



Analysis of Financial Performance in Newly Established Commercial Banks (In Case Of Wolkite Town)

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Abstract

This study entitled 'Analysis of Financial Performance in newly established commercial banks conduct. Both the trend and financial performance analysis approaches would be used. Five years an audited financial report from 2008 to 2012 of the commercial banks was taken for analysis purpose. The objective of the study would be evaluates the financial performance in newly established commercial banks in Wolkite Town by analyzing its past five year's financial performance of the bank with other commercial banks. Financial ratios would be considered to measure the ROA and ROE of the new commercial banks. To obtain information relevant to the study both primary and secondary data was used and the researcher sought to obtain opinions about financial performance banks. The study was used a descriptive research design. In order to achieve the objective of the study and answer the research questions, open and closed ended question would be taken by researcher and also both research approach was used (qualitative and quantities research approaches). In order to gather the required data, questionnaire and key informant interview would be used. Due to the size of the population is large the researcher was used probability and non probability sampling technique for many purpose those would be collected accurate data about the research topic, saving of time, cost, employee and manager was adopt, manager and employer of the staff. Responses of survey data would be present and analyze using tabular and finally summary, recommendation and conclusion would be presentented.

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Acronyms

BIB= Birhan International Bank

BIB=Buna International Bank

BS=Bank Size

DGB= Dehub International Bank

LAR=Loan to Asset Ratio

DER=Debt to Equity Ratio

DTAR=Debt to Total Asset Ratio

EMR=Equity Multiplier Ratio

AUR=Asset Utilization Ratio

IER=Income to Expense Ratio

OER=Operating Efficiency Ratio

NIM=Net Interest Margin

CROA=Cash Return on Assets

OIB=Oromia International Bank

PER=Profit to Expense Ratio

NITA=Non-interest Income to Total Asset

ROD=Return on Deposit

LDR=Loan to Deposit Ratio

ROA=Return on Asset

ROE=Return on Equity

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CHAPTER ONE

1. INTRODUCTION

1.1 Back ground of the study

Financial sector of an economy plays an important role in its economic development and prosperity of the country. Banking industry serves as the backbone of the financial sector that accumulates saving from surplus economic units in the form of deposits and provides it to deficit economic units in the form of advances.

Banking industry provides support to the economy in general and industries in particular in the time of recessions and economic crisis. But when banks are at the heart of economic recession or banks are the cause of financial crisis like the recent past financial crisis 2007-2009, it makes the situation worst for economic recovery. So it is of great importance to keenly observe the performance of the banks and their compliance with the regulatory requirements.

Performance of banks is measured at two levels, one is at the management and regulatory level of the banks and another is at external rating agencies. Purpose of regulatory and supervisory rating systems is to measure the bank performance at internal level and its compliance with regulatory requirements to keep the bank on right track. These ratings are highly confidential and are only available to the bank management.

External credit rating agencies examine and evaluate banks and issue ratings for the general public and investors in particulars. It is of great importance that both these ratings present the same results about the condition of the banks to provide clear information to investors and management. In the past several banks suffer from bankruptcy that suggests the failure of both internal rating systems and credit rating agencies.

The banking environment in Ethiopia has, for the two decades, undergone many regulatory and financial reforms like other African countries and the rest of developing world. These reforms have brought about many structural changes in the banking sector of the country and have also

encouraged private banks to enter and expand their operations in the industry (Lelissa 2007). Despite these changes, currently, the banking industry in Ethiopia is characterized by operational inefficiency, little and insufficient competition and perhaps can be distinguished by its market concentration towards the big government owned commercial bank and having undiversified ownership structure (Lelisa 2007).

The existence of less efficiency and little & insufficient competition in the country's banking industry is a clear indicator of relatively poor performance of the sector compared to the developed world financial institutions. Thus, it is important to evaluate the banks performance critically for an efficient management of banking operations as well as to ensure financial soundness of the banking industry. Banks serve as backbone to the financial sector, which facilitate the proper utilization of financial resources of a country.

The banking sector is increasingly growing and it has witnessed a huge flow of investment. In addition to simply being involved in the financial intermediation activities, banks are operating in a rapidly innovating industry that urges them to create more specialized financial services to better satisfy the changing needs of their customers. (Sundararajan et al 2002) argues that the financial system, the bank in particular, is exposed to a variety of risks that are growing more complex now a days. Furthermore, the economic downturn of 2008 which resulted in bank failures, are triggered in the U.S. and then wildly spread worldwide. It therefore increasingly urges the need of more frequent banking examination. In order to cope with the complexity and a mix of risk exposure to banking system properly, responsibly, beneficially and sustainably, it is of great importance to evaluate the overall performance of banks by implementing a regulatory banking supervision framework.

The report also specified that the most common measure for a bank's performance, ROE, is only part of the story, as a good level of ROE may either reflect a good level of profitability or more limited equity capital. This may explain why some of the high-ROE firms have performed particularly poorly over the crisis, dragged down by a rapid leverage adjustment. It is understandable that a more comprehensive analysis covering multiple aspects of performance is necessary to assess the overall financial health of banks. Good financial performance of banks is important not only to their shareholders but to the whole economy as it helps the banks to

continue their role of financial intermediation effectively and help economic growth of a country, especially in countries where financial markets are not well developed.

1.2 Statement of the problem

Performance of financial institutions is relevant from the policy point of view because as finance growth literature suggests, if banks become better-functioning entities, it is expected to be reflected in strengthening capital buffer, safety and soundness of the financial systems, (M. Joseph, 2007).

Efficiency estimates are leading indicators, as such, efficiency measurement of individual banks is an important research activity carried out by the central bank of the country in order to identify the effects of deregulation, merger, market structure as well as their scale and scope of activity. Segmenting the industry into different strategic groups can help the banks position themselves and take long-term overhauling of their delivery design process, (M. Joseph, 2007).

Profit is the final goal of commercial banks in every aspects of their service. All the strategies and activities performed are to realize this impressive objective. Beside these goals, commercial banks also have social and economic goals. Though, the goal of this study is in connection with the first and foremost objective of profitability. Among different ratios used to measure the performance of commercial banks, Return on Asset and Return on Equity are the major ones. (VincentOkoth 2013), (Murthy and Spree 2003); (Alexandru et al, 2008).

These measures have been used by analysts and bank regulators is for, assessing industry performance and, on other hand for, forecasting market structure trends which is used to predict bank failures and mergers and finally, for other purposes where a profitability measure is wanted (Gilbert and Wheelock 2007). According to (Ansarul Haque 2014), the role of Return on Asset (ROA) is to display the percentage of profit which any company's gain against its entire capital investment. It measures efficiency of the company in using its assets to generate net income. Higher values of the return on assets show that the company is more effectively managing its assets to produce greater amount of net income, (A shish Gupta 2015).

ROE is a financial ratio that refers to how much profit a company earned compared to the total amount of shareholder equity invested or found on the balance sheet or it is what the

shareholders look in return for their investment (Vincent Okoth 2013). Further, it accentuates over the well management of the organization in order to channelize the capital of the shareholders in right direction to achieve the desired goals. (Ansarul Haque 2014) Various studies had used these profitability indicators either by selecting both of them at once or either of the two separately as profitability measurements. Thus, this study would be conduct with the intention of filling this gap.

1.3 Research question

- 1) How the bank sizes affect banks performance?
- 2) Does net interest margin affect banks performance?
- 3) Does ROE affect banks performance?
- 4) Is ROA affect banks performance?

1.4 Objective of the study

1.4.1 General objective

The general objective of the study would be to assess analysis of financial performance in newly established commercial banks located in Wolkite Town

1.4.2 Specific objective

1. To evaluate the impact of Bank size on the financial performance of commercial bank in Ethiopian.
2. To evaluate the impact of net interest margin on the financial performance of commercial bank in Ethiopian.
3. To assess the effect of ROE on the financial performance of commercial bank in Ethiopian.
4. To assess the effect of ROA on the financial performance of commercial bank in Ethiopian.

1.5 Significance of the study

The researcher was believed that, this research would be providing a number of important notices to the banks management, regulators and investors in Ethiopian banking industry. These may include policy changes, new strategy development and supervision for implementation of the already applied policies & strategies concerning their day to day operation that was considerably affect the net incomes and associated risks of the banks.

The study is also hoped to provide useful information for stakeholders to make better investment decisions and to help banks to mark and re-evaluate their performance based on the performance measurement use in the study.

1.6 Scope and Limitation of the study

The Study was taken in to account the performance of the banks for the period ranging from 2008 to 2012. As a result, it includes newly established commercial banks in past of 5 years and located in Wolkite Town such as, Oromia international bank which is established on 2008 G.C., Buna international bank which is established on 2009 G.C., Birhan international bank which is established on 2009 G.C. and Dehub global Bank which is established on 2012 G.C. Due to the confidentiality of banking industry information the researcher found it fairly tough to access certain type of materials, like off balance sheet items and Non-performing loans data, which was limits the research work.

1.7 Organization of the paper

The research paper is going to have five chapters. Chapter one: an introduction part includes, background of the study, statement of the problems, research question, objectives of the study, (i.e. general objective and specific objective), significant of the study, scope and limitation of the study, and organization of the paper. Chapter two: is literature review. It includes: Theoretical literature review, Empirical literature review and research gap. Chapter three is about research methodology it consists Research Design, Data Type and Source, Methods of Collection, population and sample Design, Methods of Data Analysis. Chapter four is data analysis; and chapter five is about conclusion and recommendation.

CHAPTER TWO

2. LITERATURE REVIEW

2.1 Theoretical review

2.1.1 Factors that affect banks performance

Research in banking and finance has indicated that bank performance is related to internal and external factors. The internal factors relate to banks' characteristics and external factors are described as the economic and legal environment (Athanasoglou, 2008).

1. Internal Factors

Internal factors refer to those factors which are internal to the banking sector which have significant influence on the performance of the any bank. Some of the internal factors are insider's abuse, weak corporate governance, management of the bank etc.

Insiders Abuse

The government owned bank suffered from frequent changes in board membership and many appointments were made based on political affiliation rather than expertise consideration. On sequent upon this, board members saw themselves as representative, of political parties in sharing the national cake emanating there and thus, ascribed their loyalty to the party members rather than the proper running of the bank itself. On the side of the privately-owned banks, shareholders constituted a problem. According to,(Olufon,1992), most of the owner-managers regarded banking as an extension of their operations by appointing their relatives or friends to key positions instead of relying solely on professional managers. Thus, their appointees will mere loyalists who cared for the interest of their masters rather than the business itself. Shareholders quarrels and boardroom squabbles were common among the banks that management attention deviated in favor of unnecessary squabbles.

Weak Corporate Governance

As a result of the insiders abuse of recruiting inexperienced and incompetent personnel to hold key positions in the bank, deterioration of management culture and weak internal control system instigated by the squabbles among the high rank management decision making team, and non compliance with laws and prudential standards, mismanagement seemed to play a major role in bank failure in any country. Bank losses increased and management resorted to hiding the losses in order to buy time and remain in control.

Management of the bank

(Jensen and Meckling,1976) propose that an inverse monotonic relation should exist between the owner-managers control and agency costs, and that, as ownership increases, there is increased incentive for the owner-manager to maximize the value of the firm.

2. External Factors

The external factors are those factors which are outside the banking sector but whose changes have its own impact on the performance of any bank. These include changes in government policies, changes in the economy, and changes in rates by central banks, inflation, etc.

Change in Government Policies

Banks in most economies are the principal depositories of the public's financial savings, the nerve centre of the payment system, the vessel endowed with the ability of money creation and allocation of financial resources and conduit through which monetary and credit policies are implemented. The success of monetary policy, to a large extent, depends on the health of the banking institutions through which the policies are implemented. As a result of this central role of banks in the economy, their activities have to be kept under surveillance to ensure that they operate within the law in line with safe and sound banking practices so that the economy will not be jeopardized. Hence, governments generally legislate to influence and/or directly control banks' activities to suit the developmental objectives of the economy.

The economy

The health of the global economy has a fundamental influence on banks performance because it is ultimately responsible for driving company profits. Broadly speaking if the economy is growing, company profits will be improved and vice versa.

2.1.2 Definitions of Important Terms

A bank is a financial institution that accepts deposits and channels those deposits into lending activities. Banks primarily provide financial services to customers while enriching investors. Government restrictions on financial activities by banks vary over time and location. Banks are important players in financial markets and offer services such as investment funds and loans, a financial statement is written report which quantitatively describes the financial health of a company. This includes an income statement and balance sheet, and often also includes a cash flow statement. Financial statements are usually compiled on a quarterly and annual basis). A balance sheet is a quantitative summary of a company's financial condition at a specific point in time, including assets, liabilities and net worth. The first part of a balance sheet shows all the productive assets accompany owns, and the second part shows all the financing methods. An income statement, also referred as profit and loss statement (P&L), earnings statement, operating statement or statement of operations, is a company's financial statement that indicates how the revenue (money received from the sale of products and services before expenses are taken out, also known as the "top line") is transformed into the net income (the result after all revenues and expenses have been accounted for, also known as the "bottom line"). It displays the revenues recognized for a specific period, and the cost and expenses charged against these revenues, including write-offs (e.g., depreciation and amortization of various assets) and taxes.

Statements of retained earnings show changes in a company's or an organizations retained earnings over a specific period of time. These statements show the beginning and final balance of retained earnings, as well as any adjustments to the balance that occur during the reporting period. This information is sometimes included as part of the balance sheet or it may be combined with an income statement. However, it is frequently provided as a completely separate statement.

2.1.3 Important Concepts

2.1.3.1 Financial Statement Analysis

A careful review of a bank's financial statements can highlight the key factors that should be considered before making a trading or investing decision. Investors need to have a good understanding of the business cycle and the yield curve - both have a major impact on the economic performance of banks. Interest rate risk and credit risk are the primary factors to consider as a bank's financial performance follows the yield curve. Financial statement analysis is important to boards, managers, payers, lenders, and others who make judgments about the financial health of organizations. One widely accepted method of assessing financial statements is ratio analysis, which uses data from the balance sheet and income statement to produce values that have easily interpreted financial meaning, (H. P. George, 2005).

The purpose of financial statement analysis is to examine past and current financial data so that a company's performance and financial position can be evaluated and future risks and potential can be estimated. Financial statement analysis can yield valuable information about trends and relationships, the quality of a company's earnings, and the strengths and weaknesses of its financial position, (W. J. Charles, 2003) Financial statement analysis begins with establishing the objective(s) of the analysis. For example, is the analysis undertaken to provide a basis for granting credit or making an investment? After the objective of the analysis is established, the data is accumulated from the financial statements and from other sources. The results of the analysis are summarized and interpreted. Conclusions are reached and a report is made to the person(s) for whom the analysis was undertaken, (W. J. Charles, 2003).

2.1.3.2 Types of Financial Analysis

The problem of banking and financial system soundness has become more important in all countries over the recent years. The financial sector, and especially the banking system, is vulnerable to systemic crises which has led to the creation of costly safety nets, as depositor insurance schemes with well-known moral hazard problem. It is argued that there is increasing evidence that banks are "black boxes" due to the weak transparency and banks' unwillingness to disclose information, (Hyytinen, 2003).

Horizontal Analysis

When an analyst compares financial information for two or more years for a single company, the process is referred to as horizontal analysis, since the analyst is reading across the page to compare any single line item, such as sales revenues. In addition to comparing dollar amounts, the analyst computes percentage changes from year to year for all financial statement balances, such as cash and inventory. Alternatively, in comparing financial statements for a number of years, the analyst may prefer to use a variation of horizontal analysis called trend analysis. Trend analysis involves calculating each year's financial statement balances as percentages of the first year, also known as the base year. When expressed as percentages, the base year figures are always 100 percent, and percentage changes from the base year can be determined, (Hyytinen, 2003).

Vertical Analysis

When using vertical analysis, the analyst calculates each item on a single financial statement as a percentage of a total. The term vertical analysis applies because each year's figures are listed vertically on a financial statement. The total used by the analyst on the income statement is net sales revenue, while on the balance sheet it is total assets. This approach to financial statement analysis, also known as component percentages, produces common-size financial statements. Common-size balance sheets and income statements can be more easily compared, whether across the years for a single company or across different companies, (Hyytinen, 2003).

Ratio Analysis

Ratio analysis enables the analyst to compare items on a single financial statement or to examine the relationships between items on two financial statements. After calculating ratios for each year's financial data, the analyst can then examine trends for the company across years. Since ratios adjust for size, using this analytical tool facilitates intercompany as well as intra company comparisons.

2.1.3.3 Role of Financial Analysis

Financial analysis today is performed by various users of financial statements. Investors and Management performs the financial analysis to understand how profitably or productively the

assets of the company are used. Lenders and Suppliers of goods look for the ability of the firm to repay the dues on time. For instance, as a deposit holder of a bank, you would be interested in liquidity of the bank and would expect the bank to pay you the amount when you need.

Customers would like to know the long-term solvency of the bank to get continued support. For example, as a borrower, you would like your bank to be healthy and profitable since you will be depending on the bank for your future needs. Of course, employees would be interested in the profitability as well as liquidity of the bank. Financial managers not only prepare financial statements but also analyze the same to get further insight on the performance of the Organization. They need to examine the organization from the perspective of several users so that they can follow the needs of them and satisfy several stakeholders. Sometimes, profitability might be affected when the managers try to satisfy the needs of various stakeholders but if you focus too much on profitability, it might affect the organization in other ways. For instance, we would expect that our deposit holders need liquidity. Financial analysis, which provides historical linkage between various financial components, is useful. Suppose the top management fixes a goal to increase the net income by another twenty percent for the coming year. Using profit to sales linkage, we can estimate additional turnover required to achieve the goal. Once we know additional turnover, it is possible for us to assess how much of additional assets are required (fixed and current assets in the case of manufacturing companies) and then additional funds that are required to buy the assets. Thus financial analysis is a prerequisite for financial planning.

2.1.3.4 Types of Financial Ratios Analysis

2.1.2.4.1 Profitability Ratios

Every firm is most concerned with its profitability. One of the most frequently used tools of financial ratio analysis is profitability ratios which are used to determine the company's bottom line. Profitability measures are important to company managers and owners alike. If a small business has outside investors who have put their own money into the company, the primary owner certainly has to show profitability to those equity investors.

1. Return on Assets (ROA)

The Return on Assets ratio is an important profitability ratio because it measures the efficiency with which the company is managing its investment in assets and using them to generate profit. It measures the amount of profit earned relative to the firm's level of investment in total assets. The return on assets ratio is related to the asset management category of financial ratios.

2. Return on Equity (ROE)

The Return on Equity ratio is perhaps the most important of all the financial ratios to investors in the company. It measures the return on the money the investors have put into the company. This is the ratio potential investors look at when deciding whether or not to invest in the company.

3. Profit to Expenses Ratio (PER)

It measures the operating profitability of the bank with regards to its total operating expenses. The ratio measures the amount of operating profit earned for each dollar of operating expense. The ratio indicates to what extent bank is efficient in controlling its operating expenses. A higher profit to expense ratio means bank is cost efficient and is making higher profits.

4. Net Interest Margin (NIM)

Analysts focus on Net Interest Margin (NIM) ratio because small changes in a bank's lending margin can translate into large bottom line changes. The higher the ratio the cheaper the funding or the higher the margin the bank is obtaining. A bank's net interest margin is a key performance measure that drives ROA. Net interest income is the difference between interest income and interest expense. It is the gross margin on a bank's lending and investment activities.

5. Noninterest Income to Total Assets (NITA)

Noninterest Income to Total Assets (NITA) is an indicator of the operational performance. It indicates the proportion of fees and other income in respect of total assets of banks. This ratio is used as a measure of profitability indicator.

6. Return on Deposit (ROD)

To most financial analysts, Return on Deposit is one of the best measures of bank profitability performance. This ratio reflects the ability of bank management to utilize the customers' deposits in order to generate profits.

2.1.2.4.2 Liquidity ratios

Liquidity ratios attempt to measure a company's ability to pay off its short-term debt obligations.

This is done by comparing a company's most liquid assets to short-term liabilities. The higher liquidity ratios mean bank has larger margin of safety and ability to cover its short-term obligations. Because saving accounts and transaction deposits can be withdrawn at any time, there is high liquidity risk for both the banks and other depository institutions.

In general, the greater the coverage of liquid assets to short-term liabilities the better as it is a clear signal that a company can pay its debts that are coming due in the near future and still fund its ongoing operations. On the other hand, a company with a low coverage rate should raise a red flag for investors as it may be a sign that the company will have difficulty meeting running its operations, as well as meeting its obligations. Measures of bank liquidity include Loan to deposit Ratio (LDR and Loan to Asset Ratio (LAR).

1. Loan to Deposit Ratio (LDR)

This refers to the amount of a bank's loans divided by the amount of its deposits at any given time. The higher the ratio, the more the bank is relying on borrowed funds, which are generally more costly than most types of deposits. Bank with low LDR is considered to have excessive liquidity, potentially lower profits, and hence less risk as compared to the bank with high LDR.

2. Loans to Assets ratio (LAR)

The loan to assets ratio measures the total loans outstanding as a percentage of total assets. The higher this ratio indicates a bank is loaned up and its liquidity is low. The higher the ratio, the more risky a bank may be to higher defaults.

2.1.2.4.3 Risk and solvency ratios

One of many ratios used to measure a company's ability to meet long-term obligations. The solvency ratio measures the size of a company's after-tax income; excluding non-cash depreciation expenses, as compared to the firm's total debt obligations. It provides a measurement of how likely a company will be to continue meeting its debt obligations.

Acceptable solvency ratios will vary from industry to industry, but as a general rule of thumb, a solvency ratio of greater than twenty percent is considered financially healthy. Generally speaking, the lower a company's solvency ratio, the greater the probability that the company will default on its debt obligations.

1. Debt-Equity Ratio (DER)

The Debt to Equity Ratio measures how much money a company should safely be able to borrow over long periods of time. It does this by comparing the company's total debt (including short term and long term obligations) and dividing it by the amount of owner's equity.

This ratio indicates how much the company is leveraged (in debt) by comparing what is owed to what is owned. A high debt to equity ratio could indicate that the company may be over leveraged, and should look for ways to reduce its debt.

2. Debt to Total Assets Ratio (DTAR)

The debt to asset ratio is the percentage of total debt financing the firm uses as compared to the percentage of the firm's total assets. It helps you see how much of your asset the lower the Debt to Asset Ratio, the better, as companies with high amounts of debt introduces more risk. You certainly want to look very hard at companies that have more Total Liabilities than Total Assets, as this is a precarious position for a company to be in. Depending on the industry of the company, you might expect the company to have two or three times as many assets as liabilities. Anything less than this might be a signal that the company is running into trouble.

3. Equity Multiplier (EM)

A measure of financial leverage calculated as Total Assets/Total Stockholders' Equity. Like all debt management ratios, the equity multiplier is a way of examining how a company uses debt to finance its assets. It is also known as the financial leverage ratio or leverage ratio. In other words,

this ratio shows a company's total assets per dollar of stockholders' equity. A higher equity multiplier indicates higher financial leverage, which means the company is relying more on debt to finance its assets.

2.1.2.4.4 Efficiency Ratios

The efficiency ratios and other ratios are key ratios to understanding financial statements. Our ratio calculation spreadsheets reduce time and effort in calculating decision making ratios. They reduce risk for lenders and investors and enable owners, managers and consultants to increase productivity and business profits.

1. Asset Utilization Ratio (AUR)

How effectively the bank is utilizing all of its assets is measured by assets utilization ratio. The bank is presumably said to using its assets effectively in generating total revenues if the AU ratio is high. If the ratio of AU is low, the bank is not using its assets to their capacity and should either increase total revenues or dispose of some of the assets.

2. Income Expense Ratio (IER)

This is the most commonly and widely used ratio in the banking sector to assess the managerial efficiency in generating total income controlling its operating expenses. Income to expense is the ratio that measures amount of income earned per dollar of operating expense. High income expense ratio is preferred over lower one as this indicates the ability and efficiency of the bank in generating more total income in comparison to its total operating expenses.

3. Operating Efficiency Ratio (OER)

It measures managerial efficiency in generating operating revenues and controlling its operating expenses. In other words, how efficient is the bank in its operations unlike income expense ratio, which measures the amount of income earned per dollar of operating expense, operating efficiency is the ratio that measures the amount of operating expense per dollar of operating revenue. Lower operating expense is preferred over higher operating expense as lower it indicates that operating expenses are lower than operating revenues.

2.1.2.5 Limitations of Ratio Analysis

Ratio analysis is useful, but analysts should be aware of these problems and make adjustments as necessary. Ratios analysis conducted in a mechanical, unthinking manner is dangerous, but if used intelligently and with good judgment, it can provide useful insights into the firm's operations. The following are some of the limitations of ratio analysis.

Different Accounting Policies

The choices of accounting policies may distort intercompany comparisons. Example some firm may allow valuation of assets to be based on either revalued amount or at depreciated historical cost. The business may opt not to revalue its asset because by doing so the depreciation charge is going to be high and will result in lower profit.

Creative Accounting

The businesses apply creative accounting in trying to show the better financial performance or position which can be misleading to the users of financial accounting. Ratios are not Definitive Measures Ratios need to be interpreted carefully. They can provide clues to the company's performance or financial situation. But on their own, they cannot show whether performance is good or bad. Ratios require some quantitative information for an informed analysis to be made. Financial statements contain summarized information. Ratios are based on financial statements which are summaries of the accounting records. Through the summarization some important information may be left out which could have been of relevance to the users of accounts. The ratios are based on the summarized year end information which may not be a true reflection of the overall years results.

Interpretation of the Ratio

It is difficult to generalize about whether a particular ratio is 'good' or 'bad'. For example a high current ratio may indicate a strong liquidity position, which is good or excessive cash which is bad. Similarly noncurrent assets turnover ratio may denote either a firm that uses its assets efficiently or one that is undercapitalized and cannot afford to buy enough assets.

Price Changes

Inflation renders comparisons of results over time misleading as financial figures will not be within the same levels of purchasing power. Changes in results over time may show as if the enterprise has improved its performance and position when in fact after adjusting for inflationary changes it will show the different picture.

Technology Changes

When comparing performance over time, there is a need to consider the changes in technology. The movement in performance should be in line with the changes in technology. For ratios to be more meaningful the enterprise should compare its results with another of the same level of technology as this will be a good basis measurement of efficiency.

2.2 Empirical Review

(Kaminsky and Reinhart, 1999), argued that indicators of business failures and nonperforming loans are also usually available only at low frequencies, if at all; the latter are also made less informative by banks desire to hide their problems for as long as possible. This means that it is needed to use as fully and complexly as possible all available financial information from the official financial statements of banks for making financial analysis of banks' performance.

(Sundararajan, 2002), argued that relying too heavily on just a few indicators of bank profitability can be misleading.

While ROA, ROE, and interest margin (and non interest expenses) to gross income remain the key measures, they should ideally be supplemented by the analysis of other operating ratios. Jahangir, Shill and Haque (2007) stated that the traditional measure of profitability through stockholder's equity is quite different in banking industry from any other sector of business, where loan-to-deposit ratio works as a very good indicator of banks' profitability as it depicts the status of asset-liability management of banks. But banks' risk is not only associated with this asset liability management but also related to growth opportunity. Smooth growth ensures higher future returns to holders and there lies the profitability which means not only current profits but future returns as well. So, market size and market concentration index along with return to equity and loan-to-deposit ratio grab the attention of analyzing the bank's profitability. Understanding

the performance of banks requires knowledge about the profitability and the relationships between variables like market size, bank's risk and bank's market size with profitability.

Indeed, the performance evaluation of commercial banks is especially important today because of the fierce competition. The banking industry is experiencing major transition for the last two decades. It is becoming imperative for banks to endure the pressure arising from both internal and external factors and prove to be profitable. (Bhatt & Ghosh, 1992), observed that the profitability of commercial banks depend on several factors some of them are endogenous and some exogenous. The endogenous factors represent control of expenditure, expansion of banking business, timely recovery of loans and productivity.

The exogenous factors consist of direct investments such as SLR (Statutory Liquidity Ratio), CRR (Cash Reserve Ratio) and directed credit programs such as region wise, population wise guidelines on lending to priority sectors. The regulated and restricted regime in the operation of banking system in terms of investment, credit allocation, branch expansion, interest rate determination and internal management eroded the productivity and profitability of commercial banks.

According to, (Al-Shamrari and Salirni, 1998), profitability ratio especially return on equity (ROE) signals the earning capability of the organization. They also suggest that higher return on equity (ROE) ratio is appreciable as it is the primary indicator of bank's profitability and functional efficiency. (Hossain and Bhuiyan, 1990), stated that there is no universally accepted operational definition of performance measures. In broad sense performance level of an enterprise can be measured by the extent of its organizational effectiveness. In the context of services rendered towards public the performance of an organization can be viewed as the extent to which its work is carried out within established specifications for goods and services produced, to the general satisfaction of the clientele served, within given cost and time constraints, and in such a manner as to support or contribute to the achievement of the organization objectives. (Spathis, and Doumpos, 2002), investigated the effectiveness of Greek banks based on their assets size. They used in their study a multi criteria methodology to classify Greek banks according to the return and operation factors, and to show the differences of the banks profitability and efficiency between small and large banks, (Bateswar and Ajay 2007), have made a review on the performance of banking sector in India during post reform period. A

comparative appraisal of banks have been undertaken on the basis of seven indicators of performance namely, Net profit , Credit to deposit ratio (C/D) , Market Share, Business per Employee, Return on Assets, Capital Adequacy Ratio and Non performing Asset to Net Advances.

CHAPTER THREE

3. RESEARCH METHODOLOGY

3.1 Description of the Study Area

The study was conducted on Wolkite town which is found in Gurage zone, SNNP region. Wolkite is a town which is found in south-western Ethiopia. It is the administrative center of the Gurage zone. This town has a latitude and longitude of 8°17'N 37°47'E /8.283°N 37.783°E respectively. The town has 3 sub cities those are Gubre, Addis, and Bekur and there are also found some Keble in this town.

3.2 Study Design

This research used descriptive research design in order to answer basic research question. The major purpose of descriptive research is to describe the state of situation as it exists. It gives a basic description of statistical unit under investigation. This is because the main objective of this study to identify and describe the trend financial performance analysis approaches was used. Five years audited financial reports from 2008 to 2012 of the newly established of commercial banks was taken for analysis purpose. Year of establishment, amount of capital reserve and number of branches will take as a criterion for selecting these commercial banks for analysis purpose. Based on this criterion, four commercial banks such as Oromia international bank, Buna international bank, Dehub global bank, and Birhan international bank was selected.

3.3 Types and Source of data

The type of data that would be used for conducting this research is both primary and secondary data. When primary type of data would be collected from the banks' employees through questionnaire and would be gathered through interview which was made to banks' managers. The secondary type of data is obtained from the audited annual financial reports of the commercial banks, literature from various books, journals, newspapers, magazines, reports of the National Bank of Ethiopia and various web sites.

3.4 Methods of Data Collection

To undertake this study, the researcher was used different method of data collection. To collect the primary data, the researcher was distributed questioners for the employees of the bank and interview for the banks manager of the bank and other higher status employees of the questionnaire distributions. The distribute questioners was contain close ended questions and open ended question. The interview of the manager was contain unstructured form of interview. The reason for the selection of unstructured interview is the greatest value lies in the depth and details of information that the researcher gets from personal interview. And also the researcher was used close ended types questioners because, the close ended questions are favored over open ended questions for their efficiency and specificity, they are easier to measure ,recorded, coded and analyzed. The secondary data are collected by verifying the annual financial reports of the commercial banks, newspapers, and various websites if necessary. After the data collected from different sources, the researchers would use descriptive method of data analysis. The data would have analyzed and interpreted by using descriptive data analysis such as percentage and tabulation. It is to describe, summarize and present the data.

3.5 Population, Sampling Technique and Sampling Size

The researcher would be selecting sample from the total population of seventeen commercial banks and from total population select a sample of four commercial banks because there are only four newly established commercial banks which are found in Wolkite town. Year of establishment, amount of capital reserve and number of branches was taken as a criterion for selecting these commercial banks for analysis purpose. Based on this criterion, four commercial banks such as Oromia international bank, Buna international bank, Dehub global bank, and Birhan international bank will select. The total employees in these Banks are 61 among from this the researcher selects 38 employees. To select the employees the researcher used probability sampling method. Under this method the researcher use random sampling techniques because these techniques would be fair and provide equal chance for each and every employee to be selected as a sample. Therefore it needs sampling techniques which is the true representative of the population.

Sample size would be determined as:

$$n = \frac{N}{1 + N \cdot (e)^2}$$

where, n=sample size

N= total population

e= non-confidence level (persuasion)

The study would be used confidence level of 90% and 10% persuasion level. Then the sample size of this study was

$$n = \frac{61}{1 + 61(0.1)^2} = \frac{61}{1.61} = 37.8 \sim 38$$

3.6 Method of Data Analysis

In any research undertaking, the methodology to be followed is determined by the nature of the problem statement or more specifically by the research objectives. Here in this study the analysis consists of data of five years, from 2008 to 2012 and among each year between the chosen banks. Five years audited annual financial reports of the newly established of commercial banks will take for analysis purpose. A trend appraisal of financial ratios and changes in growth will consider measuring it; the analyzed information is present by using tables and percentage which are appropriate to explain the findings.

CHAPTER FOUR

4.1 Data Analysis, Interpretation and Presentation

This chapter deals with data analysis, interpretation and presentation on the base of data gathered through questionnaire. In order to acquire data for the study 38 questionnaires were distributed to employees of those Banks. Descriptive analysis was used to interpret the data gathered through questionnaire. The first part asks about respondents characteristics the second part contains questions about analysis of financial performance. In this particular chapter the data was analyzed and interpreted depending on their respective information.

4.2 General Information of Respondents

The first part of the questionnaire was designed to gather information about respondent characteristic. It has general information about the respondent's characteristics like gender, age educational level.

Table4.4 Descriptive analysis of sex and age of respondents

No	Description	No of respondents	Percentage
1	Sex		
	Male	32	84.2%
	Female	6	15.8%
	Total	38	100%
2	Age	No of respondents	Percentage
	20-25	4	10.5%
	25-30	17	44.7%
	30-35	12	31.6%

	35 above	5	13.2%
	Total	38	100%

Source: questionnaires (2020)

As shown in the above table 4.1 out of the total respondents 84.2% are male and the remaining 15.8% are female. This shows that most respondents are male and females are very low. Accordingly, the above table shows that 10.5% of employers are between age 20-25 and 44.7% are between age 25-30 and 31.6% of employees are between age 30-35 and above 35 years are 13.2%. As a result, the majority of employees are in the age group of 25-30 years.

Table 4.5 The educational level of the respondents

Educational level	No of respondents	Percentage
Degree	7	18.4%
Master	30	79%
PH.D	1	2.6%
Above	0	0
Total	38	100%

Source: questionnaires (2020)

The table 4.2 shows that 18.4% of the respondents have a degree, 79% of them have a master's and the remaining 2.6% of them have a PHD. As a result, the majority of employees have master's degrees.

4.3 Factors affecting Bank performance

4.3.1 Return on Asset (ROA)

Return on asset (ROA), also known as return on total assets, is a measure of how much profit a business is generated from its capital. The Return on Assets is an important profitability ratio because it measures the efficiency with which the company is managing its investment in assets and using them to generate profit. It measures the amount of profit earned relative to the firm's level of investment in total assets. The return on assets is related to the asset management category of financial ratios. The higher the percentage, the better it will be, because that means the company is doing a good job using its assets to generate profits.

Table 4.6 Descriptive analysis of ROA

Question	Answer	No of respondents	Percentage
(1) Does the ROA affect banks performance?	Yes	28	73.7%
	No	10	26.3%
	Total	38	100%

Source: questionnaires (2020)

The above table 4.3 show that 28(73.7%) of the respondents' representing the return on asset affect banks performance. On the other hand the 10 (26.3%) of the respondents indicated as the return on asset has not affect bank performance. From this the researchers conclude that ROA is one way of affecting bank performance.

4.3.2 Return on equity (ROE)

Return on equity (ROE) is a measure of financial performance calculated by dividing net income by share holder equity. It measures the return on the money the investors have put into the company. This is the potential investors look at when deciding whether or not to invest in the

company. The return on equity measures how much the shareholders earned for their investment in the company. The higher percentage, the more efficient management is in utilizing its equity base and the better return is to investors. According to Al-Shamrnari and Salirni (1998) profitability ratio especially return on equity (ROE) signals the earning capability of the organization. They also suggest that higher return on equity (ROE) is appreciable as it is the primary indicator of bank's profitability and functional efficiency.

Table 4.4 Descriptive analysis of ROE

Question	Answer	No of respondents	Percentage
(2)Does the ROE affect banks performance?	Yes	27	71.1%
	No	11	28.9%
	Total	38	100%

Source: questionnaires (2020)

The above table 4.4 show that 27(71.1%) of the respondent representintg the return on equity affect banks performance. On the other hand the 28.9%of the respondents indicated the return on equity has not affect bank performance. From this the researchers conclude that ROE is one way of affecting bank performance.

4.3.3 Net Interest Margin (NIM)

Net interest margin (NIM) is a measurement comparing the net interest income a financial firm generates from credit products like loans and mortgages with the outgoing interest it pays holders of saving accounts and certificates of deposit (CDs). Analysts focus on net interest margin because small changes in a bank's lending margin can translate in to large bottom line changes. The higher of cheaper the funding or the higher the margin the bank is obtaining. A bank's net interest margin is a key performance measure that drives ROA.

Table 4.5 Descriptive analysis of NIM

Question	Answer	No of respondents	Percentage
(3)Does the net interest margin affect banks performance?	Yes	26	68.4%
	No	12	31.6%
	Total	38	100%

Source: questionnaires (2020)

The above table 4.5 show that 26(68.4) of the respondent representintg the net interest margin affect banks performance. On the other hand the 12(31.6%) of the respondents indicated as the net interest margin has not affect bank performance. From this the researchers conclude that NIM is one way of affecting bank performance.

4.3.4 Bank Size

Bank size is ratio represents the ownerships of assets by banks. High asset ownership enables banks to offer more financial services at low cost.

Table 4.6 Descriptive analysis of bank size

Question	Answer	No of respondents	Percentage
(4)Does the bank size affect banks performance?	Yes	25	66%
	No	13	34%
	Total	38	100%

Source: questionnaires (2020)

The above table 4.6 show that 25(66%) of the respondent representintg the bank size affect banks performance. On the other hand the 13(34%) of the respondents indicated as the bank size

has not affect bank performance. From this the researchers conclude that bank size is one way of affecting bank performance.

4.3.5 Asset Quality

The asset quality rating reflects the quantity of existing and potential credit risk associated with the loan and investment portfolios, other real estate owned other assets, as well as off -balance sheets transactions.

Table 4.7 Descriptive analysis of asset quality

Question	Answer	No of respondents	Percentage
(5)Does the asset quality examine commercial banks performance?	Yes	22	58%
	No	16	42%
	Total	38	100%

Source: questionnaires (2020)

The above table 4.7 shows that 22(58%) of the respondent representing the asset quality is examine commercial bank performance. On the other hand the 16(42%) of the respondent indicated as the qualities not examine commercial bank performance. From this the researchers conclude that asset quality is one way of examine commercial bank performance.

4.4 Financial behavior

Financial behavior is the capability to capture of understanding overall impacts of financial decisions on ones (person, family, community, and country) circumstance and to make the right decisions related to the cash management, precautions and opportunities for budget planning. It can be defined as any human behavior that is relevant to money management. The financial position is the status of financial well-being regarding of a commercial bank is important to meet every current obligation. Financial position of bank it helps to consider the economic backdrop in each market the bank operates in, including the level of economic activities, interest rates, inflation and employment. In general, stronger economic backdrops are positive for banks and

support their ability to remain viable and meet their current obligations. Management capability refers to activities that build commercial banks competency and capability in the commercial banks below the senior leadership levels. This process identifies commercial banks capabilities required to meet strategic goals and ensures continual alignment of employee development, career progression, and talent management to evolving business needs. Capability management measure commercial banks by: skill assessment and transferability, competency modeling and maintenance, talent pool management and succession management for lower level leaders and all other employees.

Table 4.8 Descriptive Analysis of Financial Behavior

Question	Answer	No of respondents	Percentages %
6) Does the banks financial position to meet it current obligation?	Yes	12	31.6%
	No	26	68.4%
	Total	38	100%
7) Does the bank face difficulties in financing its loan and future investment expansion?	Yes	25	66%
	No	13	34%
	Total	38	100%
8) Is there any factors affecting the branch financial performance from business environment point of view?	Yes	27	71.1%
	No	11	28.9%
	Total	38	100%
9) Does management capability to measure commercial banks?	Yes	29	76.3%
	No	9	23.7%
	Total	38	100%

The above table 4.8 item (6) 12(31.6%) of the respondents representing are responses that the banks financial positions to meet its current obligation and 26 respondents represents 68.4% are response that the bank financial position doesn't meet its current obligation. That means most of the respondents 26(68.4) are banks financial position doesn't meet it current obligation.

Item (7) 25 respondents, representing 66% are response that the bank face difficult in financing its loan and future investment expansion and only 13 respondents, representing 34% are the bank doesn't face difficulties in financing its loan and future investment expansion. So, the most of the respondents 66% are the bank face difficult in financing its loan and future investment expansion. Item (8) 27(71.1%) of the respondents, represent response that there is factor affecting branch financial performance from business environment. And 11 respondents, represents 28.9% there is no factor affecting branch financial performance from business environment. Item (9) 29 respondents, representing 76.3% response that management capability to measure commercial banks and 9 respondents, representing 23.7% are management capability doesn't measure commercial banks.

4.5 Comparative Analysis of Oromia international Bank with Other Private Commercial Banks

In this section, the financial performance of Oromia international bank in comparison with the financial performance of other private commercial banks in Ethiopia is presented. Those banks which were established from 2008 in Wolkite town, with almost similar number of branches. Based on these criteria; the banks which were taken for comparison purpose are Buna international bank, Dehub global bank and Birhan international bank. The name of the banks, number of branches and date of establishment are presented here under.

Table 4.9 Descriptive analysis of OIB financial performance with other commercial bank

Name of bank	Established in GC	Number of branch
OIB	2008	1
BIB	2009	1
DGB	2012	1
BIB	2009	1

Source: questionnaire (2020)

The above table 4.9 as indicate that all those banks established from 2008 GC. Those banks such as OIB, BIB, DGB and BIB established in Wolkite town 2008, 2009, 2012 and 2009 respectively. Those banks have the same branch. From those four banks Oromia international bank established the first 2008 GC in Wolkite town so Oromia international bank have more customer than BIB, DGB and BIB because Oromia international bank established before those banks.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATION

5.1 Conclusion

Financial sector of an economy plays an important role in its economic development and prosperity of the country. Banks play very significant role in the economies of the nation. The well being of the economy is highly related to the soundness of its banking system. Return on asset, return on equity, Asset quality, management efficiency, size of the bank and net interest margin were the major significant variables to affect performance of commercial banks. The Return on Assets is an important profitability ratio because it measures the efficiency with which the company is managing its investment in assets and using them to generate profit. Return on equity (ROE) is a measure of financial performance calculated by dividing net income by share holder equity. It measures the return on the money the investors have put into the company. Net interest margin (NIM) is a measurement comparing the net interest income a financial firm generates from credit products like loans and mortgages with the outgoing interest it pays holders of saving accounts and certificates of deposit (CDs). Bank size is ratio represents the ownerships of assets by banks. High asset ownership enables banks to offer more financial services at low cost. The asset quality rating reflects the quantity of existing and potential credit risk associated with the loan and investment portfolios, other real estate owned other assets, as well as off -balance sheets transactions.

This study entitled 'Analysis of Financial Performance in newly established commercial banks conduct. Both the trend and financial performance analysis approaches would be used. Five years an audited financial report from 2008 to 2012 of the commercial banks was taken for analysis purpose. Generally the objective of the study would be evaluates the financial performance in newly established commercial banks in Wolkite Town by analyzing its past five year's financial performance of the bank with other commercial banks.

5.2. Recommendation

- Since the number of banks is increasing from time to time, it is important to have a responsible centralized body which can provide enough information about the sector to interested parties like academicians, researchers, analysts, etc. But in Ethiopia there is no centralized party which can provide the needed information recently. Therefore, the concerned parties (may be National Bank of Ethiopia or Ministry of Finance) have to establish such type of responsible body to facilitate fast information flow concerning the sector.
- Financial performance analysis is useful tool to know the financial health of any company. This is done by either analyzing the past financial performance trend of the company or comparing its performance to the performance of other similar companies. To compare one company's performance to the performance of the other, a standard bench mark is needed, but there is no a settled standard against which comparison can be made in Ethiopia. Even though there are a number of important determinant variables which have significant influence on the financial performance of any company such as political affairs, inflation, economy, management philosophy, etc, they were not considered in this study. Therefore, further research works should be done in this area by considering all these variables.
- As asset quality, management efficiency, liquidity and net interest margin are determinant factors to increase return on asset and return on equity, banks shall give special attention.
- Since total asset or size of the bank is determinant factor to increase return on asset, banks shall concentrate on increasing their total asset by mobilizing deposit and converting the deposit to loan.

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APPENDIX
WOLKITE UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
DEPARTMENT OF ACCOUNTING AND FINANCE

Dear respondents;

I am graduate student at Wolkite University college of Business and Economics, Department of Accounting and finance. Currently, I am conducting research titled “Analysis of Financial Performance in Newly Established Commercial Bank. In Case of Wolkite Branch)” as a partial fulfillment of requirements for the award of bachelor degree of Accounting and Finance.

The purpose of this questionnaire is to gather data for the proposed study, hence you are kindly asked to the success full completion of the study by providing the necessary information. Your participation is entirely voluntarily and the questionnaire is completely anonymous. I confirm you that the information you share me will stay confidential and only for the purpose of academic purpose only. So you genuine and timely response is key for the success of this study. For all I want thank you in advance for your cooperation and dedication of your precious time to fill this questionnaire.

Note;-

- 1) NO need of writing your name.
- 2) Put this “√or × mark on the appropriate box

Part I –Demographic Information

1) Age: - 22- 29 30- 39 40-45 above 45 years

2/ Sex: Male Female

3/ Education Qualification:

First Degree Masters degree PHD

Part II: Please express your level of agreement in the following questions by putting \surd or \times in appropriate box.

1) Does the ROA affect banks performance?

Yes No

2) Does the ROE affect banks performance?

Yes No

3) Does the banks financial position to meet it current obligation?

Yes No

4) Does the bank face difficulties in financing its loan and future investment expansion?

Yes No

5) Does the asset quality examine commercial banks performance?

Yes **No**

6) Is there any factors affecting the branch financial performance from business environment point of view?

Yes **No**

7) Does net interest margin affect the bank performance?

Yes **No**

8) Does the size of bank affect your bank performance?

Yes **No**

9) Does management capability to measure commercial banks?

Yes **No**

