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Prospects and Challenges of Foreign Bank Entry in Ethiopia

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Abstract:
This paper examines the prospects and challenges of foreign bank entry in Ethiopia using a descriptive statistic for the analysis of data collected through interview and questionnaires by deploying a purposive sampling technique. The finding of the study shows that foreign bank entry in Ethiopia could introduce new banking technologies, financial innovation and promote financial development. In addition, it enhances access to international capital and may precipitate the overseas expansion of domestic banks and greater integration of Ethiopian banks into international financial systems, which may enable them to provide a broader range of services, particularly to larger local firms with international operations. On the other hand, the stiff competition with foreign banks may threaten the survival of domestic banks that may lead them to incur high cost in the short run and decline in profit. In addition, it may; bring shocks from other country, destabilize domestic credit and may serve more productive sectors only. Policy recommendations are that allowing foreign bank entry in Ethiopia step by step is advantageous with extensive capacity building to all stakeholders and implementation of modern banking technologies. Merger and acquisition form of entry may be essential for knowledge transfer and entry via subsidiary may be preferable to resource mobilization and enhancing access to finance for the majority.

Keywords: *Domestic banks, foreign banks, financial sector liberalization, prospects & challenges*

1. Introduction

Following the financial liberalization measures taken by a number of countries since 1990s, foreign bank participation has increased in developing countries. The Federal Democratic Republic of Ethiopia has implemented market oriented economic policy reform in which financial sector liberalization was one of policy change made in 1992. As a result, the year 1994 brought new and bright beginning to the banking sector in the country for the re-establishment of private commercial banks with Monetary and Banking Proclamation No 83/1994 and Licensing and Supervision of Banking Business Proclamation No.84/1994 that laid down the legal basis which allowed private sectors to engage in banking business. Moreover, the Proclamations provided additional powers and duties to the National Bank of Ethiopia to license, supervise and properly regulate both the already existing three state owned banks, the newly entrant private banks and other financial institutions operating in the country. Accordingly, at the end of June 30, 2015, there are nineteen banks in the country comprising one state owned Development Bank and two state owned commercial banks. The remaining sixteen banks are privately owned commercial banks. Though the liberalization policy put a solid ground for re-structuring of the state-owned banks and re-establishment of privately owned commercial banks in the country, foreign nationals and investors are not allowed to participate in banking business. Article 9 of the Licensing and Supervision of Banking Business Proclamation No.84/1994 which replaced by Banking Business Proclamation No. 592/2008 states the prohibition which says "foreign nationals or organizations fully or partially owned by foreign nationals may not be allowed to open banks or branch offices or subsidiaries of foreign banks in Ethiopia or acquire the shares of Ethiopian banks." The would-be outcome of allowing foreign bank entry into the country is seen from the domestic banks, financial system and the overall economy view point.

Performance wise, during the last two decades since 1994, the total bank deposits and loans & advances showed an average annual growth of 21.0% and 18.8% respectively. For the past five years until June 2014, some performance indicators of the Ethiopian banking sector have shown progress year to year. During this period, total deposits and loans of banks grew by 18.8 %and 30.6% per annum on average respectively. The share of the state owned Commercial Bank of Ethiopia accounts for about two-third of the sector's deposits. Out of the total deposits Birr 292.8 billion at June 2014 the share of public banks was 68.5% where Commercial Bank of Ethiopia (CBE) alone took 66.4% of the total deposit liabilities of the banking sector. Private commercial banks shared less than one-third (31.5%) of bank deposits. The share of bank deposit liability to GDP is declined to 18.6% at the end of June 2014 from 25.9% before five year in 2009/10. Likewise, 68.1% of outstanding loans and advances of the banks held in public banks. More than half (53.2%) of loans and advances belongs to the giant CBE. The aggregate outstanding loans and advances of all banks constitute 16.1% of GDP in the period under review. The market share of private bank in terms of branch network and capital is becoming higher than that of public banks. The total capital of the banking sector reached Birr 26.4 billion of which 55.3% belongs to the sixteen-private commercial banks (NBE Annual reports). Concerning the financial soundness, as reported by (IMF 2014), on average, Ethiopian banks are well capitalized and profitable. The report shows the system-wide capital adequacy ratio stood at 17.5% at the end

of March 2014 which is well above the 8% minimum requirement. Return on assets and return on equity is also found comfortable, at 3.1% and 44.6% respectively. Regard to asset quality, improvement is seen from time to time. The ratio of nonperforming loans to total bank's loan found less that 3% in same period.

1.1. Foreign Bank Practice in Ethiopia

Fully foreign owned banks have a history of staying in Ethiopia for more than a half a century during the pre-Dreg era. The first private bank, Addis Ababa Bank S.C, owned by Ethiopian investors (60%) and National and Grindlays Bank of London (40%) then Banco di Rome (Ethiopia) S.C and Banco di Napoli (Ethiopia) S.C. was opened with the association of Ethiopian nationals at the last decade of the Imperial Regime. Hence, the establishment of foreign banks in the country can be categorized into three major phases. The first phase that covers the period from 1905 to 1931 during the era of Menelik II that paved the way for modern banking business in the country. In this phase, Bank of Abyssinia and three other foreign banks were established in the country. The foreign bank (Bank of Abyssinia), a branch of British owned National Bank of Egypt, was established in Addis Ababa in 1905 with a 50-year franchise agreement with an exclusive privilege in respect of banking business, coinage and issue of notes, bonded warehouse, and custody of all moneys belonging to the state and a preferential right to all state loans. The history of foreign banks in Ethiopia and agreement made between Emperor Menelik II and Mr. MacGillvrey, the representative of National Bank of Egypt, are taken from (Pankhurst 1967) and presented as follows.

1.1.1. The Provisions of the Concession Were Described under Four Articles

Article I – about the Concession Period: Article I of the agreement granted the National Bank of Egypt a 50- year concession for banking company to be called the Bank of Abyssinia. The capital of the Bank was fixed to be Pound Sterling 500,000.0 of which one-fifth was subscribed and the remaining were offered for public subscription in London, Paris, New York, Berlin, Rome, Vienna, Cairo and Addis Ababa. Article II – about the Monopolistic position and exclusive privileges of the Bank: The Bank guaranteed a monopoly position and eight privileges for a 50-year period. These privileges include: (i) The Emperor agreed not to allow any other bank to be established in his kingdom ;(ii) The bank was given the sole right to issue bank notes which were to be legal tender and freely exchangeable against gold and silver; (iii) The Government promised not to mint any coin, all minting being carried out by the Bank, in consultation with the Government and all profits there from accruing to the Bank;(iv) All the Government public funds were to be deposited with that institution, and all Government payments were to be made by cheques on it;(v) The Government agreed to give the Bank preference in the issue of loans;(vi) The Bank was permitted to build warehouses in which merchants could deposit their goods against loans;(vii) The Government agreed to give the Bank a free grant of land for the institution's head office, agencies and warehouses and (viii) The Bank was entitled to transport its species by rail at Government rate. Article III- Distribution of Profit: This article specified that after expenses had been paid, 10% of the profit placed in reserve and a 7% dividend paid to the shareholders, 20% of the remaining should accrue to the Emperor. Article IV- Validity of the contract: this article laid down that the concession would become void if the Bank was not properly constituted before July 1, 1906. Up on the agreement made between Emperor Menelik II and Mr. MacGillivrey, the representative of National Bank of Egypt, and receipt of the concession, Egyptian decree was obtained that permits the establishment of Bank of Abyssinia according to Egyptian law. Persons entrusted with the work were three Britons; Sir Elwin Palmer, F. T. Rowlatt and MacGillivrey; three Italians- Bohar Maggar, Raphael Finzi and Humbert Ebano and a German Alfred Vulliet, all of them resident in Cairo. Two nominees of the Emperor; Ras Tasssama and Ras Walda Giorgis were appointed to the Board of Directors.

Location and branch expansion of the Bank: The Bank was situated in the palace of Ras Mokennen's compound and inaugurated on February 15, 1906. Another branch in Harar was opened at the same time. Later on, the headquarters of the Bank moved in 1910 to a specially built-stone structure designed by an Italian architect Vaudetto and constructed by his compatriot Castagna. The Bank expanded its branches by opening additional branch at Dire Dawa in 1908. Following that trends, after four years, Gore and Sayo or Dembi Dollo branch as well as Gambella Sub-branch was opened in 1912 and Dessie and Djibouti transit office in 1920.

Interest rate policy: According to Pankhurst (1967), the Bank's rate of interest on deposit accounts was 3% whereas the lending rate was carried out at the rate of 15% per annum. Lending rate on Overdraft loans was 10% - 12% and for Merchandise loans, the rate was 9% - 10% per annum. In addition, real estate loan was 1% per month. The Bank was not profitable until 1914. The major reason for operating without registering profit for a decade was attributed to high costs of familiarizing the public, considerable cost of installation and costly journeys of its administrative personnel.

Employees of the Bank- MacGillivrey were appointed the first governor of the Bank of Abyssinia succeeded by three other Britons: H. Goldie, Miles Backhouse and C.S. Collier who was in charge from 1919 until the Bank's liquidation in 1931. Successive assistant governor of the Bank includes: H. Goldie, D. Brodie, E. Wright and E. Press were British. However, the rests of the staff were from various other nationalities including 7 Italians, 3 Greeks and 2 Frenchmen.

Challenges faced the Bank: From the outset, the Bank faced series problems such as considerable cost of installation. The other is interesting foreign investors in so distant a country as Ethiopia, while the local publics were not greatly attracted by a 3% rate of interest on deposit account preferring to invest money in land.

The second phase of the re-establishment of foreign banks in the country was started in 1936 with the Italian occupation. During the five years' period (1936-1941), many branches of the Italian main banks such as Banca d'Italia, Banco di Roma, Banco di Napoli, Banca Nazionale del Lavoro, Cassa di Credito Arario e Minerario and Societe Nazionale di Ethiopia were opened and operated in the main towns of the country. However, except Banco di Roma and Banco di Napoli that were remained Asmara with sub-branches in Massawa and Assab, the others were closed after the liberalization (Taffara 1973 and Belay 1987). The British owned Barclays Bank

(Then Dominion Colonial and Overseas) was established in Addis Ababa after liberalization in 1941 and operated until 1943 when the State Bank of Ethiopia established in same year (Taffara 1973). The Bank that came with British troops and organized banking service in Addis Ababa was opened branches in Asmara and Massawa in 1942 and withdrew after a decade in 1952 when the State Bank of Ethiopia opened its branches there at the time of federation of Eritrea with Ethiopia (Belay 1987). Another foreign bank, Banque De l'Indochine was established in Addis Ababa in 1943 and it was carrying on limited business activities for two decades and withdrawn in 1963 after the new banking proclamation(Ibid).

In third phase, the 1963 Banking Law recognized private ownership and allowed foreign banks to operate in the country in which at least 51% of the bank's capital is owned by Ethiopian nationals. It was the first banking law in the country that separates the functions of central bank and commercial banking activities. Following the implementation of the banking law, three commercial banks were re-applied for license. According to Belay (1987), Addis Ababa Bank S.C, the first privately owned bank, was established with Ethiopian initiatives in 1963 and started operation in 1964 with the association of National and Grind lays bank, London. While establishment, the Grindlays bank took up 40% of the shares of the Bank. The Bank started operation with paid up capital of ETH $ 2million. Banco di Rome (Ethiopia) S.C was registered as a share company with a fully paid up capital of ETH.$ 2million shared among Ethiopian and Italian shareholders and obtained a license on February 20, 1967. Banco di Napoli (Ethiopia) S.C. was established with Banco di Napoli, Head Office in Naples with a capital of ETH.$ 2million which shared among Ethiopians and foreign investors. As it can be noticed from (Taffara 1973 and Belay 1987), it was the first banking law in the country by permitting participation of private commercial banks and foreign banks in expanding banking business in the country. Despite it was stayed only for about a decade, banking activities was expanded in major towns in different parts of the country. This clearly indicates that the 1963 banking law had expanded the ownership structure of the sector in the period.

1.2. Disappearance of Foreign Banks from Ethiopia

Subsequent to the fall of the Haile Sellassie imperial regime, the provisional Military Government, the Derg proclaimed socialism and decided to transfer the ownership of the three commercial banks to the public ownership a big bank named Addis Bank. In line with its economic policy, the very purpose of the restructuring the banking sector was to encourage the socialization of the production and services as well as their distribution. Accordingly, the three commercial banks were nationalized in 1975. Study made by (Itana 1994) shows that the financial sector was geared to serve a centrally planned economy characterized by extensive price control, centralized decision-making and bureaucratic interference guided by socialist ideology. After that foreign banks are not allowed to operate in the country and the then Government has also followed the same path of restricting foreign bank participation in the Ethiopian banking business.

1.3. Evolution and Expansion of Foreign Banks

The history of financial system development has had a prolonged linkage with international trade between nations thereby bank had taken a leading role before centuries. Banks were not only among the first financial institutions to appear in history but also were among the first financial firms to venture into international markets and offer their services in distant locations. The first banks were located principally in global trading centers around the Mediterranean, including Athens, Cairo, Jerusalem, and Rome, aiding merchants in financing shipments of raw materials and goods and exchange one nation's coin for that of another to assist travelers. Much later, during the colonial period of American history, foreign banks based in Europe entered the America and met a large share of the financing needs of American businesses (Rose and Hudgins, 2008). From the 13th to 16th centuries, the merchant banks of the Medici and Fugger families had branches located throughout Europe, to finance foreign trade. Later on, in 19th century, multinationals banks were associated with the colonial powers, including Britain and, then Belgium, Germany and Japan. The well-known colonial multinational banks include the Hong Kong and Shanghai Banking Corporation (HSBC) founded in 1865. By 1870 branches of the bank had established throughout the Pacific basin (Heffernan, 2005).

The multinational expansion of bank's activity became one of the most visible epitomes of the emergence of truly globalizing world. Large banks from financially advanced, industrialized Europe reacted to epoch-making shifts in communication technology; international trade and demand for capital by sovereign and private borrowers by rapidly expanding their cross border and cross currency business (Cameron, 1991 cited in Battilosi, 2005). In 1913 there were approximately 2,600 branches of foreign banks worldwide. The dominating factor at that time was colonization; over 80% of those branches were attributed to British banks (Slager, 2005). During the 1970s and 1980s American banks expanded their presence around Pacific Rim, especially in Japan, Hong Kong, and Singapore. American, European and Japanese multinational banks played a key role in investing the huge amounts of funds flowing to petroleum producers as world oil prices rose (Rose and Hudgins, 2008). The banking sector is one of the most important economic sectors and the most influential and responsive to changes, whether international or domestic. The most important of those changes include technological developments, the internationality of money markets, and freedom from the constraints that hinder all banking activities, the removal of barriers that prevent some financial institutions from working in certain sectors, and the trend to develop and manage the risks of lending in light of the increase in international competition in this sector while seeking to attract foreign capital with the emergence of giant banking entities(Kenawy, 2009). Britain, Germany and French were played a leading role in expanding their bank branches abroad and a total of 1,610 branches were operating in various regions in 1913 with dominance of British banks (Battilosi 2005). Starting from the 1830s, before the advent of the Eurodollar market transformed in the banking industry in 1960s, British-owned banks were predominant form of multinational banks. British banks had established overseas branches first in British colonial settlements in Australia, Canada, Asia, Latina America, Africa and California whereby by the 1914, a group around 30 banks owned and operated almost 1,400 branches outside Britain (Jones, 1992). It can be noticed that unlike in the

recent pace financial globalization, the spreads of these industrialized countries' bank branch were attributed to colonial power. It was in this period that the branch of British owned National Bank of Egypt opened its branch in Addis Ababa in 1905
As the findings of various studies conducted at different time and different places shows, financial liberalization poses both positive and negative effects on economies of developing countries. For instance, Demirguc-Kunt et al, (1998) investigated that liberalization of banking sector for foreign competition accelerates the efficiency of banking sector which in turn translates into long-run economic growth. According to Levine (1996) foreign banks participation enhances financial development by providing high quality services to domestic markets, stimulates domestic banks to advance their services, cut costs and promote up grading of financial system infrastructure and increase access to international capital. On the other hand, Claessens et al, (2001) examined effects of foreign bank entry on domestic bank markets and found that, the relaxation of restrictions on foreign bank entry increases competition and thereby lowering the profits of domestic banks, foreign entry may reduce charter values of domestic banks, making them more vulnerable. This may have a destabilizing effect on the financial system especially if the domestic prudential regulations and supervision are not strong. The findings of the study made by (Cull &Martinez Peria, 2010 and Stiglitz, 1993) shows that fierce competition, shocks and regulatory concern are some of the challenges of foreign bank presence to domestic banks and the host country's economy.

1.4. East African Countries Practices

The competition between domestic and foreign banks in East Africa was assessed by (Sanya and Gaertner 2012). Their case studies focused on four East African Community countries that include Kenya, Tanzania, Uganda and Rwanda. These countries have experiences of foreign bank practices thereby Kenya has cross-border linkage with neighboring countries. During the time of the study, the Kenyan banking system comprises 43 commercial banks of which 12 were foreign banks. On the other hand, 7 Kenyan banks have 14 subsidiaries in neighboring countries. According to (IMF 2014) report, Kenyan banks have expanded throughout East African and becoming dominant player in the region which started in 1997 when Kenya Commercial Bank expanded in Tanzania. During the reporting period, 11 Kenyan banks with 288 branches operate in East Africa, including South Sudan. These Kenyan banks have entered East African markets mainly through subsidiaries. Out of the 33 commercial banks in Tanzania, 16 of them were foreign banks. The Uganda banking system composed 22 commercial banks including 14 foreign banks operating in the country. Regard to Rwanda case, one-fourth of the 12 commercial banks in the countries was foreign banks. Total of 45 foreign banks have been operating in these countries during the period under consideration. Their finding shows that foreign-owned banks have a strong presence in the East African Community controlling more than half the total assets of the banking system in Uganda, Rwanda, and Tanzania (79%, 54%, and 51%) respectively. In Kenya and Burundi, the ratio was 45% and 41% in that order.

2. Methodology

The study used balanced research approach which is a combination of both quantitative and qualitative methods. The target population for the study include; Banks (National Bank of Ethiopia, Development Bank of Ethiopia and all the 18 commercial banks), Ethiopian Bankers Association; Ethiopian Public Financial Enterprise Agency; Ministry of Finance and Economic Development; Chamber of Commerce and Sectoral Association; Ministry of Trade; and Ethiopian Investment Agency. From the population, senior officials and experts of the institutions including; Vice Presidents, Directors/Managers, Principals/heads and senior experts were selected using purposive sampling techniques for the study. The rationale for selecting purposive sampling was to get relevant response as the selected respondents have knowledge and adequate experiences to the study area. The population for the study further divided into two level strata; bank and non-bank institution based on their specific tasks. Banks are further stratified by their areas of activities; National Bank of Ethiopia (NBE) and Commercial banks. Saunders et al (2009) says purposive sampling enables a researcher to use his judgment to select cases that will best enable him to answer his research question(s) and to meet his objectives. Of the purposive sampling techniques - non-probability sampling; both quota sampling and expert sampling techniques were employed based on the specific characteristics of the selected institutions.
A proportional quota sampling method was applied by stratifying the institutions into two groups; bank and non-bank institution. All of the 20 banks (including National Bank of Ethiopia and Development Bank of Ethiopia) were selected population with the highest share (60%) of the sample whereas 40% from non-bank institutions. Expert sampling, which is just a specific sub case of purposive sampling, was used while selecting respondents from each institution. A panel of 2-5 experts was selected from each bank and non-bank institutions except National Bank of Ethiopia where 12 experts were selected from three directorates given its regulatory and supervisory position. A total of one hundred ten (110) respondents were selected to give their response and opinion for the questionnaires (the sample size for the study was computed using Yamane's (1967) sample size formula; $n=N/1+N(e)^{2}$. Where n is the sample size, N is the population size and e is the level of precision.

2.1. Data Collection and Analysis

Both primary and secondary data were used for this study. The secondary data used in the study mainly relied on historical records on foreign banks that were operating during the Menelik II and Haile Sellasie regimes in Ethiopia and some relevant data on the existing local banks and some empirical evidences on foreign bank operation in other countries. The primary data were collected from primary sources using interviews and questionnaires. The Data were analyzed using descriptive statistics and presented using frequencies, percentages and tables.

3. Result and Discussions

3.1. Survey Response Rate and Demographic Characteristics of Respondents

Self administered questionnaires which were prepared in an easy way for better understanding to respond about the prospects and challenges of allowing foreign bank entry in Ethiopia for respondents at various institutions. It was a single type questionnaire for all respondents. The researcher understood that respondents were given their response as per required and most of them reflect their opinion which helped him get in-depth and pertinent information from a variety of professionals. As the respondents were purposely selected based on their qualification, experience on policy making, macroeconomic policy management and financial regulation, they expressed their suggestion on what should be done and not regarding foreign bank entry into the country. A total of 110 questionnaires were distributed to employees of selected institutions. Out of the total questionnaires, 98 were returned with an overall response rate of 89.1% which is quite enough for analysis. In addition, 6 interview questions were prepared for key informants to obtain detail information to strengthen the research.

Most of the respondents in the sample institutions were male with big variation compared with female counter parts. The number of male respondents constitutes 82.7% of all respondents. Majority of the respondents about 43.9% were aged between 31 to 40 years followed by 39.8% aged between 20 to 30 years and the remaining 16.3% age group belongs to above 40 years. Regarding the educational levels, about two-third (65.3%) of the respondents have first degree and the remaining have second degree and above that implies their qualification can quite fit the designed questionnaires. Position wise, four Chief Executive Officers (Vice Presidents at banks) and about half (52%) of the participants are working at managerial position in the institutions and the remaining are senior experts. Regard to the work experiences of participants, the highest percentage, 69.4% of them have a work experiences between 6 to 15 years implying that most of the respondents have quite enough experiences and understanding to give relevant information. Out of all respondents, only 11.2% of them have below five-year work experiences.

3.2. Prospects of Opening up of Foreign Bank in Ethiopia

3.2.1. Promotes Financial Development and Economic Growth

Numerous evidences show that foreign banks have strong capital bases and more experiences compared with their domestic counter parts. In essence they can promote financial development processes of a country by providing high quality financial services. Towards this argument, according to response obtained from the majority of the respondents (92.8%), foreign bank entry in Ethiopia could promote the financial development process of the country from the current stage to more advanced one which is similar with conclusion made by (Levine1996) which says foreign bank promotes financial development by providing high quality financial services to the domestic markets and by exerting downward pressure on the prices of financial services and by intensifying pressures for government to improve the legal, regulatory and supervisory systems. The research made by (Demirguc-Kunt et al 1998) from 80 countries from 1988-1995 also found that foreign bank presence accelerates the efficiency of domestic banks thereby foster long run economic growth. This clearly point out that allowing foreign bank entry in Ethiopia could enhance financial development and economic growth by increasing job opportunity for citizens, dividend income to shareholders, tax revenue to government and contributes to the overall growth of the country.

3.2.2. Introducing New Banking Technologies and Financial Innovations

Despite some improvements have seen most recently at some banks, traditional banking services is still dominant in most domestic banks. Modern banking technologies are not adequately introduced and expanded with the exception of the state bank, Commercial Bank of Ethiopia and few private banks that have started implementation of some modern banking technologies. In this regard, almost all (97%) respondents agreed that the banking sector in Ethiopia will be beneficial in terms of new banking technologies and financial innovations from foreign bank entry. The finding of study conducted by (Jonse 2004) also states that competitive pressure from foreign bank enforces domestic banks to reduce waste improve management and quality of services and become more efficient. It implies that technology is one of the pillars required to transform the banking activities and enhance efficiency in Ethiopian banking business which foreign banks can do well.

3.2.3. Improving Financial System Infrastructure

Foreign bank participation improves of the country's financial system infrastructure such as good banking practice, and know-how, financial regulation, managerial and supervisory skills to international best practice. As presented in table 1 below, 91.8% of the respondents replied that foreign bank presences enhance financial system infrastructure development process. Out of all respondents, only 4.1% were preferred to be neutral on the case and 4.1% disagreed. Levine (1996) also argued that foreign bank encourages the upgrading of ancillary institutions such as accounting, auditing and rating firms, thereby improving the quality and flow of information about firms and banks. Similarly, according to (Gopalan and Pajan 2010) foreign bank presence may create pressures for local banking authorities to enhance and eventually harmonize regulatory and supervisory procedures and standards and the overall financial infrastructure to international best practice implying that foreign bank involvement in banking business in Ethiopia would improve the country's financial system infrastructure from present status.

3.2.4. Enhancing the Country's Financial System Integration with the Rest of the World

The highest percentage of respondents, 87.8% responded that opening of the Ethiopian banking sector for foreign bank participation could enhances the country's financial system integration with neighboring countries and with the rest of world. The finding of study made by (Von et al 2010) on the extent of spillover and competition effects of multinational banks headquartered in developed countries (north-south banks) and multinational banks from developing countries (south-south banks) on domestic banks in Sub Saharan Africa for the year 1999-2006 using data from a sample of 80 banks argued the same. They found positive effects of regional south-south banks on the efficiency of domestic banks implying that regional integration attempts should be fostered. Accordingly, it implies that opening banking business to foreign competition may facilitates the country's financial system integration process with neighboring countries and the rest of the world.

3.2.5. Enhancing Inflow of Foreign Capital

Foreign bank presence tends to attract foreign direct investment as foreign bank presence has relation with multinational companies to some extents thereby enhances the country's access to international capital. Concerning this, 89.8% replied foreign bank presence could do so and it has a benefit to a country. Similarly, according to (Jonse 2004) foreign banks attract foreign direct investment and channel more funds at lower costs and their presence may increase inflow of capital from their home countries and around the world. This implies that foreign bank has a far reach role in enhancing an inflow of capital in Ethiopia at normal condition.

3.2.6. Initiating Domestic Banks to Go Abroad

The other benefit from foreign bank presence for domestic bank is spillover effects. Through skill and technology transfer, sometimes, local banks focus on strategic concern and prepare themselves for internationalization or looking outward for better alternatives. This might not be in the short run as it is about future strategic concern. Regard to this 87.8% respondents replied that competing with foreign counterparts may initiates Ethiopian banks to be competitive at international level. Kenyan banks are best example for such internationalization. According to IMF (2014) report, Kenyan banks have expanded throughout East African and becoming dominant player in the region. The report shows 11 Kenyan banks with 288 branches operate in the East Africa, including South Sudan.

	Promotes financial development	Introduces new banking technologies & financial innovations	Improves financial system Infrastructure	Enhances access to international capital	Initiates domestic banks to go abroad & integration with the rest of the world
Strongly Agree	36.7	46.9	40.8	37.8	35.8
Agree	56.1	50.0	51.0	52.0	52.0
Neutral	4.1	1.1	4.1	5.1	7.1
Disagree	3.1	1.0	3.1	5.1	5.1
Strongly Disagree	0.0	1.0	1.0	0.0	0.0
Total	100	100	100	100	100

Table 1: Summary of responses to questions on prospects of foreign bank entry in Ethiopia in (%)
Source: Own Computation, 2015

3.3. Challenges of Allowing Foreign Bank Entry in Ethiopia

3.3.1. Threatens the Survival of Domestic Banks

Sometimes foreign bank entry has some adverse effect especially in the case of developing countries. Many evidences show foreign banks have more capital, experiences and better reputation compared with local banks. On the other hand, the banking sector in Ethiopia is relatively undeveloped and till infant in terms of capital bases, assets, skilled man power, modern banking technologies compared with foreign banks. Allowing foreign bank entry in this situation may threaten the survival of local banks. For this argument, the highest (79.6%) reflected their concern that fierce competition with foreign banks put local banks in serious challenges and the survival of some of them may remains in question. However, 11.2% of them kept silent and 9.2% disagreed. Responses obtained from interview made with key informants are same that at present domestic banks are not capable enough to compete with foreign banks. Allowing foreign bank entry soon may seriously affect the sustainability of domestic banks. Cull and Martinez Peria (2010) also identified in their study that fierce competition with foreign banks can threaten the survival of local banks. This implies that allowing foreign bank in Ethiopia without making enough preparation, may increase competition that may threaten the survival of domestic banks.

3.3.2. Destabilize Domestic Credit in Case of Crises

Foreign bank may decrease the stability of aggregate domestic bank credit by withdrawing or transferring funds from local markets in the face of crises either in host or home country. This "cut and run" behavior of foreign bank may destabilize the aggregate credit in case of any shocks that might happen in a country. As it appeared in table 2, the survey result reveals two-third (65.2%) of the respondents agreed on the statement. However, 19.4% of the respondents were neutral on this effect of foreign banks and 15.3% of them were disagreed on the destabilizing effect of foreign bank in case of crises. The study conducted by (Goldberg et al, 2000) also

argued that foreign bank may decrease the stability of aggregate domestic bank credit by providing additional avenues for capital flight or by withdrawing more rapidly from local markets in the face of crises either in the host or home country. Here the survey result reveals that allowing foreign bank entry in Ethiopia may destabilize domestic credit in case of crises.

3.3.3. Import Shocks from Their Home Country or from Other Country they Operate

Evidence shows that multinational banks have branches or subsidiaries in different countries. As a result, they may bring shocks from their home country or other country they operate. On this concern, 50% of the respondent agreed and 18.4% showed their strong consent that foreign bank entry may bring shocks into the country. The finding of the study made by (Cull and Peria, 2010) also indicates foreign banks may import shocks from other countries into host countries in case of crises.

3.3.4. Focuses on the Most Profitable Domestic Markets or Customers

The survey result reveals that 65.3% of respondents replied that foreign banks may focus on multinational companies and high quality borrowers. This is similar to the study made by (Cull and Martinez Peria, 2010), foreign bank can lead to reduced access to finance for a majority of domestic firms and consumers. However, according to interview made with key informants, regard to the foreign banks areas of operations, some necessary policy measure may be put in place as the case it may be in order to increase financial inclusion and access to finance for majority. The other concern is in order to compete with their foreign counter parts, local banks may incur high cost in the short run which may be another challenge for local banks which was supported by 87.4% respondents.

	Threaten the survival of domestic banks	Destabilize domestic credit	Local banks incur high cost	Bring shocks from their home countries	Engage in "cherry pick"	Negatively affect foreign exchange position
Strongly Agree	35.7	23.5	28.6	18.4	22.5	17.3
Agree	43.9	41.8	56.1	50.0	42.8	36.7
Neutral	11.2	19.4	8.2	14.3	18.4	15.3
Disagree	9.2	15.3	6.1	17.3	15.3	28.6
Strongly Disagree	0.0	0.0	1.0	0.0	1.0	2.1
Total	100.0	100.0	100.0	100.0	100.0	100.0

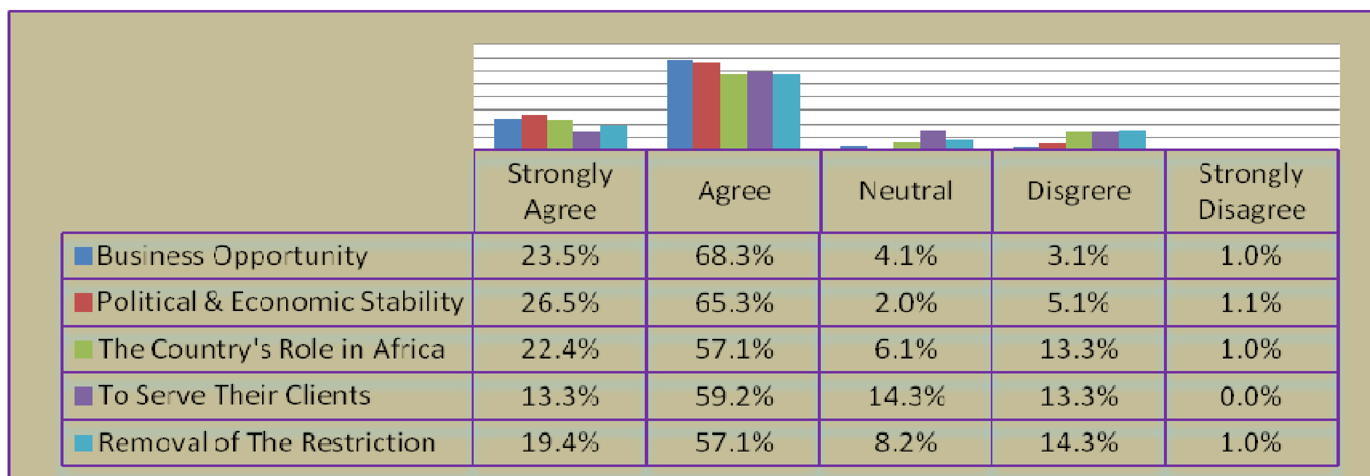
Table 2: Summary of Responses for questions on the expected challenges on foreign bank entry in Ethiopia in (%)
Source Own Computation, 2015

3.3.5. Negatively Affect Foreign Exchange Position and Capital Account of the Country

Foreign banks presence may negatively affect the foreign exchange position and capital account of a country. More than half, 54% of the respondents agreed and 15.3% were indifferent about the argument. However, 30.3% disagreed implying that foreign bank presence may not negatively affect the foreign exchange position and capital account of the country. According to (Kiyota et al 2007) foreign banks may serve as conduits for the inward and outward flows of capital which may cause foreign exchange and/or liquidity shortage, with potential adverse effects on the country's capital account. According to interview conducted with the higher officials, however revealed that as the country has strong foreign exchange management which is somewhat different from other countries, it is not a big deal as such and it will not beyond the control. Response obtained through questionnaires shows that, even though the country has strong foreign exchange management, foreign bank presence may negatively affect the foreign exchange position of the country.

3.4. Motives That May Initiates Foreign Banks to Look into Ethiopia

Of the various motives that push foreign banks to look into Ethiopia, according to response connected from 91.8% of respondents, the current state of development in the country, among others; the fast and broad-based growing economy, large and untapped local markets and favorable investment policy tend to attract foreign banks. Cull and Martinez Peria (2010) also found that pursuing economic opportunities in host country motivates foreign bank entry implying business opportunity is one of the motivational factors that may initiates foreign banks to look into Ethiopia. In similar manner, 26.5% reflect their strong believe with the support of 65.3% on the availability of relatively peace, political and macroeconomic stability of the country may be a base for foreign bank to open their branches or subsidiaries in the country. More than three- forth (76.5%) of the respondents replied that removal of the restrictive policy on foreign banks may motivates foreign bank to look into Ethiopia. likewise, the study by (Jonse 2004) argues that the effects of a host country's regulations and restriction with the aim of protecting inefficient and "infant'' domestic banks have straight forward implications on foreign bank entry. Furthermore, according to Cull and Martinez Peria (2010), local profit opportunities, the absence of barrier to entry, and the presence of mechanisms to mitigate information are some of the main driving factors for foreign bank entry into developing countries. In addition, 79.5% of the respondents were agreed that the country's active role in the region through its seat of head quarter for African Union, availability of a number of multinational accompanies and location of the country may also a cause for foreign bank presence in Ethiopia.



	Strongly Agree	Agree	Neutral	Disgrere	Strongly Disagree
Business Opportunity	23.5%	68.3%	4.1%	3.1%	1.0%
Political & Economic Stability	26.5%	65.3%	2.0%	5.1%	1.1%
The Country's Role in Africa	22.4%	57.1%	6.1%	13.3%	1.0%
To Serve Their Clients	13.3%	59.2%	14.3%	13.3%	0.0%
Removal of The Restriction	19.4%	57.1%	8.2%	14.3%	1.0%

Figure 1: Responses towards factors that will motivate foreign banks to operate in Ethiopia
Source: Own Computation, 2015

According to numerous evidences, most of the time banks follow their clients. In this regard, beside the growing economy and business opportunities, the number of foreign citizens in Ethiopia is also increasing from year to year. Information obtained from Ministry of Labor and Social Affairs shows that, during the past six years until June 2014, a total of 51,226 foreign nationals received working permit in Ethiopia which is valid for three years and subject to renewal per annum. Out of this, the Chinese citizens took the highest share (59.8%) followed by Indians (17.8%) and Europeans (9.0%). In addition, in 2015 (from July 08, 2014 to July 07, 2015) fiscal year alone 15, 237 foreign nationals from 98 countries have received work permit in the country which increased the total work permit issued to foreign nationals to 66,463 since July 07, 2009. During the past seven years, 41,776 Chinese and 10,408 Indian nationals were received work permit from the Ministry of labor and social affairs. In the same way, Information obtained from Ethiopian Investment Agency (EIA) shows that, until May 2015 the total capital of the operational projects reached Birr 154.9 billion. The share of Foreign Direct Investment is Birr 101 billion (65.7%) of all operational projects. Availability of FDI in a country tends to attract foreign banks as foreign banks serve multinational companies in most cases with the concept of follow your customer strategy. The survey shows that the highest percentage (72.5%) of respondents replied foreign bank may prefer to engage in banking business in Ethiopia and serve their clients and companies operating in the country whereas 14.3% remain neutral on the argument and 13.3% disagreed. Moreover, (Von et al (2007, Hurduc and Nitu (2011), Thi and Vencappa (2008) states that, banks go abroad mainly for profit maximization, expand business, search for profitable opportunities following their clients and multinational companies Implying that foreign banks may prefer to operate in Ethiopia to server their clients and explore the large markets in the country.

3.5. Home Field versus Global Advantage of Multinational Banks

The home field advantage theory of multinational banks argues that local banks have home field advantage compared to foreign banks in terms of language, currency, supervision and information. The survey result shows that 61.3% of the respondent agreed on this statement implying that domestic banks will be advantageous as they have detail information of their customers. On the other hand, 53.1% agreed and 42.9% showed their strong concern that given the current status of local banks, foreign bank has global advantage over domestic banks as they have more experiences of doing business in competitive environment implying working together through merger and acquisition may be beneficial to both domestic and foreign banks.

3.6. Reconsideration of the Restrictive Policy on Foreign Bank Entry

During an interview made with key informants, it was observed that all of them have no objection on the reconsideration of the restrictive policy on foreign bank entry into the country. Nevertheless, doing so may not be soon as it has to be done with utmost care. Regarding the question of when it should be, allowing foreign bank entry within the coming five years may not be right time for most of them. One of the interviewee noted that the very purpose of the restriction on foreign bank entry is mainly all about the objectives. The country has adopted developmental state model in which the role of government is strong. The prevailing high public investment and structural transformation are some of major ongoing activities by the government in the country. In this case, state owned banks play a significant role. However, foreign banks may not adequately support this objective as they may focus on most profitable sectors of the economy. The other major rationale relies on sector wise investment. Transforming the industrial sector is the one of the focus areas of the government whereas service sector may be one of the target areas for foreign banks. On the other hand, two of them replied that it is now two decades when the banking sector was restructured and privately owned banks started to flourish. But still the sector is not capable enough to compete with foreign banks. According to them, always infant behavior of the local banks for long time has its own costs to the society and the overall economy. Low level of access to finance limits the wealth creation processes in the country to some extent. Hence, with consideration of the net gain or loss of being with or without foreign bank presence in the country, allowing foreign bank entry within the coming five years is helpful from the consumer and overall economy view point. According to the respondent, the effect of foreign bank participation should be seen from three perspective; local banks, financial

system that comprises public and private sector, and the overall economy. Since there is no objection for foreign bank entry, allowing foreign bank entry into the country as soon as possible will be advantageous.

Concerning the requirement for capacity development, like that of low capacity of local banks to compete with foreign banks, currently, the regulatory and supervisory capacity of local authorities is also not capable enough to effectively regulate and monitor foreign bank operations. Interview made with the key informants assures this statement. According to response obtained from the regulatory organ (NBE) officials, the regulatory and supervisory organ has enough capacity to supervise local banks but it needs further development to regulate, supervise and monitor at international best practice level. The other respondent noted that much is expected from NBE based on the existing situation saying despite progress has been made; still there are some areas that need further improvement in supervising the local banks that should be addressed. Moreover, concerning the regulatory and supervision level of NBE for foreign banks, a great deal of improvement and preparation is required to reach at international best level. The questionnaires survey result also shows 96.9% of the respondents replied that local authorities need to develop and upgrade the regulatory and supervisory skills toward international best practice standards. The result reveals that effective and proactive regulation and supervision will save the financial system and the whole economy thereby advances preparation in all aspect is a wise policy concern for the regulatory organ and policy makers.

4. Conclusions and Policy Implications

4.1. Conclusion

The findings of the study reveal that allowing foreign bank entry in Ethiopia would; enhance the efficiency of the banking sector and promotes financial development by introducing new banking technologies and financial innovations; Improves financial system infrastructure such as good banking practice and know-how, financial regulation, managerial and supervisory skills and effective risk management mechanism. It will introduce reformation and restructuring of the banking sector and bring best practices and procedures to the country's financial system. Moreover, as foreign banks come with additional capital, the prevailing high need for finance may get solution and the competition among banks and their capacity tend to increase. Opening up of the banking business to foreign competition helps the country's financial system integration with the rest of the world that will enhances the link between domestic and global economy.

On the other hand, the study identified the likely challenge of foreign bank entry in Ethiopia. The new and fierce competition with foreign bank may be a challenge for domestic banks and it may lead them to incur high cost in the short run and face decline profit. Developing and implementing effective regulation and supervision mechanism while establishing fair playing field to domestic and foreign banks may be challenging to the regulatory organ at initial stage. Foreign bank may have adverse effect on financial system of the country if the domestic regulation and supervision are not strong enough in regulating and supervising foreign banks. Likewise, as the domestic financial markets become inevitably more open to the outside, effective use of monetary policy instruments may be challenge for macroeconomic policy makers in the short run. Developing legal and regulatory framework at international best practice level, implementation of modern technologies, upgrading the capacity of domestic banks and improvement of financial system infrastructure could potentially minimize challenges related with foreign bank entry in Ethiopia.

4.2. Policy Recommendations

Based on the findings of the study, allowing foreign bank entry is advantageous to the overall economy in general and financial system in particular considering its net benefits to the consumers, financial system and the overall economy. Doing so in step by step in terms of ownership and areas of operations is beneficial for the country that should be addressed by policy makers and the regulatory organ. Extensive capacity building requires mainly to the regulatory organ to develop a standard regulatory and legal framework. The staff of the regulatory organ needs to be well qualified and have sufficient managerial experiences in the fields of their supervision and regulation. It is recommendable to NBE to establish or

Strengthen an ongoing training program on the benefits of strong supervision on foreign bank and local operations adequately. In addition, training of the trainable and replaces the untrained staff in a sustainable way is also recommendable to the regulatory organ. Upgrading the use of the state of the art technologies being implemented somewhere else in other country needs to be implemented by the regulatory organ and local banks. It is recommendable for domestic banks to focuses on; capacity development, implementation of modern banking technologies, developing new and wide range of bank products and increasing their capital position. At the preliminary stage allowing foreign bank from developing countries or neighboring countries (south-south banks) is recommendable for policy makers given the geographical proximity, close economic and infrastructural ties, specific regional business practices & technologies. Merger and acquisition form of entry as equity investors in existing or new banks allowing majority ownership for Ethiopian investors is advantageous for knowledge transfer and strengthen local banks as well as ensuring their survival that should be recommended to the regulatory organ. The other policy recommendation to the regulatory organ (NBE) is foreign bank entry via subsidiary may be preferable to resource mobilization and enhancing access to finance for the majority.

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