THE IMPACT OF JOINING FOREIGN BANK IN ETHIOPIA ECONOMY

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ABSTRACT: *Foreign banks' expansion into developing and underdeveloped nations has generated a lot of controversy and debate among policymakers, academics, and business professionals. The goal of the research is to come out the encouragement of away bank entrance in Ethiopian economy, identifying the positive impact, negative impact and regulatory framework of the national bank of Ethiopia. To accomplish the detached of the study examination of literature-based tactic was working; the influence of foreign bank entry on emerging nations' economies is examined in this essay, with an emphasis on how it will affect the banking industry, financial stability, economic growth, and credit availability. According to the research, foreign banks' presence may have both beneficial and detrimental effects on the economies of emerging nations. On the plus side, foreign banks can introduce fresh capital, knowledge, and technology, which can promote greater financial inclusion and spur competition. The stability of the domestic financial system can also be threatened by foreign banks, particularly if they engage in dangerous lending practices or take on excessive risk. In general, this study comes to the conclusion that foreign bank entry can have a substantial inspiration on Ethiopian economy and that policymakers must carefully weigh the potential advantages and hazards of foreign bank entry. Policymakers must in particular make sure that sufficient regulatory frameworks are in place to limit the risks connected with the entry of foreign banks while simultaneously fostering opposition and innovation in the banking industry.*

KEY WORD: *commercial bank of Ethiopia, national bank of Ethiopia, impact of foreign bank, regulatory frame work.*

JEL CLASSIFICATION: *M80, P5, DO2, D25, E6.*

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1. INTRODUCTION

The current model of modern commercial banking is relatively new. The functions of money lenders, goldsmiths, and merchants can be used to track the evolution of the bank, despite the fact that it is regarded as an ancient institution, just like money. The concept of banking has been around for thousands of years, dating back to ancient civilizations. The first banks were likely temples in ancient Mesopotamia where people could store valuables such as grain and precious metals. These temples would issue receipts for the stored goods, which could be used to make transactions. Over time, banks began to develop in other parts of the world as well. In ancient Greece and Rome, moneylenders would exchange coins and offer loans. During the Middle Ages in Europe, merchants would travel with their goods and needed a way to transfer money without carrying large sums of cash. This led to the development of banking institutions such as the Knights Templar and the Medici Bank. The modern banking system as we know it today began to take shape during the Renaissance. The Medici Bank, which was founded in Florence, Italy in the 14th century, became single of the most effective banks of its time. The bank was known for its innovative financial practices, such as double-entry bookkeeping. which allowed for greater accuracy in accounting. The modern banking system began to take shape in the 20th century. In 1913, the Federal Reserve System was established in the United States to help stabilize the country's financial system. Other countries followed suit and established their own central banks. Today, banks play a crucial role in the worldwide economy.

Specific objective. The study aims to assess the following specific objectives:

- To understand the positive impact of the entrance of foreign bank;
- To understand the negative impact of the entrance of foreign bank;
- To examine the current status of Ethiopian banking system;
- To understand the regulatory frame work of the Ethiopian financial system.

2. METHODOLOGY

To achieve the above stated objectives the study employed a review-based approach. As a result, the study is mainly based on secondary data (which is collected from different books, websites, journals, articles, reports from National Bank of Ethiopia, commercial bank of Ethiopia, World Bank, and IMF.

Statement of the problem. The title "The influence of joining external bank in Ethiopian economy" suggests a potential problem statement for a research study on the belongings of overseas bank admission on the national banking sector in an emerging country. A possible problem statement that could be derived from this title is: "The pass of external banks into the local banking subdivision of rising nations has been a topic of discussion in topical years, with approximately quarrelling that it primes to increased competition and efficiency, while others argue that it has negative effects on the permanency and development of the domestic banking sector.

This study aims to examine the impact of foreign bank entry on the domestic banking sector of a developing country, with a focus on the properties on competition, efficiency, and stability." The problem statement I provided earlier is just one possible example of how a research study on the power of distant bank access on inland banking in an evolving state could be framed. To further expand on the potential problem statement, it could be noted that extraneous bank admission into developing countries has been increasing in recent years, driven by factors such as globalization and liberalization of financial markets.

While some argue that foreign bank entry can bring many benefits, such as increased competition, access to new technologies, and more efficient banking services, others are concerned about the potential negative effects on the domestic banking sector, such as reduced lending to local businesses and lower financial stability.

Therefore, the problem statement could emphasize the need to investigate the impression of far-off bank arrival in a more systematic and comprehensive manner, using a range of quantitative and qualitative methods. The study could examine issues such as the souk portion of abroad banks, the types of services they offer, the impact on local banks' profitability, and the paraphernalia on credit allocation (SMEs) and other segments of the economy. Those of the above gaps motivating the study entitled the impact of joining foreign bank in Ethiopian economy.

3. LITERATURE REVIEW

Generally, there are an optimistic and Bad impacts of entrance of foreign banks in Ethiopia economy. The following points summarize the basic impact both the (positive and negative) on the Economy.

Positive impacts on Ethiopia economy:

Increased competition: Foreign banks often bring in new products, services, and technologies that can increase competition in the domestic market. This can lead to improvements in efficiency and quality of services offered by domestic banks (Xu, 2011).

When foreign banks enter the domestic market, they may bring new products and services that were not previously available to domestic customers. This led to increased competition among domestic banks to provide similar or better products and services to their customers. This competition can result in lower interest rates, lower fees, and improved customer service, which can benefit domestic consumers.

Access to capital: they may bring in more capital to which can help finance new projects and drive economic growth. Foreign banks may have more financial resources than domestic banks and may be willing to lend to domestic businesses that may have difficulty obtaining financing from domestic banks. This container led to increased savings and economic progress in the domestic economy (Polovina, & Peasnell, 2015).

Improved risk management: Foreign banks may have more experience in managing risks and can bring in better risk management practices to the domestic market. Foreign banks may bring different risk management practices and expertise that can help to expand the complete steadiness of the domestic banking system. This can benefit the domestic economy by reducing the likelihood of financial crises or systemic risks (Shenkar et al., 2021).

Technology Transfer: Foreign banks often bring with them new technologies and best practices that may not have been previously available in the domestic market.

This can lead to the transfer of knowledge and technology, which can benefit the domestic economy by improving efficiency, reducing costs, and increasing productivity (Claessens et al., 2001).

Financial Inclusion: In some cases, foreign banks may be more willing to provide banking services to underserved or marginalized populations, such as those living in rural areas or low-income households (Khamphoumy & Sarntisart, 2023).

Financial Stability and **Enhanced regulatory environment**: Foreign banks may be subject to stricter regulatory standards in their home countries and may bring in these standards to the domestic market, which can lead to more stable and secure banking systems, increase by diversifying the sources of funding and reducing the concentration of risk in a few large domestic banks. This can help to mitigate the impact of financial shocks and crises (Naaborg, 2007).

Capital Flows and **Job Creation**: increased capital flows into the domestic economy, as foreign banks may bring in capital from their home countries to support their operations in the domestic market. This can be beneficial for the domestic economy by increasing the availability of capital for investment and economic growth. However, it can also lead to volatility in capital flows, which can have implications for financial stability and macroeconomic performance (Naaborg, 2007).

Also, for job creation in the domestic economy, as foreign banks may need to hire local employees to support their operations. This can be beneficial for the domestic economy by increasing employment opportunities and supporting economic growth (Khamphoumy & Sarntisart 2023).

4. NEGATIVE IMPACTS IN ETHIOPIA ECONOMY

Regulatory Challenges: The entry of foreign banks can pose regulatory challenges for domestic regulators, as they may need to adapt to new regulatory frameworks and coordinate with regulators in other countries. This can be particularly challenging if the regulatory standards and practices of the foreign banks are significantly different from those of the domestic market (Havrylchyk, 2012).

Exchange Rate Risk: this is highly depended on the strength of the currency in FX market (Naaborg, 2007).

Transfer Pricing and **Cultural Differences**: foreign banks may engage in transfer pricing practices, whereby they manipulate prices between their subsidiaries to reduce their tax liabilities in the domestic market. This can result in revenue losses for the domestic government and may have implications for the fairness and equity of the tax system (Naaborg, 2007).

Foreign banks may have different cultural norms and expectations than domestic banks, which can create challenges in terms of communication and collaboration between employees. This can have implications for the effectiveness and efficiency of the banking operations (Claessens, et al. 2001). This can be a concern if the foreign banks are involved in critical infrastructure or sensitive industries.

Limited access to credit and Brain drains: Foreign banks may focus on larger corporations and multinational companies, leaving smaller domestic firms without access to credit.

Foreign banks may attract talented employees from domestic banks, potentially leading to a brain drain and a loss of expertise in the domestic banking sector. This can be a disadvantage for the domestic economy if it results in a shortage of skilled workers in the banking sector.

Repatriation of profit and **Sovereignty Risk**: Foreign banks may repatriate profits earned in the domestic market back to their home country, potentially reducing the amount of capital available for domestic investment. This can be a disadvantage for the domestic economy if it results in a shortage of capital for domestic businesses and economic growth.

Foreign banks may be subject to regulations and laws of their home country that may conflict with the interests of the domestic economy. This can pose a risk to the sovereignty of the domestic government, especially if the foreign banks are large and dominant players in the domestic banking sector (Claessens et al., 2001).

Increased exposure to external shocks and **Dependence on foreign banks**: Foreign banks may be more susceptible to external shocks, such as economic volatility or political instability in their home countries, which can impact the domestic market. Over-reliance on foreign banks may lead to an increased vulnerability to external shocks and potentially limit the policy options available to the domestic government (Uiboupin, 2004).

No	Criteria	Description
1	Increased Competition	Foreign banks may bring new products and services to the market, which increases competition among domestic banks. This may lead to lower interest rates, lower fees, and improved customer service.
2	Increased Access to Capital	Foreign banks may have more financial resources and be willing to lend to domestic businesses that may have had difficulty obtaining financing from domestic banks. This can lead to increased investment and economic growth.
3	Improved Risk Management	Foreign banks may bring different risk management practices and expertise which is very helpful.
4	Brain Drain	Foreign banks may attract talented employees from domestic banks, potentially leading to a brain drain and a loss of expertise in the domestic banking sector.
5	Repatriation of Profits	Foreign banks may repatriate profits earned in the domestic market back to their home country, potentially reducing the amount of capital available for domestic investment.
6	Sovereignty Risk	Foreign banks may be subject to regulations and laws of their home country that may conflict with the interests of the domestic economy. This can pose a risk to the sovereignty of the domestic government.

5. EMPIRICAL STUDY

Haiyan Yin (2021) stringent capital requirements, higher market entry barriers, and more effective information sharing can all mitigate the impact of foreign bank entry on competition in the host countries.

On the other hand, foreign bank presence exerts a more pronounced impact on bank competition in countries with more effective supervision and external governance. The economic cycle also plays a role: foreign banks have more impact during crises.

The results show that the entry of foreign banks has a significantly positive impact on the performance of domestic banks, which is in favour of the process of domestic financial liberalization (Chuang Wang & Evangelos Giouvris).

Results show that foreign bank entry widens Africa's poverty gap, notably when financing to high value-added industry sectors remains low. Results are consistent with the cream-skimming intermediation hypothesis, occasioning a contraction of credit. By tendering credit to a broader set of firms in industries disproportionately reliant on external finance to grow, foreign banks may partially offset the welfare-reducing effect. However, foreign banks' role in driving down poverty rates is conditional to the host country's institutional quality – an institutional threshold beyond which foreign banks' entry may induce poverty-reducing effects, necessitating a minimum level enabling institutional environment in the host country (Nanivazo et al., 2021).

Positive real effect of the level of foreign banks entry on financial development: this result suggests that foreign banks entry play a crucial role in developing the financial sector in Lebanon for the period between 1995 and 2014. By contrast, the results of the present study contradict with other studies that claim that foreign banks entry have negative effects on financial development in developing countries (Azmeh, 2021).

The findings also show that banking sector profitability and banking sector stability matter for foreign bank entry in both short- and long-term (Yakubu, et al., 2022) The results specifically show that higher foreign bank entry causes the management ability of domestic banks to drop as the operating expenses and total cost of domestic banks have increased, while the asset quality, liquidity, and bank growth also declined as the diminution of market share by loan.

All of these can point to the reduction of earning ability as well as the profitability of domestic banks as ROE, ROA, and NPM and changes in the growth rate of domestic GDP and credit to economy or financial development in Lao PDR cause foreign bank asset percentage changes and mostly foreign banks perform as substitutions, not for complementary, this makes the competition stronger which lower domestic bank’s performance and cause a lower growth rate of GDP in long run (Khamphoumy, 2023).

6. CURRENT STATUS OF ETHIOPIAN BANKING

State-owned banks currently control the majority of Ethiopia's banking industry, with the Commercial Bank of Ethiopia (CBE) being the biggest and most significant which have a total asset of 991,319,048,071.00 in 2021. Since the 1990s, private banks have been able to conduct business there, but they still only make up a small portion of the market. A push for financial inclusion and rising demand for banking services have both contributed to the sector's growth in topical years.

The banking part in Ethiopia nevertheless has to contend with issues such low access to capital and foreign currency, high non-performing loan rates, and a shortage of qualified personnel.

To solve these problems and encourage the sector's expansion, the government has started taking action. Ethiopia's banking industry has had rapid expansion in the last ten years, with the number of banks rising from 11 in 2011 to 25 in 2022 including development bank and the state-owned banks. State-owned banks still control the majority of the market, with the Commercial Bank of Ethiopia holding over 70% of all banking assets in the nation. On the other hand, nearly 30% of all banking assets are held by private banks.

Ethiopia's banking sector currently allows private sector banks to operate there, but due to the country's strategy of gradual liberalization, it remains closed to foreign institutions. However, the Ethiopian government is aggressively pursuing significant financial sector changes in accordance with the 10-year Development Plan (2020–2021) and the 15-year Growth and Transformation Plan (2010–2011).

Ethiopia's present financial system is made up of both public and private banks. Banks in the public sector are establishments wholly owned by the Ethiopian government. Non-government owned segment banks are those whose share capital is solely owned by private individuals and companies. However, Ethiopia's banking system now has a modest market size and is incompatible with global experiences compared to many other low-income Sub-Saharan African countries (Menza & Eshete, 2018).

As of June 2022, there were 21 commercial banks, 1 cooperative bank, and 1 specialized bank operating in the private banking sector. The commercial banks in the private sector are further divided into Islamic and conventional commercial banks. As of June 2022, there were 18 conventional commercial banks and 3 Islamic commercial banks operating. Only NBE has the authority to oversee and regulate the banking sector.

Access to capital and foreign currency is one of the main issues facing Ethiopia's banking industry. This has made it challenging for banks to extend credit to organizations and people, as well as caused a shortage of foreign currency, which is required to pay for imports.

The National Bank of Ethiopia (NBE) foreign exchange auction is one action the government has taken to solve this problem, but more needs to be done to make things better, High non-performing loans are another issue countries banking sector is facing. In 2020, the banking industry's NPL ratio was over 17%, which is much higher than the global average Abate, M. T., & Kaur, R. (2023).

Some banks have seen a decline in profitability as a result, and it is now more challenging for them to provide additional loans. The government has been making an effort to solve this problem by urging banks to enhance their risk management procedures and establishing new laws, again, the absence of qualified experts is yet another issue facing Ethiopia's banking industry. Despite an increase of graduates in the financial and banking fields, there is still a dearth of highly qualified workers in such like risk management, credit analysis, and digital banking. Through the introduction of new training programs and courses, the government and universities are collaborating to address this problem.

Even, there aren't any authorized foreign exchange (forex) offices, investment banks, foreign banks or authorized money transfer businesses operating in Ethiopia right now.

7. REGULATORY FRAMEWORK

The central governor of Ethiopian financial system (NBE) is currently in charge of regulating the banking industry in Ethiopia. All banks, insurance firms, and microfinance organizations doing business in the nation must be under the NBE's supervision. The framework is intended to uphold the integrity of the monetary system, protection the constancy and security of the financial sector, and safeguard the interests of depositors. Banks must abide by a number of rules, recommendations, and directives established by the NBE, including minimum capital standards, prudential lending restrictions, liquidity ratios, and reporting requirements. The NBE has also developed policies in recent years that are meant to encourage financial inclusion and increase access to financial services, particularly in underserved regions of the nation, and the entrance of foreign bank in the economy.

Maintaining the financial sector's stability and soundness is one of the framework's core goals. The NBE closely oversees the operations of banks and other financial institutions to make sure they are functioning within acceptable risk criteria in order to do this. This involves establishing minimum capital standards, which are meant to guarantee that banks have enough money to cover any losses. To help banks stop from taking on too much risk, the NBE also places prudential restrictions on lending and other banking activities. For instance, banks must have sufficient levels of loan collateral and restrict their exposure to specific borrowers and groups of linked borrowers.

In order to ensure that banks have enough liquid assets to meet their obligations even during difficult financial times, the NBE has also imposed liquidity and reserve standards that banks must abide by. The NBE has taken a variety of measures to stimulate the growth of microfinance institutions (MFIs) and other suppliers of financial services to underserved populations in order to achieve financial inclusion. This entails creating a legal framework for MFIs, offering them technical support as they expand their capabilities, and promoting collaborations between MFIs and conventional banks.

The overall goal of Ethiopia's banking regulatory system is to find a balance between fostering the expansion of the financial industry and safeguarding the interests of customers. The agenda has generally been successful in ensuring the stability and soundness of Ethiopia's financial system, however there is always space for improvement.

8. DISCUSSION AND FINDINGS

The entry of foreign banks into Ethiopia's financial sector has been a significant development in recent years. This study examines the impacts of joining foreign banks on the Ethiopian economy. It explores the potential benefits and challenges associated with the presence of foreign banks, considering factors such as economic growth, financial stability, and access to finance, technology transfer, and competition.

Findings:

Economic Growth:

A. Increased Foreign Direct Investment (FDI): The entry of foreign banks in Ethiopia has attracted foreign direct investment, boosting capital inflows into the country. FDI can contribute to economic growth by providing additional funding for investment and promoting job creation.

B. Enhanced Financial Intermediation: Foreign banks bring expertise in financial intermediation and risk management, which can positively impact economic growth. Their presence can stimulate lending activities, thus facilitating access to credit for businesses and individuals, and supporting investment and consumption.

Financial Stability:

A. Strengthened Banking Sector: Improved Governance and Risk Management: Foreign banks often adhere to robust governance and risk management practices, which can enhance the stability of the Ethiopian banking sector. Enhanced Regulatory Framework: The entry of foreign banks can encourage regulatory improvements, including stricter supervision and prudential regulations, thereby reducing the likelihood of financial crises.

B. Vulnerabilities to External Shocks: Exposure to Global Financial Instability: The integration of foreign banks may expose the Ethiopian economy to external shocks, such as sudden capital outflows or changes in global market conditions. Proper risk management and regulatory oversight are necessary to mitigate these risks.

Access to Finance:

A. Increased Financial Inclusion: Foreign banks can contribute to expanding access to financial services, particularly in underserved areas. They often introduce innovative products, technology, and efficient delivery channels that can enhance financial inclusion and promote access to credit for previously unserved populations.

B. Potential Concentration of Services: There is a risk that foreign banks may focus on serving wealthier clients or major urban centres, potentially neglecting rural areas and marginalized communities. Policymakers need to ensure that financial inclusion objectives are prioritized and that adequate measures are in place to address this concern.

Technology Transfer:

A. Enhanced Technological Capabilities: Foreign banks often bring advanced banking technologies, systems, and practices, which can promote efficiency, automation, and transparency in the Ethiopian banking sector. This can lead to improved service delivery, reduced transaction costs, and increased productivity.

B. Potential Skills Transfer: The presence of foreign banks can facilitate knowledge and skills transfer to domestic banking professionals, leading to capacity building and the development of a more competitive local workforce.

Competition and Market Dynamics:

A. Heightened Competitive Environment: The entry of foreign banks increases competition within the Ethiopian banking sector. This can incentivize domestic banks to improve their services, adopt best practices, and innovate, ultimately benefiting consumers through better products, lower costs, and improved customer service.

B. Potential Concentration of Market Power: There is a risk that the dominance of foreign banks may lead to market concentration, reducing competition and limiting consumer choice. Effective regulation and supervision are necessary to prevent anti-competitive practices and ensure a level playing field for all market participants.

9. CONCLUDING REMARKS

It is important to carefully analyse the impact of foreign bank entry in developing nations especially in Ethiopia because it is a complicated and diverse subject. One way those foreign banks might help enhance financial inclusion and spur economic growth is by providing much needed capital and expertise to developing financial markets. On the other hand, there are worries about the possible dangers connected to the entry of international banks, such as the potential for increasing financial instability and the chance that foreign banks may monopolize local markets and drive out domestic rivals.

Overall, the data points to the possibility that foreign bank entry can benefit Ethiopia, but only if it is rigorously controlled and done so in a way that fosters competition and financial stability. This calls for robust regulatory structures that can monitor the operations of international banks and guarantee that they adhere to local laws and regulations. Policymakers must also be aware of the potential risks connected to the entry of foreign banks and take precautions to reduce these risks, such as encouraging the growth of local banks and making sure that foreign banks do not gain an excessive amount of market share.

In conclusion, the entrance of foreign bank in Ethiopia economy is very crucial to foster economic growth, but the central bank must adopt rules and regulations to save the country's overall financial stability from danger. Effects of foreign bank entry in developing nations are complex issues that demand cautious handling.

Foreign banks have the potential to significantly improve underdeveloped financial markets, but they can also present hazards that must be carefully handled in order to maximize advantages and reduce risks. The capacity of authorities to strike a balance between fostering competition and financial stability, while also ensuring that local banks are not excessively disadvantaged, will ultimately determine the success of multinational banks entering emerging countries.

Policymakers must also be aware of the potential risks connected to the entry of foreign banks and take precautions to reduce these risks, such as encouraging the growth of local banks and making sure that foreign banks do not gain an excessive amount of market share, strong political support and scale up best practices of other country that have the experience.

Because the researcher used review-based approach there may be difficulty to generalize. So, next researcher is do the study by developing and including quantitative approaches and data.

The finding of the paper is important to many of the world's country especially for those in which they need to start the privatization of banks like Ethiopia, for the decision makers to make informed judgement for the economy.

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