

ADDIS ABABA UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
DEPARTMENT OF ACCOUNTING AND FINANCE



**Opportunity and Challenges of Foreign investor Entry in Ethiopia
Banking Sector**

BY

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**A thesis submitted to Addis Ababa University College of Business and
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Declaration

I, Yohannes Worku declare that this paper is a result of my independent research work on the topic entitled “Opportunity and Challenges of Foreign investor Entry in Ethiopia Banking Sector” in partial fulfillment of the requirements for the Degree of Masters of Art in Accounting and Finance at Addis Ababa University. This work has not been submitted for a degree to any other university. All the references are also duly acknowledged.

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Confirmation

This is to certify that Yohannes Worku has carried out this research work on the topic entitled “Opportunity and Challenges of Foreign investor Entry in Ethiopia Banking Sector” under my supervision. This work is original in nature and has not been presented for a degree in any University and it can be submitted for the partial fulfillment of the requirements for the award of the degree of Masters of Art Accounting Finance.

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Table 1 list of banks in Ethiopia

List	Name of the banks	Established year
1	Abay Bank S.C	2010
2	Addis International Bank S.C	2011
3	Ahadu Bank S.C	2022
4	Amhara Bank S.C	2021
5	Awash International Bank S.C	1994
6	Bank of Abyssinia S.C	1996
7	Berhan International Bank S.C	2010
8	Bunna International Bank S.C	2009
9	Commercial Bank Of Ethiopia (State Bank)	1963
10	Cooperative Bank Of Oromia S.C	2005
11	Dashen Bank S.C	1995
12	Enat Bank S.C	2013
13	Gadaa Bank S.C	2023
14	Global Bank S.C	2012
15	Goh Betoeh Bank S.C	2021
16	Hibret Bank S.C	1998
17	Hijra Bank S.C	2021
18	Lion International Bank S.C	2006
19	Nib International Bank S.C	1999
20	Omo Bank S.C	2023
21	Oromia International Bank S.C	2008
22	Rammis Bank S.C	2022
23	Shabelle Bank S.C	2021
24	Siinqee Bank S.C	2021
25	Tsedey Bank S.C	2022
26	Tsehay Bank S.C	2022
27	Wegagen Bank S.C	1997
28	Zamzam Bank S.C	2021
29	Zemen Bank S.C	2009

ABSTRACT

This study aims to evaluate the opportunities and challenges associated with foreign investor entering Ethiopia's banking market. The research's goal was to pinpoint the various advantages that investor would present as well as the obstacles to their entry for domestic banks. A combination of qualitative and quantitative research method were used. Ten experts and professionals were specifically chosen for the study were interviewed in-depth, and thirty commercial banks in Ethiopia as well as higher officials from the national bank of Ethiopia provided quantitative data. STATA 14 was used to examine the gathered data and produce summary on results. The findings of the research demonstrate that introduction of international investor in to Ethiopia has the potential to strengthen the nation financial infrastructure and expand loan availability to a wide range of local businesses, regardless of size. In addition, the study's findings show that the entry of foreign investor improves local banks efficiency because of the intense competition they will face. Furthermore, by allowing those financial institution to transfer new banking technologies, they help to advance and develop local financial systems. However, because those foreign investor have the potential and power to drive domestic banks out of the market due to their superior expertise, talent and strategy, they also pose a threat to the stability of the nation's financial system. In addition to these, these investor occasionally share their knowledge of global problems with the host nation. The financial industry should be liberalized gradually as recommended for policy. This is because allowing the investor to operate freely could hurt domestic bank and make the situation harder to manage as it is unclear how these bank operate. Thus, they should progressively permit the government to look at and comprehend how they do business.

Key Words: *Foreign bank, Liberalizing, Opportunity, Challenge, Domestic bank, Ethiopia*

CHAPTER ONE:

1. INTRODUCTION

1.1 Background of the study:

International trade in goods and financial services has become increasingly significant in recent years. Many banking organizations have also expanded internationally to support such transactions. By opening foreign subsidiaries and branches and acquiring existing foreign banks, banks can expand worldwide. The global liberalization of financial markets has made it easier for the banking industry to go global. Foreign ownership of banks is now increasingly permitted in both developed and developing nations (Aliber (1984)).

This type of financial liberalization is based on the assumption that the gains to domestic market participants from foreign participation outweigh any costs to domestic banking firms. Several authors have discussed the potential benefits of foreign bank entry to the domestic economy in terms of improved resource allocation and efficiency (see Levine (1996), Walter and Gray (1983), and Gelb and Sagari (1990)). Foreign banks may (i) By fostering more bank rivalry and facilitating the use of more advanced banking techniques and technologies, enhance the standard and accessibility of financial services in the domestic financial market, (ii) stimulate the development of the underlying bank supervisory and legal framework, and (iii) improve a country's access to international capital, according to Levine (1996).

As per the authors like Alemayehu (2013) and Tassew (2015) contend that foreign banks' involvement in the domestic banking sector carries some potential risks, including foreign banks' dominance in the financial sector, the host country's economy's exposure to shocks and fluctuations in home countries, a lack of credit for small and medium-sized businesses, profit remittances, and capital flight, particularly during economic crises, which results in a shortage of funds.

Ethiopia is distinct from its neighbors in East Africa (Uganda, Kenya, and Tanzania), as well as other developing nations, in that it has not yet allowed international banks to participate in its banking system. Ethiopia's banking sector is still not open to the effects of globalization. Although Ethiopian policymakers are aware of the potential significance of financial liberalization, it is thought that liberalization may lead to a loss of economic control or even be counterproductive (Tassew 2015).

At its 13th regular session, which took place on August 4, 2022, the Council of Ministers decided to adopt a policy document that would allow foreign investors access to the banking sector. The National Bank of Ethiopia (NBE) announced the policy and a suggested modification to the banking business proclamation after making this decision. According to both the policy statement and the proposed law, foreign investors are permitted to conduct business in Ethiopia in four different ways: by purchasing stock in already-established banks, by forming subsidiaries, by constructing branches, and by establishing representative offices. Although opening a representative office cannot be compared to entering a market, numerous foreign investors have had permission to do so for many years. In addition to being prohibited to offer services to consumers, representative offices are only allowed to engage in promotional activities (Ethiopian Business Review, 2022).

As per Ethiopian Business Review, 2022 Ethiopia boasts one of the fastest-growing financial sectors in sub-Saharan Africa thanks to the tremendous growth in the number of domestic banks operating there. In the government's effort to liberalize the financial sector, foreign investors are seen as a possible change agent since they provide customers better services, more competition, and access to global markets. However, there are a number of challenges associated with this option, including operational challenges, cultural barriers, and legislative restrictions.

This study intends to assess the benefits and drawbacks of international investors entering the Ethiopian banking industry. The need to determine how foreign investors may aid in the growth and development of the nation, as well as the recent surge in their interest in Ethiopia's banking industry, are the driving forces behind this study. The research intends to address four main

areas: competition, innovation, risks involved, and contribution to the sector. The findings of this study could provide valuable insights into the potential role of foreign investor in the development of the Ethiopian banking sector, contributing to the country's overall economic growth.

1.2 Statement of the problem:

Several writers have addressed the possible benefits of foreign bank entry for the domestic economy in terms of better resource allocation and enhanced efficiency (see Levine 1996, Walter and Gray 1983, and Gelb and Sagari, 1990). By increasing bank competition, allowing for greater use of more advanced banking skills and technology, and serving to stimulate the development of the underlying bank supervisory and legal framework, Foreign investor may improve the quality and accessibility of financial services in the domestic financial market. They may also improve the country's access to foreign capital. The costs of opening up financial markets to international competition could be in addition to those advantages. For instance, Stiglitz (1993) talks about the possible consequences that the introduction of foreign investor may have for domestic banks, business owners, and the government. Foreign investor typically focus on multinational corporations, which may limit local entrepreneurs' access to financial services. Additionally, governments may find that their ability to influence the economy is weakened as a result of foreign investor ' inclination to be less responsive to their wishes.

As Ethiopia's economic landscape evolves, the influx of foreign investors into the banking sector presents both promise and peril. While the country's banking industry is experiencing rapid growth and attracting interest from foreign entities, significant challenges hinder the smooth operation of these investors. Key hurdles include the absence of a robust financial infrastructure, regulatory constraints, and stiff competition from domestic investors. Despite recent policy shifts allowing foreign investor entry since 2022, the specific obstacles and opportunities arising from their presence remain inadequately explored.

Though studies, like that by Habtamu (2017), indicate potential benefits such as enhancing financial infrastructure and expanding credit access, they overlook critical institutional factors

and regulatory frameworks affecting foreign investor entry and performance in Ethiopia. Furthermore, while the entry of foreign investors may foster competition, driving local investors to enhance their effectiveness, it also poses the risk of displacing them from the market. Additionally, the transfer of expertise, strategies, and skills by foreign investors may promote the development of the local financial ecosystem. However, potential risks of instability within Ethiopia's financial sector due to the presence of foreign investors remain unaddressed in existing literature. Therefore, a comprehensive examination of the challenges and opportunities presented by the entry of foreign investors into Ethiopia's banking sector is imperative. This entails analyzing institutional factors, regulatory frameworks, and potential impacts on local investors' competitiveness and financial stability. Such an inquiry is essential for policymakers, stakeholders, and foreign investors to navigate the intricacies of Ethiopia's evolving banking landscape and ensure sustainable growth and stability in the financial sector.

The Ethiopian banking sector has historically been exclusive to domestic banks. However, in recent years, the country has witnessed an increasing interest from foreign investor seeking to establish a presence in the Ethiopian market. This presents both opportunities and challenges to the sector. Although foreign bank entry can lead to increased competition, innovation, and access to global markets, it may also pose risks to local banks and consumers' interests. Therefore, this research aims to fill this research gap by analyzing the opportunities and challenges of foreign bank entry in Ethiopia's banking sector, and it is essential to explore these opportunities and challenges to determine how foreign bank entry can contribute to the growth and development of the Ethiopian banking sector.

1.3 Research question

The research paper aim to answer the following questions,

- What is the impact of foreign bank entry on competition and innovation within the Ethiopian banking sector?

- What are the risks involved in foreign bank entry in Ethiopia's banking sector, and how can they be mitigated?
- How do foreign investor contribute to the overall development of the Ethiopian banking sector?

1.4 Research Objectives:

1.4.1 General Objective

The primary objective of this research is to examine the opportunities and challenges faced by foreign investor entry in Ethiopia's banking sector. To achieve this primary objective, the following specific objectives will be pursued:

1.4.2 Specific objectives

1. To identify the benefit arises as a result of foreign bank entry.
2. To assess the challenges involved in foreign bank entry in Ethiopia banking sector.
3. To identify the risks involved in foreign bank entry in Ethiopia's banking sector
4. To assess the potential efficiency reform to the bank sector

1.5. Significance of the Study

Due to the importance and indisputable usefulness of conducting research in this field given the current economic conditions, this study looked at the impact of Foreign investor ' entry on the local economy from a variety of angles and came to certain findings. As a result, this study is more crucial for determining the extent of the impact and the opportunity brought about by the entry of the foreign bank into the Ethiopian market.

The findings of this study may also give the relevant parties (Domestic Banks, Government body that are responsible for controlling financial sector (national bank), and also the Foreign investor

) insight into how to manage the entry of Foreign investor in a way that serves the interests of the nation while also safeguarding it from potential risk and expense. The findings may also serve as a basis for any further investigations that will be carried out regarding foreign investor entry in Ethiopia.

1.6 Scope of the study

This study's major objective is to analyze the possible benefits and challenges of international banks entering in Ethiopia, to analyze the topic the research focuses on four key areas: competitiveness in efficiency, Benefit, associated risks, and challenges. By focusing on the above note the researcher believe that he can assess the opportunity and challenges as a result of foreign bank entry. By setting up an interview with a university professor (with a professional expertise with the topic) and high experience in banking sector, the potential research insights will be gathered. And the questioner will be given to Addis Ababa-based banking industry employees. By selecting these kind of respondent the researcher believe that these respondent are close to the topic and have a knowledge on the particular subject, and also directly affect by the decision made by the responsible body. In particular, the research's focus is solely on the banking industry as it assesses the challenges and opportunities of liberalizing financial sectors. Additionally, the research solely looks at banks and excludes all other financial organizations and sectors. . Also the study is organized and make a conclusion in one year period month.

1.7 Limitation of the study

Even if the researcher needs to take into account various variables, the research scope is restricted to evaluating the effects of foreign bank entry in Ethiopia in the banking sector. Study limitations as seen by the staff at these functional banks during the study period. Additionally, because the study is solely focused on the banking industry, it may not be able to generalize the impact and readiness on the financial industry as a whole. The study specifically focuses on the sampled banks' Addis Ababa branches in terms of geography.

1.8 Structure of the study

The study has five chapters.

Chapter one, covered introduction part of the paper contained the background of the study, statement of the research problem, research questions, research objectives, the significance of the research, research scope, and limitation of the study.

Chapter Two contained the literature review part of the paper, which contained theoretical review, and empirical analysis.

Chapter Three contained the detailed research methodology, which is comprised of the research design, study area, research population, and data collection methods.

Chapter Four contained the detail interpretation and analysis of the study.

Chapter Five contained conclusion and recommendation of the research.

CHAPTER TWO

2. LITERATURE REVIEW

2.1 Introduction

In today's globalized world, foreign investors have become an integral part of the international financial system. As such, developing countries like Ethiopia are becoming increasingly attractive for foreign banks seeking to expand their operations. The banking sector in Ethiopia has undergone significant changes in recent years, with the government taking various measures to open up the industry to foreign banks. Therefore, understanding the opportunities and challenges of foreign bank entry in the Ethiopian banking sector is crucial for policy-makers, researchers, and practitioners. In this literature review part we aim to explore existing literature related to foreign bank entry in the Ethiopian banking industry, with a particular focus on the opportunities and challenges faced by foreign banks in this emerging market.

2.2 Theoretical Literature

2.2.1 Financial liberalization

Numerous studies have examined how financial liberalization affects access to financial services, financial stability, and economic growth. (i) How financial liberalization affects economic expansion; Research on this topic has produced contradictory findings. For instance, Beck et al. (2000) examined how financial liberalization affected economic development in a sample of 50 nations between 1973 and 1995. They discovered that financial liberalization boosted economic expansion. But according to other research, financial liberalization can cause economic instability, as the Asian financial crisis of 1997–98 showed. Financial liberalization can also have a big impact on financial stability, which is why it's important to understand it. Financial liberalization may enhance the likelihood of financial crises, according to studies. For instance, Kaminsky and Reinhart (1999) found that in a sample of 20 rich and developing nations, financial deregulation was linked to a higher likelihood of financial crises. Similar findings were made by Claessens et al. (2003) who discovered that financial liberalization was a strong

predictor of banking crises in 102 countries studied between 1975 and 1999. (iii) How financial liberalization affects how people can obtain financial services: Access to financial services can be made better by financial liberalization. According to studies, financial liberalization can boost competition in the financial industry, which will result in cheaper costs and higher-quality services. For instance, Demirguc, Kunt and Maksimovic (2002) found that financial liberalization was associated with increased access to credit in a sample of 50 countries over the period 1980-1997.

2.2.2 Foreign Bank Entry in the Domestic Banking Sector

The pros and cons of foreign bank entry have both been thoroughly studied in the literature. The benefits are summarized in the World Bank report from 2002. 1) The entry of foreign banks increases the domestic banking sector's effectiveness. Increased competition frequently leads to lower costs and improved profitability, according to Claessens (1998). 2) The distribution of credits to the private sector may be improved since it is predicted that the appraisal and pricing of credit risks would be more sophisticated (Clarke, 2001). Clarke (2001) hypothesized that this would encourage further growth. 3) The presence of foreign banks helps to build a domestic legal and regulatory framework for banking and increases openness in general. 4) Since they can turn to their parents for additional capital and have easier access to global markets, foreign banks are anticipated to offer more reliable sources of credit. As a result, domestic shocks will have less of an impact on the financial markets at home. 5) Foreign banks could lower the price of recapitalizing and reorganizing banks in the wake of the financial crisis.

The fees involved with starting a foreign bank are as follows: 1) if the franchise value of international banks drops, domestic banks may feel more pressure to take on more risk (Hellmann, 2000). 2) Through the use of technologically advanced services and products, foreign banks are able to capture the most lucrative market share in domestic markets. As a result, local banks will offer services to riskier industries. 3) An increase in the number of foreign banks operating in the country can make it harder for some economic sectors to obtain credit. 4) By abandoning host countries or spreading problems from their own country, foreign banks may

make the financial instability worse. 5) International banks' lending strategies sometimes neglect domestic needs due to their divergent goals and commercial focuses. (Demirguc-Kunt, 1999) investigates how foreign banks' admission affects the domestic banking industry. They demonstrate that, when compared to domestic banks, foreign banks typically have higher earnings, higher interest margins, and higher tax obligations in developing countries. The situation is reversed in industrialized nations, though. Another intriguing finding is that when foreign banks enter the market, domestic banks' profitability and operating costs decrease. I will apply their empirical methodology to a different collection of data in this investigation. While their data covers 80 different countries for the years 1988 to 1995. Similar findings are shown by Demirguc-Kunt (1999) and Huizinga (1999). They show that, while this is not the case in industrialized countries, international banks often have higher earnings and margins than domestic banks in poorer countries.

According to Demirguc-Kunt, Levine, and Min (1998), the presence of foreign banks reduces the likelihood that a nation will go through a banking crisis. They suggest that the presence of foreign banks reduces domestic banks' operating expenses and profits. Foreign banks also boost overall economic growth by improving domestic banks' performance. Studies that concentrate on experiences at the national level also exist. (Dages, 2000) looks into the introduction of foreign banks into Turkey's banking industry. He demonstrates how foreign ownership affects the net interest margin, operating costs, and asset returns. He also suggests that the arrival of foreign banks has a significant competitive impact on the banking industry. The return on assets and overhead costs are reduced. Hasan and Marton (2000) look into the transitional period in Hungary's banking industry. They come to the conclusion that banks with greater engagement of foreign banks are more efficient. Go (Dages, 2000) and research how the health of the domestic financial systems in Argentina and Mexico is affected by international banks. The main factor affecting the growth, volatility, and cyclicity of bank credits is the condition of banks, not their ownership. But diversity in ownership tends to contribute to greater stability of credit in times of crisis and domestic financial system weakness.

2.2.3 Effects of Foreign Bank Entry

According to (Demirguc-Kunt A & Huizinga 1998), the process through which foreign banks establish their subsidiaries or branches within a host country's financial system is known as foreign bank entrance. This phenomenon is getting more and more attention as globalization and liberalization policies have gained ground everywhere. Foreign banks entering a nation's banking sector can have a significant impact on that nation's financial system and economy. Policymakers and regulators must be conscious of these consequences, which can be both advantageous and detrimental, in order to manage financial stability and economic growth. The introduction of foreign banks into a host nation's banking system has a profound effect on a wide range of aspects of the economy and financial system. Foreign banks' entry into the market will have an impact on lending practices, competition, financial stability, and dynamic impacts. By looking at these important factors, the study attempts to gain a better understanding of how foreign bank entry influences the banking environment and economic performance of the host country.

2.2.3.1 Credit Availability

Financial integration enables money to move from nations with ample capital, where returns are low, to those with limited capital, where returns are high (Obstfeld & Rogoff 1995). By increasing the amount of cash available for domestic projects, capital inflows may promote growth. Financial integration should, more generally, boost the supply of financing and so broaden the national financial systems of nations with weak financial systems, such as the economies of Eastern Europe. Accordingly, it is anticipated that financial integration will accelerate growth in all sectors (Rajan & Zingales 1998). The financial market integration's beneficiaries may vary depending on the type of capital flows. All businesses should benefit from increased funding availability because it lowers interest rates and, as a result, lowers the cost of capital (Giannetti & Ongena 2005).

2.2.3.2 Sounder Lending Practices

Domestic banks frequently engage in questionable lending activities as a result of their ownership structure. In emerging nations, domestic banks are frequently under the control of

local governments and shareholders of non-financial corporations. Conflicts of interest that have detrimental consequences on financial stability may arise as a result of state or corporate ownership. Additionally, allowing international competitors into the domestic banking industry helps to reduce these conflicts of interest. Foreign banks are often not controlled by domestic companies. These foreign state-owned banks are also by nature free of any domestic ownership ties and political motivations when making lending decisions, even though some foreign governments own some foreign banks and these banks may be motivated by political motives when lending to their respective home constituencies (Giannetti & Ongena 2005). Since many of the enterprises founded during the transition years served as simply conduits for the theft of government assets, foreign banks are likely to avoid doing business with them. There is proof that domestic bank—particularly state-owned ones—favored transitional businesses and gave sizable loans to aspiring business owners during the privatization process so they could bid on and buy businesses (Simonson, 2001). Furthermore, Song (2004) claims that by diversifying the capital and funding bases, the presence of foreign banks may enhance the stability of the lending market. Domestic banks struggle to diversify in all but a few nations due to the concentration of their lending there. In contrast, foreign banks tend to have more diversified portfolios and also usually have access to sources of funds from all over the world through their branching network. This diversification contributes to economies of scale and scope in the domestic market.

2.2.3.3 Competition, Stability, and Dynamic Effects in the Banking System

According to Crystal et al. (2002), the introduction of international banks could help stabilize the financial sector in developing nations. First, lending methods at international banks are more responsible, and they make fewer problematic loans overall. Additionally, because they have direct access to overseas savings, foreign banks might be more resilient to adverse shocks. As a result of their easier access to alternative investment options, foreign banks may, on the other hand, increase lending volatility (Morgan & Strahan 2003). The latter effect, meanwhile, is most likely to be of second order in emerging economies, which are typically subject to much greater shocks than the home countries of the foreign banks. For a group of transition countries, de Haas & Lelyveld (2003) repeatedly find no evidence of increased instability following the arrival of

foreign banks. Fewer, not more, financial crises should occur to the extent that foreign bank entry really reduces concentration (Beck & Levine 2004). Additionally, the way a foreign bank enters a country may have an impact on local funding. It is common knowledge that foreign banks that join through mergers and acquisitions run the risk of hurting small local businesses who borrow from the domestic target bank. In particular, when the acquirer has previously prioritized lending to large firms, Berger & Udell (1996) found that as domestic banks develop through consolidation, they have a tendency to restrict the supply of loans to small businesses. Globally speaking, foreign bank entry may promote competitiveness, effectiveness, and stability, in which case there should be an increase in company growth and funding. On the other hand, small firm growth and financing may be negatively affected if foreign banks enter. In that case the net effect will also depend on the dynamic response by other competing banks (Giannetti & Ongena 2005).

2.2.3.4 Enhancing Banking Market Competition and Efficiency

The profitability and overall costs of locally owned banks are indeed reduced when the percentage of foreign ownership increases, according to empirical research. These findings imply that foreign bank entrance enhances the efficiency of domestic banking markets, with favorable welfare consequences for banking clients. Similar domestic banking profit reductions and cost-cutting measures may result from loosening limitations on foreign bank entry, but with benefits to total domestic welfare (Song 2004). The foreign banks were clearly pushed because they showed signs of increased productivity. Foreign banks were permitted to establish subsidiary or completely owned branches in India. Additionally, they were allowed to collaborate with private banks on merchant or investment banking projects (Sharda 2014). Furthermore, it can also significantly contribute to development efforts by, among other things, boosting domestic savings, creating jobs and economic growth, integrating into the global economy, transferring cutting-edge technologies, increasing productivity, and improving the skills of the local labor force (Mucheru 2011).

2.2.4 Challenges of Foreign Bank Entry

Foreign banks entry is however not without risks and challenges that encounter to domestic banks financial performance. Those strong and great reputations of foreign banks entry have created higher unbalanced competition especially in domestic banks of less developed and developing countries (De Brandt and Davis, 2000; Hasan et al., 2000; 2000, Denizer C, 2007). The unbalance competition is due to the inability of domestic banks to innovate, imitate and compete with the foreign banks entry advance innovations, technology and system (Berger et al., 2000).

According to Claessens et al., (2001), the unbalanced competition has instigated certain unhealthy impact on the domestic banks financial performance; profitability. As such, according to Clark et al., (2003), as compared to domestic banks, the financial performance of foreign bank entry is more impressive in term of profitability in the domestic banking sector of less developed and developing countries. Consequently, the unbalanced competition has reasoned that domestic banks of less developed and developing countries were left behind (Lensink and Hermes, 2004).

Thus, though normally competition from foreign banks entry can persuade domestic banks to become more efficient and achieving excellent performance, but unbalanced competition can cause domestic banks from less develop and developing countries that are incompetent with the competitiveness of foreign banks entry are defeated in the competition and are left behind.

Furthermore, foreign banks entry does practice „cherry picked“ at the domestic economic sector where foreign banks entry is more concentrate on domestic blue-chipped profitable business organizations and tend to be less sensitive to those of less profitable business organizations. Hence, those domestic less profitable business organizations are left behind for domestic banks. In addition, according to Detragiache & Gupta (2006), foreign banks entry also chooses of low risk firms of domestic economic sector, and has left firms of riskier sectors of the domestic economy to domestic banks. As a result, domestic banks serve the domestic markets riskier sectors businesses organizations.

Subsequently, domestic banks have to compete with foreign banks entry for blue-chipped creditworthy domestic clients and struggle for attaining low risk firms of domestic economic 17 sector (Dages et al., 2000). As such, domestic banks have to take on greater cost by paying higher interest rate on deposits to attract domestic high net worth clients and low risk firms of domestic economic sector to compete with foreign banks entry. As a result, domestic banks pay higher interest rates on deposits but cannot charge higher interest rates on loans. Moreover, foreign banks entry also reduces and decrease market share of domestic banking sector. Thus, foreign banks entry may apparently decrease profits, net interest income and non-interest income of domestic banks (Kalluru and Bhat, 2009).

Foreign banks entry excellent financial performance is because foreign banks entry has generally operated based on a target market, focused on high value corporate clients as against the mass consumer and corporate customers by the domestic banks (Okuda and Suvade, 2007). Other factors that contributing to the better financial performance of foreign banks entry include their global network, accessibility to talents and experience in various markets as well as their superior level of information technology. There are therefore significant efficiency and Excellency gaps between foreign banks entry and domestic banks (Uiboipin, 2005).

The efficiency and excellency gaps situation has led to an increase in the operating expenses and decreased of net interest margin of domestic banks which adversely affected the domestic banks financial performance; profitability in terms of profit before tax (Claessens et al., 2001), ROA, non-interest income, and increment of overall overhead expenses of the domestic banks (Detragiache& Gupta, 2006; Isik, 2008; and Derviz & Podpiera, 2008). Thus, it is apparent that foreign banks entry may bring both advantages and disadvantages to domestic banks.

2.2.4.1 Likelihood of Bringing Instability

It is suggested that international banks with weak parents are more prone to move their capital to more lucrative areas during a crisis. Two related questions are at stake: (i) whether the existence of foreign banks increases or decreases the likelihood of systemic banking crises, for instance by opening up new channels for capital flight; and (ii) whether there is a propensity for foreign

banks to "cut and run" during a crisis. On the other hand, foreign banks can help keep the domestic financial system stable, for instance, if depositors move their money from hazardous local banks to overseas ones rather than engaging in capital flight (Song 2004). Greater foreign bank participation, according to Levine (1999), was a stabilizing element in a crisis environment.⁶³ On the other hand, Mathieson & Roldos (2001) do not definitively state whether foreign banks increase the stability of emerging market banking sectors and reduce credit volatility in their empirical studies on the relationship between foreign banks and stability in the emerging market banking system. Some empirical studies contend that a bank's soundness, not ownership in and of itself, is the key factor in the expansion and volatility of bank credit with respect to the foreign banks' propensity for lending in a crisis situation.

2.2.4.2 Challenge the Performance and Weakening Domestic Banks

Probability of Creating Instability It is suggested that international banks with weak parents are more prone to move their capital to more lucrative areas during a crisis. There are two linked questions here: (i) whether the existence of foreign banks increases or decreases the likelihood of systemic banking crises, for instance by presenting an extra route for capital flight; and (ii) whether foreign banks have a propensity to "cut and run" during a crisis. On the other hand, foreign banks can help keep the domestic financial system stable, for instance, if depositors move their money from hazardous local banks to overseas ones rather than engaging in capital flight (Song 2004).

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2.2.5 Foreign Banks and Economic Growth

Foreign banks may influence long run economic growth directly and indirectly. By bringing additional capital, energetically seeking profitable users for these funds, exerting corporate control, and facilitating risk management, foreign banks may directly boost capital accumulation and the efficiency of resource allocation in ways that accelerate long run economic growth. Foreign banks may also spur growth indirectly by intensifying competition. By contesting markets and sharpening competition, foreign banks raise the overall level of banking sector efficiency. Thus, domestic banks provide better services; domestic banks become better at mobilizing savings, energetically seeking profitable uses for these savings, exerting corporate control and easing risk management in ways that accelerate long run economic growth. Lehner and Schnitzer (2008) study the impact of foreign banks on host countries. They categorize the effects of foreign banks into two different channels, spillovers and competitiveness. Spillovers may occur when domestic banks get their staff trained abroad or when domestic staff that has been employed and trained by foreign banks fluctuates to domestic banks. The replication of high quality financial services offered by foreign banks may constitute a further channel for spillovers. In addition, spillovers may be realized through the implementation of better risk management techniques, superior forms of organization or better data processing technologies. Moreover, foreign banks are likely to press for an improved explain these channels by setting up a model of spatial bank competition. Banks compete in prices for potential borrowers that engage in investment projects of uncertain return. In their model, banks differ with respect to screening abilities (Bogale, 2017)

2.2.6 Forms of Foreign Bank Entry and Form of Organization

According to empirical data, foreign banks are more efficient and lucrative than local banks in emerging markets (Bonin et al. 2005); however they are less profitable in more developed nations (Demirguc-Kunt and Huizinga 2001). The debate over whether or not the introduction of foreign banks benefits clients is heated by these divergent findings. According to traditional industrial organization theory, the arrival of banks will increase competition, which will benefit borrowers in the long run. In fact, the presence of international banks in developing nations

facilitates loan access, particularly for big, open businesses (Mian 2006). However, lending to small and more opaque enterprises may not be affected in the same way due to differences in information distribution (soft vs. hard information) between local and international banks (Dell'Ariccia and Marquez 2004). These businesses are frequently taken over by their home bank and forbidden from receiving overseas loans. The kinds of international bank operations that each host nation will accept are decided upon. According to corporate strategy concerns, host nation legislation, and banking institutions, desired modes of entrance may differ from bank to bank and from country to country (Song 2004). Initially, banks expanded their services abroad to help domestic consumers with cross-border transactions. Some banks subsequently expanded the scope of their activities by bringing on local clients as a result of gaining a better grasp of international markets and a more established network of connections with local financial institutions. Foreign banks would first set up representative offices in accordance with this strategy. They will soon establish subsidiaries and later open branches (Amanuel 2008). Today, a wider range of variables affect the actual pattern of foreign bank entry. The pattern of foreign bank entry has increasingly been influenced by the profit prospects in the target market. Due to this, there are now a wider range of foreign participation models available, such as full acquisition, targeted purchases of particular activities, joint ventures, partnerships with local banks, and outsourcing of administrative and financial services.

a) Reprographic Offices, a representative office is the simplest and most basic organizational structure. It is often established to explore the possibilities of further involvement rather than engaging in deposit gathering and loan extending (Goldberg 1992). According to theory, representatives primarily serve a public relations role and are employed when laws are in place or business options are limited due to low per capita income (TerWengel 1995). An agency is a more expensive than a representative office type of foreign banking business and it may be necessary if banks engage in significant export services and then heavily participate in the foreign currency market (Heinkel and Levi 1992; and Tschoegl 2002). Even when consumer loans and deposits are not allowed, a bank can nonetheless make business loans thanks to its agency representation (Goldberg, 1992). Representative offices often cannot engage in any banking activity. They do, however, offer opportunities for agreements with the parent bank and

its clients on a variety of business and financial activities pertaining to the overseas market. All participants (with the exception of foreign bank representatives) concurred that local banks lack the capital, human resources, banking technology, and fundamental infrastructure to compete with foreign banks at this stage and that it will take several years for all of the aforementioned essential components to be ready; Representatives of international banks contend that the market demands their involvement and that doing so will make the completion of the aforementioned components easier (Tassew 2015). Song (2004) claims that banks initially expanded their services outside of their native countries in order to help their domestic customers with international transactions. Some banks subsequently expanded the scope of their activities by bringing on local clients as a result of gaining a better grasp of international markets and a more established network of connections with local financial institutions. Foreign banks would first set up representative offices in accordance with this strategy. They would eventually develop subsidiaries and later open branches. Setting up trading relations with domestic banks, by establishing representative offices or branches in order to secure their presence in the new markets and to monitor the new markets successfully (Charalambos 2007).

b) Foreign Branch In comparison to a representative office or agency, a foreign branch represents a higher level of commitment. A branch is a unit with its parent legally, whereas a subsidiary is a separate legal entity, and this is the key distinction between a foreign branch and a foreign subsidiary. Other distinctions between a branch and a subsidiary relate to performance, risk, and supervision. Local supervisory authorities oversee subsidiaries, whereas home country supervisors oversee branches. While branches do not have local lending limitations because they rely on the capital of the foreign parent from a consolidated point of view, subsidiaries are subject to local lending limits based on the level of their capital (Naaborg 2007). Foreign branch, which represents a higher level of commitment than a representative office, is an overseas office of a bank established in a foreign nation. Branch offices of foreign banks frequently engage in wholesale banking. Other nations adhere to the "single-entity" approach and treat a bank's international branches and all of its debtors equally, regardless of where they are domiciled (IMF 1998). As an illustration, the laws of Canada and the United States permit the authorities to "separate" the branch from its parent firm and utilize the assets to pay the liabilities incurred as a

result of the host country's restrictions. Although authorities are permitted by Canadian and American law to take the assets of a bank branch that is closing down abroad, In a nation like the UK, where a branch cannot be divided from its parent bank (Cárdenas et al. 2002), it is unclear what will happen when the home country regulator or a third party attempts to contest such acts. Gulamhussen (2004) contends that banks employ size to logically manage risk in their decision to enter overseas markets under uncertainty based on a real option approach. Banks establish local offices to gain a footing and large offices to look for new clients and compete in international markets. Goldberg and Johnson (1990) pose that US banks wanting to expand with large operations should do so in countries with less restrictive regulation, high levels of FDI by US companies, large relative foreign trade, and lower levels of GNP per capita and domestic deposits (Naaborg 2007).

c) Bank Subsidiaries Bank subsidiaries are separate legal entities from the parent bank, whose capital investment constitutes its financial commitment to the subsidiary. Retail banking markets are typically served by subsidiaries. However, in some nations, including the United Kingdom, subsidiaries are frequently involved in operations related to wholesale investment banking. It is noteworthy that foreign bank entry through branch openings, which had been the most significant organizational form of foreign entry until 1997 (foreign bank subsidiaries have only rarely been established), started to significantly slow down from 1998 after experiencing a strong increase for three straight years from 1995 to 1997 (Kim 2005).

d) Creating a Business Affiliate Relationship or Joining a Joint Venture; this may also be a strategy for international expansion. This typically entails purchasing minority holdings in regional businesses, with the foreign bank typically having little to no management participation in the regional banks. More than one company joins together to develop joint ventures. They typically serve on a board and have a financial interest. In a joint venture, the company is required to share ownership and management with a partner from the host nation. Compared to other entry modes, this one demands a lower expenditure, because of this, it offers risk, profit, and control in proportion to the investing firm's equity involvement (Taylor et al. 2001). International organizations, which have primarily entered the Albanian market through joint

ventures, are largely responsible for Albania's modernization and privatization projects. The telecommunications industry is where this type of entry mode has been employed most frequently. In order to create a successful entry strategy in this market, foreign corporations have utilized domestic companies' expertise and experience (Kllezi 2013). The demand for affiliates and subsidiaries may be clearly understood from the requirement of financial institutions to provide specialized banking services to their business customers while simultaneously achieving a careful market monitoring and trade supervision. Additionally, banks, which are businesses from a nearby nation, access the developing markets of the host nation just by acquiring local banks and creating subsidiaries there (Charalambos 2007).

2.3 Empirical Review

Several empirical studies have explored the implications of foreign bank entry in emerging markets, providing valuable insights into the opportunities, challenges, and impacts associated with such developments. Here is a brief overview of key findings from relevant literature:

Studies by Claessens and Van Horen (2014) and Buch and DeLong (2004) highlight the positive effects of foreign bank entry on financial development, including increased access to credit, enhanced efficiency, and greater financial stability. These findings are consistent with the perceived benefits identified in the present study, such as the introduction of new financial innovations and improvement in financial system infrastructure.

Research by Levine (2002) and Clarke et al. (2003) emphasizes the potential risks associated with foreign bank entry, including reduced access to credit for small and medium-sized enterprises, increased competition leading to market concentration, and vulnerability to capital outflows during economic downturns. These findings resonate with the concerns raised by respondents in the present study regarding the impact on domestic banking performance and credit allocation.

Studies by Barth et al. (2004) and Caprio et al. (2007) examine the role of regulatory and supervisory frameworks in mitigating risks and maximizing the benefits of foreign bank entry.

Effective regulatory oversight, prudential standards, and risk management practices are crucial for ensuring financial stability and consumer protection. These insights underscore the importance of strengthening supervisory capacity and regulatory frameworks, as highlighted in the present study.

Research by Moshirian and Taraz (2001) and Deidda and Fattouh (2002) explores the competitive dynamics resulting from foreign bank entry, including the impact on market structure, pricing behavior, and profitability of domestic banks. While increased competition can lead to efficiency gains and improved customer outcomes, it may also pose challenges for domestic banks, particularly those with limited resources and capabilities.

Studies by Beck et al. (2007) and Demirgüç-Kunt and Klapper (2012) investigate the implications of foreign bank entry for financial inclusion and development. Foreign banks can play a catalytic role in expanding access to financial services, promoting innovation, and fostering capital market development. However, efforts are needed to ensure that the benefits of foreign bank entry are shared equitably across diverse segments of society.

The presence of foreign-owned banks is linked to higher efficiency and more competition in the banking sector of a host nation, according to a number of cross-country empirical studies. For instance, studies by Demirguc-Kunt et al. (1998), Claessens et al. (2000, 2001), Claessens and Lee (2003), and Bayraktar and Wang (2004) demonstrate how foreign banks contribute significantly to domestic banks' efficiency by lowering expenses, profits, and net interest margins. More cost effectively than domestic banks are foreign banks. Compared to domestic banks, especially state-owned domestic banks, foreign banks are more cost and profit efficient (Bonin et al., 2005). Additionally, having foreign banks present and having fewer constraints on banks' operations has been linked to increased competition in a host country's banking industry (Claessens and Laeven, 2003; Gelos and Roldos, 2004). Other cross-country studies that compare the relative performance of foreign and domestic banks, find that foreign banks have relatively higher interest margins and profitability and lower overhead costs in developing host countries (Demirguc-Kunt and Huizinga, 2000; Micco, Panizza, and Yanez, 2007; Grigorian and Manole,

2006).). Those authors, therefore, conclude that foreign banks in developing countries are relatively strong competitors in underdeveloped banking markets and can exert pressure on domestic banks to become more efficient and competitive.

Levine (1996 and 2001) points out that international financial integration promote growth through improvements in the domestic financial markets. Barajas and et al (2000) provide evidence on the competitive effect of foreign entry in Colombia. They find that foreign entry improve the efficiency of the domestic banking 13 system by reducing nonfinancial costs and foreign banks in Colombia did not compete against domestic ones in all sectors. Similarly, Clarke et al (2000) find that although foreign banks in Argentina competed beyond the wholesale market in the late 1990s, they did not compete with domestic banks in all sectors. Using data for the Philippines (1990-98), Unite and Sullivan (2001) investigate how foreign bank entry and increased foreign ownership affected domestic banks and conclude that foreign competition forces domestic banks to be more efficient and foreign bank penetration led to an increase in loan loss provisions. In Poland, foreign banks were found to be more cost efficient than domestic banks, except those domestic banks that had a high share of foreign customers (Nikiel and Opiela, 2002). In these countries, foreign banks appear to be more efficient than their domestic counterparts are, and foreign entry seems to improve the efficiency of domestic banks. So if policymakers in developing economies relied primarily on the evidence from developed economies, they might underestimate the potential benefits of foreign entry, to the detriment of the banking sector's development. Thus, foreign banks are expected to increase economic growth by improving the functioning of domestic banks, in turn, the development level of financial markets.

Besides these positive effects, there might be some costs associated with foreign banks such that they may dominate the entire domestic financial market or foster capital flight. In the case of India, foreign banks are less cost efficient and productive than domestic banks (Sensarma, 2006). In part, this can be explained by the dominance of India's state-owned banking sector. The profitability of the foreign banks in China was lower than that of domestic banks (Wu, Chen, and Lin, 2007). Recent evidence indicates that banks with greater (minority) foreign ownership

shares and less state ownership are more cost and profit efficient than others in China (Berger, Hasan, and Zhou, 2009). Findings of recent studies focusing specifically on the recent global financial crisis suggest that at the height of the crisis global banks were transmitting shocks across borders through their affiliates. De Haas and Lelyveld (2013), for example, compare foreign banks with large domestic banks and find that the former group on average contracted their lending more. De Haas et al., (2011) find similar results for a sample of Eastern European countries. Popov and Udell (2012) show that if banks in the vicinity of the firm were experiencing distress at the onset of the global financial crisis, the likelihood of a firm being credit constrained increased. After investigating both positive and negative effects of foreign banks in the literature, but it can be said that the positive ones generally dominate.

As per María Soledad Martínez Peria and Sergio L. Schmukler published in the *Emerging Markets Review* in 2004 explores the challenges faced by foreign banks when entering emerging markets using Mexico as a case study, the authors highlight that emerging markets offer significant growth opportunities for foreign banks due to their expanding economies and untapped banking services. However they also face various challenges such as regulatory cultural and operational barriers. One of the major challenges discussed in the article is the regulatory environment in emerging markets. Foreign banks often encounter complex and restrictive regulations including high capital requirements limitations on branch expansion and restrictions on foreign ownership. These regulations can create barriers to market entry and hinder the ability of foreign banks to compete with domestic banks. Cultural challenges are also significant. Foreign banks may struggle to understand and adapt to the local customs practices laws and market conditions which can impede their ability to effectively serve local customers. Additionally language barriers and differences in business practices and regulatory frameworks can make it difficult for foreign banks to establish relationships with local customers businesses and authorities. Operational challenges are another concern identified in the article. Foreign banks may lack knowledge and experience in emerging markets making it challenging to manage risks and design appropriate products and services. Moreover the authors note that foreign banks often face higher costs due to unfamiliarity with the local market inefficiencies in information flow and difficulties in attracting and retaining qualified staff.

In the article "Foreign Banks in Developing Countries: Changing Players, Changing Issues" by Robert Cull, published in the Journal of Banking and Finance in 2009, the author examines the role and impact of foreign banks in developing countries. The study focuses on the changing landscape of foreign bank presence in developing countries, particularly in the context of increased financial globalization. The author analyzes the factors driving the entry of foreign banks into these economies and the implications for financial development and stability. The findings of the study suggest that foreign banks play a significant role in developing countries' financial systems. They bring in capital, technology, and expertise, which can positively contribute to financial development. However, the author also highlights the potential risks associated with foreign bank presence, such as increased exposure to external shocks and the potential for financial contagion.

The study conducted by Xiaolei Wang and Tao Sun focuses on the challenges faced by foreign banks operating in China and how these challenges impact the overall Chinese banking industry. The study identifies several key challenges that foreign banks face in China. One of the major challenges is the regulatory environment. The authors highlight that the regulatory framework in China is complex and the rules and regulations are constantly evolving. This makes it difficult for foreign banks to navigate and comply with the regulations especially if they have limited experience and understanding of the Chinese market. Another challenge mentioned in the study is fierce competition from domestic banks. The Chinese banking industry is dominated by state-owned banks that have a strong presence and extensive networks across the country. This makes it difficult for foreign banks to compete and gain market share especially in retail banking and small and medium-size enterprise (SME) financing. The authors also point out the issue of limited market access for foreign banks. Despite China's commitments to open up its financial sector there are still restrictions on the scope of business and the types of services foreign banks can offer. This hampers their ability to fully utilize their expertise and compete with domestic banks. Moreover the study highlights the challenges associated with cultural differences and language barriers.

Using a descriptive statistic, Raba (2017) examines the opportunities and difficulties of foreign banks entering Ethiopia. The study's conclusions demonstrate how the admission of foreign banks in Ethiopia could bring about new banking technologies, financial innovation, and financial development. Additionally, it improves access to global capital, which might lead to domestic banks expanding abroad and greater integration of Ethiopian banks into global financial systems, allowing them to offer a wider range of services, particularly to bigger local businesses with global operations. The fierce competition with international banks, on the other hand, may endanger the existence of domestic banks, causing them to incur significant costs in the short term and experience a loss in profit. Additionally, it might only benefit more productive sectors and bring shocks from other nations, as well as disrupt local credit. He also suggests that it would be beneficial to enable foreign banks to enter Ethiopia gradually, along with considerable capacity building for all players and the use of cutting-edge banking technologies.

Kiyota et al. (2007) analyze the issues related to the liberalization of the financial sector in Ethiopia with specific reference to the Ethiopian banking sector. Two factors, according to the results of their investigation, may be able to impede Ethiopia's economic development. One is Ethiopia's closed financial system, which is characterized by its absence of foreign banks, its uncompetitive market structure, and its stringent capital regulations. The other is state-owned banks' domination. Our research suggests that the financial sector's liberalization will benefit Ethiopia's economy, particularly through the admission of foreign banks and the consequent privatization of state-owned institutions.

Legesse (2012) examines the environmental prerequisites for the development of financial markets in Ethiopia and identifies potential issues and opportunities. His main focus was on outlining the roles that financial markets may play in accelerating the Ethiopian economy, as well as the environmental elements that needed to be examined and how Ethiopia's current position related to each factor. He primarily used secondary data sources and combined qualitative and quantitative elements. The study's conclusions are seen to be of utmost significance for supplying policymakers with knowledge that would help them create financial markets in Ethiopia. As a next step, the Ethiopian government must act quickly to further

research the environmental condition in order to build financial markets, recognize the opportunities that may exist, and make plans for dealing with the immediate problems.

Using data from 990 banks for the years 1990 to 1996, Lensink and Hermes (2003) conducted research on the immediate effects of foreign bank presence on domestic bank performance. The short-term consequences of foreign bank entry on local banking sector behavior are examined in this essay. They claim that these consequences depend on the degree of economic development of the host nation and provided evidence that, in countries with less economic development, the entry of foreign banks is typically accompanied with increased costs and margins for domestic banks. The consequences of foreign bank entry are either related with a decline in domestic banks' expenses, profits, and margins or they are not connected with changes in these domestic bank variables at greater levels of economic development.

2.4 Research gap

Numerous justifications are provided in the literature for how the presence of foreign banks may affect domestic banks' performance (Cho, 1990; Stiglitz, 1994; Levine, 1996; Buch, 1997; Berger and Hannan, 1998). First, the presence of foreign banks may encourage domestic banks to boost competition, drive down prices, and improve the effectiveness of current financial services. Domestic banks are under pressure to increase the quality of their services to maintain their market shares when international banks are present. Second, the presence of foreign banks may have beneficial knock-on consequences. Foreign banks may initially roll out new financial services. These new services could inspire domestic banks to create similar ones, enhancing the effectiveness of financial intermediation inside the local financial system. Thirdly, international banks may improve the domestic banking system's human capital in a number of ways. First off, local employees and bankers may learn from the methods used by these foreign bank managers if foreign banks import highly skilled bank managers to collaborate with in their foreign branches.

One of the local studies in this area is Getnet's (2010) investigation of investment limitations in and by Ethiopian banks. Abreham (2008) reports that survey respondents indicate that allowing multinational banks to operate has a beneficial impact on the effectiveness of local banking. To

learn more about how Ethiopia's institutional framework affects the entry and performance of foreign banks as well as the effectiveness and profitability effects on domestic banks of foreign bank entry, additional research is still needed. Further study is necessary to determine in delving into the impact of cultural differences, technology and innovation, regulatory and legal challenges, socio-economic implications, and market entry strategies, researchers can contribute to a more comprehensive understanding of the dynamics at play in the Ethiopian banking sector also how foreign bank entry promotes economic growth and financial inclusion in Ethiopia.

CHAPTER THREE

3. RESEARCH METHODOLOGY

3.1 Introduction

For researchers, decision-makers, and stakeholders, the opportunity and difficulties of foreign investor entry in the Ethiopian banking industry have been of interest. I want to present a thorough examination of the elements affecting the admission and operation of international banks in Ethiopia in this study. I used quantitative research techniques to do this. I go into great detail about the research technique in this section and explain how the study used to gather and evaluate data in order to respond to its research questions.

3.2 Research Design and Research Approach

The research employed both quantitative and qualitative methodology and produce quantitative and qualitative data. The qualitative method was used to gain more understanding and come up with explanations on the Opportunity and Challenge of foreign investor entry. The study adopt a cross-sectional research design with a time frame of 2023 and a single point in which data from the subjects were collected.

In actuality, this research was intended to examine the scope of the difficulties and opportunities associated with international investor entry into Ethiopia; as a result, it adopts an exploratory research approach.

Bhattacharjee (2012) asserts that exploratory research is frequently carried out in new areas of inquiry, with the goals of the research being to scope out the magnitude or extent of a specific phenomenon, problem, or behavior, to generate some preliminary ideas (or "hunches") about that phenomenon, or to determine whether it would be feasible to carry out a more in-depth investigation into that phenomenon.

3.3 Population and Sample Design

This study's target population was university professors and financial sector experts with extensive experience working in the banking sector. Consequently, the researcher utilized judgment-based (purposive) sampling to choose the sample, which involved carefully choosing the proper respondent for the interview. Because it is known that this strategy will create groups that are well matched or that are representative of the entire population, the purposive sampling was chosen using some arbitrary way. The goal is to select the sample based on a factor that is significant for the specific investigation. When a study focuses a strong emphasis on the control of a few particular factors, this approach makes sense (Singh 2006). In order to comprehend the research topic and the research questions, qualitative researchers must actively choose participants, places, documents, or visual material. Additionally, qualitative approaches are influenced by deliberate sampling, open-ended data collecting, and text or image analysis, information representation in figures and tables, and individual interpretation of the results (Creswell 2014). In order to conduct in-depth interviews and questioning of national bank officials, private bank experts, and foreign representative bank officials, the research used purposive sampling.

For the questioner part which is all commercial banks which are active during the study period and National Bank of Ethiopia in Addis Ababa was the study population. To determine the sample size for the study employed a sample determination formula developed by Cochran in 1963.

$$n = z^2pq/\epsilon^2$$

Where n is the sample size, z^2 is the abscissa of the normal curve that cuts off an area α at the tails ($1 - \alpha$) equals the desired confidence level, The z score for different significance levels is: 1.96 for 5%, 1.28 for 10%, and 2.58 for 1%, ϵ is the desired level of precision, p is the estimated proportion of an attribute that is present in the population, and q is $1-p$. Therefore, this research

$$n = \frac{(1.96)^2(50\% * 50\%)}{5\%^2}$$

$$n = 384.16$$

384

Therefore, the total sample for this study was 403 which includes 5% contingency, since the researcher believe some questioners may be rejected due to various reasons which includes non-response and incompleteness, so the researcher increased the sample size by 5% to have a good precision for the result which obtained from the study

3.4 Sources of data

The research used both primary and secondary data. Only chosen professionals and stakeholders was included in the interview because the subject only requires the argument and comments of professionals and others with sector expertise. Using in-depth interviews and key informant questioners, primary data was gathered from specified stakeholders, including regulatory authorities of banks.

Secondary data was gathered from a variety of sources, including past studies, journals, and financial books. The researcher also created the tools used to acquire the data.

3.5 Tools of Data Collection:

The study used two main tools for collecting data: Questionnaire and In-depth interviews. The questionnaire used to collect quantitative data on the opportunity and challenges of Ethiopia banking sector as a result of foreign bank entry. In-depth interviews gathered qualitative data from key respondents which have high experience in banking sector and professional experts from university professors and structured interview questions was developed for a group of respondents.

3.6 Data Analysis and Interpretation

The study utilized qualitative and quantitative data analysis techniques (thematic method). According to Bhattacharjee (2012), qualitative analysis is the examination of qualitative data, such as text from interview transcripts. Thus, content analysis has been used to analyze the qualitative data. Thematic analysis is a method of analyzing quantitative data which involves in

identifying, analyzing and reporting them or a pattern of a phenomena. The way the data was arrange in accordance with the study's goals. Additionally, the data was categorized and analyzed using an analytical approach while being in line with the goals of the study and the conclusions drawn from the data that will gathered.

After the researcher completed the data collection, data entry and data cleaning for this study; the researcher used a software of STATA 14 to get the required data analysis and summery results for study and the researcher also presented results by using charts, tables and different kinds of statistical data presentation techniques. And according to the analysis result the researcher try to infer statistically accepted inferences by giving the answer for those research questions raised in the study.

CHAPTER FOUR

4. DATA ANALYSIS, PRESENTATION AND DISCUSSION

4.1 Introduction

This chapter presents the data analysis, the research findings (results), and based on the results the researcher gives discussion on the findings and also gives some interpretation of the result. In order to presents findings and the discussion about the effect of foreign bank entry in Ethiopia; the researcher uses different form of tables and figures and qualitative and quantitative analysis done in the process.

4.2 Response Rate

A total of 403 questionnaires were administered to those officials in 28 commercial banks in Ethiopia and the National Bank (i.e. the regulatory body of the bank sector in Ethiopia) and from those questioners the researcher collects a total of 320 complete questioners and the remaining 83 questioners were not collected due to refusal to give response for the questionnaires. This gave a response rate of 79.40% According to Mugenda the statistically significant response rate for analysis should be at least 50% (Mugenda, 2003).

Table 2: Response Rate

	no of questioner	percent
Complete	320	79%
Non complete	83	21%
Total	403	100%

Source: research date (2023)

Table 3 General Information of respondents

		Count	Percent	Count	Percent	
Gender		Male		Female		
		172	54%	148	46%	320
Age Bracket	Less than 25 Years	44	14%	19	6%	63
	26-35 Years	3	1%	28	9%	31
	36-40 Years	26	8%	59	18%	85
	Over 40 years	99	31%	42	13%	141
Educational Background	certificate	0	0%	0	0%	0
	diploma	0	0%	0	0%	0
	BA/Bsc	62	19%	60	19%	122
	MSc/MA	110	34%	88	28%	198
work Experience	Less than 5 Years	44	14%	19	6%	63
	5 - 10 years	49	15%	85	27%	134
	10 - 20 years	70	22%	44	14%	114
	20+ years	9	3%	0	0%	9

Source; Research data (2023)

4.3 Feeling of respondents about foreign bank entry in Ethiopia

From the below table 3, the research found that most of the respondent of the questioner a good mood i.e. from the total of 320 respondents 46% or (148) of them are feel good as a result of allowing foreign bank entry to the Ethiopian market, while the other 23% of the respondent doesn't feel good about foreign bank entry to the market from the 23%, 15% or (47) respondent feels bad and the other 8% or (27) respondent feels stressed, And when we see the remaining respondents feeling 98 or 31% from the total respondents they are indifferent. Therefore, the respondent of the questioner are more or less they are in good mood.

These mood can be driven from the listed reason

Some people may perceive the entry of foreign investor as a positive development, anticipating economic growth, increased access to financial services, and job opportunities. Conversely, others may feel apprehensive about potential job displacement, unequal distribution of economic benefits, or a perceived loss of autonomy in the financial sector. Or can be in the reason of Trust and Credibility: The reputation and track record of the foreign investor entering Ethiopia can heavily influence public perception. People may feel positive about reputable banks bringing expertise and stability to the financial landscape, while others may be wary of unfamiliar institutions and apprehensive about their trustworthiness.

In other hand some people believe the entry of foreign investor may stimulate competition, potentially improving efficiency and lowering costs. While this could be viewed positively by consumers seeking better financial services, it may also evoke concerns about local banks' ability to compete and survive in a more competitive landscape. Or it can be People's reactions could be influenced by the perceived impact of foreign bank entry on local regulatory frameworks, legal compliance, and potential implications for consumer protection. Positive sentiments may arise from expectations of enhanced regulation and oversight, while negative reactions could stem from fears of regulatory loopholes or weaker consumer safeguards.

Also some respondent feel good as a result of foreign bank entry could lead to improved access to a wider range of financial products and services. This may be viewed positively by individuals seeking more diverse banking options. On the other hand, concerns about cultural relevance of financial offerings, changes in service quality, or potential exclusion of marginalized communities could lead to negative sentiments.

How did you feel when foreign investor entry in Ethiopia

Table 4 Feeling of respondents about foreign bank entry in Ethiopia

		Frequency	Percent	Total
Valid	Bad	47	15%	15%
	Stressed	27	8%	8%
	Indifferent	98	31%	31%
	Good	148	46%	46%
	Total	320	100%	100%

4.4 Variable rename

Table 5 variable rename

Questioner Question	Rename Variable	Indication
Introduce new financial innovation	Benefit 01	Potential Benefit
Accelerate the economics of scale	Benefit 02	
Develop the financial market	Benefit 03	
Improve the financial system infrastructure	Benefit 04	
Attracts foreign direct investment	Benefit 05	
Foreign bank entry having an effect on the performance of domestic banks in Ethiopia	Benefit 06	
Foreign investor may reduce costs	Cost 01	Potential challenges
Domestic Banking as an infant industry becomes less competitive	Cost 02	
Retains credit to small firms	Cost 03	
Lack of domestic strong supervisory body	Cost 04	
Lack of interest by foreign investor to mobilize domestic capital	Risk 01	potential risks
The infant industry argument	Risk 02	
Skews credit away from small and medium enterprise	Risk 03	
Limited supervisory capacity	Risk 04	
Fear of capital outflow	Risk 05	

Introduce a better supervision	Efficiency 01	potential efficiency reform to the bank sector
provide a more stable source of credit	Efficiency 02	
Introduce new products and service	Efficiency 03	
Enhance the competitive environment	Efficiency 04	
Encourage consolidation of banking service	Efficiency 05	
Transfer of good banking practice	Efficiency 06	
Introduce a better supervision	Efficiency 07	
Lower possible banking crises	Efficiency 08	
Foreign investor reduce local banks lending growth	Impact 01	Foreign investor on the performance of domestic banks
Foreign investor reduce local banks growth	Impact 02	
Foreign investor reduce local bank credibility	Impact 03	
Foreign investor reduce local bank growth on asset	Impact 04	
Foreign investor attracts qualified staffs	Impact 05	
Foreign investor reduce local banks market share	Impact 06	

From the above table we can see that the researcher use variable renaming in order to summarize the respondent in Stata,

4.5Benefit

From result Table 6 below, the researcher identifies the potential benefits of those Foreign investor if they begin to operate in Ethiopian market i.e. as per this survey result, for all potential benefits identified by previous researchers on entry of Foreign investor , respondents

are more or less agreed i.e. their mean scores greater the 3.8, so as a result of government decision on allowing Foreign investor to operate in Ethiopia, we will get the following benefits: they will introduce new financial innovations, they accelerate the economies of scale, there will be a development in the financial market, there will be an Improvement in the financial system infrastructure and this all leads the attraction of foreign direct investment (FDI). When we see the rank on those benefit we get from the entry of Foreign investor; the primary advantage is the introduction of new financial innovation (M=4.23; SD=.5704313). Based on the overall survey results, respondents indicated that foreign investor will introduce new financial innovation if they operate in Ethiopia under the current conditions. This is because the foreign investor have varying exposure to the various economies in which they operate, meaning that their relative exposure to the domestic financial sector gives them the advantage of introducing new financial innovation. Furthermore, foreign investor with roots in industrialized nations may be able to provide the previously mentioned advantages in comparison to a host nation like Ethiopia, which has a growing economy.

The second advantage of foreign bank entry will be that it will impact Ethiopian domestic banks' performance (M=3.97 SD=.9789117). In other words, foreign bank entry expands the financial market by attracting customers who might have otherwise gone to foreign investor abroad and helps to widen the interbank market. The third advantage resulting from foreign bank entry is the enhancement of the financial system infrastructure (M=3.95; SD=.7844429). This means that, as Table 6 shows, foreign investor may contribute to the improvement of the financial system infrastructure in the financial market if they begin to operate in this nation. This because that foreign bank and investor often bring in a capital for large scale infrastructure projects, which can significantly contributes to the country's economic growth. As per interview respondent with regard to the financial system infrastructure the interviewed respondents replied that it will be good if foreign investor enter in to the country because they bring advanced way of financial system since they have huge experience in the sector; Amanuel (2008) contends that in order to bridge the development gap, foreign investor with superior experience and expertise transfer their knowledge to the domestic financial system. By assisting these international banks, the financial sector might be improved by expanded presence of supporting agents like rating

agencies, auditors, and credit bureaus, as well as through accounting and transparency, financial regulation, and other means. Furthermore, they contend that if foreign investor operate here, they will likewise progress technology since their financial system may require more sophisticated computer technology, necessitating the involvement of new businesses or the government to maintain the system.

The 4th in the score is, they Attracts foreign direct investment (FDI) (M=3.87; SD=.7251567) i.e. Foreign investor presence may increase the amount of funding available to domestic projects by facilitating capital inflows, and diversifying the capital and funding basis. This perhaps could be utilized to potential venture businesses which currently unable to be financed due to the procedures in use. In addition, currently there is an issue on foreign currency shortage and most multinational companies are not willing to operate in countries with foreign currency shortage if they start to operate (Foreign investor) there will be an increase the country stock of foreign currency and this will lead those multinational companies since they will get enough money to for their importable items/ inputs, due to this our government will also collect much amount as tax on the imported items.

The development of the financial market by Foreign investor (M=3.72 SD=.8962599) is the fifth advantage. Put another way, this development of the financial market helps to broaden the interbank market and draw in business from clients who might have otherwise gone to foreign investor abroad. Furthermore, those international banks may be able to provide the qualified labor that this market needs from their own nation. According to the participants' responses in this study, the final benefit we get from foreign bank entry is that it accelerates economies of scale (M=3.15; SD=.8688262). The aggregate result from this survey respondent has pointed out that foreign bank with a scale of 'neutrally' will accelerate economies of scale if allowed to operate in Ethiopia with current conditions. While research made by Diresilign Dagneu the variable accelerates economies of scale has a mean of 4.5 due to the potential and available resource of those international bank, in this research the study point out that even through those international banks have more resource they are not quit possibly accelerates the economies of the country. This can be due to including regulatory hurdles, differences in the market condition, cultural barriers and varying customer behaviors

As per the interview analysis some experts claim that if there is an adequate supply of hard currency, there will be more imports, which will lead to healthy competition in the market and, ultimately, lower commodities prices for consumers. Accordingly, Amanuel (2008) clarified that there is still a larger disparity between Ethiopia's import and export of products, which has led to a recent rise in the foreign exchange rate. Consequently, there were fewer goods that could be imported from elsewhere. It is in this environment that certain large corporations have been reported to have foreign exchange shortages. He further contended that the entrance of Foreign investor increase the sock of hard currencies which in turn bust the importable items, upon which the government collect the tax on the imported items. The existence of Foreign investor would be good for the development and promotion of foreign exchange market (Zhao 2009). Moreover, it aids in resolving issues with nonperforming assets and innovative financial instruments. The globalization of the capital market has accelerated international trade in the nation, which has helped the banking sector as a whole. This is because Foreign investor offer a wide range of products and experience to the host country, as well as more advanced IT systems and better management practices.

Table 6 Potential Benefit

```
. sum benefit01 benefit02 benefit03 benefit04 benefit05 benefit06
```

Variable	Obs	Mean	Std. Dev.	Min	Max
benefit01	320	4.225	.5704313	3	5
benefit02	320	3.15	.8688262	2	4
benefit03	320	3.721875	.8962599	2	5
benefit04	320	3.953125	.7844429	2	5
benefit05	320	3.871875	.7251567	2	5
benefit06	320	3.96875	.9789117	2	5

Source (Stata report 2023, summery of benefits)

Overall, the findings from Table 6, supplemented by insights from related research, underscore the potential transformative impact of foreign bank entry on Ethiopia's financial landscape. However, realizing these benefits will require proactive measures to address challenges and

promote an enabling environment conducive to the successful operation of foreign investor within Ethiopia

4.6 Challenges

The respondents rate the possible potential costs to Ethiopian current situation and here the researcher summarize the result in the below Table 7, as a result of foreign bank entry to the Ethiopian bank market. The first potential cost is domestic banking, which is a relatively young industry and has a mean and standard deviation score of $M = 3.44$ and $SD = 1.00311$; this indicates that Foreign investor operate in the Ethiopian bank market and that domestic banks compete fiercely with those very large international banks. The government's decision to allow foreign investor to enter the market exposes domestic financial institutions to the risk that they won't be able to withstand the increased pressure from competitors and may even face bankruptcy. A bank failure of this kind would affect other banks and jeopardize the stability of the financial system in Ethiopia.

The 2nd potential cost of foreign bank entry will be “retains credit to small firms”, for this specify matter, the summary of response given by the respondents in this study, the mean is $M = 3.32$ with a standard deviation $SD = 1.038215$, this response indicates there is a fear by those bank officials Foreign investor may choose only the best clients with a potential of growth like i.e. there focus area might be medium and large firms and they will ignore those small firms since they would have little interest with those small domestic firms which may require them to hire additional expertise in dealing with those small firms to analyze the cost and benefit to work with them. Here those Foreign investor may likely to have little interest or expertise in dealing with smaller domestic companies which may not satisfy international accounting standard due to this those small firms will come to domestic banking sector with their high risk, in addition to this domestic banks will not get a chance to work with those large companies and in foreign trade, since the majority of those large firms may prefer those Foreign investor which operates in various countries. It is also slightly agreed by those respondents, “Lack of domestic strong supervisory body” with mean $M = 3.24$ and standard division of $SD = .9484974$, In view of this respondents in this study Ethiopia lacks strong supervisory body and establishing this

supervisory body will cost us, next to this there will be a risk for domestic banks since our domestic banking is infant industry. It is not agreed nor disagreed by those respondents, “foregone banks may reduce costs” with mean $M = 3.19$ and standard deviation of $SD = .8936383$. This suggests that the entry of foreign investor may result in neither a decrease in costs nor an increase in them, which suggests increased competition in the domestic market. As a result, those domestic banks that are still in their infancy may have to pay extra for advanced technology, highly qualified foreign employees, advertising to draw in medium-sized and large businesses, and other operating expenses. The mean of the possible costs resulting from international banks entering Ethiopia's banking system is 3.299, suggesting that respondents may anticipate cost issues following financial liberalization.

Table 7 Potential cost

```
. sum cest01 cost02 cost03 cost04
```

Variable	Obs	Mean	Std. Dev.	Min	Max
cest01	320	3.1875	.8936383	1	5
cost02	320	3.44375	1.00311	2	5
cost03	320	3.321875	1.038215	2	5
cost04	320	3.24375	.9484974	1	4

Source (Stata report 2023, summary of costs)

In other point as per the interview analysis The findings of this study contend that majority of the banks would be out of market within short period of time, according to the respondents this is due to very low capital of the banks compared to the international banks, some of the expert key informants replied that even the capital of all private banks together couldn't compete with a single international banks. In addition to having enormous money, these multinational banks have extensive marketing expertise, which might leave the local banks holding nothing. In support of this, Amanuel (2008) contends that international banks, with their greater capital, experience, and reputations, will pose a threat to the growth of a sustainable domestic banking sector. They contend (the infant industry argument) that Ethiopia's banking sector is too young and inexperienced to compete. Martinez-Diaz (2007) further argues that foreign ownership of the

banking industry is neither the neocolonial invasion that nationalist politicians fear nor a simple solution for weak banking systems. The banking sectors in developing and transitioning countries can benefit from the use of foreign capital, but the management of the opening process is critical. Furthermore, Song (2004) contends that the primary objection to foreign investor entering the market early is the possibility that domestic financial institutions won't be able to handle the increasing pressure from competition and may possibly end up bankrupt. Such bank failures might potentially jeopardize financial market stability and have a cascading effect on other institutions.

Interpretation of these findings suggests that while the entry of foreign investor into Ethiopia's banking market offers potential benefits, it also poses significant risks and challenges for domestic financial institutions. Proactive measures, including strengthening regulatory oversight, enhancing the competitiveness of domestic banks, and fostering collaboration between domestic and foreign institutions, will be essential to navigate these challenges effectively and ensure a balanced and resilient banking sector that contributes to Ethiopia's economic development and stability.

Furthermore, insights from related research underscore the complex dynamics at play in the opening of the banking sector to foreign ownership. While foreign capital can bring opportunities for growth and innovation, effective management of the opening process is crucial to mitigate risks and ensure that the interests of domestic institutions and the broader economy are safeguarded. The experiences of other countries, as highlighted in the literature, provide valuable lessons for Ethiopia as it navigates the path towards financial liberalization and integration into the global banking landscape.

4.7 Risk

The synthesis of findings from Tables 8 and 10 provides a comprehensive understanding of the potential risks and impacts associated with the entry of foreign investor into the Ethiopian banking sector. By juxtaposing the perceived risks with the anticipated impacts on domestic banks, we can discern the complex dynamics at play and their implications for Ethiopia's financial landscape.

Firstly, the identified potential risks associated with foreign bank entry underscore the challenges and vulnerabilities that domestic institutions may face. The primary concern highlighted by respondents is the fear of capital outflow, with a mean score of 4.14, indicating widespread agreement among respondents regarding the potential negative impact on capital flows and foreign exchange reserves. The interview analysis further elucidates this risk, with experts expressing apprehension about the potential destabilizing effects of capital outflows during economic downturns, exacerbating existing vulnerabilities within the financial system.

Additionally, concerns about the lack of desire on the part of international banks to mobilize domestic capital and the potential for skewed credit allocation away from small and medium-sized businesses highlight the risks of reduced access to financing and inequality in the distribution of financial resources. The infant industry argument further underscores the perceived threat posed by foreign investor to the growth and sustainability of the domestic banking sector, given their superior resources and expertise.

In contrast, the anticipated impacts of foreign investor entry on the performance of Ethiopian domestic banks reveal a nuanced picture of both challenges and opportunities. The identified impacts, including a slowdown in local bank growth, a decline in local bank credibility, and a reduction in local bank market share, underscore the competitive pressures that domestic banks may face in the presence of foreign counterparts. This competition could potentially constrain lending activities and diminish profitability for domestic banks, particularly as foreign investors leverage their capital and technological advantages to attract customers and expand their market share.

However, the entry of foreign investor also presents opportunities for the recruitment of qualified employees and the enhancement of operational efficiency within the domestic banking sector. The potential for increased competition and access to advanced technology and infrastructure may incentivize domestic banks to innovate and improve their services, ultimately benefiting consumers and fostering broader financial inclusion.

Overall, the synthesis of findings highlights the importance of adopting a balanced and proactive approach to foreign bank entry in Ethiopia. While acknowledging the risks and challenges, such as the potential for capital outflows and competition-induced pressures on domestic banks, it is essential to leverage the opportunities presented by foreign bank entry to drive innovation, enhance efficiency, and promote sustainable growth within Ethiopia's banking sector.

Policymakers and regulators must prioritize measures to strengthen regulatory oversight, mitigate systemic risks, and foster collaboration between domestic and foreign investor to ensure a level playing field and safeguard the stability and inclusivity of Ethiopia's financial system. Additionally, investments in human capital development and technological infrastructure will be crucial to enhance the competitiveness and resilience of domestic banks in the face of increasing globalization and financial liberalization.

Table 8 potential risk

```
. sum risk01 risk02 risk03 risk04 risk05
```

Variable	Obs	Mean	Std. Dev.	Min	Max
risk01	320	3.81875	1.090695	1	5
risk02	320	3.490625	.9401725	2	5
risk03	320	3.01875	1.264276	1	5
risk04	320	3.396875	1.201614	1	5
risk05	320	4.140625	.6687655	1	5

Source (Stata report 2023, summery of risks)

Table 9 potential impact on domestic bank

```
. sum impact01 impact02 impact03 impact04 impact05 impact06
```

Variable	Obs	Mean	Std. Dev.	Min	Max
impact01	320	4.08125	1.041291	1	5
impact02	320	4.34375	.537577	3	5
impact03	320	4.296875	.6783644	2	5
impact04	320	4.08125	.9366911	2	5
impact05	320	4.26875	.8245593	2	5
impact06	320	4.1125	.9467814	1	5

Source (Stata report 2023, summary of impact)

4.8 Efficiency in reforming to the banking sector

The findings presented in Table 9 highlight the perceived effectiveness of various reforms aimed at improving the domestic banking industry in Ethiopia, particularly in response to the entry of foreign investor. Respondents generally agree on the potential benefits of these reforms, indicating a consensus on the importance of enhancing the competitiveness and stability of the banking sector through regulatory and operational improvements.

The foremost efficiency improvement identified is the introduction of new products and services, with a mean score of 4.25. This underscores the expectation that foreign investor will bring advanced technology, expertise, and innovative practices to the Ethiopian banking market, thereby enriching the range of financial products and services available to consumers and businesses.

Additionally, the potential for better supervision and risk management, as indicated by a mean score of 4.10, highlights the importance of strengthening regulatory oversight to ensure the stability and integrity of the financial system. The presence of foreign investor with experience in diverse regulatory environments can facilitate the adoption of best practices and enhance the effectiveness of supervision mechanisms in Ethiopia.

Moreover, the anticipated reduction in banking crises and the transfer of good banking practices underscore the potential for foreign bank entry to mitigate systemic risks and improve overall industry standards. By leveraging their expertise and risk management capabilities, foreign investor can contribute to a more resilient and stable banking sector in Ethiopia.

However, respondents also recognize the challenges and potential drawbacks associated with foreign bank entry, particularly in terms of maintaining a competitive environment and ensuring equitable access to financial services. The emphasis on enhancing the competitive environment and encouraging financial service consolidation reflects concerns about the potential for foreign investor to dominate the market and exert undue influence on traditional banking practices.

Furthermore, the need for better disclosure and a more stable source of credit underscores the importance of transparency and reliability in financial markets. While foreign bank entry may bring benefits in terms of improved credit availability and stability, concerns remain about the potential for skewed credit allocation and neglect of certain sectors, such as agriculture and small-scale enterprises, which are vital for the country's development agenda.

Overall, the findings suggest that while foreign bank entry presents opportunities for reform and improvement in the domestic banking sector, careful consideration must be given to regulatory frameworks, market dynamics, and the equitable distribution of financial services. Policymakers and regulators play a critical role in ensuring that reforms are implemented effectively to promote a competitive, inclusive, and resilient banking sector that supports Ethiopia's economic growth and development objectives. Collaboration between domestic and foreign institutions, coupled with robust oversight and governance mechanisms, will be essential to navigate the challenges and harness the potential benefits of foreign bank entry in Ethiopia's evolving financial landscape.

Table 10 Potential efficiency reform to the bank sector

```
. sum efficiency01 efficiency02 efficiency03 efficiency04 efficiency05 efficiency06 efficiency07 efficiency08
```

Variable	Obs	Mean	Std. Dev.	Min	Max
efficiency01	329	4.189375	.8258997	2	5
efficiency02	329	3.6	1.060549	2	5
efficiency03	329	4.253125	.6894791	1	5
efficiency04	329	4.989375	.6456313	2	5
efficiency05	329	3.96875	.9184647	2	5
efficiency06	329	4.953125	.9964327	2	5
efficiency07	329	3.78625	.9274421	2	5
efficiency08	329	4.875	.8429754	2	5

Source (Stata report 2023, summary of efficiency)

The comprehensive analysis of the findings from Tables 6, 7, 8, 9, and 10 provides a multifaceted understanding of the opportunities, challenges, risks, and impacts associated with the entry of foreign investor into the Ethiopian banking sector. These insights offer valuable insights into the potential implications for the financial landscape, regulatory frameworks, and the broader economy of Ethiopia.

Opportunities and Benefits:

The entry of foreign investor is expected to bring various benefits, including the introduction of new financial innovations, acceleration of economies of scale, development of the financial market, improvement in financial system infrastructure, and attraction of foreign direct investment (FDI). These benefits are underscored by respondents' high mean scores, indicating widespread agreement on the potential positive impacts of foreign bank entry.

Foreign investor are perceived to have the expertise, technology, and resources to enhance the efficiency and competitiveness of the domestic banking sector, as evidenced by their potential to introduce new products and services, improve supervision mechanisms, mitigate banking crises, transfer good banking practices, and enhance the competitive environment.

Challenges and Risks:

Despite the potential benefits, the entry of foreign investor also poses significant challenges and risks. These include concerns about the impact on domestic banking performance, potential

capital outflows, reduced access to credit for small and medium-sized enterprises, and risks associated with limited supervisory capacity and skewed credit allocation.

Respondents express apprehension about the potential for intensified competition and market dominance by foreign investor, which could undermine the stability, credibility, and market share of domestic banks. Moreover, fears of capital outflows and credit concentration towards large enterprises highlight concerns about financial vulnerability and inequality in credit access.

CHAPTER FIVE

5. CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion

The study began by looking into the possibility, benefits, hazards, and strategies for reducing these risks associated with foreign investor entering Ethiopia. The study started by looking at the theoretical frameworks and lessons learned from other countries in relation to the problem, with four main objectives in mind. The study used both qualitative and quantitative data collection methods, especially interviewing experts in-depth to get their perspectives on the research goal and having banking industry employees complete survey questions. The participants in the study were selected from a variety of relevant groups, such as local banks, regulatory agencies, and other industry players. Once the process of data collection has concluded, the data has been analyzed according to the five objectives that the research seeks to address.

The country's current financial infrastructure might be improved by the arrival of international banks with cutting-edge technology and financial systems, as per the research analysis and findings. Moreover, a lot of well-established businesses, big and small, need working capital as the nation strives to shift its economy from agricultural to industry. As a result, these international banks might be able to provide adequate credit access. In addition, in any environment with sufficient and equitable competition, firms would operate more efficiently since the incompetent ones would be forced out of the market. For this reason, the entry of foreign investor may boost the proficiency and effectiveness of local banks. Having a sufficient amount of hard currency is crucial for a country like Ethiopia, where most commodities are imported. Additionally, since most raw materials used by manufacturing companies are imported, allowing foreign investor to enter the market could potentially address the common issue of foreign currency in the country. International standards will be met more easily by the financial sector's expansion and economic activity thanks to the arrival of foreign investor. Allowing these banks, however, may not always have benefits; if caution is not exercised, these foreign investor may quickly engulf local banks and drive them out of business. Additionally, because these are global businesses, they are not always successful, and their crises in one part of

the world may have an impact on the economy of the host nation. Aside from this, the government may not be able to control them if they seize control of the nation's financial system owing of their sophisticated technology and unidentified base. This might result in foreign investor engaging in unethical behavior that would undermine the financial sector.

In conclusion, there is a complicated environment that has to be carefully considered when evaluating the opportunities and challenges of international banks entering the Ethiopian banking system. The introduction of foreign investor carries risks, expenses, and worries about the dynamics of the local market and ownership, even as it also offers possible advantages including more competition, increased efficiency, and access to expertise. It takes a balanced strategy that maximizes the advantages while minimizing the dangers to navigate these dynamics. Ethiopia may be able to capitalize on the resources and experience that international banks bring while preserving the stability and resilience of its banking industry by creating a regulatory framework that values cooperation, healthy competition, and the protection of local interests. With thoughtful planning, collaboration, and a focus on sustainable growth, the entry of foreign investor has the potential to contribute positively to the Ethiopian banking sector, ultimately benefiting consumers, businesses, and the economy as a whole.

5.2 Recommendation

The different pros and cons of foreign banking in Ethiopia is discussed so far, in line with the finding of this study the researcher forward the following suggestions for different stakeholders in which he believed that should be done in the future.

Local Banks

- Local banks should consider diversification and expansion strategies, including exploring opportunities for regional expansion and seeking partnerships with non-banking financial institutions to broaden their service offerings and customer base
- Investments in human capital development, technological infrastructure, and financial literacy are crucial to enhancing the competitiveness and resilience of domestic banks and ensuring equitable access to financial services across diverse segments of society.

- Maintaining a strong focus on customer relationships, service quality, and financial inclusion initiatives can be a key differentiator for local banks, enabling them to build loyalty and trust among their customer base in the face of increased competition.

Regulatory Body

- The findings underscore the importance of adopting a balanced and proactive approach to foreign bank entry, informed by robust regulatory frameworks, enhanced supervision mechanisms, and strategic policy interventions
- Policymakers and regulators must prioritize measures to strengthen regulatory oversight, mitigate systemic risks, and promote financial inclusion, while also fostering collaboration and knowledge transfer between domestic and foreign institutions.
- NBE should be alert in its due diligence of foreign investor to identify banks with potentially suspicious reputations and with risk prone banking practices.
- There needs to be strict regulations especially when it comes to outflow of funds for foreign investor to minimize the risks associated to unexpected capital flight.
- The mode of entry of foreign investor should be a step by step process whereby an arrangement such as joint ventures and minority stakes and gradual increase are promoted and full ownership mode of entry is regulated at the starting phase.

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Annex -1.Questionnaires

Addis Ababa University

College of Business and Economics

Masters of Science in Accounting and Finance

Questionnaire on “opportunity and challenge of Foreign Bank Entry in Ethiopia banking sector.”

Dear Respondents,

This questionnaire is designed to explore the **opportunity and challenge of** foreign investor entry in Ethiopia Banking sector. This study is conducted in partial fulfillment of the requirements for the Master’s degree in Accounting and Finance at Addis Ababa University. Its main objective is to assess the opportunity and challenge of Foreign Bank Entry in Ethiopia banking sector.

Your response is vital to the outcome of the study and you are requested to completely and objectively answer all questions. The research is going to be carried out based on your responses and other relevant data that could support it. It forms a major part of the research and the information you will enable the researcher to critically analyze to answer research questions where the researcher raised in this study.

Your cooperation to respond genuinely is very important to this study because it represents in the sample. Please answer all questions. Space is provided at the end of the questionnaire for you to add further explanations or comments. I would promise that all information you provide would be strictly confidential.

Please tick () or provide your own answers where applicable. Thank you for participating in this research study.

Thank you in advance for your indispensable cooperation to spare invaluable time and energy to complete these questionnaires

Name: Yohannes Worku/ MSc student at AAU Telephone: +251-945-80-61-48 or email: johnworku9@gmail.com

PART1. General Information and Demographic Background of Respondents

1.1. Gender

Male

Female

1.2. Age Bracket

Less than 25 Years

36-40Years

26-30 Years

Over 40Years

31-35Year

1.3. Educational Background

Certificate

MSc/ MA

Diploma

Other Specify _____

BA/BSC Degree

1.4. How long have you been working in the financial institution?

< 5Years

10 to 20 Years

5 to 10 Years

> 20Years

1.5. How did you feel when foreign investor entry is allowed in Ethiopia?

Bad

Stressed

Indifferent

Good

PART 2:

The scale below will be applicable as Five-point scales ranging from “Strongly Disagree” to “Strongly Agree”

That is: 1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree 5 = Strongly Agree.

Please make an (x) in the respective box.

2.1. How would you rate the potential benefit to the Ethiopia current situation, if foreign investor are allowed to operate?

	1	2	3	4	5
Introduce new financial innovation					
Accelerate the economies of scale					
Develop the financial market					
Improve the financial system infrastructure					
Attracts foreign direct investment					

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

	1	2	3	4	5
Foreign investor may reduce costs					
Domestic Banking as an infant industry becomes less competitive					
Retains credit to small firms					
Lack of domestic strong supervisory body					

2.3. The policymakers in Ethiopia have identified the following potential risks towards foreign bank entry. How would you rank the potential risks?

	1	2	3	4	5
Lack of interest by Foreign investor to mobilize domestic capital.					
The infant industry argument					
Skews credit away from small and medium enterprise					
Limited supervisory capacity					
Fear of capital outflow					

2.4. How would you rate the following potential efficiency reform to the general economy, if Foreign investor are start to operate with current conditions?

	1	2	3	4	5
Improve financial regulation					
Introduce other financial activities					
Attract a foreign direct investment					
Enhance the overall stability					

2.5. How would you rank the following potential efficiency reform to the bank sector, if Foreign investor start to operate with current conditions?

	1	2	3	4	5
Lower possible banking crises					
Provide a more stable source of credit					

Introduce new products and services					
Enhance the competitive environment					
Introduce a better supervision					
Introduce better disclosure					
Transfer of know how					
Transfer of good banking practice					
Encourage consolidation of banking service					

2.6. What will be the impact of foreign investor on the performance of Ethiopian domestic banks, if allowed to operate within the coming 5 years?

	1	2	3	4	5
Foreign investor reduce local banks market share					
Foreign investor attracts qualified staffs					
Foreign investor reduce local bank credibility					
Foreign investor reduce local bank total growth					
Foreign investor reduce local bank total growth asset					
Foreign investor reduce local banks lending growth					

2.7. Foreign bank entry having an effect on the performance of domestic banks in Ethiopia

Strongly Disagree, Disagree, Neutral, Agree Strongly Agree

Any other comment/ suggestion; please State

Thank you for your participation! Your responses are greatly appreciated and will contribute to our research on the opportunities and challenges of foreign bank entry in the Ethiopian banking sector.

Annex -2-Interview questions for experts

- I. What will be the effects of financial liberalization on foreign currency deposit?
- II. Does foreign bank entry skew credit allocation towards large scale industrial real estate, service enterprises, agriculture, small scale firms?
- III. Does financial liberalization have positive effects on the efficiency of the banking sector?
- IV. Do you think the development of a viable domestic banking sector will be threaten by Foreign investor because they have more capital, more experience, and better reputations?
- V. What will be the impact of foreign investor on Domestic banks performance in terms of attracting qualified staffs, reducing local banks and reducing local banks total growth asset?
- VI. Will foreign investor entry Enhances competition among financial institutions/banks in terms of setting deposit rate, interest rate, service quality and develops a greater diversity of financial institutions?