



FACTORS AFFECTING CAPITAL STRUCTURE DECISION

The Case of Private Commercial Banks in Ethiopia

PREPARED BY: ERMIAS ABERA

I.D. NO. GSR/1559/99

**PROJECT SUBMITTED TO THE SCHOOL OF GRADUATE
STUDIES OF ADDIS ABABA UNIVERSITY IN PARTIAL
FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE
OF MASTERS IN BUSINESS ADMINISTRATION**

ADVISOR: DR. MEHARI MEKONNEN (PH.D.)

ASSISTANT PROFESSOR IN FINANCE AND INVESTMENT

ADDIS ABABA UNIVERSITY

FACULTY OF BUSINESS AND ECONOMICS

MBA PROGRAM

June, 2008



ADDIS ABABA UNIVERSITY
SCHOOOL OF GRADUATE STUDIES
Faculty of Business & Economics
MBA Program

FACTORS AFFECTING CAPITAL STRUCTURE DECISION
The Case of Private Commercial Banks in Ethiopia

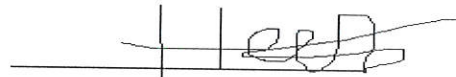
Prepared By: Ermias Abera Reta

June, 2008

Approved by

Advisor: Dr. Mehari Mekonnen

(Asst. Prof. of Finance & Investment)



Signature

Examiner:



Signature

July 22nd, 08

Examiner:

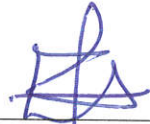


Signature



DECLARATION

I declare that the project entitled “Factors Affecting Capital Structure Decision: The Case of Private Commercial Banks in Ethiopia” is my original work and has not been presented in Addis Ababa University or any other University, and that all sources of material used for conducting the research project have been duly acknowledged.



Ermias Abera
(Student Researcher)

Advisor: Dr. Mehari Mekonnen (Ph.D.)
Assis. Professor in Finance and Investment
Department of Accounting and Finance
Faculty of Business and Economics
Addis Ababa University
Addis Ababa, Ethiopia

LETTER OF CERTIFICATION

This is to certify that **Ermias Abera** has carried out his project on the topic entitled “Factors Affecting Capital Structure Decision: The Case of Private Commercial Banks in Ethiopia” under my advise. This work is original in nature and is suitable for submission for the award of Master of Business Administration.



Dr. Mehari Mekonnen
(The Research Advisor)

Acknowledgement

Before all, I send glory to my God and to our mother Mary, and proud of Kiddush Michael grandeur, for the nothing I missed nothing.

It is my delight to forward my gratitude to my honored and dedicated advisor Dr. Mehari Mekonnen for encouraging and his interesting approach to have accomplished this study.

I would like to pull-out my thank to the financial officers of the private banks and the banking supervision section at NBE. I thank every of my family and friends, who helped me.

God Bless Ethiopia!!!!!!!!!!!!!!!!!!!!!!

And the *millennium* @

Abstract

This research paper presents the factors affecting capital structure decisions of private commercial banks in Ethiopia. The study was conducted mainly on sets of data that were collected from the six private banks in five consecutive years (2003 - 2007) and by conducting interview with the financial managers of the six private commercial banks; AIB, BOA, DB, NIB, UB and WB, which could provide the pertinent and necessary data existing at least during the last five years.

The collected data were analyzed using the pooled time-series correlation. The mean values of the dependent variable (capital structure) are correlated with the mean values of the independent variables. The study has also inculcated in the analysis the primary data obtained by conducting interview with the financial officers and banking supervisors.

The results from the analysis has emphasized on two findings: the first has identified the major factors affecting the capital structure decision of the selected private commercial banks. The second finding has justified the relationship (positive or negative) between the factors affecting capital structure decision such as financial risk, profitability, tax-shield, asset composition, and dilution of control, with debt -to- equity ratio i.e. the measure of capital structure. Based on the analysis, conclusions and recommendations were forwarded.

Handwritten signature or mark in the top right corner.

Table of contents

Titles	Pages
Acknowledgement	i
Abstract	ii
Table of Contents	iii
List of Tables	v
Chapter One: Proposal of the Study	1
1.1 Definition of Basic terms	1
1.2 Background of the study	2
1.3 Statement of the problems	3
1.4 Objectives of the study	4
1.5 Significance of the study	5
1.6 Scope and Limitations of the Study	6
1.7 Hypothesis and Variables Modeling	6
1.8 Research Methodology	12
1.8.1 Data collection Method	12
1.8.2 Method of data Analysis	12
Chapter Two: Literature Review	14
2.1 Capital Structure Decisions: General Review	14
2.2 Factors affecting Capital Structure	23
2.3 Bank Capital Structure Decisions	27



Chapter Three: Analysis of Empirical Data	36
3.1 Results of Empirical Data	39
3.2 Analysis of Empirical Data	45
3.3 Analysis of the Primary Data from Interview	54
Chapter Four: Conclusions and Recommendations	63
4.1 Conclusions	63
4.2 Recommendations	66
Bibliography	
Appendices	

List of Tables

Pages

Table 1:- Debt-to-Equity (DE) Ratio -----	39
Table 2:- Fixed-Payment-Coverage Ratio -----	41
Table 3:- Return on Equity (ROE) -----	42
Table 4:- Tax-Shield-----	43
Table 5:- Asset composition ratio -----	45
Table 6:- Earning Per Share (EPS) -----	46
Table 7:- Mean Values of the variables among the banks over the five years period-----	48
Table 8:- Standard Deviations of the Variables among the banks over the 5 years -----	48
Table 9:- Correlation Matrix to test for multi-collinearity of independent variables-----	50
Table 10:- Correlation Matrix to compute the correlation between DE ratio and the Values of the independent variables-----	51



Chapter One

Proposal to the Study

1.1. Definition of basic terms

- **Asset composition ratio:** is the relative size of loans and security investment in the total assets of the banks
- **Capital Structure:** is determined by the ratio of the debt capital to equity capital in the bank
- **Debt capital:** is the capital of the bank that include deposits received and other liabilities existing in the balance sheet
- **Equity capital:** The difference between a firm's assets (what it owns) and its liabilities (What it owes), also called net worth.
- **Financial risk:** is the risk firms assume as a result of acquiring fixed-charge source of capital (see detail of financial leverage p13)
- **Levered firm:** a firm that uses debt in its capital structure.
- **Optimum Capital Structure:** is the debt-equity mix at which a firm attains minimum cost of capital and maximum value.
- **Profitability:** ability of firms to generate positive return.
- **Unleveled firm:** a firm with no debt in its capital structure.

1.2. Background of the Study

Commercial banks play a vital role; even they are back bones of the economic system or the business works, because they dealt with the major resource of every organization, *capital*. Hence, capital in turn plays essential role in the banking industry. It is also core to the establishment, as well as survival and growth of the banks. (Koch, 2004)

For a bank to survive and grow should balance the demand (requirement) of the three constituencies: owners (shareholders), customers (depositors) and bank regulators. In developing counties, like Ethiopia, the government policies and regulations are also more focused on encouraging private investors to be involved in the banking industry.

The main purpose of private commercial banks management is for profit. In an extreme case, the financial management, in which capital structure decision is important to be considered as a necessary issue in private banks management. Managers, therefore, to pursue wealth maximization objectives of the private banks, should examine the major factors affecting their decisions. Much more difficult, is answering the capital structure questions in the context of developing countries where the financial system is not well developed. Moreover, considering the factors affecting will make the capital structure decision more complex. (Brigham & Ehrhardt, 2002)

Capital structure decision can be simplified as the determination of the proportionate mix of debt and equity capital sources, in due attention to the major factors affecting the decision. Thus, the concern for the factors affecting capital structure decision of private banks in Ethiopia has received a special attention of the researcher to deserve this research study.

1.3. Statement of the Problem

Although earlier studies have a tremendous contribution to the theory of capital structure, they were limited to well-developed financial systems that emanated from the advanced and developed countries. The less developed (or developing) countries with insufficient and inefficient financial system receive little attention in the theory. Among all types of firms banks in developing countries are working in such not well-developed financial system, hence they may pay little attention to practice capital structure theory for their related decision. Therefore, there should be concern for the attributes of capital structure decisions in commercial banks.

This research study tried to identify the factors affecting the capital structure decision of private commercial banks in Ethiopia, one of the developing countries. Hence, the research targeted to assess the correlation between capital structure and;

- ❑ Financial risk related to the banking industry
- ❑ Profitability such as maximizing rate of returns
- ❑ Tax advantages (Tax-shield)
- ❑ Asset compositions of the bank
- ❑ Dilution of controlling intent of shareholders
- ❑ Other factors such as Financial systems and regulatory directives



1.4. Objectives of the study

The main objective of this research study is to identify the factors affecting capital structure decision in private commercial banks in Ethiopia. Hence, the study attempts to achieve the following specific objective:

- ❖ To discuss the factors that affect the sources of capital
- ❖ To evaluate which sources of financing are more emphasized in the banking business
- ❖ To identify, which sources of capital are more accessible to determine the adequate level of bank capital and the mix of debt and equity.
- ❖ To assess the level of debt-equity ratio that can minimize cost of capital
- ❖ To evaluate, currently, how banks are taking tax-shield/advantage in their optimal capital structure
- ❖ To study the relationship of capital structure and concept of risk-return trade-off.
- ❖ To assess the extent of profit determine the capital structure decisions

- ❖ To describe how the debt equity ratio change with the asset composition of the banks.
- ❖ And finally, to make recommendations that might provide additional information to enhance the present capital structure decision of commercial banks.

1.5. Significance of the study

Since banking industry business is emerging and also flourishing in Ethiopian economy, assessing the factors affecting capital structure decision will help in inducing enhanced banking business and innovative action by concerned parties that create packages of benefits to their capital flows.

Even though research studies related to the area of capital structure decisions are plenty, those that are concerned in the financial system of developing countries are few. This study, therefore, attempts all the best to contribute to the literature by assessing the factors affecting capital structure decision of the commercial banks in the developing countries like Ethiopia.

The research study can also be used as launch-pad for researchers interested in making further studies in the banking industry as well as related to capital structure decision.

1.6. Scope and Limitations of the study

The study focuses on factors affecting capital structure decision of private commercial banks. It has excluded public commercial banks, because they mostly have state (government) policy directives on top of their profit concern and flexibility. The study also has not included private commercial banks currently announced such as Cooperative Bank of Oromia, Ambesa International Bank, Access Bank, Birhan international Bank, Bunna International Bank, and others that might emerge until the completion of the research that can not provide all the necessary data, since they are starting late to provide reports.

The minor limitations can be that the bankers may not give due attention to provide all pertinent information needed in the research, even it was what the researcher has encountered while in the pilot survey for the proposal. Moreover, the usual limitation of research studies for academic requirement is financial shortage.

1.7. Hypothesis and Variables Modeling

Commercial banks maintain debt-equity mix that is determined through a conscious financing decision or due to influence of certain factors. Determining the factors (independent variables) that affect bank's capital structure (dependent variable) will enable us to recognize how the decisions behaves as there is a change in those factors.

This research study provides the hypothesis that the financial risk, profitability, tax shield, asset composition, and dilution of control of shareholders on the banks are factors affecting capital structure decision of commercial banks in Ethiopia. *Capital structure is mainly measured by debt-to-equity Ratio.*

In general, the lesser the debt-to-equity ratio, the better is the capital structure, because the banks are having lesser use of liability in the sources of capital, thus they can reduce their risks. On the other hand, the cost of debt is lesser than other sources of capital, thus it results in more profit. However, liquidity risk is more dangerous, so the banks are always attempting to avoid liquidity risks than making more profit at the expense of their liquidity. (Pandey, 2001 and Sinkey, 2002)

The hypotheses development and variables modeling are discussed below:

Financial Risk

Financial risk is taken by nearly every commercial bank. According to Sinkey (2002) the adequacy of a bank's capital depends on its risk exposure. The more the debt and other fixed cost resource a firm uses in its capital structure, the more will be the risk exposure, because the return (net income) provided may be unable to cover the interest and other fixed payments, resulting in bankruptcy costs. (Hampton 2003)

Financial risk is measured by fixed-payment-coverage ratio (i.e. earning before interest and tax divided (EBIT) by fixed-charges such as interest charge and fixed preferred dividends) i.e. formulated as

$$\text{Fixed-Payment-Coverage Ratio} = \text{EBIT} / (\text{Interest payments} + \text{Preferred Dividend})$$

Based on the above reasoning, we can model the following hypothesis:

Hypothesis 1: *There is inverse relationship between the financial risk and debt-to-equity ratio*

Profitability

Performance of a bank prominently is considered from the profit it generates. As a result, this profit is either provided to owners as dividend or partially retained in the firm. If the retained earnings are available, they are the most preferable financing sources, because they remove the explicit cost of capital. Thus, banks tend to find external sources of capital only when internal funds are not sufficient (Sinkey, 2004). Profitability is measured with its common and comprehensive tool: *the return on equity* that is determined as:

$$\text{ROE} = \text{Net Income after tax} / \text{total Stock holders Equity}$$

Based on this argument, the following hypothesis can be developed:

Hypothesis 2: *there is negative relationship between profitability and debt-to-equity ratio*

Taxes-shield:

According to Hampton (2003), interest expense is paid on debt before calculating the corporate income tax. This tax policy makes the payment of interest on debt is cheaper than the payment of dividends on stock or equity sources. To understand how capital structure affects the value of the firm, the concept of tax-shield is critical thus, it is important to consider the concept of tax deductibility of interest expense, thus it increases the total net income that levered firms can payout more divided to its stockholders than unleveled firms. Tax-shield is measured as tax-saving part of interest expense (i.e. Interest charge multiplied by corporate tax rate).

Therefore, the following hypothesis can be formulated:

Hypothesis 3: *there is negative relationship between tax-shield and the debt-to-equity ratio.*

Asset composition of the bank

As a nature of operation, while a bank is accepting deposits from customers, it is incurring liability, but its main operations such as advancing loan to borrowers will be more facilitated. Banks resort to customers deposits as a means of raising debt capital in addition to the initial and subsequent equity capital provided by shareholders.

But there are regulatory reserve requirement directives, like National Bank of Ethiopia (NBE) vested directive No SBB 37/2004, which oblige banks to



hold reserve deposit at NBE to protect and maintain confidence for depositors, shareholders and regulatory body, in banks capital structure.

Thus, the accepted deposits with the other sources of fund facilitate its basic operations i.e. advancing loan and investing in the financial system. These advanced loans and investment on financial securities, are the major components of the total assets of the banks, because to do so is their major objectives. Therefore, the more is the loan and investment, the more will be the fund requirements and thus the more is the deposit mobilization from customers that will increase the debt-to-equity ratio. The proportion of the loans and investments on financial securities in total assets is measured in terms of Asset Composition Ratio.

The asset composition ratio is measured by the proportion of the sum of loans and security investments to the total assets of the banks. i.e.

$\text{Asset Composition Ratio} = \frac{(\text{Loans} + \text{Investments on securities})}{\text{Total Assets}}$
--

Hence, from the understanding, the following hypothesis can be developed.

Hypothesis 4: There is positive relationship between the asset composition ratio and the debt-to-equity ratio.

Dilution of control

As it is viewed by Pandey (2001), the owners need to consider that the capital structure should involve the minimum possibility loss of control on the company. On the managers' attitude, with regard to financing decision

are quite often influenced by their own desires not to lose control of operation. Thus, in share companies like banks, concern for dilution of control is the most important.

As of Hampton (2003), surrendering operational control as one internal factor that affect capital structure, stated that in some cases a firm is unable to sell bonds without allowing the bond holders to exercise certain operational payment controls, and at the same time, the sale of common stock brings new voting stockholders into the firm and dilutes the control of existing shareholders. Thus, the possible loss of operational control is a factor affecting the financing mix. Dilution of control is evaluated using the trend proportion of Earnings per Share (EPS) that is as the bank earns more, the potential investors may be keen to acquire shares of the bank, thus, the bank will get the better option to raise funds it require. Therefore, the more the EPS, the more is the equity financing than debt in the capital structure, in turn the lesser will be the debt-to-equity ratio. Consequently, the new incoming shareholders dilute the existing shareholders controlling extent. Dilution of control is evaluated using Earnings per Share as follows:

$$\text{EPS} = \frac{\text{Net Income available to common stock holders}}{\text{Number of common shares outstanding}}$$

Hence, it can be possible to formulate the following hypothesis.

Hypothesis 5. There is positive relationship between the dilutions of control of owners and the debt-to-equity ratio.

1.8. Research Methodology

8.1. Data collection Method

The main source of data is the financial reports of the private banks and National Bank Ethiopia. The data are both quantitative and qualitative such as annual reports, financial notes, rules, policies and regulations of each bank. The private banks included are Awash International Bank (AIB), Bank of Abyssinia (BOA), Dashen Bank (DB), Nib International Bank (NIB) United Bank (UB) and Wegagen Bank (WB) share companies.

To collect other pertinent data interviews are conducted with financial officers of each private bank, and with banking supervisors in the NBE.

Audited financial statements of the Banks will be used in order to avoid possible distortions associated with provisional financial statements.

8.2. Method of Data Analysis

The data collected will be analyzed using the *pooled time-series cross-sectional correlation* that will be computed for the five consecutive years. The statistical tools used are mean and standard deviation of the five year data of the independent variables such as fixed-payment-coverage ratio, return on equity, tax-shields, asset composition ratio, and earning per share, and then they will be correlated with the average debt-to- equity ratio of banks.

Test of autocorrelation will be made among the research parameters, since the existence of significant autocorrelation will adversely affect the outcome

of the research. Capital structure, the dependent variable, is the average (mean) ratio of total debt to total shareholders equity among the banks over the five consecutive years. Hence, its correlation with the independent variables will be determined; after testing the hypotheses developed based on the correlation outcomes. Here, it should be remarked that correlation does not always indicate cause and effect, but they relate. Thus, the analyses also inculcate the primary data obtained by conducting interview.

A
de Cillonis

Handwritten signature

Chapter Two

LITERATURE REVIEW

2.1 Capital Structure Decision: Overview

2.1.1 General Review

A path to development could not be realized without enabling to evaluate the environmental factors and particularly factors affecting access to finance. Finance, in this case, is the most important factor that determines the growth and even survival of a firm in both developing and developed countries. Consequently, managerial decisions related to finance are at the center of the economic/business activities, which is the subject matter of financial management discipline. Financial management, as disciplinary area has three major decision functions/activities:

First: *Capital budgeting (Investment) Decision*-that deal with the efficient use of capital or funds to acquire assets. It is more concerned with the size, type and percentage composition of assets of a firm.

Second: *Capital structure (financing) decisions*-that emphasizes on the effective choosing among the sources of capital i.e. debt vs. equity. It deals mainly with the size, type and percentage composition of capital sources.

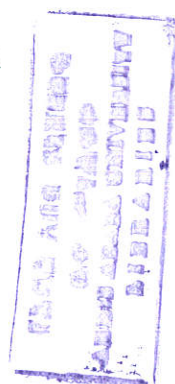
Third: *Asset management decision*- is the other dealing to efficient utilization of assets, being acquired through investment decision.

Here, the literature is to focus on capital structure decisions in general theories, and particularly related to commercial banks, getting insight into the factors affecting capital structure decisions. It can be defined as:

- ✶ □ *Capital structure is the composition of debt and equity capital sources that comprise a firm's financing of assets. Both debt and equity financial securities, bonds and stocks respectively are used in most large corporations. (Hampton, 2003)*

The various sources (means) of financing represent the capital structure of the firm. The term capital structure is used to represent the proportionate relationship between debt and equity. Debt represents the creditors' claim i.e. liabilities or borrowings. Equity includes paid-up share capital, share premium, and reserve and surplus (retained earnings).

Managers in the extent to pursue wealth maximization objective of the firm, should examine the set of theories and at least major factors affecting the decision that help them choose the optimal capital structure. Normally firms have option of choosing debt financing, equity financing, or combination of the two, with the other option of internal financing mainly from the retained earnings. Such dealings for financing decisions are, in fact, termed as Capital Structure Decisions.



The initial advocates: *Modigliani and Miller (M&M)* (1958, 1963) made effort to valuation of a firm that had significant contribution to the concern of the capital structure theory. Essentially, they derived two sets of propositions under stringent assumptions: the first, *proposition I* demonstrated that in a perfect market and in the absence of taxes, the capital structure is irrelevant for determining the value of firms. Hence, levered and unlevered firms should have similar value.

M&M second, *proposition II* demonstrated that the introduction of corporate taxes allowed firms to deduct (or shield) interest on debt in computing profits after tax. This suggests that tax advantages derived from debt would lead firms to be more financed by debt. But the reality is not only to provide the key benefit of debt i.e. tax-shield also to consider the additional debt the firms acquire that may bear bankruptcy risk and the costs associated with such bankruptcy. (Gebrie, 2005).

Therefore, the introduction of corporate tax associated with bankruptcy costs in to the capital structure theory, forced firms to seriously consider the optimal mix of debt and equity financing sources.

As per Pandey (2003, chap, 18 and 19); the capital structure is reviewed as follows. Given the capital budgeting (investment) decision of a firm, it has to decide the way in which the capital for investment projects will be financed. Each time the firm makes investment decision, it is at the same time



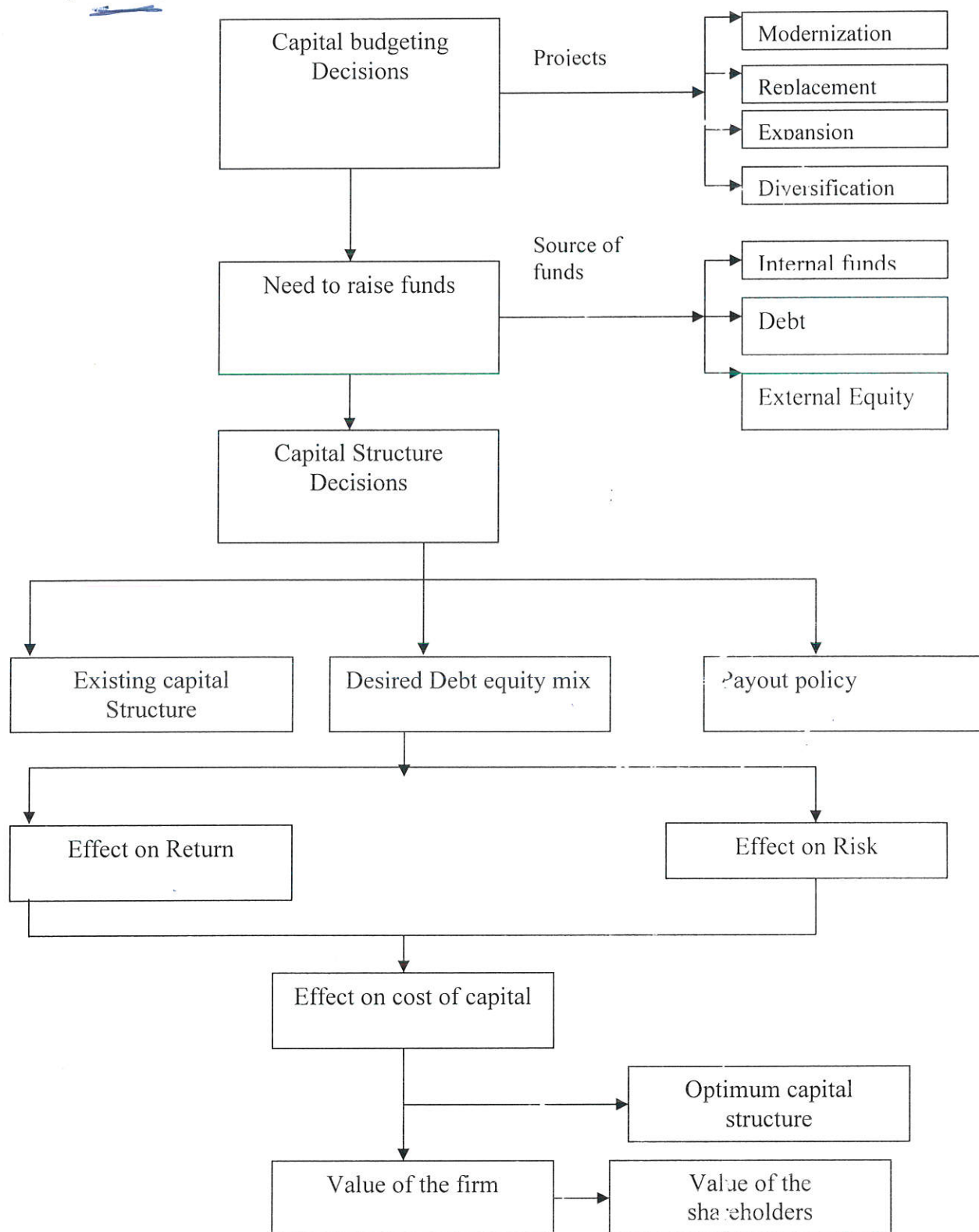
Handwritten signature or mark in blue ink.

making a financing decision. Most of the efforts of the financial decisions process are centered on the determination of the optimal capital structure of a firm i.e. making the decision of the optimal debt-to-equity ratio.

The financing or capital structure decision is very significant managerial decisions. It exists whenever funds have to be raised to finance investment. A need for raising funds creates a new capital structure; hence a decision has to be made as to the size (quantity) and types (forms) of capital financing. This decision will involve the analysis of existing capital structure and the factors affecting or governing the decision at present. The new financing decision of the company may affect its debt-equity mix. The debt-equity mix has implications for the shareholders earnings and risk, which in turn, will affect the cost of capital and the market value of the firm.

The optimal capital structure is theoretically obtained when the market value per share is maximized. The financial manager should plan an optimal capital structure to maximize the use of the funds and to be able to adapt more easily to the changing conditions.

The process of capital structure decision model is shown below as depicted by Pandey, 2003, p635:



2.1.2 Financial Leverage in Capital Structure

As stated earlier, a company can finance its investment using debt and/or equity. In addition, the company may also use preference capital by issuing preferred stocks which is hybrid of bonds (debt security) and common stock. The rate of interest on debt is *fixed* and the company has a legal binding to pay interest on debt irrespective of its rate of return on assets. The rate of preference capital is also basically fixed, but preferred stock dividends are paid when the company earns profits. The rate of the equity divided is not fixed and depends on the dividend policy of the company, which is the earnings the ordinary shareholders are entitled to the residual income i.e. after interest and taxes (less preference dividends, if any).

The use of the fixed-charges sources of funds, such as debt and preference capital along with the owner's equity in the capital structure, is described as *financial leverage or gearing or trading on equity*. The use of the term trading on equity is derived from the fact that it is the owner's equity that is used as a basis to raise debt, i.e. the equity traded upon. The suppliers of debt (creditors) have limited participation in the profit of the company, therefore, they will insist on protection in earnings and protection in values represented by ownership equity.

The financial leverage employed by a company is intended to earn more on the fixed charges funds than their costs. The surplus (or deficit) will increase (or decrease) the return on the owners equity. *The rate of return of owner's equity is levered above or below the rate of return on total assets. Thus, financial leverage provides the potentials of increasing the shareholders earnings as well as creating the risks of loss to them.*

Pandey (2003) summarized the concepts of financial leverage as follows:

The financial leverage at least suggests consideration of pertinent variables: the lower the interest rate, the greater will be the profit and the less the chance of loss, the less the amount borrowed, and the lower will be the profit or loss. Also, the greater the borrowing, the greater the risk of unprofitable leverage and the greater the chance of gain. It has also provided the most commonly used measures of financial leverage, these are:

1. Debt Ratio (DR): - the ratio of debt to total assets

$$\boxed{DR = D / (D + S)}$$
 Where DR= Debt Ratio

Or D= Total Debt

$$\boxed{DR = D / V}$$
 S= Total Shareholders Equity

V= total value of capital i.e. total assets of the firm.

2. Debt-to-Equity (DE) Ratio: - the proportion of debt to equity

$$\boxed{DE \text{ Ratio} = D / S}$$

3. Interest Coverage (I.C) Ratio: - the ratio of net operating income i.e. earning before interest and tax (EBIT) to interest charges:

$$\text{I.C. Ratio} = \text{EBIT} / \text{Interest charges}$$

The first two measures (DR and D-E-R) of financial leverage are related to each other, they rank companies in the same order and they show the borrowing position of the company at a point of time. *The Debt-to-equity ratio, as a measure of financial leverage, is more popular in practice.*

There is usually an accepted industry standard to which the company's Debt-equity ratio is compared. The company will be considered risky if its D-E-R exceeds the industry average. *Financial institutions and banks in India also focus on debt-equity ratio in their financing decisions.*



2.1.3 Features of Appropriate capital structure

The board of directors (BOD) or the Chief Financial Officer (CFO) of a company should develop appropriate capital structure which is most advantageous for the company. This can be done only when all those factors which are relevant to the capital structure decision are properly analyzed and balanced. Thus, the capital structure should be planned generally keeping in view the interests of the equity share holders and the financial requirements of the company.

As stated by Pandey (2003, P 719); A sound or appropriate capital structure should have the following features:

- Return: the capital structure of the company should be most advantageous. Subject to other considerations, it should generate maximum returns to the shareholders without additional cost.
- Risk: the use of excessive debt threatens the solvency or liquidity of the company. To the point debt does not add significant risk it should be used as source of capital; or its use should be avoided.
- Flexibility: the capital structure should be flexible. It should be possible for a company to adapt its capital structure with a minimum cost and delay if warranted by a changed situation. It should also be possible for the company to provide funds whenever needed to finance its profitable activities (projects).
- Capacity: the capital structure should be determined within the debt capacity of the company, and this capacity should not be exceeded. The debt capacity of a company depends on its ability to generate future cash flows.
- Control: the capital structure should involve minimum risk of loss to control of the company. The owners of closely held companies are particularly concerned about dilution of control.

2.2 Factors Affecting Capital Structure

Hampton (2003) discussion of factors affecting capital structure could also be reviewed as follows, categorizing in to three schemes.

The choice of the amount of debt and equity is made after a comparison of certain major factors such as: characteristics of each kind of security, internal factors related to the firm's operations, and external factors that can affect the firms in the industry. These will be discussed in turn.

i. Security Characteristics that affect capital structure

Security characteristics that affect the firm's capital structure fall under four classifications:

1. *Ownership rights.* New holders of common stock, except for class a nonvoting stock, receive immediate and full ownership rights.
If the shareholders do not wish to share their ownership rights with new investors, the firm will attempt to use debt or preferred-stock financing rather than common-stock financing.
2. *Repayment Requirements.* Debt matures and must be repaid according to the conditions in the bond indenture or other agreement. If the firm does not wish to face specific repayment requirements, preferred or common stock is preferable to debt.
3. *Claim on Assets.* The bondholders have the first claim on assets in the event of liquidation, the preferred shareholders the next claim, and the

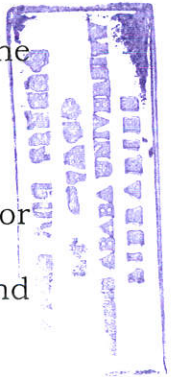
common shareholders the residual claim. If the firm does not want to give new investors a priority claim on assets, common stock is desirable.

4. *Claim on profits.* Interest must be paid on bonds regardless of the level of profits. The common shareholders have the absolute right to share in the profits of the firm. If the firm wants to restrict the right of new investors to share in the firm's profits, debt or preferred stock is desirable.

ii. Internal Factors that Affect capital structure

Internal factors are those considerations within the firm that have a bearing on the kinds and amounts of securities in the capital structure, such as the following.

1. Matching fluctuating Needs against short- Term sources. For fluctuating needs, the firm would probably reject long term debt and equity securities and prefer a short-term loan for a bank.
2. Degree of risk. The more debt firm has, the larger the interest payments and the greater the chance of inability to make the payments, with consequent bankruptcy. Equity securities need not be repaid and dividends need no be obligatory. Thus, equity securities reduce risk; debt securities increase risk.
3. Increasing owner's profits. The ability to increase the owner's return without increasing their investment is an argument for debt financing i.e. the concept of financial leverage.



4. Surrendering operational control: the sale of common stock brings new voting investors into the firm and dilutes the control of the existing shareholders. The possible loss of operational control is a factor influencing the financing mix.
5. Future flexibility. A firm is expected to maintain a balance mixture of debt and equity securities. Excessive debt reduces the firm's ability to borrow and hence reduces flexibility. The need to maintain a balance to ensure flexibility of financing alternatives affects the capital structure.

iii. External Factors that Affect Capital Structure

External factors are those considerations outside the firm that have a bearing on the composition of debt and equity securities such as follows:

1. General Level of Business Activity. If the overall level of business activity is rising, most firms need money to expand their operations. The need for additional long-term funds brings a firm to the money market for either debt or equity funds. On the other hand, a decline in business activity may allow a firm to cut back its operations and use its cash to retire debt or equity securities.
2. Level of Interest Rates. Interest rates on bonds fluctuate in the market in response to supply and demand factors. If interest rates become excessive, firms delay debt financing, switch to short-term

financing until long-term debt can be offered at lower rates, or switch to equity securities more often.

3. Level of Stock prices. When firms issue new common stock, the hope to receive as much money as possible from each share. When stock prices are depressed, the firm does not offer common stock. If stock prices are high, the firm can raise relatively large amount of money by issuing relatively few shares.
4. Availability of funds in the markets. Money and capital markets are a constantly changing, complex phenomenon. At times money is plentiful and reasonably priced securities can be sold. At other times, money is scarce and offerings fail to sell out. The availability of funds affects the firm's ability to offer debt and equity securities.
5. Government regulations and Tax Policy on interest and dividends: At present. Interest is paid on debt prior to the calculating of the corporate income tax. Dividends are declared after the tax calculation. This tax policy makes the payment of dividends more costly than the payment of interest.

2.3 Banks Capital Structure Decision: Review

Banks are one of the financial intermediaries that operate in the financial system of the economic system. They act as intermediaries to transfer and allocate money from the savers to needy borrowers. (Hempel, Simonson, and Coleman, 1998).

Banks are back bone of the economy and to all business activities. Commercial banks can thus fill the diverse desires of both the ultimate borrowers and lenders of capital. Capital is a fundamental and vital part of the commercial banking industry. Bank capital plays important role in the establishment of the banking entity by providing the necessary funds, and also critical to the perpetuation of the entity in its capacity as on going concern. A commercial bank mainly obtains funds from creditors i.e. debt (deposits) ownership (equity) sources (p 60). As a result, the basic objective of bank management should be to maximize the value of the owner's investment in the banks. For most banks, useful information, on the appropriate trade-offs between returns and risk is obtained from relatively efficient markets.

2.3.1 Do M&M Propositions Apply to Banks? (Sinkey, 2002)

An important question in corporate finance is "Does capital structure matter?" when asked, if "M&M propositions" apply to banks, answered "yes and no" Miller (1995). On the affirmative, Miller says that it is hard to see

anything about demand securities (bank deposits) being so special to rule out the application of M&M propositions to banks. What make banks special, however, are not the securities they issue but the government guarantees that protect these securities. The important point to recognize that capital can be acquired from a number of sources.

Government guarantees for bank deposits and other liabilities, found on other corporate securities, will affect the cost of capital from these sources. Moreover, since common equity is the most expensive source of bank capital, bankers continually search for debt-like substitute. The two recent developments that have affected the cost of bank capital have been the Bank Accord on Risk-Based-Capital (RBC) Requirements phase in 1992, and Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991.

- Since 1992, the Base Accord on RBC requirements has mandated that banks determine their regulatory capital *based on their exposure to credit risk* i.e. more risk requires more regulatory capital.
- In contrast, the FDICIA attempts to reduce the moral hazard and agency problems, in effect, it forces banks to substitute their own capital for a smaller but still credible government guarantee.

2.3.2 Optimal Bank Capital and the Value of the banking firm

To understand how financial structure affects the value of the firm, the concepts of tax shield and bankruptcy costs are critical.

- First, consider the concept of the tax shield; the important point is that the tax deductibility of interest expense increases the total income that a levered firm can pay out to both its stockholders and bond holders.
- If the first proposition is true, however, what next steps firms form becoming purely debt-financed. Entering in to bankruptcy costs, which have two components: the direct costs (such as legal and administrative costs) and indirect costs or costs of financial distress as manifested by a higher cost of capital. Specially, as a firm increases its use of debt, its risk of not being able to cover its interest expenses increases that eventually could lead to bankruptcy.
- Combining costly bankruptcy with the tax deductibility of interest produces a situation in which bankruptcy costs provide a disincentive that offsets the tax shield incentive to expand debt. Under these dual conditions, the optimal capital structure exists in which the value of the firm is maximized.

2.3.3 The Costs of Bank Financial distress

As the view of Sinkey (2002):

The costs of bank financial distress take two forms:

- 1) Increased cost of capital or funds, which operate through market discipline, and

2) Increased regulatory interferences, which operated through regulatory discipline

As per the first form, banks with inadequate capital will be perceived by the market as being riskier, which means they will incur higher costs of funds on uninsured obligations.

Banks pay interest on most of their deposits, on non deposit funds, and on their debt capital. What do they have to pay for equity capital? The return that shareholders expect to earn on their investment represents the implicit cost of equity capital. This expected total return ($E(r)$) can be viewed in terms of a dividend yield (D / P) and a price appreciation or capital-gains yield ($\text{Change in } P / P$). Symbolically:

$$E(r) = (D / P) + [(\text{change in } P) / P] \quad \text{where, } D \text{ is dividend per share}$$

P is price per share

Change in P is the change in price per share

over the period of holding the stock

Or

$$E(r) = D / (P + g)$$

g = constant growth in dividend

The cost of total capital is measured using weighted average cost of capital (WACC) that is computed as

$$WACC = W_d (\text{cost of debt}) + W_e (\text{cost of equity})$$

$$WACC = W_d (K (1-t)) + W_e (E(r))$$

Where, W_d = the percentage composition of debt in total capital



W_e = the percentage composition of debt in total capital

K = Interest rate averaged on total liability

t = tax rate

$$E(r) = D / (P + g)$$

2.3.4 Risk-Return Trade-offs Banks (Hempel, Simonson, and Coleman, 1998).

Risk measures are related to the return measurements because a bank must take risk to earn adequate returns. The difficulty in obtaining conflicting goals and the trade-offs between returns and risks taken by nearly every commercial bank. Four basic categories of risk measures are as following:

- a) *Liquidity Risk* of a bank refers to a comparison of its liquidity needs for deposit outflows and loan increases with its actual or potential sources of liquidity from either selling assets it holds or acquiring an additional liability.
- b) *Interest rate risk* of the bank is related to the changes in asset and liability returns and values caused by movements in interest rates.
- c) *Credit Risk*- is defined as the risk that the interest or principal, or both, on securities and loans will not be paid as promised.

d) *Capital Risk*-indicates how much asset values ~~may decline~~ before the position of its depositors and other creditors is jeopardized.

Clearly, returns are increased by increasing one or more of the four primary risks a bank may take. Therefore, bank management would prefer the highest returns for a given level of risks and/or the lowest risks for a given level of returns.

The main situations of Return-Risk Trade are changing the banks liability portion of the capital structure i.e. increasing or decreasing capital position of debt:

- i) liquidity, low-capital situation
- ii) profitability, high-capital situation
- iii) shifting fund sources situation
- iv) rapid growth situation

2.3.5 Bank's Capital Adequacy Determination

It is important to determine, how much capital does the bank need to ensure the confidence of depositors, creditors, investors and regulators? "The adequacy of a bank's capital depends on its risk exposure. More risk requires more capital, and vice versa." This proposition is nothing more than the basic risk-return trade off expressed in terms of bank capital as a buffer for unexpected losses.

A financial management standard mandates that a bank's capital adequacy reflects its risk exposure. In this context, the issue of capital adequacy ties directly to risk management, which is as much art as it is science.

In line with the dependence of adequate bank capital on the risk exposure, there are three primary factors affecting the appropriate amount of capital for the bank's capital structure. These are:

To determine how much capital is appropriate for a bank's capital structure, there are three primary factors affecting the appropriate amount of capital for a bank. These are:

1. The purpose of Bank capital

Determining the amount of capital needed to meet the purposes of bank capital, such as

- to maintain confidence and protection for depositors
- to supply the working capital tools of the bank
- to provide protection for unanticipated adversity

2. The need for leverage to improve the returns to owners the need for financial leverage to increase the returns to bank's owner affects the amount of appropriate capital for a bank.

3. Regulatory capital adequacy criteria and concerns Bank regulators have the responsibility of protecting depositors funds and the safety of the banking system.

2.3.6 Sustainable Internal Growth ✓

The internal growth of a bank is considered from the return (profit) it generates. As a result, this profit is either retained in the firm or partially provided to the owners as dividend.

If retained earnings are sufficient to fill the bank's needs, they are the best form of bank equity capital source to use. There are three variables (factors) to determine how much of the bank's growth can be sustained through the retention of earnings. These are:

1. the amount of capital the bank and its regulators determine to be adequate
2. the earnings the bank is able to generate and
3. the proportion of these earnings that is retained in the bank.

Hence, the main concern is the relationship between the proportion of capital that is deemed to be adequate and how much growth is financed internally mainly from the retained earnings.

Advanced loans are mainly long term while deposits are typically short term, therefore, banks suffer due to the maturity transformation performed that highly affects profit and capital. Bank capitalization may also influence the reaction of credit supply to output shocks. This effect depends on the link between bank capital and risk-aversions. Thus, well-capitalized banks are risk-averse. Banking supervisors set prudent and appropriate minimum

capital adequacy requirements for all banks. Such requirements reflect the risks that the banks undertake, and define the components of capital, bearing in mind their ability to absorb losses. (Gebrie, 2005)

- A bank's capital structure usually is defined in terms of its Debt-to-Asset or Debt-to-Equity Ratios. Of course, the better measure of Debt-to-Equity Ratio
- The components of bank capital: Deposits (domestic or Foreign) of customers i.e. the debt financing portion of the bank's capital.
 - Current Deposit
 - Fixed Deposit
 - Saving Deposits
- Non-deposit liabilities those are spontaneous to any firm
- Equity that includes
 - Common shares values the authorized legal capital
 - Surplus (Additional paid-in capital to share values)
 - Reserve i.e. legal to the equity capital, and
 - Retained earnings - profit not yet divided to owners.

In Ethiopia case, the NBE vested reserve requirement directives No. 5BB 37/2004, which obliges banks to hold some proportion of deposits balance with account in NBE.

Chapter Three

ANALYSIS OF EMPIRICAL DATA

The pertinent data for the study are collected from the five years (2003 to 2007) audited financial statements of the six selected private commercial banks denoted as follows: -

1. Awash International Bank (AIB) is the first private bank in the new Banking Proclamation No. 83/1994. It has obtained its license from the NBE on November 10, 1994 and started operation on February 13, 1995 at paid-up capital of Birr 23.2 million from 486 shareholders. Currently, the paid up capital at the end of 2007 reached Birr 282.3 million it is expected that it will reach Birr 300 million ahead of December, 2008.
2. Bank of Abyssinia (BOA) was inaugurated and started operation in the December, 1996. At the end of June 2007 it has weighted average of 2.65 million shares out standing of Birr 100 par value at paid-up capital of Birr 353.03 million.
3. Dashen Bank (DB) was established and started operation in January, 1996. At the end of June, 2007 it has out standing shares of 187,800 at paid-up capital of Birr 282.21 million.
4. Nib International Bank (NIB): was established and started operation in October, 1999. At the end of June, 2007 it has 417 million out standing shares of Birr 500 per share paid-up for Birr 307 million.

5. United Bank (UB) was established and started operation in the 1997.

At the end of June, 2007 it has 2,593,267 out standing shares at par of Birr 100 and paid-up capital of Birr 282.21 million.

6. Wegagen Bank (WB) was established and started operation in 1997.

At the end of June, 2007 it has issued 233,139 shares at par value of Birr 1000 paid-up reached Birr 233.1 million.

The remaining private commercial banks are not included in this research, which can not encompass the required five year (2003 to 2007) financial statements, since they are established late. The research also excludes the public commercial banks, because they mostly have state (government) policy directives on top of their profit concern and flexibility.

The capital structure of the banks is measured by the *Debt-to-Equity Ratio*, which can be measured using market and book values. Although market value is believed to give more accurate picture of the value of the ratio, this study has considered the book-values of the parameters to determine the ratio. This is due to the unavailability of the market values in current financial system of the country. Therefore, the other variables used in this study have been determined using the book values.

The *pooled time-series correlation analysis* of the research is conducted having the empirical data computed for the variables using the following formulae:

- To measure capital structure:

Debt-to-Equity ratio = Total liabilities / Total Stockholders Equity

- To determine financial risks (basically the *credit risk* that is the interest or other fixed periodic payments), the Fixed-Payment-Coverage Ratio is appropriate.

Fixed-Payment-Coverage Ratio = EBIT / (Interest payments + Preferred Dividend)

EBIT is Earning Before Interest and Tax

- Profitability is measured by the indicator: Return On Equity (ROE)

ROE = Net Income after tax / total Stock holders Equity

- Tax-shield is tax saving of interest expenses, because the interest expenses are tax deductible expresses

Tax-Shield = interest expense * tax rate

- Asset Composition Ratio of the banks –i.e. the proportion of the loans advance and investments from the total assets

Asset composition Ratio = loans + investment on securities / Total assets

- Dilation of control is measured by using Earning per Share (EPS). Of course, the dilution of control should be measured using Price-Earning ratio, but there is no feasible market price of stock unit for each period of every bank

EPS = Net Income available to Shareholders / Number of shares out standing



3.1 Results of the Empirical Data

The empirical data are presented first by computing the values of the variables in each bank for the five years and then the interpretations/discussion of each variable and its value will be followed.

Computation of the variables of each bank for 5 years

(Figures are in millions of birr)

Table 1:- Debt-to-Equity (DE) Ratio = total liability / total stockholders (SHs) equity

The Private Banks		2003	2004	2005	2006	2007
AIB	Total Liability	1264	1615	1998	2650	3396
	Total SHs Equity	137	155	228	304	434
	Debt-Equity Ratio	9.2263	10.419	8.7632	8.7171	7.8249
BOA	Total Liability	1184	1392	1803	2432	2993
	Total SHs Equity	149	155	254	402	403
	Debt-Equity Ratio	7.9463	7.2124	7.0984	6.04975	7.4268
DB	Total Liability	1862	2505	3177	4160	5496
	Total SHs Equity	129	172	243	386	545
	Debt-Equity Ratio	14.434	14.564	13.074	10.777	10.084
NIB	Total Liability	760	1074	1508	1742	2187
	Total SHs Equity	125	173	224	285	425
	Debt-Equity Ratio	6.08	6.2081	6.7321	6.1123	5.1459
UB	Total Liability	378	578	948	1408	1823
	Total SHs Equity	91	96	125	191	360
	Debt-Equity Ratio	4.1539	6.0208	7.584	7.3717	5.0639
WB	Total Liability	796	1011	1436	2004	3077
	Total SHs Equity	93	129	180	255	403
	Debt-Equity Ratio	8.5594	7.8372	7.9778	7.85882	7.6352

As viewed in table 1 of debt-to-equity ratio to show the proportionate mix of debt and equity capital sources i.e. the capital structure decision.

In general, the lesser the DE ratio, the better the banks in reducing their financial risks because they can have lesser debt proportion as compared to equity composition of the capital structure. For the private banks considered, the debt-to-equity ratios have been decreasing except a few fluctuations; hence, the banks are reducing their indebtednesses i.e. making their capital structure better and better since 2004 in almost all of the banks.

For instance, take the DE ratio of Awash International Bank, in the year 2003 its capital structure contained Birr 9.2 of debt financing for each Birr 1 equity financing. In 2004, the proportional mix of debt to equity was 10.4:1, then the DE ratios have been declining, i.e. the banks has been reducing the use of debt financing, thus its capital structure has been taking more of equity financing and retained earning in the time series 2004 to 2007. Of course, the banks have grown in size (assets) that indicates both the debt and equity extents are increasing, but the increase in equity are greater than the increase in debt proportion of the capital structure that is why debt-to-equity ratio has been decreasing since 2004 in most of the banks.

Table 2:- Fixed-Payment-Coverage Ratio = EBIT / Interest Expenses

	2003	2004	2005	2006	2007
AIB	1.69	2.17	2.62	3.31	4.29
BOA	1.3	2.86	3.48	3.98	2.58
DB	2.23	2.9	2.87	3.76	3.77
NIB	2.73	4.27	3.75	3.45	3.52
UB	2.17	1.91	3.53	3.07	3.19
WB	1.88	3.5	3.86	3.69	3.75

Considering table 2 that denotes the fixed payments-coverage ratio to measure the financial risks (particularly, credit risks) of the private banks. The coverage ratio indicates, the earnings availability and capacity of the banks to cover (pay) their fixed periodic payments. In general, the higher the coverage ratio, the better capacity of the bank to cover its fixed payments from its earnings of the period. The coverage ratio can be stated as: how many times the EBIT can cover the fixed payment in the specific period.

In the calculation of the ratio, the fixed periodic payment in the private banks is only the interest expenses they incur. As it can be seen from the table, the coverage ratios of the banks have increasing trends in almost all the periods. That is the banks have been improving (making better) their coverage capacity of interest expenses by increasing their earnings before interest and tax (EBIT).

For instance, take the coverage ratios of BOA. That in the year 2003 the EBIT is 1.3 time the interest payments, in 2004 the EBIT is 2.86 times the interest payments, and so on. For more, in the year 2007, the EBIT is 4.29 times the interest payment, i.e. it covers the interest payments 4.29 times, hence, after covering the interest expenses it has safely margin of 77% (i.e. Birr 3.29 less Birr 1 of interest divided by Birr 4.29). The coverage ratio of BOA for 2007 can also be interpreted as the bank has provided Birr 4.29 for each Birr 1 interest expenses.

Table 3:- Return on Equity (ROE)=Net income / total SHs Equity

	2003	2004	2005	2006	2007
AIB	10.4	17.8	19.8	29.3	38.8
BOA	4.1	22.2	27.3	25.9	16.6
DB	21.51	37.21	34.22	42.29	40.19
NIB	11.6	23.5	23.2	22.8	21.4
UB	5.6	7.5	28.1	27.8	23.2
WA	14	28.8	31.1	32.6	34

With regard to the Return on Equity (ROE) ratio computed in table 3, which is used to determine the profitability of the bank on behalf of the investment (equity) of stockholders. In general, the higher the ROE ratio, the better the banks are making profit on behalf of investment of owners. Moreover, the higher returns can avail more retained earnings, which are the most preferable source of capital because they can avoid the explicit cost of

capital, and the higher return can also attract shareholders to buy stocks. Hence, the company can raise more funds from equity sources than debt financing.

Considering the values in the table, the banks' ROE ratios have been increasing in trend of the five years, which indicates that the private commercial banks have generated more and more profit on behalf of the shareholders' investment.

For example, the ROE ratio of DB shown that in 2003 the bank has generated Birr 21.51 for each Birr 1 investment of owners i.e. 21.51% return on the investment of owners (equity capital), in 2004 ROE was 37.21% and so on.

Table 4:- Tax-Shield = Interest Expense *Corporate tax rate (in millions of birr)

	2003	2004	2005	2006	2007
AIB	10.4	12	13.6	19.2	24.8
BOA	10.8	11.6	13.2	16.4	24
DB	12	16.4	20.8	25.8	37.2
NIB	4.4	6	9.6	13.2	16.8
UB	2.4	4.4	6.8	11.6	16
WB	6.8	7.2	8.8	14	22

The computations of table 4 denote the Tax-Shield of the private banks during the five years. The values indicate the tax savings of interest expenses will increase the profit available to the shareholders. The more the interest expenses the bank pays, the more will be the profit remaining to the

shareholder, but in turn will increase its credit risk that could arise from the possible inability to cover the interest expense with its principal (that is the expression of "profitability at the expense of risk"). Commonly that is why debt financing is cheaper, but risky.

Regarding the banks' tax-shield values, they are at all increasing in each consecutive period. That indicates the banks are paying more interest expenses and also saving tax payment tremendously. For instance, considering the NIB figures basically, from interest expense of 2003 Birr 4.4 million, from the 2004 Birr Million has been covered by the tax shield from government, hence the banks incurred more interest expense and have taken more tax shield, in turn increased profit for the shareholders.

Table 5:- Asset composition ratio = (loans + investments on Securities) / total assets

	2003	2004	2005	2006	2007
AIB	0.8	0.73	0.69	0.7	0.66
BOA	0.61	0.72	0.6	0.69	0.74
DB	0.71	0.75	0.66	0.7	0.66
NIB	0.66	0.7	0.65	0.73	0.7
UB	0.62	0.57	0.55	0.63	0.6
WB	0.64	0.64	0.62	0.71	0.62

Concerning the asset composition ratio depicted in table 5, this shows the extent of utilizing the capital to advance loans and to invest on financial assets. The more the ratio indicates that the more the banks are allocating

their funds to assets that bear direct earning (interest). On the other hand, the availability of funds will affect the banks direct earning extent i.e. the funds could be provided by incurring more liability (debt) as it can be seen from the table, but in the five years there is no significant change in the assets compositions ratio except some declining trends for AIB, the remaining banks have some increase and decreasing trends. The indication is that the *treasury bills* issued by the NBE are acquired by the bank in some of the periods, except the UB and WB.

As to the indication of the figures for instance taking WB, it has 64% of its total assets composed of loans and investment of financial assets in the years 2003 and 2004 and it has 62% of loans and financial investments in the total assets of 2005, and exceptionally in 2007 it has 71% of these assets that is the period it has greatly increased its total loans and advance.

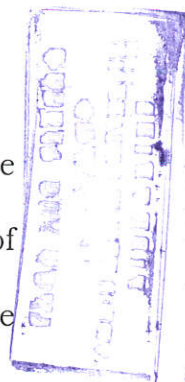
Table 6:- EPS= Net Income / Number of Shares out standing (figures are in birr)

	2003	2004	2005	2006	2007
AIB(for Br 1000)	112	279	302	620	600
BOA(for Br 000)	164.8	284.3	322.7	430.2	250.2
DB(for Br 1000)	540	712	256	1102	960
NIB(for Br 1000)	52.5	148	160	161	160
UB(for Br 1000)	63	77	345.7	416	358.7
WB(for Br 1000)	256	380	478	553	573

As enumerated by table 6 of the Earning per Share (EPS) that describe the earning provide on behalf of each out standing capital stocks. In general, the more the EPS, the more the company can satisfy the existing stock holds, in addition, it can attract potential investors to acquire ownership interest; hence, the banks can have preference to use equity financing than debt financing.

As viewed from the table all the banks have been increasing their EPS, hence they can get feasible source of raising the required funds, if any, from the equity of potential investors those who could be attracted by the higher EPS.

Therefore, the more the EPS, the access to equity financing, in turn the number of outstanding shares increases, which reflects the dilution of control of existing owners. Moreover, as more equity financing is used, the surrendering operational control of creditors will be reduced and the banks get flexibility and minimize risks.



3.2 Analysis of the Empirical Data

The empirical data of variables' values computed for five consecutive years (2003 - 2007) using audited financial statements of the selected private banks, and the primary data collected by conducting interview with the financial managers the banks and the Banking Supervisor at the NBE. All these data are analyzed using the *pooled-time series correlation analysis*, for which the researcher is assisted by SPSS application software.

Thus, this part of the study would present the correlation analysis between the independent variables that are hypothesized factors affecting capital structure decision and the dependent variable (DER ratio) indicating capital structure decision.

The values of the variables are pooled from the six private banks i.e. mean of the values of the variables, then the mean values of the independent variables is correlated with the dependent variables to consider that whether the hypothesized factors could affect positively or negatively, or could not affect the capital structure decisions. The banks' pooled values or mean values of all the variables and standard deviations are computed as follows:

Table 7:- Mean Values of the variables among the banks over the five years period

	2003	2004	2005	2006	2007
Debt-Equity Ratio	8.3999468	8.71031	8.53826	7.81448	7.196849
Fixed-Payments-Coverage Ratio	2	2.935	3.35167	3.54333	3.516667
Return On Equity	11.201667	22.835	27.2867	30.115	29.03167
Tax-Shield amounts	7.8	9.6	12.1333	16.8667	23.46667
Asset Composition Ratio	0.6733333	0.685	0.62833	0.69333	0.663333
Earning per Share	167.05	296.05	386.733	522.7	490.4833

Table 8:- Standard Deviations of the Variables among the banks over the 5 years

	2003	2004	2005	2006	2007
Debt-Equity Ratio	3.4853001	3.27678	2.3317	1.77776	1.883265
Fixed-Payments-Coverage Ratio	0.4929909	0.86535	0.49652	0.33056	0.583221
Return On Equity	6.2722577	10.0357	5.21585	6.80742	9.913729
Tax-Shield amounts	3.8760805	4.51132	4.98745	5.54497	7.655238
Asset Composition Ratio	0.0714609	0.06775	0.04956	0.03386	0.051251
Earning per Share	118.19143	186.918	188.944	264.16	304.5496

At average, the banks DE ratio has decreasing trends during the five years. That is indicating the banks more inclination to the equity financing than deposit mobilization. Even the standard deviations shows in the five years that most of the banks have focused more on equity financing that debt financing.

As to the fixed-payment coverage ratios in average over the five years indicate fluctuations that may point out the banks at all could not maintain a better position on their coverage capacities.

Regarding the average values of the ROE ratios and the tax-shield during the five years that show the banks have been increasing the earnings on behalf of owners' equity and taking advantage on interest payments, respectively.

The average values of the asset composition ratios indicate almost similar in the trends of the five years.

The average EPS is increasing each year except a slight decline in the year 2007. But the deviation between banks is very high.

In correlation analysis, the coefficient of correlation originated by K. Pearson (1900), describes the strength of the relationship between two sets of ratio-scaled variables. The Pearson's Correlation Coefficient assumes any value from -1.00 to +1.00 inclusive. Correlation Coefficient of -1.00 or +1.00 indicates perfect correlation. The +1 indicates the directly perfect relationship between dependent and independent variables, while the -1 indicates the inversely perfect relationship between dependent and independent variables. The more the value approaches to +1 or -1, refers that there is strong relationship between the two variables directly or inversely, respectively. When there is loose (weak) relationship between the two variables directly or inversely, the Correlation Coefficient gets closer to

zero in the absolute values. If there is no relationship between the two set of variables, the Correlation Coefficient will be zero.

Before the consideration of the correlation results it is better to examine the multi-collinearity among the variables, thus the correlation matrix of the independent variables has been depicted as follows using SPSS:

Table 9:- Correlation Matrix to test for multi-collinearity of independent variables

	Fixed-Payment Coverage Ratio	ROE	Tax- Shield	Asset Composition Ratio	EPS
Fixed-Payment Coverage Ratio	1.00				
ROE	0.09	1.00			
Tax-Shield	0.01	0.07	1.00		
Asset Composition Ratio	0.54	0.34	0.15	1.00	
EPS	0.07	0.08	0.01	0.03	1.00

As viewed in the above table, the correlation coefficients are not significantly to cause collinearity problems in the correlation analysis of the independent variables and the dependent variables. The only variables at which the values being quite significant are between the asset composition ratio and the fixed-payment coverage ratio (54%) and ROE (34%).

Table10:- Correlation Matrix to compute the correlation between DE ratio and the Values of the independent variables

Correlation between	Correlation Coefficients
DER and FP Coverage Ratio	-0.5098022
DER and ROE	-0.4900724
DER and Tax-Shield	-0.9387957
DER and Asset Composition Ratio	-0.1358381
DER and EPS	-0.6947282

For analysis purpose values are taken in two decimal places.

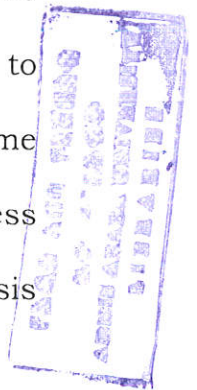
As depicted in table 10, the correlation between DE ratios and Coverage ratios is -0.51 that shows inverse (negative) relationship between DE ratio Fixed-Payment Coverage Ratios. Hence, the hypothesis developed as: *There is inverse relationship between the financial risk and DE ratio* is true.

That is as the coverage ratio of the banks at average increases and DE ratio declines, which indicates good position to the banks in managing their risks, during of the five years. The inverse relationship is some how strong.

Concerning the correlation of DE ratio and ROE, the coefficient shows -0.49, which is pointing out they have inversely relationship that makes true the hypothesis developed as: there is negative relationship between profitability and debt-to-equity ratio. The increase in the profitability indicated by ROE has effect of decreasing the DE ratio i.e. the banks' capital structure

decision has focused more on equity financing than debt financing. But the correlation has average strength (-0.49).

Regarding the relationship between DE ratio and Tax-Shield, the correlation coefficient is -0.94, which indicates the ~~increases in the tax saving has~~ inversely affected the DE ratio i.e. the more the advantage the banks are having from tax-shields by using more interest paying deposits, in turn the is the will be the net income that more levered firms can payout more dividends to shareholders, hence the more is their capital structure to contain equity financing than debt financing, because the higher net income attracts the new investors to acquire shares, thus the company has a less risky capital option from the potential investors, Therefore, the hypothesis developed is also true. The relation is very strong i.e. very close to 1 (0.97).



Based on the correlation coefficient (-0.14) stated for the relationship between DE ratio and Asset Composition ratio, the relation is very weak though it is inverse. However, the hypothesis was developed stating that *there is positive relationship between the assets composition ratio and DE ratio*. The correlation coefficient result is disproving the hypothesis. Thus, there is a need to deal more on the ratios. The more habitable evidence is the theory framed as: The more the asset composition ratio is to mean the more are the loans and investments on securities from the total assets. Hence, to grant more loans and acquire more financial assets, the banks

should raise more capital that is to mobilize more deposits from customers, because as the nature of the banking business, banks are primarily to allocate funds from depositors to needy borrowers.

Lastly, with regard to the relationship between DE ratio and EPS, the correlation coefficient approximated at -0.70 is the indication of inverse relation between DE ratio and EPS and it can be stated as strong correlation. This is also disproving the hypothesis that states there is positive relationship between dilution of control and DE ratio. But, in this case the correlation can be accepted in the view that the higher the EPS may indicate better earning to the existing shareholders, which may influence the potential investors to be enthusiasts to acquire the share of the banks. Therefore, the banks will get better option to raise the funds they need from the potential investors, which is the indicator of the banks inclination to use more equity financing than debt financing. However, the practice is more of preserving preemptive right to the existing shareholders.

3.3 Analysis of Primary Data from Interview

The banks financial managers (officers) stated that the banks capital structure contains mostly the deposits from customers (creditors) and shareholders investments (equity capital).

The deposit from the customers comes in three main ways; Demand Deposits, Savings Deposits and Fixed Time Deposits. The first is payable on demand (Demand Deposits) accounts received from private sectors, public agencies and institutions, cooperatives and associations, and residents and non-residents foreign currency. The second one is the saving deposits from the general public and from institutions. The third component is the Fixed-Time (Term) deposits from private sectors, public agencies and institutions, cooperatives and associations.

All the banks' Demand Deposits are non-interest bearing to the depositors, but should be so live that the customers can withdraw it any time. It is mostly processed by check. This account is very sensitive to cash shortage for its settlement, since customers may need cash from their deposit current to be withdrawn. Specifically the researcher has identified that Wegagen Bank has special type of the demand deposit to pay interest on arrangements.

The Saving Deposit accounts of the banks pay interest for their depositors currently 4% per annum and there are some restrictions put aside, but open to any citizen having proper identification card. Still in Wegagen Bank this deposit type contains Children trust funds i.e. funds set aside by parents and guardians from court in the name of their children and minors. The fixed time deposits are accepted from the customers through contractual agreements that stipulate terms expressing the obligations and rights of each party. These deposits are commonly accepted from private sectors, public agencies and institutions, cooperatives and associations that can be more liable in their position and legality. The terms for interest rate are set by negotiation based on time and amount. The longer the fixed period and the larger the amount is deposited, the more will be the interest rate to be paid. The interest rate ranges 5% to 7.5%. This type of deposit is more useful to the banks to manage their liquidity.

In addition to the accepted deposits, there are sources of funds such as Margin held on letter of credit and some other spontaneous liabilities reported as other liabilities such as CPO (Cashiers Payment Order), Drafts Payable, Unclear mail and telegram transfers, provision for tax, and accrued liabilities and deferred revenues.

The owners' equity capital is raised from issuance of shares, from legal and special (general) reserves and from retained earnings. The capital raised from the issuance of shares is recorded as Paid-up (Share) capital. The

share capital contains the amount of shares issued and paid, and Shares Premium. In some banks the shares are issued at partial payments, and new shareholders are charged for premium at 5%-10% of the par value, mostly the shares are owned by existing owners. The bank is not allowed to acquire its own stock (there is no treasury stock).

The Paid-up capital is mainly required by the NBE as minimum requirement to establish banking businesses. For all the banks considered in this research, initially the minimum capital requirement was Birr 20,000,000 (twenty millions), but in the late announced regulation, the banks are required to raise funds at the minimum of Birr 75,000,000 (Seventy –five millions). Therefore, in the last two years the banks have been issuing shares to raise their capital to the requirement of the regulatory body, and also the banks have been subscribing and issuing more shares each year to facilitate their activities in the competitive environment.

Moreover, the need for owners' equity capital comes from different requirements such as;

- to increase the single borrower limits set by the NBE i.e. the private banks can grant loans and advances to a single borrower (private sectors and institutions) up to 25% of the paid-up capital
- to protect the interest of depositors and the general public, since capital from shares are less risky.

- to expand branches and to increase the types of their products/services through acquiring fixed facilities that could make the too growing.
- to prosper to the international banking business and to capture international trade opportunities, i.e. the banks are expected to have adequate capacity that is measured by their paid-up capital to deal with international banks, this is because the risks on share capital is very low, hence, it grants the banks,
- to hold more foreign currencies that are hard currencies, at which the banks are limited by NBE to hold hard currencies up to 15% of their shares capital,
- to increase creditors and debtors confidence in the competition, that the customers feel their bank has better capacity to exist and progress,
- the increase in the general business trends may require to have a higher capital to grasp opportunities and to tackle threats,
- some times to bond the agency of the management to the ownership, which is a means to motivate managers to perform to their best to maximize the wealth of shareholders and to retain managers and some out-performing employees in the banks for long period.

The subscription and issuance of shares is mostly initiated by the management considering the above issues requiring the share capital, being justified will be approved by the general assembly of the shareholders. In the current period, most of the banks are issuing shares to the general public after preserving the preemptive right for the previously existing shareholders. The current issuance to new shareholders is by charging premium price, which is considering the current market situation and the trends of share issuance of other financial institutions.

The other source of capital is the legal reserve. The Licensing and Supervision of the Banking Proclamation No. 84/1994, Article 13(4) provides that 25% of the net profit after taxation shall be transferred to the legal reserve account until the balance reaches the paid-up capital. Furthermore; recently the banks have kept special reserves set aside for their own purposes at 15% of the retained earning of the year.

- Concerning the interview related to the impact financial risk assessment on the capital structure decision of the banks, due attention is given to the four types of risks: credit risks, liquidity risks, interest rate risks and foreign currency risks. Commonly, most of the banks' financial managers argued that they have good risk management positions. The researcher has focused on the credit risks and liquidity risks of the banks. Because the interest rate risk is as such significant to affect the capital structure in its trends, the



foreign exchange risks are controlled by maintaining major currencies whose exchange rate against Birr has always been appreciating.

The credit risk, both on and off balance sheet, is managed and monitored in accordance with defined credit policies ~~and procedures~~. The credit worthiness of each counter part is evaluated and appropriate credit limits are established. To reduce individual counter party credit risk the banks ensure, whenever necessary, that all loans are secured by acceptable forms of collateral. Although the banks have not yet established credit limits across industries and products, they regularly review their credit exposures. The banks loans are diversified against various sectors. Therefore, the private banks are granting loans and advances preserving their deposit mobility i.e. using measures from On-balance sheet such as keeping the loan-to-deposit ratio at plausible level, and considering the Off-balance sheet items such as commitments for letter of credit, overdrafts and other loan provisions in analysis. In the current period the government is resisting the banks not to grant loans excessively, due to the prevailing inflation of the country.

The liquidity risk arises in the general funding activities of the banks and the management of positions. It includes the risk of being unable to fund assets at appropriate maturities and rates and the risk of being unable to liquidate an asset at a reasonable price and in appropriate time frame. The

banks have reasonable funding bases. The funds are raised mainly from customers' deposits. The maturity profile is monitored by management to ensure adequate liquidity is maintained. The critical strategy to maintain adequate liquidity is identifying the contractual maturity of assets (loans and investments) and the liabilities. These have been determined on the basis of the remaining period to maturity as at the balance sheet date on those loans and deposits having the maturity date, and some how trend analysis could be used to determine the due of demand (current) deposits since these deposits have no maturity. That is all to avoid mismatch between available funds and the maturing liabilities. Mostly, the banks maintain about 25% of Cash and cash equivalent amounts in their assets. Above all they have reserve and other accounts with the NBE, for which the governing body has vested reserve requirement directives No. 5BB 37/2004, that obliges commercial banks to hold 15% of the deposit on cash and cash equivalents with the account in the NBE, as payment and settlement accounts .

Therefore, the banks in order to maintain adequate liquidity position they should raise funds i.e. adjust their capital structure. Hence, they need to enhance/mobilize deposits from customers and/or issue shares of ownership.

For the discussion that the researcher inquired the financial officers: "how could they determine to choose either to enhance deposits or to issue shares?" Most of them answered that they do both to mobilize the deposits

and to issue shares. The issuance shares needs the approval in the general assembly of the shareholders. But the mobility of deposit requires some enhancement techniques such as:

- to provide attractive interest rates
- approaching enterprises at their project developments
- opening new branches and providing new product using latest technology
- inviting prospective investors by preparing ceremonies like dinner party,
- sharing expertise business consultancy and advises

Moreover, as particularly argued by financial officer of NIB, the issuance share to the general public can have opportunity to enhance deposits from the activities if the shareholders and their affiliates.

→ In the dealing the researcher made, a question is raised as to the tax advantage they are taking by paying more interest expenses. In this the researcher explained that the use of more debt financing (in the banks case the acceptance of more interest paying deposit) have the more interest payment, hence the tax deductibility of the interest expenses results in tax-shield or tax saving, in turn this increases the net profit available to existing shareholders. The financial officers replied that they do not so much bother about the tax-shield; they consider the margin between interest income and interest expenses.

In the interview regarding the effect of EPS (Earning Per Share) on the capital structure of the banks, i.e. the more the earning the more will be the willingness of the new potential investors to acquire shares of the bank, hence the controlling extent of the previous owners will be diluted, for this the existing owners may refuse the issue of additional share. Most of the officers argued that there is no so much analysis of the earning of the banks by the new investors; rather they are to be informed from their affiliates basically about the dividend paid out to shareholders. The reason can be lack of developed financial system, particularly the financial markets. Therefore, except that the higher EPS results in better dividend payments, there is a trend of each period subscribing and issuing of shares.

Chapter Four

Conclusions and Recommendations

Based on the analysis of the empirical data conducted and the information articulated from the interview, the following conclusions are derived and recommendations are commented.

4.1 Conclusions

The research has been dealing with the empirical data collected from the five consecutive years' (2003 - 2007) financial reports of the six private commercial banks: Awash International Bank (AIB), Bank of Abyssinia (BOA), Dashen Bank (DB), Nib International Bank (NIB), United Bank (UB), and Wegagen Bank (WB). The analysis was conducted using correlation analysis of value of the dependent variable (Debt-to-Equity Ratio) with the values of the independent variables considered them as factors affecting capital structure decision. As a result of the analysis the following conclusions:

- ❖ The private banks capital structure decision has been affected by the concern of managers to financial risks. As it has approved the hypothesis indicated as -0.51 i.e. the coverage ratio is inversely correlated with the DE ratio. Thus, the financial risk is one of the factors affecting the capital structure decisions. Moreover, the financial

managers of the banks argued that they give main concern to the credit risks and liquidity risks.

- ❖ The profitability moderately affects the capital structure decisions of the banks. As it was hypothesized the ROE is inversely correlated with the DE ratio, shown by the coefficient as -0.49. The higher the returns the banks are providing on behalf the owners' investment, the more will be the retained earnings and appealing of potential investors, hence the banks can raise more capital from issuance of shares. The increases on equity financing have been more and more than the increase in the debt financing (deposits mobilizing).
- ❖ With regard to the value of correlation coefficient (-0.94) indicating very strong inverse relationship between the tax-shield and DE ratio, as it was hypothesized. The banks have been tremendously taking tax saving by higher payment of interest expenses but the banks are having lesser debt (deposit from customers) proportion than equity capital as indicated by declining trend of the DE ratio in the five years.
- ❖ As indicated by the correlation coefficient (-0.135), the Asset composition ratio and the DE ratio are inversely but insignificantly related as it is opposing the hypothesis, that states the loans and investment proportion in the total assets is directly (positively) related

with the DE ratio. Of course, the correlation coefficient may not always indicate cause and effects, thus the researcher has emphasized on the primary data obtained through the interview of the financial officers of the banks. As a result they promulgate that the increase in the loan advancing option of the banks necessitate raising more funds particularly from mobilizing customers' deposits. Therefore, the loans and other financial investment composition in the total asset of the banks is directly related to the DE ratio, in turn shows asset composition is one of the factors affecting capital structure decisions.

- ❖ The banking regulation and directives of NBE have been affecting the capital structure decision of the private commercial banks; especially they lead the banks to more of equity financing.
- ❖ Finally, the correlation result of -0.7 shows strong but inverse relation between DE ratio and EPS. The correlation result is falsifying the hypothesis the declared there is positive relationship between DE ratio and EPS. However, in this case the correlation result can be accepted in the view that the higher the EPS may indicate better earning to the existing shareholders, which may appeal potential investor to the bank. Therefore, the banks will get better option to raise the funds they need from the potential investors, which is the indicator of the banks inclination to use more equity financing than debt financing. With this

it can be concluded that the dilution of control represent by EPS can affect the capital structure decision.

4.2 Recommendations

Sanding on the analysis and conclusions reached, the researcher has profound and forwarded the following recommendations:

- The private commercial banks considered in this study have no more specific dealing towards the proportion of the debt-to-equity proportion in their capital structure. They are more of to adhere to the policies and procedures of the NBE and some times they are attempting loophole mining on the regulation. Being in line with the policies and regulations, the banks should have stipulated standard to determine the proportion of debt -to-equity ratio.
- Of course, the banks have been issuing additional shares each year, most of them to the general public, simultaneously; they are greatly mobilizing deposits from customers. It is a good trend that their equity financing is greater than the deposit mobilized from customers, hence they are minimizing their financial risks.
- In the current situation the banking industry is more profitable and even there are still abundant potential banking services to be

provided, not yet provided by the existing banks. Even that is why a number of banks are emerged. The profit may not continue as it is, it will be shared by the incoming banks, hence, the banks can make better profit and exist, by considering factors affecting their capital structure decisions and to cherish from their experience.

- As the researcher was informed while conducting the interview, most of the financial managers do not consider the tax advantage of interest expenses, but as a rule of thumb they are enhancing the deposit i.e. the debt, as a nature of the banking business. Therefore, the officers better inculcate in the future concept of tax-shield in their profit generation as far as they are having buffer in their liquidity.
- Generally, all the banks have a higher proportion of mobilized deposits from customers when compared to the existing capital and reserves that is depicted on Table 7, which shows at average banks have liabilities of 8 time the capital and reserve amounts, but some how in the 5 years it is reduced to 7 times. The higher ratio could be the nature of banking business, banks as far as possible should be so conservative in the level of liability they are incurring, and in the mean time they should raise more capital from issuance of shares to the public to minimize the risks associated to their capital structure.

Bibliography

Books

1. Brigham E. and Ehrhardt M. (2002) Financial Management Theory And Practice, 10th ed., south-western Thomson Learning, USA
2. Hampton John (2003), Financial Decision Making, 4th ed, Prentice Hall of India
3. Hempel G.H., Simonson D.G. and Coleman A.B.,(1998), Bank Management Text and Cases, 6th ed, John Wiley & Sons Inc., USA
5. Koch T.W, (2004), Bank Management, 6th ed, The Dryden Press, USA.
6. Pandey I.M., (2001), Financial Management, 8th ed., VIKAS Publishing Pvt. Ltd., India
7. Ross W.F (2001), Essentials of Corporate Finance, 10thed, Thomson Press, USA,
8. Sinkey J. (2002), Commercial Banks Financial Management, 6th ed, Prentice Hall, USA
9. Van Horn J. (2002) Financial Management and Policy, 12th ed, Prentice Hall, New Jersey,



Publications and Reports

1. **National Bank of Ethiopia(NBE) Publications:** Prepared by Economic Research and Monetary Policy Directorates
 - i. Annual Report, Fiscal years Series, Since1997 E.C
 - ii. Licensing and Supervision of Banking Business Directives No SBB/9/95, SBB/15/96, and SBB/37/2004
 - iii. Private Banking in Ethiopia: Performance and Prospects A.A., February 1999
 - vi. <http://www.nbe.gov.et>

2. Annual Reports of the Private Commercial Banks in Ethiopia

Journals

1. Davis Y.G.C and Leathem D.J., (2001). Impact of Interest rate swaps on corporate capital structure: An empirical investigation, *Applied financial economics*, Volume 11, No. 1. Pp.75-85.
2. Ellene Kebede and Jolly C.M., (2001), Effects of Financial structure and instruments on the income of low income credit unions, *Applied Financial Economics*, Volume 11, No. 2. Pp. 231-236.
3. <http://www.emeraldinsight.com/login>

Project Papers

1. Ashenafi Beyene (2005), Determinants of Capital Structure in Medium Enterprises in Ethiopia, FBE, AAU
2. Gebrie Work (2006), Liquidity and its Impact on the Performance of Commercial Banks in Ethiopia, FBE, AAU
3. Tewodros Giday (2005), What Determines the Financing Decisions of Micro and Small Enterprises Operating in Addis Ababa, FBE, AAU

STREET
CROSSING

Interview Questions to the financial officers of the private banks

1. What are the major sources of capital for your bank?
2. How frequently you have ever encountered the practice of C.S. decisions?
3. Is there authorized and responsible unit/body to make C.S. decisions?
4. Would you specify the major factors affecting your capital structure decisions? Such as:
 - i. What are the financial risks considered?
 - ii. To what extent profitability affects the C.S. decisions?
 - iii. How do you consider tax-shield/advantage in C.S. decisions?
 - iv. At what level the asset composition affects the C.S. decisions?
 - v. How do you entertain the dilution of control as one factor?
5. Do you have specific types of model or software used for C.S. decision?
6. Are there any specific techniques used to evaluate and follow-up the implementation and results of C.S. decisions?
7. Which source of capital is more emphasized: debt or equity?
8. What are the initiatives to raise funds using debt financing sources?
9. What are the schemes to raise funds using equity financing sources?
10. In general, how do you consider the D-to-Equity Ratio of your bank?

Interview Questions to Banking Supervisors at NBE

11. Are there rules and regulations stipulated as to the C.S. of the banks?
12. Are there directives to the private commercial banks that influence their C.S. decisions in the recent periods?
13. Do you think that any of the rules/regulations and directives are considered by the private commercial banks as factors affecting their C.S. decisions?

**AWASH INTERNATIONAL BANK SHARE COMPANY
BALANCE SHEET
AT 31 DECEMBER 2007**

CURRENCY: BIRR

ASSETS	Note	2007	2006
Cash and Bank Balances			
Cash on hand	1a	177,462,283	105,689,430
Reserve Account with National Bank of Ethiopia		310,248,703	130,248,703
Payment and settlement account with National Bank of Ethiopia		235,413,409	122,421,058
Deposits with local banks		557,732	687,170
Deposits with foreign banks	1a	<u>350,943,402</u>	<u>328,963,890</u>
		1,074,625,529	688,010,251
Other assets			
Treasury bills	1a, 2	241,391,566	201,528,315
Investments in shares	3	550,000,000	101,000,000
Loans and advances		3,564,400	3,266,345
Customers' liabilities for commercial letters of credit and acceptances, as per contra	4, 5	2,402,600,567	2,354,977,415
Fixed assets	1b	417,687,080	270,447,069
	1c, 6	<u>93,192,385</u>	<u>63,339,359</u>
TOTAL ASSETS		<u>4,783,061,527</u>	<u>3,683,068,754</u>
LIABILITIES			
Deposits			
Demand deposits		697,938,076	578,085,765
Savings deposits		2,426,412,932	2,022,048,650
Fixed deposits		<u>294,846,699</u>	<u>121,168,665</u>
		3,419,197,707	2,721,303,080
Margins held on letters of credit		88,772,718	64,165,583
Other liabilities	7	322,192,075	246,486,423
Provision for tax		52,680,764	38,907,720
Bank's liabilities for commercial letters of credit and acceptances, as per contra	1b	<u>417,687,080</u>	<u>270,447,069</u>
TOTAL LIABILITIES		<u>4,300,530,344</u>	<u>3,341,309,875</u>
CAPITAL AND RESERVES			
Share capital	8	282,300,378	200,000,000
Legal reserve		98,591,017	66,928,989
Retained earnings		6,653,706	6,653,706
Profit and loss account		<u>94,986,082</u>	<u>68,176,184</u>
		482,531,183	341,758,879
TOTAL LIABILITIES AND CAPITAL		<u>4,783,061,527</u>	<u>3,683,068,754</u>

BEKELE NEDIR

CHAIRMAN OF THE BOARD OF DIRECTORS



**AWASH INTERNATIONAL BANK SHARE COMPANY
PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2007**

CURRENCY: BIRR

INCOME	Note	2007	2006
Interest income			
Commissions and services	9	232,346,001	177,927,916
Gain on foreign currency transactions and translations		52,288,426	43,331,911
Other income		84,909,801	51,896,792
		<u>12,559,141</u>	<u>10,836,901</u>
		<u>382,103,369</u>	<u>283,993,520</u>
EXPENSES			
Interest expense			
Salaries and benefits	10	84,680,302	64,233,180
Administrative and general expenses		42,905,968	41,899,040
Provision for doubtful loans, advances and other receivables	11	46,670,398	27,567,899
Audit fee	4	28,402,827	23,784,730
		<u>115,000</u>	<u>78,900</u>
		<u>202,774,495</u>	<u>149,919,739</u>
NET PROFIT BEFORE TAX		179,328,874	134,073,781
PROVISION FOR TAX		(52,680,764)	(38,907,420)
NET PROFIT AFTER TAX		126,648,110	95,166,061
TRANSFER TO LEGAL RESERVE		(31,662,028)	(23,791,515)
DIRECTORS' ALLOWANCE		94,986,082	71,374,546
		<u>7</u>	<u>(3,568,727)</u>
		<u>94,986,082</u>	<u>67,805,819</u>
BALANCE BROUGHT FORWARD		68,176,184	61,185,349
Finance lease liability premium			
Prior years adjustment			2,093,440
			<u>370,365</u>
		<u>68,176,184</u>	<u>63,509,154</u>
DIVIDENDS PAID		(68,176,184)	(63,509,154)
RETAINED EARNINGS			(1,093,641)
		<u>7</u>	<u>370,365</u>
BALANCE CARRIED FORWARD		94,986,082	68,176,184
EARNINGS PER SHARE		526	529



BALANCE SHEET

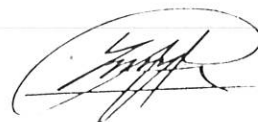
AS AT 30 JUNE 2007

		CURRENCY: BIRR	
	Notes	2007	2006
ASSETS			
Cash and Bank Balances			
Cash on hand		128,155,838	101,106,090
Deposits with local commercial banks		428,828	5,068,762
Deposits with foreign banks.	1c	260,260,211	203,021,312
Reserve Account with National Bank of Ethiopia		130,017,347	99,017,347
Other accounts with National Bank of Ethiopia		303,141,373	372,994,734
		822,003,597	781,208,245
Items in course of collection from other banks		119,367,091	99,371,516
Deposits and prepayments	2	9,184,928	5,151,392
Loans and advances to customers	3	2,197,341,801	1,901,466,545
Treasury bills		199,900,000	
Other assets	4	7,047,312	9,356,072
Customers' liabilities on letters of credits, per contra	1f	181,807,580	180,332,154
		3,536,652,309	2,976,885,924
Intangible fixed assets	1d, 5	672,206	846,477
Tangible fixed assets	1a, 6	40,639,495	36,327,279
TOTAL ASSETS		3,577,964,010	3,014,059,680
LIABILITIES			
Deposits	7		
Demand deposits		511,058,029	403,228,373
Savings deposits		1,898,101,450	1,548,299,795
Fixed time deposits		312,168,110	225,357,313
		2,721,327,589	2,176,885,481
Margins held on letters of credit		34,703,482	45,447,427
Other liabilities	8	208,919,138	172,866,461
Provision for tax	9	28,454,915	36,904,583
Bank's liabilities on letters of credits, per contra	1f	181,807,580	180,332,154
TOTAL LIABILITIES		3,175,212,704	2,612,436,106
CAPITAL AND RESERVES			
Paid-up capital	10	265,000,000	264,713,109
Legal reserve	11	74,598,461	58,023,261
Special reserve	12	13,427,245	13,427,245
Retained earnings		49,725,600	65,459,959
		402,751,306	401,623,574
TOTAL LIABILITIES AND SHAREHOLDERS FUND		3,577,964,010	3,014,059,680



PHILIPPOS W/MARIAM

CHAIRMAN OF THE BOARD OF DIRECTORS



ASSELEFECH MULUGETTA

PRESIDENT

PROFIT AND LOSS ACCOUNT

FOR THE YEAR ENDED 30 JUNE 2007

INCOME	Notes	CURRENCY: BIRR	
		2007	2006
Interest income			
Less: Interest expense	1b, 14	201,548,788	165,275,931
Net interest income	17	(60,490,965)	(40,771,344)
Provision no longer required		141,057,823	124,504,587
Gain on fluctuation of exchange rates	13	-	444,770
Service charges – foreign and local	1c	33,795,470	25,790,857
Commission earned		14,757,678	13,663,773
Other income	15	8,161,545	7,311,719
	16	8,424,363	7,951,475
		206,196,879	179,667,181
EXPENSES			
Salaries and benefits			
General and administration		31,730,478	26,104,024
Board of Directors' fees	18	29,841,319	22,853,201
Audit fee	19	2,787,907	3,548,779
Provision for doubtful loans and advances		100,000	80,354
Provision for other receivables		46,756,843	-
		-	4,159,280
		111,216,547	56,745,638
PROFIT BEFORE TAX		94,980,332	122,921,543
LESS: PROVISION FOR TAX			
	9	(28,456,730)	(36,905,600)
PRIOR PERIOD ADJUSTMENTS		(222,802)	1,264,003
NET PROFIT AFTER TAX		66,300,800	87,279,946
TRANSFER TO LEGAL RESERVE		(16,575,200)	(21,819,987)
		49,725,600	65,459,959
RETAINED EARNINGS BROUGHT FORWARD		65,459,959	45,791,732
LESS: TRANSFER TO SPECIAL RESERVE		-	(7,920,809)
DIVIDENDS PAID		(65,459,959)	(37,870,923)
		-	-
RETAINED EARNINGS CARRIED FORWARD		49,725,600	65,459,959
EARNINGS PER SHARE			
(PAR VALUE OF BR. 25)	20	6.25	10.76
EARNINGS PER BIRR 100 SHARES	20	25.02	43.02

DASHEN BANK S.C.
BALANCE SHEET
AS AT 30 JUNE 2007

Currency : Ethiopian Birr

	Notes	2007	2006
ASSETS			
Cash and balances with other banks			
Cash on hand	3	150,166,259	120,447,048
Deposits with local commercial banks		13,080,857	1,374,628
Deposits with foreign banks		646,460,130	546,014,884
Deposit with National Bank of Ethiopia	4	861,184,640	482,049,266
		1,670,891,886	1,149,885,826
Investments	5	28,385,795	27,801,795
Items in course of collection from other banks	6	234,986,600	153,864,230
Loans and advances to customers	7	3,889,003,611	3,080,263,248
Other assets	8	120,366,856	74,185,344
Fixed assets	9	97,279,472	60,012,535
TOTAL ASSETS		<u>6,040,914,220</u>	<u>4,546,012,978</u>
LIABILITIES			
Customers' deposits			
Demand deposits		1,360,926,459	1,039,091,412
Saving deposits		2,842,853,597	2,343,244,480
Fixed deposits		656,767,450	309,267,163
		4,860,547,506	3,691,603,055
Margin held on letters of credit		145,500,202	136,392,485
Other liabilities	10	419,230,188	280,367,023
Provision for taxation	14	71,164,202	51,777,613
TOTAL LIABILITIES		<u>5,496,442,098</u>	<u>4,160,140,176</u>
SHAREHOLDERS' FUNDS			
Share capital	11	232,210,000	156,190,000
Legal reserve		136,973,606	89,973,776
General reserve	16	64,717,354	64,709,026
Retained earnings	17	60,571,162	75,000,000
		544,472,122	385,872,802
TOTAL LIABILITIES AND SHAREHOLDERS' FUNDS		<u>6,040,914,220</u>	<u>4,546,012,978</u>

DASHEN BANK S.C.
PROFIT AND LOSS STATEMENT
FOR THE YEAR 2007

INCOME	
Interest income	
Loans and advances	
Surplus fund	
Total interest income	
Interest expense	
Interest paid on deposits	
Less: Provision for interest income	
Other income	
Service charge	
Letters of credit	
Commissions	
Gains on foreign exchange	
Sundry income	
Investment income	
EXPENSES	
Salaries and benefits	
Rent	
General and administrative	
Depreciation	
Directors' remuneration	
Audit fee and expenses	
PROFIT BEFORE PROVISION FOR TAXATION	
Provision for taxation	
NET PROFIT AFTER PROVISION FOR TAXATION	
Transfer to legal reserve	
Transfer to retained earnings	
Earnings per share	

DASHEN BANK S.C.
PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 30 JUNE 2007

Currency : Ethiopian Birr

2006
120,447,048
1,374,628
546,014,884
482,049,266
1,149,885,826
27,801,795
153,864,230
3,080,263,248
74,185,344
60,012,535
4,546,012,978
1,039,091,412
2,343,244,480
309,267,163
3,691,603,055
136,392,485
280,367,023
51,777,613
160,140,176
156,190,000
89,973,776
64,709,026
75,000,000
85,872,802
46,012,978

Currency : Ethiopian Birr

	Notes	2006	2006
INCOME			
Interest income			
Loans and advances	299,345,467		227,942,449
Surplus fund	20,582,225		13,950,849
Total interest income		319,927,692	241,893,298
Interest expense			
Interest paid on deposits		(92,511,233)	(66,887,818)
Less: Provision for doubtful loans and advances		227,416,459	175,005,480
		(7,849,833)	(13,560,113)
		219,566,626	161,445,367
Other income			
Service charge	24,988,268		24,221,209
Letters of credit opening charges	9,848,581		10,507,419
Commissions	32,804,602		26,038,498
Gains on foreign exchange	85,363,666		54,376,042
Sundry income	10,280,175		8,252,709
Investment income from Tana Building	1,540,686		1,334,477
		164,825,978	124,730,354
EXPENSES			
Salaries and benefits	51,802,159		39,917,551
Rent	17,525,028		12,452,314
General and administrative	39,267,852		32,841,576
Depreciation	15,841,137		14,775,353
Directors' remuneration	698,769		698,769
Audit fee and expenses	110,000		122,757
		(125,244,945)	(100,808,320)
PROFIT BEFORE PROVISION FOR TAXATION			
Provision for taxation		259,147,659	185,367,401
		(71,159,443)	(51,777,613)
NET PROFIT AFTER PROVISION FOR TAXATION			
Transfer to legal reserve (25%)		187,988,216	133,589,788
Transfer to retained earnings		(46,997,054)	(33,397,447)
		140,991,162	(100,192,341)
Earnings per share			
	15	1,001	953

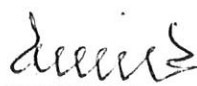
UNITED BANK SHARE COMPANY
BALANCE SHEET
AT 30 JUNE 2007

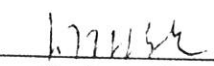


Currency: Ethiopian Birr

	Notes		2006
ASSETS			
Cash and bank balances	2h,3	757,713,731	592,675,420
Loans and advances	2d,4	1,367,883,083	974,949,418
Other assets	5	24,235,873	17,440,479
Deferred charges	2i,6	1,041,530	917,154
Investment	7	320,000	--
Property, plant and equipment	2e,8	31,549,592	13,586,332
Total assets		<u>2,182,743,809</u>	<u>1,599,568,803</u>
LIABILITIES			
Deposit from customers	9	1,541,089,453	1,220,580,816
Deposit from financial institutions	10	139,680,126	72,178,991
Other liabilities	11	85,258,458	51,960,005
Margin held on letter of credit		34,395,684	47,534,159
Profit tax payable	12	22,585,753	15,955,194
Total liabilities		<u>1,823,009,474</u>	<u>1,408,209,165</u>
CAPITAL AND RESERVES			
Paid up capital	13	259,326,669	130,834,967
Share premium	13	9,057,087	1,595,547
Legal reserve	13	40,792,802	24,724,204
Retained earnings	13	50,557,777	34,204,920
		<u>359,734,335</u>	<u>191,359,638</u>
Total liabilities, capital and reserves		<u>2,182,743,809</u>	<u>1,599,568,803</u>

Addis Ababa
02 October 2007


Eyessus W. Zafu
Chairman of the Board of Directors


Berhanu Getaneh
President

The attached notes on pages 25 to 38 form part of these financial statements



UNITED BANK SHARE COMPANY
INCOME STATEMENT
FOR THE YEAR ENDED 30 JUNE 2007

Currency: Ethiopian Birr

INCOME

	Notes		2006
Interest income	2f, 14	122,146,169	71,269,924
Less: Interest expense	15	<u>39,576,527</u>	<u>28,553,034</u>
Net interest income		<u>82,569,642</u>	<u>42,716,890</u>

Commission fees and charges- net	2f, 16	26,605,012	25,388,260
Net gains from dealings in foreign currencies	2g	40,380,801	26,824,029
Other income	17	<u>2,973,824</u>	<u>2,578,691</u>
Net operating income		<u>152,529,279</u>	<u>97,507,870</u>

Provision for doubtful loans and advances	2d,4	<u>(13,269,166)</u>	<u>(6,391,600)</u>
Net interest and other income after provision for doubtful loans		<u>139,260,113</u>	<u>91,116,270</u>

EXPENSES

Salaries and benefits		22,891,653	13,859,278
General and administration expenses	18	26,973,539	15,863,386
Directors' fee	19	2,464,778	1,689,653
Audit fee		<u>70,000</u>	<u>58,121</u>
		<u>52,399,970</u>	<u>31,470,438</u>

PROFIT BEFORE TAXATION		86,860,143	59,645,832
-------------------------------	--	------------	------------

PROVISION FOR TAXATION	12	<u>22,585,753</u>	<u>15,961,742</u>
-------------------------------	----	-------------------	-------------------

NET PROFIT AFTER TAXATION		64,274,390	43,684,090
----------------------------------	--	------------	------------

LEGAL RESERVE		<u>16,068,598</u>	<u>10,921,023</u>
----------------------	--	-------------------	-------------------

NET PROFIT AFTER TAX AND LEGAL RESERVE		<u>48,205,792</u>	<u>32,763,067</u>
---	--	--------------------------	--------------------------

EARNING PER SHARE OF BIRR 100	24	<u>35.87</u>	<u>41.60</u>
--------------------------------------	----	---------------------	---------------------

WEGAGEN BANK SHARE COMPANY

BALANCE SHEET

AT 30 JUNE 2007

Currency: Ethiopian Birr

	Notes		2006
ASSETS			
Cash and bank balances with local banks	2h,3	486,043,345	318,670,756
Reserve with National Bank of Ethiopia		131,388,527	94,388,526
Deposits with foreign banks	4	702,374,258	248,294,591
Loans and advances	2d,5	2,060,606,572	1,516,839,343
Stock of supplies	6	6,094,277	5,797,315
Other assets	7	44,462,090	50,547,074
Deferred charges	2i,8	597,068	—
Leasehold land	9	15,835,026	—
Property, plant and equipment	2e,10	32,879,227	25,006,916
Total assets		3,480,280,390	2,259,544,521
LIABILITIES			
Deposit from customers	11	2,236,538,813	1,530,944,846
Deposit from financial institutions	12	487,087,044	247,473,182
Other liabilities	13	153,783,036	118,428,665
Margin held on letters of credit		144,467,640	84,661,826
Profit tax payable	14	41,305,813	23,367,734
leasehold land payable	9	13,892,078	—
Total liabilities		3,077,074,424	2,004,876,253
CAPITAL AND RESERVES			
Paid up capital	15	233,139,000	147,605,000
Share premium	15	5,241,450	2,670,300
Legal reserve	15	73,622,138	45,878,375
Special reserve	15	7,972,089	5,367,333
Retained earnings	15	83,231,289	53,147,260
		403,205,966	254,668,268
Total capital, reserves and liabilities		3,480,280,390	2,259,544,521

Addis Ababa
29 September 2007

Sebhat Negga
Chairman of the Board of Directors



Araya G/Egziabher
A/President & CEO



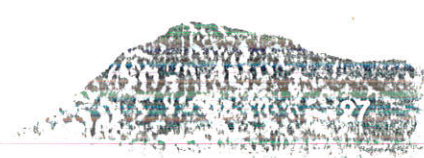
WEGAGEN BANK SHARE COMPANY

INCOME STATEMENT

FOR THE YEAR ENDED 30 JUNE 2007

Currency: Ethiopian Birr

	Notes	2006	
INCOME			
Interest income	2f,16	185,021,035	120,457,213
Less: Interest expense	17	(55,291,901)	(34,553,832)
Net interest income		129,729,134	85,903,381
Net fees and commission income	2f,18	66,633,394	52,411,420
Net gains from dealings in foreign currencies	2g	66,689,701	46,379,629
Other income	19	1,704,659	1,564,220
Net operating income		264,756,888	186,258,650
Provision for doubtful loans and advances	2d,5	(32,109,500)	(29,070,829)
Direct write-off other than loans and advances		(47,675)	(370,850)
Net interest and other income after provision for doubtful loans		(32,157,175)	(29,441,679)
		232,599,713	156,816,971
EXPENSES			
Salaries and benefits		38,902,832	29,720,170
General and administrative expenses	20	36,213,750	31,286,596
Directors' fee	21	5,098,766	1,487,457
Audit fee		103,500	92,000
PROFIT BEFORE TAXATION		80,318,848	62,586,223
		152,280,865	94,230,748
PROVISION FOR TAXATION	14	41,305,813	23,367,734
NET PROFIT AFTER TAXATION		110,975,052	70,863,014
LEGAL RESERVE		27,743,763	17,715,754
NET PROFIT AFTER TAX AND LEGAL RESERVE		83,231,289	53,147,260
EARNING PER SHARE OF BIRR 1000	26	573	553



Awash International Bank

Balance Sheet

Year ending June

(In millions of Birr)

Assets	2003	2004	2005	2006	2007
Cash on hand	76	100	129	125	181
Cash at Bank	2	0	2	2	1
Reserve Account with NBE	61	206	233	237	520
Deposit with foreign Banks	100	116	267	367	426
Treasury bills	✓ 316	337	235	198	
Other Investments	✓ 3	3	3	3	3
Trust Funds	-				
Other debit balances	30	61	72	152	196
Total Loans Advances	✓ 800	946	1290	1872	2512
Less Provision For Doubtful Debts	44	73	80	92	109
* Net Loans & advances	756	873	1,210	1,780	2,403
Customers' liability for L/C	-				
Fixed assets	57	74	75	90	100
Total	1,401	1,770	2,226	2,954	3,830
Liabilities					
Deposits	1,164	1,493	1,940	2,567	3,112
Demand Deposits	245	287	422	574	603
Saving Deposits	875	1141	1437	1833	2223
Fixed Deposits	44	65	81	160	286
Foreign Bank their A/C					
Trust Funds					
Short term loans					
Other credit balances	73	94	16	18	214
Margin held on L/C	27	22	42	65	70
Loang term loans					
Provision for taxation		6			
State dividend payable					
Other provisions					
Bank's liability to L/C					
Capital & reserves	137	155	228	304	434
Authorized & paid	111	127	155	188	252.5
Legal reserves	19	23	32	43	67
General reserves	2	3	7	8	7.5
Retained Earning					
Profit & loss A/C	5	2	34	65	106.5
Total	1,401	1,770	2,226	2,954	3,830
	1,401	1,770	2,226	2,954	3,830

Loans and Investments
(Total Loans & advances +
TBs, Other Investments)

1199

1347
1286

1600
1528

2073

2512

Awash International Bank
Year-ending June Income Statement
(In millions of Birr)

Description	2003	2004	2005	2006	2007
		A			
Interest Income	58	68	94	137	214.5
Interest Expense	26	30	34	48	62
Net Interest Income	32	38	60	89	153
Service Charge & Commission Income	17	21	34	48	48
Other Income	26	35	21	43	80.5
Total Non Interest Income	43	56	55	91	129
Net Interest Income & Non Interest income	75	94	115	180	281
Employees Salary & Benefits	14	16	22	30	38
Provision For Doubtful Loans	24	19	9		
General Expenses	19	24	29	39	39
Total Non Interest Expenses	57	59	60	69	77
Prior Year Ajustment					
Operating Income before Tax	18	35	55	111	204
Tax	4	9	17	33	61
Net Income After Tax & Provisions	14	26	38	78	143

$EBIT = a + b$

Fixed Pmt Coverage Ratio = $\frac{EBIT}{A}$

44 65 89 159 266

Awash International Bank
Financial Ratios (%)

Description	2003	2004	2005	2006	2007
		A	B	C	
Return on Assets	1.1	1.6	1.9	3.0	4.2
Return on Equity	10.4	17.8	19.8	29.3	38.8
Profit Margin	13.9	21.0	25.5	34.2	41.7
Gross yield on Asset	8.0	7.8	7.5	8.8	10.1
Interest income /Av.Assets	4.6	4.3	4.7	5.3	6.3
Non Interest Income/Av. Assets	3.4	3.5	2.8	3.5	3.8
Equity Multiplier	9.4	10.9	10.4	9.7	9.2
Net Interest Margin	2.6	2.7	3.3	3.6	5.2
Speard	1.9	2.4	3.0	3.2	4.8
Efficiency Ratio	75.4	94.9	91.7	131.9	166.9
Non Interst Income/Gross Revenue	42.6	45.2	36.9	39.9	37.5
Interest income/Gross Revenue	57.4	54.8	63.1	60.1	62.5
Non Interst expense/Gross revenue	56.4	47.6	40.3	30.3	22.4
Salary & benefit/Non Interest Expense	24.6	27.1	36.7	43.5	49.4
Liquid Assets/Deposits	47.7	50.8	44.6	36.2	36.2
Liquid Assets/Total assets	39.6	42.9	38.9	31.4	29.5
Interst margin/gross income	31.7	30.6	40.3	39.0	44.5

Bank of Abyssinia
Balance Sheet
At year ending June
(In millions of Birr)

Assets	2002	2003	2004	2005	2006	2007
Cash on hand	28	51	58	110	101	128
Cash at Bank	252	242	170	16	5	1
Reserve Account With NBE	70	73	104	440	472	433
Deposit with foreign Banks	85	141	123	193	203	260
Treasury Bills	✓ 0	0	173	0	0	200
Other Investments	✓ 5	5	5	0	0	
Trust fund	0	0	0	0	0	
Sundry Debtors & Other debit balances	58	61	44	90	113	136
Total Loans & Advances	✓ 669	809	962	1234	1963	2305
Less Provision for doubtful Debts	38	62	73	61	61	108
Net Loans & advances	631	747	889	1,173	1,902	2,197
Customers liability	-	90	67			
Fixed assets	13	13	19	35	38	41
Total	1,142	1,333	1,585	2,057	2,834	3,396
Liabilities						
Deposits	909	1,076	1,275	1,627	2,177	2,721
Demand Deposits	134	207	223	333	403	511
Saving Deposits	631	719	937	1183	1548	1898
Fixed Deposits	144	150	115	111	226	312
Foreign Bank	0	0	0	0	0	
Trust fund	0	0	0	0	0	
Short term loans	0	0	0	0	0	
Other credit balances	54	67	84	118	173	209
Margin held on L/C	29	39	17	37	45	35
Long term loans	0	0	0	0	0	
Provision for taxation	9	2	16	21	37	28
State dividend	0	0	0	0	0	
Other provisions	0	0	0	0	0	
Bank liability	0	90	67			
Capital & reserves	141	149	193	254	402	403
Authorized & paid	129	132	137	166	265	265
Legal reserves	10	11	21	36	58	75
General & Special reserves	4	4	6	6	13	13
Retained Earning	-2	2	29	46	66	50
Profit & loss A/C						
Total	1,142	1,333	1,585	2,057	2,834	3,396
	1,142	1,333	1,585	2,057	2,834	3,396

loan and investment

~~674~~

814

1140

1234

1963

2505

Bank of Abyssinia
Income Statement
Year ending June
(In millions of Birr)

Descriptions	2002	2003	2004	2005	2006	2007
Interest Income	65	62	A 97	B 105	C 165	D 202
Interest Expense	✓ 34	27	29	33	41	60
Net Interest Income	31	35	68	72	124	142
Service Charge & Commission Income	1	8	12	14	21	23
Other Income	14	11	14	33	34	42
Total Non Interest Income	15	19	26	47	55	65
Net Interest Income & Non Interest income	46	54	94	119	179	207
Employees Salary & Benefits	7	8	10	13	30	35
Provision For Doubtful Loans	20	24	11	0	4	47
General Expenses	11	14	19	24	23	30
Total Non Interest Expenses	38	46	40	37	57	112
Prior Year Ajustment						
Operating Income before Tax	✓ 8	8	54	82	122	95
Tax	10	2	16	21	37	28
Net Income After Tax & Provisions	2	6	38	61	85	67
EBIT		35	83	115	163	155

Bank of Abyssinia
Financial Ratios
(In Percent)

Description	2002	2003	2004	2005	2006	2007
Return on Assets	-0.2	0.5	A 2.6	B 3.3	C 3.5	D 2.2
Return on Equity	-1.4	4.1	22.2	27.3	25.9	16.6
Profit Margin	-2.5	7.4	30.9	40.1	38.6	25.1
Gross yeild on Asset	7.9	6.5	8.4	8.3	9.0	8.6
Interest income /Av.Assets	6.4	5.0	6.6	5.8	6.7	6.5
Non Interest Income/Av. Assets	1.5	1.5	1.8	2.6	2.2	2.1
Equity Multiplier	7.1	8.5	8.5	8.1	7.5	7.7
Net Interest Margin	4.1	3.7	5.4	5.0	5.7	5.1
Speard	4.2	3.4	4.9	4.8	5.3	4.6
Efficiency Ratio	39.5	41.3	65.0	127.0	96.5	58.0
Non interst income/Gross Revenue	18.8	23.5	21.1	30.9	25.0	24.3
Interest income/Gross Revenue	81.3	76.5	78.9	69.1	75.0	75.7
Non interst expense/Gross revenue	47.5	56.8	32.5	24.3	25.9	41.9
Salary & benefit/Non Interest Expense	18.4	17.4	25.0	35.1	52.6	31.3
Liquid Assets/Deposits	47.9	47.1	49.3	46.7	35.9	37.6
Liquid Assets/Total assets	38.1	38.0	39.6	36.9	27.6	30.1
Interst margin/gross income	38.8	43.2	55.3	47.4	56.4	53.2

Dashen Bank
Balance Sheet
Year ending June
(In millions of Birr)

Assets	2003	2004	2005	2006	2007
Cash on hand					
Cash at Bank	103	77	110	120	150
Reserve Account with NBE	34	81	75	1	13
Deposit with foreign Banks	138	225	390	482	861
Treasury Bills	245	190	446	546	647
Other Investments	✓ 129	299			
Trust fund	✓ 23	26	28	28	28
Other debit balances					
Total Loans & Advances	75	113	165	229	356
Less Provision For Doubtful Debts	✓ 1267	1690	2232	3164	3988
Net Loans & advances	49	63	72	84	99
Customers liability	1,218	1,627	2,160	3,080	3,889
Fixed assets	-	-			
Total assets	26	39	46	60	97
Liabilities	1,991	2,677	3,420	4,546	6,041
Deposits	1,621	2,178	2,833	3,692	4,861
Demand Deposits	466	623	793	1039	1361
Saving Deposits	1056	1,448	1,897	2,343	2843
Fixed Deposits	99	107	143	310	657
Foreign bank their a/c					
Trust fund					
Short term loans					
Other credit balances	117	166	214	280	419
Margin held on L/C	94	101	104	136	145.5
Long term loans					
Provision for taxation	10	22	26	52	71
State /dividened payable	20	38			
Other provisions	0	0			
Bank's liability	0	0			
Capital & reserves	0	0	0	0	
Authorized & paid	129	172	243	386	545
Legal reserves	75	100	100	156	282
General Reserve	25	39	57	90	137
Retaned Earning			86	65	65
Profit & loss A/C	29	33		75	60.5
Total	0	0	0	0	
	1,991	2,677	3,420	4,546	6,041
	1,991	2,677	3,420	4,546	6,041

Loans and Investments --- By 1419 2015 2260 3192 4016

Dashen Bank
Income Statement
Year ending June
(In millions of Birr)

Description	2003	2004	2005	2006	2007
		A	B	C	D
Interest Income	82	117	162	242	320
Interest Expense	✓ 30	41	52	67	93
Net Interest Income	52	76	110	175	227
Service Charge & Commission Income	25	17	38	61	68
Other Income	27	58	34	64	97
Total Non Interest Income	52	75	72	125	165
Net Interest Income & Non Interest income	104	151	182	300	392
Employees Salary & Benefits	19	23	29	41	53
Provision For Doubtful Loans	23	16	12	14	8
General Expenses	25	34	44	60	73
Total Non Interest Expenses	67	73	85	115	134
Prior Year Ajustment					
Operating Income before Tax	✓ 37	78	97	185	258
Tax	10	22	26	52	71
Net Income After Tax & Provisions	27	56	71	133	187

EBIT

67

114

144

252

351

Dashen Bank
Financial Ratios
(In percent)

Description	2003	2004	2005	2006	2007
		A			
Return on Assets	1.55	2.40	2.33	3.34	3.53
Return on Equity	✓ 21.51	37.21	34.22	42.29	40.19
Profit Margin	20.15	29.17	30.34	36.24	38.56
Gross yeild on Asset	7.71	8.23	7.68	9.21	9.16
Interest income /Av.Assets	4.72	5.01	5.31	6.08	6.05
Non Interest Income/Av. Assets	2.99	3.21	2.36	3.14	3.12
Equity Multiplier	13.85	15.51	14.69	12.66	11.38
Net Interest Margin	3.13	3.45	4.07	4.68	4.87
Speard	2.33	2.67	3.44	3.95	4.21
Efficiency Ratio	77.61	102.74	84.71	108.70	123.13
Non interst income/Gross Revenue	38.81	39.06	30.77	34.06	34.02
Interest income/Gross Revenue	61.19	60.94	69.23	65.94	65.98
Non interst expense/Gross revenue	50.00	38.02	36.32	31.34	27.63
Salary & benefit/Non Interest Expense	28.36	31.51	34.12	35.65	39.55
Liquid Assets/Deposits	40.04	40.04	36.04	31.12	34.38
Liquid Assets/Total assets	32.60	32.57	29.85	25.27	27.66
Interst margin/gross income	38.81	39.58	47.01	47.68	46.80

Nib International Bank
Balance Sheet
As at end of June
(In millions of Birr)

Assets	2002	2003	2004	2005	2006	2007
Cash on hand	41	67	76	138	111	147
Cash on bank	25	10	21	28	23	21
Reserve Account with NBE	5	40	62	98	93	279
Deposit with foreign banks	96	97	92	200	208	249
Treasury Bills	✓ 0	30	80	0	0	
Other Investments	✓	1	1	2	2	3
Trust fund		0	0	0		
Sundry Debtors & Other debit balances	42	106	152	170	141	111
Total Loans & Advances	✓ 324	550	786	1133	1475	1817
Provisions	4	22	30	47	57	62
Net Loans & advances	320	528	756	1086	1418	1755
Customers liability		131	149			
Fixed assets	5	6	7	10	31	42
Total Assets	534	885	1,247	1,732	2,027	2,607
Liabilities and Capital						
Deposits	345	588	832	1,223	1,452	1,879
Demand Deposits	95	152	229	292	327	423
Saving Deposits	203	336	493	709	837	1085
Fixed Deposits	47	100	110	222	288	371
Foreign bank		0	0	0		
Trust fund		0	0	0		
Short term loans		0	0	0		
Other credit balances	61	125	181	215	211	223
Margin held	20	41	47	50	56	50
long term loan		0	0	0		
Provisions for taxation	9	6	14	20	23	30
State dividend		0	0	0		
Other provisions		0	0	0		
Bank liability	0	131	149			
Capital & reserves	99	125	173	224	285	425
Authorized & paid	84	105	129	160	200	307
Legal reserves	7	10	18	30	44	63
General & Special reserves		1	1	1	1	1
Retained earning		0	0	0		
Profit & loss A/C	8	9	25	33	40	54
Total Liabilities and Capital	534	885	1,247	1,732	2,027	2,607
	534	885	1,247	1,732	2,027	2,607

Loans & Investments for 324 581 867 1135 1477 1820

Nib International Bank
Income Statement
Year ending June
(In millions of Birr)

Descriptions	2003	2004	2005	2006	2007
	A	B	C	D	
Interest Income	37	56	83	107	147
Interest Expense	✓ 11	15	24	33	42
Net Interest Income	26	41	59	74	105
Service Charge & Commission Income	13	18	23	25	27
Other Income	16	19	29	29	34
Total Non Interest Income	29	37	52	54	61
Net Interest Income & Non Interest income	55	78	111	128	166
Employees Salary & Benefits	6	8	11	17	25
Provision For Doubtful Loans	20	8	18	9	5
General Expenses	10	13	16	21	30
Total Non Interest Expenses	36	29	45	47	60
Prior year adustment					
Operating Income before Tax	✓ 19	49	66	81	106
Tax	6	14	20	23	30
Net Income After Tax & Provisions	13	35	46	58	76
	30	64	90	114	148

Nib International Bank
Measures of Profitability
(in percent)

	2003	2004	2005	2006	2007
	A	B	C	D	
Return on Assets (%)	1.8	3.3	3.1	3.1	3.3
Return on Equity (%)	✓ 11.6	23.5	23.2	22.8	21.4
Profit Margin (%)	19.7	37.6	34.1	36.0	36.5
Gross Yield on Assets (%)	7.5	7.5	7.8	7.9	8.0
Interest Income/Av.Assets (%)	5.2	5.3	5.6	5.7	6.3
Non Interest Income /AV.Assets (%)	4.1	3.5	3.5	2.9	2.6
Equity Multiplier (times)	6.3	7.2	7.5	7.4	6.5
Net Interest Margin (%)	3.8	4.3	4.4	4.4	5.1
Spread	2.9	3.4	3.6	3.4	4.2
Efficiency Ratio (%)	80.6	127.6	115.6	114.9	101.7
Non Interest Income/Gross Revenue (%)	43.9	39.8	38.5	33.5	29.3
Interest Income/Gross Revenue (%)	56.1	60.2	61.5	66.5	70.7
Non Interest Expense/Gross Revenue (%)	54.5	31.2	33.3	29.2	28.8
Salary and Benefits/Non Interest Expense (%)	16.7	27.6	24.4	36.2	41.7
Liquid assets/Deposit	41.5	39.8	37.9	30.0	37.0
Liquid assets/ assets	41.5	39.8	37.9	30.0	37.0
Interst margin/gross income	39.4	44.1	43.7	46.0	50.5

UnitedBank
Balance Sheet
Year ending June
(In millions of Birr)

Assets	2003	2004	2005	2006	2007
Cash on hand	35	34	44	68	116
Cash at Bank	13	14	15	72	33
Reserve Account with NBE	55	47	135	286	141
Deposit with foreign Banks	70	195	290	167	468
Treasury Bills	0	0	0	0	
Other investment	0	0	0	0	
Trust fund	0	0	0	0	
Sundry Debtors & Other debit balances	4	6	8	17	25
Total Loans & Advances	290	384	593	1004	1410
Less Provision for doubtful Debts	7	15	23	29	43
Net Loans & advances	283	369	570	975	1368
Customers liability					
Fixed assets	9	9	11	14	32
Total	469	674	1,073	1,599	2,183
Liabilities					
Deposits	287	532	865	1,220	1,541
Demand Deposits	60	118	191	331	385
Saving Deposits	172	276	397	681	849
Fixed Deposits	55	138	277	208	307
Foreign bank	0	0			
Trust fund	0	0			
Short term loans	0	0			
Other credit balances	72	30	42	124	225
Margin held on L/C	17	13	29	48	34
Long term loans	0	0	0	0	
Provision for tax	2	3	12	16	23
State dividend	0	0	0	0	
Other provisions	0	0	0	0	
Bank liability	0	0	0	0	
Capital & reserves	91	96	125	191	360
Authorized & paid	83	85	88	132	259
Legal reserves	4	6	14	25	41
General & Special reserves	0	0	0	0	9
Retained Earning	4	5	23	34	51
Profit & loss A/C	0	0	0	0	
Total	469	674	1,073	1,599	2,183
	469	674	1,073	1,599	2,183

Loans & Investment

290 384 593 1004 1410

United Bank
Income Statement
Year ending June
(In millions of Birr)

Descriptions	2003	2004	2005	2006	2007
	A	B	C	D	
Interest Income	19	27	46	71	122
Interest Expense	✓ 6	11	17	29	40
Net Interest Income	13	16	29	42	82
Service Charge & Commission Income	5	8	20	25	27
Other Income	7	11	25	30	43
Total Non Interest Income	12	19	45	55	70
Net Interest Income & Non Interest income	25	35	74	97	152
Employees Salary & Benefits	4	7	10	14	23
Provision For Doubtful Loans	5	9	7	6	13
General Expenses	9	9	14	17	29
Total Non Interest Expenses	18	25	31	37	65
Prior Year Ajustment					
Operating Income before Tax	✓ 7	10	43	60	87
Tax	2	3	12	16	23
Net Income After Tax & Provisions	5	7	31	44	64

13 21 60 84 127

**United Bank
Financial Ratios**
(In percent)

Description	2003	2004	2005	2006	2007
		A	B	C	D
Return on Assets	1.3	1.2	3.5	3.3	3.4
Return on Equity	5.6	7.5	28.1	27.8	23.2
Profit Margin	16.1	15.2	34.1	34.9	33.3
Gross yeild on Asset	7.9	8.0	10.4	9.4	10.2
Interest income /Av.Assets	4.9	4.7	5.3	5.3	6.5
Non Interest Income/Av. Assets	3.1	3.3	5.2	4.1	3.7
Equity Multiplier	4.4	6.1	7.9	8.5	6.9
Net Interest Margin	5.3	4.7	5.2	6.1	6.5
Speard	2.6	2.0	2.7	2.8	3.0
Efficiency Ratio	66.7	76.0	145.2	148.6	107.7
Non interst income/Gross Revenue	38.7	41.3	49.5	43.7	36.5
Interest income/Gross Revenue	61.3	58.7	50.5	56.3	63.5
Non interst expense/Gross revenue	58.1	54.3	34.1	29.4	33.9
Salary & benefit/Non Interest Expense	22.2	28.0	32.3	37.8	35.4
Liquid Assets/Deposits	60.3	54.5	56.0	48.6	49.2
Liquid Assets/Total assets	36.9	43.0	45.1	37.1	34.7
Interst margin/gross income	41.9	34.8	31.9	33.3	42.7

UNIVERSITY OF CALIFORNIA
LIBRARY

Wegagen Bank
Balance Sheet
Year ending June
(In millions of Birr)

Assets	2003	2004	2005	2006	2007
Cash on hand	86	75	104	147	167
Cash at bank	33	54	104	91	124
Reserve Account with NBE	55	95	62	175	327
Deposit with foreign Banks	140	185	350	248	702
Treasury Bills	✓ 0	0	0		
Other Invesments	✓ 0	0	0		
Trust Funds	0	0	0		
Sundry Debtors & Other debit balances	18	20	24	57	67
Total Loans & Advances	✓ 571	738	1002	1593	2155
Less Provision for Doubtful Debts	29	43	51	77	95
Net Loans & advances	542	695	951	1,516	2,060
Customers' liability for L/C					
Fixed assets	15	16	21	25	33
Total	889	1,140	1,616	2,259	3,480
Liabilities					
Deposits	704	876	1,288	1,778	2,724
<i>Demand Deposits</i>	251	375	590	725	1209.5
<i>Saving Deposits</i>	274	351	518	723	803.5
<i>Fixed Deposits</i>	179	150	180	330	710.5
Foreign Bank their A/C					
Trust Funds					
Short term loans					
Other credit balances	55	72	89	118	168
Margin held on L/C	33	50	43	85	144
Long term loans					
Provision for taxation	4	13	16	23	41
State dividend payable					
Other provisions					
Bank's liability to L/C					
Capital & reserves	93	129	180	255	403
Authorized & paid	77	89	113	151	238
Legal reserves	8	16	28	46	74
General reserves			3	5	8
Retained Earning	8	24	36	53	83
Profit & loss A/C					
Total	889	1,140	1,616	2,259	3,480
	889	1,140	1,616	2,259	3,480

Loans and Investment Br 571 738 1002 1593 2155

LIBRARY

Wegagen Bank
Income Statement
Year ending June
(In millions of Birr)

Description	2003	2004	2005	2006	2007
		A	B	C	D
Interest Income	42	66	80	120	185
Interest Expense	✓ 17	18	22	35	55
Net Interest Income	25	48	58	85	130
Service Charge & Commission Income	16	27	39	52	67
Other Income	9	17	31	48	68
Total Non Interest Income	25	44	70	100	135
Net Interest Income & Non Interest income	50	92	128	185	265
Employees Salary & Benefits	11	14	20	31	44
Provision For Doubtful Loans	8	14	19	29	32
General Expenses	16	19	26	31	36
Total Non Interest Expenses	35	47	65	91	112
Prior Year Ajustment					
Operating Income before Tax	✓ 15	45	63	94	153
Tax	4	13	15	23	41
Net Income After Taxes & Provisions	11	32	48	71	112
	32	63	85	129	205

Wegagen Bank
Financial Ratios
(In percent)

Description	2003	2004	2005	2006	2007
		A	B	C	D
Return on Assets	1.4	3.2	3.5	3.7	3.9
Return on Equity	✓ 14.0	28.8	31.1	32.6	34.0
Profit Margin	16.4	29.1	32.0	32.3	35.0
Gross yeild on Asset	8.7	10.8	10.9	11.4	11.2
Interest income /Av.Assets	5.5	6.5	5.8	6.2	6.4
Non Interest Income/Av. Assets	3.3	4.3	5.1	5.2	4.7
Equity Multiplier	9.8	9.1	8.9	8.9	8.7
Net Interest Margin	3.5	5.2	4.3	4.6	4.6
Speard	2.2	3.6	2.8	3.2	2.8
Efficiency Ratio	71.4	93.6	107.7	109.9	120.5
Non interst income/Gross Revenue	37.3	40.0	46.7	45.5	42.2
Interest income/Gross Revenue	62.7	60.0	53.3	54.5	57.8
Non interst expense/Gross revenue	52.2	42.7	43.3	41.4	35.0
Salary & benefit/Non Interest Expense	31.4	29.8	30.8	34.1	39.3
Liquid Assets/Deposits	44.6	46.7	48.1	37.2	48.5
Liquid Assets/Total assets	35.3	35.9	38.4	29.3	37.9
Interst margin/gross income	37.3	43.6	38.7	38.6	40.6

የወገን ባንክ
 አዲስ አበባ
 የፋይናንስና
 የዕቅድ ሚኒስቴር
 አስተዳደር

Private Banks					
Consolidated Balance Sheet					
(In millions of Birr)					
Assets	2,003	2,004	2,005	2,006	2,007
	A	A	B	C	D
Cash on hand	418	420	640	690	955
Cash at Hand	334	340	241	196	298
Reserve Account with NBE	422	739	1,473	1,808	2,685
Deposit with foreign Banks	793	901	1,746	1,745	2,800
Treasury Bills	475	889	235	198	200
Other Investments	32	35	33	33	35
Trust Funds	-	-	-	-	-
Sundry Debtors & Other debit balances	294	396	533	713	907
Total Loan & Advances	4,287	5,506	7,487	11,198	14,501
Less Provision for Doubtful Debts	213	297	334	401	520
Net Loans & advances	4,074	5,209	7,153	10,797	13,982
Customers' liability for L/C	221	216	-	-	-
Fixed assets	126	164	199	263	365
Total	7,189	9,309	12,253	16,443	22,227
Liabilities					
Deposits	5,440	7,186	9,791	12,984	17,237
Demand Deposits	1,381	1,855	2,634	3,463	4,717
Saving Deposits	3,432	4,646	6,143	7,987	9,841
Fixed Deposits	627	685	1,014	1,534	2,680
Foreign Bank their A/C	-	-	-	-	-
Trust Funds	-	-	-	-	-
Short term loans	-	-	-	-	-
Other credit balances	509	627	696	928	1,480
Margin held on L/C	251	250	305	435	482
Long term loans	-	-	-	-	-
Provision for taxation	24	74	95	151	193
State dividend payable	20	38	-	-	-
Other provisions	-	-	-	-	-
Bank's liability to L/C	221	216	-	-	-
Capital & reserves	724	918	1,306	1,945	2,834
Authorized & paid	583	667	895	1,213	1,871
Legal reserves	77	123	197	306	457
General reserves	7	10	103	99	111
Retained Earning	43	91	105	228	245
Profit & loss A/C	14	27	66	99	152
Total	7,189	9,309	12,253	16,443	22,226
	7,189	9,309	12,253	16,443	22,227

CPD
Libra

