



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

**FACTOR AFFECTING FINANCIAL PERFORMANCES OF PRIVATE  
COMMERCIAL BANK OF ETHIOPIA (CASE OF AWASH BANK)**

A Research paper Submitted to the Department of Accounting and Finance in  
Partial Fulfillment of the Requirements for the Award Bachelor of Degree in Art  
(BA) in Accounting and Finance

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## **ABSTRACT**

*This study entitled ‘Financial Performance Analysis’ was conducted on Awash Bank. Both the trend and comparative financial performance analysis approaches were used. Five years audited financial reports from 2005 to 2009 of the private commercial banks were taken for analysis purpose. So far, most researches have tried to assess the growth of private banks relative to state-owned banks in terms of asset ownership and loan granting ability. But this paper has tried to assess whether the private commercial banks are financially sound or not by specifically considering only the private commercial banks and by Awash bank as a case study. The objective of the study is to evaluate the financial performance of Awash Bank by analyzing its past five year’s performance trend and comparing the financial performance of the bank with other private commercial banks operating in Ethiopia (United Bank, Wegagen Bank and Nib International Bank). Financial ratios were considered to measure the credit quality, liquidity, efficiency and profitability as well as sustainability (financial and operating) of the private commercial banks.*

*Key words: Profitability, Liquidity, Risk and Solvency, Efficiency*

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## Acronyms

AB/AIB=Awash bank

UB=United Bank

WB=Wegagen Bank

NIB=Nib International Bank

ROA=Return on Asset

ROE=Return on Equity

NIM=Net Interest Margin

IT=Information Technology

CROA=Cash Return on Asset

PER=Profit to Expense Ratio

NITA=Non-interest Income to Total Asset

ROD=Return on Deposit

LDR=Loan to Deposit Ratio

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

L/C=Letter of credit

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# CHAPTER ONE

## 1. Introduction

### 1.1. Background of the study

A commercial bank is a type of financial system and a type of bank. Commercial banking is also known as business banking. It is a bank that provides checking accounts, savings accounts, and money market accounts and that accepts time deposits. (B. Fabozzi, 2003) Bank Plays. Commercial banks play a vital role in the economy for two reasons: they provide a major source of financial intermediation and their checkable deposit liability represent the bulk of the nation's money stock. Evaluating their overall performance and monitoring their financial condition is important to depositors, owners, potential investors, managers and of course regulators. Currently financial ratios are often used to measure the overall financial soundness of a bank and the quality of its management. (Y. Piyu, 2004)

Beyond their traditional role in project finance transactions, commercial banks are developing new roles in providing advisory financial performance activity; construction financing; intermediation permanent long-term fixed-rate financing; commodity, currency, and interest rate risk management; foreign tax absorption; and working capital financing for projects throughout the world. Looked at separately, the development of these roles is a response to increasing competition both among commercial banks and between commercial banks and other institutional lenders and intermediaries to meet an explosion of worldwide project finance needs.

Commercial banks differ considerably in their ability to provide such Activity. (The Financier, May 1995). The emergence of banks owned by the local private sector began in the mid-1970 in Africa.

Financial markets in Africa in the period since independence was are dominated by foreign and government-owned commercial banks. But deficiencies in financial intermediation provided an opportunity for local private investors to enter financial markets, especially in those countries where the domestic private activity was relatively well developed, such as Kenya and Nigeria. (The Financier, May 1995).

Financial resource like any other economic resources is believed to be the critical input in any country's development endeavor. This resource is considered to be one of the most critical factors impeding the socio-economic development of countries like Ethiopia.

The vast majority of Ethiopians are still deprived of the capacity to participate in the wealth creation of the nation due to the extreme shortage of the resource as well as the obstacles in the legal framework of access to it.

Improving access to financial performances activity is an important development tool, because it helps in creating employment opportunities for the unemployed and increases their income and consumption, which would in the final analysis reduce poverty. (S. Arega, 2007) Access to financial performance to the poor also facilitates economic growth by easing liquidity constraints in production, by providing capital to start-up new enterprises or adopt new technologies, and by

helping producers to assume production risk. Moreover, the transformation from subsistence to a more commercially driven economy requires capital formation and increased demand for working capital. To secure such objectives managing the financial resources of any company in the most efficient and effective way is compulsory. The Ethiopian economy was been state controlled through a series of industrial development plans since the Imperial Government of Haile Selassie. It is managed as a Soviet-style centrally planned economy under a socialist government from 1976-1991. (K. Kozo, 2007).

The post-1991 government led a transition to a more market-based system. Although state control has been reduced and domestic and foreign (private) investment promoted, the state still plays a dominant role in the economy today.

Ethiopia's financial performances activity 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.

A series of financial performances reforms has been introduced since 1994, when private banks was 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 performances development and through integrating Ethiopia into the global economy. (K. Kozo, 2007). For the purpose of a bank's financial analysis, it is important to use a consistent framework for developing its performance indicators.

The analytical framework normally used in this process is a set of financial accounts. Financial statements are therefore the starting point of bank financial appraisal. (A. M. Santomero, 1997). Banks' performance monitoring, analysis and control needs special analysis in respect to them operation and performance results from the viewpoint of different audiences, like investors/owners, regulators, customers/clients, and management themselves. (A. August,2002) The problem of banking and financial system soundness has become more important in all countries over the recent years. The financial performances, 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 week transparency and banks' unwillingness to disclose information (Hyytinen, 2003).

This paper was focused in examining the financial performance of Awash bank versus other private commercial banks in Ethiopia using both the trend and comparative analysis approaches of financial performance.

## 1.2 Statement of the Problem

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

Several studies have found that the performance of private banks is typically better than state owned banks. The total assets and return on assets (ROA) of Ethiopian state-owned and private banks from 1998 to 2006 shows that the share of assets of private banks grew from 6.4 percent in 1998 to 30.4 percent in 2006.

The growth of private banks was much faster than state-owned banks, although more than two-thirds of assets are still held by state-owned banks. It is also an evident that private banks show generally better performance than state-owned banks. In seven out of nine years, private banks would higher ROA than state-owned banks. (K. Kozo, 2007).

Thus, the purpose of this project is to analyze the financial performance of private commercial banks in Ethiopia to reinforce the previous works.

So far, most researches have tried to assess the growth of private banks relative to state-owned banks in terms of asset ownership and loan granting ability. But this paper was being tried to assess whether the private commercial banks are financially sound or not by specifically taking only the private commercial banks.

As to the Awash bank there was no information related to the financial performance of the company. Hence, this becomes the basis of the study and the researcher has tried to analyze the financial performance of the bank by considering its past performance using the trend analysis and by comparing it with other private commercial banks using the comparative financial performance analysis approach.

### 1.3 Objectives of the Study

#### 1.3.1 General Objective:

The general objective of the study is to compare the financial performance of Awash bank with other private commercial banks operating in Ethiopia.

#### 1.3.2 Specific Objectives

The specific objectives of the study the conceptual of the schema of the relationship the dependent variable return of asset and independent (bank specific) variables is depicted.

- 1) To assess the trend financial performance of Awash bank for the last five years.
- 2) To evaluate the financial profitability of Awash bank?
- 3) To analyze the financial performances of Awash bank?
- 4) To compare the financial performance of awash bank versus the other private commercial banks average for the last five years.

5) To give recommendations for the stakeholders of the banking sector.

#### **1.4 Research Questions**

1. What looks like the financial performance of awash bank for the last five years?
2. How profitable is Awash bank?
3. How sustainable are the private commercial banks financially?
4. What looks like the financial performance of Awash bank versus the other private commercial banks?

#### **1.5 Significance of the Study**

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) Since it revolves around one of the popular issues of current business scenario, the financial aspect, the following are the expected significances of the study.

It provides some insight about the financial performance analysis approaches of private commercial banks.

It has identified the strong and weak sides of the private commercial institutions concerning their finance management.

It also provides significant information related to the sector for those individuals who are interested to join the business as well as for those who are in the policy making responsibility.

It was being tried to give appropriate recommendations to the concerned companies so that it was help them to reassess their current practices.

#### **1.6 Scope of the Study**

This study focuses on one company, Awash Bank, and it has analyzed the financial performance of the bank by using both the trend and comparative approaches. The study was considered only those private commercial banks which has established before the year 2009.

#### **1.7 Organization of the Paper**

The organization of this study takes the following form: The first chapter is introductory which consists of background of the study, statement of the research problem, objectives of the study, research methodology, significance of the study and scope and limitation of the study.

The second chapter provides the related summary of literature review on the financial performance analysis. Chapter three: Literature Review. Chapter four is devoted to analysis of data and discussion based on data collected; Chapter five concludes the study and provides relevant recommendations.

## CHAPTER TWO

### 2.1 LITERATURE REVIEW

#### Introduction

##### 2.1.1 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. (<http://www.investorwords.com/401/bank.html>)

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. ([http://www.investorwords.com/1957/financial\\_statement.html](http://www.investorwords.com/1957/financial_statement.html))

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. ([http://www.investorwords.com/1957/financial\\_statement.html](http://www.investorwords.com/1957/financial_statement.html))

Statements of retained earnings show changes in a company's or an organization's 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. ([http://www.investorwords.com/1957/financial\\_statement.html](http://www.investorwords.com/1957/financial_statement.html))

##### 2.1.2 Therotical review

##### **Factors that affect banks performances**

Researchers in banking and finance have 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 insiders' 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 are makes based on political affiliation rather than expertise consideration. Consequent upon this, board members say themselves as representative, of political parties in sharing the national cake emanating there of and thus, described 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), 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 have mere loyalists who cared for the interest of their masters rather than the business itself. Shareholders quarrels and boardroom squabbles are 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 Mackling (1976) propose that an inverse monotonic relation should exist between the owner-manager's 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 conduct 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. (<http://eurojournals.com>) 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.

### Changes in Rates by Central Banks

Looking at the changing scenario, central banks keep on changing rates like cash reserve ratio, interest rate, etc. These rates have a direct relation with the bank's performance. Thus, a change in these rates or even a speculation changes in these rates have affect banks performance a lot. Inflation Economists will generally argue that more information is better. Having a central bank more fully communicate its objectives, its assessment of economic conditions, and the expected effects of its policy actions will enhance social welfare, because agents will be better able to align their decisions with those of the central bank and the economy will adjust more smoothly.

As Woodford (2005) argues, monetary policy is more effective when it is expected, since better information on the part of financial markets about central bank actions and intentions implies that the change in the policy rate required to achieve the desired outcome can be much more modest when expected future rates also move.

### 2.1.3 Important Concepts

#### 2.1.4. 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

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)

#### *2.1.4.1. 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.

#### *2.1.4.2. Role of Financial Analysis*

Financial analysis today is performed by various users of financial statements. Investors and Management perform 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. (<http://vpatras.blogspot.com/>)

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.

If we plan for more liquidity, it might affect profitability. (<http://vpatras.blogspot.com/>) On the other hand, if we continue to have low liquidity, we may not get funds or we need to pay more interest to attract funds.

While financial analysis is often used for evaluating current or historical performance, management uses the input of such analysis for future planning exercise. For instance, in preparing budgets, the inputs of financial analysis are extensively used. Financial analysis provides linkage between operating activities and funding activities. Normally, top management sets the goal and operational managers then determine the level of operations required to achieve the goal. It would be difficult to increase the level of operations without any investments unless there is a huge idle capacity. Thus, increased activity demands more addition to assets and this in turn puts a demand for capital. The first step in this process is to know how much of additional assets we need and how much of capital we need to mobilize from various sources. (<http://vpatras.blogspot.com/>)

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 other 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(<http://vpatras.blogspot.com/>)?

#### *2.1.4.3. Users of Financial Statements*

There are different kinds of users of financial statements. The users of financial statements may be inside or outside the business. They are classified and detailed as follows:

## 1. Internal Users

The internal users are the individuals who have direct bearing with the organization and include the following. (contactus@mapssoftworld.com)

### Managers and Owners

For the smooth operation of the organization the managers and owners need the financial reports essential to make business decisions. So as to provide a more comprehensive view of the financial position of an organization, financial analysis is performed with the information supplied in the financial statements. The financial statement is used to formulate contractual terms between the company and other organizations. A variable of the financial statement like the current debt to equity ratio is important in deciding the amount of long-term capital that would be required to be raised. The financial statements of other companies can also provide investment solutions to different companies. Sometimes it becomes difficult to decide the right field in which financial resources may be channelized. In such situations the financial statements of other companies provide the appropriate guideline. (contactus@mapssoftworld.com)

### Employees

The financial reports or the financial statements are of immense use to the employees of the company for making collective bargaining agreements. Such statements are used for discussing matters of promotion, rankings and salary hike. (contactus@mapssoftworld.com)

## 2. External Users

Institutional Investors the external users are basically the investors who use the financial statements to assess the financial strength of a company. This would help them to make logical investment decisions.

### Financial Institutions

The financial statements are also used by the different financial institutions like banks and other lending institutions to decide whether to help the company with working capital or to issue debt security to them. (contactus@mapssoftworld.com)

### **Government**

The financial statements of different companies are also used by the government to analyze whether the tax paid by them is accurate and is in line with their financial strength.

### Customers

The relationship between a firm and its customers can extend over many years. In some cases, these relationships take the form of legal obligations associated with guarantees, warranties, or deferred benefits. In other cases, the long-term association is based on continued attention to customer service. (contactus@mapssoftworld.com)

## Financial Ratios

A financial ratio (or accounting ratio) is a relative magnitude of two selected numerical values taken from an enterprise's financial statements. Often used in accounting, there are many standard ratios used to try to evaluate the overall financial condition of a corporation or other organization. Financial ratios may be used by managers within a firm, by current and potential shareholders (owners) of a firm, and by a firm's creditors. ([www.netmba.com/finance/ratios/](http://www.netmba.com/finance/ratios/))

### *2.1.4.4. Types of Financial Ratios Analysis*

#### *2.1.4.5. 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.

(<http://www.investopedia.com/terms/p/profitabilityratios.asp>)

#### 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. (<http://www.investopedia.com/terms/p/profitabilityratios.asp>)

#### 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 (<http://www.investopedia.com/terms/p/profitabilityratios.asp>)

#### 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. (<http://www.investopedia.com/terms/p/profitabilityratios.asp>)

#### 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. (<http://www.investopedia.com/terms/p/profitabilityratios.asp>)

#### 5. Non-interest Income to Total Assets (NITA)

Non-interest 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. (<http://www.investopedia.com/terms/p/profitabilityratios.asp>)

#### *2.1.4.6. 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). ([www.investopedia.com](http://www.investopedia.com))

##### 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. ([www.investopedia.com](http://www.investopedia.com))

##### 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 riskier a bank may be to higher defaults. ([www.investopedia.com](http://www.investopedia.com))

#### *2.1.4.7. 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.

#### **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 overleveraged, and should look for ways to reduce its debt. Equity and debt are two key figures on a financial statement, and lenders or investors often use the relationship of these two figures to evaluate risk. The ratio of your business' equity to its long-term debt provides a window into how strong its finances are. Equity will include goods and property your business owns; plus, any claims it has against other entities. Debts will include both current and long-term liabilities. (<http://www.fimarkets.com/pagesen/solvency-ratio-mcdonoughcooke.htm>)

#### **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 assets are financed using debt financing. The lower the Debt to Asset Ratio, the better, as companies with high amounts of debt introduce 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. (<http://www.fimarkets.com/pagesen/solvency-ratio-mcdonough-cooke.htm>)

#### **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. (<http://www.fimarkets.com/pagesen/solvency-ratiomcdonough-cooke.htm>)

#### ***2.1.4.8. 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. (<http://kbr.dnb.com/help/ratios/efficiency-ratios.htm>)

##### **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

(<http://kbr.dnb.com/help/ratios/efficiency-ratios.htm>)

##### **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 vis-à-vis 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. (<http://kbr.dnb.com/help/ratios/efficiency-ratios.htm>)

##### **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. (<http://kbr.dnb.com/help/ratios/efficiency-ratios.htm>)

#### ***2.1.4.9. 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. (<http://www.kutenk.com/tag/limitations-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 year's 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, non-current 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.

## **Different Financial and Business Risk Profile**

No two companies are the same, even when they are competitors in the same industry or market. Using ratios to compare one company with another could provide misleading information. Businesses may be within the same industry but having different financial and business risk. One company may be able to obtain bank loans at reduced rates and may show high gearing levels while as another may not be successful in obtaining cheap rates and it may show that it is operating at low gearing level. To an uninformed analyst he may feel like company two is better when in fact its low gearing level is because it cannot be able to secure further funding.

## **Impact of Government Influence**

Selective applications of government incentives to various companies may also distort intercompany comparison. One company may be given a tax holiday while the other within the same line of business not, comparing the performance of these two enterprises may be misleading.

## **Window Dressing**

These are techniques applied by an entity in order to show a strong financial position. This can improve the current and quick ratios and make the balance sheet look good. However, the improvement was strictly window dressing as a week later the balance sheet is at its old position.

## **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 banks' profitability.

Chowdhury (2002) observed that the banking industry of Bangladesh is a mixed one comprising nationalized, private and foreign commercial banks. Many efforts have been made to explain the performance of these banks. 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 depends 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-Shamrarni 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.

Spathes, and Duomos, 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 bank's profitability and efficiency between small and large banks Bates war and Ajay (2007) have made a review on the performance of banking sector in India during post reform period. A comparative appraisal of banks has 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. The paper reveals that public sector banks have improved considerably and their performance was now comparable with other banks. Yet, they were lagging behind in trust areas such as business per employee, asset quality, and non-performing asset to net advances, and capital adequacy.

In addition, a lot of literatures are developed to examine the factor affecting of operational performances of private banks but those study show different and even contradictory results. This shows that is no consensus in the banking literature on the factor affecting operational performance of private banks.

The researcher has expected two additional variables are affects operational performance of private banks those are natural disasters and disorder between the peoples.

## 2.3 Research Gap

From the review of the relevant literature to the factor affecting of operational performance on private commercial bank, it is possible to see the existence of knowledge gap. Even though studies were undertaken by Habtamu (2012), Ebysa (2012), Worku (2010), Semu (2010) and Okoth and Gmechu (2013) and other researcher said on the factor affecting operational performance on private commercial bank, they all fails to include the challenges of private banks are non-performing loans, inflation, lack of appropriate technology, banking business risk, foreign exchange risk and credit risk and the other. Those variables are affects operational performance of private banks

Besides, the growth and development of the private bank of Ethiopia, the total asset and capital, branch network, increasing their outreach to remote of the factor affecting of operational performance of private banks, a lot of literatures are developed to examine the factor affecting of operational performances of private banks but those study show different and even contradictory results. This shows that is no consensus in the banking literature on the factor affecting operational performance of private banks.

In addition to those explained above the researcher will be filled the gap that will not addressed in the literature reviews that is net interest margin (NIM).

## CHAPTER 3

### Data Source and Methodology

#### 3.1 Research Methodology

##### 3.1.1 Study Design

This study entitled ‘Financial Performance Analysis’ was conducted on awash bank. The Qualitative data analysis comparative financial performance analysis approaches are used. Five years audited financial reports from 2005 to 2009 of the private commercial banks were taken for analysis purpose. To select the banks which are used for comparative analysis purpose, purposive sampling method was used. Year of establishment, amount of capital reserve and number of branches was taken as a criterion for selecting these private commercial banks for analysis purpose. Based on this criterion, three other private commercial banks in addition to Awash bank, i.e., Wegagen Bank, United Bank and Nib International Bank (NIB) are selected.

The profitability ratios, liquidity ratios, risk and solvency ratios, efficiency ratios and credit quality ratios which are appropriate to evaluate bank performance were used in the study.

#### 3.2 Data Collection Methods.

The data used for this study were both primary and secondary sources. The audited annual financial reports of the private commercial banks, literature from various books, journals, newspapers, magazines, reports of the National Bank of Ethiopia and various web sites are used as a source of secondary data. In addition, interviews with the concerned managers will be conducted.

#### 3.3 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 2005 to 2009 and comparison is done among each year between the chosen banks. Five years audited annual financial reports of the private commercial banks were taken for analysis purpose.

A trend and comparative appraisal of financial ratios and changes in growth were considered to measure the credit quality, liquidity, efficiency and profitability as well as sustainability (financial and operating) of the private commercial banks. In some cases, the analyzed information is presented by using graphs, tables and diagrams which are appropriate to explain the findings.

#### 3.3. Background of the Banking Industry in Ethiopia

The history of the use of modern money in Ethiopia can be traced back more than 2000 Years (Pankhurst 1968 cited in Gedey 1990). It flourished in what is called the Axumite Era which ran

from 1000 BC to around AD 975. It is widely assumed that the pioneer bank in Middle Ages were the “Venus Bank” it is established in 1157, but this bank is not a kind of bank that as we know today but mainly an office established to transfer public debt from one party to the other.

The modern bank as we know it today has started giving service in 15<sup>th</sup> century in Greece and Italy. But leaving the ancient period and starting from the modern era, like his other modernization legacies, modern banking services in Ethiopia started at the time of Emperor Menelik II. The then Emperor also credited for bringing the first telecommunication, railway and postal services as well as a modern banking service started during his time.

Modern banking in Ethiopia is introduced in 1905. At the time, an agreement is reached between the Ethiopian Emperor Menelik II and a representative of the British owned National Bank of Egypt to open a bank which led to Bank of Abyssinia inaugurated in Feb.16, 1906 by the emperor himself. In the 30’s the bank is bought by the Ethiopian government and the State Bank of Ethiopia and is established by a proclamation issued in august 1942. This bank is later disintegrated to two different banks forming the National Bank of Ethiopia and the Commercial Bank of Ethiopia. (Lulseged, 2005)

Though Emperor Menelik gives the Bank of Abyssinia mentioned above many attractive concessions and when the Bank started operation Mr. D. Mack Glivime is appointed as the first governor of the Bank. At that time the uses and services of a bank was not widely known by the public, and many of its customers were foreigners and only few Ethiopians who knew the uses of a bank was customers. The public rather than putting his money in a bank for a small a limited amount of interest, it prefers to buy land by his money. Because the public was not known about the services of a bank, the bank has to face many problems. The uses of a check are not known at all, and only few foreigners use it. After the Ethio – Djibouti rail way started operation the business of the bank started to expand. The Ethio – Djibouti railway line is constructed in 1894 at the reign of Emperor Menelik. (Gedey, 90).

This bank also opened branch offices in Harar, Dire Dawa, Gore, Dembidolo, and in addition to that it had representative office in Gambella and it also had transit office in port of Djibouti. The bank was responsible for the accounts of the government, to it also lends small amount of money for import and export, and also handles different activities.

After Emperor Haile Selassie came to the throne the operation of the bank is criticized for being inappropriate and is attacked on the grounds that it stands only for its own profit, so the emperor replaced the bank with Ethiopian Bank. And the shares of the bank were presented for the public for sale.

Guaranteed buyers of the share are found and the government paid larger share of the money. And with that sale a new bank emerged as the Ethiopian Bank. The new enterprise named as Ethiopian Bank and it is fully owned by Ethiopia and it is also the first National Bank in Africa. Knowing is a profitable venture the shares are bought by the emperor and the aristocracy.

The Italian invasion in 1935 brought the demise of one of the earliest initiatives in African banking. During the Italian occupation, Italian banks are active in Ethiopia. (NBE, 2007) On April 15, 1943, the State Bank of Ethiopia became the central bank and is active until 1963.

The National Bank of Ethiopia is established in 1963 by Proclamation 206 of 1963 and began operation in January 1964. (NBE, 2007) Prior to this proclamation, the Bank carried out dual activities, i.e., commercial banking and central banking. The proclamation raised the Bank's capital to ten million Ethiopian dollars and granted broad administrative autonomy and juridical personality. Following the proclamation, the National Bank of Ethiopia has entrusted with the following responsibilities:

- To regulate the supply, availability and cost of money and credit.

- To manage and administers the country's International reserves.

- To license and supervise banks and hold commercial banks reserves and lend money to them.

- To supervise loans of commercial banks and regulate interest rates.

- To issue paper money and coins.

- To act as an agent and the Government.

- To fix and control the foreign exchange rates.

However, monetary and banking proclamation No. 99 of 1976 came into force on September 1976 to shape the Bank's role according to the socialist economic Principle that the country adopted. Hence the Bank will be allowed to participate actively in national planning, specifically financial planning, in cooperation with the concerned state organs. The Bank's supervisory area is also increased to include other financial institutions such as insurance institutions, credit cooperatives and investment-oriented banks. Moreover, the proclamation introduced the new 'Ethiopian Birr' in place of the former Ethiopian Dollar that ceased to be legal tender. (NBE, 2007)

This proclamation was in force till the new proclamation issued in 1994 to reorganize the Bank according to the market-based economic policy so that it could foster monetary stability, a sound financial system and such other credit and exchange conditions as are conducive to the balanced growth of the economy of the country. Accordingly, the following are some of the powers and duties vested in the Bank by proclamation 83/1994. (NBE, 2007)

### 3.4 Organizational Profile of Awash bank

On 13 February 1994, ninety years to the day following the establishment of the Awash bank a new privately-owned bank with this historic name, but otherwise not connected with the older bank, came into existence. (www.bank.com) The subscribed capital of the new Bank of Awash are Birr 24.2 million and its authorized capital Birr 50 million, with more than 700 shareholders, in Ethiopian.

### 3.5 Vision, Mission, Values

#### Vision Statement

As Awash bank is one of the recent civilizations in these times and as awash will be the recent bank in the history of Ethiopia, Bank of awash shall be a standard bearer in the banking industry in Ethiopia and an international player capable of being compared favorably with the best institution in its class worldwide. (www.bank.com)

#### *Mission Statement*

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Awash bank's mission is to provide domestic and international banking services through innovative utilization of technology, human and other resources, and be recognized as quality focused, results oriented, financially sound and socially responsible bank.

#### **Values Statement**

Uncompromised Integrity, Honesty, Loyalty, and Ethical Standards. Integrity, honesty, loyalty, and ethical standards are paramount to the Bank's interest. We constantly work to make them part of the social architecture of the Bank.

Dedication to Customer Satisfaction. We care for the customer so as to make Awash Bank his/her first choice.

Enduring Commitment to Quality and Innovation. Awash bank shall provide superior services to the best satisfaction of its customers which shall continually include generation of new products and alternative services.

Commitment to Employees Satisfaction. Awash bank provides its employees a conducive and transparent working environment where they receive fair treatment and equal opportunity in the area of training, promotion, compensation as well as clearly defined individual duty and responsibility that will ensure superior performance.

Social Responsibility. Awash Bank is a socially responsible corporate citizen and always operates mindful of this responsibility.

### 3.6. Types of Services provided awash bank currently offers the following standard services:

Current (checking) Accounts

Savings Accounts

Time Deposits

NR/NT Accounts

Overdraft Facilities

Term Loans

Merchandise Loan

#### **Key facts about the Awash bank**

Awash bank currently has 486 shareholders, all private individuals or institutions in the private sector. Awash bank's branches are expanding. Currently we have 24 branches in Addis Ababa and 24 in the regions (Awassa, Bahir Dar, Gondar, Mekelle, Jimma, Nazareth, Dire Dawa, Debre Brehan, Dilla, Debre Markos, Bishoftu, Dessie, Arba-Minch, Motta, Teppi, Debere-Tabor, Hossaena, Sahsemene, Alemgenna, Harrar, Hagere Mariam, Modjo, Humera, and Chagni). Awash bank is a very competitive Bank. It has won four consecutive tenders for banking services. All commercial banks participated in these bids. Awash bank is the only commercial bank which provides on-site services to diplomatic missions. In every branch, we have a listening post which keeps us close to our customers. Our suggestion boxes! We open each of every Friday and listen to customers' concerns (and, yes, to their compliments too). And we act promptly on each suggestion or complaint!!

### 3.7 Services for the Diaspora Ethiopians living abroad can open

**A Checking Account:** It is a non-interest-bearing account. Withdrawals from the account are unlimited. Monthly bank statement will be sent to customers regularly.

**A Savings Account:** Deposits and withdrawals are made using the Bank's form. It is an interest-bearing account. Deposits and withdrawals are shown in a saving passbook that is kept with the customer. This type of account may not be convenient for an account holder living abroad unless he/she arranges the account to be operated through another person holding power of attorney.

**A Special Saving Account:** It can be operated using special check. It is an interest-bearing account. Saving passbook is not required for special saving account but monthly 31 bank statements will be sent regularly to the account holder. The frequency of withdrawals from the account is limited, say, up to four times per month

## CHAPTER FOUR

### Discussion and Analysis

In this chapter the results of the financial performance analysis are presented. The analysis is made from the audited financial statements of the private commercial banks. Five consecutive fiscal years audited balance sheet and income statement were taken from the banks considered in the study.

Trend analysis of Awash Banks performance which includes the profitability ratios (return on asset, return on equity, net interest margin, profit to expense ratio, non-interest income to total asset), liquidity ratios (loan to deposit ratio and loan to total asset ratio), risk and solvency ratios (debt to equity ratio, debt to total asset and equity multiplier), efficiency ratios (asset utilization, income to expense, and operating efficiency) and credit quality ratios (equity to loan, equity to total asset, non-performing loan to total loan) are presented consequently.

#### 4.1. Trend Analysis of Awash bank

##### 4.1.1 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.

Suyanto (2007) has evaluated interbank performance of Bank Muamalat Indonesia in profitability, liquidity, risk and solvency, and community involvement for the period 2000 – 2004. Financial ratios (Return on Asset, Return to Equity, Profit Expense Ratio, and Non-Net Interest

Margin, Cash to Deposit Ratio, Loan to Deposit Ratio, capital Adequacy Ratio, Debt to Asset Ratio and Non-performing loan to Total Loan Ratio) were applied in measuring these performances. The study found that the Bank Muamalat Indonesia (BMI) relatively had more profit and commitment to community development but had less liquidity compared to the conventional banks. BMI does not show (statistically) any difference in risk performance with the conventional banks.

## 1. Return on Asset Ratio (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. 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.

The calculation for the return on assets ratio is:

$$\text{ROA} = \text{Net Income} / \text{Total Assets}$$

**Table 4.1 Return on Asset Ratio**

<i>particulars</i>	<b>Fiscal Year</b>				
	2005	2006	2007	2008	2009
Net income	61,055,643	87,279,946	66,300,800	16,655,459	100,367,944
Total asset	2,230,722,739	3,014,059,680	3,577,964,010	4,269,946,935	5,476,625,540
<b>ROA- Ratio</b>	0.03	0.03	0.02	0.01	0.02

*Source: researcher computation from financial statement of Awash bank*

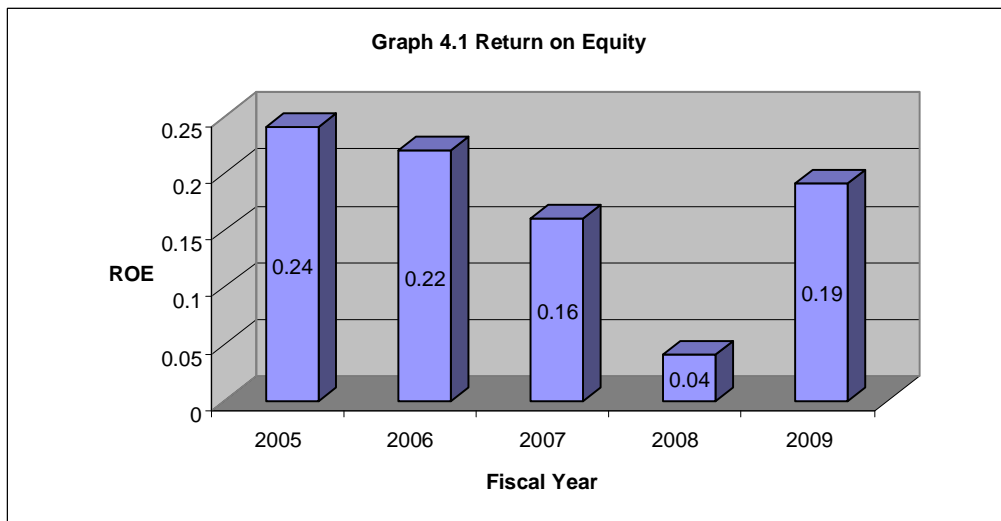
As it can be seen from the above Table 4.1, the return on asset of Awash bank has shown declining trend from 2005 to 2006 and reached the lowest level in the year 2008 which was around one percent and in 2009 it has reached two percent. This implies that the assets of the bank are contributing only a little amount for the total profit of the bank, in the fiscal years 2005 and 2006 only three percent of the total profit was fetched from the bank's assets and in 2008 it has been declined only to one percent. The management of the bank is not using the assets to

generate higher profit which implies that most of the assets of the bank are put idle without any contribution for the profit of the company. The reasons for these were the continuous increment of expenses like provision for doubtful loans and advances which shows almost four times change from 2006 to 2007 (i.e.,46,756,843 in 2007 and 142,771,341 in 2013), salaries and benefits and administrative costs.

## 2. Return on Equity Ratio (ROE)

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. The return on equity ratio measures how much the shareholders earned for their investment in the company. The higher the ratio 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) ratio is appreciable as it is the primary indicator of bank's profitability and functional efficiency.



*Source: researcher computation from financial statement of AB*

As it is depicted on Graph 4.1 above, the return on equity of Awash bank has shown the maximum figure in the year 2010 which was around 24 percent and then it follows a declining trend. In the year 2013, it has declined to the lowest point which was around 4 percent. The return on equity of the bank has shown improvement in the fiscal year 2009 and it has grown to around 19 percent. This implies that the investors of the bank were getting 24 cents for each one Birr investment they have made in the fiscal year 2005 and it has shown a declining trend till 2013 and it reached at the point where investors have enjoyed only four cents for each one birr investment they have made in the fiscal year 2007. As it can be seen from the financial statement of the bank, the reasons for these fluctuations were the less proportion of growth observed in the owners' equity and the continuous reduction on the net income of the bank.

### 3. Profit to Expense 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 the bank is efficient in controlling its operating expenses. A higher profit to expense ratio means the bank is cost efficient and is making higher profits.

It is calculated as:

$$\text{PER} = \frac{\text{Profit before tax}}{\text{Operating Expenses}}$$

#### Table 4.2 Profit to Expense Ratio

<i>particulars</i>	Fiscal Year				
	2005	2006	2007	2008	2009
Profit before tax	82,040,574	122,921,543	94,980,332	21,907,426	145,399,775
Operating expense	36,683,611	56,745,638	111,216,547	232,135,062	147,346,454

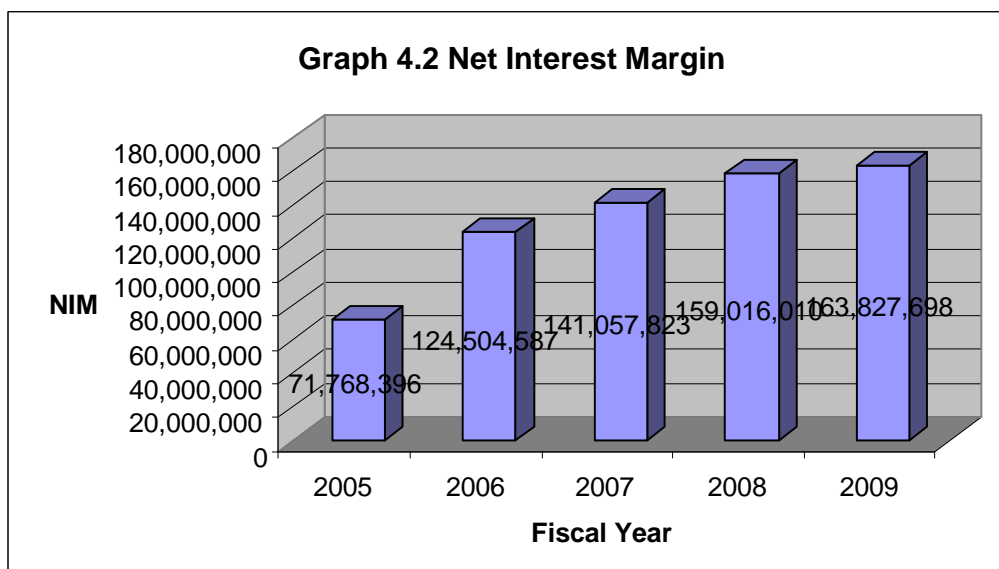
<b>PER-Ratio</b>	2.24	2.17	0.85	0.09	0.99
------------------	------	------	------	------	------

*Source: researcher computation from financial statement of AB*

As it can be observed from Table 4.2 above, Profit to expense ratio of Awash bank was 2.24 in 2005, which means for every one-birr expense the bank incurred; it has generated a profit of around 2 birr and 24 cents. In the succeeding fiscal years, the bank's profit to expense ratio has shown a declining trend. In the fiscal year 2013 Awash bank, has earned the lowest profit in which it has fetched only 9 cents for its one-birr expense it has incurred. This ratio showed that there is an increasing trend in the expenses of the bank but a decreasing trend in the revenue of the bank. As it can be seen from the financial statement of the bank there is a continuous increment in the expense of the bank, for instance from the fiscal year 2005 to 2006 the expense has grown by more than hundred percent but such progress was not observed in the profit of the company. Therefore, these are the causes for the continuous decline in the profit to expense ratio.

#### **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. It is calculated as: **NIM=interest income – interest expense**



*Source: researcher computation from financial statement of AB*

As it has been shown in graph 4.2 above, the net interest margin of Awash bank has shown a continuous improvement from the fiscal year 2005 to 2009. This implies that the bank's deposit is showing progress (from 1,627,627,080 in the fiscal year 2005 to 4,494,186,427 in the fiscal year 2009) and the bank has used this deposit to grant loans for its customers, this in turn maximizes the net interest income of the company. As it can be seen from the financial statement of the bank, the loan has shown growth from 1,172,965,585 birr in 2005 to around birr 2,442,747,456 in the fiscal year 2009 by showing more than hundred percent growth.

#### 4.1.2 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 the 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.

## 1. Loan to Deposit Ratio

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.

It is calculated as:

$$\text{LDR} = \text{Loan / Deposit}$$

**Table 4.4 Loan to Deposit Ratio**

<i>particulars</i>	<b>Fiscal Year</b>				
	2005	2006	2007	2008	2009
Total loan	1,172,968,585	1,901,466,545	2,197,341,801	2,566,577,377	2,442,747,456
Total deposit	1,627,627,080	2,176,885,481	2,721,327,589	3,477,767,008	4,494,186,427
<b>LD-ratio</b>	0.72	0.87	0.81	0.74	0.54

*Source: researcher computation from financial statement of AB*

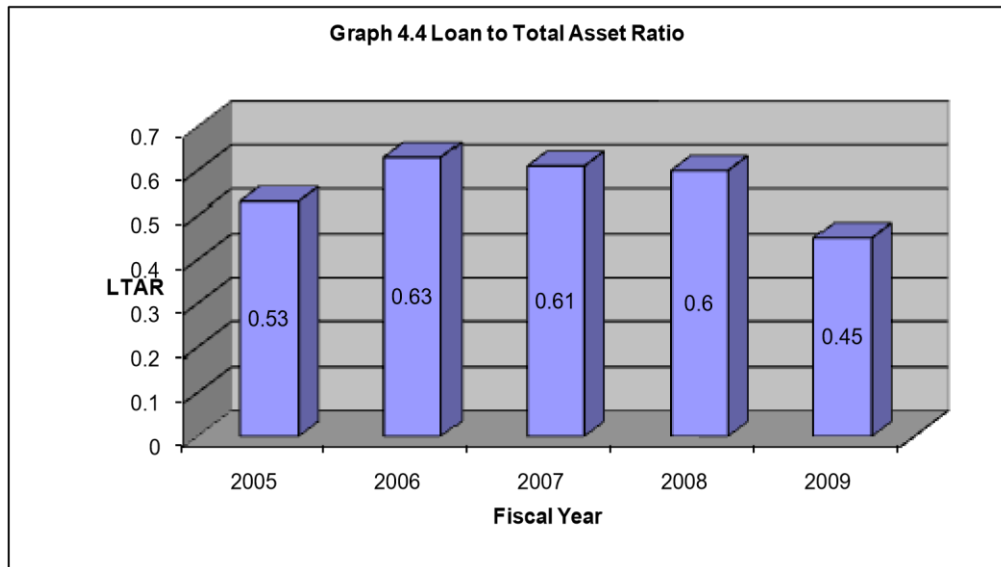
As it can be seen from Table 4.4 above, the loan to deposit ratio of Awash banks has reached its maximum peak in the year 2006 which was around 87 percent which implies the bank has granted eight-seven percent of its deposits as a loan to its customers and only thirteen percent was kept in the bank, this shows that although the bank was generating interest income from the loan granted, the bank may face liquidity risk because customers may withdraw their saving account and transaction deposits at any time. In 2009, it has reached to 54 percent which shows

the banks conservative measures taken to grant loan to customers. This was because the loan that was granted to the bank's customers has shown declining trend comparing the previous year 2008 but the deposit of the bank has increased by about 22.6 percent.

## 2. Loan to Asset Ratio

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 riskier a bank may be to higher defaults. This figure is determined as follows:

$$\text{Loans to Assets} = \text{Loan} / \text{Total Asset}$$



*Source: researcher computation from financial statement of Awash bank*

As it can be seen from graph 4.4 above, the loan to asset ratio of Awash bank has shown irregular trend. In the fiscal year 2006, it was around 63 percent and in the fiscal year 2009 it has declined to around 45 percent which implies that the total loan granted to the bank's customers accounts about 63 percent of the total asset in the fiscal year 2006 and 45 percent in 2009. As it can be seen from the financial statement of Awash bank although the loan granted to its customers has shown growth, the total asset has also increased continuously between the fiscal

years 2005 to 2009 (from a total asset of 2,230,722,739 in the fiscal year 2005 to a total asset of 5,476,625,540 in 2009).

### 4.1.3 Risk and Solvency Ratios

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.

For a bank, debt consists essentially of sight deposits. The financial assets are the loans granted. After all, the purpose of a bank is to distribute loans!

A bank's solvency therefore consists of its ability to fulfill the withdrawal demands of its depositors. And that is where the regulatory authorities come in to ensure that banks are indeed capable of meeting their obligations. This is a matter that affects the economic stability of an entire country. Debt-Equity Ratio (DER), Debt to Total Assets Ratio (DTAR), and Equity Multiplier (EM) are the most important measures used to gauge risk and solvency of a bank.

#### 1. Debt to Equity Ratio

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 overleveraged, and should look for ways to reduce its debt.

Equity and debt are two key figures on a financial statement, and lenders or investors often use the relationship of these two figures to evaluate risk. The ratio of your business' equity to its long-term debt provides a window into how strong its finances are. Equity will include goods and property your business owns; plus, any claims it has against other entities. Debts will include both current and long-term liabilities.

It is calculated:

$$\text{DER} = \text{Total liabilities} / \text{share holders' equity}$$

**Table 4.5 Debt to Equity Ratio**

<i>particulars</i>	<b>Fiscal Year</b>				
	2005	2006	2007	2008	2009
Total liabilities	1,977,494,722	2,612,436,106	3,175,212,704	3,849,866,780	4,957,396,033
Shareholders' equity	253,228,017	401,623,574	402,751,306	420,080,155	519,229,507
<b>DER-Ratio</b>	7.81	6.50	7.88	9.16	9.55

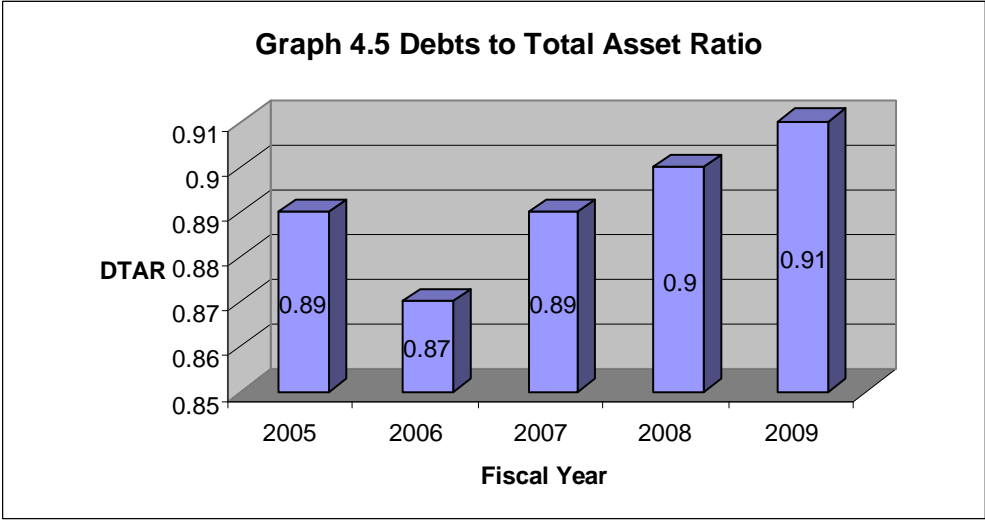
*Source: researcher computation from financial statement of AB*

As it has been shown in table 4.5 above, debt to equity ratio of Awash bank was having the highest ratios in 2008 and 2009 which were 9.16 and 9.55 respectively which means creditors of Awash banks has provided about 9.2 Birr in 2008 and almost 9.6 Birr in 2009 in financing for every one Birr contribution by owners. As it can be observed from the financial statement of the bank, the total liability of the bank has grown by 76 percent from the fiscal year 2005 to 2006, by 82 percent from 2006 to 2007 and by 64 percent from 2007 to 2009 but the growth of the total shareholders' equity is by 64 percent from 2005 to 2006, only by 0.1 percent from 2006 to 2007 and by 19 percent from 2008 to 2009. This implies that the bank is highly dependent on the fund generated from creditors or it is highly leveraged. The bank's management should take serious measures in making important adjustments so as to rectify the problem.

## **2. Debt to Total Asset Ratio**

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 assets are financed using debt financing.

The lower the Debt to Asset Ratio, the better, as companies with high amounts of debt introduce 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.



*Source: researcher computation from financial statement of AB*

As it is shown in the Graph 4.5 above, in the year 2009, the debt to total asset ratio of the Awash Bank of was around 0.91. The bank was having the same debt to total asset ratio in the fiscal years 2005 and 2007 which was around 0.89; and 0.87 and 0.90 debt to total asset ratio was reported in the fiscal years 2006 and 2008 respectively. This implies that from the bank's total assets, 89 percent of the assets were financed by the fund generated from the creditors in the fiscal year 2005, 87 percent in 2006, 89 percent in 2007, 90 percent in the fiscal year 2008 and 91 percent in the fiscal year 2009. As it can be seen from the financial statement Awash bank the proportion of creditors contribution to the bank's total assets is showing continuous upward trend and this implies that the bank's performance is showing a declining trend i.e., the bank is highly dependent on the fund granted from creditors. Therefore, the bank's management should appraise the causes in detail and take corrective measures.

### 3. Equity Multiplier Ratio

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.

It is calculated as:

$$\text{EM} = \text{Total Assets} / \text{Total Stockholders' Equity}$$

**Table 4.6 Equity Multiplier Ratio**

<i>particulars</i>	<b>Fiscal Year</b>				
	2005	2006	2007	2008	2009
Total assets	2,230,722,739	3,014,059,680	3,577,964,010	4,269,946,935	5,476,625,540
Total shareholders' equity	253,228,017	410,623,574	402,751,306	420,080,155	519,229,507
<b>EM-Ratio</b>	8.81	7.50	8.88	10.16	10.55

*Source: researcher computation from financial statement of AB*

As it can be seen from the above Table 4.6, the equity multiplier ratio Awash bank has shown continuous growth starting from 2006 to 2009. It has grown from 7.50 in 2006 to 10.55 in 2009 which implies the bank's total assets has been continuously financed by creditors of the bank in huge amount or the contribution of the bank's owners is getting lesser and lesser. In other words, the creditors are highly investing in the assets of the company which implies the bank is becoming highly leveraged. For instance, in the fiscal year 2005, for owners each one birr contribution, the creditors of the bank are contributing around Birr eight and eighty-one cents, this grows to almost to Birr ten and Birr eleven in the fiscal years 2008 and 2009. This shows that the management of the bank has to work hard in reducing the debt amount through maximizing the bank's profit, increasing the efficiency of the workers, and using the idle assets in generating profits, etc.

#### 4.1.4 Efficiency Ratios

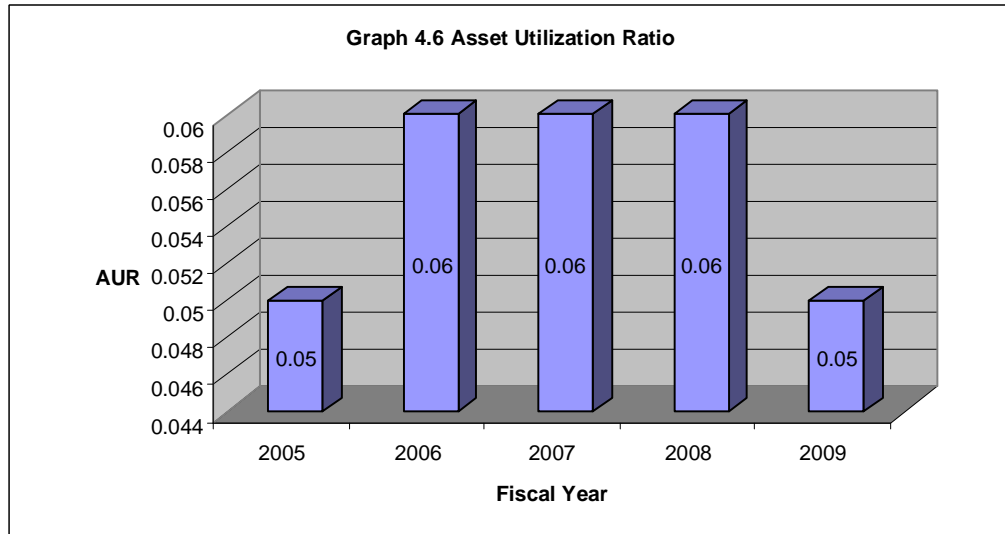
The efficiency ratios and other ratios are key ratios to understanding financial statements. Our ratio calculation spreadsheets reduce time and effort in calculating decision making ratios. They reduce risk for lenders and investors and enable owners, managers and consultants to increase productivity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

##### 1. Asset Utilization Ratio

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.

It is calculated as:

$$\text{AUR} = \text{Total Revenue} / \text{Total Asset}$$



*Source: researcher computation from financial statement of Awash bank*

As it has been indicated in graph 4.6 above, asset utilization ratio of Awash bank has showed constant trend from the fiscal year 2006 to 2008 which was around six percent. In 2005 and 2009 it was having an asset utilization ratio of five percent; from the total profit the company has generated the assets were contributed only six percent (in the fiscal years 2005 and 2009) and five percent (in the fiscal years 2006 to 2008). This implies that even though the total asset proportion was increasing from year to year, the contribution of the assets to the total profit of the bank is not showing progress which implies that there are assets which are contributing nothing for the profit of the company. Therefore, the management of the bank has to make those assets which are idle to contribute for the profit of the company, if is not possible to do so the idle assets have to be disposed of and reinvesting the fund in other profitable investments.

## **2. Income to Expense Ratio**

This is the most commonly and widely used ratio in the banking sector to assess the managerial efficiency in generating total income vis-à-vis 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.

It is calculated as:

$$\text{IER} = \text{Total income} / \text{Total Operating Expenses}$$

**Table 4.7 Income to Expense Ratio**

<i>particulars</i>	<b>Fiscal Year</b>				
	2005	2006	2007	2008	2009
Total income	118,724,185	179,667,181	206,196,879	254,042,488	292,746,229
Total operating expense	36,683,611	56,745,638	111,216,547	232,135,062	147,346,454
<b>IER-Ratio</b>	3.24	3.17	1.85	1.09	1.99

*Source: researcher computation from financial statement of Awash bank*

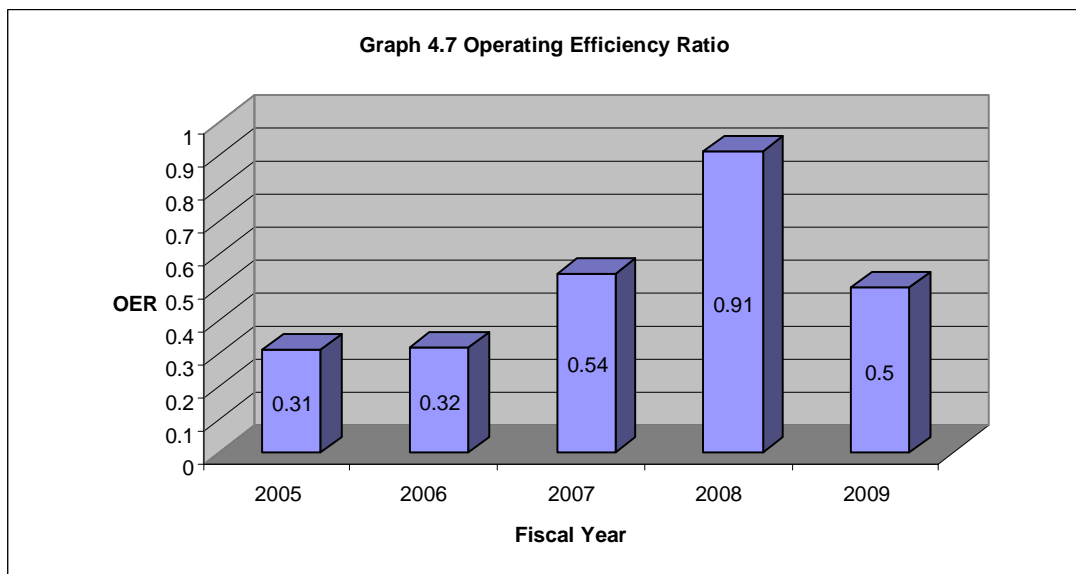
As it can be observed from table 4.7 above, the income to expense ratio of the bank has shown a declining trend from the fiscal year 2005 to 2008 continuously, this implies that the bank's expenses are showing an upward trend continuously but the total income was following the reverse path or the total income that was generated from a single dollar of expense is declining. For instance, the total expense of the bank has grown by more than four hundred percent (From Birr 36,683,611 to Birr147, 346,454) in the fiscal year 2009 than it was seen in the fiscal year 2005 but the total income of the bank was grown only by two hundred percent (from Birr 118,724,185 to Birr 292,746,229) in the fiscal year 2009 than it was observed in the fiscal year 2005. In the fiscal year 2005, the income to expense ratio of the bank was 3.24 and it has reached 1.09 in 2009 which implies that the bank has generated Birr 3.24 and Birr 1.09 on each of the

single dollar expense it has incurred. It again showed increment to 1.99 in 2009 fiscal year. Generally, the management of the bank in reducing costs and maximizing the total income is shown a weaker effort. Therefore, the bank management has to assess the causes for these problems critically and should take serious measures in controlling the total expense and maximizing the total income of the company.

### 3. Operating Efficiency Ratio

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 to 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 expense indicates that operating expenses are lower than operating revenues. It is calculated as:

$$\text{OER} = \text{Total Operating Expenses} / \text{Total Operating Revenue}$$



*Source: researcher computation from financial statement of AB*

As it has been seen in Graph 4.7 above Awash bank operating efficiency ratio has shown an increasing trend from the year 2005 to 2008 which implies the amount of expense incurred on each dollar of revenue is increasing. For instance, in the fiscal year 2005, the bank has incurred

only Thirty-one cents on each of one Birr revenue it has enjoyed but it has grown to Fifty-four cents in 2007, Ninety-one cents in the fiscal year 2008. As it can be seen from the financial statement of the bank, the efficiency of the bank's management in controlling costs is showing a declining trend, whose consequence is reducing the total revenue. Therefore, the management should take appropriate measures to improve the performance of the bank i.e., they should seriously work in reducing expenses and maximizing costs.

#### 4.1.5 Credit Quality Ratios

One of the most important sources of income for commercial bank is the issuing of loans. However, when a commercial bank makes loans it is exposed to risks, because banks operate in asymmetric information. The principal risk it faces is the risk of defaulting interest payment or the principal or both interest and loans. Thus, loan performance measures bank's risk associated with loans created by bank. In other words, it measures the quality of loans. The greater is the amount of loan and interest in default, the higher is a risk for a bank, and the bank is going to be rated as poor. The following three financial measures are used for measuring the credit quality of commercial banks.

##### 1. Equity to Total Asset Ratio (ETAR)

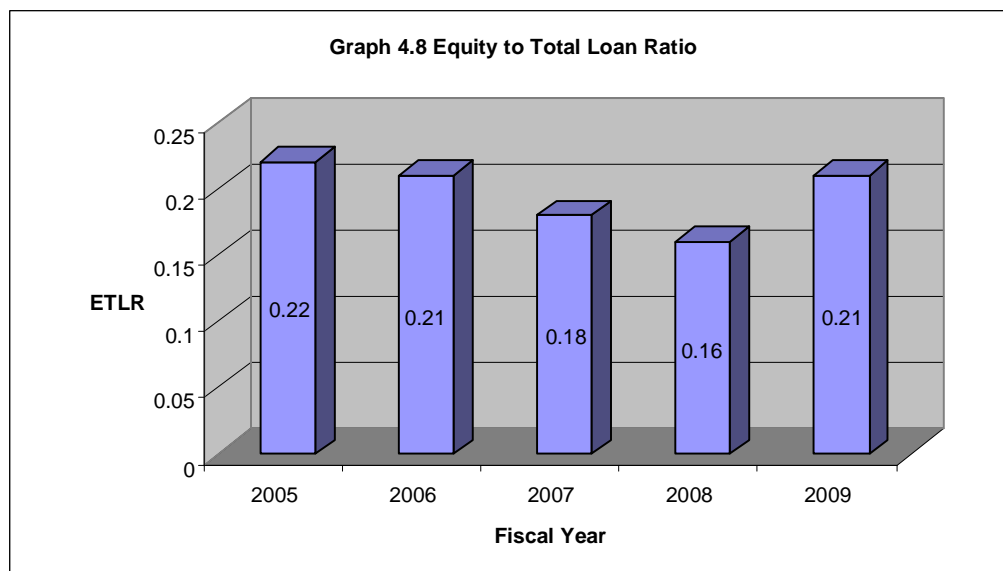
Equity to Asset ratio measures equity capital as a percentage of total assets. It provides percentage protection afforded by banks to their investment in asset. It measures the overall shock absorbing capacity of a bank for potential loan asset losses. The higher the ratio of EQTA, the greater is the capacity for a bank to sustain the assets losses.

It is calculated as:

$$\text{ETAR} = \text{Total Equity} / \text{Total Asset}$$

## 2. Equity to Loan Ratio (EQL)

Equity to loan ratio measures equity capital as a percentage of total loans. It provides equity as a cushion (protection) available to absorb loan losses. The higher the equity to loan ratio, the higher it will be the capacity for a bank in absorbing loan losses.



*Source: researcher computation from financial statement of AIB*

As it has been indicated in graph 4.8 above, the equity to total loan ratio of Awash bank has shown a declining trend from the fiscal year 2005 to 2008, this implies that the proportion of the total share holders' equity of the company to the total loan of the bank is getting lower and lower. This in turn shows that the bank is granting huge amount of loan to its customers and if in case the bank faces risk of loan repayment, the proportion of the owners in resisting the shock of loss is lower i.e. the company will be in a position to face bankruptcy. For instance, the loan of the bank that was granted to its customers has grown from Birr 1,172,968,585 in the fiscal year

2005 to Birr 2,442,747,456 in the fiscal year 2009, it has grown by more than hundred percent but the total equity did not show such amount of changes (it has grown by only about Birr 250 million from the fiscal year 2005 to 2009). This indicates that the bank did not take measures to maximize shareholders equity. Therefore, the bank management has to work to maximize the total shareholders' equity and to use strict techniques of credit management to appraise customers' position before granting loans.

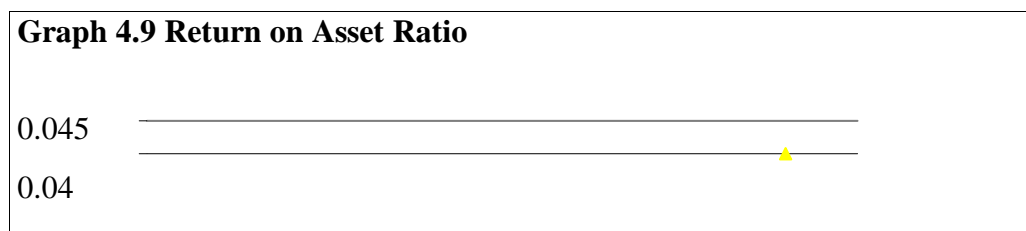
### 3. Non-Performing Loans to Total Loan Ratio (NPTLR)

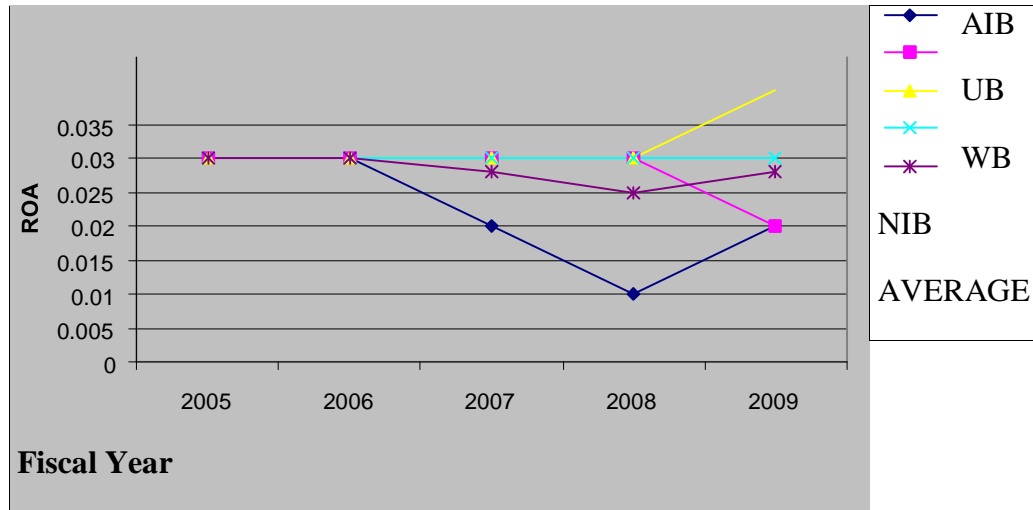
Non-performing loan to total loan ratio is one of the most important criteria to assess the quality of loans or asset of a commercial bank. It measures the percentage of gross loans which are doubtful in banks' portfolio. The lower the ratio of non-performing loan to total loan ratio, the better is the asset/credit performance for the commercial bank.

To measure banks' creditworthiness and risk exposures is a complicated issue and it is not easy to interpret banks' accounting data. (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.

#### 4.2.1 Profitability Ratios

##### 1. Return on Asset Ratio





*Source: researcher computation from financial statement of the banks*

As it has been in Graph 4.9 above, all the private commercial banks have shown the same return on asset ratio in 2005 and 2006 which was around three percent which implies the total asset of the banks has contributed only three percent of the banks' profit. From 2007 to 2009, Awash banks has scored lower ratio than the average of all the private commercial banks. As it was already explained this was caused as a result of the continuous increment observed in the bank's expenses (especially in the provisions for doubtful loans and advances) and declining trend in the profit of the bank. Wegagen bank has shown the highest return on asset ratio in 2009 which was around four percent.

## 2. Return on Equity

**Table 4.10 Return on Equity**

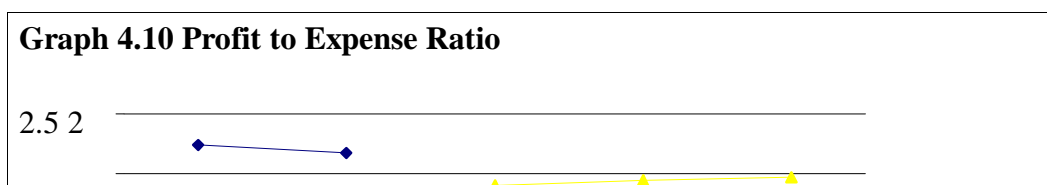
year	Commercial banks				average
	AIB	UB	WB	NIB	

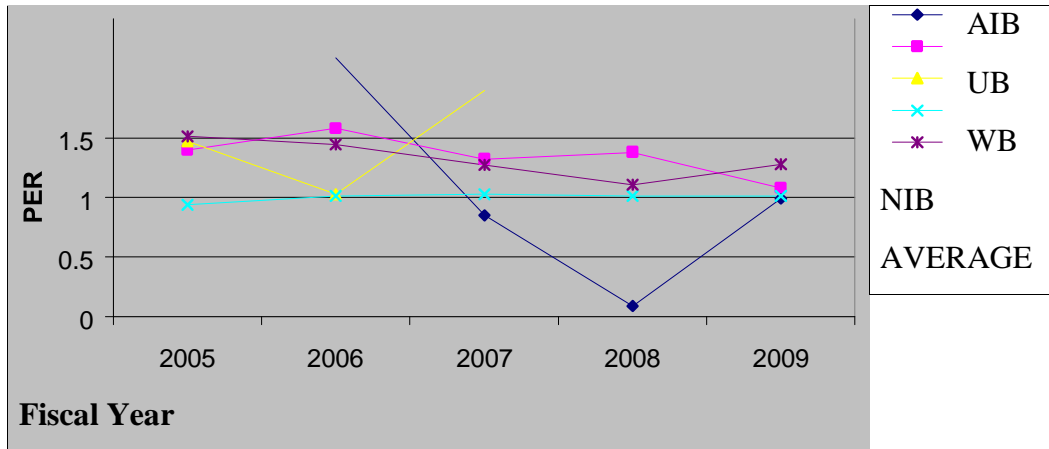
2005	0.24	0.25	0.26	0.21	0.240
2006	0.22	0.23	0.28	0.20	0.233
2007	0.16	0.18	0.28	0.18	0.200
2008	0.04	0.19	0.23	0.19	0.163
2009	0.19	0.18	0.22	0.21	0.200

*Source: researcher computation from financial statement of the banks*

As it can be seen from the above Table 4.10, Awash banks return on equity ratio has shown the lowest figure in all the fiscal years from 2005 to 2009 when it is compared with the average of private commercial banks return on equity ratio which implies that the total shareholders' equity of the bank is contributing a lower amount for the total profit of the bank. For instance, in the fiscal year 2005, about 24 percent of the total profit was generated from the equity of the bank; 22 percent in 2006, but in the fiscal year 2008, only four percent of the total profit was generated from the equity of the bank. Wegagen bank has shown the highest return on equity ratio in 2006 which was 28 percent and the lowest return on equity ratio by Bank of Abyssinia in 2008 which was four percent.

### 3. Profit to Expense Ratio





*Source: researcher computation from financial statement of the banks*

From the Graph 4.10 above, in the fiscal years 2005 and 2006, Awash bank has reported a higher profit to expense ratio than the average profit to expense ratio of the private commercial banks which was around Birr 2.24 and 2.17 respectively, this implies that from each one birr expense the bank has incurred, it has enjoyed a profit of Birr two and twenty-four cents in the fiscal year 2005 and Birr two and seventeen cents in 2007. From the fiscal years 2007 to 2009, a lesser profit to expense ratio was seen in Awash bank. This shows that when comparing the bank with the other private commercial banks in terms of controlling costs and maximizing profits, its management has performed weaker and needs to make corrective measurements especially in controlling costs and improving profits.

#### 4. Net Interest Margin

**Table 4.11 Net Interest Margin**

year	Commercial banks				average
	AIB	UB	WB	NIB	

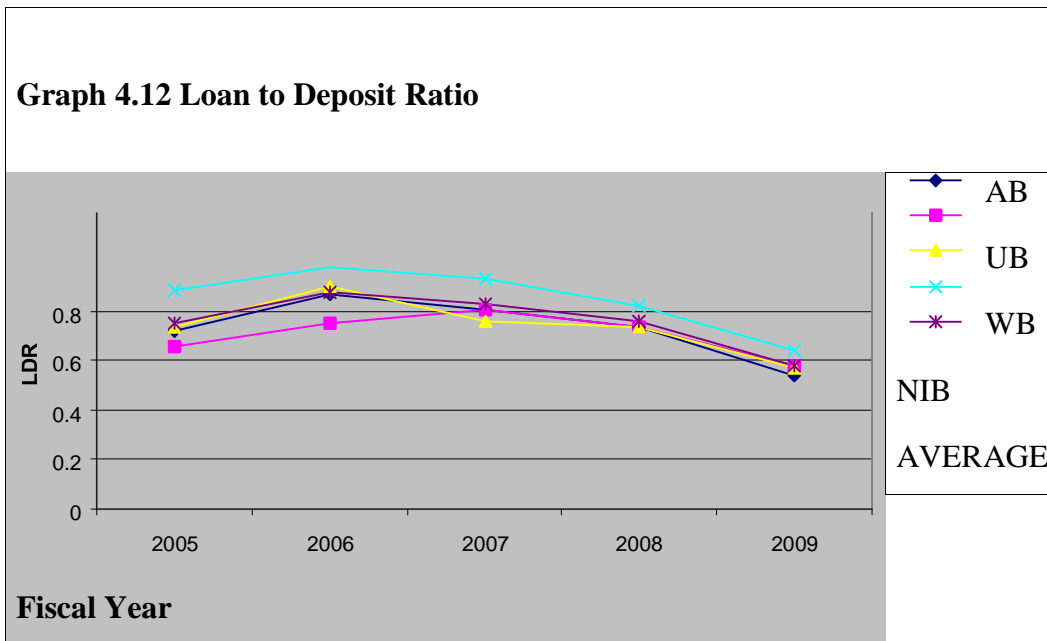
2005	71,768,396	28,507,850	58,397,888	59,065,964	54,435,025
2006	124,504,587	42,716,890	85,000,000	73,093,026	81,328,626
2007	141,057,823	82,569,642	129,729,134	105,152,759	114,627,340
2008	159,016,010	108,303,969	148,565,012	147,780,386	140,916,344
2009	163,827,698	122,411,144	150,085,783	178,477,545	153,700,543

*Source: researcher computation from financial statement of the banks*

As it has been shown in Table 4.11 above Awash bank has shown the highest net interest margin in all the fiscal years from 2005 to 2009, even the net interest margin of the bank was much greater than the average rate of all the private commercial banks taken for comparison purpose. As it can be seen from the financial statements of the banks (see from appendix) , Bank of Abyssinia has granted huge amount of loan comparing it with the loans granted by the other private commercial banks taken for analysis purpose, which in turn enables the bank to generate high amount of net interest income. But on the contrary, extending huge amount of loan implies that the bank's credit policy is not strict and the bank does not use critical credit appraisal techniques and the management has to take cautions in granting loans.

## 4.2.2 Liquidity Ratio

### 1. Loan to Deposit Ratio



*Source: researcher computation from financial statement of the banks*

As it can be seen from Graph 4.12 above, when the loan to deposit ratio of Awash bank was compared with the average loan deposit ratio of the other private commercial banks, it has shown better performance than United Bank and lesser performance than Nib International Bank. The loan to deposit ratio of Awash bank has reached its maximum peak in the year 2006 which was around 87 percent which implies the bank has granted eight-seven percent of its deposits as a loan to its customers and only thirteen percent was kept in the bank, this shows that although the bank was generating interest income from the loan granted, the bank may face liquidity risk because customers may withdraw their saving account and transaction deposits at any time. Nib international bank has granted 98 percent of the deposits as loan to its customers in the fiscal year 2006 and 93 percent in 2007.

## **2. Loan to Asset Ratio**

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 riskier a bank may be to higher defaults.

**Table 4.13 Loan to Asset Ratio**

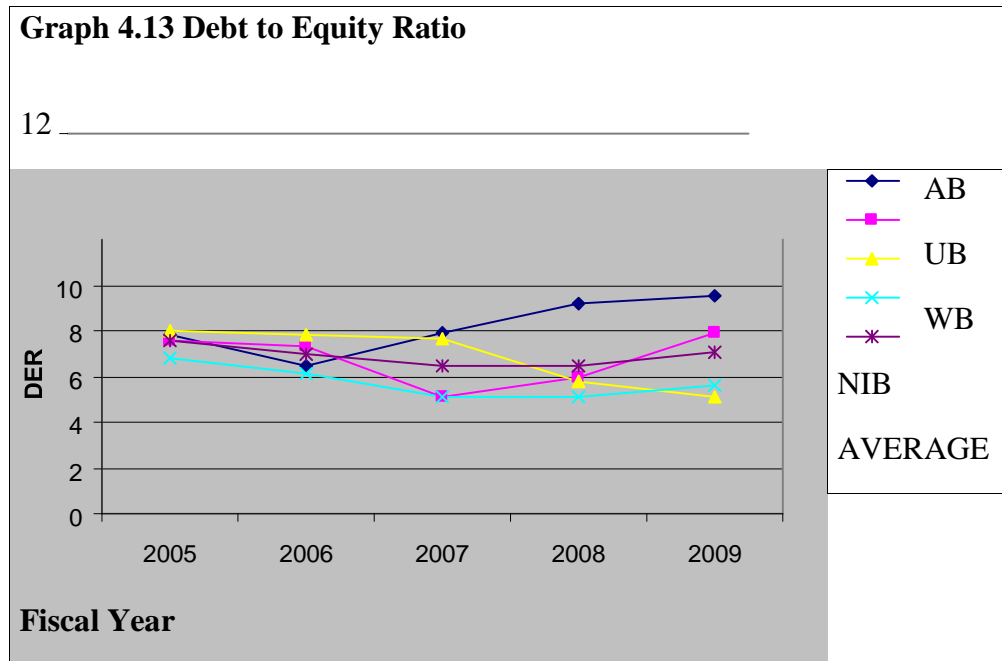
<i>year</i>	<i>Commercial banks</i>				
	AB	UB	WB	NIB	<b>average</b>
2005	0.53	0.53	0.59	0.63	0.570
2006	0.63	0.61	0.71	0.70	0.663
2007	0.61	0.63	0.59	0.67	0.625
2008	0.60	0.56	0.54	0.56	0.565
2009	0.45	0.49	0.41	0.44	0.448

*Source: researcher computation from financial statement of the banks*

As it is indicated in Table 4.13 above, Awash bank's loan to total asset ratio has shown a better figure from the fiscal year 2005 to 2007 in which the total loan to total asset ratio was lesser than the average total loan to total asset ratio of the other private commercial banks. The total loan of the bank was accounting only 53 percent of the total assets in 2005, it has grown to 63 percent in 2006 and 61 percent in 2007; these ratios showed the bank's better performance comparing it with the other private commercial banks considered in the study. In 2008 and 2009 the loan to total asset ratio of Bank of Abyssinia has declined comparing it with the average loan to total asset ratio of the private commercial banks taken for comparison purpose, 60 percent in 2008 and 45 percent in the fiscal year 2009.

### 4.2.3 Risk and Solvency Ratios

## 1. Debt to Equity Ratio



*Source: researcher computation from financial statement of the banks*

As it has been shown in Graph 4.13 above, the debt to equity ratio Awash bank has shown a lower rate than the average debt to equity ratio of the other private commercial banks except in the fiscal year 2006. In the fiscal year 2008 and 2009, the debt to equity ratio Awash bank's was 9.16 and 9.55 respectively which implies for every one birr contribution by the owners, creditors of the bank has contributed almost birr nine in 2008 and birr ten in 2009. This shows that the bank is highly dependent on borrowed funds, which in turn reminds the bank management to search ways to maximize the contribution of shareholders. From all the private commercial banks Nib International Bank has reported better performance.

## 2. Debt to Total Asset Ratio

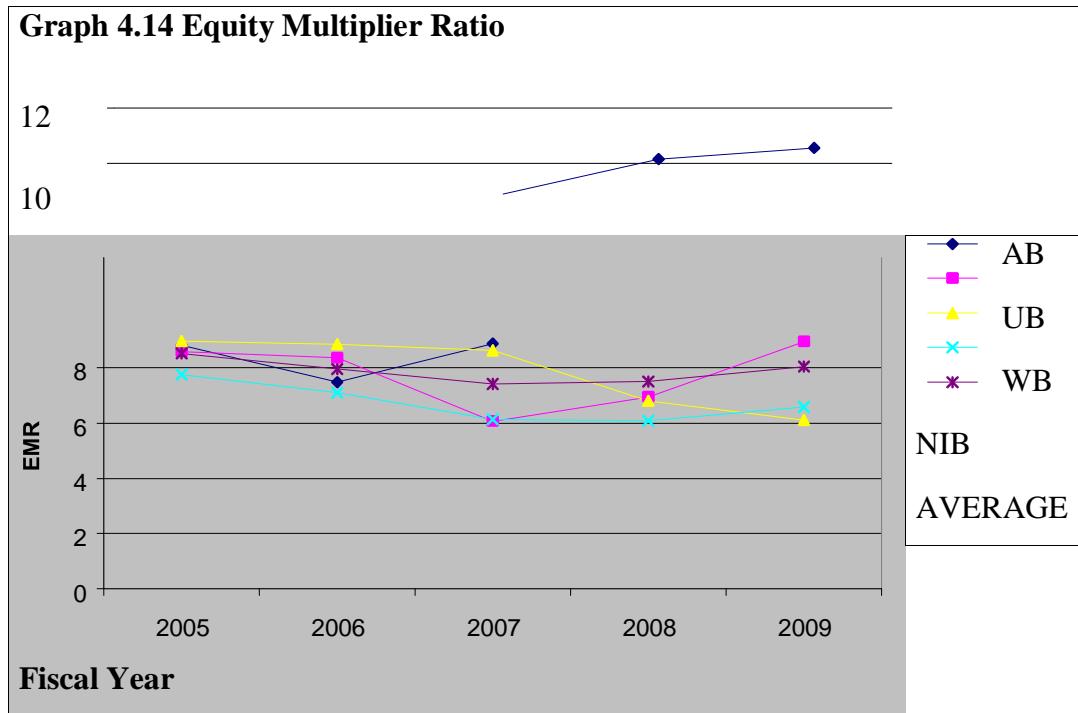
**Table 4.14 Debt to Total Asset Ratio**

<i>year</i>	<i>Commercial banks</i>				<b>average</b>
	AB	UB	WB	NIB	
2005	0.89	0.88	0.89	0.87	0.883
2006	0.87	0.88	0.89	0.86	0.875
2007	0.89	0.84	0.88	0.84	0.863
2008	0.90	0.86	0.85	0.84	0.863
2009	0.91	0.89	0.84	0.85	0.873

*Source: researcher computation from financial statement of the banks*

As it can be seen from the Table 4.14 above, although all the private commercial banks have reported relatively closed figures, Awash banks debt to total asset ratio showed the lowest rate than the average ratio of the private commercial banks. For instance, in the fiscal years 2008 and 2009 the debt to total asset ratio of the bank was 0.90 and 0.91 respectively, which implies that from all the total assets of the company almost 90 percent in the fiscal year 2008 and 91 percent in 2009 of the assets have been already financed by funds generated from creditors. As it has been already explained, this is an indication of the bank's high dependence on borrowed capital.

### 3. Equity Multiplier Ratio



Source:

*researcher computation from financial statement of the banks*

As it has been indicated in Graph 4.14 above, when comparing the average equity multiplier ratio of the private commercial banks with that of Awash bank equity multiplier ratio, Awash banks has still showed the lowest performance. For instance, in the fiscal years 2008 and 2009 the bank’s equity multiplier ratios were 10.16 and 10.55 respectively which implies for every one Birr contribution by the owners the creditors of the bank have contributed Birr ten in the fiscal year 2008 and almost Birr eleven in 2009 and this in turn implies that the company is suffering from high amount of debt. Nib International Bank has shown the best performance of all the other private commercial banks considered for the study.

#### 4.2.4 Efficiency Ratio

##### 1. Asset Utilization Ratio

**Table 4.15 Asset Utilization Ratio**

<i>year</i>	<i>Commercial banks</i>				
	AIB	UB	WB	NIB	<b>Average</b>
2005	0.05	0.07	0.08	0.08	0.070
2006	0.06	0.06	0.08	0.08	0.070
2007	0.06	0.07	0.08	0.08	0.073
2008	0.06	0.07	0.08	0.09	0.075
2009	0.05	0.06	0.08	0.09	0.070

*Source: researcher computation from financial statement of the banks*

As it is depicted in Table 4.15 above, when comparing the average asset utilization ratio of the private commercial banks with that of Awash banks asset utilization ratio Awash bank has still showed the lowest performance. In the fiscal years 2006 to 2008, only six percent of the total profit was generated from the assets of the company which is much lesser than the average ratio of the private commercial banks and only five percent of the total profit of the bank was generated from the total assets of the bank in the fiscal years 2005 and 2008. This shows that the bank is not using its assets to contribute more to the profit of the bank or there are idle assets which are bringing nothing to the bank's profit. Nib International Bank has shown the best performance of all the other private commercial banks considered.

## **2. Operating Efficiency Ratio**

**Table 4.16 Operating Efficiency Ratio**

<i>year</i>	<i>Commercial banks</i>				
	AIB	UB	WB	NIB	<b>Average</b>
2005	0.31	0.42	0.33	0.52	0.395
2006	0.32	0.39	0.49	0.50	0.425
2007	0.54	0.43	0.30	0.49	0.440
2008	0.91	0.42	0.29	0.50	0.530
2009	0.50	0.48	0.33	0.48	0.448

*Source: researcher computation from financial statement of the banks*

As it has been depicted in Table 4.16 above, when the performance of Awash bank is compared with the other private commercial banks' operating efficiency ratio, 2005 and 2006 fiscal years were marked by better performance of the bank. It has incurred lower expenses for the revenues it has generated; an expense of 0.32 cents per an income of Birr one generated in the fiscal year 2005 and only an expense of 0.31 cents in 2006. From 2007 onwards its performance showed a declining trend and it has even shown the lowest effort in 2009 by having an operating efficiency ratio of 0.91, incurring 91 cents on each Birr one of revenue. From all the private commercial banks considered in the study, Wegagen bank has showed the best performance by controlling the costs of the company and maximizing its profits.

### **3. Equity to Loan Ratio (ELR)**

**Table 4.17 Equity to Loan Ratio**

<i>year</i>	<i>Commercial banks</i>				<b>Average</b>
	AIB	UB	WB	NIB	
2005	0.22	0.22	0.19	0.21	0.21
2006	0.21	0.20	0.16	0.20	0.19
2007	0.18	0.26	0.20	0.24	0.22
2008	0.16	0.26	0.27	0.29	0.25
2009	0.21	0.25	0.40	0.34	0.30

*Source: researcher computation from financial statement of the banks*

From Table 4.17 above, the equity to total loan ratio of Awash bank has shown a declining trend from the fiscal year 2005 to 2008 (0.22 in the fiscal year 2005 to 0.16 in the year 2008), which means from the total loan granted to borrowers of the bank the owners have contributed only 22 percent in the fiscal year 2005 and 16 percent in 2008. This implies that the proportion of the total share holders' equity of the company to the total loan of the bank is getting lower and lower. This in turn shows that the bank is granting huge amount of loan to its customers and if in case the bank faces risk of loan repayment, the proportion that the owners will contribute in resisting the shock of loss is lower which on the other hand shows the company's potential exposure to the possibility of bankruptcy.

## CHAPTER FIVE

### Conclusions and Recommendations

This chapter which is entitled as conclusion and recommendation is designed to present the conclusions made from the discussion and analysis part of the study and it then provides some recommendations.

#### 5.1 Conclusions

The return on asset of Awash bank has shown a declining trend each year from the fiscal year 2006 to 2008. In the fiscal year 2008, it has reached the minimum level which was around two percent. When the bank's return on asset has been compared with the other private commercial banks, its performance was showing the lowest rate comparing it with the average return on asset ratio of the banks considered in the study.

Awash banks have reported the maximum return on equity in the fiscal year 2005. From the fiscal year 2006 onwards the return on equity of the bank has declined continuously and in the fiscal year 2008 it has reached the lowest rate which was around 4 percent. When the bank's return on equity was compared with the average of the private commercial banks performance, it was having the lowest rate of all the other banks considered in the study.

Profit to expense ratio of Awash banks was showing the maximum rate in the fiscal years 2005 and 2006 which was around 2.24 and 2.17 respectively. These rates were even the highest rates when compared them with the average profit to expense ratio of the private commercial banks. Starting from the fiscal year 2007 to 2009 the profit to expense ratio has shown declining trend which was lesser than the average profit to expense ratio.

Awash banks have shown a constant rate of non-interest income to total asset ratio from the fiscal year 2005 to 2009 which was around 0.02. This rate was the lowest rate comparing it with the average non-interest income to total asset ratio of the private commercial banks.

The same rate of return on deposit was reported Awash banks which was around 0.04 in the consecutive fiscal years of 2005 and 2006. The minimum rate was shown in 2008. From 2007 to 2009 the return deposit ratio of the bank was lower than the average rate of the private commercial banks.

In the fiscal years 2005 to 2007 Awash banks has reported a better rate in the total loan to total asset ratio comparing it with the average ratio of the private commercial banks. Less performance in this ratio was seen in the consecutive years, 2008 to 2009.

The debt to equity ratio of Awash bank has shown the lowest rate in all the fiscal years starting from 2005 to 2009. In 2009 the bank's debt to equity ratio has reached the lowest level which was around 9.55.

Debt to total asset ratio Awash bank was the same in the fiscal years 2005 and 2007. The bank has reported the lowest rate in 2009. Comparing it with the average rate of the private commercial banks, weak performance has been reported by Awash bank.

The equity multiplier of awash banks has shown continuous improvement from the fiscal year 2005 to 2009. But when it is compared with the average rate of the private commercial bank, the banks performance was the lowest.

The same asset utilization ratios in the fiscal years 2006 to 2008 was reported by the Awash banks. Lower rate of performance was reported by the bank in all the fiscal years when it is compared with the average rate of the private commercial banks.

The income to expense ratio of the Awash Bank has shown a declining trend from 2005 to 2008. But in 2005 and 2006 the banks performance was better than the performance of the other private commercial banks. From 2007 onwards the banks performance has shown a declining trend.

The operating efficiency ratios of Awash Bank were remarked by an increasing trend in 2005 and 2006. From 2007 to 2009 the performance of the bank has shown a declining trend when it was compared with the average operating efficiency ratio of the other private commercial banks.

The proportion of non-performing loan to total loan of Awash bank has shown a declined trend from the fiscal year 2006 to 2009 which implies that the bank's credit management is becoming weaker and weaker or the bank is not appraising the quality of borrowers and the increment of doubtful loan left uncollectible.

From all the measurements used in the study to analyze the financial performance of Awash Bank of (both the trend and comparative financial performance analysis approaches), it is concluded that the bank's financial performance is declining from one fiscal year to the other in all the study periods considered in the paper (2005 to 2009), which implies the bank's future sustainability is under question.

## 5.2 Recommendations

The profitability ratios (return on asset, return on equity, return on deposit, income expense ratio, non-interest income to asset ratio) of Awash banks have shown a declining trend in all the study periods (from the fiscal year 2005 to 2009). This implies that the performance of the bank became weaker and weaker. In order to improve its profitability the management of Awash banks has to reduce the proportion of nonperforming loan to total loan, search for less costly capital sources, dispose of the assets which are not contributing for the profitability of the bank, and work to maximize the overall profits of the bank through investing in profitable investments.

Awash Bank liquidity ratio showed a fluctuating trend. From 2005 to 2006, it has grown by 15 percent but from the fiscal year 2006 to 2009, this ratio has shown a declining trend which implies that the bank has started to retain most of its deposits. This in turn shows that the bank has much unproductive cash in the store, which is costly since continuous interest rate will be paid on this idle cash. This had its own impact on the overall profitability of the bank. Therefore,

the bank management has to work to retain optimum amount of cash and granting the excess amount to borrowers of the bank as a loan or investing it in other profitable investments.

The risk and solvency ratios (debt to equity ratio, debt to total asset ratio and equity multiplier ratio) of Awash bank have shown a continuous growth. This implies that the bank has becoming more and more dependent on funds from creditors of the

Company; this is very risky for the overall sustainability of the bank. Therefore, the bank's management has to work to maximize the amount of owners' equity, and has to search for other sources of cash (like selling shares), etc. so that the performance of the bank can be improved.

The efficiency ratios of the bank (asset utilization ratio, income to expense ratio, and operating efficiency ratio) have shown that the bank's performance is deteriorating from year to year. This was because the costs of the bank were increasing from time to time but the revenues of the bank were following the reverse trend. Therefore, the bank's management has to work to reduce the costs (for instance, reduce the expense incurred for the proportion of non-performing loans to total loan and other administrative expense) and maximize the revenues of the bank by reducing the expense per dollar of the revenues generated.

The credit quality of Awash bank has shown that the bank's performance is becoming weaker and weaker from time to time. This implies that the bank's performance in collecting its loan granted to its borrowers is becoming lesser which in turn increases the expenses of the bank (because interest has to paid on deposits) and this makes the bank to be more dependent on creditors to cover other administrative and operational costs. Therefore, the bank's management has to work to reduce the proportion of nonperforming loan to total asset ratio and to maximize the proportion of owners' equity of the company. 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.

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# Appendix

AWASH BANK SHARE COMPANY

BALANCE SHEET

AS AT 30 JUNE,

	2005	2006	2007	2008	2009
ASSETS					
Cash and Bank Balances					
Cash on hand	109,500,832	101,106,090	128,155,838	325,464,779	612,145,892
Deposits with Local Commercial Banks	15,773,899	5,068,762	428,828	1,464,888	15,628,916
Deposits with Foreign Banks	193,235,775	203,021,312	260,260,211	294,932,194	374,929,138
Reserve Account with NBE	80,017,347	99,017,347	130,017,347	445,017,347	605,017,346
Other Accounts with NBE	<u>360,337,637</u>	<u>372,994,734</u>	<u>822,003,597</u>	<u>375,767,206</u>	<u>1,088,572,508</u>
	758,865,490	781,208,245	822,003,597	1,442,646,414	2,696,293,802
Items in course of collection from other banks	75,739,464	99,371,516	119,367,091	101,102,831	131,298,130
Deposits and Prepayments	3,984,886	5,151,392	9,184,928	10,435,575	10,591,683
Loans and Advances to Customers	1,172,968,585	1,901,466,545	2,197,341,801	2,566,577,377	2,442,747,456
Other Assets	13,837,763	9,356,072	7,047,312	83,213,659	118,055,094
Customers' Liabilities on L/C	<u>173,517,858</u>	<u>180,332,154</u>	<u>181,807,580</u>	-	-
	2,198,914,046	2,976,885,924	3,536,652,309	2,761,329,442	2,702,692,363
Intangible fixed Assets	1,020,748	846,477	672,206	-	1,153,004
Tangible fixed Asset	<u>30,787,945</u>	<u>36,327,279</u>	<u>40,639,495</u>	<u>65,473,144</u>	<u>75,998,395</u>
TOTAL ASSETS	2,230,722,739	3,014,059,680	3,577,964,010	4,269,946,935	5,476,625,540
LIABILITIES					
Deposits					

Demand Deposits	333,275,052	403,275,052	511,058,029	785,253,055	1,211,306,002
Savings Deposits	1,183,255,052	1,548,299,795	1,898,101,450	2,411,495,128	3,049,747,076
Fixed time Deposits	<u>111,096,783</u>	<u>225,357,313</u>	<u>312,168,110</u>	<u>281,018,825</u>	<u>233,133,349</u>
	1,627,627,080	2,176,885,481	2,721,327,589	3,477,767,008	4,494,186,427
Margins held on L/C	36,889,148	45,447,427	34,703,482	76,834,074	89,332,936
Other liabilities	118,476,315	172,866,461	208,919,138	287,933,943	328,909,679
Provision for tax	20,984,321	36,904,583	28,454,915	7,331,755	44,966,991
Bank's liabilities on L/C	<u>173,517,858</u>	<u>180,332,154</u>	<u>181,807,580</u>	<u>76,834,074</u>	<u>89,332,936</u>
TOTAL LIABILITIES	1,977,494,722	2,612,436,106	3,175,212,704	3,849,866,780	4,957,396,033
CAPITAL AND RESERVES					
Paid-up capital	165,726,575	264,713,109	265,000,000	312,571,450	313,141,425
Share premium	-	-	-	2,827,540	2,827,540
Legal reserve	36,203,274	58,023,261	74,598,461	78,762,326	103,854,312
Special reserve	5,506,436	13,427,245	13,427,245	13,427,245	29,918,839
Retained earnings	<u>45,791,732</u>	<u>65,459,959</u>	<u>49,725,600</u>	<u>12,491,594</u>	<u>73,487,391</u>
	253,228,017	401,623,574	402,751,306	420,080,155	519,229,507
Total Liabilities and Shareholders Fund	2,230,722,739	3,014,059,680	3,577,964,010	4,269,946,935	5,476,625,540

Source: Financial Statement of AB from 2005 to 2009

UNITED BANK SHARE COMPANY

BALANCE SHEET

AT 30 JUNE,

	2005	2006	2007	2008	2009
ASSETS					
Cash and bank balances	484,382,029	592,675,420	757,713,731	1,385,712,083	2,485,621,432
Loans and advances	570,025,059	974,949,418	1,367,883,083	1,809,902,837	2,086,516,735
Other assets	6,757,045	17,440,479	24,235,873	18,945,191	36,221,539
Deferred charges	1,042,996	917,154	1,041,530	1,544,003	1,325,320
Investment	-	-	320,000	320,000	506,000
Fixed assets	10,725,125	13,586,332	31,549,592	33,857,202	42,251,974

TOTAL ASSETS	1,072,932,254	1,599,568,803	2,182,743,809	3,250,281,316	4,652,443,000
LIABILITIES					
Deposits from customers	746,432,689	1,220,580,816	1,541,089,453	2,324,388,261	3,381,837,372
Deposits from institutions	118,735,542	72,178,991	139,680,126	118,963,649	233,914,724
Other liabilities	42,129,282	51,960,005	85,258,458	142,400,869	182,933,109
Margin held on L/C	28,795,152	47,534,159	34,395,684	161,861,101	293,825,226
Profit tax payable	<u>11,963,204</u>	<u>15,955,194</u>	<u>22,585,753</u>	<u>34,795,499</u>	<u>39,958,060</u>
TOTAL LIABILITIES	948,055,869	1,408,209,165	1,823,009,474	2,782,409,379	4,132,468,491
CAPITAL AND RESERVES					
Paid-up capital	87,664,950	130,834,967	259,326,669	330,277,074	355,202,724
Share premium	130,676	1,595,547	9,057,087	5,278,954	7,019,008
Legal reserve	13,803,181	24,724,204	40,792,802	63,551,864	86,948,104
Retained earnings	<u>23,277,578</u>	<u>34,204,920</u>	<u>50,557,777</u>	<u>68,764,045</u>	<u>70,804,673</u>
	124,876,385	191,359,638	359,734,335	467,871,937	519,974,509
TOTAL LIABILITIES AND CAPITAL	1,072,932,254	1,599,568,803	2,182,743,809	3,250,281,316	4,652,443,000

Source: Financial Statement of UB from 2005 to 2009

WEGAGEN BANK SHARE BANK

BALANCE SHEET

AT 30 JUNE,

	2005	2006	2007	2008	2009
ASSETS					
Cash and balances with banks	619,515,948	661,000,000	1,319,806,130	1,803,396,676	2,915,000,000
Loans and	951,028,332	1,516,000,000	2,060,606,572	2,207,928,130	1,984,000,000

advances					
Other assets	21,733,898	-	43,711,990	45,989,232	-
Deferred charges	2,351,713	-	597,068	815,801	-
Fixed assets	<u>21,022,695</u>	<u>25,000,000</u>	<u>49,464,353</u>	<u>56,391,267</u>	<u>58,000,000</u>
Total Assets	1,615,652,586	2,259,000,000	3,480,280,390	4,124,891,893	5,118,000,000
LIABILITIES					
Deposits from customers	1,230,004,473	-	2,236,538,813	2,567,876,386	-
Deposits from institutions	58,444,599	-	487,087,044	398,453,771	-
Demand deposits	-	725,000,000			1,870,000,000
Savings deposits	-	723,000,000			1,518,000,000
Fixed deposits	-	330,000,000			340,000,000
Other liabilities	88,756,525	118,000,000	153,783,036	228,878,979	264,000,000
Margin held on L/C	42,683,699	85,000,000	144,467,640	260,159,917	214,000,000
Provision for profit tax	15,583,530	23,000,000	41,305,813	51,153,448	75,000,000
Leasehold land payable	-	-	13,892,078	12,920,604	-
Total liabilities	1,435,472,826	2,004,000,000	3,077,074,424	3,519,443,105	4,281,000,000
CAPITAL AND RESERVES					
Paid-up capital	110,994,000	151,000,000	233,139,000	370,825,000	532,000,000
Share premium	1,683,200	-	5,241,450	9,679,450	-
Legal reserve	28,162,621	46,000,000	73,622,138	108,331,515	153,000,000
Special reserve	3,557,722	5,000,000	7,972,089	12,484,693	16,000,000
Retained earnings	<u>35,782,217</u>	<u>53,000,000</u>	<u>83,231,289</u>	<u>104,128,130</u>	<u>135,000,000</u>
	<u>1,615,652,586</u>	<u>255,000,000</u>	<u>403,205,966</u>	<u>605,448,788</u>	<u>836,000,000</u>
TOTAL CAPITAL AND LIABILITIES	1,615,652,586	2,259,000,000	3,480,280,390	4,124,891,893	5,118,000,000

Source: Financial Statement of WB from 2005 to 2009

## BALANCE SHEET

AS AT JUNE,

	2005	2006	2007	2008	2009
ASSETS					
Cash and bank balances					
Cash on hand	138,129,044	110,843,536	146,874,312	341,295,450	1,026,241,659
Reserve account with NBE	54,917,075	62,916,920	80,916,920	317,916,920	412,916,920
Payment account with NBE	42,806,914	30,549,825	197,758,297	402,171,911	493,347,150
Deposit with local banks	27,677,144	22,778,504	20,604,640	93,725,297	189,093,330
Deposit with foreign banks	<u>200,099,342</u>	<u>207,761,791</u>	<u>248,908,693</u>	<u>177,576,042</u>	<u>212,960,066</u>
	463,629,519	434,850,576	695,062,862	1,332,685,620	2,334,559,125
Other assets	169,978,292	140,729,956	111,303,896	238,108,548	293,884,214
Investment in shares	2,400,000	2,434,000	2,653,000	2,652,500	3,778,500
Loans and advances	1,085,710,775	1,418,048,098	1,755,831,156	2,033,788,606	2,118,055,100
Fixed assets	<u>10,185,168</u>	<u>30,957,098</u>	<u>41,746,558</u>	<u>42,875,885</u>	<u>56,230,088</u>
TOTAL ASSETS	1,731,903,754	2,027,020,081	2,606,596,372	3,650,111,159	4,806,507,027
LIABILITIES					
Deposits					
Demand deposits	292,413,467	327,306,953	422,953,177	670,979,595	1,031,726,983
Savings deposits	709,440,657	836,589,389	1,084,627,147	1,436,580,753	1,995,516,308
Fixed deposits	<u>222,322,642</u>	<u>287,875,543</u>	<u>871,354,235</u>	<u>362,370,955</u>	<u>269,146,679</u>
	1,224,176,766	1,451,771,885	1,878,934,559	2,469,931,303	3,296,389,970
Margins held on L/C	50,116,556	55,787,380	49,871,589	162,822,443	200,646,985
Other liabilities	214,676,882	211,366,186	222,912,510	373,500,276	514,936,300
Provision for tax	19,970,404	23,074,286	29,731,593	45,732,463	65,710,214
TOTAL LIABILITIES	1,508,940,608	1,741,999,737	2,181,450,251	3,051,986,485	4,077,683,469
CAPITAL AND RESERVES					
Share capital	160,000,000	200,000,000	297,573,500	416,901,000	487,129,000
Share premium	-	-	10,030,900	8,663,900	1,293,700
Legal reserve	29,883,586	44,048,978	62,954,884	91,214,596	129,729,210
Special reserve	600,000	700,000	800,000	900,000	1,000,000

Profit and loss account	<u>32,479,560</u>	<u>40,271,366</u>	<u>53,786,837</u>	<u>80,445,178</u>	<u>109,671,648</u>
	222,963,146	285,020,344	425,146,121	598,124,674	728,823,558
TOTAL CAPITAL AND LIABILITIES	1,731,903,754	2,027,020,081	2,606,596,372	3,650,111,159	4,806,507,027

Source: Financial Statement of NIB from 2005 to 2009

AWASH BANK

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 30 JUNE,

	2005	2006	2007	2008	2009
<b>INCOME</b>					
Interest income	104,677,146	165,275,931	201,548,788	252,419,524	275,894,414
Less: interest expense	<u>32,908,750</u>	<u>40,771,344</u>	<u>60,490,965</u>	<u>93,403,514</u>	<u>112,066,716</u>
Net interest income	71,768,396	124,504,587	141,057,823	159,016,010	163,827,698
Provision no longer required	11,531,638	444,770	-	-	-
Gain on fluctuation of exchange rates	16,631,389	25,790,857	33,795,470	52,999,000	68,580,780
Service charges-foreign and local	9,708,058	13,663,773	14,757,678	19,260,650	22,468,433
Commission earned	4,165,335	7,311,719	8,161,545	11,768,831	13,381,401
Other income	<u>4,919,369</u>	<u>7,951,475</u>	<u>8,424,363</u>	<u>10,997,997</u>	<u>24,487,917</u>
	118,724,185	179,667,181	206,196,879	254,042,488	292,746,229
<b>EXPENSES</b>					
Salaries and benefits	12,863,552	26,104,024	31,730,478	45,260,827	65,908,915
General and administration	17,852,583	22,853,201	29,841,319	42,672,401	65,306,729
Board of directors' fees	3,391,505	3,548,779	2,787,907	236,400	255,473
Audit fee	70,000	80,354	100,000	120,119	93,765
Provision for other receivables	2,505,971	4,159,280	-	1,073,974	139,974
Provision for doubtful loans & advances	<u>2,505,971</u>	<u>4,159,280</u>	<u>46,756,843</u>	<u>142,771,341</u>	<u>15,641,598</u>
	36,683,611	56,745,638	111,216,547	232,135,062	147,346,454
Profit before tax	82,040,574	122,921,543	94,980,332	21,907,426	145,399,775
Less: provision for tax	20,984,931	36,905,600	28,456,730	7,333,668	45,031,831
Prior period adjustments	-	<u>1,264,003</u>	<u>222,802</u>	<u>2,081,701</u>	-
Net profit after tax	61,055,643	87,279,946	66,300,800	16,655,459	100,367,944
Transfer to legal reserve	<u>15,263,911</u>	<u>21,819,987</u>	<u>16,575,200</u>	<u>4,163,865</u>	<u>25,091,986</u>

	45,791,732	65,459,959	49,725,600	12,491,594	75,275,958
Retained earnings brought forward	28,682,784	45,791,732	65,459,959	49,725,600	12,491,594
Less: transfer to special reserve	-	7,920,809	-	-	12,491,594
Dividends paid	28,682,784	37,870,923	65,459,959	-	12,491,594
Less: directors' share on profit	=	=	=	=	<u>1,788,567</u>
Retained earnings carried forward	45,791,732	65,459,959	49,725,600	12,491,594	73,487,391
Earning per share					
(par value of Birr 25)	10.08	10.76	6.25	1.45	8.02
Earnings per Birr 100 shares	40.32	43.02	25.02	5.79	32.09

*Source: Financial Statement of BOA from 2005 to 2009*

#### UNITED BANK SHARE COMPANY INCOME STATEMENT

FOR THE YEAR ENDED 30 JUNE,

	2005	2006	2007	2008	2009
<b>INCOME</b>					
Interest income	45,955,806	71,269,924	122,146,169	171,133,540	210,075,178
Less: interest expense	<u>17,447,956</u>	<u>28,553,034</u>	<u>39,576,527</u>	<u>62,829,571</u>	<u>87,664,034</u>
Net interest income	28,507,850	42,716,890	82,569,642	108,303,969	122,411,144
Net fees and commission income	19,643,120	25,388,260	26,605,012	40,268,128	56,186,560
Net gains from dealings in foreign currencies	23,630,994	26,824,029	40,380,801	59,408,716	72,867,127
Other income	<u>1,635,821</u>	<u>2,578,691</u>	<u>2,973,824</u>	<u>8,842,052</u>	<u>5,813,492</u>
Net operating income	73,417,785	97,507,870	152,529,279	216,822,865	257,278,323
Provision for doubtful loans and advances	7,119,714	6,391,600	13,269,166	13,584,580	16,700,000
Net interest and other income after provision for doubtful loans and advances	66,298,071	91,116,270	139,260,113	203,238,285	240,578,323
<b>EXPENSES</b>					
Salaries and benefits	9,587,021	13,859,278	22,891,653	34,346,397	54,677,915
General and administration expenses	12,553,252	15,863,386	26,973,539	39,481,316	48,681,455
Directors' fee	1,211,012	1,689,653	2,464,778	3,473,324	3,561,936

Audit fee	<u>58,121</u>	<u>58,121</u>	<u>70,000</u>	<u>105,500</u>	<u>114,000</u>
	23,409,406	31,470,438	52,399,970	77,406,537	107,035,306
Profit before taxation	42,409,406	59,645,832	86,860,143	125,831,748	133,543,017
Provision for taxation	<u>11,968,355</u>	<u>15,961,742</u>	<u>22,585,753</u>	<u>34,795,499</u>	<u>39,958,060</u>
Net profit after taxation	30,920,310	43,684,090	64,274,390	91,036,249	93,584,957
Legal reserve	<u>7,730,077</u>	<u>10,921,023</u>	<u>16,068,598</u>	<u>22,759,062</u>	<u>23,396,240</u>
Net profit after tax and legal reserve	23,190,233	32,763,067	48,205,792	68,277,187	70,188,717
Earning per share of Birr 100	34.73	41.60	35.87	29.51	27.06

*Source: Financial Statement of UB from 2005 to 2009*

WEGAGEN BANK SHARE COMPANY

INCOME STATEMENT

FOR THE YEAR ENDED 30 JUNE,

	2005	2006	2007	2008	2009
INCOME					
Interest income	79,913,317	120,000,000	185,021,035	238,242,127	233,543,954
Less: interest expense	<u>21,515,429</u>	<u>35,000,000</u>	<u>55,291,901</u>	<u>89,677,115</u>	<u>83,458,171</u>
Net interest income	58,397,888	85,000,000	129,729,134	148,565,012	150,085,783
Commission, fees and charges	39,176,276	52,000,000	66,633,394	90,625,922	90,186,237
Net gains from dealing in foreign currencies	29,370,387	46,500,000	66,689,701	98,687,993	139,694,032
Other operating income	1,280,673	1,500,000	1,704,659	2,686,487	8,815,418
Net operating income	128,225,224	185,000,000	264,756,888	340,565,414	368,781,470
Provision for doubtful loans and advances	19,082,579	29,000,000	32,109,500	50,183,892	=
Provision for doubtful debts other than loans and advances	<u>2,899,757</u>	=	<u>47,675</u>	<u>2,285,574</u>	<u>2,901,000</u>
	<u>21,982,336</u>	<u>29,000,000</u>	<u>32,157,175</u>	<u>52,469,466</u>	<u>2,901,000</u>
Net interest and other income	106,242,888	157,000,000	232,599,713	288,095,948	385,880,470
OPERATING EXPENSES					
Salaries and benefits	20,070,095	31,000,000	38,902,832	50,348,419	74,344,643

General administration expenses	22,655,141	31,000,000	36,213,750	43,097,034	49,701,732
Directors' fee	124,500	-	5,098,766	4,495,435	5,652,543
Audit fee	<u>100,000</u>	-	<u>103,500</u>	<u>164,105</u>	<u>80,098</u>
Total operating expense	<u>42,949,736</u>	<u>62,000,000</u>	<u>80,318,848</u>	<u>98,104,993</u>	<u>129,779,016</u>
Net profit before tax	63,293,152	95,000,000	152,280,865	189,990,955	256,101,454
Provision for profit tax	<u>15,583,530</u>	<u>23,000,000</u>	<u>41,305,813</u>	<u>51,153,448</u>	<u>75,499,105</u>
Net profit after tax	47,709,622	72,000,000	110,975,052	138,837,507	180,602,349
Legal reserve	<u>11,927,405</u>	<u>18,000,000</u>	<u>27,743,763</u>	<u>34,709,377</u>	<u>45,150,587</u>
Net profit after tax and legal reserve	35,782,217	54,000,000	83,231,289	104,128,130	135,451,762
Earning per share of Birr 1000	478	497	573	449	389

*Source: Financial Statement of WB from 2005 to 2009*

NIB INTERNATIONAL BANK

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 30 JUNE,

	2005	2006	2007	2008	2009
<b>INCOME</b>					
Interest income	82,954,648	106,187,449	147,290,760	209,998,084	253,590,455
Commission and service charges	23,428,070	24,851,943	26,955,828	48,275,800	90,192,623
Gain on foreign currency transactions	28,259,538	25,242,049	29,607,784	55,076,142	77,259,553
Other income	<u>1,238,075</u>	<u>1,862,518</u>	<u>3,646,585</u>	<u>3,232,348</u>	<u>4,973,798</u>
	135,880,331	158,143,959	207,500,957	316,582,374	426,016,429
<b>EXPENSES</b>					
Interest expense	23,888,684	33,094,423	42,138,001	62,217,698	75,112,910
Salaries and benefits	11,544,374	16,856,138	24,628,932	35,548,133	53,471,759
Administrative and general expenses	16,498,112	19,320,379	30,305,106	40,906,582	54,151,280
Provision for doubtful debts	18,184,058	9,170,090	4,993,195	19,035,151	23,391,813
Audit fee	<u>69,000</u>	<u>80,500</u>	<u>80,500</u>	<u>103,500</u>	<u>120,000</u>
	70,184,228	78,521,530	102,145,734	157,811,064	206,247,762
Net profit before taxation	65,696,103	79,622,429	105,355,223	158,771,310	219,768,667
Provision for taxation	<u>19,970,404</u>	<u>23,074,286</u>	<u>29,731,593</u>	<u>45,732,463</u>	<u>65,710,214</u>
Net profit after taxation	45,725,699	56,548,143	75,623,630	113,038,847	154,058,453

Appendix	Appendix	Appendix	Appendix	Appendix	Appendix
Less: transfer to legal reserve	11,431,425	14,165,392	18,905,907	28,259,712	38,514,613
Less: directors' allowance	1,714,714	2,124,809	2,830,886	4,233,957	5,772,192
Less: transfer to special reserve	100,000	100,000	100,000	100,000	100,000
Surplus for year balance	24,606,930	32,479,560	53,786,837	80,445,178	109,671,648
Dividend paid	<u>24,606,930</u>	<u>32,479,560</u>	<u>40,271,366</u>	<u>53,786,837</u>	<u>80,445,178</u>
Balance,30 June	32,479,560	40,271,366	53,786,837	80,445,178	109,671,648
Earning per share	160	161	160	161	170

*Source: Financial Statement of NIB from 2005 to 2009*

### **Interview Schedule**

The interview was conducted with the management Awash bank to have an understanding about the company and the causes for the fluctuations seen in the different financial ratios. The researcher has raised questions concerning the issues here under.

General information;

vision, mission and values of the bank

number of branches

total capital reserve

type of services provided

Causes for fluctuations of the financial ratios of the company Credit policy of the company:

Efficiency of the workers

Current status of the bank