

The credit risk grading process involves the assessment of the following four parameters and classifying the borrower based on the perceived risk.

i. **Borrower's loan account performance:**

Here the borrower's utilization of the credit facilities and/or loan repayments is analyzed. Performance of overdraft account is assessed using parameters like overdraft turnover and swing. For settled term loans borrowers are evaluated by assessing the condition of settlement and for outstanding term loans borrowers are evaluated by assessing whether repayments are up to date, the existence of arrears, the level of arrears and the reasons for the arrears.

ii. **Borrower's Financial Condition/Business strength**

The purpose of analyzing the borrower's financial condition is to establish the extent to which the borrower is able to service the debt from the income generated by his/her business establishment. The analysis considers and includes both the financial and non-financial data and information that relate to the borrower's business. The major variables used in assessing and evaluating the borrower's financial condition/business strength include the strength of the financial management system of the customer, the borrower's ability to overcome its short-term obligation, the exposure of the borrower's business to operational risks and the extent to which the borrower's business is financed by debt.

iii. Customer Relationship

Here the variables to be assessed include the integrity of the borrower, the borrower's past dealing, the borrower's response to the bank's information requirement and the willingness of the borrower to allow the bank's authorized personnel to have access to the books of records as well as the business and the collateral.

iv. The Strength of the security/collateral

The strength of collateral depends on the stability of its realizable value and convertibility to cash as and when desired. To determine the strength of the collateral held, the bank assesses/reviews whether:

- The security/collateral is estimated and/or re-estimated by the concerned organs of the bank or other authorized institutions as per the credit policy and procedures.
- The security/collateral coverage (security to loan ratio) is as per the bank's requirement.
- The mortgage or pledge contract is properly executed and signed in the presence of witnesses.
- Collateral documentation is adequate
- Insurance policy for collateral pledged or mortgaged is renewed and its coverage
- Comments are given by the bank engineer on the property estimation format.

The risk grading procedure states that new or additional credit facilities should be considered only for borrowers classified as Grade 1 and Grade 2. In exceptional cases, however, the respective credit committees may approve new or additional credit to borrowers classified as Grade 3, 4 and 5 on the basis of their approval authority limit if such approval is to the advantage of the bank.

Risk based pricing requires lenders to charge a rate that compensates for the riskiness of the loan. The idea is straightforward: less risky borrowers pay less for credit than those borrowers who are more risky. The Commercial Bank of Ethiopia, however, is not using the risk grading system for pricing purposes and is charging a specified across the line interest rate for all loans.

3.8. The Role of Collateral in the Risk Management Process

Loan decision in the Ethiopian context is generally security based. Borrowers are required to provide marketable and fully registered properties, at least equivalent to the loan they requested. This, obviously, is not desired by the business community and many criticize the bank for relying on securities than on business operations and project viability in lending activities.

Data collected from the Central Statistics Authority (CSA) shows that out of the 533 establishments covered by a survey, 125(23.45%) of them cited high collateral requirement by banks as the main reason for not solving their working capital problem. Among the problems raised by the establishments, high collateral requirement by banks is ranked to be the first problem of those establishments.

But in a country where record keeping and auditing is little known, the options available to the banking system are often limited. Credit based on cash flow, capital structure, financial positions of companies and on management skills would have been the best procedure to follow, but this has little value in the Ethiopian situation. Only a limited number of companies keep accounts of reasonable quality. Another data from the

Table 3.12. **Number of Establishments by Industrial Group and Main Reason for not Solving Problem of Shortage of Working Capital**

(In Number)

Industrial Group	Insufficient Loan	High collateral requirement	High Interest Rate	Short loan repayment	Loan processing takes long time	Others	Total
Manufacture of food products except grain mill services	5	8	4	3	5	1	26
Manufacture of grain mill services	92	88	99	19	22	102	422
Manufacturing of wearing apparel; dressing and dying of fur	4	2	-	1	2	1	10
Manufacture of Luggage, hand bars and footwear	-	1	-		-	-	1
Manufacture of wood and of products of wood and cork, except furniture; manufacture of articles of strew and plaiting materials	1	2	-	-	-	2	5
Publishing, printing and reproduction of recorded media	-	-	-	-	-	1	1
Manufacture of other non-metallic mineral products	-	2	-	1	-	-	3
Manufacture of fabricated metal products, except machinery and equipment	12	15	2	-	3	-	32
Manufacture of furniture	8	7	3	1	10	3	32
Total	**123**	**125**	**108**	**25**	**42**	**110**	**533**
Percentage	**23.08**	**23.45**	**20.26**	**4.69**	**7.88**	**20.64**	**100**

Source: Central Statistics Authority Small-Scale Manufacturing Industry Survey, September 2003

CSA shows that 83.73% of the 31863 small-scale manufacturing industries included in a survey are with no books of accounts. The same data reveals that 15.79% of the establishments have incomplete books of accounts and that only 0.49 percent of the establishments have proper books of accounts.

Table 3.13. Number of Establishments by Industrial Group and Availability of Books of Accounts

(In Number)

Industrial Group	Full book of Accounts	Incomplete book of Accounts	No books of Accounts	Total
Manufacture of food products except grain mill services	46	104	543	693
Manufacture of grain mill services	-	4494	22729	27223
Manufacture of textile	1	4	18	23
Manufacture of wearing apparel, dressing and dying of fur	9	64	889	962
Manufacture of luggage, handbags and footwear	2	4	9	15
Manufacture of wood and of products of wood and cork, except furniture; manufacture of articles of strew and plaiting materials	7	17	143	167
Manufacture of paper and paper products	1	1	2	4
Publishing, printing and reproduction of recorded media	14	41	173	228
Manufacture of chemicals and chemical products	1	-	1	2
Manufacture of other non-metallic mineral products	5	24	77	106
Manufacture of fabricated metal products, except machinery and equipment	26	121	1159	1306
Manufacture of machinery and equipment	1	6	23	30
Manufacture of parts and accessories for motor vehicles and their engines	1	-	4	5
Manufacture of furniture; manufacturing NEC	41	150	908	1099
Total	155	5030	26678	31863
Percentages	0.49	15.79	83.73	100

Source: Central Statistics Authority, Small Scale Manufacturing Industry Survey, September 2003, Addis Ababa

On the other hand, a recent data from the CSA on large and medium scale manufacturing enterprises shows that 51%[2] of the 1053 privately owned establishments which were included in a survey are with no books of accounts. According to the data, only a very small number of the private enterprises get their companies audited. Under such a situation, cash flow statements and other financial statements produced by borrowers are likely to be of less reliable. Low degree of record keeping may as well indicate the quality of entrepreneurship in the country.

Collateral based loan could therefore be less convenient to those without physical assets or properties but with good project ideas. For the bank, the means by which it would be able to assess the creditworthiness of borrowers is rather limited other than through the physical asset the borrowers have accumulated. Given the current conditions, the cost of credit administration would simply be too high to bear if banks shift to a non-security based loan. Undue risk in loan can have significant adverse impact on the bank, as interest income on loan constitutes a very large source of income.

Lending based on non-security would require knowledge of reasonable degree about how borrowers are operating and running their business for which the available database is weak. For cash flow statement to be relevant in credit decisions the necessary conditions for establishing credit worthiness of borrowers must be in place of which honest and acceptable record keeping and good track record of management performance are some of them. There must also be a system that imposes a discipline whereby at least those relatively bigger companies could regularly produce reasonably good quality and audited reports. In this regard, the CBE has a

[2] Report on large and medium scale manufacturing and electricity industry survey, statistical bulletin 380, November 2006

policy that requires borrowers to produce audited financial statements if their exposure exceeds Birr 5 million.

Collateral based loan does not, however, mean that it is risk free. Collateral is simply a second best solution that partly fills the information gap banks are having on the performance of borrowers. As far as current practice goes, residential and non-residential buildings, vehicles and merchandise goods are most commonly held as collateral by the CBE though the list of collateral that could be held by the bank includes many other properties. The price of these properties, however, varies from time to time, substantially reducing their reliability to hedge risks of loan loss. These properties may also be subjected to a high rate of depreciation, higher than the rate normally applied to account for depreciation allowance in standard reports. It may also involve moral hazard, as the borrower knowing he will not pay back the loan may misuse the properties held as collateral.

Moreover, when a borrower fails to repay, properties held as collateral may not be immediately (without much delay, cost etc) be convertible in to cash, and hence may entail substantial cost to the bank. Because of these and other factors there is a possibility that the full amount of the loan granted may not be recovered even if the bank is most reliant on collateral.

Problems of Collateral Estimation

According to interviewees, the bank depends highly on the value of tangible security offered while making its lending decisions. 81% of the interviewees expressed that the loan size the bank advances is significantly dependent upon the value of collateral mortgaged. This practice according to the respondents has become the major source of dissatisfaction for the customers of the bank. What borrowers are disappointed at is not only the bank's high dependence on tangible collateral but also on the way the bank values their collateralizable assets. Responses from the interview revealed that borrowers are claiming that the CBE values their property at much lower prices when compared to the private banks. Borrowers also claim that different engineers of the bank value the same property at significantly differing prices, which indicates the lack of uniformity in the bank's property valuation practice.

High dependence on collateral, tight credit policy environment and an ever-increasing deposit levels have become the major contributing factors to the continuous rise in the level of liquid assets. As of June 2005, the level of liquid assets, in relation to net deposits, stood at about 69%. This is very much higher than the necessary liquidity requirement level of 15%. The loan to deposit ratio has also been between 35.1% and 49.6% in the last four years. Hence, it is important for the bank to channel these excessive deposits to productive use.

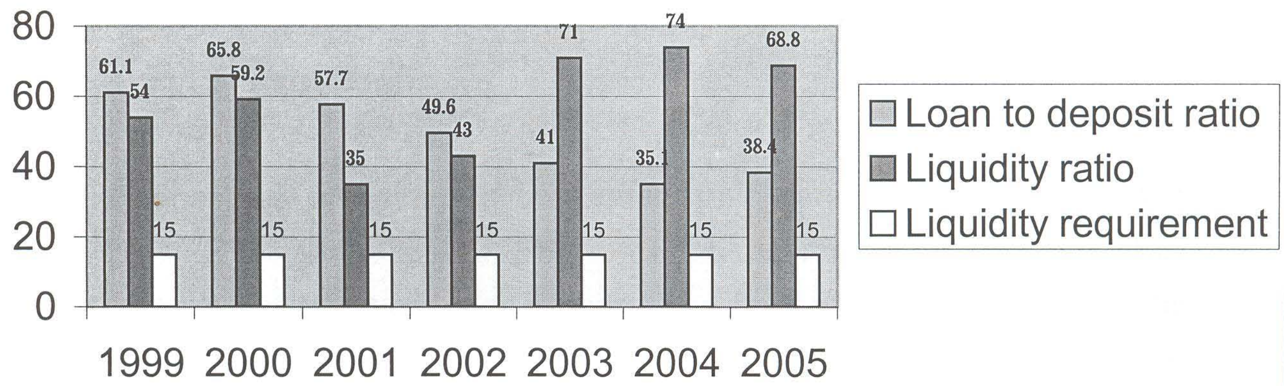
Table 3.14. Liquidity Position of the Bank

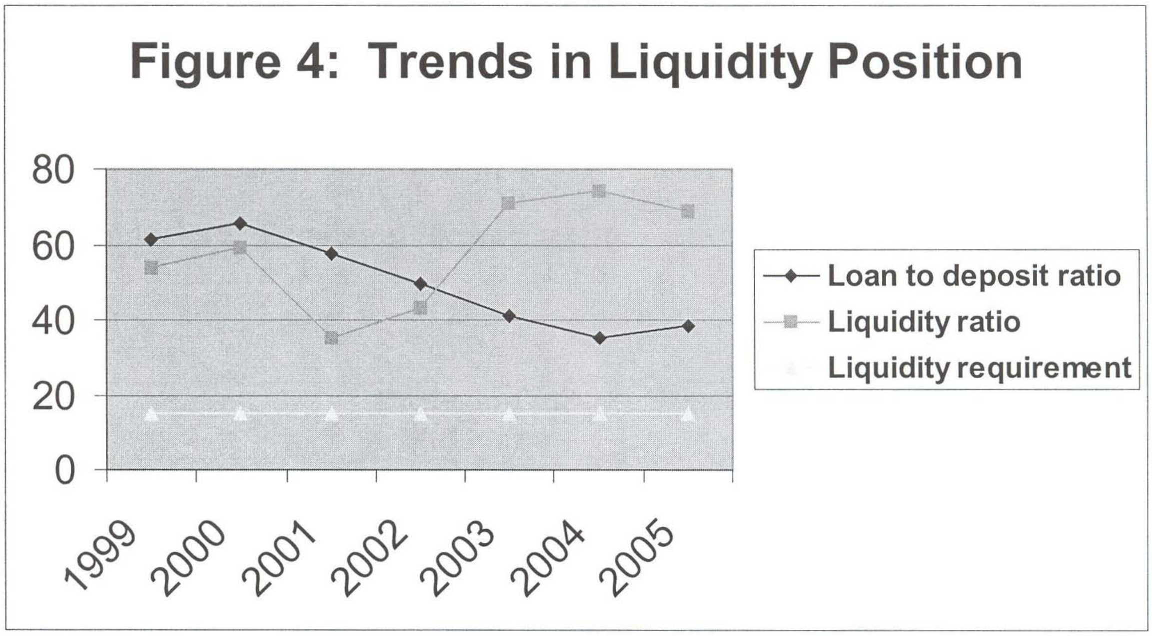
(In Percent)

	1999	2000	2001	2002	2003	2004	2005
Loan to deposit ratio	61.1	65.8	57.7	49.6	41	35.1	38.4
Liquidity ratio	54	59.2	35	43	71	74	68.8
Liquidity requirement	15	15	15	15	15	15	15

Source: CBE Statistical Service and Annual Report

Figure 3: Trends in liquidity Position





3.9. Quality of Loans and Advances

With the majority of the bank's assets in the form of loans, the lending function plays a critical role in managing its risk. As discussed in chapter 2, the objective of the lending function is to create value for the bank and the primary danger in granting credit is the chance that the borrower will not repay the loan on a timely basis, thereby destroying value. Proper and prudent management of credit risk is the way to create value in the lending function. Mismanagement of credit risk manifests itself in the form of loan loss provisions, excessive non-performing loans, and loan losses or charge offs, which destroy, bank value.

3.9.1. Provisions

The health of a commercial bank often is measured by the amount of sick loans it has in its books. The regulatory agency in Ethiopia, the NBE, forces banks to put provision against these types of loans in order to protect the public that deposits its savings with them. A bank's provision for loan loss (PLL) is one proxy for credit risk and is a measure of loan quality. The following table shows the provisions for bad loans and their growth rates in the last eleven years.

Table 3.15. Provision for bad loans

(In '000 Birr)

Year	Provision for bad loans	Growth Rate %	Yearly Change
1995	566,395		
1996	583,203	2.97%	16,808
1997	977,494	67.61%	394,291
1998	978,867	0.14%	1,373
1999	1,354,580	38.38%	375,713
2000	1,436,502	6.05%	81,922
2001	1,925,260	34.02%	488,758
2002	2,394,158	24.36%	468,898
2003	2,474,158	3.34%	80,000
2004	2,028,828	-18.00%	-445,330
2005	2,023,035	-0.29%	-5,793

Source: Annual reports of CBE

Table 3.15 shows that except for the years 2004 & 2005, the amount of provision put aside by the bank has been increasing in all the years. In the eleven years, the provision held by the bank has increased by 257%. The trend partly shows that the bank's NPL has been on the rise except for the two years cited above. Out of the years reviewed, for example, year 2003 registered the largest amount of provision and during the same year the ratio of NPLs has been 53%, the ever-highest rate. On the other hand, the increase in the provisions may also show the poor performance of the bank in its loan collection operations. Though it seems that things are changing for the better in the last two years, much remains to be done, as the provisions are still significant in amount.

3.9.2. Non-performing Loans

Though it has been declining in recent years, the NPLs ratio in CBE remains significant. Reports of the bank show that the bank's NPL ratio had been as high as 53% in the year 2003. This figure, however, went down to 35% in the following year (i.e. 2004). A recently obtained data from the annual performance report of the bank shows that as of June 2006 the ratio of NPLs has reached 22.5%. This, of course, is a significant achievement when compared to the high NPL ratios of the preceding years. However, a lot remains to be done to bring down the amount of the NPLs to an acceptable level, as it is still significant. These significant ratios of NPLs indicate, among other things, shortcomings in the credit risk management practice of the bank. When we see the ratio that was registered just before the 1997 financial crisis of the East Asian Countries, it was only 14%. Indeed, the Commercial Bank of Ethiopia has set a target to reduce the NPLs ratio to 15.6% by the end of June 2007. Alongside the effort to reduce the NPLs level, it is important for the bank to revamp the risk management practice, which would enable it, prevent loans turning to NPLs.

Table 3.16. NPLs ratio of the CBE

(In Percent)

Year	2006	2005	2004	2003
NPL Ratio	22.5%	28%	35%	53%

Source: Annual reports and CBE Newsletter

According to the guidelines issued by the National Bank of Ethiopia, when an account becomes non-performing interest is not recognized. Such interest is held in a memorandum account off the balance sheet. Available data shows that interest held in memorandum account in the last five years were significantly large showing the extent of the problem that the poor quality assets have posed. When compared to the amount in 2001, interest held in a memorandum account as of June 2005 has increased by 99%.

Table 3.17. Interest on NPLs and Advances

(In Birr)

Year	Amount	Growth Rate
2001	1,307,261,641	
2002	1,741,052,795	33%
2003	2,364,341,682	36%
2004	2,687,555,304	14%
2005	2,598,688,234	-3%

Source: CBE Annual Reports

Review of the financial statements of the bank reveals that in the last couple of years the amount of loans written off from the bank's balance sheet has been increasing dramatically. The amount of loans written off in the year 2000, for example, was Birr 24,760,459 and this figure has jumped to Birr 192,403,119 as of June 2002. In 2004, the written off loans reached Birr 656,813,930 showing 2553% increase when compared to the amount written off in year 2000. Writing off bad debts, of course, is one of the ways of improving the quality of a bank's asset and is not a practice to criticize. However, when a bank registers an ever-increasing stock of written off loans, it indicates the existence of some element of mismanagement of credit risk.

Summary of other problems and challenges raised by interviewees

Interviewees raised the following points as the major problems and challenges of the bank in managing its credit risk.

- Low level of employee's skill in identifying and measuring credit risk
- Absence of a uniform collateral valuation practice by all the banks in the country has created a difference in property appraisal methodology between the CBE and the privately owned banks. And collateral valuation by the private banks at relatively higher prices is making customers of the CBE dissatisfied with the practice.
- Many of the information received from customers are of less quality and are less dependable.
- Absence of adequate inputs from the economic research department of the bank in appraising customer requests.
- Tight policy environment and high tendency of the bank towards collateral based lending.
- Though CBE has a guideline for handling collateral valuation, the professionals in charge of appraising collateralizable assets do estimate the same property at significantly varying values. This is becoming another major source of disappointment for customers of the bank.
- Absence of credit concentration limits for geographic areas, credit products, and maturities (short, medium and long term loans)
- Shortage of manpower at the credit processing organs of the bank is affecting the quality of the credit risk analysis by way of putting burden on the officers and by making them not to do an indepth risk analysis.
- Absence of adequate periodic training on risk identification and measurement techniques.
- Low credit to the public because of the perception of high lending risk (due to information asymmetry).

CHAPTER IV

Summary, Conclusion and Recommendations

Summary

Among several products and services that banks are providing, credit services always rank on top towards generating the lion's share of profit, as lending is their primary activity. Credit has become the business of banking and the primary basis on which a bank's quality and performance are judged.

The effective management of credit risk is a critical component of a comprehensive approach to risk management and is essential to the long-term success of any bank. The study has shown that the Commercial Bank of Ethiopia (CBE) has passed through different economic systems that have directly influenced the credit deployment and management of the associated risks.

Under the socialist economic system, the primary function of the bank was to avail a significant amount of credit to customers (mostly government institutions) without being worried about credit quality and credit risk. The bank used to implement the instructions given by the government in extending credit to public enterprises. The change in the economic system from a command economy to free market economy has, however, indicated that CBE could not keep on granting credit without paying due attention to the quality of the loan it is granting and to the potential risk thereof.

Following the financial reform program, the increase in demand for credit particularly from the private sector coupled with the rapid growth in deposits made the bank to lend aggressively and take excessive risk. The study found out that such a move by the bank gradually led to the accumulation of huge non-performing loans. As a result, the bank's NPLs ratio as of June

2003 has been as high as 53%. In fact, the poor performance of the economy in the years preceding 2003 also had some contribution to this effect. These days, the NPLs of the bank have declined considerably when compared to the earlier years. Generally, however, performance indicators have shown the need to revamp the bank's risk management system so as to ensure the long term success of the bank.

Conclusion

The following are the major concluding remarks by the researcher:

- Excessive concentration of credit in certain economic sectors, geographic areas, credit products, maturities, individuals and groups may expose the bank to higher risks of loss. In this regard, the research has found out that the bank has set concentration limit to only economic sectors. In fact, the concentration limit to individuals and related parties, which has been communicated by the NBE to all banks (including CBE) some years back is still enforce. However, concentration levels to geographic areas, credit products and maturities are not developed to date though some of the officials of the bank have described that the bank is intending to do so.

- Credit officers, especially at the head office level, are usually made to handle loan requests of many customers and that they are expected to process them in a specified time limit. This practice is said to have affected the quality of the credit analysis as every officer is rushing to process all the requests in the specified period. While commending the bank's effort to provide fast service to its customers, respondents stressed that such efforts should be supported by the assignment of adequate manpower to the credit organs of the bank. The other equally important out come of the study is that employees have expressed that their skills to identify and measure credit risk is insufficient.

- Absence of a uniform nationwide practice of property valuation by banks has created a huge difference between the CBE and private banks in appraising collateralizable properties of credit applicants. This has brought for the CBE the risk of losing its customers as customers are said to have started leaving for the private banks because of the fact that the private banks are valuing properties at a relatively higher prices which in turn would enable customers to borrow larger amounts. The more serious problem with regard to property valuation in CBE is that different bank engineers are valuing the same property at significantly differing prices. These problems are becoming the major source of dissatisfaction for the credit customers of the bank.

- The sluggish pace of credit to the business community coupled with the ever-increasing deposit levels have made the bank to be too liquid. The bank's perception of a higher lending risk (due to information asymmetry) and its high dependence on physical collateral for deploying credit to those who need to borrow have important bearing on the low level of credit to the business community. In this regard, the economic research department of the bank is not providing adequate inputs to the credit-appraising department concerning the trends in the local and international markets where borrowers are engaged in. The economic research department is also said to be not furnishing important information on the global and national economic situations which have direct impact on the performance of borrowing firms.

Recommendations

Based on the foregoing major findings of the study, the researcher forwards the following recommendations:

- The bank has to develop appropriate concentration levels and a balanced portfolio of credits that are spread over all sectors to ensure well diversified and less risky portfolio which will not be affected by unique problems or happenings to any one of the geographic areas, credit products, and maturities.

- The bank has to seek ways of dealing with the collateral valuation problems. The bank could take the initiative to organize a nationwide organ which would prepare a procedure that will be used by all the banks in the country in estimating collateralizable properties of credit applicants. Moreover, the bank has to follow up and ensure the strict and uniform implementation by the bank engineers of the existing and any forthcoming procedures concerning property valuation.

- The bank need to organize periodic training sessions which would enable the credit personnel of the bank to improve their skills in the identification, measurement and control of credit risk. Moreover, helping employees to update their knowledge and skills in risk identification, measurement and control by making them know new development in the field would benefit the bank a lot.

- The CBE has to strengthen the various credit organs of the bank with adequate and qualified manpower as it will improve the credit risk management practice by lessening the burden of the limited number of officers in analyzing customer requests which in turn is affecting the quality of credit analysis.

- The information database of the bank has to be strengthened as information asymmetry has become one of the major factors for the sluggish credit deployment to the business community. In addition to the borrower specific information which is being gathered from the NBE and the credit applicant, the economic research department of the bank has to provide adequate and timely information on how the different sectors of the economy are performing and their future prospects. The department should also be made to deliver inputs to credit sanctioning organs regarding the performance of major international markets and their impact on local firms.

➔ I also recommend for future researchers to study the subject matter by widening its scope.

In general, management's credit philosophy determines how much risk the bank should take and in what form. In this regard, it is important for the bank to further strengthen the credit culture, which would encourage the management at various levels to maintain high quality asset. Such a strong credit culture could also make credit officers to concentrate on long-term performance and consider a wide range of possible outcomes of their recommendations or decisions. On the other hand, the bank has to invest more in its people, technology and system so as to register better performance in credit risk management. Finally, the protection against the risks of lending should consist maintaining high credit standards, appropriate diversification, intimate knowledge of the borrower's affairs, and of prime importance, alert collection procedures.

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Annex I

Interview Questions

Name____

Place of Work__________________________________

Position______________________________________

Service Years in the Bank______________________

Interview Date_________________________________

1. What are the major requirements that a borrower should fulfill to get a loan?
2. How reliable is the information that you receive from customers? Why?
3. Are you receiving inputs form the economic research unit which would enable you make an in-depth analysis of customer requests?
4. Do you think that employees in the credit department are well equipped with the necessary skills to identify and measure credit risk? Why?
5. What are the issues that you include in analyzing and appraising loan requests?
6. Which areas do you give special emphasis in undertaking credit analysis?
7. Are your customers satisfied with the amount of loan the bank is approving to them? Why?
8. How often do borrowers get the full amount of loans that they have applied for? Why?
9. What are your customers' views on the requirements to get a loan?
10. How do you rate the bank's reliance on collateral in extending credit to the business community?
11. Are your customers satisfied with the property valuation practice of the bank? Why?

12. Has the bank established credit concentration levels for economic sectors, geographic areas, credit products, maturities, individuals and related parties?

13. Do you think that failure to develop credit concentration levels to all sectors would endanger the bank? Why?

14. Why do you think is the bank so reluctant to lend out the excessively liquid deposit at its disposal?

15. Is the bank charging the same interest rate for all loans despite the degree of risk that each loan carries? Why?

16. Who makes the follow up of loans after they are disbursed?

17. Are you satisfied with the post disbursement follow up of the bank? Why?

18. What do you think are the major problems and challenges of the credit risk management practices of the bank?

19. What are your suggestions to improve the credit risk management practice of the bank?

Annex 2. Number and Investment Capital of Domestic & Foreign Projects Approved by Sectors

Sector/Sub-sector	1987(1994/95)		1988(1995/96)		1989(1996/97)		1990(1997/98)		1991(1998/99)		1992(1999/00)		1993(2000/01)		1994(2001/02		1995(2002/03)		1996(2003/04)		1997(2004/05)	
	No. of Proj.	Investment Capital	No. of Proj.	Investment Capital	No. of Proj.	Investment Capital	No. of Proj.	Investment Capital	No. of Proj.	Investment Capital	No. of Proj.	Investment Capital	No. of Proj.	Investment Capital	No. of Proj.	Investment Capital	No. of Proj.	Investment Capital	No. of Proj.	Investment Capital	No. of Proj.	Investment Capital
Industry	251	1,757.25	323	2,319.90	376	1,935.26	471	4,193.68	372	2,307.37	240	2,611.04	259	3,539.84	206	1,824.59	361	3,525.96	822	8,507.18	919	10,520.01
Agriculture	49	100.74	374	1,016.80	179	2,373.32	140	551.26	97	485.57	103	568.27	77	569.58	68	613.62	96	1,401.90	254	4,142.39	463	7,657.15
Real Estate Development	33	190.10	32	1,072.83	36	575.28	49	2,540.88	40	474.08	40	2,600.93	24	1,208.63	23	113.50	45	364.89	100	947.47	167	4,125.83
Hotel and Tourism	59	510.17	82	217.15	55	204.90	22	172.28	24	141.39	27	128.25	9	32.51	8	42.34	24	120.51	134	800.68	269	1,593.84
Education Service	6.00	46.64	15.00	72.78	31.00	176.35	54.00	573.75	29.00	254.38	33.00	626.83	42	303.98	70	1,190.70	114	1,519.92	182	862.60	175	1,076.56
Health Service	8	28.57	14	249.77	26	225.03	42	478.70	33	227.91	27	149.43	34	244.44	23	156.56	34	1,264.48	60	483.67	46	1,277.79
Construction	21	943.34	26	1,336.26	35	833.63	50	948.42	36	806.17	49	812.33	62	934.21	110	1,674.60	129	1,087.00	138	1,379.10	150	2,084.08
Trade	13	34.62	25	69.49	18	33.49	31	151.51	29	242.06	25	184.23	32	374.27	14	191.71	9	33.73	41	400.40	68	377.30
Transport and Storage Service	3	873.35	4	53.85	12	147.22	3	15.10	10	29.16	12	53.69	11	13.23	2	1.32	3	566.43	7	23.86	20	48.64
Mining and Quarrying	8	160.21	6	41.30	2	14.03	6	70.44	12	76.19	8	84.03	3	10.13	3	14.62	6	27.94	9	71.73	1	38.59
Electricity Generation	1	101.00			1	1.71	2	9.08	2	1.30			1	77.17	5	1,550.96	7	822.48	7	881.51	10	633.26
Construction Machinery Leasing																	360	2,601.32	384	2,320.79	512	6,060.93
Other Busiensses	12	29.30	6	34.50	23	194.40	27	220.06	20	99.23	51	548.17	125	1,215.15	269	1,815.77	29	101.33	87	398.51	72	972.67
Grand Total	**464**	**4,775**	**907**	**6,485**	**794**	**6,715**	**897**	**9,925**	**704**	**5,145**	**615**	**8,367**	**679**	**8,523**	**801**	**9,190**	**1,217**	**13,438**	**2,225**	**21,220**	**2,872**	**36,467**

Source: Ethiopian Investment Authority

*Projects with initial investment capital below Birr 250,000 are not included.

Annex 3. Number and Investment Capital of Domestic & Foreign Investment Projects which have commenced

(Investment Capital in Million of Birr)

Sector/Sub-sector	1987(1994/95)		1988(1995/96)		1989(1996/97)		1990(1997/98)		1991(1998/99)		1992(1999/00)		1993(2000/01)		1994(2001/02		1995(2002/03)		1996(2003/04)		1997(2004/05)	
	No. of Proj.	Investment Capital	No. of Proj.	Investment Capital	No. of Proj.	Investment Capital	No. of Proj.	Investment Capital	No. of Proj.	Investment Capital	No. of Proj.	Investment Capital	No. of Proj.	Investment Capital	No. of Proj.	Investment Capital	No. of Proj.	Investment Capital	No. of Proj.	Investment Capital	No. of Proj.	Investment Capital
Industry	63	177.46	92	218.31	97	340.21	195	978.10	216	681.76	183	2,382.62	33	348.00	114	457.00	19	78.83	79	970.97	61	1,167.64
Agriculture	156	452.50	185	365.34	86	1,415.31	31	79.51	53	107.39	94	397.10	3	3.00	15	44.00	6	45.35	46	863.69	33	277.08
Real Estate Development			1	0.50	6	13.89	6	21.48	2	6.21	3	5.92	1	5.00	6	985.27			36	150.62	1	3.16
Hotel and Tourism	3	2.88	12	32.90	22	31.00	21	1,243.06	17	56.38	20	39.60	1	5.00	12	46.94			21	72.31	5	4.99
Education Service					1.00	0.28	7.00	26.18	5.00	18.95	5.00	247.01	5	11.00	14	99.00	14	774.65	27	98.68	16	88.52
Health Service			3	17.26	2	25.55	4	8.42	3	19.13	6	6.16	3	14.00	7	50.00	4	7.81	1	0.91	2	7.55
Construction	2	46.51	5	197.87	8	479.67	11	418.78	4	175.65	6	111.29	3	35.00			1	0.69	8	518.45	6	345.98
Trade	1	0.30	6	15.31	3	4.79	7	21.41	8	48.22	4	11.44	4	36.00	5	22.00			11	168.02	3	3.91
Transport and Storage Service	1	833.00			1	1.18	2	41.33	1	1.31	1	3.46	3	5.00	1	2.84					0	-
Mining and Quarrying	2	135.06	3	12.56							3	8.88	1	11.00							1	0.15
Electricity Generation																						
Construction Machinery Leasing																	5	28.06			65	177.82
Other Busiensses	1	1.03	2	1.19	3	80.19	2	4.23	2	4.25	2	2.95	5	9.00	3	4.00			12	9.70	9	5.69
Grand Total	**229**	**1,649**	**309**	**861**	**229**	**2,392**	**286**	**2,843**	**311**	**1,119**	**327**	**3,216**	**62**	**482**	**177**	**1,711**	**49**	**935**	**241**	**2,853**	**202**	**2,082**

Source: Ethiopian Investment Authority

*Projects with initial investment capital below Birr 250,000 are not included.

Annex 4. Data of Loans and Advnaces of the Ethiopian Banking Industry

1. Loans and Advances by Lender banks (In Million of Birr)													
Bank	1999/00	2000/01			2001/02			2002/03			2003/04		
	O/B	Disb.	Collected	O/B	Disb.	Collected	O/B	Disb.	Collected	O/B	Disb.	Collcted	O/S
CBE	12,774.80	2,184.20	2,656.50	17,184.80	1,600.60	2,193.40	17,856.40	1,636.10	2,312.60	18,399.70	2,285.40	2,336.10	20,978.
DBE	4,021.40	348.90	424.90	4,264.80	128.10	267.00	4,441.20	56.70	291.20	4,543.10	290.30	223.20	3,529.
CBB	803.10	18.00	145.20	796.10	39.60	121.00	760.10	68.80	117.60	731.30	100.80	98.60	741.
Total (A)	**17,599.30**	**2,551.10**	**3,226.60**	**22,245.70**	**1,768.30**	**2,581.40**	**23,057.70**	**1,761.60**	**2,721.40**	**23,674.10**	**2,676.50**	**2,657.90**	**25,248.**
Market Share	89.70%	64.90%	76.20%	89.10%	55.90%	68.20%	87.20%	43.00%	59.80%	83.40%	43.10%	50.80%	79.9
AIB	596.70	368.40	302.50	615.60	328.50	306.80	775.40	432.20	343.70	116.10	654.40	561.40	1,283.
DBE	552.60	431.80	295.30	723.50	373.40	305.00	1,012.10	660.60	421.50	1,378.30	940.80	557.70	1,979.
BOA	507.40	270.50	129.20	687.30	159.60	135.50	672.10	203.50	215.00	788.50	215.50	229.50	1,121.
WB	283.30	210.70	196.60	363.70	306.70	248.80	402.40	604.60	531.40	570.90	1,187.40	718.50	737.
UB	81.70	97.10	83.50	130.60	92.00	84.30	188.30	200.30	154.90	290.50	218.00	245.50	360.
NIB	n.a	n.a	n.a	210.30	137.10	124.60	324.10	235.10	164.80	580.60	319.00	262.10	866.
Total (B)	**2,021.70**	**1,378.50**	**1,007.10**	**2,731.00**	**1,397.30**	**1,205.00**	**3,374.40**	**2,336.30**	**1,831.30**	**3,724.90**	**3,535.10**	**2,574.70**	**6,348.**
Market Share	10.30%	35.10%	23.80%	10.90%	44.10%	31.80%	12.80%	57.00%	40.20%	16.60%	56.90%	49.20%	20.1
Total (A+B)	**19,621.00**	**3,929.60**	**4,233.70**	**24,976.70**	**3,165.60**	**3,786.40**	**26,432.10**	**4,097.90**	**4,552.70**	**27,399.00**	**6,211.60**	**5,232.60**	**31,597.**
2. Loans and Advances by Economic Sector (In Million of Birr)													
Eco. Sector													
Agriculture	1,431.60	650.50	724.50	1,452.30	588.90	639.80	1,554.90	445.20	552.80	1,510.00	583.00	572.40	1,162.
Industry	2,224.60	533.10	392.00	2,673.50	353.50	415.70	2,835.30	508.10	430.50	3,069.90	729.00	508.20	4,207.
Trade	5,484.10	1,967.50	1,795.40	5,407.10	1,706.50	1,681.10	4,891.40	2,188.80	2,171.60	4,507.00	3,119.40	2,826.40	5,589.
Housing & Con.	1,640.70	183.90	279.50	1,756.70	52.40	92.90	458.20	392.30	428.70	1,954.30	32.90	86.30	322.
Gov't Deficit Fin.	2,865.80			7,031.80			8,513.30			10,577.60			13,847.
Others	6,033.40	594.50	1,042.40	6,655.30	464.70	956.90	8,179.70	563.50	969.20	6,780.80	1,740.20	1,239.10	6,468.
Total	**19,680.20**	**3,929.50**	**4,233.80**	**24,976.70**	**3,166.00**	**3,786.40**	**26,432.80**	**4,097.90**	**4,552.80**	**28,399.60**	**6,204.50**	**5,232.40**	**31,597.**
3. Loans and Advances by Borroer (In Millions of Birr)													
Borrower													
Central Gov't	2,865.80	n.a	n.a	7,031.80			8,513.30			10,577.60			13,847.
Pub. Enterprises	1,771.40	n.a	n.a	1,560.60	42.90	215.90	1,820.90	223.40	176.50	1,364.20	748.40	409.60	2,227.
Inter-bank	676.90	n.a	n.a	564.30			517.70		85.30	456.60		38.40	414.
Cooperatives	788.40	n.a	n.a	722.10	476.40	555.60	757.90	307.60	382.50	738.50	466.30	484.60	513.
Private Indus.	13577.50	n.a	n.a	15097.80	2646.30	3015.20	14822.20	3566.90	3908.50	15262.30	4997.10	4299.90	14595.
Total	**19,680.00**	**-**	**-**	**24,976.60**	**3,165.60**	**3,786.70**	**26,432.00**	**4,097.90**	**4,552.80**	**28,399.20**	**6,211.80**	**5,232.50**	**31,597.7**

Source: *Annual & Quarterly Reports of NBE with slight modification and additional calculations.*

Note:

1. Disbursements and collections do not include overdraft facilities a7 government borrowings
2. O/B (Outstanding Balance) of the year 1999/00 by economic sector do not include inter-bank lending
3. Loans and advances for other economic include loans to Hotel & Turism, Mines & Water resources, individuals, etc

Annex 5. SECTORIAL BREAKDOWN OF OUTSTANDING BALANCES OF LOANS AND ADVANCES

('000 Birr)

Year	Agri-cultrue	Manufa-cturing	Domestic Trade & Service					Foreign Trade			Building & Const.	Personal & ESL	Financial Inst.	Co-Fin. Of Projects	I.F.A.D.	Total Loans & Advances	Growth Rates (%)
			Domestic Trade	Tranpsort	Hotel & Tourism	Other Services	Total	Export	Import	Total							
1981 June	46,856	128,981	146,348	67,227	6,098		219,673	91,239	376,957	468,196	95,679	12,150	24088			995,623	
1982 June	44,081	147,220	158,722	69,204	5,592	7,149	240,667	122,815	352,014	474,829	114,439	10,262	24816			1,056,314	6.1
1983 June	44,868	122,375	181,324	81,791	5,481	6,662	275,258	172,094	218,136	390,230	130,324	9,678	22083			994,816	-5.8
1984 June	45,352	113,657	151,013	79,331	9,994	9,084	249,422	160,588	212,892	373,480	151,182	9,131	21200			963,424	-3.2
1985 June	45,352	108,656	75,029	83,092	8,443	13,574	180,138	170,175	219,393	389,568	152,343	10,930	20,317			907,304	-5.8
1986 June	45,212	102,676	134,650	75,175	11,593	16,708	238,126	210,470	131,325	341,795	163,635	10,139	19,433			921,016	1.5
1987 June	68,550	126,119	180,105	75,957	13,217	17,628	286,907	148,912	249,787	398,699	157,517	10,623	18,550			1,066,965	15.8
1988 June	71,565	164,017	247,382	117,860	11,008	14,544	390,794	156,694	329,264	485,958	178,787	11,062	17,667			1,319,850	23.7
1989 June	58,910	211,083	172,529	85,530	10,745	11,704	280,508	235,436	278,384	513,820	186,665	10,863	16,783	7,381		1,286,013	-2.6
1990 June	49,502	189,137	158,401	68,510	11,244	14,194	252,349	173,737	296,104	469,841	195,474	12,621	14,133	8,934		1,191,991	14.8
1991 June	49,635	198,394	136,577	66,549	13,891	14,810	231,827	211,641	184,063	395,704	202,844	13,104	15,017	10,131		1,116,656	-6.4
1992 June	43,637	234,308	183,714	66,030	17,509	9,467	276,720	296,716	199,084	495,800	195,427	12,621	14,133	8,934		1,281,580	14.8
1993 June	43,380	548,800	429,832	134,189	44,633	12,190	620,844	412,968	540,363	953,331	207,805	17,346	96,250	14,316		2,502,072	95.2
1994 June	75,814	496,214	783,607	227,469	73,300	25,239	1,109,615	567,071	490,573	1,057,644	226,877	13,134	95,367	32,607		3,107,272	24.2
1995 June	162,835	451,065	1,245,732	493,153	175,592	243,097	2,157,574	729,488	821,994	1,551,482	306,399	12,833	179,483	55,571		4,877,242	57
1996 June	210,526	578,202	1,728,305	851,902	158,786	275,396	3,014,389	943,745	1,085,672	2,029,417	350,618	14,737	527,600	93,987	2,628	6,822,104	39.9
1997 June	326,804	711,878	1,939,000	948,202	190,216	319,106	3,396,524	929,983	1,443,418	2,373,401	428,411	15,807	540,876	148,242	6,111	7,948,054	16.5
1998 June	345,630	790,576	1,920,401	874,074	202,655	461,983	3,459,113	992,353	1,665,087	2,657,440	419,305	17,732	496,672	597,288	6,636	8,790,392	10.6
1999 June	439,443	891,104	1,767,336	658,674	170,111	608,393	3,204,514	1,166,725	1,735,107	2,901,832	639,595	19,105	554,803	871,710	7,739	9,529,845	8.4
2000 June	467,360	900,360	1,999,050	940,877	168,755	439,907	3,548,589	1,019,028	1,803,904	2,822,932	680,963	20,080	676,906	973,357	8,429	10,098,976	6
2001 June	454,724	1,036,013	1,869,262	837,768	190,209	563,382	3,460,621	1,066,785	1,718,668	2,785,453	912,066	22,566	564,322	1,039,858	7,918	10,283,541	1.8
2002 June	549,168	1,074,857	1,622,236	669,502	235,188	474,474	3,001,400	1,000,994	1,757,062	2,758,056	729,119	24,316	517,656	1,032,989	8,213	9,695,774	-5.7
2003 June	482,931	1,092,721	1,394,934	508,318	158,662	540,449	2,602,363	730,521	1,193,000	1,923,521	733,830	31,100	456,550	1,031,309	6,677	8,361,002	-13.8
2004 June	476,285	1,103,792	1,488,425	565,170	136,295	870,734	3,060,624	771,696	1,570,682	2,342,387	688,490	43,379	414,151	453	5,407	8,134,968	-2.7
2005 June	1,023,242	1,233,263	1,506,829	583,035	125,190	1,281,513	3,496,567	870,078	2,001,692	2,871,770	547,262	44,130	340,188			9,556,422	17.5
2006 June	1,586,404	1,329,593	1,382,627	592,035	105,050	1,084,411	3,164,123	471,740	1,972,334	2,444,074	449,173	47,153	274,939			9,295,459	-2.7
% Share-1			43.7	18.7	3.3	34.3	100.0	19.3	80.7	100.0							
% Share-2	17.1	14.3					34.0			26.3	4.8	0.5	3.0	-	-	100	Yearly Av.Gr. Rate= 11.9

Source: CBE Statistical Service

Annex 6. OUTSTANDING BLANCES OF TERM LOANS & OVERDRAFT LOANS

Year	Term Loan (Incl. Mdse & ALD)					Overdraft (Incl. Advances)					Grand Total	Growth Rates, (%) (for Grand Total)
	Private & Indv.	Pub. Ent. & Age	Co-operatives	Total	Gr. Rates, (%) (Total T/Ls & Mdse)	Private & Ind.	Pub. Ent. & Age.	Co-operatives	Total	Gr. Rates, (%) (Total O/D & Adv.)		
1981 June	238,926	383,927	2,689	**625,542**		127,508	241,797	776	**370,081**		**995,623**	
1982 June	243,667	406,325	2,096	**652,088**	4.2	145,210	257,748	1,258	**404,216**	9.2	**1,056,304**	6.1
1983 June	297,670	286,340	3,062	**587,072**	(10.0)	94,574	311,814	1,356	**407,744**	0.9	**994,816**	(5.8)
1984 June	315,192	246,872	3,362	**565,426**	(3.7)	55,174	342,824		**397,998**	(2.4)	**963,424**	(3.2)
1985 June	311,675	193,458	2,032	**507,165**	(10.3)	49,635	350,352	152	**400,139**	0.5	**907,304**	(5.8)
1986 June	295,127	198,079	2,751	**495,957**	(2.2)	57,305	367,754		**425,059**	6.2	**921,016**	1.5
1987 June	301,376	244,875	28,275	**574,526**	15.8	80,262	410,637	1,540	**492,439**	15.9	**1,066,965**	15.8
1988 June	346,313	241,875	20,210	**608,398**	5.9	106,235	604,714	503	**711,452**	44.5	**1,319,850**	23.7
1989 June	305,211	272,407	18,817	**596,435**	(2.0)	60,962	625,343	3,273	**689,578**	(3.1)	**1,286,013**	(2.6)
1990 June	301,201	238,449	10,477	**550,127**	(7.8)	66,755	573,670	2,292	**642,717**	(6.8)	**1,192,844**	(7.2)
1991 June	324,104	220,687	9,507	**554,298**	0.8	57,833	504,292	233	**562,358**	(12.5)	**1,116,656**	(6.4)
1992 June	339,010	227,279	22,240	**588,529**	6.2	62,394	630,657		**693,051**	23.2	**1,281,580**	14.8
1993 June	688,284	695,114	28,062	**1,411,460**	139.8	288,121	797,488	5,003	**1,090,612**	57.4	**2,502,072**	95.2
1994 June	1,026,720	458,245	64,670	**1,549,635**	9.8	398,308	1,158,345	984	**1,557,637**	42.8	**3,107,272**	24.2
1995 June	1,972,064	356,263	107,584	**2,435,911**	57.2	1,023,823	1,417,347	161	**2,441,331**	56.7	**4,877,242**	57.0
1996 June	3,017,727	984,490	98,408	**4,100,625**	68.3	1,821,784	891,130	8,565	**2,721,479**	11.5	**6,822,104**	39.9
1997 June	3,622,183	914,941	119,333	**4,656,457**	13.6	2,090,031	1,198,619	2,944	**3,291,594**	20.9	**7,948,051**	16.5
1998 June	4,047,562	887,339	111,391	**5,046,292**	8.2	2,655,056	1,086,079	2,964	**3,744,099**	13.7	**8,790,391**	10.6
1999 June	4,267,276	881,747	314,247	**5,463,270**	8.3	3,200,333	863,875	2,368	**4,066,576**	8.6	**9,529,846**	8.4
2000 June	4,872,957	1,079,740	298,541	**6,251,238**	14.4	2,900,462	947,278		**3,847,740**	(5.4)	**10,098,978**	6.0
2001 June	5,213,793	789,215	256,292	**6,259,300**	0.1	3,079,573	944,668		**4,024,241**	4.6	**10,283,541**	1.8
2002 June	4,893,453	1,031,533	298,416	**6,223,402**	(0.6)	2,536,760	935,610		**3,472,370**	(13.7)	**9,695,772**	(5.7)
2003 June	4,946,816	894,530	283,891	**6,125,237**	(1.6)	1,687,226	548,538		**2,235,764**	(35.6)	**8,361,001**	(13.8)
2004 June	3,907,952	1,758,822	323,641	**5,990,415**	(2.2)	1,482,231	662,087	225	**2,144,543**	(4.1)	**8,134,958**	(2.7)
2005 June	3,817,839	2,572,243	899,274	**7,289,356**	21.7	1,530,949	736,117		**2,267,066**	5.7	**9,556,422**	17.5
2006 June	3,771,720	2,105,767	1,444,967	**7,322,454**	0.5	1,158,858	814,240		**1,973,098**	(13.0)	**9,295,552**	(2.7)
% Share-1	51.5	28.8	19.7	**100.0**		58.7	41.3		**100.0**			
% Share-2				**78.8**	Yearly Av.Gr.Rate= 13.9				**21.2**	Yearly Av.Gr.Rate=10.0	**100.0**	Yearly Av.Gr.Rate=11.9

Source: CBE Statistical Service

Annex 7. TERM LOAN DISBURSMENT & COLLECTION BY BENEFICIARY

('000 Birr)

Year	DISBURSED					COLLECTED				
	Private	Public	Co-operatives	Total	Gr. Rates (%)	Private	Public	Co-operatives	Total	Gr. Rates, (%)
1981/82	244,144	457,487	3,822	**705,453**		239,403	435,089	4,415	**678,907**	
1982/83	432,385	901,315	6,638	**1,340,338**	90.0	378,382	1,021,300	5,672	**1,405,354**	107.0
1983/84	293,387	458,027	7,169	**758,583**	(43.4)	275,865	497,495	6,869	**780,229**	(44.5)
1984/85	216,154	183,969	4,280	**404,403**	(46.7)	219,671	237,383	5,610	**462,664**	(40.7)
1985/86	203,057	152,441	5,491	**360,989**	(10.7)	219,605	147,820	4,772	**372,197**	(19.6)
1986/87	164,445	211,631	35,260	**411,336**	13.9	158,196	164,835	9,736	**332,767**	(10.6)
1987/88	196,980	182,911	58,758	**438,649**	6.6	152,043	185,912	66,823	**404,778**	21.6
1988/89	168,832	210,007	53,630	**432,469**	(3.5)	162,731	217,678	55,023	**435,432**	7.6
1989/90	178,930	130,771	28,174	**337,875**	(20.2)	182,940	164,729	36,514	**384,183**	(11.8)
1990/91	193,676	107,546	38,774	**339,996**	0.6	170,773	125,308	39,744	**335,825**	(12.6)
1991/92	222,285	117,133	24,852	**364,270**	7.1	207,379	110,541	12,119	**330,039**	(1.7)
1992/93	676,943	628,060	55,061	**1,360,064**	273.4	327,669	160,205	49,239	**537,113**	62.7
1993/94	1,094,823	206,241	72,550	**1,373,614**	1.0	856,387	443,110	35,942	**1,335,439**	148.6
1994/95	2,443,383	200,652	282,203	**2,926,238**	113.0	1,517,067	283,506	239,389	**2,039,962**	52.8
1995/96	2,552,377	639,310	231,474	**3,423,161**	11.0	1,928,102	275,053	279,899	**2,483,054**	21.7
1996/97	2,350,407	210,303	232,155	**2,792,865**	(18.4)	2,174,252	241,595	243,974	**2,659,821**	7.1
1997/98	1,873,954	125,894	300,500	**2,300,348**	(17.6)	1,799,014	151,161	262,585	**2,212,760**	(16.8)
1998/99	1,950,139	222,793	590,797	**2,763,729**	20.1	1,703,017	273,719	549,615	**2,526,351**	14.2
1999/00	2,067,019	236,146	626,206	**2,929,371**	6.0	1,661,654	267,071	536,266	**2,464,991**	(2.4)
2000/01	1,696,203	135,507	408,302	**2,240,012**	(23.5)	1,530,506	382,536	742,053	**2,655,095**	7.7
2001/02	1,069,519	139,080	457,223	**1,665,822**	(25.6)	1,484,049	160,051	461,945	**2,106,045**	(20.7)
2002/03	1,129,269	170,395	314,467	**1,614,131**	(3.1)	1,709,410	216,677	320,569	**2,246,656**	6.7
2003/04	1,085,880	1,093,137	400,438	**2,579,455**	59.8	1,455,980	396,248	425,392	**2,277,620**	1.4
2004/05	1,508,071	1,312,690	1,151,437	**3,972,198**	54.0	1,877,036	643,186	586,512	**3,106,734**	36.4
2005/06	2,124,616	307,370	1,683,949	**4,115,935**	3.6	2,175,964	894,965	1,304,896	**4,375,825**	40.8
									-	
% Share-1	66.5	21.0	12.5	**100.0**		65.2	20.8	14	**100.0**	

Source: CBE Statistical Service

Annex 8. TERM LOAN DISBURSEMENT BY ECONOMIC SECTOR

('000 Birr)

Year	Africulture (Incl. IFAD)	Manu-facturing	Domestic Trade & Services					Foreign Trade			Building & Const.	Personal	Fin. Institu.	Co-Fin.	Total
			Domestic Trade	Transport	Hotel & Tourism	Other Services	Total	Export	Import	Total					
1980/81	62,461	65,375	109,849	20,748	7,205		**137,802**	122,929	324,539	**447,468**	25,070	7,818	238		**33,126**
1981/82	39,752	74,500	121,184	36,645	3,714	8,244	**169,787**	57,465	335,218	**392,683**	18,309	9,414	1,008		**28,731**
1982/83	28,150	70,667	236,397	53,915	6,412	7,249	**303,973**	81,425	771,148	**852,573**	73,784	10,000	1,191		**84,975**
1983/84	30,187	69,024	109,528	46,639	9,733	7,034	**172,934**	89,291	375,396	**464,687**	11,688	10,063			**21,751**
1984/85	12,130	67,883	81,142	49,144	6,969	2,697	**139,952**	77,751	80,500	**158,251**	14,570	11,617			**26,187**
1985/86	14,843	55,964	129,926	28,998	10,220	5,488	**174,632**	76,743	16,108	**92,851**	9,481	13,218			**22,699**
1986/87	33,505	40,303	101,641	38,494	17,810	5,942	**163,887**	49,495	104,457	**153,952**	11,491	8,198			**19,689**
1987/88	53,313	46,235	93,559	63,408	7,231	2,760	**166,958**	59,775	72,261	**132,036**	27,685	12,422			**40,107**
1988/89	34,573	77,327	121,574	15,201	11,739	7,024	**155,538**	71,865	57,096	**128,961**	12,701	6,988		7,381	**27,070**
1989/90	8,296	66,261	110,562	17,200	12,745	8,743	**149,250**	57,667	25,586	**83,253**	14,036	14,112		2,667	**30,815**
1990/91	5,570	46,447	145,818	26,114	14,999	8,611	**195,542**	46,279	20,858	**67,137**	4,617	20,600		83	**25,300**
1991/92	1,969	79,680	148,929	18,073	20,969	11,402	**199,373**	27,624	10,821	**38,445**	33,675	11,128			**44,803**
1992/93	7,495	392,431	381,810	94,262	56,887	24,939	**557,898**	127,361	145,954	**273,315**	16,754	22,966	83,000	6,205	**128,925**
1993/94	62,898	194,255	641,193	166,343	91,342	49,576	**948,454**	49,320	62,183	**111,503**	13,203	24,491		18,810	**56,504**
1994/95	298,797	137,146	1,242,749	360,502	196,919	274,748	**2,074,918**	111,238	144,464	**255,702**	19,038	32,209	85,000	23,428	**159,675**
1995/96	317,489	292,546	1,344,174	399,916	123,748	100,223	**1,968,061**	261,400	276,924	**538,324**	29,853	35,259	182,000	59,629	**306,741**
1996/97	325,128	161,084	1,161,419	268,074	111,807	127,987	**1,669,287**	196,649	270,142	**466,791**	22,930	33,982	60,000	53,663	**170,575**
1997/98	341,226	135,335	797,684	99,993	74,051	84,885	**1,056,613**	108,397	221,027	**329,424**	39,732	32,404		365,614	**437,750**
1998/99	554,006	249,793	593,816	38,501	63,145	131,279	**826,741**	343,523	152,593	**496,116**	260,783	39,530	100,002	236,757	**637,072**
1999/00	517,320	295,330	772,782	50,105	82,176	170,845	**1,075,908**	438,937	178,448	**617,385**	80,263	32,605	200,000	110,560	**423,428**
2000/01	522,221	284,109	574,829	38,144	76,137	41,656	**730,766**	271,851	248,407	**520,258**	77,190	25,974		79,494	**182,658**
2001/02	508,642	142,644	352,263	26,177	33,369	23,390	**435,199**	168,586	351,108	**519,694**	33,185	26,457			**59,642**
2002/03	346,740	273,294	337,318	17,659	24,948	214,487	**594,412**	121,222	111,038	**232,260**	127,443	39,982			**167,425**
2003/04	447,046	189,809	368,017	220,296	17,121	525,044	**1,130,478**	196,106	517,915	**714,021**	42,327	55,775			**98,102**
2004/05	1,140,038	227,631	533,162	125,506	21,628	538,114	**1,218,410**	311,860	999,194	**1,311,054**	32,680	42,386			**75,066**
2005/06		**1,567,633**	**340,642**	**703,918**	**134,328**	**31,399**	**51,911**		**348,899**	**847,430**		**43,587**	**46,189**		**89,776**
% Share-1			**76.4**	**14.6**	**3.4**	6	**100.0**	**29.2**	**71**	**100.0**					
% Share-2	**38.1**	**8.3**					**22.4**			**29.1**	**1.1**	**1.1**			**100**

Source: CBE Statistical Service

Annex 9. TERM LOAN COLLECTION BY ECONOMIC SECTOR

('000 Birr)

Year	Africulture (Incl. IFAD)	Manu-facturing	Domestic Trade & Services					Foreign Trade			Building & Const.	Personal	Fin. Institu.	Co-Fin.	Total
			Domestic Trade	Transport	Hotel & Tourism	Other Services	Total	Export	Import	Total					
1980/81	61,739	91,776	131,110	45,972	9,080		**186,162**	151,405	273,368	**424,773**	24,860	12,865	883		**803,05**
1981/82	42,495	66,056	113,896	28,111	3,669	5,387	**151,063**	59,730	334,637	**394,367**	13,344	11,302	280		**678,90**
1982/83	27,142	88,679	214,604	54,931	6,589	7,491	**283,615**	77,910	894,401	**972,311**	19,099	10,584	3 924		**1,405,35**
1983/84	34,020	83,420	133,908	31,438	7,326	7,487	**180,159**	89,132	371,041	**460,173**	10,964	10,610	883		**780,22**
1984/85	7,778	57,264	106,671	44,552	8,504	2,543	**162,270**	69,480	142,821	**212,301**	12,350	9,818	884		**462,66**
1985/86	15,016	47,228	98,558	36,103	17,455	3,433	**155,549**	64,722	36,978	**101,700**	9,142	7,714	883		**337,23**
1986/87	10,551	47,228	98,558	36,103	17,455	3,433	**155,549**	64,722	36,978	**101,700**	18,323	11,983	883		**346,21**
1987/88	62,305	43,903	85,678	20,150	7,919	4,241	**117,988**	49,067	100,325	**149,392**	18,323	11,983	883		**404,77**
1988/89	39,499	43,170	146,986	45,842	8,630	5,625	**207,083**	53,515	71,402	**124,917**	12,692	7,187	884		**435,43**
1989/90	20,952	66,558	106,101	36,979	11,843	6,879	**161,802**	76,737	31,117	**107,854**	11,752	14,382	883		**384,18**
1990/91	4,978	59,247	132,349	26,537	12,643	7,679	**179,208**	27,900	39,589	**67,489**	5,931	18,089	883		**335,82**
1991/92	4,833	43,369	131,780	25,832	17,341	15,276	**190,229**	36,362	14,152	**50,514**	27,402	11,611	884	1,197	**328,84**
1992/93	3,464	133,168	216,963	24,390	30,934	19,337	**291,624**	46,854	33,745	**80,599**	8,331	18,241	883	823	**536,31**
1993/94	31,944	355,825	522,845	68,146	64,605	48,974	**704,570**	126,076	67,767	**193,843**	19,152	28,703	883	519	**1,334,92**
1994/95	214,142	254,814	974,116	98,394	101,416	93,659	**1,267,585**	89,545	166,108	**255,653**	13,910	32,510	884	464	**2,039,49**
1995/96	295,384	220,893	999,035	201,698	166,809	116,690	**1,484,232**	203,265	230,515	**433,780**	14,358	32,751		1,656	**2,481,39**
1996/97	259,569	184,659	1,132,754	258,480	101,886	164,287	**1,657,407**	176,779	275,279	**452,058**	22,135	32,462	50,669	863	**2,658,95**
1997/98	281,971	152,283	810,902	253,235	83,934	127,080	**1,275,151**	155,042	246,488	**401,530**	27,288	31,572	40,819	2,246	**2,210,61**
1998/99	385,608	172,041	777,341	364,983	85,599	60,784	**1,288,707**	355,902	192,335	**548,237**	35,450	40,969	33,503	21,835	**2,504,51**
1999/00	520,909	328,329	562,292	264,012	61,919	43,969	**932,192**	247,579	169,205	**416,784**	80,925	30,225	116,519	39,109	**2,425,88**
2000/01	580,248	167,432	567,362	316,012	73,604	52,266	**1,009,244**	345,717	237,404	**583,121**	62,556	24,024	146,138	82,333	**2,572,76**
2001/02	456,011	192,029	519,558	223,754	57,000	35,361	**835,673**	207,832	211,790	**419,622**	95,089	24,549	55,484	27,587	**2,078,45**
2002/03	461,754	208,063	470,173	191,332	40,860	34,130	**736,495**	222,370	261,358	**483,728**	123,044	31,860	118,310	83,402	**2,163,25**
2003/04	466,029	151,299	420,944	185,049	38,085	57,413	**701,491**	182,578	503,279	**685,857**	77,461	44,486	62,531	88,466	**2,189,15**
2004/05	676,970	204,579	559,114	147,060	78,906	163,807	**948,887**	539,310	475,115	**1,014,425**	123,630	43,938	93,355	459	**3,106,28**
2005/06	961,903	330,047	579,557	153,067	26,650	316,183	1,075,457	621,494	1,027,272	1,648,766	234,348	45,323	79,980		4,375,82
% Share-1			53.9	14.2	2.5	29	100.0	37.7	62	100.0					
% Share-2	22	7.5					24.6			37.7	5.4	1	1.8		10

Source: CBE Statistical Service

Annex 10. NUMBER OF ACCOUNTS IN LOANS & ADVANCES BY ECONOMIC SECTOR

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SECTORS	June 1990	June 1991	June 1992	June 1993	June 1994	June 1995	June 1996	June 1997	June 1998	June 1999	June 2000	June 2001	June 2002	June 2003	June 2004	June 2005	Sept. 2005	% Share-1
Agriculture	398	324	313	363	634	2,049	**2,560**	2,580	2,740	**2,834**	3,301	2,963	3,163	3,519	**3,746**	5,085	**4,596**	**17.1**
Manufacturing	348	359	303	636	694	988	**698**	784	674	**637**	633	584	356	310	**287**	275	**271**	**1.0**
Domestic Trade & Services	4,673	4,657	6,245	9,872	15,964	22,545	**26,886**	25,799	22,801	**18,934**	13,408	6,911	5,339	4,282	**3,929**	3,975	**2,928**	**14.6**
International Trade	262	232	270	403	481	745	**680**	738	756	**604**	600	679	441	388	**323**	360	**301**	**1.1**
Export	79	102	126	119	158	165	**202**	204	214	**195**	215	268	131	106	**92**	137	**114**	**0.4**
Import	183	130	144	284	323	580	**478**	534	542	**409**	385	411	310	282	**231**	223	**187**	**0.7**
Building and Construction	1,289	837	822	699	530	572	**571**	411	337	**37**	356	225	172	161	**114**	112	**99**	**0.4**
Personal & ESL	6,585	8,981	9,681	9,977	8,389	5,530	**4,852**	4,895	4,962	**4,964**	5,171	6,232	6,278	6,554	**6,914**	6,955	**6,871**	**25.6**
IFAD							**40**	105	64	**26**	89	141	384	294	**288**			**0.0**
Financial Institution							**4**	4	4	**5**	6	6	6	6	**6**	4	**3**	**0.0**
Co-Finance of Projects							**3**	4	5	**7**	7	7	6	6	**6**			**0.0**
ALD+LIR	3,407	3,016	2,723	2,830	2,651	2,707	**2,786**	3,623	4,768	**5,662**	9,287	13,753	14,333	13,664	**13,362**	12,772	**10,773**	**40.1**
TOTAL	16,962	18,406	20,357	24,780	29,343	35,136	39,080	38,943	37,111	34,010	32,858	31,501	30,478	29,184	28,975	29,538	26,842	100.0
Growth Rates, (%)		8.5	10.6	21.7	18.4	19.7	11.2	-0.4	-4.7	-8.4	-3.4	-4.1	-3.2	-4.2	-0.7	1.9	-9.1	
																	Yearly Av.Gr.Rate= 4.2	

Source: CBE Statistical Service

Annex 11. SUMMARY OF INCOME & EXPENSE ACCOUNTS

Particulars	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92
INCOME												
Interest Income	102,076	104,996	116,927	132,786	131,185	140,178	126,593	148,330	155,634	153,402	158,416	156,347
Commission Earned	16,545	919,235	17,444	17,774	18,151	17,251	21,529	23,819	22,380	20,224	17,121	17,417
Other Income	30,342	29,423	32,164	32,253	32,020	40,196	43,192	39,509	35,581	38,952	23,153	42,050
Total Income	148,963	1,053,654	166,535	182,813	181,356	197,625	191,314	211,658	213,595	212,578	198,690	215,814
Grwoth Rates, (%) (Total Income)		3.10	8.40	9.80	(0.80)	9.00	(3.20)	10.60	0.90	(0.50)	(6.50)	8 3/5

Particulars	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	% Shares-1 (2003/04)
INCOME													
Interest Income	274,322	474,765	681,696	924,092	836,424	812,710	875,510	997,770	987,010	586,969	670 029	680,341	53.80
Commission Earned	37,719	56,080	70,047	92,611	73,550	77,280	79,162	76,165	94,570	95,477	97,695	126,442	10.00
Other Income	43,601	98,144	156,794	126,936	201,996	109,391	275,620	246,112	261,573	322,945	533,753	457,937	36.20
Total Income	355,642	628,989	908,537	1,143,639	1,111,970	999,381	1,230,292	1,320,047	1,343,153	1,005,391	1,301,477	1,264,720	100.00
Grwoth Rates, (%) (Total Income)	64 4/5	76.9	44.4	25.9	-2.8	-10.1	23.1	7.3	1.8	-25.1	29.4	-2.8	

Source: CBE Statistical Service

Annex 12. BREAKDOWN OF TOTAL DEPOSITS BY OWNERHSIP

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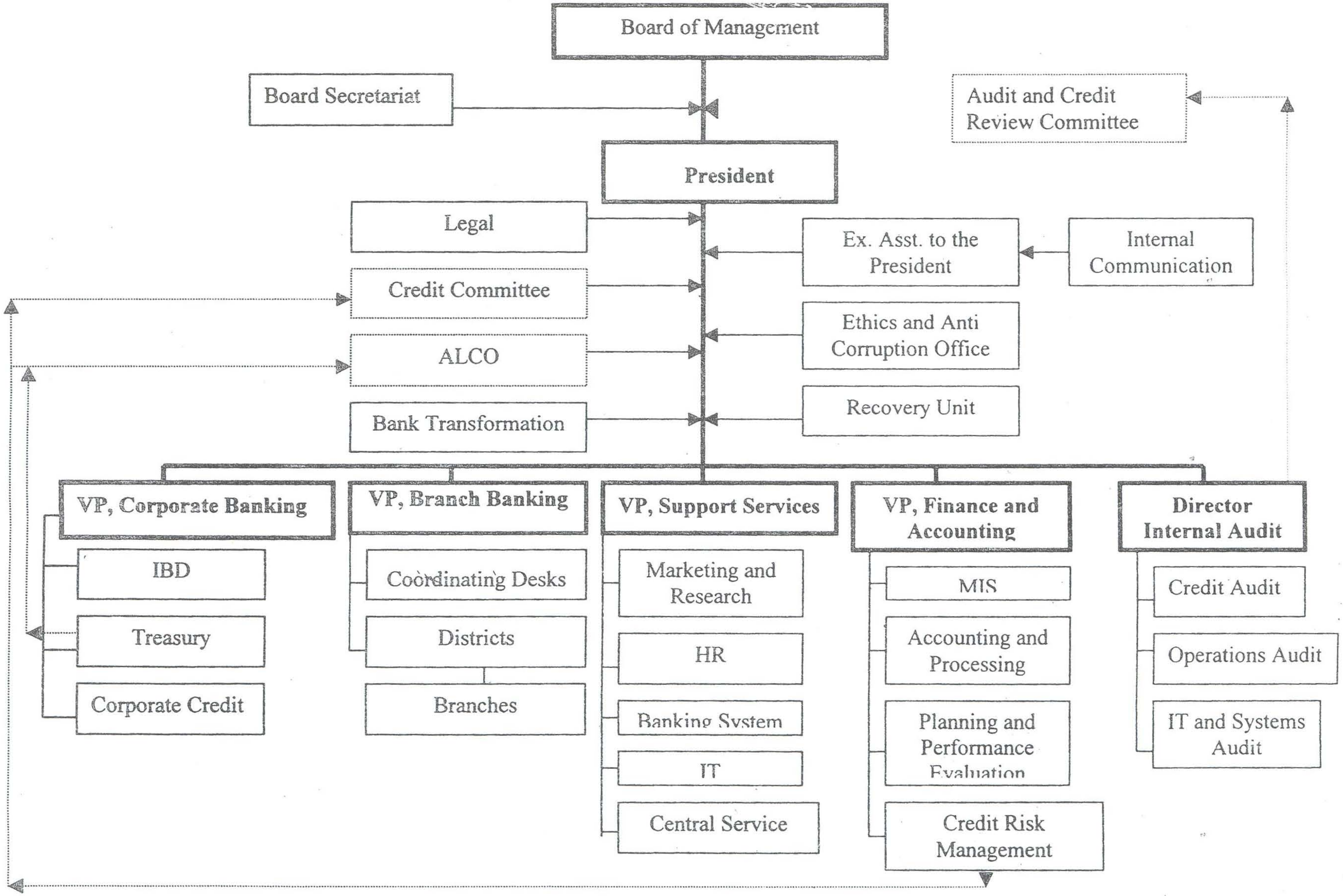
Year	Private & Individuals	Co-operatives	Public Enterprice & Agencies	Dom. Bnaks & Other Fin. Agen.	Central & Local Gov'ts	Foreign Banks	Non-Resident	Trust Fund Contra	Foreign Currency A/C	Total Deposits (Excl. Djib.)	Total Deposits (Inc. Djib.)	Growth Rates (%) (for Total Excl. Djib)
1981 June	694,737	96,849	417,147	130,597	100,909	31,805	42,721			1,514,765	1,514,765	
1982 June	761,290	121,938	483,187	127,159	100,922	52,278	75,261			1,722,035	1,729,002	13.7
1983 June	866,062	145,711	593,381	164,126	108,967	67,430	81,801			2,027,478	2,037,590	17.7
1984 June	1,019,327	165,532	733,732	170,397	1,112,325	35,446	86,038			3,322,797	2,331,994	14.6
1985 June	1,130,661	205,564	930,485	195,363	89,883	30,045	102,231			2,684,232	2,693,137	15.6
1986 June	1,333,447	238,780	1,046,150	198,468	107,236	33,404	91,169			3,048,654	3,060,286	13.6
1987 June	1,562,225	269,077	903,898	292,596	127,332	23,681	86,056			3,264,865	3,281,830	7.1
1988 June	1,716,314	309,683	937,097	323,968	124,484	60,589	98,850			3,570,985	3,586,713	9.4
1989 June	1,910,997	305,904	988,351	290,179	144,604	44,751	93,390			3,778,176	3,795,240	5.8
1990 June	2,159,248	325,278	1,140,383	281,323	167,447	19,745	107,912			4,201,336	4,221,492	11.2
1991 June	2,322,037	294,294	1,084,563	375,003	164,604	45,557	128,318			4,414,376	4,438,480	5.1
1992 June	2,835,870	249,697	1,278,364	268,181	243,282	40,487	106,031			5,021,912	5,040,749	13.8
1993 June	3,542,195	257,724	1,391,390	316,766	342,222	174,256	202,245			6,226,798	6,299,092	24.0
1994 June	4,255,577	224,100	1,596,529	305,082	464,241	346,722	344,708			7,536,959	7,517,898	19.4
1995 June	5,456,375	239,925	1,961,370	359,995	586,203	615,791	377,654			9,597,313	9,653,593	29.0
1996 June	6,504,977	318,329	1,843,838	501,717	850,411	816,408	357,876			11,193,556	11,256,554	16.6
1997 June	7,055,277	416,991	2,364,396	312,517	813,023	1,335,134	353,386	50,872		12,701,596	12,772,259	13.5
1998 June	8,202,296	406,222	3,108,867	519,657	1,029,620	1,870,108	354,579	13,870	9,732	15,514,951	15,680,106	22.1
1999 June	8,305,384	442,694	2,738,859	496,754	1,058,537	1,450,112	452,624	16,114	55,823	15,016,901	1,518,064	(3.2)
2000 June	8,992,318	495,886	315,907	433,512	1,089,312	1,757,859	564,982	31,176	35,993	13,716,945	17,083,613	12.7
2001 June	10,538,143	521,700	3,494,646	389,952	1,836,423	1,406,010	488,577	55,644	79,578	18,810,673	18,983,545	11.2
2002 June	10,660,483	567,366	4,176,682	638,545	1,507,311	1,334,676	488,374	66,918	135,578	19,575,933	19,744,234	4.1
2003 June	11,472,327	618,603	3,631,958	696,448	2,693,810	1,190,675	676,070	48,897	90,448	21,119,236	21,307,584	7.9
2004 June	12,391,550	794,890	3,928,663	776,750	3,900,848	55,307	942,441	25,511	82,370	22,898,330	22,973,236	8.4
2005 June	14,123,461	1,006,067	4,048,804	288,731	5,109,061	263,560	873,033	22,463	138,276	25,873,456	25,933,564	13.0
2006 June	15,632,328	1,147,662	3,963,550	285,744	6,576,502	53,389	862,340	17,389	124,665	28,663,569	28,663,567	10.8
% Share	54.5	4.0	13.8	1.0	22.9	0.2	3.0	0.1	0.4	100.0	Yearly Av. Gr. Rate= 12.8	

Source: CBE Statistical Service

1. ORGANIZATIONAL STRUCTURE

The organizational structure of the Commercial Bank of Ethiopia (CBE) is presented here below:



DECLARATION

This project is my own original work, has not been presented for a degree in this or any other university and that all sources of materials used for the project have been duly acknowledged.

Declared By	**Confirmed By**
Endalkachew Wedaje	**Professor G.K. Murthy**
______________	______________
March 22, 2007	**March 22, 2007**