Expanding Branches of Commercial Bank of Ethiopia and the Position of Private Banks

Ebisa Deribie
Planning and Research Officer, Awash International Bank, E-mail: ebacheru@gmail.com.

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The major objective of this paper is to show expansion scenarios of Commercial Bank of Ethiopia and look at future prospects of private commercial banks and stress potential threats of CBE’s aggressive opening of branches. In this study, secondary data sources were the main source of information. Industry observations have been also conducted to supplement the secondary data. Although, the government often issues strict directives favoring public sector banks and to the contrary impacting private banks, still private banks are striving to expand their business and reach the unbanked society. Though CBE contributes much to growth of the economy, its aggressive move in opening branches seem to contradict with free private enterprise. Expansion of the Commercial Bank of Ethiopia is not apparently sharing markets but killing future prospects of private commercial banks. This is true particularly from the view point that CBE is taking the future market of private banks now. To withstand the being eaten market share of private banks by CBE, the banks may have to search alternative banking solutions.

Key words: Branch expansion, Commercial Bank of Ethiopia, free market system, market shares, private banks.

INTRODUCTION

The commercial banking business has been changing rapidly in the country over the past two decades. Many changes have happened both in the structure of the industry as well as modernizations in the delivery of banking services to persons, firms and the various level governments. In line with this, there are big concerns that the ever varying regulatory situations could affect the smooth functioning of banks in general and private sector banks in particular.

In the period before mid1990s, apparently commercial banking business was so monopolized by the government. Besides, the then sole Commercial Bank of Ethiopia was under pressure from the government to expand its branch network; the expansion which took place was not so rapid, apparently, as to endanger the efficiency and therefore the profitability of the bank.

According to Harvey (1997), Commercial Bank of Ethiopia showed a fairly steady branch expansion before 1996, which contrasts strongly with the sort of reckless branch expansion which may overstretch management capacity and contribute substantially to institutional decay as it happened in some countries of Africa like Uganda in the late 1980s.

The commercial banks continued their drive to open significant numbers of branches across the country. As an effect, the number of commercial bank branches in operation increased by 90 percent in the last two years from 680 in 2010 to 1,289 in 2012. The majority of the increase comes from the state-owned Commercial Bank of Ethiopia (CBE), which increased its branch network by 167 percent during the first two years of the GTP. Private banks showed a slower increase in their bank branch network, which is a reflection of their smaller size and ability; the latter is constraint given the 27 percent rule that limits the availability of funds to lend and hence the ability to expand.

Objective of the study

The major objective of this thought paper is to show expansion scenarios of Commercial Bank of Ethiopia and look at future prospects of private commercial banks and stress potential threats of CBE’s aggressive opening of branches and thereby put forward some coping mechanisms for private banks to withstand CBE’s
expansion.

Methodology of the study

In this study, secondary data sources were the main source of information. Industry observations have been also conducted to supplement the secondary data. The secondary sources used cover different documents of the IMF and World Bank. In addition, various quarterly progress reports of private banks and other relevant resources were used to achieve the objective of the study. Furthermore, essential information was also gathered from the various reports of the National Bank of Ethiopia.

Imbalance between Public and Private Financial Institutions

The country's banking sector comprises 19 banks, including a dominant state-owned bank, CBE, whose assets represent about 70 percent of the sector total, as of April 2012. The remaining 16 banks, mainly private, together account for the remainder. The government's development strategy is based on directed lending mainly to public enterprises via CBE and, to some extent, government targeted private sector activities via the government-owned Development Bank of Ethiopia (DBE). This policy results in a significant transfer of resources from creditors (savers) to borrowers, especially the public sector.

According to IMF report (2012), the NBE directive introduced in April 2011 is having tangible impacts on the banking sector, including maturity mismatch and less profitability. The requirement on private banks to purchase NBE bills equivalent to 27 percent of any new loans appears to have a sizable negative impact on private banks' intermediation activities.

The requirement also has the potential of creating maturity mismatches as private banks collect savings at two to three-year maturity and even shorter in some cases, but have to freeze these resources for five years at rates lower than cost of funds.

There is also a risk that as the profitability of private banks reduces on account of less intermediation because of this directive, they could raise noninterest income charges such as fees and commissions to recoup these losses, further impacting negatively on the private sector.

The directive does not have any direct effects on liquidity for the banking sector. The liquidity absorbed through the issuance of the NBE bills is re-injected into the system via DBE, where the proceeds are transferred for on-lending to finance government targeted private sector activities. The NBE bills are illiquid as they are not tradable since banks are required to hold them to maturity.

Recent developments in the banking sector require continued close scrutiny by the NBE. Ethiopia's financial sector policies mirror the country's development strategy. These policies have so far delivered robust economic growth and the NBE is strengthening its oversight of the financial sector to ensure its stability.

However, recent developments such as the increasingly dominant market share of CBE and its growing exposure to large public enterprises, and the impact of the 27 percent requirement on private banks, suggest a need for a closer scrutiny of the banking system. It would be important to undertake a diagnostic of the sector to better assess potential vulnerabilities that might be building up even in the context of the government's ongoing implementation of measures in the sector.

Growth Strategy of CBE

CBE is the leading bank in Ethiopia which was established in 1942. It is pioneer to introduce modern banking to the country. It was leading African bank with assets of Birr 155 billion as of June 30, 2012. As it is focusing more on public sector enterprises it plays a catalytic role in the economic progress and development of the country. Commercial Bank of Ethiopia:

- The first bank in Ethiopia to introduce ATM service for local users.
- Currently has more than 4 million account holders.
- It has strong correspondent relationship with more than 50 renowned foreign banks and a SWIFT bilateral arrangement with 500 others.
- Combines a wide capital base with more than 12,800 employees.
- Pioneer to introduce Western Union Money Transfer Services in Ethiopia.
- Has long-standing relationships with many internationally acclaimed banks throughout the world.

Above all, CBE is aggressively expanding its branches across the country with the said objective of increasing the saving habit of the society while being closer to the unbanked society. Obviously, Ethiopia's banking system is dominated by government-owned banks. This makes Ethiopia an exception within Sub-Saharan Africa and across the developing world, where banking systems have much higher shares of private and foreign participation. As of December 2012, public banks represented over 70 percent of total banking sector assets and provided 77 percent of total loans to the economy, with the remaining 23 percent being divided among the 15 private banks.

As of June 30, 2010 the total number of branches of CBE was 220. The number of branches became 380 as of June 30, 2011 showing a 72.7 percent growth rate.
Table 1. Branches of private banks in Ethiopia

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<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>AIB</td>
<td>86</td>
<td>115</td>
<td>120</td>
</tr>
<tr>
<td>2</td>
<td>Dashen</td>
<td>76</td>
<td>103</td>
<td>111</td>
</tr>
<tr>
<td>3</td>
<td>BOA</td>
<td>63</td>
<td>78</td>
<td>85</td>
</tr>
<tr>
<td>4</td>
<td>Wegagen</td>
<td>63</td>
<td>72</td>
<td>82</td>
</tr>
<tr>
<td>5</td>
<td>United</td>
<td>68</td>
<td>73</td>
<td>77</td>
</tr>
<tr>
<td>6</td>
<td>NIB</td>
<td>57</td>
<td>71</td>
<td>71</td>
</tr>
<tr>
<td>7</td>
<td>CBO</td>
<td>66</td>
<td>78</td>
<td>81</td>
</tr>
<tr>
<td>8</td>
<td>Lion</td>
<td>38</td>
<td>43</td>
<td>43</td>
</tr>
<tr>
<td>9</td>
<td>Zemen</td>
<td>6</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>10</td>
<td>OIB</td>
<td>46</td>
<td>65</td>
<td>69</td>
</tr>
<tr>
<td>11</td>
<td>Bunna</td>
<td>24</td>
<td>33</td>
<td>37</td>
</tr>
<tr>
<td>12</td>
<td>Birhan</td>
<td>15</td>
<td>22</td>
<td>23</td>
</tr>
<tr>
<td>13</td>
<td>Addis Inter</td>
<td>7</td>
<td>11</td>
<td>12</td>
</tr>
<tr>
<td>14</td>
<td>Abay</td>
<td>28</td>
<td>48</td>
<td>51</td>
</tr>
<tr>
<td><strong>Industry Total</strong></td>
<td><strong>643</strong></td>
<td><strong>818</strong></td>
<td><strong>868</strong></td>
<td></td>
</tr>
</tbody>
</table>

Source: AIB, Progress Report (Sept. 30, 2013)

With the bank’s aggressive expansion of branches in the country the total number of branches has reached 718 at the end of September 2013. At the end of October, 2013 CBE with its additional two branches opened in Amahara regional state and in Addis Ababa administration reached 727 branches. The bank is currently opening branches in each and every week.

**Branch Expansion of Private Banks**

Ethiopia is a country with a large population which is one of the indicators that the untapped potential in the sector is immense. Not only that, since foreign investors are prohibited in the sector, investment in the banking sector is attractive to domestic investors than other sectors.

Various kinds of businesses are floating shares to raise capital to undertake various economic activities in sectors such as brewery, cement, agro-industry, trade, transportation, oil, eco-energy, and health; however, they seem unable to raise the required capital to start their businesses from the share market within the specified share floating period. The growing economy is sparking more investment in the banking business, expanding the industry in which more and more private banks are floating shares to raise capital in the public market. Bank shares seemed more attractive.

Given the good performance of the economy, and attractive profits declared in the private banking industry, investors are attracted to invest in this sector with the hope that the future value of their shares will be high. As a result, so far, many banks have floated shares to raise the required capital to start a banking business.

Undoubtedly the banking industry in Ethiopia is underdeveloped and therefore there is an all immediate need to embark on capacity building arrangements and modernize the banking system by employing the state of the art technology being used anywhere in the world. With a growing international trades and international relations, the current banking system is short of providing efficient and dependable services. When we look at the branch expansion of various private commercial banks in the country, we find an encouraging business expansion though not comparable to CBE’s growth.

**The Government’s Development Plan and Support of Private Banks**

Ethiopia’s economy is growing very fast, in fact, the fastest growing non oil economy in Africa and one of the top ten fastest growing economies in the world. According to the Economist, Ethiopia is forecasted to be the third-fastest growing country in the world over the next five years, after China and India and at this early stage of the GTP implementation, the country has begun to see encouraging improvements in all aspects.

The government’s Growth and Transformation Plan:

- It is ambitious five-year growth plan, with projected Gross Domestic Product (GDP) growth of 11-15% per year from 2010 through 2015.
- The total cost is estimated at US$75-79 billion over five years.
- It encompasses vast industrial and infrastructural projects.
- Also it is planned to complete Ethiopia’s accession to the World Trade Organization (WTO) and improve commercial regulatory framework.

The GTP period has gone halfway, in these periods apart from the clear bigger role of public sector banks in
Table 2. NBE bills purchased by private banks in Ethiopia In Million Birr

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Banks</th>
<th>June 30, 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>AIB</td>
<td>3,147</td>
</tr>
<tr>
<td>2</td>
<td>Dashen</td>
<td>2,923</td>
</tr>
<tr>
<td>3</td>
<td>BOA</td>
<td>2,090</td>
</tr>
<tr>
<td>4</td>
<td>Wegagen</td>
<td>2,359</td>
</tr>
<tr>
<td>5</td>
<td>United</td>
<td>2,185</td>
</tr>
<tr>
<td>6</td>
<td>NIB</td>
<td>1,911</td>
</tr>
<tr>
<td>7</td>
<td>CBO</td>
<td>688</td>
</tr>
<tr>
<td>8</td>
<td>Lion</td>
<td>613</td>
</tr>
<tr>
<td>9</td>
<td>Zemen</td>
<td>729</td>
</tr>
<tr>
<td>10</td>
<td>OIB</td>
<td>708</td>
</tr>
<tr>
<td>11</td>
<td>Bunna</td>
<td>393</td>
</tr>
<tr>
<td>12</td>
<td>Birhan</td>
<td>349</td>
</tr>
<tr>
<td>13</td>
<td>Addis</td>
<td>103</td>
</tr>
<tr>
<td>14</td>
<td>Abay</td>
<td>374</td>
</tr>
<tr>
<td></td>
<td>Industry Total</td>
<td>18,572</td>
</tr>
</tbody>
</table>

Source: AIB, Progress Report (June 30, 2013)

supporting the plan private banks have also contributed a lot. One of the ways that private banks support the successful implementation of the GTP is through the purchase of NBE bills. Table 2 shows NBE bills purchased by private banks in the country. The 14 private banks considered in this study have spent a total of Birr 18.6 billion as of June of 30, 2013 for the purchase of NBE bills to support the government's ongoing development plans. Although, the government often issues strict directives favoring public sector banks and to the contrary impacting private banks, still private banks are striving to expand their business and reach the unbanked society.

Does Expansion of CBE Contradict with free market system?

Also known as the free market system, capitalism requires unregulated market and little or no government interference in matters of doing business. After the fall of the Dergue regime, the current government introduced a free market system in which private entrepreneurs can do business without a limitation on capitals. In line with the financial sector deregulations, many private commercial banks have been established and operating in the country. However, public sector banks are still dominating the banking industry especially by making use of government favoring policies. The CBE has engaged in an aggressive branch opening particularly in 2011/12 financial year and after. This expansion of state owned CBE contradicts with the very objective of capitalism that advocates free private enterprises. In one way or other, CBE's aggressive branch expansion means reduced future market for private banks. Despite this aggressive move of CBE, private banks are expanding their branches year after year in an effort to deepen into the market.

Some authors argue in favor of public bank expansion. For instance, in analyzing the importance of public bank and its side by side operation with private banks Ellen (2013) stated that publicly owned banks are important for a capitalist market economy to run properly. By providing inexpensive, accessible financing to the free enterprise sector of the economy, public banks make commerce more vital and stable. Generally, though CBE contributes much to growth of the economy, its aggressive move in opening branches seem to contradict with free private enterprise. The CBE is rather expected to limit itself with the existing number of branches and set aside significant markets for private banks.

What Should Private Banks Do to Counteract CBE’s Move?

Apparently, it is a question of survival for private banks. The state's giant commercial bank is said to open two branches in almost three days. The argument in favor of the expansion of state owned commercial bank is that lending has been done for public sector enterprises and of course these enterprises are the focus of government's development plan. However, expansion of CBE implies eroding of free enterprise which was set forth by the market system. It is also obvious that public sector investments generally are bigger than private domestic investments in the country. This shows in turn a strong emphasis given by the government to the public sector initiatives and which strongly reflects the country's development strategy. Above all, to withstand the being eaten market share of private banks, the banks may have to search alternative banking solutions. Private commercial banks should have to engage massively in new product development by urging the National Bank of Ethiopia to prepare directives.
on new banking technologies. Skills and knowledge transfer is vital particularly from those countries having a strong banking experiences. Unless and otherwise, competing in the sector could be very difficult for the private banks given that the Commercial bank of Ethiopia maintains its position of policy favored bank.

On the other hand, the very objective of CBE and private banks look different especially from the point of view of profit making. The former is more or less not worrying about profits due to the fact that expansion is done to implement government’s policy. However, the latter are purely profit motivated as they are doing business to gain financial benefits.

Way forward

Certainly, the Commercial Bank of Ethiopia (CBE) has been playing a prominent role in economic development of the country for 70 years. Now a day, like never before, the CBE has aggressively expanded its presence in all regions of the country. Notwithstanding the flourishing of private commercial banks, the CBE has remained in the front in terms of assets, deposits, capital, customer base and branch network.

However, as opposed to the free market system, expansion of the Commercial Bank of Ethiopia is not apparently sharing markets but killing future prospects of private commercial banks. This is true particularly from the view point that CBE is taking the future market of private banks now. On the other hand, in reaching the unbanked society, the CBE is doing good work. However, domination of state owned banks is unacceptable given that the economic system is a free market system. Therefore, to encourage expansion of private banks the government should take some reform measures.

First of all, the National Bank of Ethiopia should repeal the capital requirement set to establish private banks. This will provide an opportunity for more private banks to enter into the market and reach the remote and unbanked areas. Second, partial entry of foreign banks should be allowed so as to acquire international experiences and state of art technology in the global banking industry. This is also good as it helps significantly for the accession process to the World Trade Organization. Thirdly, NBE bill purchase directive which compels private banks to purchase NBE bills equivalent to 27 percent of any new loans should be relaxed in a way it considers private banks’ growth efforts. Generally, it is worthwhile for the government of Ethiopia to smooth out aggressive expansion of CBE because its rapid expansion may inhibit private banks’ prospects.

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