THE EFFECT OF FINANCIAL LIBERALIZATION ON THE PERFORMANCE OF COMMERCIAL BANKS IN ETHIOPIA

TASSEW GEBRE WOLDE

A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION, SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

NOVEMBER, 2015

DECLARATION

I declare that this is my original work and has not been presented for a degree in any other university or Institution of Higher Learning. .

Signature …….. Date …….

TASSEW GEBRE WOLDE: D61/64526/2013

This project has been submitted for examination with my approval as the University Supervisor:

Signature …….. Date …….

MR. HERICK ONDIGO

Lecturer,

Department of Finance and Accounting

School of Business, University of Nairobi

ACKNOWLEDGEMENTS

Most of all I thank God for the gift of wisdom and strength to complete this project. I would like to thank most sincerely all those whose contributions have made this project a success. To my supervisor Mr. Herick Ondigo for his assistance and advice all through making this project a success.

A special feeling of gratitude to my wonderful family for their support both morally and financially. To my caring, loving, and supportive wife, Rebka: my deepest gratitude. It was a great comfort and relief to know that you were willing to provide management of our household activities while I complete my work. My heartfelt thanks.

I feel indebted to the management of the National Bank of Ethiopia who provided that data which without it the project would not have been done. I will always appreciate their support, especially Mr. Zeynu Jemal and Mr. Seifu WoldeMicheal for their great contribution.

DEDICATION

I dedicate this project to my family for their unfailing encouragement and love. To my dear wife Rebka Kebede, my daughters Menata and Rewina and my brother Pastor Bekele Gebre for their unwavering support.

I also dedicate this project to my many friends, colleagues and Ethiopian Embassy in Nairobi who have supported me throughout the process.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF ABBREVIATION

ATM	-	Automated Teller Machines
CBE	-	Commercial Bank of Ethiopia
GDP	-	Gross Domestic Product
IRS	-	Interest Rate Spread
ROA	-	Return on Assets
ROE	-	Return on Equity

ABSTRACT

In the present day globalized market, it is believed that a good financial system consisting of a competitive market and well-built financial institutions is one of the vital bulwarks of sustainable economic development. However, this will be achieved in a country if there is intensified financial integration of the domestic financial market with world markets and rapid growth in global trade in goods and financial services. Obviously, the pace and scope of the integration process varies across countries and has been found to be hastened by financial liberalization. Integration of financial services and internationalization of the banking sector has made the entry of foreign banks much more important than at any time before. During the last decades, financial liberalization accelerated the pace of globalization of financial markets has also been found to enhance the performance of commercial bank. Thus, liberalization of financial sector creates a financial environment suitable to enhance positive returns on money capital as well as an appropriate institutional framework which eventually leads to an increase in deposits and investment leading to financial performance of banks. This study sought to investigate the effect of financial liberalization on the performance of commercial banks in Ethiopia. It was based on Financial Liberalization Theory and Financial Intermediation Theory. This study employed descriptive research design. The population of interest in this study was all the commercial banks in Ethiopia that have operated between 2010 and 2014. Since the number of the respondents is limited, then the study was a census survey. The study was an event research where data was collected from annual reports submitted to the National Bank of Ethiopia. Multiple regression analysis was applied to the data to examine the effect of the various aspects of liberalization on the performance of the commercial banks in Ethiopia. The F- test was used to determine the significance of the regression while the coefficient of determination, $R^{2,}$ will be used to determine how much variation in Y is explained by X. This was done at 95% confidence level and correlation analysis was carried out to find the direction of the relationship between ROA and the independent variables. The Statistical Package for Social Sciences (SPSS) was used to analyze the data. The study found that there was positive relationship between return on assets and all the predictor variables (market share of the bank, concentration ration, branch network, loan asset ratio, equity to asset ratio, and age of the bank).The study concluded that the liberalization has brought a significant change in the bank with regard to credit quality performance. Thus, the bank has the greater capacity to sustain the assets losses in the post reform period than before. The study recommended that more investments should be done through establishing more branch networks across the country which is associated positively with their financial performance and managers should also develop new services by using new technologies, such as the online trading.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

The internal structural reforms and the opening to the outside of the financial sector are two important processes that are necessary for the development of both a financially competitive and efficient system in order to facilitate economic growth and financial system stability. The need for a financial system to be efficient has been enhanced by the recent financial crisis which brought into fore the benefits of financial liberalization (Isik and Hassan, 2010). However, there are other opinions that the financial deregulation and the increasing of the process of globalization were the main causes what amplified the recent financial crisis. Financial liberalization has the fundamental objectives in a country which among others reinforcement of financial integration in order to enhance investment and improve the degree of economic development. However, the achievement of such objectives depends specifically on each country's economic level when opening its market (Nguyen 2010).

Aziakpono (2004) point out that the creation of an effective and solid financial system constituted an important objective of the process of reform and transition from centralized economy to a market economy for many developing countries. Indeed as one of the important aspect of a countries economic ingredient, among them, the liberalization of the circulation of goods, services and capital, the deregulation of financial systems, globalization and the mutations on the level of the economic, social and political environment had a significant impact on the development of the banking system in developing countries such as Ethiopia. The banking systems in the developing countries suffered ample mutations with the purpose of creating some

efficient banking institutions, with a high degree of soundness capable of facilitating economic growth (CharlierandOguie, 2008).

According to the financial liberalization theory, if the financial regime in a country is characterized by financial repression through interest rate ceilings that keeps interest rates low, this will lead to a low savings which will consequently lead to a decrease in the quantity of investment is stifled (Mehrez and Kaufmann. 2000).This will lead to constrained investment due to the limited savings. The country's' investment level will be constrained due to investors fear of low return from their investment. However, with financial liberalization, Menkhoff and Suwanaporn (2007) opine that interest rate deregulation will lead to the rise of interest rate which will give rise to increasing savings and also investment. The increased investment results in the rationing out of low-yielding projects and the subsequent undertaking of high-yielding projects.

1.1.1 Financial Liberalization

Different authorities in finance and economics have defined differently the concept of financial liberalization. Nguyen (2008) observes that Financial liberalization, refers to a reduction in the role of government, and an increase in the role of the market, in allocating credit. He further points out that financial liberalization can be measured by taking into account credit controls, interest rate controls, entry barriers for banks, regulations, privatization, and restrictions on international financial transactions. Harangus (2008) reported that financial liberalization is associated with the influx of new banks led the banking system on a new corridor of performance due to the intensification of competition and the increase in offering new products and complex bank services. He further argues that financial liberalization lead to an increase in competition and productivity across all banks (both public and private). On their part, Majid, Muhamed and

Sufian(2007) in their study of Malaysian Banks, where they found that the influx of new banks with some restrictions on banking operations led to increase competition in the banking sector.

Traditionally, commercial banks have been oriented towards corporate business while savings banks primarily served retail customers. Most of these savings bank customers held low average balances and valued convenience and proximity of branch offices. After the regulatory reform process began, the commercial and savings banks followed different strategies in adapting to the new financial market (Brealey, Myers and Marcus, 2009).Commercial banks focused more on adjusting their deposit and loan rates to meet increased competition. In contrast, savings banks pursued a growth strategy by expanding branch and ATM network and undertaking a series of mergers. How successfully the authorities perform their role as supervisor, owner, or customer will be an important determinant of the success of reform. Moreover, financial liberalization is only one component of a successful development strategy. Appropriate macroeconomic policy, institutional development, and structural reform must accompany financial liberalization and create the stable context required for it to succeed (Pradhan and Pill 1997).

A number of vies have been advanced that criticize financial liberalization for a number of reasons. The foremost criticism is based on the argument that savings may not necessarily depend on the rate of interest and, if they do, the rate of interest may actually reduce rather than increase the volume of savings. Thus an increase in the interest rate has two effects, namely the positive substitution effect (which promotes savings) and the negative income effect (which deters savings) (Bandiera et al. 1999). However, it is likely that the negative income effect will offset the positive substitution effect, thereby leading to a negative overall effect on savings. An

increase in interest rates will only reallocate the existing volume of savings in favour of financial savings and leave the total volume of savings unchanged (Mahambare and Balasubramam 2000) and at low levels of income, interest rates are unlikely to stimulate savings because the totality of incomes will be devoted to consumption rather than savings (Ogaki, Ostry, and Reinhart, 1996).

1.1.2 Financial Performance

Organizational performance can be measured by financial aims attainment or workers satisfaction. Further, financial depth has been driven mainly by expansion of domestic credit to the private sector as opposed to the public sector. Financial liberalization and privatization of domestic state-owned banks contribute to net profitability, better capitalization of domestic banks and operating efficiency due to scale economies. In the same manner According to these researchers, there are many factors that can be used to measure a bank's performance such as market shares, financial performance, efficiency and effectiveness of an organization performance, and human resource management.

There is general agreement that bank profitability is a function of internal and external factors. Koch (1995) observed that the performance differences between banks indicate differences in management philosophy as well as differences in the market served. Profitability is a function of internal factors that are principally influenced by a bank's management decisions and policy objectives such as the level of liquidity, provisioning policy, capital adequacy, expense management and bank size, and the external factors related to industrial structural factors such as ownership, market concentration and stock market development and other macroeconomic factors (Athanasoglou*et al,* 2006). Though most of the studies on bank profitability are based on developed countries especially the USA and Europe, a couple of studies focusing on developing

countries Flamini et al (2009), Sufian and Chong (2009), and (Naceur (2003) have also used similarly the same variables to study the determinants of bank profitably.

A number of vies have been advanced that criticize financial liberalization for a number of reasons. The foremost criticism is based on the argument that savings may not necessarily depend on the rate of interest and, if they do, the rate of interest may actually reduce rather than increase the volume of savings. Thus an increase in the interest rate has two effects, namely the positive substitution effect (which promotes savings) and the negative income effect (which deters savings) (Bandiera et al. 1999). However, it is likely that the negative income effect will offset the positive substitution effect, thereby leading to a negative overall effect on savings. An increase in interest rates will only reallocate the existing volume of savings in favor of financial savings and leave the total volume of savings unchanged (Mahambare and Balasubramam 2000) and at low levels of income, interest rates are unlikely to stimulate savings because the totality of incomes will be devoted to consumption rather than savings (Ogaki, Ostry, and Reinhart, 1996).

1.1.3 Effect of Financial Liberalization on the Banks Performance

The factors that determine bank performances can be classified into bank specific (internal) and macroeconomic (external) factors (Al-Tamimi, 2010). These variables determine the output level of a bank. Internal factors are individual bank characteristics which affect the banks performance. These factors are basically influenced by internal decisions of management and the board. The external factors are sector-wide or country-wide factors which are beyond the control of the company and affect the profitability of banks. The internal factors are bank specific variables which influence the profitability of specific bank. These factors are within the scope of the bank to manipulate them and that they differ from bank to bank. These include capital size,

size of deposit liabilities, size and composition of credit portfolio, interest rate policy, labor productivity, and state of information technology, risk level, management quality, bank size, ownership and the like. CAMEL framework often used by scholars to proxy the bank specific factors (Dang, 2011). CAMEL stands for Capital Adequacy, Asset Quality, Management Efficiency, Earnings Ability and Liquidity. Each of these indicators is further discussed below.

The macroeconomic variables used in determining the financial performance of commercial banks are GDP which is measured using growth rate by Growth in real GDP in per cent, Inflation rate is measured by change in annual average retail consumer price level in per cent (IR), Level of financial intermediation is measured using domestic credit provided by banking system percentage of GDP, and Interest rate spread which is determined using the lending rate minus deposit rate percentage (IRS) (Allen and Bali, 2004). Bank performance is expected to be sensitive to macroeconomic control variables. The impact of macroeconomic variables on bank risk has recently been highlighted in the literature (Boyd and Runkle, 1993). GDP growth is used as a control for cyclical output effects, which we expect to have a positive influence on bank profitability (Brock and Rojas Suarez, 2000).As GDP growth slows down, and, in particular, during recessions, credit quality deteriorates, and defaults increase, thus reducing bank returns. In line with the previous literature, we include a variety of macroeconomic variables in our model (Allen and Saunders, 2004).

Mahar and Williamson (1998) provide evidence that financial liberalization leads to financial development and more efficient bank operations but with accompanying risk of financial crisis. Lee (2002) observe that financial liberalization and with the accompanying foreign bank entry and an increase in the real interest rate stimulate saving, expand supply of credit to private sector

and growth in large firms' sales revenue, assets and leverage, but credit to small entrepreneurial firms remains relatively low. More recently, Dinger (2009) also finds supporting evidence that the stabilizing role of foreign banks can be attributed to access to more diversified sources of liquidity which significantly reduces the risk of aggregate liquidity shortages in emerging economies during crises.

1.1.4 Commercial Banks in Ethiopia

Ethiopia's financial sector remains closed and is much less developed than its neighbors. Ethiopia has no capital market and very limited informal investing in shares of private companies. As at 30th June 2015, Ethiopia had 19 Commercial banks (Appendix I). A series of financial sector reforms has been introduced since 1994, when private banks were allowed to be re-established. But the three large state-owned banks continue to dominate the market in terms of capital, deposits and assets. The current government is committed to alleviating poverty through private sector development and though integrating Ethiopia into the global economy. However, the government does not at this time seem prepared to privatize large state-owned enterprises (or banks), allow for private ownership of land, or open the financial sector to foreign participation and competition.

Moreover, bank concentration, defined as the asset share of the three largest banks, is 87.9 percent in Ethiopia, which is the highest in East Africa. Indeed, the Ethiopian banking sector is dominated by one large state-owned bank, the Commercial Bank of Ethiopia (CBE). The asset share of the CBE was 66.3 percent, while the share of all three state-owned banks was nearly 80 percent. These results clearly indicate the dominant state control of the Ethiopian banking sector.

1.2 Research Problem

In the present day globalized market, it is believed that a good financial system consisting of a competitive market and well-built financial institutions is one of the vital bulwarks of sustainable economic development (Chari and Henry, 2004). However, this will be achieved in a country if there is intensified financial integration of the domestic financial market with world markets and rapid growth in global trade in goods and financial services. During the last decades, financial liberalization accelerated the pace of globalization of financial markets has also been found to enhance the performance of commercial banks (Ariccia, Igan, &Laeven. 2012). According to Nguyen (2010) financial deregulation has a positive impact on banking efficiency and on the productivity of banks, while other authors consider that deregulation has a negative effect on the performance of banks, determining a decrease of technical efficiency. Thus, liberalization of financial sector creates a financial environment suitable to enhance positive returns on money capital as well as an appropriate institutional framework which eventually leads to an increase in deposits and investment leading to financial performance of banks **(**Ngugi, 2000).

The important roles of banks in financial stability of a country have been reinforced in many publications and policy guidelines in various countries. Commercial banks play an important role in liquidity creation and fostering economic vital role in the economic resource allocation of countries growth. Ethiopia has a country can be considered to be a closed economy where government intervention in the financial system is much evident and this interventions by the government affects in most cases the performance of the commercial banks. The financial system in Ethiopian requires more liberalization because it is expected that more liberalization of the sector will lead to better performance.

A number of studies have been undertaken on the effect of financial liberalizations on the financial performance of commercial banks. Gorton and Winton (2000) show how a higher capital ratio may reduce liquidity creation through the crowding out of deposits. They argue that deposits are more effective liquidity hedges for investors than investments in bank equity capital. Mwega (2011) documents that the financial service industry of Kenya benefits from reduced concentration and increased competition during 1998–2007 following the financial deregulations initiated since 1994. Using an endogenous growth model, Mwenda and Mutoti (2011) also find that bank efficiency, financial depth, and reform initiatives have a significant positive impact on economic growth in Zambia during the financial deregulation regime. Brissimis et al. (2012) examine the relationship between banking system reform and bank performance and found that both banking system reform and competition exert a positive impact on the bank efficiency, while the effect of reform on total factor productivity growth is significant only by the end of the reform process.

From the above studies, the results were not conclusive since inclusion of other variables like foreign deposits; average local deposits, credit risk and financial growth and increasing the study period to more years could give a real effect on financial performance of commercial banks. In addition, the researcher is not aware of a study that links financial liberalization to performance of commercial banks in Ethiopia. Hence the Research question is; what is the effect of financial liberalization on the performance of commercial banks in Ethiopia?

1.3 Research Objective

To determine the effect of financial liberalization on the performance of commercial banks in Ethiopia

1.4 Value of the Study

The findings from this study will assist in providing more literature to support existing theoretical propositions on the effect of financial liberalization on the performance of commercial banks. It will also be a significant source of literature on financial liberalization and performance of banks for future researchers or those in the academic field.

The government of Ethiopia will be able to understand the effect of financial liberalization on the performance of commercial banks. The government will also get to understand how this affects the economic growth and development of the country. The findings will therefore assist the government to come up with appropriate financial liberalization policies that can enhance not only the performance of banks but the economy at large.

The commercial banks in Ethiopia will be able to understand how changes and variations in financial liberalization „instruments by the existing government is likely to affect or impact on their financial performance. This will enable them to take necessary approaches to react to variations instruments of financial liberalization.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter contains the review of various studies that are relevant to financial liberalization and organizational performance. It presents a review of the relevant theories that explains financial liberalization and the performance of commercial banks

2.2 Theoretical Review

This study will be guided by two theories namely: theory of financial intermediation and financial liberalization theory. These theories will provide theoretical evidence of various arguments by different scholars and researchers in relation to financial liberalization and financial performance in the banking sector.

2.2.1 Financial Liberalization Theory

Kaminsky and Schmukler (2003) advanced the theory of financial liberalization; the scholars explained that liberalization of the capital account is captured by the regulations on offshore borrowing by financial institutions and by non-financial corporations, on multiple exchange rate markets and on capital outflow controls. In a fully liberalized capital account regime, banks and corporations are allowed to borrow abroad freely (Kaminsky and Schmukler, 2003).They may need to inform the authorities but permission is granted almost automatically. Reserve requirements might be in place but are lower than 10 per cent. In addition, there are no special exchange rates for either the current account or the capital account transactions; nor are there any restrictions to capital outflows (King, and Levine, 1993).

A fully liberalized domestic financial system is characterized by lack of controls on Lending and borrowing interest rates and certainly, by the lack of credit controls, that is, no Subsidies to certain sectors or certain credit allocations. Also, deposits in foreign currencies are permitted. In a fully liberalized stock market, foreign investors are allowed to hold domestic equity without restrictions and capital, dividends and interest can be repatriated freely within two years of the initial investment. Financial liberalization theory, then, argues for improved economic growth through financial sector reforms (Kaminsky and Schmukler, 2003).The supporters of financial liberalization base their arguments on the works of McKinnon and Shaw. According to the theory, positive real deposit rates raise the saving rate, thus increasing the flow of financial savings (Trabelsi, 2004). Developing countries with repressed financial systems thus mounted financial reforms aiming at: mobilization of financial resources with increased amounts of domestic savings channeled through the formal financial sector, reducing the role of direct controls in determining the allocation of credit, increasing reliance on market based system of monetary control and broadening the range of domestic sources of finance (Stiglitz, 2000).

2.2.2 Financial Intermediation Theory

Diamond and Dybvig (1983), postulated the theory of financial intermediation, they argued that, financial intermediaries exist to solve three main problems: information problems, transaction costs and regulatory factors. The informational asymmetries generate market imperfections. These imperfections generate specific forms of transaction costs. Financial intermediaries appear to overcome these costs. Diamond and Dybvig (1983) consider banks as coalitions of depositors that provide households with insurance against shocks that affect their liquidity position. Diamond (1984) is also of the view that financial intermediaries act as delegated monitors on behalf of savers.

The transaction cost approach contradicts the assumption of complete markets. Here, the financial intermediaries act as coalitions of individual lenders or borrowers who exploit economies of scale in the transaction technology. The notion of transaction costs encompasses not only exchange or monetary transaction costs (Tobin, 1963). Here the role of financial intermediaries is to transform particular financial claims into other types of claims. As such, they offer liquidity (Pyle, 1971) and diversification opportunities (Hellwig, 1991).

The proponents of this theory argue that the third approach is based on the regulation of money production and of saving in and financing of the economy. Regulation affects solvency and liquidity within the financial institution. Diamond and Rajan (2000) show that bank capital affects bank safety, the bank's ability to refinance, and the bank's ability to extract repayment from borrowers or its willingness to liquidate them. Many view financial regulation as something that is completely exogenous to the financial industry.

Thus, to summarize, according to the modern theory of financial intermediation, financial intermediaries are active because market imperfections prevent savers and investors from trading directly with each other in an optimal way (Fischer, 1983).The most important market imperfections are the informational asymmetries between savers and investors. Financial intermediaries, banks especially, fill as agents and as delegated monitors‟ information gaps between ultimate savers and investors. They screen and monitor investors on behalf of savers. To ensure the sustainability of financial intermediation, safety and soundness regulation has to be put in place (Towey, 1974).

2.3 Determinant of Financial Performance

Financial liberalization indicators used in determining financial performance of commercial banks include; average annual nominal interest rate and commercial bank assets as a percentage of total financial assets (Liquid liabilities as a percentage of GDP). This is the broadest financial indicator of financial intermediation because it looks at the overall size of the financial sector, private credit by commercial banks as a percentage of GDP. It measures the ability of financial intermediaries to carry out their primary function to direct savings to investors. Private credit by commercial banks and other banking institutions as a percentage of GDP, the ratio of commercial bank assets over central bank assets, a widely used measurement of financial development and finally the ratio of stock market capitalization to GDP, an indicator of the size of the stock market(Quispe and Mcquerry,2001).

2.3.1 Bank Specific Factors/Internal Factors

The bank internal factors are bank specific variables which influence the profitability of specific bank. These factors are within the scope of the bank to manipulate them and that they differ from bank to bank. These include capital size, size of deposit liabilities, size and composition of credit portfolio, interest rate policy, labor productivity, and state of information technology, risk level, management quality, bank size, ownership and the like. CAMEL framework often used by scholars to proxy the bank specific factors (Dang, 2011). CAMEL stands for Capital Adequacy, Asset Quality, Management Efficiency, Earnings Ability and Liquidity. Each of these indicators are further discussed below

A banks' capital is one of the bank specific factors that influence the level of bank profitability. Banks capital creates liquidity for the bank due to the fact that deposits are most fragile and

prone to bank runs and that greater bank capital reduces the chance of distress (Diamond, 2000). However, it is not without drawbacks that it induce weak demand for liability, the cheapest sources of fund Capital adequacy is the level of capital required by the banks to enable them withstand the risks such as credit, market and operational risks they are exposed to in order to absorb the potential loses and protect the bank's debtors. According to Dang (2011), the adequacy of capital is judged on the basis of capital adequacy ratio (CAR). Capital adequacy ratio shows the internal strength of the bank to withstand losses during crisis. Capital adequacy ratio is directly proportional to the resilience of the bank to crisis situations.

The bank's asset is another bank specific variable that affects the profitability of a bank. The bank asset includes among others current asset, credit portfolio, fixed asset, and other investments. Often a growing asset (size) related to the age of the bank (Athanasoglou et al., 2005). More often than not the loan of a bank is the major asset that generates the major share of the banks income. Loan is the major asset of commercial banks from which they generate income. The quality of loan portfolio determines the profitability of banks. The loan portfolio quality has A direct bearing on bank profitability. The highest risk facing a bank is the losses derived from delinquent loans (Dang, 2011).

Management Efficiency is one of the key internal factors that determine the bank profitability. It is represented by different financial ratios like total asset growth, loan growth rate and earnings growth rate. Yet, it is one of the complexes subject to capture with financial ratios. Moreover, operational efficiency in managing the operating expenses is another dimension for management quality. The performance of management is often expressed qualitatively through subjective

evaluation of management systems, organizational discipline, control systems, quality of staff, and others. Yet, some financial ratios of the financial statements act as a proxy for management efficiency.

2.3.2 External Factors

The macroeconomic policy stability, Gross Domestic Product, Inflation, Interest Rate and Political instability are also other macroeconomic variables that affect the performances of banks. For instance, the trend of GDP affects the demand for banks asset. During the declining GDP growth the demand for credit falls which in turn negatively affect the profitability of banks. On the contrary, in a growing economy as expressed by positive GDP growth, the demand for credit is high due to the nature of business cycle. During boom the demand for credit is high compared to recession (Athanasoglou, Sophocles, and Matthaios, 2005). The same authors state in relation to the Greek situation that the relationship between inflation level and banks profitability is remained to be debatable. The direction of the relationship is not clear (Vong and Chan, 2009).

2.4 Empirical Reviews

Hardy and de Patti (2006) examined the cost and revenue efficiency of 33 banks in Pakistan during 2001–2005 by utilizing DFA. They find that during the post-liberalization period, both costs and revenues of banks increased, and therefore conclude that the benefits of improvements in revenue efficiency were transferred to customers, e.g. borrowers and depositors. However, it is submitted here that during the post-liberalization period, the interest rate margin of the banking industry in Pakistan increased considerably. They found that banks charged higher interest rates on their loans, but did not transfer the higher rates to their depositors.

Ayadi and Hyman (2006) in testing the relationship between financial liberalization and price rigidity in the Nigerian banking system studied wholesale and retail interest rates for the period 1987 to 2001 quarters. He used co integration and error correction models to analyze their long run as well as short run dynamics of real and wholesale interest rates. The retail lending and deposit rates possess a long run equilibrium relationship. Moreover, the Minimum Rediscount (Wholesale) Rate (MRR) and the deposit rate also exhibit a long run equilibrium relationship. If the lending and deposit rates diverge from their long run equilibrium relationship, 37 per cent of the disequilibrium is corrected each quarter by changes in the lending rate. On the other hand, any disequilibrium in the long run relationship between the deposit and MRRs can be corrected by changes in the MRR at about 58 per cent per quarter.

Karikari (2010) assessed the relationship between financial liberalization, financial development and growth in the 15 Sub-Saharan African countries with annual observations over the period of 1976-2005. The research used various measures of proxies for financial intermediary development including ratio of private sector credit and share of domestic credit to income. The results obtained from a heterogeneous panel investigation and time series methodology such as Granger causality, indicate a long-run equilibrium relationship between financial development and economic growth. This is consistent with the view that financial development can act as an "engine of growth" and plays a crucial role in the process of economic development. However, there is little evidence to support the hypothesis that financial liberalization directly "leads" growth.

According to Chauhan (2012) in the study of the Effects of Financial Liberalization in Emerging Market Economies many countries failed to reap the benefits of liberalization because of weaknesses in the regulatory structure, undercapitalized banks, volatile markets and contagion

effects. A descriptive survey of was used; the aim of the study was to show the effects of financial liberalization on emerging market economies, how these economies removed restrictions on financial institutions so that they can be globally integrated, and to show the flow of international finance in and out of a country. Secondary data was used since the nature of the data was quantitative. A regression model was used for data analysis, it was concluded that the long-term gains of liberalization certainly supersede short-term instability of liberalization.

Awojobi (2013) while assessing time series evidence of the economic growth pattern of Greece and the hidden impact of its financial liberalization process found that in terms of the links between trade and gross domestic output for the period 1960-2009 found that there is long-run convergence among financial development, trade openness and domestic output in Greece. This convergence is expected within an average of five cumulative years. Furthermore, the Granger causality test shows that there is a causal relationship between financial development and economic growth, but that financial development has no causal impact on trade in the case of Greece, which is theoretically unexpected.

Hassan, Benito and Faisal (2013) examined the impact of financial liberalization and foreign Islamic bank entry on the performance of domestic Islamic banks, and credit availability to the private sector. The results indicate that foreign Islamic banks, on average, follow aggressive financing in host countries and enjoy higher net profit margin. Banks returns play an important role in the entry decision and presence of foreign banks.

Onukwa & Maduka (1986) used cross-section analysis to estimate the correlation between financial deepening and economic growth by using data for 20 countries in Africa from 1969 - 1983. The degree of financial intermediation was measured using the ratios of monetary liabilities (M1, M2, and M3) to GDP. For the full sample, all the monetary liabilities were negative and only the ratios of M3 to GDP were statistically significant. When the countries are split into high and low income countries, some of the coefficients of the monetary liabilities are positive while some are negative. However, they are all insignificant and offer no support to the growth enhancing capabilities of financial intermediation.

Oshikoya (1992) used time series econometrics to see how interest rate liberalization has affected economic growth in Kenya. The author used data from 1970 to 1989 and the results showed a negative and insignificant coefficient for the real interest rate. The sample was then split into two subperiods: 1970-1979 and 1980-1989. The real interest rate had a negative and significant coefficient for the 1970-1979 period, but was positive and significant for the 1980-1989 period; thus offering no robust result of the effect of interest rate liberalization on growth.

Omondi (2003) in The Impact of Liberalization on the Financial Performance of the Kenyan Banking Industry examined the effect of financial sector reforms on bank profitability as measured by capital adequacy, asset quality, earnings, liquidity and managerial efficiency ratios. The study focused on profitability ratios. The study established that government owned banks recorded the lowest profitability in terms of ROA and ROE during the study period. Operating expenses continues to undermine the profits of the banks and that foreign owned banks were more efficient in the utilization of resources thereby posting the lowest managerial efficiency ratio. The evidence in the study showed that some signs of financial repression still exist, although some positive developments have taken place.

Bundi (2013) studied the effects that interest rate liberalization, opening of financial sector to foreign investors and credit control elimination has had on private domestic savings in Kenya using annual time series data for the period 1975-2011. The results indicate that interest rate liberalization together with credit control elimination have a negative effect on private domestic saving. This implies that financial liberalization has worked only through financial intermediation. The results of the study therefore suggest the need to formulate policies to change the negative influence of real deposit interest rate to positive influence and promote financial deepening.

Thus, for financial liberalization to have predominantly positive effects, attention should be drawn to the importance of a more prudent regulatory and supervisory environment. Furthermore, financial liberalization must be accompanied by a sound institutional infrastructure, proper conduct of monetary and fiscal policies, a reduction in corruption, and an increase in transparency. In addition, liberalization should be a gradual process whereby the right measures are taken in the right sequence.

2.5 Summary of the Literature Review

Overall, the empirical literature review suggests that there is mixed effect of financial liberalization on financial performance of a country's commercial banks. Whilst there is a sufficient body of literature in support of the efficacy of the financial liberalization theory, there are theoretical arguments against financial liberalization and whether financial liberalization indeed contributes to improved bank performance. Moreover, given that different countries have different financial infrastructures, such an outcome may differ from country to country and over time.

From the studies reviewed, it is evident that very few of them have tried to establish the effect of financial liberalization on performance of commercial banks, and more so in the African context. With an exception of Mwigana (2013) who concludes that ROA and ROE through financial development have positively and significantly affected financial development though his study only focused on few variables and short study period. A financially liberalized economy tends to generate more financial resources than a repressed economy. This is an old lesson (McKinnon 1973) that points to a positive correlation between the performance of commercial banks and the degree of liberalization in an economy. The studies are few and far between and there is need to carry out more studies in order to ascertain the authenticity of the findings and in this case in Ethiopia.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter sets to explain the research design, the population of interest, the basis of sample selection, the type of secondary data used, the sources of data, the techniques of analysis used and the data analysis.

3.2 Research Design

This study employed descriptive research design. A descriptive research is a procedure in which subjects' score on two variables are simply measured, without manipulation of any variable, to determine whether there is a relationship. The study also used cross-sectional study in which data was gathered just once over the period 2010 to 2014 and as such, a causal study was undertaken in a non-contrived setting with no researcher interference. A cross sectional study wasused to determine the interrelationship between the variables under consideration among the different commercial banks in the study and this permitted the researcher to make statistical inference on the broader population and generalize the findings to real life situations and thereby increase the external validity of the study.

3.3 Population and Sample of the Study

The population of interest in this study was all the commercial banks in Ethiopia that have operated between 2010 and 2014. Currently, there are 19 commercial banks operating in Ethiopia (Appendix I). The reason as to why this industry was chosen was due to the availability and the reliability of the financial statements in that they are subject to the mandatory audit by

internationally recognized audit firms as well as Central Bank of Ethiopia as regulator. In addition, all the banks have their headquarters in Addis Ababa and its environs and this make it convenient in terms of time and accessibility to the researcher. Since the number of the respondents is limited, then the study was a census survey.

3.4 Data Collection

The study was an event research where data was collected from annual reports submitted to the National Bank of Ethiopia. Vide the Proclamation No. 591/2008 dated August 11, 2008, the Ethiopian government introduced far reaching reforms in the country's' financial system which can be considered the origin of the financial liberalization in Ethiopia. As a result, the research will collect the data from the 19 commercial banks that were operational before the year 2008 and also afterwards. Hence the researcher collected data from the banks three years before and after 2008. Hence the data to be collected was for the period 2005 – 2007 and then the years 2009 – 2011. From the financial statements and publications on the banking industry in Ethiopia, the researcher collected information on market share, market concentration, number of branches, loan–to–asset ratio and equity-to-asset ratio. In addition, in order to obtain a representative sample from the population, a number of filters was applied. Observations of firms with anomalies such as negative values in their total assets, current assets, fixed assets, capital, depreciation or the interest paid was eliminated. In addition, only firms that were continuously operated over the period 2010 to 2014wereconsidered in the study.

3.5 Data Analysis

3.5.1 Analytic Model

Multiple regression analysis was applied to the data to examine the effect of the various aspects of liberalization on the performance of the commercial banks in Ethiopia. The regression model runs from the financial reports of the banks that had been in operation since 2010 and whose annual report was available for the periods. The statement of financial position as well as the statement of financial performance and their notes were studied to get the data for the variables mentioned in the model

The regression is adapted from the one used by Huang and Lin (2012) when they did a similar research on Taiwan banks. The model took the form;

Profitability = *f* (Market share, concentration, branch network, loan-asset-ratio, equity-to-asset ratio, α)

The model will specifically take the form;

$$Y = \beta o + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \varepsilon$$

Where;

Y - Financial Performance as measured by Return on Assets

β_i = (i = 0 – 6) = Regression coefficient

X_1 - Market share of the bank = Based on end of-year deposits of each bank

X_2	-	Concentration Ration	= The sum of the 10 MS of the banks in a given year
X_3	–	Branch Network	= Total number of branches in a given year
X_4	-	Loan Asset Ratio	= Total Loan Portfolio / Total Assets
X_5	-	Equity – to Asset Ratio	= Total Shareholders Equity / Total Assets
X_6	-	Age of the Bank	= Natural logarithm of the number of years the bank will have been in existence since its inception.
ε	-	Random error term	

3.5.2 Test of Significance

The F- test was used to determine the significance of the regression while the coefficient of determination, $R^{2,}$ will be used to determine how much variation in Y is explained by X. This was done at 95% confidence level and correlation analysis was carried out to find the direction of the relationship between ROA and the independent variables. The Statistical Package for Social Sciences (SPSS) was used to analyze the data.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND INTERPRETATIONS

4.1 Introduction

This chapter discusses the interpretation and presentation of the findings obtained from the field. The chapter presents the background information of the respondents, findings of the analysis based on the objectives of the study. Descriptive and inferential statistics have been used to discuss the findings of the study.

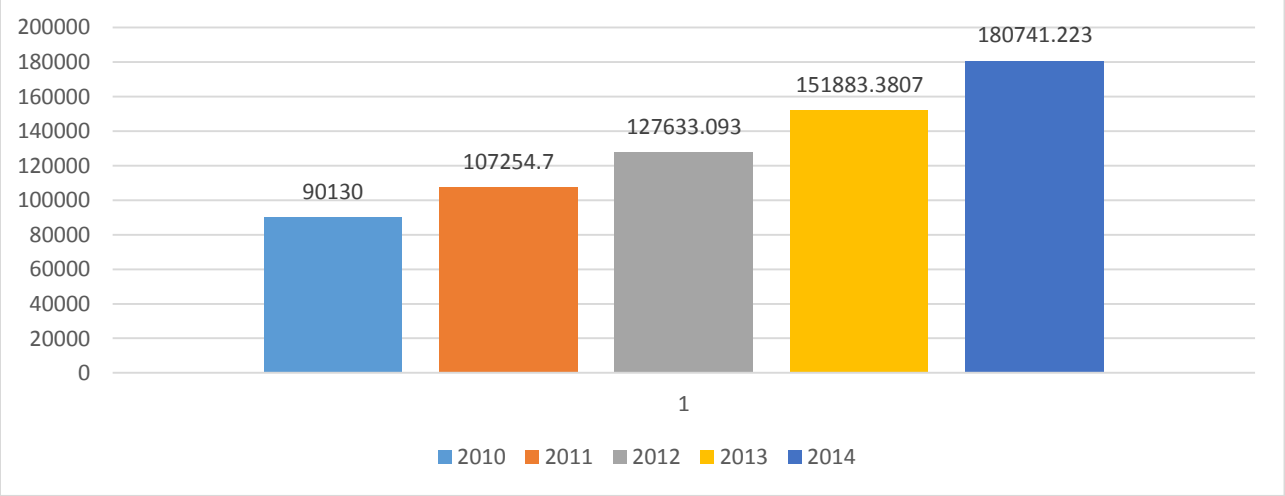
4.2 Descriptive Statistics

This section covers the description of the variables without making generalization of the findings on other banks. The section will cover the existing market share of the banks, concentration ratio, loan-asset ratio, equity-to-asset ratio and the financial performance of the banks during the period.

4.2.1 Market share of the bank (deposits of each bank)

The researcher sought to investigate the trends in market share of the bank of commercial banks of Ethiopia from the year 2010 to 2014. The results are displayed on the table below

Figure 4.1: Market share of the bank (deposits of each bank)



Source: Research Findings

The findings indicated that, the total deposits of commercial banks in Ethiopia showed a continuous increase at an increasing rate yearly since 2010 and registered an average rate of increase of 19% during the study periods. The total deposits of the banks include the three main types of deposits: demand deposits, saving deposits, and time deposits.

4.2.2 Concentration Ratio

The researcher sought to investigate the trends in Concentration Ration of commercial banks of Ethiopia from the year 2010 to 2014. The results are displayed on the table below

Table 4.1: Concentration Ratio

Year	Concentration Ratio
2010	0.7345
2011	0.7513
2012	0.7345
2013	0.8097
2014	0.7618

Source: Research Findings

On the concentration ratio, the year 2013 recorded the highest value (0.8097), followed by the year 2014 (0.7618) however the year 2010 recorded the lowest value of concentration ratio (0.7345).The trend of concentration ratio was noted to be irregular during the five year period.

4.2.3 Loan Asset Ratio

The researcher sought to investigate the trends in Loan Asset Ratio of commercial banks of Ethiopia from the year 2010 to 2014. The results are displayed on the table below

Table 4.2: Loan Asset Ratio

Year	Loan Asset Ratio
2010	35.60
2011	36.22
2012	36.31
2013	36.98
2014	37.02

Source: Research Findings

Based on the findings the year 2014 recorded the highest value of loan asset ratio of 37.02 while the year 2010 recorded the lowest the ratio of 35.60. This implies that there has been a significant increase in loan asset ratio since 2010.

4.2.4 Equity to Asset Ratio

The researcher sought to investigate the trends in Equity to Asset Ratio of commercial banks of Ethiopia from the year 2010 to 2014. The results are displayed on the table below

Table 4.3: Equity to Asset Ratio

Year	Equity to Asset Ratio
2010	8.51
2011	8.93
2012	8.96
2013	9.02
2014	9.06

Source: Research Findings

Equity to Asset Ratio (EQTA) measures equity capital as a percentage of total assets. It provides percentage protection afforded by banks to their investment in asset. It measures the overall shock absorbing capacity if a bank for potential loan asset losses. The higher the ratio of EQTA, the greater is the capacity for a bank to sustain the assets losses. Besides (Abdus, 2004 and Bates war and Ajay, 2007) have used this ratio for measuring the credit quality performance of a bank in their study. As it can be seen from the above table the trends of EQTA from 2010 to 2014 are not regular. In addition, the table shows that the highest EQTA ratio of 9.02 in 2014

and the lowest EQTA ratio of 8.51 in 2010. This further shows that the liberalization has brought a significant change in the bank with regard to credit quality performance. Thus, the bank has the greater capacity to sustain the assets losses in the post reform period than before.

4.2.5 Financial performance

The researcher sought to investigate the trends in financial performance of commercial banks of Ethiopia from the year 2010 to 2014. The results are displayed on the table below

Table 4.4: Descriptive Statistics on Financial performance

Year	Median	Minimum	Maximum	Mean	Std deviation
2010	44.31	42.23	46.13	45.11	1.12
2011	53.01	44.21	58.25	54.23	1.06
2012	55.23	51.52	62.31	57.07	1.16
2013	77.31	60.14	84.16	76.44	1.21
2014	81.12	78.11	92.15	82.21	1.74

Source: Research Findings

From the findings, it can be noted that the year 2010 recorded the lowest value in Financial performance, at as shown by a mean value of 45.11 while the year 2014 recorded the highest value Financial performance at 82.2. In addition, values for stardard deviation depicts variability in investment in Financial performance during the five –year period with the highest deviation of 1.74 in the year 2014 and the lowest at 1.12 in the year 2010. The findings revealed that there have been a significant increase in Financial performance during the five-year period.

4.3 Inferential Statistics

This section covers the correlation between the variables under consideration, the regression analysis relating the variables and the determination of the strength of the variables.

4.3.1 Correlation analysis

After the descriptive analysis, the study conducted Pearson correlation analysis to indicate a linear association between the predicted and explanatory variables or among the latter. It, thus, help in determining the strengths of association in the model, that is, which variable best explained the relationship between financial liberalization and the performance of commercial banks in Ethiopia

Table 4.5: Correlations

		Return On Assets	Market share	Concentration ration	Branch network	Loan asset ratio	Equity to asset ratio	Age of the bank
Return on assets	Pearson Correlation	1	.597	.018**	.598*	.588**	.609**	.640
	Sig. (2-tailed)		.001	.016	.014	.024	.003	.029
	N	95	95	95	95	95	95	95
Market share	Pearson Correlation	.597	1	.016	.005	.103	.293*	.016
	Sig. (2-tailed)	.001		.898	.965	.406	.016	.897
	N	95	95	95	95	95	95	95
Concentration ration	Pearson Correlation	.018**	.016	1	.746**	.021	.168	.731**
	Sig. (2-tailed)	.016	.898		.000	.863	.173	.000
	N	95	95	95	95	95	95	95
Branch network	Pearson Correlation	.598*	.005	.746**	1	.052	.058	.591**

	Sig. (2-tailed)	.014	.965	.000		.676	.641	.000
	N	95	95	95	95	95	95	95
Loan asset ratio	Pearson Correlation	.588**	.103	.021	.052	1	-.580**	-.022
	Sig. (2-tailed)	.024	.406	.863	.676		.000	.862
	N	95	95	95	95	95	95	95
Equity to asset ratio	Pearson Correlation	.609**	.293*	.168	.058	-.580**	1	.170
	Sig. (2-tailed)	.013	.016	.173	.641	.000		.168
	N	95	95	95	95	95	95	95
Age of the bank	Pearson Correlation	.640	.016	.731**	.591**	.022	.170	1
	Sig. (2-tailed)	.029	.897	.000	.000	.862	.168	
	N	95	95	95	95	95	95	95

Source: Research Findings

From the finding in the table above, the study found that there was positive correlation coefficient between return on assets and Market shares shown by correlation factor of 0.597, this relationship was found to be statistically significant as the significant value was 0.001 which is less than 0.05, the study found weak positive correlation between return on assets and Concentration ratio as shown by correlation coefficient of 0.018, the significant value was 0.016 which is less than 0.05, the study found positive correlation between return on assets and Branch network as shown by correlation coefficient of 0.598, at a significant value was 0.014 which is less than 0.05, the study found that there was positive correlation coefficient between return on assets and Loan asset ratio, as shown by correlation factor of 0.588, this relationship was found to be statistically significant as the significant value was 0.024 which is less than 0.05 , the study found positive correlation between return on assets and Equity to asset ratio as shown

by correlation coefficient of 0.609, the significant value was 0.013 which is less than 0.05, finally the study found positive correlation between return on assets and Age of the bank as shown by correlation coefficient of 0.640 this two was also found to be significant at 0.029.

4.3.2 Regression Analysis

In this study, a multiple regression analysis was conducted to test the influence among predictor variables. The research used statistical package for social sciences (SPSS V 21.0) to code, enter and compute the measurements of the multiple regressions.

The study used coefficient of determination to evaluate the model fit. The model summary are presented in the table below

Table 4.6: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.822[a]	.675	.635	.38112

Source: Research Findings

The adjusted $R^{2,}$ also called the coefficient of multiple determinations, is the percent of the variance in the dependent explained uniquely or jointly by the independent variables. The model had an average coefficient of determination (R^2) of 0.675 and which implied that 67.5% of the variations in financial performance of commercial banks of Ethiopia are caused by the independent variables understudy (market share of the bank, concentration ration, branch network, loan asset ratio, equity to asset ratio, age of the bank).

4.3.3 Analysis of Variance

Analysis of variance (ANOVA) is a statistical technique that is intended to analyze variability in data in order to infer the inequality among population means. ANOVA is used to test general rather than specific differences among means. Analysis of variance was used to test the

homogeneity of variances in order to establish the relationship between the variables. Below are the results of the findings provided in table 4.7 below:

Table 4.7: Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1.971	6	0.3285	4.8806	.002[b]
	Residual	0.875	13	0.06730769		
	Total	2.846	19			

Source: Research Findings

Critical value =2.797

From the ANOVA statics, the study established the regression model had a significance level of 0.2% which is an indication that the data was ideal for making a conclusion on the population parameters as the value of significance (p-value) was less than 5%. The calculated value was greater than the critical value (4.8806>2.797) an indication that investment in market share of the bank, concentration ration, branch network, loan asset ratio, equity to asset ratio, age of the bank, all have a significant effects on financial performance of commercial banks of Ethiopia. The significance value was less than 0.05 indicating that the model was significant

The following tables gives the coefficients which helps in establishing the regression line

Table 4.8: Table of Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	0.177	0.229		0.773	.000

	Market share	0.610	0.143	0.459	4.266	.003
	Concentration ratio	0.099	0.142	0.076	0.673	.048
	Branch network	0.605	0.142	0.565	4.261	.002
	Loan asset ratio	0.611	0.113	0.513	4.927	.001
	Equity to asset ratio	0.615	0.154	0.557	3.994	0.00
	Age of the bank	0.586	0.123	0.529	4.764	.004

Source: Research Findings

The established regression equation was

$$\mathbf{Y = 0.177+0.610X_1+ 0.099X_2+ 0.605X_3 + 0.611\ X_4+ 0.615\ X_5+0.586\ X_6}$$

The analysis was undertaken at 5% significance level. The criteria for comparing whether the predictor variables were significant in the model was through comparing the obtained probability value and α=0.05. If the probability value was less than α, then the predictor variable was significant otherwise it wasn't. From the regression model below, it is can be deduced that, holding all independent variables (market share of the bank, concentration ration, branch network, loan asset ratio, equity to asset ratio, age of the bank) constant the financial performance of commercial banks of Ethiopia would be 0.177 (17.7%), it's was also established that a unit increase in Market share while holding other factors at constant would cause an increase in financial performance of commercial banks of Ethiopia by a factor of 0.610 (61.0%), a unit increase in Investment in Concentration ration, while holding other factors at constant would cause an increase in financial performance of commercial banks of Ethiopia by

only a factor of 0.099 (9.9 %), and that a unit increase in branch network would cause increase in financial performance of commercial banks of Ethiopia by a factor of 0.605 (60.5%). Additionally, while holing other factors constant a unit change in loan asset ratio increase financial performance of commercial banks of Ethiopia by 0.611(61.1%), while holing other factors constant a unit change in equity to asset ratio increase financial performance of commercial banks by a factor of 0.615 (61.5%). Finally, while holing other factors constant a unit change in age of the bank increase financial performance of commercial banks in Ethiopia by a factor of 0.586 (58.6%). This Cleary shows that there is a positive relationship between in financial performance commercial banks of Ethiopia and all predictor variables analyzed (market share of the bank, concentration ratio, branch network, loan asset ratio, equity to asset ratio, age of the bank)**.**Therefore it was established that all the predictor variables were significant in the model as their probability values were less than α=0.05.

4.5 Interpretations of the Findings

The research sought to investigate how various factors affected the performance of financial banks (ROA) in Ethiopia between 2010 and 2013. On correlation analysis the study found that there was positive correlation coefficient between return on assets and market share as shown by correlation factor of 0.597, the study also however found weak positive correlation between return on assets and concentration ration as shown by correlation coefficient of 0.018, the study found positive correlation between return on assets and branch network as shown by correlation coefficient of 0.598, the study found that there was positive correlation coefficient between return on assets and loan asset ratio, as shown by correlation factor of 0.588, the study found positive correlation between return on assets and equity to asset ratio as shown by correlation coefficient of 0.609, finally the study found positive correlation between return on assets and

age of the bank as shown by correlation coefficient of 0.640. All values were found significant at levels below 0.05.

On regression analysis, the study found that the model had an average coefficient of determination (R^2) of 0.675 and which implied that 67.5% of the variations in financial performance of commercial banks of Ethiopia are caused by the independent variables understudy (market share of the bank, concentration ration, branch network, loan asset ratio, equity to asset ratio, age of the bank). The value of R (correlation) 0.822 implied that market share of the bank, concentration ration, branch network, loan asset ratio, equity to asset ratio, age of the bank were strongly positively correlated with performance of the commercial banks. This findings were supported by the ANOVA findings which indicated that the calculated value was greater than the critical value (4.8806>3.59). The significance value was less than 0.05 indicating that the model was significant. The findings on the Coefficients indicated that Equity to asset ratio was the most influential factor in relation to commercial bank performance in Ethiopia (B= 0.615, p-value 0.00) while concentration ratio was the least influential factor in relation to commercial banks' performance in Ethiopia (B= 0.018, p-value 0.048) The results however, revealed that all other variable had a p-value less than 0.05 which was an indication that all variables significantly affected the commercial banks' performance.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents summary of the study findings, conclusion and recommendations. The chapter is presented in line with the objective of the study which was to to establish the effect of financial liberalization on the performance of commercial banks in Ethiopia

5.2 Summary

The findings indicated that like that of the assets of the banks, the total deposits of these banks showed a continuous increase at an increasing rate yearly since 2010 and registered an average rate of increase of increase of 19% during the study periods. Trends in the concentration ratio indicate that the year 2013 recorded the highest value (0.8097) while the year 2010 recorded the lowest value of concentration ratio (0.7345). The findings further established that the year 2014 recorded the highest value of loan asset ratio of 37.02 while the year 2010 recorded the lowest the ratio of 35.60. This implies that there has been a significant increase in loan asset ratio since 2010.As observed the trends of EQTA from 2010 to 2014 are not regular. In addition, the findings shows that the highest EQTA ratio of 9.02 in 2014 and the lowest EQTA ratio of 8.51 in 2010. The trends in the investigated variables imply that the liberalization has brought a significant change in the bank with regard to credit quality performance. Thus, the bank has the greater capacity to sustain the assets losses in the post reform period than before.

The study conducted Pearson correlation analysis to indicate a linear association between the predicted and explanatory variables or among the latter. It, thus, helped in determining the strengths of association in the model, that is, which variable best explained the relationship between financial liberalization and the performance of commercial banks in Ethiopia. The study

found that there was positive correlation coefficient between return on assets and all the predictor variables (market share of the bank, concentration ration, branch network, loan asset ratio, equity to asset ratio, and age of the bank).

From regression analysis, the ANOVA statics established the regression model had a significance level of 0.2% which is an indication that the data was ideal for making a conclusion on the population parameters as the value of significance (p-value) was less than 5%. The model was found significant too. The Coefficients of variation values indicated that that there was a positive relationship between in financial performance commercial banks of Ethiopia and Investment in all predictor variables analyzed (market share of the bank, concentration ration, branch network, loan asset ratio, equity to asset ratio, age of the bank)**.** Therefore it was established that all the predictor variables were significant in the model as their probability values were less than α=0.05.

5.3 Conclusion

The study found a positive relationship between age of the bank and performance of commercial banks. The study findings concur with Coad et al. (2010) findings that as the firms grow in age, it is expected to gain an experience in the production processes, handling with customers, understanding needs of employees, and adopting with whole stakeholders. Coad et al. (2010) found evidence that firms improve with age, because ageing firms are observed to have steadily increasing levels of productivity and higher profits. Additionally the findings are in line with Dogan (2013) that longer period of bank operating in the market provides greater opportunity for the bank to achieve skills and experience, as well as to build up a brand and good reputation, resulting in higher profitability. On the other hand, since inertia and bureaucracy may be related

to age, older banks may have less flexibility in adjusting to changing business conditions, resulting in lower profitability. The study finding further contradicts the findings by Majudmdar (1997); who found significant negative relationship between age and profitability. Other studies also concluded no significant relationship between age and profitability like Stiewarld (2009).

The study a weak positive correlation between concentration ratio and performance of commercial banks. The results support Dogan (2013) view that level of concentration positively affects bank profitability in a weak sense. Besides industrial concentration, bank profitability is affected by bank-specific factors as well external financial and macroeconomic variables. Bank size, age, intermediation ratio, interest rate spread and stock market return positively contribute to bank performance. The opposite is true for credit risk and monetary instability. The importance of concentration ratios arises from their ability to capture structural features of a market. Concentration ratios are therefore often used in structural models explaining competitive performance in the banking industry as the result of market structure. Concentration ratios are also able to reflect small changes in concentration as a result of the entry of a bank into the market or its exit from it, or caused by a merge.

The study further found a positive correlation market share and banks profitability The finding also concur with Poshakwale and Qian (2011), who found a positive relationship between market share and banks profitability. A higher market share usually means greater sales, lesser effort to sell more and a strong barrier to entry for other competitors. A higher market share also means that if the market expands the leader gains more than the others. By the same token, a market leader - as defined by its market share - also has to expand the market, for its own growth. Additionally Poshakwale and Qian (2011), stated that increasing market share is one of the most important objectives of business. The main advantage of using market share as a measure of

business performance is that it is less dependent upon macro environmental variables such as the state of the economy or changes in tax policy Market share is a measure of the consumers' preference for a product over other similar products.

The study found strong positive correlation between financial performance of commercial banks Ethiopia and Loan Asset Ratio. These findings support the finding by Dinger (2009), that loan-asset ratio is a useful instrument to determine bank liquidity, and by extension, it influences the profitability of the banks. The bank profit is based on the interest charged against the assets including deposits; it means the profit is generated through the positive difference between interest of loans and interest on assets.

The study therefore concludes that the liberalization has brought a significant change in the bank with regard to credit quality performance. Thus, the bank has the greater capacity to sustain the assets losses in the post reform period than before.

5.4 Recommendations for Policy and Practice

Based on the study findings the research recommends that commercial banks in Ethiopia need to continue applying the financial liberalization indicators including: market share of the bank, branch network, loan asset ratio, equity to asset ratio, age of the bank as they were all found to positively influence the performance. The findings revealed that branch network is directly related to the banks financial performance. More investments should therefore be done through establishing more banking networks across the country which is associated positively with their financial performance, the findings illustrated that financial performance of commercial banks in Ethiopia is highly dependent on the level of the Equity to asset ratio as illustrated on the coefficient of variation table. To facilitate favorable financial performance in commercial banks

in Ethiopia there is need to formulate strategies to facilitate Equity to asset ratio so as ensure efficiency in financial operations in CBE. The findings of this study also have managerial implications. Commercial banks can enlarge their market share to improve profitability. Bank managers should not worry about the degree of concentration in the industry. The analysis shows that it is other factors rather than concentration which affects bank performance. Although the bank sector is a homogeneous industry, managers should develop new services by using new technologies, such as the online trading. Commercial banks in Ethiopia should try to improve their profitability through other factors including: liquidity, capital adequacy and asset quality.

5.5 Limitations of the Study

The descriptive and correlation analysis relied on secondary data which had already been compiled by banks. Secondary data used in this research was obtained from the sources and the researcher had no means of verifying for the validity of the data which were assumed to be accurate for the purpose of this study. The study results are therefore subject to the validity of the data used, the study used the ordinary least square regression method of analysis which may have its own weaknesses compared to other methods which may limit the general applicability of the study results.

5.6 Recommendations for Further Research

The study sought to determine the effect of financial liberalization on the performance of commercial banks in Ethiopia. The research recommends that similar studies need to this time exploring of effect of financial liberalization on the performance of commercial banks in Kenya.

REFERENCES

Allen, F., Bali , D., (2000). *Comparing Financial Systems*. The MIT Press, Cambridge

Allen, L. & Saunders, A. (2004). Incorporating Systemic Influences into Risk Measurements: A Survey of the Literature, *Journal of Financial Services Research* 2(6):161-191

Al-Tamimi, H., Hassan, A. (2010) *Factors Infuluncing Performance of the UAE Islamic and Conventional National Banks.* . Department of Accounting, Finance and Economics, College of Business Administration, University of Sharjah

Ariccia, G.D., C. Cottarelli and I. Vladkova-Hollar (2005), 'Early Birds, Late Risers, and Sleeping Beauties: Bank Credit Growth to the Private Sector in Central and Eastern Europe and in the Balkans', *Journal of Banking and Finance*, Vol. 29, pp. 83–104.

Athanasoglou, P.P., Sophocles, N.B., Matthaios, D.D. (2005) Bank-specific, industry-specific and macroeconomic determinants of bank profitability. Working paper, Bank of Greece. 1(1), 3-4.

Awojobi, O. (2013). *Does trade openness and financial liberalization foster growth*: An empirical study of Greek economy. Department of Economics, Eastern Mediterranean University, Famagusta, TRNC, Turkey.

Aziakpono, M.J. (2004), 'Financial Development and Economic Growth in Southern Africa', paper presented at the CSAE Conference

Brissimis S, Delis M, Papanikolaou N (2008) Exploring the nexus between banking sector reform and performance: Evidence from newly acceded EU countries. Journal of Banking & Finance 32: 2674–2683.

Chari, A., and P. Henry. 2004. "Risk Sharing and Asset Prices: Evidence from a Natural Experiment." Journal of Finance 59 (3): 1295–1324.

Charlier, F. and C.N. Oguie (2008), 'The Impact of Interest Rate Liberalization: Empirical Evidence from Sub-Saharan Africa', *Savings and Development*, Vol. 26, No. 4, pp. 355–79.

Dang, Uyen. (2011) The CAMEL Rating System in Banking Supervision: a Case Study of Arcada University of Applied Sciences, International Business.

Dell Ariccia, G., D. Igan, and L. Laeven. (2012). "Credit Booms and Lending Standards: Evidence from the Subprime Mortgage Market." Journal of Money, Credit and Banking 44 (2–3): 367–384.

Diamond, D.W., Raghuram, A. (2000) A Theory of Bank Capital. The Journal of Finance 52(6), 12-23.

Dinger, V. (2009), 'Do Foreign-Owned Banks Affect Banking System Liquidity Risk?',*Journal of Comparative Economics,* Vol. 37, pp. 647–57.

Isik, I. and Hassan, M. K. (2010) Financial deregulation and total factor productivity change: an empirical study of Turkish commercial banks, Journal of Banking and Finance, 27(8), 1455–85.

Kaminsky, L. &Chmukler, L. (2003) Short-run pain, long-run gain: the effects of financial liberalization. *IMF Working Paper* 03/34

King, G., & Levine, R. (1993).Finance and Growth: Schumpeter Might Be Right. Quarterly. *Journal of Economics,* August 1993, 717-738

Majid, G., Muhamed., G and Sufian (2007)*Financial Liberalization in Retrospect: Interest Rate Policies in LDCs.* In The State of Development Economics, edited by G. Ranis and T. P. Schultz. Oxford: Basil Blackwell, 1988.

Mehrez, G., and D. Kaufmann. 2000. Transparency, Liberalization and Banking Crises. World Bank Policy Research Working Paper 2286

Menkhoff, L., and C. Suwanaporn. (2007). "10 Years after the Crisis: Thailand's Financial System Reform." Journal of Asian Economics 18 (1): 4–20.

Mwega, F. (2011), 'The Competitiveness and Efficiency of the Financial Services Sector in Africa: A Case Study of Kenya', *African Development Review*, Vol. 23, No. 1, pp. 44–59.

Mwenda, A. and N. Mutoti (2011), 'Financial Sector Reforms, Bank Performance and Economic Growth: Evidence from Zambia', *African Development Review*, Vol. 23, No. 1, pp. 60–74.

Nguyen, D. K. (2010). "The Dynamics of Stock Market Volatility around the Opening of Capital Markets." *EconomieetPrévision* 192 (1): 65–82.

Ngugi, R. W. &Kabubo, J. W (1998). *Financial Sector Reforms and Interest Rate Liberalization; the Kenya Experience.* African Economic Research Consortium, Nairobi, Kenya

Pradhan, M. & Pill, H. (1997). *Financial Liberalization in Africa and Asia.* Finance & Development journal: UK

Poshakwale, S.S. and B. Qian (2011), 'Competitiveness and Efficiency of the Banking Sector and Economic Growth in Egypt', *African Development Review*, Vol. 23, No. 1, pp. 99–120

Stiglitz, J. E. (1994). The role of the state in financial markets, Proceedings of the World Bank

Trabelsi, M. (2004). Finance and Growth, Empirical Evidence from Developing Countries: 1960-1990, *Institute des Hautes Etudes Commercials de Carthage (IHEC)*, Tunisia.

Vong, A, Hoi, S. (2009) Determinants of Bank Profitability in Macao. Faculty of Business Administration, University of Macau

APPENDIX I: LIST OF BANKS IN ETHIOPIA

1	Awash International Bank
2	Commercial Bank of Ethiopia
3	Development Bank of Ethiopia
4	Construction and Business Bank
5	Dashen Bank
6	Wegagen Bank
7	Bank of Abyssinia
8	United Bank
9	Nib International Bank
10	Cooperative Bank of Oromia
11	Lion International Bank
12	Zemen Bank
13	Oromia International Bank
14	Bunna International Bank
15	Berhan International Bank

16 Abay Bank S.C

17 Addis International Bank S.C

18 Debub Global Bank S.C

19 Enat Bank S.C

Source: National Bank of Ethiopia