ST. MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

OWNERSHIP AND ORGANIZATIONAL PERFORMANCE: A COMPARATIVE ANALYSIS OF PRIVATE AND STATE

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OWNERSHIP AND ORGANIZATIONAL PERFORMANCE: A COMPARATIVE ANALYSIS OF PRIVATE AND STATE OWNED BANKS

A THESIS SUBMITTED TO THE SCHOOL OF GRADUATE STUDIES OF ST' MARY UNIVERSITY IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE DEGREE OF MASTERS OF BUSINESS ADMINISTRATION (MBA)

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DECLARATION

I, the undersigned, declare that this study entitled is prepared with my own effort. It has not been presented for a degree in any other university or higher institutions, and that all the sources of data used for the study have been acknowledged

Name: Abeneazer Wondwossen

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ENDORSEMENT

This thesis has been submitted to St. Mary's University, School of Graduate Study examination with my approval as a university advisor.

Advisor: Elias Nour (PhD)

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Abbreviations

AIB	Awash International Bank
AU	Asset Utilization
BIB	Birhan International Bank
BOA	Bank of Abyssinia
BUIB	Buna International Bank
CBE	Commercial Bank of Ethiopia
CBB	Construction and Business Bank
CBO	Cooperative Bank of Oromia
DER	Debt Equity Ratio
DB	Dashen Bank
DBE	Development Bank of Ethiopia
EM	Equity Multiplier
LIB	Lion International Bank
IER	Income Expense Ratio
LADR	Liquid Asset to Deposit Ratio
LAR	Loan to Asset Ratio
LDR	Loan to Deposit Ratio
LIB	Lion International Bank
NBE	National Bank of Ethiopia
NIB	Nib Bank
OIB	Oromia International Bank
OE	Operating Efficiency
PM	Profit Margin
ROA	Return on Asset
ROE	Return on Equity
SOE	State Owned Enterprises
UB	United Bank
WB	Wegagen Bank
ZB	Zemen Bank

Abstract

Ethiopia's banking industry has experienced major structural transformations over the past decades; some of the key transformations include establishment of new banks, privatization of state-owned banks, domestic mergers and acquisitions (M&A). These changes have substantially altered the governance of banking organizations operating in Ethiopia. On the Study the performance of Banks were studied under their respective ownership category. The study highlight the role of ownership on the Ethiopian Banking sector and examines data and evaluates the performance of Banks in Ethiopia by categorizing them in to Private ownership and State ownership. It also examines the mode of ownership results in a higher performance rate. The core objective of the research is to spot the effects of ownership on performance of privately and state owned banks in Ethiopia and for this purpose Private and State owned Banks are selected based on their operation life in the banking sector. The study used available secondary data from published balance sheets and income statements from 2005 to 2010. Practically evidences are showing that state owned banks are better in performance than privately owned banks, out of all ratios, only four ratios (DER, ROA, and AU & EM) proved that private ownership is greater. However, the playing ground which private and state owned banks are competing is not fair, for example, the NBE-Bill is valid only to private banks, and any public offices and sectors are forced to work with CBE and also resources for condominium housing is mobilized only by the public owned CBE, so, this unequal treatment of private and state owned banks negatively affected private banks. Thus, the regulatory body of the banking system must revise directives issued on privately owned banks to encourage their participation and to motivate private banks to strive for more growth in the banking sector.

Key words; ownership, private ownership, state ownership

CHAPTER ONE

INTRODUCTION

1.1. Background of the study

Ownership structure is considered as an important factor that affects a firm's health (Zeitun and Tian, 2007). Some studies show, private corporations and partnerships outperform public corporations. This difference can be attributed to close monitoring by owners and greater motivation by professional workers seeking ownership stakes. Ownership structure is widely accepted in the finance and economics literature as an instrumental determinant of firm performance.

Ethiopia's banking industry has experienced major structural transformations over the past decades; some of the key transformations include establishment of new banks, privatization of state-owned banks, domestic mergers and acquisitions (M&A), These changes have substantially altered the governance of banking organizations operating in Ethiopia. Therefore, it is warranted to investigate how these transformations affect bank performance. A few studies investigate bank ownership and performance in Ethiopia and find that private banks outperform public ones. The researchers (Micco, A., Panizza, U., Yañez, M., 2007) analyzes and states that political factors also do affect bank performance.

Over the past three decades, a new wave of bank privatizations has significantly changed bank ownership structure in many countries. While governments have reduced their ownership stakes in banks, foreigners, and, to a lesser extent, large domestic block holders, including local companies and individuals, have stepped in.

Consequently, the banking sector has experienced major transformations in its operating environment (Delis & Papani kolaou, 2009). Academic and practical study on the correlation between ownership structure and company performance was initially motivated by the separation of ownership from control which has been a vital research topic, and formed ongoing argument in the literature of commercial finance. Some researches favor state owned organizations while rest of them favor private organization for greater performance. Such as La Porta, R., F. L´opez-de-

Silanes, A. Shleifer, and R. W. Vishnyhave (2002) found that the performance of private banks is typically better than state-owned banks. A study conducted by Majumdar (1998) to evaluate the comparative performance of government owned, mixed and private enterprises with the help of Data Envelopment Analysis in India and concluded that government owned enterprises are less efficient than mixed and private enterprises. Mixed enterprises on their turn are less efficient than private enterprises. Figueira, Nellis & Parker (2009) conducted a study to investigate the effect of ownership on bank efficiency in Latin America. They used a range of financial and economic ratios, and regression modeling and study revealed that there is little difference in performance of state and private banks. Yet there is growing practical indication on the impact of ownership and company performance in advanced markets while ownership is estimated an important part of bank operation, little considerations have been given and there is very little practical proof in developing economy such as Ethiopia to inspect what creates ownership structure and its power on firm's performance.

In the speedily developing markets of Ethiopia, as in countless other evolving markets, the banks are likely to show a crucial role. Study has confirmed that financial institutions are critically important for growth and efficient capital allocation (Levine 2005). It is, therefore, vital to recognize the key elements for exploiting the performance of banks and their role in the rising markets.

Consequently, the research examined which of the two sectors (private or state owned banks) is greater in performance. Numerical (quantitative) approach was used in this study to compare performance of state and private banks in Ethiopia in terms of profitability, liquidity, solvency and efficiency. Comparative and trend analysis were used for this purpose.

1.2. History of the Banking Sector

The government promised not to allow any bank to be established in the country within the 50-year concession period. Within the first fifteen years of its operation, Bank of Abyssinia opened branches in different areas of the country. In 1906 a branch in Harar (Eastern Ethiopia) was opened at the same time of the inauguration of Bank of Abyssinia in Addis Ababa. Another at Dire Dawa was opened two years later and at Gore in 1912 and at Dessie and Djibouti in 1920. Mac Gillivray, the then representative and negotiator of Bank of Egypt, was appointed to be the governor of the new bank and he was succeeded by H Goldie, Miles Backhouse, and CS Collier were in change

from 1919 until the Bank's liquidation in 1931. The society at that time being new for the banking service, Bank of Abyssinia had faced difficulty of familiarizing the public with it. It had also need to meet considerable cost of installation and the costly journeys by its administrative personnel. As a result, despite its monopolistic position, the Bank earned no profit until 1914. Profits were recorded in 1919, 1920 and from 1924 onwards. Generally, in its short period of existence, Bank of Abyssinia had been carrying out limited business such as keeping government accounts, some export financing and undertaking various tasks for the government. Moreover, the Bank faced enormous pressure for being inefficient and purely profit motivated and reached an agreement to abandon its operation and be liquidated in order to disengage banking from foreign control and to make the institution responsible to Ethiopia's credit needs. Thus by 1931 Bank of Abyssinia was legally replaced by Bank of Ethiopia shortly after Emperor Haile Selassie came to power. The new Bank, Bank of Ethiopia, was a purely Ethiopian institution and was the first indigenous bank in Africa and established by an official decree on August 29, 1931 with capital of £750,000. Bank of Egypt was willing to abandon it's on cessionary rights in return for a payment of Pound Sterling 40,000 and the transfer of ownership took place very smoothly and the offices and personnel of the Bank of Abyssinia including its manager, Mr. Collier, being retained by the new Bank. Ethiopian government owned 60 percent of the total shares of the Bank and all transactions were subject to scrutiny by its Minister of Finance.

Bank of Ethiopia took over the commercial activities of the Bank of Abyssinia and was authorized to issue notes and coins. The Bank with branches in Dire Dawa, Gore, Dessie, Debre Tabor, Harar, agency in Gambella and a transit office in Djibouti continued successfully until the Italian invasion in 1935. During the invasion, the Italians established branches of their main Banks namely Banca d'Italia, Banco di Roma, Banco di Napoli and Banca Nazionale del lavoro and started operation in the main towns of Ethiopia. However, they all ceased operation soon after liberation except Banco di Roma and Banco di Napoli which remained in Asmara. In 1941 another foreign bank, Barclays Bank, came to Ethiopia with the British troops and organized banking services in Addis Ababa, until its withdrawal in 1943. Then on 15th April 1943, the State Bank of Ethiopia commenced full operation after 8 months of preparatory activities. It acted as the central Bank of Ethiopia and had a power to issue bank notes and coins as the agent of the Ministry of Finance. In 1945 and 1949 the Bank was granted the sole right of issuing currency and deal in foreign currency. The Bank also functioned as the principal commercial bank in the country and engaged in all commercial

banking activities. The State Bank of Ethiopia had established 21 branches including a branch in Khartoum, Sudan and a transit office on Djibouti until it ceased to exist by bank proclamation issued on December, 1963. Then the Ethiopian Monetary and Banking law that came into force in 1963 separated the function of commercial and central banking creating National Bank of Ethiopia and commercial Bank of Ethiopia. Moreover, it allowed foreign banks to operate in Ethiopia limiting their maximum ownership to be 49 percent while the remaining balance should be owned by Ethiopians. The National Bank of Ethiopia with more power and duties started its operation in January 1964. Following the incorporation as a share company on December 16, 1963 as per proclamation No.207/1955 of October 1963, Commercial Bank of Ethiopia took over the commercial banking activities of the former State Bank of Ethiopia. It started operation on January 1, 1964 with a capital of Eth. Birr 20 million. In the new Commercial Bank of Ethiopia, in contrast with the former State Bank of Ethiopia, all employees were Ethiopians.

There were two other banks in operation namely Banco di Roma S. and Bank of di Napoli S.C. that later reapplied for license according to the new proclamation each having a paid-up capital of Eth. Birr 2 million. The first privately owned bank, Addis Ababa Bank Share Company, was established on Ethiopians initiative and started operation in 1964 with a capital of 2 million in association with National and Grindlay Bank, London which had 40 percent of the total share. In 1968, the original capital of the Bank rose to 5.0 million and until it ceased operation, it had 300 staff at 26 branches. There were other financial institutions operating in the country like the Imperial Savings and Home Ownership Public Association (ISHOPA) which specialized in providing loans for the construction of residential houses and to individuals under the guarantee of their savings. There was also the Saving and Mortgage Corporation of Ethiopia whose aims and duties were to accept savings and trust deposits account and provide loans for the construction, repair and improvement of residential houses, commercial and industrial buildings and carry out all activities related to mortgage operations. On the other hand, there was a bank called Agricultural Bank that provides loan for the agricultural and other relevant projects established in 1945. But in 1951 the Investment Bank of Ethiopia replaced it. In 1965, the name of the bank once again hanged to Ethiopian Investment Corporation Share Company and the capital raised to Eth. Birr 20 million, which was fully paid up. However, proclamation No.55 of 1970 established the Agricultural and Industrial Development Bank Share Company by taking over the asset and liability of the former Development Bank and Investment Corporation of Ethiopia. Following the

declaration of socialism in 1974 the government extended its control over the whole economy and nationalized all large corporations. Organizational setups were taken in order to create stronger institutions by merging those that perform similar functions. Accordingly, the three private owned banks, Addis Ababa Bank, Banco di Roma and Banco di Napoli Merged in 1976 to form the second largest Bank in Ethiopia called Addis Bank with a capital of Eth. birr 20 million and had a staff of 480 and 34 branches. Before the merger, the foreign participation of these banks was first nationalized in early 1975. Then Addis Bank and Commercial Bank of Ethiopia S.C. were merged by proclamation No.184 of August 2, 1980 to form the sole commercial bank in the country till the establishment of private commercial banks in 1994. The Commercial Bank of Ethiopia commenced its operation with a capital of Birr 65 million, 128 branches and 3,633 employees. The Savings and Mortgage Corporation S. and Imperial Saving and Home Ownership Public Association were also merged to form the Housing and Saving Bank with working capital of Birr 6.0 million and all rights, privileges, assets and liabilities were transferred by proclamation No.60, 1975 to the new bank. Proclamation No.99 of 1976 brought into existence the Agricultural and Industrial Bank, which was formed in 1970 as a 100 percent state ownership, was brought under the umbrella of the National Bank of Ethiopia. Then it was reestablished by proclamation No. 158 of 1979 as a public finance agency possessing judicial personality and named Agricultural and Industrial Development Bank (AIDB). It was entrusted with the financing of the economic development of the agricultural, industrial and other sectors of the national economy extending credits of medium and long-term nature as well as short-term agricultural production loans.

The financial sector that the socialist oriented government left behind constituted only 3 banks and each enjoying monopoly in its respective market. The following was the structure of the sector at the end of the era.

- The National Bank of Ethiopia (NBE)
- The Commercial Bank of Ethiopia (CBE)
- Agricultural and Industrial Development Bank (AIDB)

1.3. Statement of the Problem

Many scholars (Eg. Figueira, Nellis & Parker (2009), Delis & Papani kolaou, 2009) have examined the relationship between Ownership and organizational performance and offered their conclusions on the foundation of realities and statistics. Ownership and organizational performance is a subject, which has attracted the interest of a large number of intellects and has been discussed by scholars for a much-extended period of time.

Analysis of the work done by diverse scholars in the world directs three potential conditions:

A. Some scholars demonstrated that private organizations are greater in performance, as La Porta, R., F. L´opez-de-Silanes, A. Shleifer, and R. W. Vishnyhave (2002) found that the performance of private banks is typically better than state-owned banks.

B. Others evidenced that ownership structure does not have any control on performance. In their conclusions, other factors like environment and externalities regulate the performance. (Eg. Micco, A., Panizza, U., Yañez, M., 2007)

C. Others verified that publicly held organizations are greater in performance. (Eg. Unal, Aktas & Acikalin (2007)

The Ethiopian financial sector has not been studied to any great extent, from viewpoint of ownership and performance. What separates this study is that, the study will take a close look at the Ethiopian banking sector by developing banks data to study the performance of state-owned and privately owned banks. The exploration will predominately focus on the consequence of ownership on banks performance and provides indications in a new setting and the research has predominately focused on the effect of ownership on banks performance and provides evidences with respect to Ethiopian corporate culture. Specifically, the study compared the effects of two forms of ownership which are private and state ownership on banks performance.

1.4. Research Questions

The core research question for this study is, which ownership structure performs better between private and state owned banks in Ethiopia?

Specific questions are the following;

1. What kind of link exists among ownership and bank profitability in Ethiopia?
2. What kind of link exists between state ownership and bank profitability in Ethiopia?

3. What is the relationship between private ownership and bank profitability in Ethiopia?

1.5. Objective of the Study

The core objective this research is to spot the effects of ownership on performance of privately and state owned banks in Ethiopia and to know which ownership structure performs better between private and state owned banks. In addition, the study has the following specific objectives;

- To profoundly investigate the financial performance of the banking area.
- To establish which of the two sectors (private or public ownership) is higher in performance.
- To determine the relationship between ownership and bank profitability in Ethiopia.
- To determine the relationship between state ownership and bank profitability in Ethiopia.

1.6. Significance of the study

Monetary executives will be more delicate to the effect that the various owners may have to closely check the decisions they make with regard to the various corporate decisions such as dividend policy, investment policy and capital budgeting decisions of banks. Monetary managers will additionally identify whether minority investors have a role to play.

The government through the supervisors will be interested to know how the various owners may make decisions that may affect some sectors of the economy and come up with guidelines.

Policy makers will pursue economic reforms that will influence the corporate policies to be geared towards the safety of the nation at large and shield against minority investors.

The study will also guide strategy architects in the banking area particularly the Central Bank of Ethiopia.

In detail this Study:

- Will be useful for evaluating the presently dominant ownership structure of the banking area.

- The study will help the present and possible shareholders, bank depositors, investors, Ministry of Finance and bank managers.
- The study will provide a base for further study and research on assessment of the impact of the currently prevailed ownership and market structure on the performance of the Ethiopian banking industry.
- Finally, the research will give insight to scholars and learners about the problem and motivate further exploration of the topic to be carried on.

1.7. Scope of the Study

The study assesses the performance of the Ethiopian banking industry based on the structure of ownership, especially the financial performance. In order to make the study homogenous and reasonable, the study takes statistics from commercial banks that are established for revenue earnings and were in operation for more than 15 years.

Banks with development objective like Development Bank of Ethiopia (DBE) will not be involved in the research. Furthermore, only information's which can be broadcasted for the community by commercial banks will be referenced for the investigation.

1.8. Limitations of the Study

Although the research has reached its goal, there were some unavoidable limitations. First because of time limit, the research has only included some selected banks. But it should have included all banks under private ownership and state ownership. Second there were a cost limitations in developing the research. Third some data quality problems have been seen and most data were taken from bank reports which are initially designed to please shareholders.

1.9. Definition of Terms

Profitability; - is the ability of a business to earn a profit. A profit is what is left of the revenue a business generates after it pays all expenses directly related to the generation of the revenue, such as producing a product, and other expenses related to the conduct of the business activities. Banking profitability is commonly measured by return on equity and return on assets. However, in this investigation, to know whether private or state owned banks are more profitable, different variables are used to assess ability of the bank to earn profit in comparison with all its expenses.

Return on Assets (ROA); is an indicator of how profitable a company is relative to its total **assets**. **ROA** gives an idea as to how efficient management is at using its **assets** to generate earnings. Calculated by dividing a company's annual earnings by its total **assets**, **ROA** is displayed as a percentage. The return on assets (ROA) is financial ratio used to measure the relationship of profits or earnings and total assets. (ROA) measure assesses the profitability performance of total assets, and could be treated as measure of financial performance in this study. As mentioned earlier, ROA reflects the bank management ability to generate profits by using the available financial and real assets. It is calculated as (Net Profit / Total Assets). Other indicators of profitability are Return on Equity (ROE) (Net Profit / Shareholders' Equity) are used as a measure of banks performance in terms of profitability. The other one is profit margin which can be measured as **(Interest Income + Noninterest Income/Net Profit)**

Liquidity; - the degree to which an asset or security can be quickly bought or sold in the market without affecting the asset's price. Liquidity ratios measure ability of the firm to meet its short-term (less than a year) obligations and reveal short-term financial strength and weakness (Ross, Westerfield & Jaffe 2005).

Solvency and Risk: Solvency is the ability of a company to meet its long-term financial obligations. Solvency is essential to staying in business as it asserts a company's ability to continue operations into the foreseeable future. Greater is the probability that the firm will become unable to fulfill its contractual obligations leading to bankruptcy and financial distress. Although debt is important source of financing and provide significant tax advantage but it may create conflict of interest between debtors and shareholders (Ross, Wester field & Jaffe 2005). If number of assets held by a firm is greater than all types of liabilities, then firm is considered solvent. Variables that are used to measure solvency in this study are Debt-Equity Ratio (DER) (Total Debt / Shareholders' Equity) and Equity Multiplier (EM) (Total Assets/ Shareholders' Equity).

Efficiency; **-** The state or quality of being efficient. Weather to know Private or state owned banks are more efficient in assets or resource management efficiency ratios are utilized. These ratios measure overall effectiveness of the firm in utilizing its assets to generate sales, quality of receivables and success in collection, effectiveness of inventory management practices and efficiency of the firm in controlling its expenses. While variables to be used to measure efficiency of sample banks for this study includes; Asset Utilization (AU) (Total Revenue / Total Assets),

Operating Efficiency (OE) (Operating Revenue / Total Operating Expenses) and Income Expense Ratio (IER) (Total Operating Income/Total Operating Expense).

Growth performance; to know the increment in performance, this study examines how Assets, Loans and deposits are used.

1.10. Organization of the Study

The first Chapter of this study have a background of the study and introduced the problem statement also described the specific problem, the significance of the study and the research questions with the study scope and limitations. The second chapter presents a relevant research associated with the problem addressed in this study. The third chapter presents the methodology and procedures used for data collection and analysis. And described the different kinds of variables used in the study. The Fourth chapter contains an analysis of the data and presentation of the results with findings. The fifth chapter offers summary, conclusions, and recommendations for future research.

CHAPTER TWO

RELATED LITERATURE

The firm can be viewed as a link of contracts between resource holders. A relationship ascends when one or more persons, titled principals, employ one or more other individuals, called agents, to perform some service and then delegate decision-making authority to the agents. The primary agency relationships in business are those between stockholders and managers; and between debt holders and stockholders. These relationships are not necessarily harmonious; indeed, agency theory is concerned with so-called agency conflicts, or conflicts of interest between agents and leaders. This has implications for, among other things, corporate governance and corporate ethics. When agency occurs it also tends to give rise to agency expenses, which are expenses incurred in order to sustain an effective agency relationship. Accordingly, agency theory has emerged as a dominant model in the financial economics literature, and is widely discussed in business ethics texts. Agency theory in a formal sense originated in the early 1970s, but the concepts behind it have a long and varied history (Bowie & Edward, 1992). The principal-agent model suggests that managers are less likely to engage in strictly profit maximizing behavior in the absence of strict monitoring by shareholders (Prowse, 1992; Agrawal & Knoeber, 1996). Therefore, if owner-controlled firms are more profitable than manager controlled firms, it would seem that intense ownership provides better monitoring which take to better performance. Resource Based View (RBV) holds that firms can earn sustainable super-normal returns if and only if they have superior intangible resources that are protected by some form of isolating mechanism preventing their diffusion throughout industry.

According to Wernerfelt (1984) and Rumelt (1984), the fundamental principle of the RBV is that the basis for a competitive advantage of a firm lies primarily in the application of the bundle of valuable resources at the firm's disposal. To transform a short-run competitive advantage into a sustained competitive advantage requires that these resources are heterogeneous in nature and not perfectly mobile (Barney, 1991; Peteraf, 1993). Essentially, these valuable resources become a source of sustained competitive advantage when they are neither perfectly imitable nor substitutable without great effort (Barney, 1991). In a nutshell, therefore, to realize these justifiable

average returns, the firm's bundle of resources must be valuable, rare, imperfectly imitable and non-substitutable (Barney, 1991). The extent to which exterior and interior factors affect managerial discretion will depend on, among other factors, the manager's locus of control, perception of discretion and the amount of power that people perceive the manager to own.

Foreign shareholders are gifted with good monitoring competences, but their financial focus and emphasis on liquidity results in them unwilling to commit to a long-term relationship with the firm and to engage in a process of restructuring in case of poor performance. These shareholders prefer strategies of exit rather than voice to monitor management (Aguilera &Jackson, 2003). Consequently, foreign shareholders are postulated to have a moderate impact on firm performance. Domestic shareholders possess characteristics that represent the worst of both worlds. Their financial focus leads to short-term behavior and a preference for liquid stocks while their domestic affiliation often results in a complex web of business relationship with the firm and other domestic shareholders (Claessens, S., Djankov, S. and Lang, L. (2000); Dharwadkar, R., George, G. and Brandes, P. (2000). Therefore, these owners are likely to have undesirable impact on Company's performance.

2.1. Types of ownership

We can categorize ownership by different kinds of characteristics as controlling abilities and enduring rights which also can be the assignment of property rights. Generally, ownership can be private, public, or state.

Private Ownership: The raw definition it's the fact of being owned by a private individual or organization, rather than by the state or a public body Private Ownership should generally be preferred to public ownership when the incentives to innovate and to contain costs must be strong. In essence, this is the case for capitalism over socialism, explaining the "dynamic vitality" of free enterprise. The great economists of the 1930s and 1940s failed to see the dangers of socialism in part because they focused on the role of prices under socialism and capitalism, and ignored the enormous importance of ownership as the source of capitalist incentives to innovate. Moreover, many of the concerns that private firms fail to address "social goals" can be addressed through government contracting and regulation, without resort to government ownership. The case for private provision only becomes stronger when competition between suppliers, reputational

mechanisms, the possibility of provision by private not-for-profit firms, as well as political patronage and corruption, are brought into play. (Andrei Shleifer, 1998)

Public Ownership: Governor Rights and residual rights are assigned to all members of community. It is a pure public ownership. It is an open system with lack of exclusivity. In public property, right system, exclusive rights are not assigned to any individual, to any organization or even to state. So, this property right system is considered as nonprofit. The examples of public property right system are waterways, public roads and ocean fisheries beyond internationally agreed limits (Carroll, 2004.). Technically public property right system is very close to state property right system but has a clear demarcation. The best example that can be presented here is of public parks. State or local government develops these parks for welfare of general public. State technically has capability to limit public access from using public parks by imposing fee for entrance. If this right is used by the state frequently then parks can be identified as state-owned property. If the state does not use this right, then parks can be identified as public property (Alchian and Demsetz, 1973).

State Ownership: Control rights and residual rights are assigned to government or state. In state property, right system, state is granted exclusive rights to a resource and the state can limit access of public to the resource. For example, state can limit public access to military bases or federal lands (in Ethiopia land is on the hands of government and can neither be rented nor sold) by putting restrictions on commercial activities. In this property, right system, state is also granted transferability right. So, government can sell or lease a government property (Carroll, 2004).

2.2. Organizational Performance

Company's performance will be compared to goals and objectives. Within corporate organizations, there are three primary outcomes mostly be analyzed which are financial performance, market performance and shareholder value performance. Performance can be demarcated as firm's capacity on achieving set objectives in an efficient and effective manner with evenness without looking for resolution from analysis. If analysis or measurement is carried out too often then it will consume more resources and become counterproductive (Stainer, 2006). Business firms are compared in terms of profits, sales, market share, productivity, debt ratios, and stock prices. Hospitals use cost recovery, mortality and morbidity rates, board certification of physicians, and

occupancy rates. Universities use research productivity and prestige of faculties, test scores of students and rankings by popular magazines. Such comparisons become a basis for evaluating executives, for making decisions about allocation of human and other resources, for writing history, and for stimulating arrogance and shame (Sutton, 1997).

2.3. Standards for Measuring Performance

Performance measurement is the regular systematic collection, analysis, and reporting of data that tracks resources used, work produced, and whether specific outcomes were achieved by an organization. Performance Measurement should be based on program goals and objectives that is tied to a statement of program mission or purpose. The performance measurement systems must produce measurable outcomes directly related to specific programs. Those outcomes are used as indicators for resource allocation comparisons over a period of time. Performance measurement provides for resource allocation comparisons over time and measures efficiency and effectiveness to encourage continuous improvement. Measurements must be verifiable to ensure their validity and usefulness is not a question; they must be understandable or the risk will be wrongly applied or wrongly interpreted; and they must be timely to ensure conditions have not changed since the measurements and the measurements are available in a time frame to assist in making management decisions, particularly budget preparation. Measurements must be consistent throughout and applicable to the strategic plan, the budget, and the current accounting and reporting systems (Alan Probst 2009)

In performance measurement, it is important to remember the difference between **efficiency** and **effectiveness**.

Efficiency is related to cost effectiveness, i.e. the lowest costs for a given output level. In performance measurement, the ratio of total input to useful output or outcome is referred to as “efficiency.” it can also be described as the production of the desired effects or results with minimum waste of time, effort, or skill.

Effectiveness is related to if the service level meets the demands of the citizens. An effort is effective if it is adequate to accomplish propose and produces the intended or expected results. (Alan Probst 2009)

Past Periods: Relating performance of a business with earlier years, it can be assumed that performance of the business is successful or failing. Issues can happen by choosing previous stages as standard as nearly most businesses have business cycles. Thus, performance can be enhanced or worsened due to these business cycles and it is tough to omit outcome of business cycles from performance. Because of this reasons and the result of the performance dimension will not be dependable.

Similar Businesses: Good setting, businesses are usually associated with other businesses of similar production. Then we can resolve the problem of business Cycles. Yet problems may appear as different businesses have different accounting principles and year ends. All banks in Ethiopia have similar accounting principles and similar year's ends, as this research is going to compare state versus private banks, parallel business standard is taken in to consideration.

Planned Performance: Performance can be measured with goals that organization established earlier, and in order to catch valuable outcomes; intended level should be based on genuine expectations.

2.4. Ownership and Organizational Efficiency

State-owned banks, and private domestic banks have a number of efficiency advantages and disadvantages relative to one another, and the measured efficiency of each ownership type reflects the net effects of these comparative advantages/disadvantages. Foreign banks headquartered in developed nations have generally superior managerial expertise/experience, access to capital, use of hard-information technologies, and ability to diversify risk in most developing host nations, where domestic institutions have not acquired comparable skills. However, foreign banks also generally suffer from disadvantages due to distance-related diseconomies, language and cultural differences, and poor ability to access and process locally-based soft information. State-owned institutions may have funding advantages due to government subsidies, but also often have disadvantages because of mandates to make certain types of loans. State-owned banks may also be inefficient due to a lack of market discipline.

The most common findings for developing nations are that on average, foreign banks are more efficient than or approximately equally efficient to private, domestic banks. Both of these groups are typically found to be significantly more efficient on average than state-owned banks, but there

are variations on all of these findings. To illustrate, some research using data from the transition nations of Eastern Europe finds foreign banks to be the most efficient on average, followed by private, domestic banks, and then state-owned banks (Bonin, Hasan, and Wachtel 2005a, b). However, another study of transition nations finds the mixed result that foreign banks are more cost efficient, but less profit efficient than both private, domestic and state-owned banks (Yildirim and Philippatos 2003). A study using 28 developing nations from various regions finds foreign banks to have the highest profit efficiency, followed by private, domestic banks, and then state-owned banks (Berger, Hasan, and Klapper 2004). For cost efficiency, the private, domestic banks rank higher than the foreign banks, but both are still much more efficient than state-owned banks. Two studies using Argentine data (prior to the crisis in 2002) find roughly equal efficiency for foreign and private, domestic banks, and that both are more efficient on average than state-owned banks (Delfino 2003, Berger, Clarke, Cull, Klapper, and Udell 2005). A study employing Pakistani information finds foreign banks are more profit efficient than private, domestic banks and state-owned banks, but all of these groups have similar average cost efficiency (Bonaccorsi di Patti and Hardy 2005). Finally, a study of banks in India finds that foreign banks are more efficient on average than private, domestic banks (Bhattacharya, Lovell, and Sahay 1997). This research will study also which ownership type will be more efficient on banks in Ethiopia.

2.5. Reasons for Variance in Performance

The Effect of Competition and Regulation: Competition is highly prevalent across society. Competition as a process "in which the comparison of an individual's performance is made with some standard in the presence of at least one other person who is aware of the criterion for comparison and can evaluate the comparison process" (Martens, 1975, p.71). Indeed, how we perform a given task when compared to others can define excellence. Furthermore "win-lose" terms are a common feature in the language of domains ranging from business and politics to education and sport. For example, a businessman "achieves" a promotion, the prime minister "wins" the general election, a pupil is "top of the class" and a boxer "defeats" his opponent.

Competition has consequence on performance of state owned and private establishments with a greater extent. Competition bring into line the behavior of managers in both state and private organizations. Two different views are found in literature about the effect of competition on performance of ownership. First group of scholars who are supporters of the argument that

‘primacy of competition versus ownership’ has argued that competition in product markets is more important determinant of efficiency than ownership of organization. When competitive product markets are normatively appropriate i.e. there is no product markets failure then ownership does not matter. There is no difference in efficiency of state and private organizations. It is only the competition that drives performance of state and private organizations. It can be concluded here that the introduction of competition in product market can eliminate the need for privatization. This argument was supported by Megginson et.al. (1994). the supporters of the argument witnessed that state-owned enterprises that were privatized in noncompetitive environment did not show any improvement in returns on sales. However, improvements were dramatic where privatization was carried in a competitive environment. So, degree of competition and effectiveness of regulatory policy have more effects than ownership (Vickers and Yarrow 1988).

Today the demand rises that in alike competitive setting which issues can be accountable for the variance in performance of state plus private establishments? This question is answered by Mujumdar (1998). Saying with similar competition, state owned and private enterprises can differ in performance based on their institutional environment. The choice of institutional environment is affected by form of ownership. So, ownership cannot be ruled out.

The Effect of Politics: We can define it as politics in organization is there are two possible explanations for poor performance of state owned organizations versus private organizations. First school of thought argues that state organizations have a social and developmental role which makes them socially profitable but financially unprofitable (Stiglitz 1994). Those who are critical to this thought are supporters of public choice theory and argue that state owned organizations are controlled by politicians who use them for their political objectives and as a result efficiency of state organizations is lowered than private organizations (La Porta, R., F. L´opez-de-Silanes, A. Shleifer, and R. W. Vishnyhave (2002)). Public Choice Theory studies economic behavior of non-market decision makers like politicians, voters and bureaucrats and assumes that man is an egoist, rational and utility maximizer and consequently suggests that government ministers and civil servants have different goals than profit maximization and they exhibit individual utility maximizing behavior. They are involved in increasing their vote bank and achieving budget maximization objectives leading to waste and inefficiencies (Shleifer and Vishny 1994).

Politicians increase their vote bank and political support in number of ways which in turn lower performance of state-owned organizations as compared to private organizations.

2.6. Banking Sector Reform

Financial sector slackening started earlier the fall of the Derg Government. Yet two proclamations were issued in 1994 with the current Government initiation, Monetary and Banking Proclamation (No. 83/1994), and the Licensing and Supervision of Banking Business (No. 84/1994). The primary declaration in toting to increasing the role of the National Bank of Ethiopia made unlawful any NBE lending other than the government while the second declaration allowed the Central Bank to supervise the financial institutions. Furthermore, dual additional declarations, 200/1994 and 203/1994 updated and retitled the Agricultural and Industrial Bank, and Housing and Saving Bank into Development Bank of Ethiopia and Construction and Saving Bank of Ethiopia, correspondingly and the two banks were recapitalized as public enterprises, and the financial sector reform did not invite private sector participation in the present government owned banks else entry of foreign banks in full share as well as with restricted share as partners with Ethiopian citizens. After 1994, Experts focus their energies on constructing ability in the monetary area as well as on other priority areas of economic transition, in particular further slackening of the foreign exchange system and trade liberalization measures. In cycle with such official preparation of the financial sector, sequence of policy measures, which include interest rate marketing and exchange rate reforms among others were undertaken. But financial slackening accelerated again when the lending rate was decontrolled and left to be determined by the banks themselves as late as January 1998 as compared to October 1992 when the bias between public and private charging of deposit rate was abolished.

Currently there are 16 private banks and 3 government-owned banks, 19 private and 1 government owned insurance companies, and 35 MFIs (as of May, 2012.). (NBE, Library book, History of the Banking Sector in Ethiopia)

2.7. The Post Reform Period

Following the end of the Dergue regime in 1991 that ruled the country for 17 years under the rule of command economy, the EPRDF declared a liberal economy system. In line with this, Monetary and Banking proclamation of 1994 established the national bank of Ethiopia as a judicial entity, separated from the government and outlined its main function.

Monetary and Banking Proclamation No.83/1994 and the Licensing and Supervision of Banking Business No.84/1994 laid down the legal basis for investment in the banking sector. Consequently, shortly after the proclamation the first private bank, Awash International Bank was established in 1994 by 486 shareholders and by 1998 the authorized capital of the Bank reached Birr 50.0 million. Dashen Bank was established on September 20, 1995 as a share company with an authorized and subscribed capital of Birr 50.0 million. 131 shareholders with subscribed and authorized capital of 25.0 million and 50 million founded bank of Abyssinia. Wegagen Bank with an authorized capital of Birr 60.0 million started operation in 1997. The fifth private bank, United Bank was established on 10th September 1998 by 335 shareholders. Nib International Bank that started operation on May 26, 1999 with an authorized capital of Birr 150.0 million. Cooperative Bank of Oromia was established on October 29, 2004 with an authorized capital of Birr 22.0 million. Lion International Bank with an authorized capital of Birr 108 million started operation in October 02, 2006. Zemen Bank that started operation on June 17, 2008 with an authorized capital of Birr 87.0 million. The last bank to be established to date is Oromia International Bank that started operation on September 18, 2008 with an authorized capital of Birr 91 million.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1. Sample selection

Private and State owned Banks are selected for the study. The Banks selection is based on operation life in the area as banks being on operation for more than fifteen years. Awash, Dashen, Abyssinia, Wegagen, United and NIB were being on operation and giving service for more than 15 years. The study is focused on private and state owned banks for one major reason, which is information's are widely available and easy to find.

The below listed Banks are include in the research.

Table 1: Selected Sample Banks

Name of Bank	Ownership	Year of Establishment	Number of Branches
Commercial bank of Ethiopia (CBE)	state	1974	**1140**
Construction and business bank(CBB)	state	1975	**120**
Awash international bank(AIB)	Private	1994	**187**
Wegagen (WB)	Private	1997	**194**
Abyssinia (BOA)	Private	1996	**196**
NIB Bank(NIB)	Private	1999	**171**

Source: Bank Profiles

3.2. Source of data

Available secondary data from published balance sheet and income statements from 2005 to 2010 are used on selected banks.

3.3. Data analysis

To directly give explanation for the first question, financial ratio analysis are used to specifically state the performance of state owned and private sector banks. Financial ratio analysis has calculations of some same relations between facts involved temporarily in the financial reports and

then implementing those relations as percentages to ideally use the business financial position and financial performance. It clearly view the performance of the business procedure. So, with the study current operations are compared with the pervious performance parallel using trend analysis. Industry ratios are linked with the firm's rations to know the company position in its industry and sector rations are also linked with the sector ratio to identify which of the two sectors are showing better performance.

On the research analysis, indicators on the variance in performance between state or private owned banks in Ethiopia have been showed. Additionally, the banking sector have been calculated with profitability, solvency, liquidity and efficiency in each banking sector.

3.4. Variables Used

3.4.1. Ownership variables

Today's understanding gave us two ownership variables. Which are private and state owned banks. In this study, Private ownership is to mean, institutions established by investors and shareholders and state ownership is to mean banks which are in control of the Government.

3.4.2. Performance variables

Indicators are profitability, solvency, liquidity, and efficiency to measure firm performance. All questions will be answered with the listed indicators.

3.4.3. Government Favors

The study includes favors from the Government or special treatments from the regulatory body which encourages Sate owned banks over private owned banks. The Government of Ethiopia for consecutive times have given chances for State banks specially "CBE" which helped the bank to increase its efficiency and number of customers. For example, giving the condominium saving structure which increases the bank customers and which directly increases the strength of "CBE" on saving strength perspective.

Private Banks in Ethiopia have challenges as a result of government policies, regulation and directives which hinder their competitiveness in terms of capital formation, resource mobilization and allocation of the resources in the form of loan.

CHAPTER FOUR

RESULT AND DISCUSSION

On the discussion part, the investigations of information's collected and observed, and empirical findings are presented. Industry averages are used as a benchmark and in addition one sector with other sector (state and private) are used as benchmark. The primary empirical findings of ratio analysis are presented with comparative analysis of performance of state and private banks. Lastly assets and deposit of both state and private banks are investigated. And the growing of lending also included on the investigation.

4.1. Profitability Ratios

Findings are clearly stated which gives information's regarding the profitability of banks. These indicators are Return on Equity (ROE), Return on Assets (ROA) and Profitability Margin (PM).

4.1.1. Return on Assets (ROA)

ROA quantifies all the profitability of banks in their assets involvement. The greater the ratio, the greater the profit in the bank. ROA is calculated for private and state sectors. ROA of state banks has shown increment on 2009 by 0.93% and on 2010 by 2.95%. Private bank ROA has shown increment on 2005 and on 2006 by 1.11% and on 2007 and 2008 decreased by 0.13%.

The increment on years from 2005 to 2006 was only by 0.34% and 2007 is also an increment for private banks by 3.42%. On the next two years, it was different, the private sector experienced decrement by 2.98% and by 2.90%. But 2010 showed an increment by 0.25% and reached 3.15%. On all the years private banks were better than state owned banks except on 2009 private sector showed a little increment and state owned banks showed a somehow greater increment.

Both state and private sector is below the Industry average in all the years except 2009 for private banks and 2008 for state owned banks are above Industry average.

As of Ross, Westerfield and jaffe in 2005 stated the higher the Return on Asset the better the managerial performance. So, we can clearly define private banks are better in managerial performance than state owned banks. And the investigation showed that private banks are more

profitable than state banks in the definition of ROA which shows greater percentage for private banks by 0.95%. On the below table, we can see the trend in the performance of both sectors.

Table 2: Return on Asset

Sector	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**Average**	**Std. Deviation**
State	1.40	2.55	2.59	2.46	3.39	2.95	2.56	0.605191
Private	2.98	3.32	3.42	2.98	2.9	3.31	3.15	0.222568
Industry average	2.07	2.61	2.58	2.94	3.18	1.48		

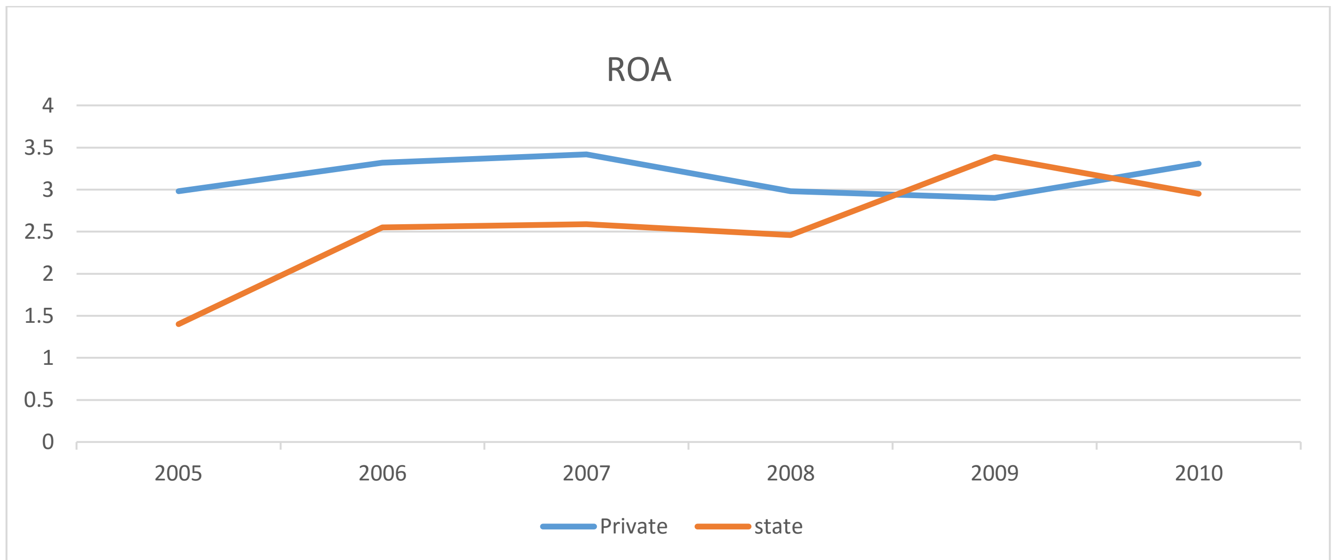

Figure 1: Return on Assets

4.1.2. Return on Equity (ROE)

The Return on equity is also part of the major indicators of profitability. The calculations here show the profitability of banks, the higher the ratio the more profitable of the banks which is in terms of their equity. On the years of 2005 state owned banks showed an increment from 28.74 to 43.22 and on 2006 this increment changed in to decrement to 32.7 which is in terms of percentage by 9.38%. On 2007 showed some increment to 35.73 and decrement on 2009 to 35.29. And an increment on 2010 to 35.55%. When we see private banks ROE in the 2005 to 2006 was an increment from 27.29% to 30.22% and a decrement on 2007 having 29.03. And on years from

2008 and 2009 also showed a decrement by 23.4. Increment have been viewed on the year 2010 by 27.5.

State sectors are above the industry average in all the years except in 2005 which is a 5.04 below the industry average. Private sectors are below the industry average except from the years 2007 to 2010. Totally ROE of private banks is less than the state banks by 9.5%. Which clearly shows that state banks are more profitable than private banks with ROE concept.

Table 3: Return on Equity

Sector	2005	2006	2007	2008	2009	2010	Average	Std. Deviation
State	28.74	43.32	32.7	35.73	35.29	34.55	36.31	0.605191
Private	27.29	30.22	29.03	23.4	23.4	27.5	26.81	0.203176
Industry Average	32.71	40.65	28.81	27.75	31.14	11.86		

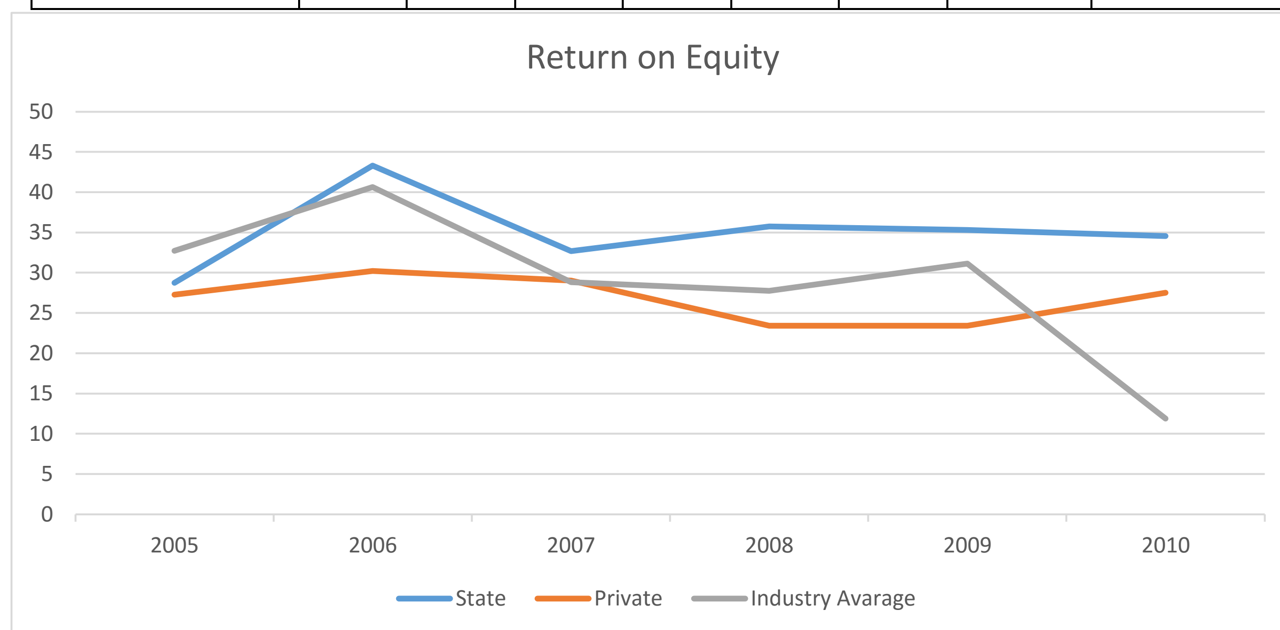

Figure 2: Return on Equity

4.1.3. Profit Margin

As discussed above there are couple of ways to measure profitability and profit margin is the one to measure. Here the higher the margin means there is an increase in net income and the lower need for financing from external than internal incomes. Private owned banks Profit margin has shown increment on the up to 2007 and showed a decrement on the year of 2008. Again 2009 marked an increment as 28.96% on 2008 to 31.53% in 2010. On the next year, private banks showed increment and registered 34.92%. On the same hand state, owned banks also showed increment from 28.3% in 2005 to 39.71% in 2008. And 2007 registered decrement by 32.08% then showed improvement to 41.98% in 2008. And 2010 showed 39% which is a decrement.

Profit Margin of state owned banks i.e. 37.03% is greater than that of private banks i.e.33.12%. So, it can be concluded that state owned banks are better in terms of profit margin than private banks.

Table 4: Profit Margin

Sector	2005	2006	2007	2008	2009	2010	Average	Std. Deviation
State	28.36	39.71	32.02	41.98	41.12	39	37.03	
Private	32.69	35.37	35.03	28.96	31.53	34.92	33.12	
Industry Average	36.68	39.97	36.34	38.30	41.08			

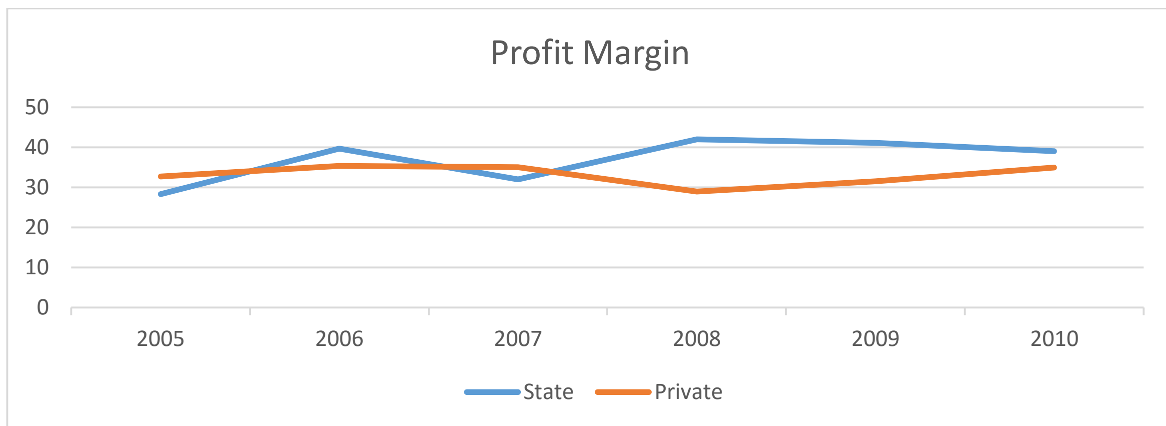

Figure 3: Profit Margin

4.2. Liquidity Ratios

On this Section Liquid asset to deposit ratio (CDR), Loan to Deposit Ratio (LDR) and Loan to Asset Ratio (LAR) to provide data about liquidity position of banks.

4.2.1. Liquid Asset to Deposit Ratio (LADR)

Ratio explains the ability to accommodate the demands of depositors to withdraw. The higher the ratio the more liquid the bank but the outcome lies on increasing the trust of customers and hurting the banks earing profit from cash. This will answer the capability of banks meeting the daily cash deposit withdrawal needs of depositors. Liquidity of banks are monitored by National bank of Ethiopia because liquidity problems will collapse banks. As NBE directive any banks should always maintain 25% of its total demand.

Private Banks liquidity decreases in the year 2005 to 2006 by 8.39% then shows continues increment up to 66.87% till 2009 and slightly decreased to 66.1% on 2010. Differently state owned banks showed increment on the year 2005 to 2006 by 2.52% (65.74% on 2005 to 66.26% on 2006). On 2010 shows decrement.

State owned banks are above the industry average except on the years of 2009. And private banks are below the industry average for the first three years. (2005 – 2007) and began to prosper and became above the industry average for the rest of the years unto 2010.

On the conclusion, it is clear that state owned banks are more liquid than private banks. And state owned banks have stronger liquidity position.

Table 5: Liquidity Ratios

Sector	2005	2006	2007	2008	2009	2010	Mean	Std. Deviation
State	63.74	66.26	64.56	55.04	43.72	41	55.72	10.12175
Private	44.89	36.50	40.48	51.34	66.87	66.1	51.04	12.94782
	57.17	58.47	61.48	46.19	45.46	50		

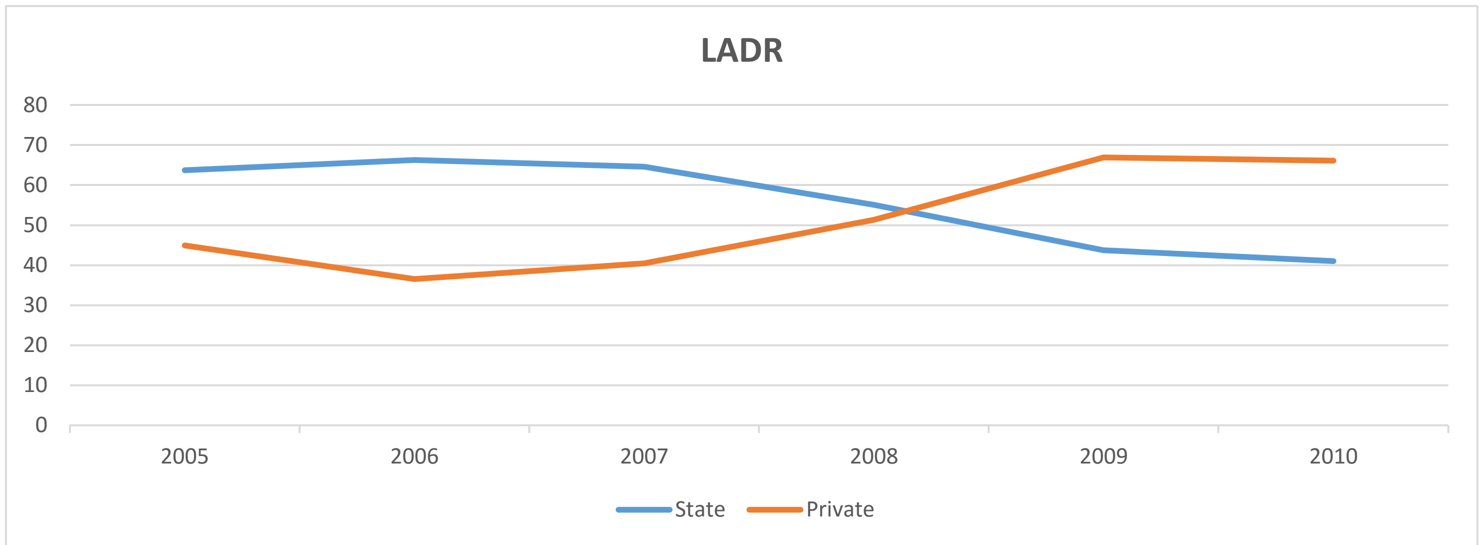

Figure 4: Liquidity Ratios

4.2.2. Loan to Deposit Ratio (LDR)

LDR is the ratio which indicates the liquidity of the banks, the higher LDR, the lower the deposit the banks have than the loans accessible to customers' means banks have lower demand to meet their short-term responsibilities. But the chance of earning from deposit will be higher. Private Banks on the year 2005 to 2006 shows decrement starting from 76.55 to 59.84. And recorded the highest growth in 2007 by 84.09. 2007. From the years 2005 to 2006 LDR of state banks decreases from 39.47% to 35.80% respectively. In 2007 for the state banks LDR also showed a slight decrement and reached 32.60%. In 2008 an increment was recorded up to 47.87% by continuously increasing on 2009 to 49.6%. In 2010 state banks experienced the highest LDR up to 84.09%. The conclusion is that private banks take the highest risk to earn profit. But when we see it overall the mean LDR of private banks is greater than that of state banks by 15.20% which shows clearly that state banks are more liquid than private banks in terms of LDR.

Table 6: Loan to deposit ratio

Sector	2005	2006	2007	2008	2009	2010	Mean	Std. deviation
State	39.47	35.80	32.60	47.87	49.60	84.09	48.24	
Private	76.55	59.84	84.25	76.05	58.37	55.56	63.44	10.91558
Industry average	42.62	46.15	45.85	54.57	51.19	55.43		

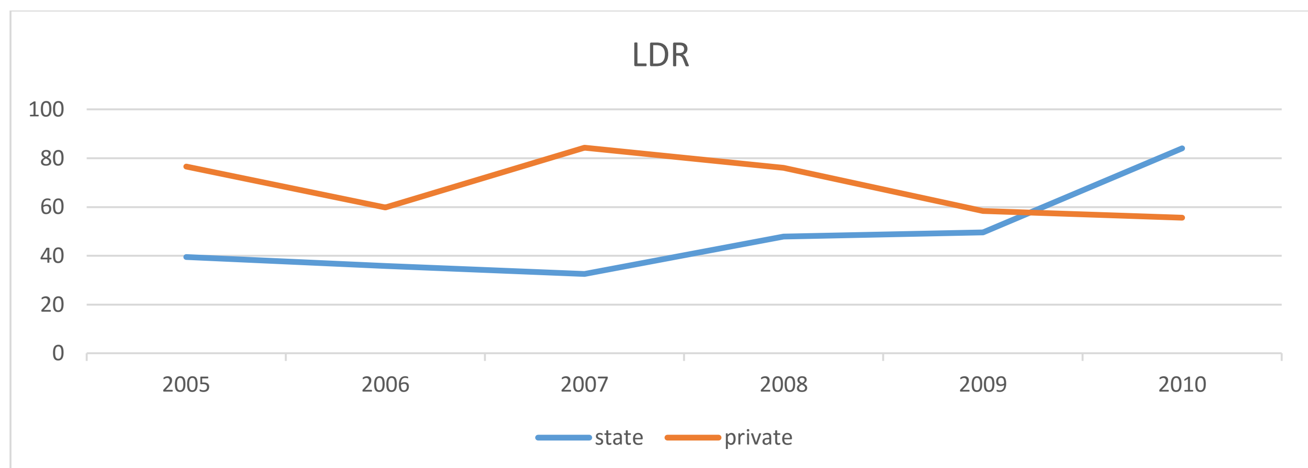

Figure 5: Loan to deposit ratio

4.2.3. Loan to Asset Ratio (LAR)

Loan to asset measures the liquidity of banks by comparing their loan capability and total assets. The less loan to asset ratio of banks the more liquid is the bank and vice versa. The higher liquid is the bank means that banks are giving loans within their capacity and there are no barriers that will hider them to meet their short-term responsibilities.

LAR of private banks in 2005 to 2006 shows a decrement from 61.72 to 49.77. And showed a slight increment in 2007 to 65.87 and continuously decreases up to 42.96 in 2010. When we came to state banks there is also a decrement in 2005 to 2006 from 29.75% to 28.82% and decrease again in 2007 to 24.45 and increase in the year 2008 to 35.46% and end at 2010 by 2010.

We can conclude that state owned banks are more liquid than private banks in terms of LAR, means state owned banks meet the short-term obligations better. And the mean LAR of state owned banks is 31.56% is less than that of private banks as being 53.94%.

Table 7: Loan to Asset ratio

Sector	2005	2006	2007	2008	2009	2010	Mean	Std. Deviation
State	29.75	27.82	24.45	35.46	36.25	35.63	31.56	
Private	61.72	49.77	65.87	58.18	45.17	42.96	53.94	
Industry average	37.88	36.05	26.82	40.84	38.17	42.49		

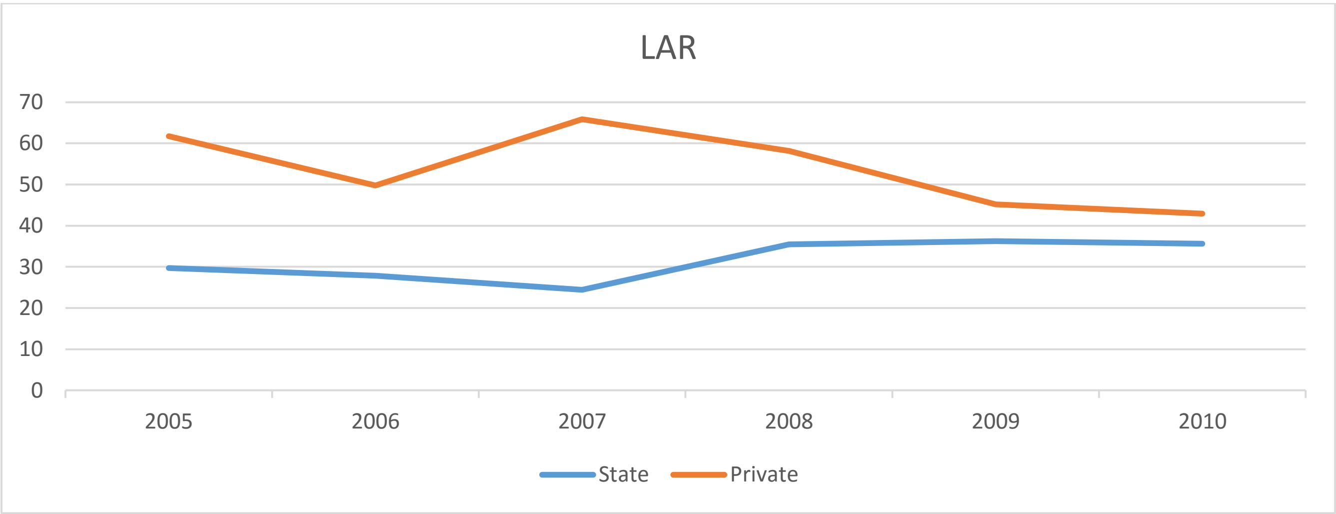

Figure 6: Loan to Asset ratio

4.3. Solvency and Risk Ratios

When we came to Solvency and Risk ratios we will check the banks' ability to meet long-term obligations. On this study two ratios are used:

1. Debt-Equity Ratio (DER)
2. Equity Multiplier (EM

4.3.1. Debt-Equity Ratio (DER)

Banks will depend either on debt financing or equity financing. This ratio measures the degree to which a bank depends on debt financing and measures the ability of banks to absorb financial shocks. The higher the debt ratio the riskier is the bank operations and higher the bank to default on its debts. In 2005 state, owned banks showed a decrement till 2008 with debt ratio value from 16.94 to 9.38 and shows no change in till 2010 which increases with a value to 10.50. Private Banks experienced the same trend except a rise in 2009 to 7.37 continuously in 2010 an increment to 7.58. Checking the mean DER of state owned banks is greater than private banks which is an implication that private banks are more solvent and less risk than state owned banks.

Table 8: Debt-Equity Ratio

Sector	2005	2006	2007	2008	2009	2010	Mean	Std. Deviation
State	16.94	16.711	11.78	9.38	9.38	10.5	12.45	3.199412
Private	8.58	8.11	7.4	7.13	7.37	7.58	7.7	0.496748
Industry average	14.82	14.07	8.31	8.58	9.04	7.17		

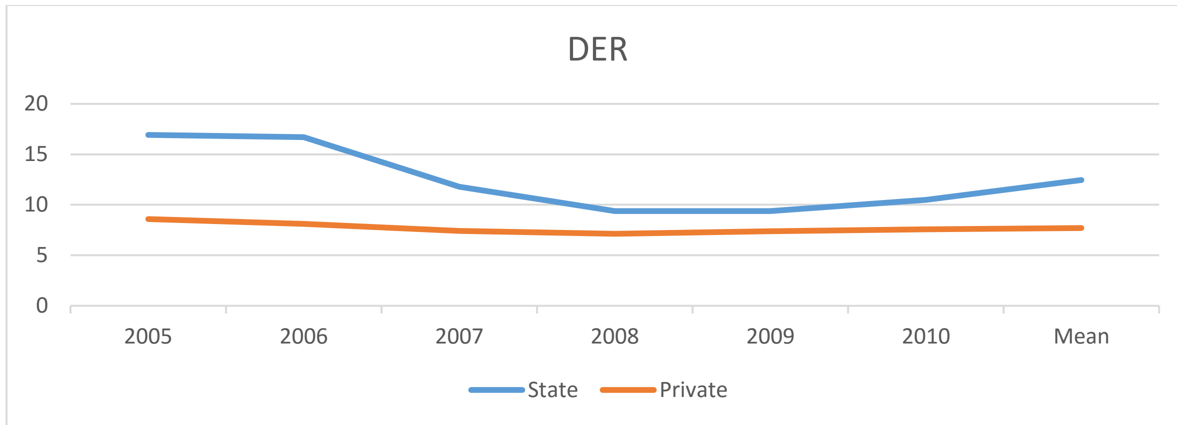

Figure 7: Debt-Equity Ratio

4.3.2. Equity Multiplier (EM)

When we come to another indicator of solvency we find equity Multiplier, it is a measurement of how much the banks have converted their debts to assets with contracting to owned equity. If equity multiplier is high, the banks will be leading to risky situations. The Equity multiplier of private banks shows decrement until 2009 which showed increment to 8.37 and 2010 was increment too to 8.58. State owned banks also showed a decrement from the years of 2005 to 2008. As Data gathered from 2005 to 2010, EM result shows that state banks are higher than private banks. And the mean also depicted that state-owned banks is greater than private banks by 4.76. This directs to conclude state owned banks are more dependent on debt financing than private banks and state owned banks symbolizes risky situations.

Table 9: Equity Multiplier

Sector	2005	2006	2007	2008	2009	2010	Mean	Std. Deviation
State	17.94	17.71	12.78	10.38	10.38	11.50	13.45	
Private	9.58	9.11	8.40	8.13	8.37	8.58	8.69	
Industry average	15.82	15.57	11.19	9.45	9.79	8.00		

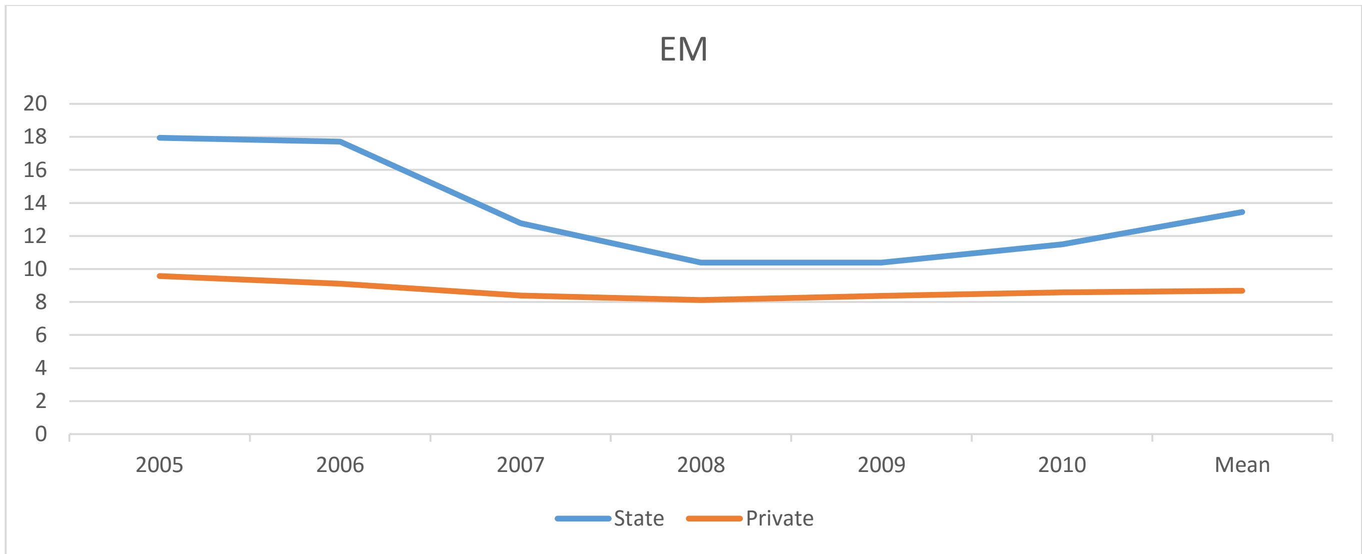

Figure 8: Equity Multiplier

4.4. Efficiency or Activity Ratios

To check the efficiency of banks we will use:

1. Asset Utilization (AU)
2. Income expense ratio (IER)
3. Operating Efficiency (OE)

4.4.1. Asset Utilization (AU)

Utilization of assets is the best way to depict the banks efficiency. It is a method of knowing how banks are utilizing its assets in generating revenues. The higher value means banks are efficient in utilizing assets. Private owned banks AU shows increment from 2005 to 2008 from 7.23% to 8.90% and decrement to 7.96 in 2009. And lastly showed increment in 2010 reaching 8.49%. And state owned banks showed increment from 2005 to 2009 with values of 4.24% to 6.57%. And 2010 marked decrement to 6.15%. Overall the mean AU of private banks is greater than that of state owned banks which is clear that private banks are more efficient than state banks.

Table 10: Asset Utilization

Sector	2005	2006	2007	2008	2009	2010	Mean	Std. Deviation
State	4.24	5.23	5.45	6.04	6.57	6.15	5.61	0.757731
Private	7.23	7.48	8.43	8.90	7.96	8.49	8.08	0.641854

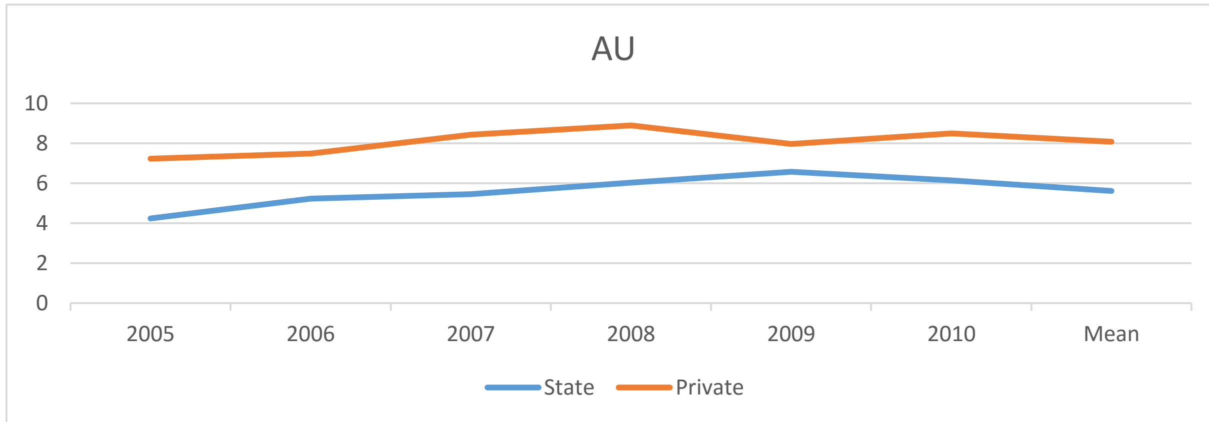

Figure 9: Asset Utilization

4.4.2. Income Expense Ratio (IER)

The IER is an efficiency determinant of banks in generating profit while controlling their expenses. The lower the ratios the lower the efficiency of banks in generating income and in controlling expense. Private owned banks show an increment except a small decrement on the year 2008 to 2009 with a value of 1.61 to 1.41. But state owned banks showed increment on the years 2005 to 2006 from 0.42 to 8.24. Then showed decrement in the years of 2007 and again increased on 2008 to 2009 from 2.67 to 3.33. On the conclusion, the IER of state banks is greater than private banks in all the years expect on 2005. The financial report also depicted that the expense of banks showed decrement from year to year. Which directly points that state-owned banks are more efficient in controlling expenses and points the greater in being more and more profitable.

Table 11: Income Expense Ratio

Sector	2005	2006	2007	2008	2009	2010	Mean	Std. Deviation
State	0.42	8.28	1.16	2.67	3.33	1.99	2.97	
Private	1.40	1.62	1.65	1.41	1.44	1.67	1.53	

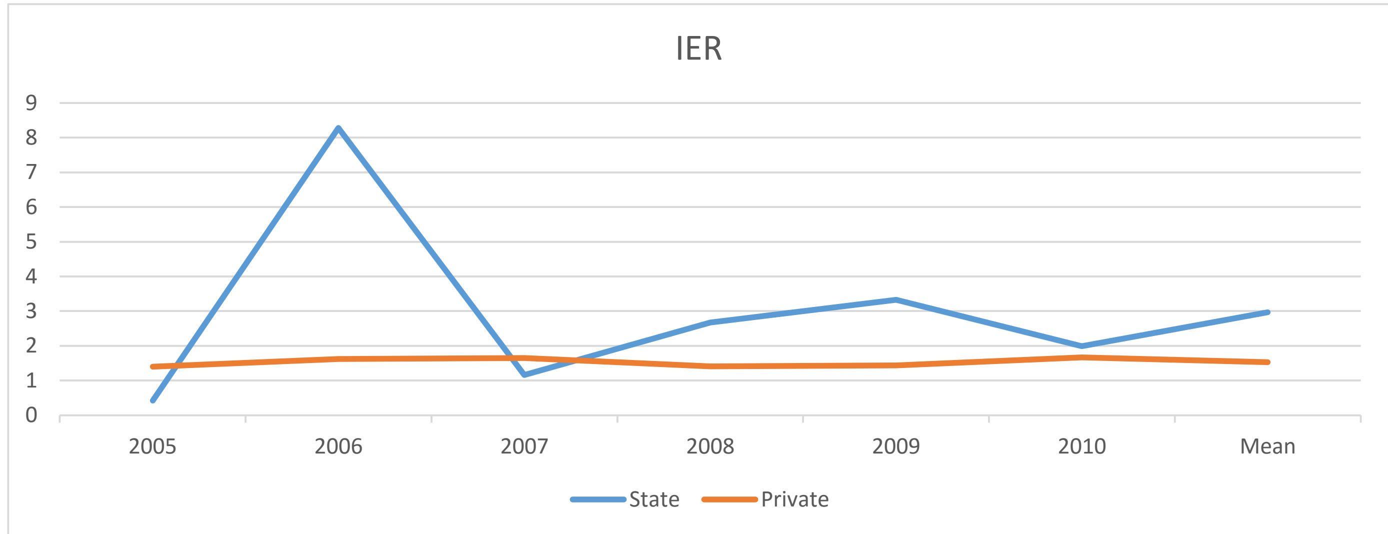

Figure 10: Income Expense Ratio

4.4.3. Operating Efficiency (OE)

The other measurement tool used to measure the banks efficiency in developing operating revenues and in controlling operating costs. If a bank experience high ratio of OE it depicts that the bank is highly efficient. As seen on 2005 of the state-owned banks experienced an increment from 1.94 to 2.12 to 2006. And 2007 marked a decrement to 1.37 and again 2008 showed an increment to 2.66 and continues to grow to 4.21 in 2009. And ending till the study on 2010 to reaching 2.86. In conclusion when we calculate the mean OE of state owned banks is more than private banks which implicates that state banks are more efficient in generating operating revenues and controlling their operating expenses than private banks.

Efficiency results showed that state owned banks are more efficient than private banks. This depicts the more profitability of state owned banks.

Table 12: Operating Efficiency

Sector	2005	2006	2007	2008	2009	2010	Mean	Std. Deviation
State	1.94	2.12	1.37	2.66	4.21	2.86	2.54	0.895352
Private	1.76	2.02	2.12	1.80	1.88	1.65	1.87	

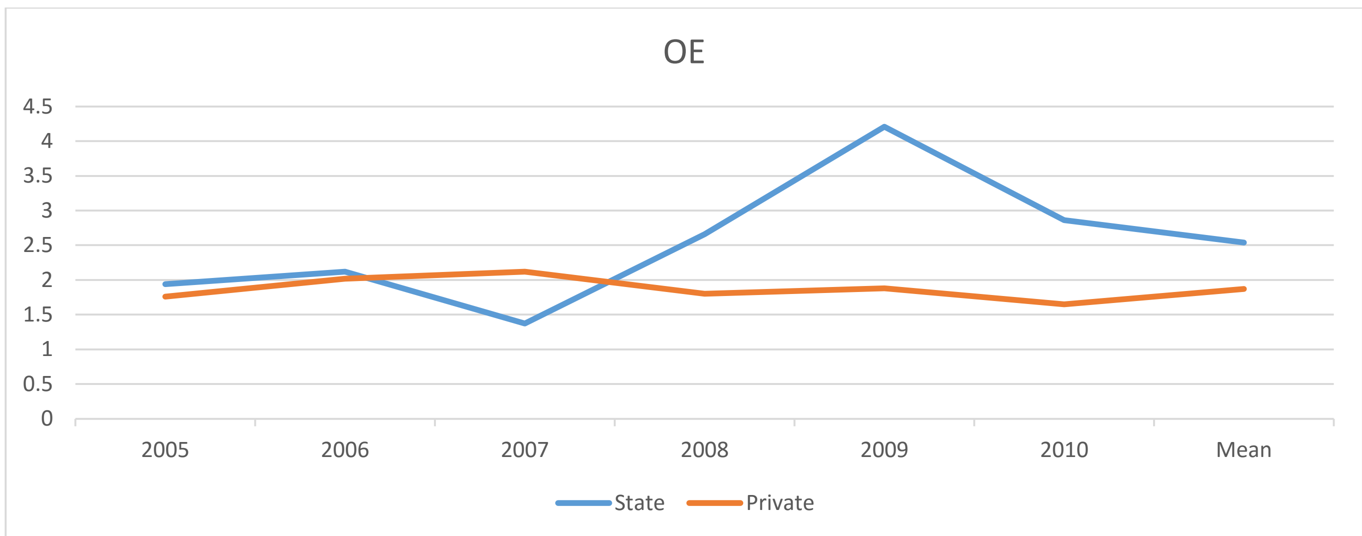

Figure 11: Operating Efficiency

4.5. Government Favor

Contribution of private banks is meaningful. These days especially on countries like Ethiopia which is building numerous infrastructures private banks plays greater role in backing financially. Private Banks branch network and capital involved is highly important. But the playing grounds that private banks and state banks are not fair and equal. The Government don't treat both equally, which is widely seen on the directives of the banking system. Additionally, the deposit and loanable fund of private banks are highly affected. National Bank of Ethiopia have a favor the regulatory body of the banking system, some of the directives that are drained from the expansion of the banking systems are completely affecting the fair competition and equal treatments within the players of the banking industry. We can take the directives which introduces NBE-Bill and directive that forces all private banks' short-term loans to create at least 40% of total loans. Other major policies that kills the fair competition is

policy which makes compulsory to the deployment of resource of 10/90, 20/80 and 40/60 per cent condominium housing only by the public owned CBE and responsibility of sector offices and initiatives to work with CBE, all these reduce and kills the capacity of Private Banks to activate and distribute resource.

A regulatory framework that encourages efficiency and competition for the banking system should be created by the regulatory body. As Spong (2000), Banking regulations and government policies should not favor certain groups over others. This kind of intervention in banking, except in cases of obvious distortions, is not desirable for several reasons. Rules that interfere with the market are inconsistent with this principle and may have unforeseen side effects (Spong, 2000).

Regulatory bodies should benchmark the Core Principles for Effective Banking Supervision issued by the Basel Committee and IMF's Framework for sound banking for assessing the quality of supervisory systems. To begin with, the key objective of supervision is to maintain stability and confidence in the financial system, thereby reducing the risk of loss to depositors and other creditors.

For banking institution, to play a vital role in the economy, the participation of private banks has to be encouraged; accordingly, government bodies should revisit some directives issued in relation to the operation of private banks with wider consultations.

Intervention in banking is often likely to be fruitless, or nearly so, since borrowers and other customers can frequently shift their business into "favored" areas or switch to less regulated entities. Consequently, banking regulation must be unbiased in its effects on various groups. Regulation should not give special treatment to financial institutions or to their customers, and it should not favor one size or type of financial institutions over another. In the interest of a competitive and efficient banking system, good bank regulation should have minimal effects on credit and resource allocation decisions and should not encourage costly effects.

4.6. Findings

The results of all the four performance measures shows that state owned banks are greater in mean performance measures than private banks. Out of all ratios, only four ratios (DER, ROA, and AU & EM) proved that private ownership is greater. In terms of profitability state owned banks are greater than private banks. It is only in terms of ROA, solvency and risk in which private banks are greater. Where as in case of efficiency ratio state banks are better than private banks in terms of IER and OE but private banks are better in asset utilization. The ground which both ownership structures are operating is not fair.

Table 13: Overall Comparison and finding on State and Private Banks

Ratio	Ownership	Mean	Mean difference
Return On Asset	State Ownership	2.56	-0.59
	Private Ownership	3.15	
Return On Equity	State Ownership	36.31	9.50
	Private Ownership	26.81	
Profit Margin	State Ownership	37.03	3.95
	Private Ownership	33.12	
Liquid Asset To Deposit Ratio	State Ownership	55.72	4.69
	Private Ownership	51.04	
Loan To Asset Ratio	State Ownership	31.56	-22.38
	Private Ownership	53.94	
Loan To Deposit Ratio	State Ownership	48.24	-20.20
	Private Ownership	68.44	
Debt Equity Ratio	State Ownership	12.45	4.76
	Private Ownership	7.70	

Equity Multiplier	State Ownership	13.45	4.76
	Private Ownership	8.69	
Asset Utilization	State Ownership	5.61	2.47
	Private Ownership	8.08	
Income Expense Ratio	State Ownership	2.97	1.44
	Private Ownership	1.53	
Operating Efficiency	State Ownership	2.53	0.66
	Private Ownership	1.87	

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1. Summary

The core objective this research is to spot the effects of ownership on performance of privately and state owned banks in Ethiopia and to know which ownership structure performs better between private and state owned banks. The research has conducted in a new environment that is in case of the banking culture of Ethiopia. The study mainly utilized a quantitative study by using financial ratio analysis along with qualitative analysis of empirical findings of ratios.

Private and State owned Banks are selected for the study. The Banks selection is based on operation life in the area as banks being on operation for more than fifteen years. The sample banks are two state banks and four private banks which are, Commercial Bank of Ethiopia, Construction and Business Bank, Awash international Bank, Wegagen, Abyssinia Bank, NIB Bank and from selected banks available secondary data from published balance sheet and income statements from 2005 to 2010 are used.

Out of all ratios, only four ratios (DER, ROA, and AU & EM) proved that private ownership is greater and the remaining ratios shows greater mean for state owned banks. However, the playing ground which private and state owned banks are competing is not fair, for example, the NBE-Bill is valid only to private banks, and any public offices and sectors are forced to work with CBE and also resources for condominium housing is mobilized only by the public owned CBE, so, this unequal treatment of private and state owned banks negatively affected private banks. Thus, the regulatory body of the banking system must revise directives issued on privately owned banks to encourage their participation and to motivate private banks to strive for more growth in the banking sector.

5.2. Conclusions

The study is mainly based on quantitative study by implementing financial ratio analysis, and also including qualitative analysis of empirical results of ratios. The study mainly utilized a quantitative study by using financial ratio analysis along with qualitative analysis of empirical findings of ratios. From the empirical findings, state owned banks have shown superior performance than private banks. This conclusion is the same as that of Unal, Aktas & Acikalin (2007)

From the Ratios implemented to check the banks performance, seven of the ratios implicated that state owned banks are superior in performance as equated to private banks, the remaining four ratios depicted private owned banks are greater in performance than state owned banks. In Ethiopia, the study concluded from empirical findings, the performance of state owned banks is superior to private banks, to be specific better in ratios of profitability, liquidity, solvency, and efficiency.

Two of the profitability indicators, return on assets (ROE) and net profit margin are consistently larger for state-owned banks than private-owned banks. For example, the average annual profit margin from 2005-2010 is 37.03% for state-owned banks and 33.12% for private-owned banks. While ROA for the period 2005-2010 is greater for private banks. The average annual ROE of state owned banks 36.31 is greater than private banks (26.81). Moreover, from three ratios to measure liquidity of the banking sector, evidences suggested that state owned banks are more liquid in two ratios and private banks are more liquid only in one ratio. So it can be concluded that state owned banks are more liquid. But in terms of solvency and risk ratios, private banks are more solvent and less risky than state owned banks in both ratio measures. From the ratio measure which are used as an indicator of efficiency of banks in using its asset or resource management, state owned banks shows superiority in two measures whereas private banks are superior in one of the ratio. So it can be concluded that state owned banks are more efficient than private banks.

Though state owned banks have shown some lead, the variance is not that much larger. This is because ownership based advantages may have very limited impact on performance outcomes for banks in Ethiopia which are operating in environments that are weakly competitive and highly regulated. It can also be concluded from the findings that privatization is not the only answer to

poor performance. Competition can substantially improve the performance of both state and private ownership.

5.3. Recommendations

This Study focused on profitability, liquidity, solvency, and efficiency, for quantitatively knowing the performance of selected private and state owned banks. And Government special treatments have also been seen and the findings was that there is favor to the state-owned banks than private banks and In order to maintain banking sector stability and in order to make the financial playing ground sound and fair, the Government must decrease activities, which limits the performance of private commercial banks in Ethiopia. For Private Banks to play a crucial role in the economy, the participation of private banks has to be encouraged; thus the regulatory body is recommended to revise some directives. This study due to limitations, has selected only some sample banks for the research. Future researchers should consider to include all state and private banks in Ethiopia and can undertake a comprehensive study by including primary sources of data and including non-financial performance indicators.

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