Soundness of Ethiopian Banks

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Abstract

A well-functioning financial institution will sustain a country's economic development and play a great role in reduction of poverty. One of the major participants in the financial institution is the banking industry. However, the mal-functioning of the banking system can be extremely costly to the real economy. As Bank is one of the participants and major key player in the financial institutions, it needs a continuous assessment by its supervisory and management. Mere ratio analyses are commonly used Performance measurement among the banking industry in Ethiopia. Nonetheless, these financial ratios are more of traditional as well as partial measurements. As such this study conducted using CAMEL framework set by bank for international settlement. The study takes secondary data which are gathered from audited annual reports of all banks. The result shows CAMEL framework is the best fit measurement for Ethiopian Banks and it give a comprehensive result which is very helpful for the governor to set a well determined policy and procedure.

Key words: Commercial banks, CAMEL framework, performance

JEL classification: G21, G32

Introduction

Today World is aspiring what one can get from globalization, and globalization be the means to combine one to another. This free movement creates many opportunities for different financial institution specially found in the least developing countries. The creation of free movements by globalization from country to country creates a competition between the arrival and domestic financial institution. Those financial institutions mobilize asset from those who have the capacity to invest to those who need money (Mishkin, 2004). As a result, the financial institution may urge the economy of the country in existence.

The key players of the financial institutions, Banks are the key player to the economy and take the higher percentage compare to the other financial institution. The history of banks goes back to the year 2000 B.C when the Babylonian developed a system of banking (Shekar, 2002). From the beginning as banks start operation goes through different stages to reach what it has known. Through its different stages, Bank’s play a major role in the development of a country’s economy and take the highest percentage of the financial institutions. In Africa there are many commercial banks
involves as a financial institution. Flamini in January 2009, state most sub-Saharan African countries have shown an increase to their return. When compare to the rest of the other countries bank, those sub-Saharan African commercial banks are in a better position.

The history of the banking sector in Ethiopia goes back to the year 1905 when the first banks of Abyssinia establish. This bank is owned by British-owned national bank of Egypt (Harvey, 1994). As its early establishment of banks in Ethiopia the growth is very slow compare to other developed countries (BekezelaNcube,na). Even the capital base for the banking industry increase at this time, the Ethiopian banking industry is still very small even by African standard suggesting the need for further efforts to enhance financial intermediation in the country (NBE report, 2009/2010). When we go back to the year 1963 the most part (51%) of the banking sector in Ethiopia is occupied by foreigner (Harvey, 1994). But especially in the Derg regime the policy will not allow foreign banks to involve. At recent time bank in Ethiopia is in its high growth rate as the government is allowing new private banks to establish. Concerning the policy, foreign banks not allowed participating in the banking industry.

At current time, there are 19 banks in operation, and 33 micro finance institutions. From 19 banks in operation 16 are private banks and the rest 3 are state owned banks. As reported by access capital in 2010 from the financial institutions that are involved the main leader is the banking sector. Banks take the higher percentage compared to insurance and micro finance institution. In 2008 Ethiopian banking industry cover 91.5% of the total asset share of the financial institution and the recent 8.5% is covered by insurance and micro finance institution1. As such the financial regulators & Central banks have devoted much effort to monitoring & regulating the banking industry.

Performance of banks in Ethiopia as stated by many researchers is in good position when compared to other African countries as well as when compared to some European countries in some aspect. Ethiopian banks are on the way of increasing in growth, profit and dividends. Mostly the private banks in Ethiopia get their main revenue from collecting deposit, loan providing and foreign exchange (Access capital, 2010).By the end of June 2011, the sector had capital and reserves of 12,321 billion Br while having a loan portfolio of 21,385 billion Br with 23.7pc capital adequacy ratio (CAR) that was remained same from 2009 figure, (Addis fortune, 2010).

Overall the study focus to see the performance of Ethiopian banks in a comprehensive manner based on international and national standards. There are different measurements of bank performance that are used by different countries. The international framework that is set by the bank for international settlement in the Basel accord is used as a base in most countries to evaluate the financial performance of their banks. This framework set as to the extent in which banks should acquire capital at least 8% of their risk weighted asset. Similarly, National Bank of Ethiopia set it standard as the same to the Basel committee agreement made in the year 19882. Accordingly, the researchers tests whether banks in Ethiopia meet the directive set with respect to financial performance in general and check their financial health to identify the strength and weakness of the banks and to give identical views to strength the banking sector.

For evaluating bank health the research, select CAMEL framework. CAMEL framework has firstly developed by the Basel committee to measure the financial performance of different financial institution. As far as the researchers knowledge there are no research that is done to check the health of banks by using CAMEL framework in Ethiopia. CAMEL framework is an abbreviation stand for capital adequacy, Asset quality, Management quality, Earning Ability and Liquidity position.

Financial institutions provide service as intermediaries of financial markets. A well-functioning financial institution will sustain a countries economic development and play a great role in reduction of poverty. But the mal-functioning of the banking system can be extremely costly to the real economy. Financial institutions are responsible for transferring funds from investors to companies in need of those funds. One of the major participants in the financial institution is the banking industry. Banks serve as backbone to the financial sector, which facilitate the proper utilization of financial resources of a country (Dang, 2011). As Bank is one of the participants and major key player in the financial institution, it needs a continuous assessment by its supervisory and management (Saidov, 2011). That is why financial regulators and central banks devotes much effort to monitoring & regulating the banking industry. In the region of sub-Saharan Africa, country like Ethiopia has banks involved as financial

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1 Ethiopian Economic Association report, 2011
Ethiopian economic report

2 NBE under its directive No SBB/24/99
intermediaries. In previous years, few studies have been done in Ethiopia regarding performance of banks. As few researches are undergone in the countries to see the performance of commercial bank in Ethiopia they are using only mere ratio analysis, which is the only indicator of the performance of the institution in some aspects (Dzeawuni and Muhammed, 2008). However, this will not indicates the performance of the banks in comprehensive manner and in international standard aspect. None of the studies in Ethiopia undertaken so far evaluated the performances of the banking sector in a comprehensive manner as well as in line with international standards. Banks in Ethiopia use different inputs of financial statement in order to have an output, which is problematic for all the banks to know their standpoint compared to other bank. Moreover, there are no previous studies conducted in Ethiopia using CAMEL framework set by bank for international settlement, which measure the performance of the banks from each parameter.

Therefore, the researchers attempt and answer the following questions:

Strength of using CAMELS framework as a tool of performance evaluation for commercial banks in Ethiopia

In general the study focus to check the status of Ethiopia commercial banks using selected proxies of CAMEL framework, so as to provide comprehensive information about the financial health of the commercial banking industry in Ethiopia.

Literature Review

Saidov, 2011, stated that the role of the commercial banks considered as a backbone to the survival of the economy in the country. They are the main players in the financial system and the most active sector in the economy. Some objectives of commercial banks such as a commercial bank’s are to make a profit by intermediating between depositors (savers) and borrowers (investors). Most commercial banks in different countries use different methods to evaluate their performance. In addition to the customary ratio analysis banks use methods like CAMEL framework, GIRRAFE, EAGELS and PEARLS. Uyen in 2011 stated that CAMEL can figure out the performance of banks in all aspects and is a useful tool to examine the safety and soundness of banks, and help mitigate the potential risks, which may lead to bank failures. As kouser in 2012 indicate that CAMEL framework is used for the evaluation of performance, ranking and assessing based on capital adequacy, Asset quality, management ability, earning ability and liquidity position.

“CAMEL rating has become a concise and indispensable tool for examiners and regulators”. This rating ensures a bank’s healthy conditions by reviewing different aspects of a bank based on variety of information sources such as financial statement, funding sources, macroeconomic data, budget and cash flow (Dang, 2011). Nevertheless, Hirtle and Lopez in 1999, p. stress that the bank’s CAMEL rating is highly confidential, and only exposed to the bank’s senior management for projecting the business strategies, and to appropriate supervisory staff.

Basel Accord

The Basel Accords refer to the banking supervision Accords (recommendations on banking regulations)—Basel I, Basel II and Basel III—issued by the Basel Committee on Banking Supervision (BCBS). They are called the Basel Accords as the BCBS maintains its secretariat at the Bank for International Settlements in Basel, Switzerland and the committee normally meets there.

Implication of CAMEL Framework

CAMEL framework has five components, capital adequacy, Asset quality, management quality, Earning ability and Liquidity position.

Capital Adequacy

Capital adequacy or sometimes regulatory capital is determined how well banks or other depository institution can have enough capital equal to their asset in order to sustain operational losses and to show if whether those institution are not participating in investment that increase risk to default. The capital structure of banks is highly regulated. This is because capital plays a crucial role in reducing the number of bank failures and losses to depositors when a bank fails as highly leveraged firms are likely to take excessive risk in order to maximize shareholder value at the expense of finance providers (Olweny and Shipo, 2011).

Capital adequacy for this study has been analyzed using two ratio. The first one is by applying capital adequacy ratio, which is measured by capital to risk weighted asset and the second measurement is by using leverage ratio.

Asset Quality

The asset quality is one of the major factors that will affect the health of banks. The quality of asset held by an individual bank has an impact to the performance of
the bank. Exposure of credit risk, trends of non-performing loan, bank borrower profitability health, will determine the heath of the asset quality of the bank (Baral, 2005). In addition to assessing trends in classified assets, delinquent loans, and credit concentrations, the asset quality component rating takes into account management’s ability to underwrite and administer credits in a prudent and sound manner (Ilhomovic, 2009).

To evaluate asset quality, the study uses two financial ratios. This is loan loss provision to total loan and loan loss provision to total asset.

**Management Quality**

Measuring of management quality is subjective by its nature. As such Sound management is a key to bank performance but is difficult to measure. It is primarily a qualitative factor applicable to individual institutions. Several indicators, however, can jointly serve as an indicator of management soundness. Expenses ratio, earning per employee, cost per loan, average loan size and cost per unit of money lent can be used as a proxy of the management quality (Baral, 2005).

For this study the researcher select two ways to measure management performance this are operating expense ratio and interest expense ratio.

**Table 1 Operationalization of the Study Variable**

| Dependent variable | Measurement |
|--------------------|-------------|
| ROA                | Net income/ Average total asset |
| ROE                | Net income/ Average shareholder equity |

| Independent variable |
|----------------------|
| Capital adequacy     | Capital/Risk weighted Asset |
| Asset Quality        | Loan loss provision/ Total Asset |
| Management Quality   | Total non-Interest Income/ Total non-Interest expense |
| Earning Quality      | Net income After tax & Provision/ (Interest income + Non-Interest income) |
| Liquidity position   | Liquid Asset / Total deposit |

**Earning Quality**

Earning ability indicate the ability of the banks in generating revenue by using the asset, shareholders equity and using the proportion of gross income. To assess the earnings performance of a bank, it will be helpful to look at a variety of ratios and measures: these include: (1) return on assets (ROA) (2) return on equity (ROE) and profit margin (PM).

**Liquidity position**

Liquidity is defined as the capacity of financial institutions to finance increases in their assets and comply with their liabilities as these mature. Siegel, (2007) defines liquidity as the ability of a firm to meet its short-term obligation. Management of banks can concretely manage their liquidity risk in a number of dimensions in the way, such as where it is exactly performed in the organization, how liquidity is measured and monitored, what measures banks can take to prevent or tackle a liquidity shortage, etc. Following overview of the banking industry’s practices is based on a survey conducted at a number of banks in each EU country (Miguel, et al, 2006).

**Research Design and Methodology**

As the main objective of the study is to check the health of selected commercial banks using a developed model known as CAMEL(s) Framework, Quantitative data has been used for evaluation. The data relevant to meet the objective has been collected from the audited annual reports of the selected commercial banks from the year 2003-2013. The main reason for using secondary data is the study aimed only to evaluate the performance of different banks using the CAMEL Framework which mainly demands data from published and audited financial reports. Panel data type is more convenient to compare the performances of the respective banks at a given point in time throughout the study years.

**Sample Size and Sampling Technique**

The researchers use purposive sampling technique to select the commercial banks that is convenient to the study currently operating in the country primarily based on three criteria size, establishment year and rank in Africa in the year 2010.

**Operationalization of the Study Variable**

This contain variable extracted from different literature for the purpose to see the impact of CAMEL framework on the performance of Ethiopian banks.

**Model specification**

\[
ROA= \beta_0 + \beta_1CAit + \beta_2AQit + \beta_3MAit + \beta_4EAit + \beta_5LPit + \varepsilon \tag{E1}
\]

\[
ROE= \beta_0 + \beta_1CAR1it + \beta_2AQ12it + \beta_3IER3it + \beta_4PM4it + \beta_5LP15it + \varepsilon \tag{E2}
\]

ROA= return on asset
ROE= return on equity
β₀ = is the constant variable  
CAR₁it = capital adequacy of banks at time t  
AQ₁it = Asset quality of the banks at time t  
MA₁it = management Ability of banks at time t  
EA₁it = Earning Ability of banks at time t  
LP₁it = Liquidity position of banks at time t  
ε =error term  
(β₁, β₂… β₅ represent the coefficient that infer the change to the dependent variable ROA and ROE)

Empirical study support the ROA and ROE as a measure of bank performance by (Ahmed.Z, 2011; Zewedu.S, 2010; Ilhomovic.S, 2011; Abubaker.N; Tahir.I, 2009 and Ali et.al, 2011)

Results and discussion

Descriptive statistics

Capital Adequacy

Capital adequacy ratio refers to the ability of the capital base of a financial institution to absorb unanticipated shocks. Capital adequacy of any financial institution is instrumental in the formation of risk perceptions about it amongst its stakeholders. Capital adequacies are a measure of the amount of a bank's core capital expressed as a percentage of its assets weighted credit exposures. Based on the risk weighted asset many countries measure their capital adequacy based on risk level of asset. The percent threshold varies from bank to bank. As different types of assets have different risk profiles, capital adequacy ratio will be adjusts for assets that are less risky by allowing banks to "discount" lower-risk assets. The specifics of CAR calculation vary from country to country, but general approaches tend to be similar for countries that apply the Basel Accords.

The study takes into consideration two measurement of capital adequacy of the bank in Ethiopia. The first one is by capital adequacy ratio, which is measured by the comparing the total capital to the level of risk weighted which is set by the Basel accord II, and the second is to measure based up on the leverage ratio, which take into consideration core capital which is Tier I capital to total assets.

The banks in Ethiopia have no such problem regarding capital adequacy which all the banking sector have average greater than 8%, which is set by the Basel accord and to the standard set by the national bank of Ethiopia. The national bank of Ethiopia which is the mayor of the banking sector set capital adequacy of the banking sector to be at minimum 8%. The average capital to risk weighted asset is 15%, which is said to be the capital of the bank is sustain well above the average. In Ethiopia there are banks under government ownership and to private banks. When we compare the private sector and government owned banks, the state owned banks are in better position. These resemble the same result with Saumya in 2011, in the Indian banking sector and with Dincer et.al in the Turkish banking industry. Regarding national bank of Ethiopia which sets status greater than 15% is said to be strong bank. We have given rating based on camel rating and the score is between 1-5. Bank score 1 is said to be banks with strong capital level relative to the financial institutions risk and a rating 5 indicates a critical deficient level of capital in which immediate assistance from shareholders or external resources is required. Therefore the Ethiopian banks rating score is 1.

The second measurement is based up on the core capital of the banking industry. Regarding the evaluation of leverage ratio we have checked whether the asset of the banks exceeds it equity.

Regarding the Basel accord in order to say bank is levered the score should be greater than or equal to 4. Regarding this measurement Ethiopian banking industry are said to be highly leverage because the average for the industry for the last ten year is above the sets standards. The higher the ratio is the better status of the banks. Regarding leverage the private banks are said to be highly levered compared to the state owned banks.

Asset Quality

Asset quality is an important parameter for any banking institution, as the quality of its assets has a major role on the earning ability of that institution. A deteriorating quality of assets is the prime source of banking problems. Asset quality measured in relation to the level and severity of non-performing assets, recoveries and the level of provisioning. Knowing the level of asset quality of the banking industry using different tool specifically using non-performing loan data will be very crucial. For the purpose of evaluating the quality of asset for Ethiopian banking industry we are using loan loss provision to total loan and advances. This will indicate how the banks managers control its loan. As loan is money that is providing to the customer it needs a continuous assessment and due care. The higher the ratio indicates the bank is in higher risk compared to those with lower ratio. Ethiopian banking industry has shown a decrease of loan loss provision ratio from year to year, which is a good sign to the most risky industry. Regarding the measurement of the Basel accord banks
which have average greater than 100% is said to be the asset quality of the industry is in the good situation. All the banking industry has scored above the threshold set by the standard. Compared to the state owned bank the private banks are less risky. But this also have another implication the private banks will not involve in the lending process. Ethiopian banking industry indicates a strong asset quality and minimal portfolio risks.

Management Quality

Measure of management quality is subjective by its nature. Management quality needs information like qualitative data applicable to individual institution. However several indicators can jointly serve as an indicator of management soundness. The study measure the quality of the manager by using efficiency ratio. Under the countries scenario efficiency is measured by comparing total non-interest income with total non-interest expense. The banking industry in Ethiopia spent more of the non-interest income to the non-interest expense, like for employee salary and benefit, provision for doubtful loans expense and general expense. Ethiopian banks managers are said to be somewhat efficient, because the higher portion of the non-interest income spent on non-interest expense.

The second measure is based on the interest expense ratio to total loan. This ratio shows how well banks manage the loan as a result the bank pay ratio. The higher the ratio is the worsening of the financial health of the banks. This in turn indicates the managers of the banks is not efficient in utilizing and control its asset. Ethiopian banks managers spent less interest expense compared to the interest income from loan providing to their customer. Therefore most banks managers are said they are efficient in utilizing and control of their asset.

Earning Ability

The earning ability of specific banks shows how well the performance of the bank is. The higher the performance of the bank is the higher profitability of the banking industry.

The earning ability of the banking sector in Ethiopia has been measured by comparing how well the average assets generate income which is the return on asset. The higher the ratio is the better soundness of the banking sector. The Basel accord states if banks returns on asset greater than or equal to 1% is said to banks performance is in good position. Ethiopian banking industry is greater than the minimum point set by the accord. Olweny and shipo, 2011 state that if banking industry scored above 1.5 the banks is said to be strong. The average of Ethiopian banking sector for the last ten year is above other African banks average.

The other measurement is based on returns on equity, which reveals how much profit the banks earned in comparison of the shareholders equity. And also it shows how the managers are effective in converting the reinvested money into profit. The Basel accord states if banks returns on equity are 15 or greater than is said to be the banks is in good status. Based on our result from audited annual report the returns on equity of Ethiopian banks are above the threshold. These indicate the banks manager work highly in converting the reinvested money of the shareholders into profit.

Liquidity position

Liquidity positions specifically determine how well the banks are liquid in order to cover immediate disturbance to the banks. The liquidity position of the banking sector in Ethiopia have been measured how the liquid asset are able to cover deposit disturbance occur. The national bank of Ethiopia which is the mayor of the banking industry put a minimum result of 20% to say banks in good status. The higher the ratio indicates the banks are able to control the disturbance that will be occurring. In this regard banks in Ethiopia are strong enough to control the disturbance. All banks in Ethiopia satisfy the minimum requirements 20% for more than last ten year.

The other measurement tools help to know the liquidity position is loan to deposit ratio. Banks should always have a balanced result between the loan and deposit. As loan is asset for the banks and deposit is liability, the banks should always maintain a balanced level of liquidity position. The higher the ratio is the weaker of the financial health of the banks. Ethiopian banks have a good liquidity position regarding the set of Basel accord in which the level of banks should be less than 80%.

Econometrics Analysis

The econometrics analysis has been done in order to see the relationship and effects of the independent variable and the dependent variable. Under the study we have recognize the level of financial soundness of the bank by using two profitability measurements. One is return on asset and the second is return on equity. The model summary which is first measured by return on asset indicates that the explanatory variable of the study well represent the bank’s profitability about 95.9% and the remaining 4% will be determined by another unseen variable in the study. In the other measurement which is return on equity only capital adequacy affect negatively, but earning Ability, Asset quality, management ability and liquidity position affect profitability positively. In
our finding the explanatory variable represent profitability about 84.7%. The study shows that there is no multicollinearity problem between the independent variable as indicate by the durbin-watson test. The durbin-watson test determines there is no multicollinearity between the variable if the result is greater than 1.5. As such the result is above the minimum requirement.

The study shows that capital adequacy ratio which is measured by total capital to risk weighted asset and earning ability which is measured by profit margin affect profitability positively but asset quality, management ability and liquidity position affect profitability measured by return on asset negatively. Collinearity problem have been checked by tolerance factor and by seeing the variance inflation factor. In order to say there is no multicollinearity problem the tolerance factor should be greater than 0.1 and the VIF should be less than 10. To this view all the study variable have no any multicollinearity problem because the two measurements fulfill the requirement.

The model is stated as follows

\[
\begin{align*}
ROA &= 0.77 + 0.17 CA - 0.08 AQ - 0.32 MQ + 1.19 EA - 0.34 LP \quad E3 \\
ROE &= -1.23 - 0.39 CA + 0.019 AQ + 0.009 MQ + 0.74 EA + 0.23 LP \quad E4
\end{align*}
\]

Conclusions

Ethiopian banks are said to be good in different measurement tools. CAMEL framework can well measure Ethiopian banks. Therefore, Banks are highly recommended to use CAMEL framework as there measurement tools.

Capital adequacy

Capital adequacy ratio refers to the ability of the capital base of a financial institution to absorb unanticipated shocks. Capital of Ethiopian Banks has the ability to cover any shock that will occur in any circumstances. Specially, those public banks have a strong capacity to cover the shock than the private banks. The banks in Ethiopia have no such problem regarding capital adequacy which all the banking sector have average greater than 8%, which is set by the Basel accord and to the standard set by the national bank of Ethiopia. The higher the ratio indicates the bank’s capital have the ability to absorb any losses that occur in the future. The econometrics result also revealed that capital adequacy have a positive relationship with profitability measured using return on asset and negative relationship with return on equity of the banks. This result shows that banks with high capital to risk weighted asset have a strong positive on the profitability of the banks. Based on camel rating Ethiopian banks rating score 1 on which is said to be Ethiopian banks with strong capital level relative to the financial institutions risk.

Asset Quality

Asset quality is an important parameter for any banking institution, as the quality of its assets has a major role on the earning ability of that institution. A deteriorating quality of assets is the prime source of banking problems. Asset quality of Ethiopian banks is in a good position. The public banks asset quality is poor compared to the private banks. Poor asset quality management will result a decline in the returns generated from the assets, which in turn may led to bankruptcy. The Asset dimension of CAMEL framework findings of this study indicates that private banks are good in credit management than the public banks which indicates that the private banks are efficient in using of their deposit. The proper use of resource can have a direct impact to the growth of the economy. Resource will mobilize easily from the banks to other who needs it to invest.

The higher the ratio indicates the bank is in higher risk compared to those with lower ratio. Ethiopian banking industry has shown a decrease of loan loss provision ratio from year to year, which is a good sign to the most risky industry. Ethiopian banking industry indicates a strong asset quality and minimal portfolio risks.

Management quality

The nature of the measurement of management quality is subjective. Baased on this the study have applied to measure by using efficiency ratio. The banking industry in Ethiopia spent more of the non-interest income to the non-interest expense, like for employee salary and benefit, provision for doubtful loans expense and general expense. Ethiopian banks manager are said to be somewhat efficient, because the higher portion of the non-interest income spent on non-interest expense. Based on the second measurement which is interest expense ratio, Ethiopian banks spent less to interest expense compared to interst revenue they generate. The higher the ratio is, the worsening of the financial health of the banks is. This in other term indicates the manager of the bank is not efficient in controlling its asset. Based on the result as it has indicated all banks managers perform good regarding controlling the money they receive as interest from loan providing to their customer.
Earning Ability

Earning ability state how well manager make control to the asset of the bank and equity in order to get a better earning. Earning quality of Ethiopian banks for this study has been analyzed by using three measurements. These are ROA, ROE and profit margin. From the cumulative average of the banks in the last ten years all banks score below other African countries benchmark and Ethiopian banking industry average. In general, these shows Ethiopian banks are very strong in generating revenue using their Asset efficiently and also shareholders equity. Ethiopian banking industry is greater than the minimum point set by the accord which indicate banks that score above 1% are said to be strong. Olweny and shipo, 2011 state that if banking industry scored above 1.5 the banks is said to be strong. The average of Ethiopian banking sector for the last ten year is above other African banks average too.

The second measurement Return on equity reveals how much profit a company earned in comparison to the total amount of shareholder equity found on the balance sheet. It indicates how effective the management team is in converting the reinvested money into profits. The higher the ROE is, the more money a company able to generate for the same birr spent by the banks. Access capital (2010), state ROE of other African countries and Ethiopian banks is 21 and 22 respectively. This show Ethiopian banks are strong enough than other African countries regarding in generating profit using properly their shareholder equity. When compared Ethiopian banks with other African countries standard both private and public banks are above the standard. The DuPont analysis suggest that the average result of the public banks is greater than the private banks is because of their equity multiplier is higher (Saumya Lohia, 2011). Therefore based on the DuPont theory as is in the case above the public banks has greater ROE compared to the private bank.

Profit margin is used to determine how well the bank is profitable by properly control its costs. The higher the ratio is explaining the better performance of the banks. In general, the health of the banks based on profit margin, Ethiopian banks are in a good level. Compared to private and state owned banks in Ethiopia, profit margins of the private banks fulfill the average standard to a certain extent but not the public banks. This is a sign in which the public banks interest income and non-interest income in providing one unit of net income is weak.

Liquid position

Liquidity position determines how well the banks are liquid in order to cover an immediate disturbance to the financial health of the banks. Liquid Asset to Deposit Ratio indicates how well the banks liquid assets have the ability to cover immediate disturbance made to the deposit. Deposit is an obligation of the banks to pay for the depositor during request. The higher the ratio is the more liquidity position of the bank. National bank of Ethiopia state that banks to be said strong should meet the average greater than 20. The industry average for the last ten years in Ethiopia is higher. This is a good indication for the bank to attract more customers because customer will be free of fear to deposit in the banks. But sometimes the higher the ratio also indicates that the banks have higher tied money in their account. High-unutilized money in banks indicates resource mobilization not be accessed easily to other who needs it to invest.

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