



College of Business and Economics

Department of MBA

What Motivates Foreign Banks Entry in Low-Income Sub-Saharan Countries

A Thesis Submitted to Addis Ababa University College of Business and Economics, Graduate Studies in Partial Fulfillment of the Requirements for the Degree of Master of Business Administration in Finance

By: Noah Yoseph

Advisor: Temesgen Worku (PhD)

October 2019 G.C

Addis Ababa, Ethiopia

STATEMENT OF DECLARATION

I, Noah Yoseph, declare that this thesis entitled: “*What Motivates Foreign Banks Entry in Low-Income Sub-Saharan Countries*” and submitted in partial fulfillment of the requirements for the Degree of Master of Business Administration in Finance, has been prepared with my own effort under the advice and guidance of my advisor. I also assert that this thesis has not been presented for a degree in any university and all sources of material used for this thesis have been duly acknowledged.

Noah Yoseph

Signature_____ Date_____

STATEMENT OF CERTIFICATION

Addis Ababa University

School of Graduate Studies

This is to certify that the thesis prepared by Noah Yoseph, entitled: *What Motivates foreign banks entry in low-income Sub-Saharan Countries* and submitted in partial fulfillment of the requirements for the Degree of Master of Business Administration in Finance complies with the regulations of the University and meets the accepted standards with respect to originality and quality.

Signed by the Examining Committee:

Approved by Advisor

Temesgen Worku (PhD) Signature _____ Date _____

Internal examiner

Zinegnaw Abiy (PhD) Signature _____ Date _____

External examiner

Alem Hagos (PhD) Signature _____ Date _____

ACKNOWLEDGMENTS

First of all, I would like to thank my Lord and Savior Jesus Christ for his mercy and help throughout my season without him this wouldn't be possible. I would like to express my sincere gratitude to my advisor Temesgen Worku (PhD) for his feedback and cooperation. In addition, I would like to express my gratitude to my family and friends for their support in overcoming numerous challenges I have been facing through my research.

Abstract

This paper examines the motivations of foreign banks in low income sub-Saharan African countries. The main purpose of the paper is to understand what the foreign banks target are and what outcomes could follow as their presence in the host countries grows. The research used secondary data from thirteen low-income African countries. The researcher estimates the panel data using the time fixed effects model to investigate the relationship between possible motivations for foreign banks. The data covered a period of nine years from 2005-2013 since further years data was not available from possible sources. In the research foreign bank presence has been used as dependent variable and inflation, GDP growth, FDI net inflow, trade, and external debt are used as independent variables. The analysis result shows that inflation and GDP growth has negative impact on the entry of foreign banks. FDI inflow and trade are huge motivation in entering the market. The entry mainly targets giant companies operating in the host country. On the other hand, the foreign banks are not motivated in borrowing.

Key Words: Foreign Bank Presence, Host Countries

Table of Content

ACKNOWLEDGMENTS.....	I
ABSTRACT.....	II
LIST OF TABLES	V
LIST OF FIGURES	VI
ABBREVIATIONS	VII
CHAPTER ONE	1
INTRODUCTION.....	1
1.1. BACKGROUND OF THE STUDY	1
1.2. STATEMENT OF THE PROBLEM	2
1.3. OBJECTIVES	3
1.3.1. General Objectives.....	3
1.3.2. Specific Objectives	3
1.4. RESEARCH QUESTIONS.....	4
1.5. RESEARCH HYPOTHESIS	4
1.6. THE SIGNIFICANCE OF THE STUDY	4
1.7. SCOPE AND LIMITATIONS OF THE STUDY	5
1.8. ORGANIZATION OF THE STUDY	5
CHAPTER TWO	6
2. LITERATURE REVIEW	6
2.1. THEORIES OF MULTINATIONAL BANKS	6
2.1.1. Internalization Theory	6
2.1.2. Eclectic Theory	6
2.2. RELATIONSHIP BETWEEN MNB AND FDI	8
2.3. WHAT MOTIVATES FDI?	8
2.4. SPECIFIC REASONS FOR FOREIGN BANKS EXPANSION.....	11
2.5. LIMITATIONS ON FOREIGN BANKS ENTRY IN THE BANKING INDUSTRY.....	12
2.6. WHY DOES THE ETHIOPIAN GOVERNMENT BLOCK THE ENTRY OF FOREIGN BANKS?	12
2.7. WHY SHOULD COUNTRIES ALLOW FOREIGN BANKS?.....	14
2.8. CENTRAL BANK’S ROLE IN MONITORING THE FINANCIAL SECTOR	14
2.9. FOREIGN BANKS ENTRY MODE	15
2.9.1. Branches vs. subsidiaries.....	15
2.9.2. Degree of intra-group integration	15

2.9.3. Merger and acquisition vs. greenfield investment	16
2.9.4. Representative office.....	17
2.10. EMPIRICAL LITERATURE REVIEW	17
2.11. RESEARCH GAP	19
2.12. CONCEPTUAL FRAMEWORK.....	20
CHAPTER THREE	21
3. RESEARCH METHODOLOGY	21
3.1. SOURCE OF DATA AND SAMPLING.....	21
3.1.2. Data Analysis	21
3.1.3. Research Model.....	22
3.1.4. Variable clarification	23
CHAPTER FOUR.....	25
4. DATA ANALYSIS AND INTERPRETATION.....	25
4.1. SUMMARY OF VARIABLES	25
4.2. CORRELATION MATRIX.....	27
4.3. MULTICOLLINEARITY TEST	27
4.4. REGRESSION ANALYSES AND HYPOTHESES TESTING.....	28
4.4.1. Regression	29
4.4.2. Hypothesis Testing.....	31
4.5. PANEL DIAGNOSTIC TEST.....	35
4.5.1. Heteroskedasticity Test.....	36
4.5.2. Normality Test	36
CHAPTER FIVE.....	39
5. CONCLUSION AND RECOMMENDATION	39
5.1. CONCLUSION	39
5.2. RECOMMENDATION.....	40
REFERENCES.....	41

List of Tables

Table 1. Summary of Variables	25
Table 2. Correlation matrix	27
Table 4. Multicollinearity Test	28
Table 3. Regression.....	29
Table 5. White Test.....	36
Table 6. Sktest (Skewness/Kurtosis tests for normality).....	37
Table 7. Shapiro-Wilk Test	37
Table 8. Jarque-Bera Test.....	37

List of Figures

Figure 1. MNE's Entry Advantages.....	7
Figure 2. Conceptual Framework	20
Figure 3. Histogram Diagram	38
Figure 4. Normality Distribution Plot	38

Abbreviations

ANOVA	Analysis of variance
EPRDF	Ethiopian People's Revolutionary Democratic Front
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IMF	International Monetary Fund
MFI	Micro Finance Institutions
MNB	Multinational Banks
MNC	Multinational Corporation
NBE	National Bank of Ethiopia
OECD	Organization for Economic Co-operation and Development
OLS	Ordinary Least Square
SME	Small and Medium Enterprises
UNCTAD	United Nations Conference on Trade and Development
US	United States
WTO	World Trade Organization

CHAPTER ONE

Introduction

1.1. Background of the study

Foreign Direct Investment (FDI) is an essential part of an open and effective international economic system and a major catalyst to development (OECD, 2002). Growing international linkage through foreign direct investment (FDI) is an important feature of financial globalization and raises important challenges for policymakers and analysts in industrial and developing countries alike (Neil Patterson et al, 2004). In the last few decades, several countries have liberalized FDI in their financial systems due to this investment of foreign companies in domestic institutions has been growing. Investment in banks has been one of the major parts of FDI.

In this globalized world, the banking sector plays a vital role in the development of countries more than any other time. The more the sector gets to strengthen the more the country's economy developed and stabilized. Since the end of World War II, foreign direct investment is highly recognized and foreign banks developed comparatively an attempt to fulfill the banking service needed to those multinational companies abroad (Herbert, 1977).

Most FDI is carried out by multinational corporations (MNCs) which have progressed toward becoming household names. Examples (with no specific order in mind) are Toyota, IBM, Phillips, Nestle, Sony, Royal Dutch Shell, GM, Coca-Cola, McDonald's, Daimler-Benz, and Bayer. It is, however, difficult to pinpoint what constitutes an MNC, and there is not even an agreement on what to call these firms. The literature shows various 'labels' for these firms, comprising of the words 'international', 'transnational', or 'global' followed by any of the words 'corporations', 'companies' and 'enterprises'. What is more important is that there is no single definition for an MNC (Imad Moosa, 2002).

When a foreign bank sets up operations in the host country the process referred to as foreign bank entry. (George Clarke et al. 2003) Different authors interchangeably use cross border

banking and multinational banking for similar definitions as foreign banks. (Thoresten et al., 2014; Herbert Grubel, 1977). The banks are considered to be foreign-owned if they are controlled by a shareholder or group of shares outside their licensed jurisdiction. (Thoresten et al., 2014)

Foreign banks are a significant piece of Africa's financial landscape. Foreign banks were the first banks to be established on the continent during colonial times (Thorsten Beck et al., 2014). Africa's banking sectors are small, concentrated, and mostly foreign-owned. The ownership structure has experienced significant changes over the past 50 years since gaining independence. At the time of independence, Africa's banking systems were mostly dominated by colonial banks, many of which were subsequently nationalized (or "Africanized," however the result state ownership was often the same). Basic adjustment and privatization programs in the 1980s saw a return to private ownership among a significant number of these banks, sometimes in favor of the same European banks that had once been the proprietors. At the present time, Africa is the region with the highest share of foreign-owned banks with the exception of the transition economies of Europe and Central Asia (Thorsten Beck et al., 2011)

1.2. Statement of the problem

All of the countries in the sub-Saharan, apart from Ethiopia have had a colonial past, with most of them gaining independence in the 1960s (Franklin Allen et al., 2010) during those colonial times in almost all the countries the colonizers were owning banks in the countries they were colonizing. That even goes to the same for Ethiopia foreign banks from Italy, France, and Britain used to have their branches in Ethiopia for periods of varying lengths during the emperor (Haile Selassie I) was in power (Arnaldo Mauri, 1971). It is believed to be the foreign banks came to existence with mutual agreement with the country, unlike the other African countries. For the last three decades, the government of Ethiopia has taken reform works in the banking sector since taking power in 1991. The major reforms were Proclamation No. 84/1994 that allowed the private sector to involve in the banking business marked the beginning of a new era in Ethiopian banking and re-establishing the National Bank of Ethiopia (NBE) as central bank and financial market regulator (Abay, 2011) are the two major reforms made with EPRDF but has never

granted foreign banks a permission to enroll in the country. Policymakers had gone in a debate over liberalizing the banking sector to foreign banks entry and it's widely considered that it could be a liability to the country instead of using it to the country advantage but this is not the only reason for prohibiting foreign banks from entering. The government follows oppressive policies that fully or partially hinder the private and foreign companies not to perform in their full capacity to safeguard its companies interest in the likes of telecommunication, airlines, insurances, etc. even though the government of Ethiopia is suggesting there are reasons behind that. With that being said in order to enter once country both the country and the investor have to be willing. The foreign banks have their own perspective in entering a country. For the other African countries, the foreign banks were operating during the colonial times they still exist after post-colonization for different reasons in almost all African countries and they didn't get a chance to say yes or no at the entry foreign banks since it was decided for them by the colonizers

1.3. Objectives

1.3.1. General Objectives

The main objective of the study is to investigate what motivates foreign banks in low income sub-Saharan African countries to increase their presence and what possible outcome could follow as a result.

1.3.2. Specific Objectives

- To investigate how inflation impacts the entry of foreign banks
- To investigate how GDP growth impact the entry of foreign banks
- To investigate how FDI impact the entry of foreign banks
- To investigate how trade impact entry of foreign banks
- To investigate how External debt impact the entry of foreign banks

1.4. Research Questions

The general research question is what the motivations for foreign banks entry are. Based on this general research question the followings specific questions are raised

- Does inflation impact the entry of foreign banks?
- Does GDP growth impact the entry of foreign banks?
- Does FDI inflow impact the entry of foreign banks?
- Does trade impact the entry of foreign banks?
- Does External debt impact the entry of foreign banks?

1.5. Research Hypothesis

Based on the above research questions the following hypotheses have been formulated.

Ha1: Inflation affects the entry of foreign banks

Ha2: GDP growth has an impact on the entry of foreign banks

Ha3: FDI net inflow attracts the entry of foreign banks

Ha4: Trade has a relationship with the entry of foreign banks

Ha5: External debt attracts the entry of foreign banks

1.6. The significance of the study

The financial sector holds so much weight in a countries economy. Especially the developing countries count on their financial sectors to help out gain more assets to the economy. The finding of this study will contribute in knowing and understanding what really motivates the foreign banks so that every party related to the financial sector act and work hard on the places that are needed to be improved so that a good and vibrant environment exist in the host country.

1.7. Scope and limitations of the study

The study primarily focuses on the motivations of the foreign banks entry in the low-income sub-Saharan countries as their presence grows in the countries for the period 2005-2013. One of the main limitations in doing this paper was finding timely data concerning the dependent variable. There was no new available data about the percentage of foreign banks among total banks after 2013. The other limitation was there are no abundant papers in this area to refer to especially when it comes to developing countries.

1.8. Organization of the study

The paper has five chapters. The first chapter covers the introduction part including the statement of the problem, objectives, research hypothesis, significance of the study, and scope and limitation of the study. The second chapter deals with the literature review related to the subject. Chapter three is all about the methodology of the research. Chapter four explains how the data is analyzed and interpreted and the fifth and the last chapter deals with conclusions and possible recommendations.

CHAPTER TWO

2. Literature Review

2.1. Theories of Multinational Banks

The effects of foreign bank presence are closely related to FDI in the manufacturing sector. Thus, the theoretical analysis in this study often refers to this sector. The internalization theory and the eclectic theory are presented to study the multinationalization of banks from developing and industrialized countries. By combining these theories with the technological gap theory, the effects of foreign bank presence in developing countries are established. (Pohl, Birte, 2010)

2.1.1. Internalization Theory

Internalization theory, originating in the pioneering work of Coase (1937). The theory has focused primarily on explaining which parameters would stimulate firms to expand across borders, and on entry mode choice. More recent internalization theory extensions have focused on establishing linkages with strategic management perspectives on the MNE, and on describing differentiated network MNEs (Peter J. Buckley et al., 2017). The great strength of internalization theory is its comparative institutional approach to assessing the efficiency and effectiveness of MNE choices in the realm of choosing firm boundaries, establishing linkages with the external environment and selecting a specific organizational form. (Alan M. Rugman et al., 2008)

2.1.2. Eclectic Theory

The eclectic theory has been developed by John Dunning in a series of publications (Dunning 1980, 1981, 1988, 1992). There are three factors that determine the international activities of multinational enterprises (MNEs). These are ownership (O) advantages, location (L) advantages, and internalization (I) advantages. Therefore, the Dunning eclectic theory is also known as the OLI paradigm. The OLI theory clarifies outward FDI. It suggests that MNEs develop competitive O advantages at home and then transfer these abroad to particular countries (depending on L advantages) through FDI, which enables the MNE to internalize the O advantages. In contrast to the eclectic paradigm, internalization theory is mainly used to clarify

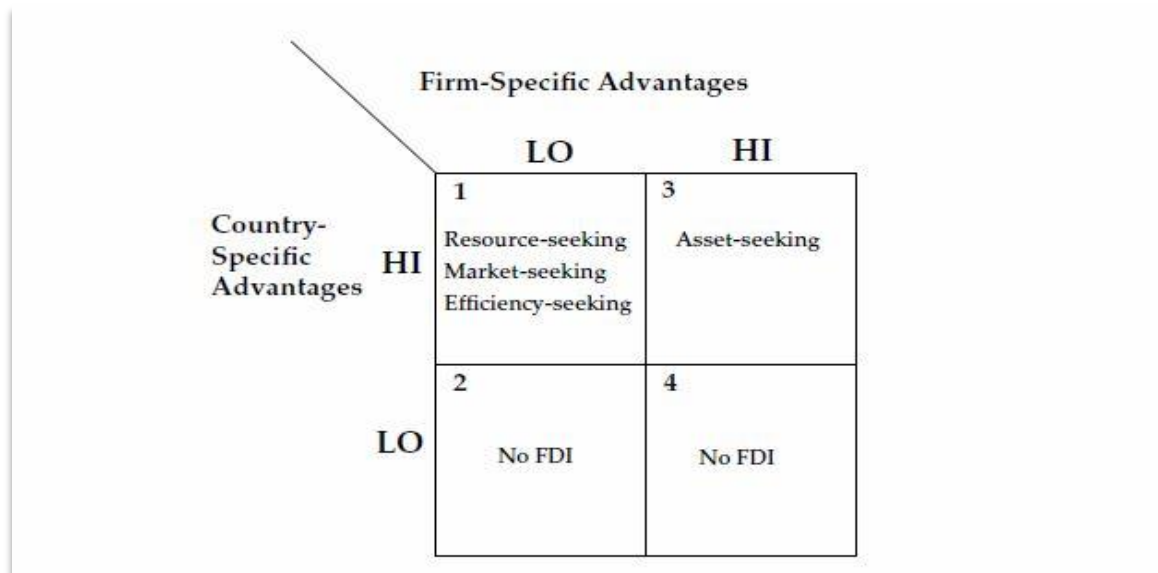
the entry mode. For instance, I advantages overcome the externality of knowledge as a public good, such that FDI is preferred to licensing, joint ventures, or alliances. (In all of the last three modalities, there is a risk of dissipation of the firm's knowledge advantage.) Using Dunning's own reasoning, it is apparent that there is close linkage among O and I advantages in that a knowledge-type O advantage should be internalized. (Alan M. Rugman, 2010)

The OLI theory stated that entry mode decisions are determined by the composition of three sets of advantages as perceived by enterprises;

- A. Ownership advantages (i.e. advantages that are specific to nature and the nationality of the proprietor),
 - B. Internalization advantages (i.e. advantages arising from transferring ownership advantages across national boundaries within own the organization), and
 - C. Location advantages (arising from the fact that different locations feature different resources, institutions, and regulations affecting the revenue and the cost of production).
- Zhao, Xuemin et al. (2004).

The diagram below shows how the FDI comes to existence

Figure 1. MNE's Entry Advantages



Alan M. Rugman, 2010

2.2. Relationship between MNB and FDI

It remains the case that the relationship between multinationals and FDI is straightforward: firms become multinational (transnational) when they undertake FDI. Thus FDI signifies an internal organizational expansion by multinationals. The term ‘multinational corporation’ (MNC) generally to imply the firms that indulge in FDI (Imad, 2002). MNB are subcategories of MNC and foreign banks are part of an MNB which is controlled by a mother bank. (Pohl, 2010)

“The effect of FDI varies because of sectors of the economy where it is directed. The effect of FDI varies because sectors have their own features and link to other sectors in different ways.” (UNCTAD, 2001 cited in Maryia Akulava, 2011, p8)

A foreign bank is a bank with a business existence outside its nation of origin, for no less than one branch or subsidiary. Branches are entities that work as a bank yet don't have a different legal status and are part of the same legal entity as the (foreign) parent bank. Conversely, subsidiaries are separate legal entities that might be completely possessed or dominant part claimed by a bank in another country. Subsidiaries may themselves possess subsidiaries in another country. Alongside branches and subsidiaries, banks can likewise open a representative office. While agent workplaces are commonly precluded from performing any banking activity, they offer the open door for banks to encourage associations between the parent bank and financial business outside the home country.

2.3. WHAT MOTIVATES FDI?

Imad Moosa, (2002) From one perspective, FDI can be seen as an activity that fulfills essential business needs. Hence, there are firm-specific motivations for indulging in FDI. The following is a general outline of the reasons why FDI is undertaken.

The Need for Markets

When the growth of sales is limited in the domestic market, a firm considers expanding abroad. Under special circumstances, expansion takes place by setting up production facilities abroad, which enables the firm to exploit the economies of scale. If markets are segmented and there are markets that offer higher profit margins, then firms will move into these markets. Numerous

MNCs give primary in their business strategies to seeking markets, and a large number of cross border investments are incited by the need to expand and diversify markets on a global basis.

The Need for Production Efficiency

The need for production efficiency encourages companies to produce in countries where resource inputs are relatively cheap. This is why American companies invest in Mexico and South East Asia for labor-intensive production. Nike, for example, carries out the bulk of its production of training shoes in Asia, paying workers very low wages.

The Need for Raw Materials

To avoid the transportation costs related to importing raw materials that are inaccessible in the home country, a firm will set up a production facility near to the source of raw materials in a foreign country. This is particularly the case if the foreign country is a market for the finished products. This factor underlies FDI in numerous industrial sectors, for example, petroleum, metals mining, forest products, and plantation activities.

The Need for Information and Technology

The requirement for information and technology has inspired FDI in US organizations fabricating computer software and hardware, as well as pharmaceutical companies.

The Need to Minimize or Diversify Risk

The risk factor has prompted FDI in countries being considered more stable and offering low political risk. Market risk can be reduced by investing in several countries.

Integrating Operations

Vertical integration is achieved when a firm indulges in different stages of the production process. For instance, vertical integration is achieved in the oil industry when a firm takes part in operations ranging from exploration and extraction to retailing. It is beneficial because it results in assured delivery between various stages of production. If different stages can be carried out in various locations, then expansion in foreign countries will take place.

Non-transferable Knowledge

If a firm develops expertise in the production of a certain commodity, and if it's hard to exchange this knowledge, the firm will be better off expanding overseas.

Protecting Knowledge

A firm may have a transferable ability that it doesn't wish to transfer. In this case, the firm itself will take production abroad.

Protecting Reputation

To protect a brand name or product quality, a firm may choose to carry out production abroad to produce what they are good at.

Capitalizing on Reputation

Firms with an international (good) reputation may capitalize by expanding abroad. International well-known banks, for instance, can attract deposits when they set up branches in foreign countries.

Avoiding Tariffs and Quotas

When production takes place in a foreign country it will be a substitute for exports that may be liable to tariffs and quotas

Exchange Rate Considerations

Firms move into countries with weak currencies because the initial setup cost is low. In general, firms choose to establish production facilities in countries where currencies are weak or undervalued, and sell their product in countries whose currencies are strong or over-valued. The extent of overvaluation and undervaluation might be estimated by deviations from purchasing power parity.

Foreign banks entry related to other MNCs

Some MNCs expand abroad because they follow others. This is especially valid for banks and other financial institutions. If an MNC chooses to set up a subsidiary in a particular foreign

country, the bank or financial institution serving the parent company at home may open a branch in the same foreign country to service the banking and financial needs of the subsidiary. This, in fact, was one of the reasons for the growth of international banking. Specific reasons for foreign banks expansion

2.4. Specific reasons for foreign banks expansion

The cross-border expansion of African banks is because of numerous reasons, however, the quest for business openings abroad, typically driven by the banks' bigger corporate customers, is the dominant driver. Financial analysts distinguish pull factors and push factors while surveying the drivers for cross-border business expansion. Push factors are conditions in the home country that disclose why banks choose to move past their country. Chief among them are diminishing opportunities in the home jurisdiction and regulatory prerequisites. Pull factors, conversely, are opportunities in host nations that make it attractive for a bank to enter the new market. At the end of the day, pull factors are the normal advantages that banks would like to harvest by wandering into a specific remote market. (Thorsten et al., 2014)

There are two main motives concerning why banks establish a physical presence abroad. The first main motive is to pursue its customers abroad. The client following proposes that banks move abroad to serve their home clients to guarantee the proceeding with association with parent companies at home by keeping foreign corporate affiliates from turning to new banks (which could be those from a similar home countries having offices in outside host countries Secondly, thanks to prior association with customers in home country, banks have great information on their clients' businesses, which helps to bring down service charges and risk. Thirdly, in favor of customers, manufacturing firms may like to choose to keep up connections with acknowledged firms in giving credit service in order to avoid costs related to providing corporate information to new banking partners. The second main motive is; the profit exploiting view proposes that banks expand abroad to exploit business opportunities in domestic markets. Scattered evidence seems to suggest that there is motivation for banks to go abroad other than following their clients (Philip Molyneux et al., 2013). Even though Ethiopia didn't allow foreign banks to enter in its country according to the official website of Commercial Bank of Ethiopia, since June 2009, the bank has opened four branches in South Sudan in pursuit of the above-mentioned opportunities.

2.5. Limitations on foreign banks entry in the banking industry

If there are any limitations set for foreign banks to enter the domestic banking through (1) Acquisition ;(2) Subsidiary; (3) Branch. Concerning foreign ownership of domestic banks, the government evidently forbids foreign citizens or companies to; own banks fully or partially, open banks or branch offices or subsidiaries of foreign banks or purchase the shares of Ethiopian banks. Ethiopia emerges exceptionally compared with its neighbors Kenya, Tanzania, and Uganda and other developing countries in that it has not so far liberalized its banking industry. The Ethiopian banking sector still did not influence by the world's financial distress and is out of the effect of globalization. Despite the fact that the ruling party comprehends the potential advantage of financial liberalization, it believed, that liberalization may result in loss of control over the economy and may not be economically beneficial. For instance, Ethiopia's late prime minister (Meles Zenawi) which was the engineer of the present policy regime of Ethiopia contended that; "When finance has liberalized the entry of foreign banks to some degree increased competition. The foreign banks have had to concentrate on the most beneficial segments of the market and these happen to be the biggest urban centers and the greater corporate customers. They have therefore had a trend of reducing their presence in the smaller towns and provincial areas and diminishing their service to customers outside the large corporate sector. The new entrants have begun with such a barely focused approach while the older ones have had to move towards such a narrow focus. Obviously, there has been little improvement in the quality of service or range of service". (Mekonen Kassahun et al., 2014)

2.6. Why does the Ethiopian government block the entry of foreign banks?

Private Banks and government may fear that unrestricted entry foreign banks will result in dominant positions in the domestic market by disposing of less productive or less capable domestic banks. They expect that domestic customers may have more confidence in foreign banks failures, however, foreign banks have an exceptional aura of safety around them. (Joydeep, 1993)

Ethiopia one of the two countries in Africa that were not colonized forbids foreign banks to invest and operate in the country. According to Federal Negarit Gazeta proclamation No.592/2008 “Foreign nationals or organizations fully or partially owned by foreign nationals may not be allowed to open banks or branch offices or subsidiaries of foreign banks in Ethiopia or acquire the shares of Ethiopian banks”. Despite pressure from the IMF and World Bank on Ethiopia to liberalize its financial sector and allow foreign banks Ethiopia acted unresponsive for the call (Arkebe Oqubay, 2015).

Mekonen et al., (2014) The Ethiopian government recognizes that liberalization of its financial sector is imperative for financial advancement, it gradually steps up the liberalizing process for the following reasons

1. The foreign banks have huge capital and more experience, it can outplay the local banks since they are early for a challenge like this, little in numbers and untested. This strategy of the government is also backed by domestic private financial investors.
2. Since Ethiopia is an agricultural led country and most of its citizens are living in the rural areas its credit policy gives advantage to those who are in the agricultural sector, small enterprises. However, when foreign banks enter the country the credit policy can take sides to the large scale enterprises due to their status and adequate collateral foreign banks will eye lending to urban residents and enterprises, as a result, their contribution to the rural area development will be much less.
3. Evidence from developing countries indicates that foreign banks are stronger in loaning their foreign capital than in taking part in domestic savings.
4. Because foreign banks are involved in international capital markets that may make foreign exchange deficiencies, this can have an incompatible impact on the balance of payments and capital account that constrained the capacity of the National Bank of Ethiopia in directing and regulating the financial markets.

The government intends to proceed with this arrangement until local banks accomplish the required financial, administrative, and technological ability to go up against foreign banks, and until institutions are advanced to regulate giant foreign financial institutions. (Arkebe Oqubay, 2015)

2.7. Why should countries allow foreign banks?

The entry of foreign banks conveys vast advantages to host countries' financial systems and economies at large. Benefits originate from efficiency gains achieved by new technologies, products, and management techniques just as from increased competition animated by new entrants. Also, as foreign banks may have more prominent access to resources from abroad, they have steadier funding and lending patterns than domestic banks.

Foreign bank entry may likewise encourage the efficiency and development of domestic financial markets by increasing the number of financial products available to local customers through imported technologies and expertise. (Juan Cárdenas et al., 2003)

The other reason is international contracts and payments tend to be hard to enforce. Since foreign banks are available in many countries, they probably deal better with these enforcement issues. Also when they are present in both the importing and exporting country, they can more easily guarantee contracts on both sides of the transaction and along with these boosts, the credibility of payment ensures. (Claessens et al., 2017)

2.8. Central Bank's Role in monitoring the financial sector

To ensure well-functioning banking sector, governments have to define regulatory rules and create various authorities to supervise all the banks (both domestic and foreign banks). Regulations here refer to “the set of laws and rules applicable to banking” while supervision refers “to the monitoring by authorities of banks’ activities and the enforcement of banking regulations”. In other words, regulation is the body of law establishing rules while supervision is the implementation and monitoring of the regulation and rules (Franklin Allen et al.,2010).

2.9. Foreign Banks Entry Mode

2.9.1. Branches vs. subsidiaries

Foreign banks can enter host countries by forming branches or subsidiaries. The choice to enter by branch or subsidiary is to an enormous degree driven by regulatory requirements in Africa, while other contemplations, for example, differences in tax rates, seem secondary. However, even where the option of branching is available, branching requirements often do not differ substantially from requirements for establishing a subsidiary. For example, in Kenya regulations establish similar minimum capital requirements for branches and subsidiaries, thus eliminating a key reason (lower set-up costs) for establishing a branch rather than a subsidiary. The decision to enter by branch or subsidiary can also be driven by the business model pursued by a foreign bank. Foreign banks that aim to serve a narrow corporate clientele or are reluctant to invest sizeable capital as long as the size of their cross-border activity in the relevant market is uncertain, may find the branch model more attractive. In contrast, foreign banks with the intent to establish a more broad-based retail operation may find the subsidiary model that provides for the host-country operation to be run as an independent bank, including with separate liquidity and capital buffers, and with its own management, board, and committees, more suitable. (Thorseten Beck et al., 2014)

2.9.2. Degree of intra-group integration

Beyond the choice of whether to enter a market by branch or subsidiary, banks additionally face the decision of how closely to integrate their operations at the group level. The degree of intra-group integration in numerous African countries is limited, at least in part, by regulatory requirements. Not only are banks expanding across borders almost universally required to establish self-standing subsidiaries, however, they are also often required to establish local IT functions, to utilize predominantly local labor, and to establish independent, local management functions (such as boards and risk-management capacity). These regulations are part of so-called “indigenization” policies.

Nevertheless, variety in the degree of intra-group integration across banks exists. Some banks have pooled functions and resources in the areas of IT, risk management, customer service, or treasury operations, so their subsidiaries depend strongly on their functionality on the parent.

Some foreign banks also have deep financial linkages within the group in the form of placements (e.g., subsidiaries place deposits with their parent institutions), and/or through intra-group swap transactions, joint guarantees, and syndicated lending operations involving the parent and/or foreign subsidiaries. In other instances, subsidiaries of foreign banks are independent entities in that they have their own systems and conduct intra-group financial transactions at arm's length. In general, foreign banks from outside of Africa have low levels of integration, while the operations of African-based foreign banks tend to be more closely integrated. (Thorseten Beck et al., 2014)

2.9.3. Merger and acquisition vs. greenfield investment

Foreign banks can enter host countries by merging or acquiring the operation of an existing financial institution, or by establishing a presence from scratch (greenfield investment).

The reasons behind choosing one mode over the other often depend on various factors, including the degree of difficulty of obtaining a new banking license, whether any suitable banking operations can be acquired, and whether banks intend to establish a retail-focused presence or enter to follow existing corporate customers. Acquiring the operations of an existing financial institution can often give relatively quick and easy access to extensive operations; however, it is not without challenges, such as combining different corporate cultures. On the other hand, banks have also reported significant start-up costs and long break-even periods from entering a host country in the form of greenfield investment. (Thorseten Beck et al., 2014). According to Hryckiewicz (2010), the main way in acquisition has been largely led by the privatization of state-owned banks and the rescue of struggling domestic financial institutions.

2.9.4. Representative office

Frequently, the representative office of foreign banks also negotiate associations with local banks. It offers the banks a minimal cost entry mode, enabling them to build up their brands without having any capital costs identified with setting up a branch or subsidiary. This activity gives a specific bit of advantage when the entry value on the local market has yet to be proven or the regulatory frameworks have a degree of uncertainty.

A foreign bank representative office is the most restricted type of organization and the less expensive one. Still, it can't play out any sort of activity. That is the reason it is for the most part utilized for exploring business opportunities from a foreign country. (Nicoleta Hurduc et al., 2011)

Despite Ethiopia shut nature financial system, various foreign banks have opened a representative office in Ethiopia in recent years. German Commerzbank was the first foreign bank to open an office in 2007 and in 2013 various African banks, including Ecobank, South African Standard Bank and some Kenyan banks, have established or have declared their plan to establish representative offices in the capital city of Ethiopia. (Thorsten Beck et al., 2014)

2.10. Empirical Literature Review

Abreham (2009) carried out a study on the title “Is Ethiopia ready to accept foreign banks?” He used the Statistical analysis technique to analyze the data. The researcher used both primary and secondary data. He underlined foreign banks will not operate in the unstable macroeconomic environment and investment reforms have to be made to attract them and the entry would benefit the customers get quality service since the competition will be high with the domestic banks. He concluded that with the entry of the foreign banks it comes benefits and as well as risks but suggests the benefit outweigh the risk.

Mekonnen (2017) examined the potential effects of opening the Ethiopian banking sector to foreign banks. The main objective of the paper was to analyze how far the domestic banking sectors are ready to compete with the new technology and modern management system. He used

the statistical analysis technique to analyze the data. A cross-sectional design was employed. He used primary data by distributing questionnaires to random bank employees from different hierarchical levels. According to his respondents, foreign bank entry will reduce costs and retain credit to small firms like microfinance. And believes that the local banks are no match for the foreign banks to compete with so they suggest strong supervisory body is needed in order to protect the financial sector from any upcoming crises related to the entry. He concluded that the majority of the respondents agree with foreign bank entry and the entry will accelerate the country's economic growth.

Habtamu (2017) examined opportunities and challenges of liberalizing the banking sector in Ethiopia. The researcher tried to identify the different opportunities that the foreign banks would bring and their entry challenge on domestic banks. The study employed a qualitative approach and he tries to get insight and generate explanations about the opportunities and challenges of foreign bank entry. The study adopted a cross-sectional research design. One of the findings from the results is that foreign banks could help transform Ethiopia from agriculture-led economy to industrial led by providing small scale and large scale firms enough credit access. He also concluded that it has a positive outcome in terms of solving a foreign currency shortage.

Philip Molyneux et al., (2013) carried out a study on foreign bank entry in South East Asia. They used the OLS method to analyze the data for the years 1998 to 2004 in five Southeast Asian countries. They conclude that foreign banks tend to expand to countries where they can make profits and where banking systems are less efficient. FDI and trade, that reflect customer-following motivations, on the other hand, exert a marginal and non-robust effect on foreign bank presence across models.

Lai, Tat-kei, et al., (2016) The Chinese financial sector has traditionally been dominated by 4 giant state-owned commercial banks which, in general, have worse performance than other banks. After china's accession to the WTO on December 11, 2001, foreign banks can enter the local currency market in phases; since the end of 2006, there have been no restrictions on foreign bank entry. Recent studies have documented that the entry of these foreign banks tends to be associated with a more competitive and efficient banking environment in china. During the same period, the Chinese economy has developed quickly with the GDP growth rate increasing from roughly 8% in 2001 to above 14% in 2007.

As it has been observed during the accession process of many of the developing countries, developed member countries of WTO pressure opening up of specific sectors like banking and telecom services of the acceding country. (Semahagn Gashu, 2011) Ethiopia is still not a member but it's one of the nations that applied to be one of the members in WTO with other 21 countries. (Amadeo, 2018)

Enrica Detragiache et al. (2008) did their research on foreign banks in poor countries covering from 1990-2002. And they concluded that in poor countries, foreign banks tend to lend mainly to large firms (domestic or multinationals) and the government rather than to smaller businesses for which local knowledge is necessary.

Claessens (1998) specifically mentions that foreign banks may (1) improve the quality and availability of financial services in the domestic financial sector by increasing bank competition, and enabling the application of more modern banking skills and technology, (2) serve to stimulate the development of the basic bank supervisory and legal framework, and (3) enhance a country's access to international capital.

Arpita Khare (2011) carried out a study on "customers' perception and attitude towards service quality in multinational banks in India". The SERVQUAL model was adopted and modified for the research. Through a survey administered on Indian customers and their perceptions about service, quality was identified. ANOVA, Post-hoc analysis and multiple regression tests were used to analyze the data. The researcher conceded the customers are positive towards the multinational banks and consider them efficient and competent.

2.11. Research gap

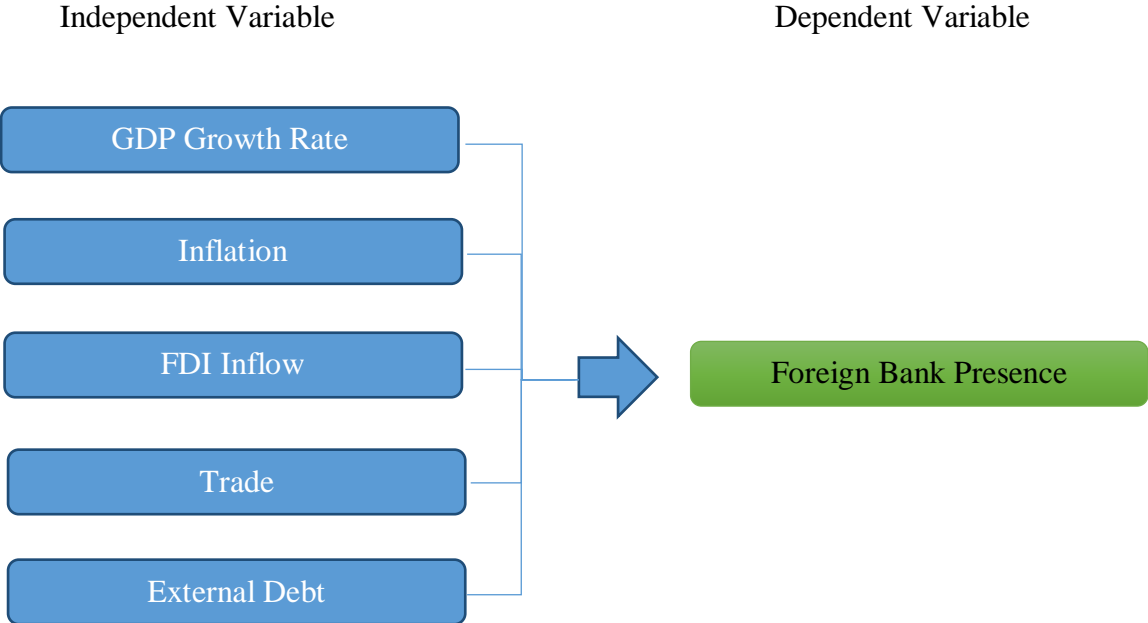
Lack of empirical evidence in what motivates foreign banks to increase their presence and enter in host countries can be mentioned as the main research gap. And there are different views around what foreign banks contribute with those who already allowed the foreign banks and those who refused to let the foreign banks invest in their country. And papers from Abreham (2009), Mekonnen (2017), and Habtamu (2017) came to a similar conclusion which is a positive outcome is expected and suggested the entry of foreign banks would benefit Ethiopia. They all mainly used primary data (questionnaire) to examine and reach to a conclusion. As they used

primary data the outcome from the research audience may not be always feasible and the tendency to manipulating the independent variables following a planned design and observes the effects of the independent variables on the dependent variable, the outcome variable (Joop J. Hox et al., 2005). This paper mainly plans to investigate on the secondary data as it enables the researcher to cover time periods that would not otherwise have access to and analyzing the data from a different perspective or theoretical framework may reveal an unexpected relationship between the variables (Robert et al., 2003).

2.12. Conceptual Framework

A conceptual framework is a visual representation of how the concepts of the theory are related to each other linked to each other by unidirectional pathways (Jan Dul et al., 2007). After reviewing both theoretical and empirical literature, the following conceptual framework has been formulated and illustrates how the independent variables affect the dependent variable.

Figure 2. Conceptual Framework



CHAPTER THREE

3. Research Methodology

3.1. Source of Data and sampling

This study uses panel data starting from 2005-2013 annually with a sample of 13 sub-Saharan African countries. In which all the sample countries are categorized under low-income countries by the World Bank. The variable data related to the subject was obtained from the World Bank, and IMF indicators.

3.1.2. Data Analysis

This study used a descriptive research design and analyzed in a quantitative form. It employed a multiple regression using Ordinary Least Square (OLS) model to estimate motives for foreign banks entry and possible outcomes from the banks entry. The data collected from the sources were entered into STATA for regression and analysis.

Ordinary least-squares (OLS) regression is a generalized linear modeling technique that may be used to model a single response variable which has been recorded on at least an interval scale. The technique may be applied to single or multiple explanatory variables and also categorical explanatory variables that have been appropriately coded. (Hutcheson, G. D.,2011)

The method of Ordinary is attributed to Carl Friedrich Gauss, a German mathematician. The method of least square has some very attractive statistical properties that have made it one of the most powerful and popular methods of regression analysis. (Damodar N. Gujarati, 2004)

The OLS regression model writes as follows

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \dots + \varepsilon$$

Where Y is the dependent variable, β_0 , is the intercept of the model, it indicates the value of Y when all values of the explanatory variables are zero. Each β_1 and β_2 parameter indicates the

average change in Y that is associated with a unit change in X, whilst controlling for the other explanatory variables in the model and ε (epsilon) is the random error with expectation 0 and variance σ^2 .

3.1.3. Research Model

The data collected is panel (longitudinal) data. Panel data observations on a cross-section of countries over several time periods (13 countries in a span of 9 years). The researcher applied one of the panel data's estimation models time fixed effect. We would use such a model where we thought that the average value of y_{it} changes over time but not cross-sectionally. Hence with time-fixed effects, the intercepts would be allowed to vary over time but would be assumed to be the same across entities at each given point in time. We could write a time-fixed effects model as

$$y_{it} = \beta_0 + \beta x_{it} + \lambda t + \varepsilon_{it}$$

where λt is a time-varying intercept that captures all of the variables that affect y_{it} and that vary over time but are constant cross-sectionally. (Brooks, 2014)

The multiple regression function that includes the dependent variable and independent variables it's written as follows respectively

$$FBP_{it} = \beta_0 + \beta_1(GDPg)_{it} + \beta_2(Inf)_{it} + \beta_3(FDIIn)_{it} + \beta_4(NTra)_{it} + \beta_5(ExD)_{it} + \lambda t + \varepsilon_{it}$$

Dependent Variable

Y = Foreign Bank Presence (FBP)

Independent Variables

X₁=GDP growth rate (GDPg)

X₄=Net Trade (NTra)

X₂=Inflation (Inf)

X₅=External Debt (ExD)

X₃=Net Inflow FDI (FDIIn)

ε =Error term

The independent variables were used to measure how much effect they put on the dependent variable. The independent variables suggest the outcomes for those countries that allowed foreign bank entry.

3.1.4. Variable clarification

Dependent Variable

Foreign Bank Presence: -The percentage of foreign banks among the total banks in the country. Banks with 50 percent or more of its shares are owned by foreigners. The data source is from the IMF working paper by Claessens, and Neeltje, 2015.

Independent Variables

Trade: -Trade is a significant engine for economic growth, especially for developing countries. To calculate trade, the net trade in goods and services is derived by offsetting imports of goods and services against exports of goods and services. Exports and imports of goods and services include all transactions involving a change of ownership of goods and services between residents of one country and the rest of the world. The data source is the World Bank.

GDP Growth rate: -The GDP growth rate measures how fast the economy is growing. It does this by comparing one period of the country's gross domestic product to the previous period. The data source is the World Bank.

Net FDI Inflow: - Foreign direct investment refers to direct investment equity flows in the reporting economy. It is the amount of equity capital, reinvestment of earnings, and other capital. Direct investment is a category of cross-border investment associated with a resident in one economy having control or a significant degree of power on the management of an enterprise that is resident in another economy. The data source is the World Bank

Inflation: -Inflation is a quantitative measure of the rate at which the average price level of a set of selected goods and services in an economy increases over a period of time. It is the constant rise in the general price level where a unit of currency buys less than it did in prior periods. Often

expressed as a percentage, inflation indicates a decrease in the purchasing power of a country's currency. The data source is the World Bank.

External Debt: - External debt is the total debt owed to nonresidents repayable in internationally accepted currencies. The external debt includes both the private and government sector as a whole. The data source is the world bank.

CHAPTER FOUR

4. Data Analysis and interpretation

In this chapter, the researcher has tried to analyze the data collected that are believed to be related to the research. To investigate what motivates the foreign banks the researcher used 13 sub-Saharan African countries that are labeled low-income by the World Bank. The research covers a nine years span from 2005-2013 with further year data for the dependent variable found to be unavailable. The sample includes the following countries Benin, Burkina Faso, Burundi, Congo, Dem. Rep, Ethiopia, Madagascar, Malawi, Mali, Niger, Rwanda, Tanzania, Togo, and Uganda.

4.1. Summary of Variables

Table 1. Summary of Variables

<i>Variable</i>	Obs	Mean	Std. Dev.	Min	Max
PFB	117	58.47863	31.45402	0	100
NTra	117	-1.484872	1.527194	-8.14	0
FDIn	117	0.4795727	0.5858451	-0.24	2.89
Inf	117	8.298632	7.137416	-0.76	44.36
GDPg	117	5.801709	2.89843	-4.01	12.55
ExD	117	3.26641	3.223426	0.43	13.14

As it's presented above the dependent variable foreign bank presence is measured by the foreign banks coverage among the total banks. In which 50% or more of its shares are held by foreigners is considered a foreign bank. Form the sample countries Ethiopia is the only country with no foreign bank presence. Foreign banks are operating in all the other sample countries. As stated by Philip Molyneux et al. (2013) from a policy perspective it appears that financial liberalization moves to attract foreign bank entry needs to be engaged in removing restrictions and one of the

examples are membership of the WTO. Ethiopia is the only country that is not a member of the WTO.

The presence of foreign bank has a minimum of 0% (Ethiopia) and a maximum of 100 (Madagascar) the average presence of the foreign banks is 58.47% which means more than half of the countries' banks are owned by foreigners.

Net trade is derived by offsetting imports of goods and services against exports of goods and services. As shown in the above (Table1) the net trade's minimum is -8.14 and maximum 0 with the mean of approximately -1.5 which means the countries are more importing countries than exporting (**Note.** The numbers are in billions).

As a developing country, FDI inflow plays a vital role to make a substantial contribution to economic growth by inviting investors in sectors and bringing along with other indirect positive impacts including the transfer of technology, training, skills, employment (Moolio et al. 2013). FDI net inflow with the minimum being -0.24 the maximum is 2.89 and the mean is 0.48. (**Note.** The numbers are in billions and also the study only covers from 2005-2013. Recent FDI inflow figure is more than the maximum number mentioned above)

Inflation, as measured by the consumer price index, reflects the annual percentage change. The minimum, maximum and the mean respectively are -0.76, 44.36, and 8.3. As for external debt is the portion of a country's debt that was borrowed from foreign lenders the minimum, maximum and mean are 0.43, 13.13, and 3.26 billion respectively. And last but not least GDP growth rate - 4.01, 12.55, and 5.80 signifies the minimum, maximum and mean respectively.

4.2. Correlation Matrix

To understand the relationship between the variables Pearson correlation matrix have been computed

Table 2. Correlation matrix

<i>Correlation</i>	FBP	GDPg	Inf	FDIn	NTra	ExD
FBP	1.0000					
GDPg	-0.3282	1.0000				
Inf	-0.3025	0.2485	1.0000			
FDIn	0.2473	0.0842	0.0793	1.0000		
NTra	0.2758	-0.3964	-0.4120	-0.3681	1.0000	
ExD	-0.0149	0.1523	0.2691	0.5614	-0.5831	1.0000

As shown above the result of Pearson's correlation matrix analyses to test the relationship between variables used in the study. It shows that some variables maintained a positive relationship with others and showing negative. The foreign bank presence has a negative relationship with GDP growth rate, inflation, and external debt, on the other hand, a positive relationship between FDI net inflow and net trade. The magnitude of the Pearson correlation coefficient with > 0.05 has a high strength of the correlation.

4.3. Multicollinearity Test

An implicit assumption that is made when using the OLS estimation method is that the independent variables are not correlated with one another. If there is no relationship between the independent variables, they would be said to be orthogonal to one another. If the explanatory variables were orthogonal to one another, adding or removing a variable from a regression equation would not cause the values of the coefficients on the other variables to change. (Brooks, 2014)

To confirm that a test for inter-correlations or inter-association among the independent variables has been done.

Table 3. Multicollinearity Test

Variable	VIF	1/VIF
ExD	1.95	0.512576
NTra	1.93	0.517785
FDIn	1.49	0.672899
Inf	1.24	0.808850
GDPg	1.21	0.823834
Mean VIF	1.56	

As displayed above the independent variables variance inflation factor is below 2. It means that the variable could be considered as a linear combination of other independent variables since the variance inflation factor result is below 10.

4.4. Regression Analyses and Hypotheses Testing

Regression is a statistical measurement which objective is to predict the strength of the relationship between one dependent variable and a series of other independent variables (C.R. Kothari, 2004). As this paper overall objective is understanding the motives for foreign banks entry the researcher used foreign bank presence as a dependent variable and other five independent variables that are believed to have a relationship in the presence of the foreign banks. The independent variables are inflation, FDI net inflow, trade, GDP growth rate, and external debt.

4.4.1. Regression

The regression and all other tests have been done by STATA 15.

Table 4. Regression

FBP	Coef.	Std. Err.	t-Statistic	P> t 	[95% Conf. Interval]	
GDPg	-2.385076*	0.9110197	-2.62	0.010	-4.191869	-0.5782835
Inf	-1.018919*	0.3446116	-2.79	0.006	-1.74204	-0.2957979
FDIn	18.71033*	4.4807	4.18	0.000	9.82392	27.59675
NTra	5.315633*	1.840554	2.89	0.005	1.66533	8.965937
ExD	0.36872	0.8209552	0.45	0.654	-1.259451	1.996891
_Cons	78.48761	6.472721	12.13	0.000	65.65049	91.32472
Prob > F	0.0000					
Obs	117					
R²	0.3036					
Adj R²	0.2157					

* Indicates statistically significant at 1% level (highly significant)

The results show that the GDP growth rate is negatively related to foreign bank presence at 1% significance level. The results show that the higher the GDP growth rate, the less the foreign bank presence. Inflation was also negatively associated with foreign bank presence at 1% significance level. The results show that higher inflation is negatively related to foreign bank presence. FDI is positively associated with the presence of foreign banks at a 1% significance level. Also, Trade is positively correlated with foreign bank presence at 1% significance level. The bigger the trade, the more the foreign bank presence will be and vice versa. The last

independent variable which is the external debt was also positively associated but the p-value is greater than the 5% significance level which leads to the conclusion that the variable is not significant.

These are the values for the regression equation after predicting the dependent variable from the independent variable.

$$FBP = 78.48 - 2.38 * GDPg - 1.02 * Inf + 18.71 * FDIIn + 5.31 * NTra + 0.37 * ExD$$

R Squared (R^2) = R-squared is a statistical measure of how close the data are to the fitted regression line. It is also identified as the coefficient of determination or the coefficient of multiple determination for multiple regression. In this case, R squared and adjusted R squared is 30.36% and 21.57% respectively. The R squared result seems lower but R squared is just an overall measure of the strength of association and does not reflect the extent to which any particular independent variable is associated with the dependent variable. According to Jim Frost (2013), R squared has two main key limitations. "R-squared cannot determine whether the coefficient estimates and predictions are biased, which is why you must assess the residual plots. And also R-squared does not indicate whether a regression model is adequate. You can have a low R-squared value for a good model, or a high R-squared value for a model that does not fit the data!" So even the R-squared is low, low P values still indicate a real relationship between the significant predictors and the response variable.

Prob > F = the p-value is lower than 0.05 to show a highly significant relationship between X and Y. The null hypothesis that all of the model coefficients are zero so we reject this null hypothesis.

4.4.2. Hypothesis Testing

The method of hypothesis testing uses tests of significance to determine the likelihood that a statement is true, and accept the statement as true (Adam et al., 2006). The following hypotheses are tested to examine the significance of the independent variables on the dependent variable.

Ha1: Inflation affects the entry of foreign banks

The term inflation is used to indicate an increase in domestic prices of the commodities relatively more than the increase in the prices of the commodities globally (Ayub et al.,2014). As an economy grows, businesses and consumers spend more money on goods and services. In the growth stage of an economic cycle, demand typically outstrips the supply of goods, and producers can raise their prices. As a result, the rate of inflation increases. If economic growth accelerates very rapidly, demand grows even faster and producers raise prices continually and inflation generally increases this discourages borrowing, decreases the money supply, dampens economic activity and subdues inflation. (PIMCO,2011)

As banks take deposits at a lower rate and lend at a higher rate. They make most of their earnings from the difference between the net deposit rate and net lending rate. With less motive to borrow due to inflation, the foreign banks may end up paying interests for the deposits made by the customers which would lead them to lose. And also the customers may want their money in their hands instead of depositing it and even it could be hard for those customers to pay their debt to the banks.

The other issue is concerning the interest rate. When inflation rises, interest rates also tend to rise either due to market expectations of higher inflation or because the Central Banks have raised interest rates in an attempt to fight inflation (PIMCO,2011). This interest rate increase could be turn out for good or bad for the bank depending on the net interest spread. That makes the banks not to operate in a stable way.

The p-value is used to determine the statistical significance of the results. A p-value that is less than or equal to 0.05 is usually used to indicate whether there is strong evidence against the null hypothesis. The p-value for inflation shows a 0.006 statistically significant at 1% level (highly significant). The coefficient results -1.019 which signifies inflation negative effect on the foreign

bank presence. This is evidence that the null hypothesis is invalid so we reject the null hypothesis. This result is consistent with Abreham (2009) who concluded that the foreign banks would not operate in an unstable macroeconomic situation.

Ha2: GDP growth has an impact on the entry of foreign banks

As the economy grows, one of the things that change for good is technological advancement. The technology advancement to the introduction of new financial technologies that increase the efficiency and productivity of the banking sector. As discussed in the literature review part different authors mentioned one of the main ways for foreign banks to penetrating into the market is the technological advancement and what they have is enormous compared to the domestic banks. That gives them a huge competitive advantage over the domestic banking sector. Debit and credit cards, ATM, internet banking, mobile banking are some of the technological advancement takes place in.

Even though the leading owners of technology advancement are the foreign banks the domestic banks follow behind not to be left out from the market. This growth in economy and technology pressures the foreign banks in a way they could lose their cutting edge.

According to the regression, the p-value is 0.010 statistically significant at 1% (highly significant) with the coefficient implying a negative -2.385 relationship. Since the p-value is less than $\alpha = 0.05$, we reject the null.

According to Lai, Tat-kei, et al., (2016) they mentioned the foreign banks entry and GDP growth has a positive relationship which is inverse to the result found from this test. As China was the discussion country the reason for different results could be that the economic level that China and these developing countries are found.

Ha3: FDI inflow attracts the entry of foreign banks

Foreign investors have huge capital and financial need. And for foreign banks, this is a perfect market to snatch from the domestic banks. It is understood that the main reasons for FDI are cheap labor, adequate resources in developing countries. Even the governments of the countries encourage foreign investors in their country to benefit directly or indirectly from the investment and utilize it effectively in the promotion of development objectives (Duncan 2012). But that is

may not be enough for foreign investors. According to Poelhekke (2015), the presence of foreign banks subsequently boosts FDI by non-financial firms especially when from the same home country. The reason is that the foreign banks are believed to have advanced technology and financial capacity to help out the foreign investors in whatever needs more than the domestic banks and the relationship gets stronger between the bank and the investor when having a history before meeting in a new market. So the foreign banks understanding they have more technological advancement and financial capacity but also knowing they are needed by the foreign investors even gives them the motive to dominate the market. In recent years the low-income countries are becoming one of the highly FDI hubs in Africa more than any other time. This motivates foreign banks to enter the country even more.

From the regression (Table 3) we can see that FDI inflow has a very high coefficient of 18.71 with a highly significant effect ($p\text{-value} = 0$) on foreign bank presence. So we could say there is sufficient evidence to reject the null hypothesis. This result is the same as stated by Aina (2018) Japanese banks follow up on the foreign direct investment (FDI) flow to enter into other countries market.

Ha4: Trade has a relationship with the entry of foreign banks

Every trade (international) is processed through banks from both the buyer and seller side. On either side, the banks charge fees for the services (Letter of Credits, Advance Payments, Cash Against Documents, Consignments, etc.) they provide.

Trade boosts economic growth, efficiency, technological progress, and what ultimately matters the most, consumer welfare. By lowering prices and increasing product variety available to consumers, trade especially benefits the developing countries. In a developing country where enough supply is needed importing is the only way to do it even to produce the materials needed the machinery are needed in which the country has to import one way or another. It's a plain fact the developing countries have a negative trade balance. Foreign banks have more outstanding access to resources from abroad, they have steadier funding more than the domestic banks. (Juan Cárdenas et al., 2003). They could use it as an introduction to getting into the market.

The export companies are mostly are giant local companies and FDI firms by nature. According to Zafar (2013), FDI is considered as an important means of promoting export of the host

countries. And there is a stable long-run equilibrium relationship between FDI and export growth. The foreign banks main aim is owning those companies.

Achieving in grabbing foreign investors means a huge amount of profit and foreign currency inflow for foreign banks. This leads to a conclusion they are inclined to the export side more than the import. The foreign banks help the exporting companies in reducing their financial constraints but on the other hand, it could be a problem for the host country in gaining foreign currency. The foreign banks will be a big challenger in partaking the host country for the foreign currency.

The p-value for trade is 0.005 statistically significant at 1% (highly significant) with the coefficient implying a positive 5.315 relationship which means the foreign banks are highly interested in the trade service. Since the p-value is less than $\alpha = 0.05$, we reject the null hypothesis. Claessens et al., (2017) also mentioned there is a positive relationship between foreign banks and trade in the way of exporting.

Ha5: External debt attracts the entry of foreign banks

Banks aim to make a profit and expect their lending to be returned with high interest. According to Enrica Detragiache et al. (2008) in the case of foreign banks operating in poor countries, the distance (both geographic and cultural) between headquarters and local subsidiaries/branch is likely to be especially large. In addition, many, if not most, potential borrowers lack usable collateral and reliable financial statement and are therefore getting information is difficult. Several studies find that foreign banks in poor countries lend mainly to safer and more transparent customers, such as multinational corporations, large domestic firms, or the government because they are the once who are believed to be providing the necessary information and who could generate the banks huge amount of profit with minimum risk.

Another authors Giannetti et al. (2012) also supports Foreign banks could snatch depositors and safe borrowers from domestic banks while remaining unwilling to lend to local SME's instead they focus on large firms with foreign owners.

That makes foreign banks better than domestic banks at monitoring "hard" information, such as accounting information or collateral values, but not at monitoring "soft" information, such as the

borrower's entrepreneurial ability or trustworthiness. That is because developing countries have a high level of corruption, inflation, and deficit makes it hard to pay the borrowings so a clear picture of the process needs to be put. This leads most of the SME's to take as their only option to borrow from domestic banks.

It's a fact that developing countries are getting external debt from other countries, an international financial institution like the IMF and World Bank which shares the same goal of raising living standards in their member countries especially the developing countries. Their approaches to this goal are complementary, with the IMF focusing on macroeconomic issues while the World Bank concentrating on long-term economic development and poverty reduction. The reasons for the external debt variable not being significant is the countries main external debt sources are the IMF, World Bank, and other countries governments which out counts the debt found from the foreign banks by a huge number.

As stated in Habtamu (2017), foreign banks could provide high credit access that could be an answer for Ethiopia's financial need and development. According to this research result, the foreign banks main focus is not giving credit and there does not appear to be any evidence to support the hypothesis that foreign debt positively motivates the foreign banks because the p-value is $0.654 >$ than the significance level of 0.05 which leads to a conclusion it's not significant so we fail to reject the null hypothesis.

4.5. Panel Diagnostic Test

Diagnostic tests are implicit whether a regression model is correctly specified in terms of the regressors that have been included. In diagnostic tests rejection of a particular diagnostic test null hypothesis should be interpreted as showing that there is something wrong with the model (Chris, 2014). Tests for Heteroskedasticity (White Test) and Normality (Sktest, Shapiro-Wilk Test, and Jarque-Bera Test) tests have been computed and it is presented as follows.

4.5.1. Heteroskedasticity Test

Heteroskedasticity is present when the error terms don't have a constant variance. Heteroscedasticity causes standard errors to be biased. Richard, (2015) To test that the following test is applied.

Table 5. White Test

Chi2(20) = 18.97			
Prob>chi2 = 0.5238			
Source	Chi2	df	p
Heteroskedasticity	19.02	20	0.5205
Skewness	9.85	5	0.0797
Kurtosis	1.89	1	0.1687
Total	30.76	26	0.2373

The White test is a heteroscedasticity test used in the study. The test statistic has a p-value of 0.5238 above an appropriate threshold 0.05 then the null hypothesis of homoscedasticity is accepted and heteroscedasticity is not assumed.

4.5.2. Normality Test

To determine whether the data do not follow a normal distribution, the researcher compared the p-value to the significance level of 0.05.

Sktest is one the features on STATA to test for normality based on skewness and another based on kurtosis and then combines the two tests into an overall test statistic

Table 6. Sktest (Skewness/Kurtosis tests for normality)

<i>Variable</i>	Obs	Pr (Skewness)	Pr (Kurtosis)	Adj chi2 (2)	Prob>chi2
Residual	117	0.1303	0.4404	2.95	0.2289

Based on the above table the probability p-value (0.2289) is larger than the significance level (α or alpha) 0.05. The skewness 0.1303 and the kurtosis 0.4404 as well are above the significance level which means cannot conclude the data do not follow a normal distribution.

Another non-graphical test is the Shapiro-Wilk test for normality. It tests the hypothesis that the distribution is normal. Residuals in the model are normally distributed with a significance level of 0.19784 which is higher than 0.05

Table 7. Shapiro-Wilk Test

<i>Variable</i>	Obs	W	V	z	Prob>z
Residual	117	0.98448	1.462	0.849	0.19784

Table 8. Jarque-Bera Test

Jarque- Bera normality test	Chi (2) = 0.2412
-----------------------------	------------------

In the Jarque Bera result, the null hypothesis states that the data follow a normal distribution. Because the p-value is 0.2412, which is greater than the significance level of 0.05, the decision is to reject the null hypothesis.

The following graphs will help check for normality in the residuals additionally.

Figure 3. Histogram Diagram

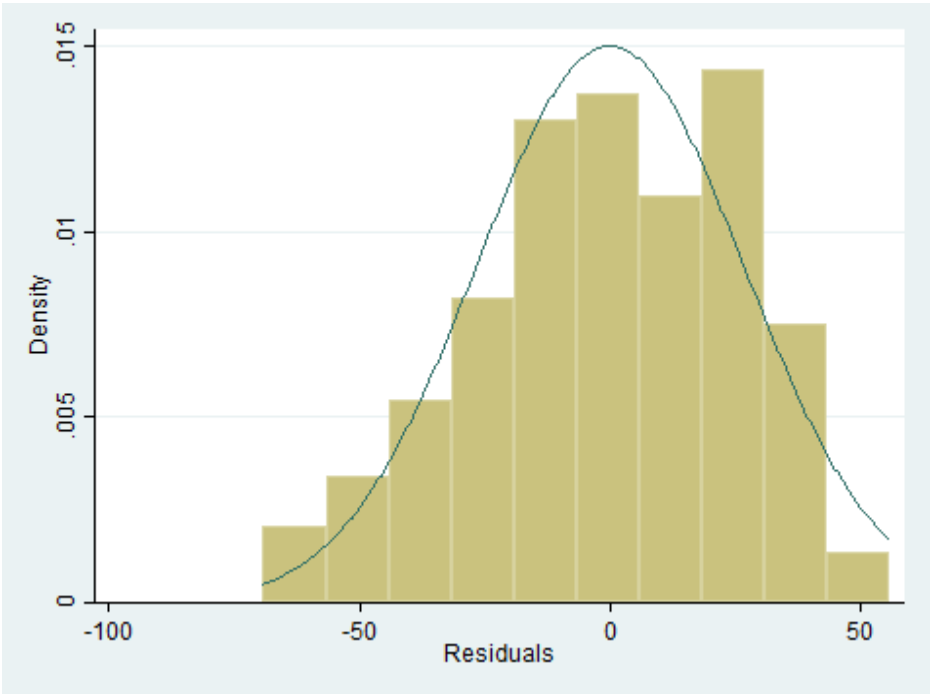
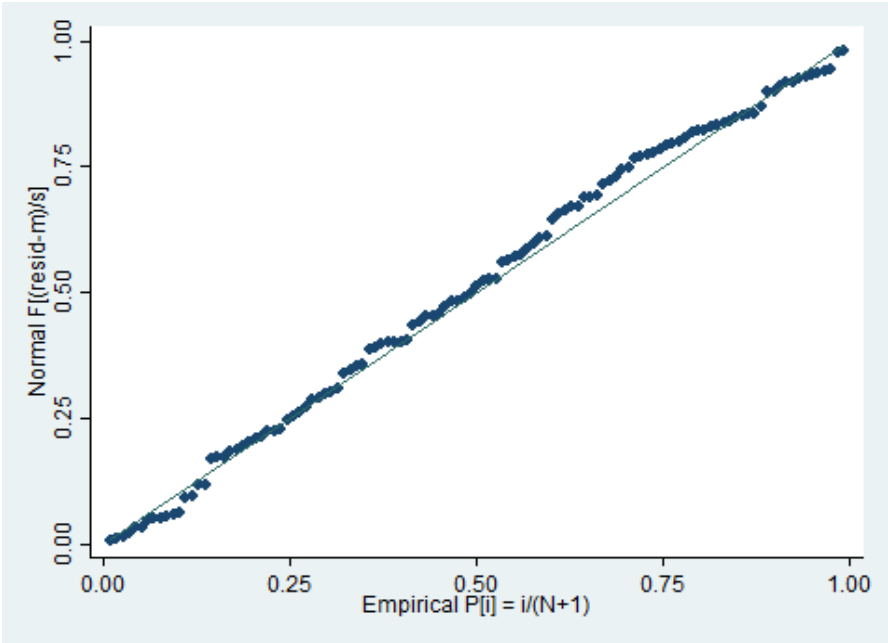


Figure 4. Normality Distribution Plot



In the above probability plot, the data form an approximately straight line along the line. The normal distribution appears to be a good fit to the data.

CHAPTER FIVE

5. Conclusion and Recommendation

The research focused on what the motivations are for foreign banks as they look to expand their presence in low-income sub-Saharan host countries. The paper aims to get the answers for what are the things they look to achieve (motive) as they increase their presence/enter in the host country. The research tried to identify and discover specific variables, like inflation, GDP growth rate, FDI inflow, Trade, and External Debt. The research has used quantitative data collected from the World Bank and the IMF. The researcher used 13 low income sub-Saharan African countries for conducting the research.

5.1. Conclusion

From the research result, it is concluded that FDI inflow and trade are positively related to foreign banks presence. The main objective of the foreign banks is gaining those companies with huge capital and financial need because those are the real potential customers that could generate higher profit with lesser risk. Those companies are mostly are foreign companies who are export-led companies. This has a positive impact on the export companies in reducing financial limitations but at the same time, the foreign currency falls under the hand of the foreign banks which is not good news for developing countries who are always in short of foreign currency.

Inflation and GDP growth are negatively related to foreign banks presence. The reason for inflation is it creates instability for the customers in a way that affects the banks overall activity. And GDP growth is also another factor that affects foreign bank presence. The more the economy grows the technological advancement also grows in a way that narrows the chance of entering and expanding the banks in a country since technology is one of the main advantages the foreign banks have over the domestic once.

Last but not least is external debt, external debt as a whole contains both the private and government sectors debt from a foreign source. As the result shows foreign banks are not interested in being the main source of debt for different reasons.

5.2. Recommendation

The increase of the foreign banks presence could be turn out for good or bad depending on the host country's action to make the financial sector vibrant and readiness to face the challenge from the foreign banks side. Knowing the motivations of the foreign banks help to respond and work hard on the areas that need to be improved so that stiff competition could exist for better service to the customers and even to the host country, domestic banks, and the foreign banks.

- As the foreign banks are highly equipped with advanced technology the local banks need to equip themselves with advanced technology as well in order to compete at a high level with foreign banks otherwise they will find themselves in a hard position to compete and close the gap with the foreign banks.
- Since the foreign banks chase those huge local companies and multinational companies the local banks should create and maintain a strong relationship with customers is the key otherwise they will lose their customers to the foreign banks.
- The foreign banks have the experience and quality more than the domestic banks. In order to give higher quality service skilled and productive employees are necessary. So the domestic banks have to empower their employees to achieve that.
- Formulating and evaluating the specific policy that governs the foreign banks in the host country.
- Strong supervision from the central banks in order to regulate the financial situation.

As for future research should seek to investigate how other variables like real interest rate, credit to the private sector, saving, corporate income tax, etc. affect foreign bank entry and also how the entry is affected on the industrial level.

References

- * Abreham Amanuel, (2009), Is Ethiopia ready to accept foreign banks?
- * Akulava, M. (2011). The Impact of Foreign Direct Investment on Industrial Economic Growth in Belarus (No. 11). Belarusian Economic Research and Outreach Center (BEROC).
- * Allen, F., Otchere, I., & Senbet, L. W. (2011). African financial systems: A review. *Review of Development Finance*, 1(2), 79-113.
- * Amadeo, K. (2018). 6 Steps to Join the World Trade Organization <https://www.thebalance.com/how-does-a-country-become-a-wto-member-3306362>
- * Ayub, G., Rehman, N. U., Iqbal, M., Zaman, Q., & Atif, M. (2014). Relationship between inflation and interest rate: evidence from Pakistan. *Research Journal of Recent Sciences*, Vol. 3(4), 51-55.
- * Beck, T., Fuchs, M., Singer, D., & Witte, M. (2014). Making cross-border banking work for Africa. Eschborn, Germany: Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH.
- * Beck, T., Maimbo, S. M., Faye, I., & Triki, T. (2011). Financing Africa: Through the crisis and beyond. The World Bank.
- * Bhattacharaya, J. (1993). The role of foreign banks in developing countries: A survey of evidence. Unpublished manuscript, Cornell University.
- * Buckley, P. J., & Tian, X. (2017). Internalization theory and the performance of emerging-market multinational enterprises. *International Business Review*, 26(5), 976-990.
- * Campbell, D., & Ahmed, I. (2012). The labour market in developing countries. Perspectives on Labour Economics for Development (ILO, 2013).

- * Cardenas, J., Graf, J. P., & O'Dogherty, P. (2003). Foreign banks entry in emerging market economies: a host country perspective. CGFS Working Group on FDI in the financial sector.
- * Chris, B. (2014). Introductory econometrics for finance, 3rd Edition. Cambridge University Press
- * Claessens, S, Huizinga, H., & Demirgüç-Kunt, A. (1999). How does foreign entry affect the domestic banking market?. The World Bank.
- * Claessens, S., & Van Horen, N. (2015). The impact of the global financial crisis on banking globalization. *IMF Economic Review*, 63(4), 868-918
- * Claessens, S., Hassib, O., & Van Horen, N. (2015), The Role of Foreign Banks in Trade
- * Claessens, S., Hassib, O., & Van Horen, N. (2017). The role of foreign banks in trade.
- * Claessens, S., van Horen, N., & De Haas, R. (2017). Trade: The benefits of foreign banks. <https://voxeu.org/article/trade-benefits-foreign-banks>
- * Clarke, G., Cull, R., Peria, M. S. M., & Sanchez, S. M. (2003). Foreign bank entry: experience, implications for developing economies, and agenda for further research. *The World Bank Research Observer*, 18(1), 25-59.
- * Dagnachew, H. (2017). OPPORTUNITIES AND CHALLENGES OF LIBERALIZING THE BANKING SECTOR IN ETHIOPIA (Doctoral dissertation, St. Mary's University).
- * Detragiache, E., Tressel, T., & Gupta, P. (2008). Foreign banks in poor countries: theory and evidence. *The Journal of Finance*, 63(5), 2123-2160.
- * Dul, J., & Hak, T. (2007). Case study methodology in business research. Routledge.
- * Federal Negarit Gazeta, (2008), Banking Business Proclamation, Proclamation No. 592/2008

- * Frost, J. (2013). Regression analysis: How do I interpret R-squared and assess the goodness-of-fit. *The Minitab Blog*, 30.
- * Giannetti, M., & Ongena, S. (2012). “Lending by example”: Direct and indirect effects of foreign banks in emerging markets. *Journal of International Economics*, 86(1), 167-180.
- * Grubel, H. G. (1977). A theory of multinational banking. *PSL Quarterly Review*, 30(123).
- * GuechHeang, L., & Moolio, P. (2013). The relationship between gross domestic product and foreign direct investment: The case of Cambodia. *KASBIT Business Journal*, 6, 87-99.
- * Gujarati, D., & Porter, D. C. (2004). *Basic Econometrics*, 2004. Editura McGraw-Hill, 858.
- * Habtamu Dagnachew Limeneh. (2017). Opportunities and challenges of liberalizing the banking sector in Ethiopia.
- * Hagos, M. K., & Asfaw, M. (2014). Financial Regulation and Supervision in Ethiopia. *Journal of Economics and Sustainable Development*, 5(17).
- * Hox, J. J., & Boeije, H. R. (2005). Data collection, primary versus secondary, *Encyclopedia of Social Measurement*
- * Hryckiewicz, A., & Kowalewski, O. (2010). Economic determinates, financial crisis and entry modes of foreign banks into emerging markets. *Emerging Markets Review*, 11(3), 205-228.
- * Hurduc, N., & Nițu, A. (2011). Forms and Strategies of the Banks to Enter on a Foreign Market. *Theoretical & Applied Economics*, 18(7).
- * Hutcheson, G. D. (2011). Ordinary least-squares regression. L. Moutinho and GD Hutcheson, *The SAGE dictionary of quantitative management research*, 224-228.

- * Khare, A. (2011). Customers' perception and attitude towards service quality in multinational banks in India. *International Journal of Services and Operations Management*, 10(2), 199-215.
- * Kothari, C. R. (2004). *Research methodology: Methods and techniques*. New Age International publishers.
- * Lai, T. K., Qian, Z., & Wang, L. (2016). WTO accession, foreign bank entry, and the productivity of Chinese manufacturing firms. *Journal of Comparative Economics*, 44(2), 326-342.
- * Massey, A., & Miller, S. J. (2006). *Tests of hypotheses using statistics*. Mathematics Department, Brown University, Providence, RI, 2912, 1-32.
- * Mauri, Arnaldo, (1971), *The Ethiopian Banking System*, Banking system in Africa, G. Dell' Amore, ed., Cariplo - Finafrica, Milan, pp. 61-70.
- * Mekonnen Hurisa, (2017), *Potential effects of opening the Ethiopian banking sector to foreign banks*
- * Miller, R. L., & Brewer, J. D. (Eds.). (2003). *The AZ of social research: a dictionary of key social science research concepts*. Sage.
- * Molyneux, P., Nguyen, L. H., & Xie, R. (2013). Foreign bank entry in South East Asia. *International Review of Financial Analysis*, 30, 26-35.
- * Moosa, I. (2002). *Foreign direct investment: theory, evidence and practice*. Springer.
- * OECD. Publishing. (2002). *Foreign direct investment for development: Maximising benefits, minimising costs*. Organisation for Economic Co-operation and Development.
- * Oqubay, A. (2015). *Made in Africa: industrial policy in Ethiopia*. Oxford University Press, USA.

- * Patterson, N. K., Montanjes, M., Cardillo, C., & Motala, J. (2004). Foreign direct investment: trends, data availability, concepts, and recording practices. International Monetary Fund.
- * PIMCO, (2011), Inflation and its impact on investment
- * Poelhekke, S. (2015). Do global banks facilitate foreign direct investment?. European Economic Review, 76, 25-46.
- * Pohl, B. (2010). Foreign Banks in Sub-Saharan Africa-Do North-South and South-South Banks Induce Different Effects on Domestic Banks?.
- * Richard Williams, (2015), Heteroskedasticity, University of Notre Dame
- * Rugman, A. M. (2010). Reconciling internalization theory and the eclectic paradigm. Multinational Business Review, 18(2), 1-12.
- * Rugman, A. M., & Verbeke, A. (2008). Internalization theory and its impact on the field of international business. In International business scholarship: AIB fellows on the first 50 years and beyond (pp. 155-174). Emerald Group Publishing Limited.
- * Semahagn Gashu, (2011), Ethiopia's accession to World Trade Organization and the implications to its financial sector policies, Ethiopian Journal of Economics, Ethiopian Economics Association, vol. 19(1),
- * Sultan, Z. A. (2013). A causal relationship between FDI inflows and export: The case of India. Journal of Economics and Sustainable Development, 4(2), 1-9.
- * Zhao, X., & Decker, R. (2004). Choice of foreign market entry mode-Cognitions from empirical and theoretical studies.