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ANALYSIS OF BANKING POLICY ENVIRONMENT IN ETHIOPIA: POST-1991

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ABSTRACT

This study involves the analysis of public policy of National Bank of Ethiopia on the Ethiopian banking system post 1991. Through the qualitative research method, the study collects primary data from senior bank officials and other stakeholders and analyzes them through discourse analysis. The findings of the study reveal that public policies changes including the financial reforms have positively influenced the performance of the industry and had achieved their major targets. This achievement is manifested by the increasing number of private banks, branches, customers, savings mobilized, funds channeled to the economy, banking services, technology, and overall contribution to the economic growth. Nevertheless, some of the policy implementation problems observed are lack of consistency, inflexibility, shortsightedness, limiting nature, prioritizing the public sector and limited capacity in monitoring. Finally, the study recommends the regulatory body should develop its capability both in formulating and implementing policies.

Key Words: Public Policy, Ethiopian Banking System, Resource Mobilization, Bank Regulation

INTRODUCTION

Banks have been major actors in the economic system by creating liquidity that drives consumption, investment, entrepreneurship, employment, financial markets, and economic growth. Moreover, in the last few years, banks have addressed different economic sectors through their credit services by developing several financial products and derivatives (Bouheni, Ameur, Cheffou, & Jawadi, 2014). Government also uses the banking system to raise funds so as to finance its growth and developmental programs. Such strategic roles of the banking system in the national development necessitate the existence of sound banking system (CBN, 2011). Having a safe and strong banking system is crucial to protect investors, financial markets, and the whole real economy; whereas weak banking system creates fragile economic and political institutions. As a result, governments give much emphasis to ensure the soundness of their banking system and they use public policy instruments for the purpose.

In its simplest form, public policy is defined as the relationship between the governmental units and their environment (Eyestone, 1971) expressed in terms of the actions, objectives, and statements of governments on particular matters (Wilson, 2006). Public policy in banking system is usually guided by a country's contextual conditions including the state of the economy, the legal and supervisory framework, the structure of the financial system, the quality of accounting, and regulatory and auditing standards. The policy adopted could be a repressive one or a liberal one and it establishes the ground rules of competition and thus creates varieties of market behaviors. Public policy encourages more competition by allowing the entry of private sector banks and foreign banks in leveling the playing field. Public policy affect branch network of the banking system in order to reach unbanked society in a country. Public policy has contributed to an efficient transitional path of the banking system to move from a regulated focus on predetermined objectives to a more liberalized regime (Reddy, 1999). Overall, banking policies help to prevent the occurrence of systemic risk to the banking sector and thereby increase the transparency and effectiveness of the banking sector and contributing to the protection of small depositors (Kasiak, 2000 as cited in Davis & Obasi, 2009).

The performance of Ethiopian banking has been influenced by different policies and National Bank of Ethiopia is mandated with the responsibility of issuing public policies as well as licensing and supervision of both public and private banks in Ethiopia. In this regard, even though the government of Ethiopia acknowledges the importance of financial liberalization for financial development, it follows the gradualism approach to liberalization (Mekonen and Melese, 2014). After the regime change in Ethiopia in 1991, the then government initiated various changes in the economic sphere including the financial sector that include the banking sector though not very fast. Although the banking system in the country has shown encouraging results in mobilizing resources and expanding the branch network, it appears to have several structural vulnerabilities and weaknesses in the supervisory, regulatory and legal frameworks. Much of the Ethiopian banking system is affected by a weak credit culture, poor risk assessment and management as well as supervision and regulation that are not fully in line with international standards and inefficient legal and judicial framework. The ability of the banking system to supply credit, including the priority sectors that financial policies aimed to support is weak and there is a wide gap between total investment needs and domestic resource mobilization when seen from deposit/GDP ratio in comparison with the Sub-Saharan African standard, though it introduces various resource mobilization schemes recently. However, as observed from the widening saving-investment gap to GDP ratio, the fast and high economic growth during the last decade relies more and more on foreign loans and grants (Fekadu, 2017).

In light of this background, the study aims to conduct a thorough analysis of the public policy in the Ethiopian banking system from 1991 onwards with much focus on policies towards resource mobilization i.e. deposits, borrowing, loan collection, and foreign exchange reserve positions. The policies to be analyzed in the study are proclamations issued by the government as well as directives and regulations issued by the National Bank of Ethiopia in line with the proclamation to supervise the banking system.

REVIEW OF LITERATURES

Policy, Policy Environment and Banking System

There is no precise and universal definition of public policy, and hence different definitions of policy are provided by different scholars depending on what the researcher wants to consider. Dye (1987) broadly defined policy as "whatever governments choose to do or not to do" while Eyestone (1971) defined Public Policy as "the relationship of governmental units to their environment". Another broad definition is provided by Wilson (2006) that considered policy as actions, objectives, and pronouncements of governments on particular matters, the steps they take or fail to take, to implement them, and the explanations they give for what happens or does not happen. On the contrary, James Anderson defined policy narrowly as "a purposive course of action or inaction that is undertaken by an actor or set of actors in dealing with a problem or matter of concern (Anderson, 1994). Overall, there is a general agreement that public policy includes the process of making choices, the actions associated with implementing those choices, and the outputs and outcomes produced by those actions; moreover "public" policy is that choices or actions which are backed by the coercive powers of the state; and that, at its core, public policy is a response to a perceived problem (Birkland, 2001).

Public policy is affected by different variables like social and economic conditions, prevailing political values and the public mood at any given time, the structure of government, and national and local cultural norms, among other. To understand how these variables shape the policymaking process, it is best to understand social, political, economic, governing, and cultural contexts (Kraft and Furlong, 2003).The implementation of those policies and regulations raise important questions on the appropriateness of the regulatory and supervisory approaches pursued in the run-up and it also prompted to consider the effectiveness of those policies in regulation and supervision of the banking sector.

The banking sector is a subset of the financial sector and it plays a dominant role in the financial intermediation process of most counties. The banking sector development can boost economic productivity and growth among firms (Aluko& Ajayi, 2017). The banking system plays a critical role in fueling economic growth (Vinh & Vo, 2008) and also in transmission of monetary policy (Cetorelli and Goldberg, 2012). The banking sector has been an issue of policy interest focused largely on the presumed tendency towards concentration and its effects on economic efficiency, bank profitability, financial and hence macroeconomic stability (Davis, 2004). Otherwise poorly functioning banking systems impede economic progress, exacerbate poverty, and destabilize economic development. Governments and policymakers put forward several programs to save the banking systems, but they were not enough, and the banking crisis was more severe and rapid than previously expected (Bouheni, Ameur, Cheffou, & Jawadi, 2014).

Regulation is one of the best-known policy instruments that encompass several different kinds of government laws that legislatures enact to ensure compliance. Predominantly, citizens and corporations comply voluntarily with legal requirements, but the means are available to force compliance when necessary (Kraft and Furlong, 2004). Banking regulation and supervision has gained attention from governments after the global financial crisis happened in 2008 so as to protect global financial systems. The most notable reform on the financial regulatory framework is the Basel Committee on banking supervision's reform package known as Basel III (Basel Committee on Banking Supervision, 2010a, b).

Though there is growing empirical evidence on the relationship between bank regulation, supervision, and stability, there is limited evidence, on the effect of the regulatory environment on bank efficiency (Kouki & Mabrouk, 2016). There are two opposing perspective on the relationship between bank regulations and bank efficiency; public and private interest view. The 'public interest view' suggests that the government safeguards the interests of the public through regulating banking activities, which in turn promotes bank efficiency and helps to mitigate the prospect of market failure. Whereas, the 'private interest view' suggests that certain bank regulations are enacted or enforced to maximize the interest of a particular group, leading to a decline in bank efficiency (Barth et al., 2013; Allen & Carletti, 2013). Some opponents argue that giving supervisors more power and independence fosters corruption because supervisors are mainly interested in increasing their welfare (Shleifer and Vishnny, 1998; Djanov et al., 2002; Quintyn and Taylor, 2002). Similarly, Barth et al. (2004) show that official supervisory power does not have a significant effect on bank development and performance.

Notably, there is, yet, no consensus on the theoretical benefits of more stringent regulation and supervision on bank efficiency and performance. Buch & DeLong (2008), who used the database compiled by Barth et al. (2001), indicated that tighter restrictions on bank activities exert a negative impact on bank efficiency. On the one hand, some theoretical models argue that supervisors need significant resources and powers or prevent banks from engaging in undesirable activities and from taking excessive risks, especially in light of the growing complexity of banking activities (Stigler 1971; Beck et al., 2006). Chortareas et al. (2012) and Pasiouras et al. (2009) provide support to this view by showing that empowering supervisors leads to enhanced bank efficiency. Interestingly, Barth et al. (2013a, b) conclude that this relationship holds only for independent supervisors (Kouki & Mabrouk, 2016).

In general offering supervisors more power in itself has no significant effect on bank efficiency while the independence and experience of supervisors are positively associated with enhanced efficiency. Overall regarding the impact of regulations and supervision on the banking sector seem to be hybrid and correspond specifically to the period and degree of sophistication and complexity of the national economy in question.

Theoretical Framework

There are four public policy models i.e. Political System Theory, Institutional Theory, Agent and Principal Theory, and Rational Choice Theory. However, this study gives much emphasis on the institutional theory combined with the Agency-Principal theory since the study focuses on the policy impact as well as the relationship of between the institutions involved i.e. National Bank of Ethiopia as a 'Principal' and banks as an "Agency".

The Institutional theory emphasizes the formal and legal aspects of government structure and their rules and procedures. Those rules include basic characteristics such as the degree of access to decision-making provided to the public, the availability of information from government agencies, and the sharing of authority between the national and state governments under federalism (Kraft& Furlong, 2003). Institutions are the humanly devised constraints that structure human interaction where they are composed of formal rules (statute law, common law, regulations), informal constraints (conventions, norms of behavior, and self-imposed codes of conduct), and the enforcement characteristics of both (Douglass, 2005). The study employs this theory since structure, rules, policymaking, and access to decision-making will have paramount importance in the implementation and performance of a given policy towards the banking system.

On the other hand, in principal-agent models, some actor (or group of actors) called an agent undertakes action on behalf of another actor (or group of actors) called a principal. The principal, for its part, can make decisions that affect the incentives of the agent to take any of its various possible actions. This process of structuring incentives for the agent is the central focus of principal-agent theory. The Principal agency theory in the policy environment can be explained through the electoral agency (voters as principals and politicians as agents). The principal-agent model identifies two major difficulties that occur when a principal contracts with a set of agents under asymmetric information. These difficulties are moral hazard (hidden action) and adverse selection (hidden knowledge) and they surface whether the contract is explicit and enforceable in court, as with policy implementation, or the contract is opaque and only enforceable to a limited extent, as with politics (Lane, 2013).

Ethiopian Banking System Policy Environment

The key role of a bank as an institution is to mobilize resources and distribute its idle resources to potentially productive sectors, with the aim of raising the level of economic development. In modern times the role of commercial banks is found important. Since the coming to power of the Derg in 1974 and during its stay till 1991, Ethiopia had been under the central planning economic system through which macro incentives such as interest rates, exchange rates, and prices of major commodities were administratively fixed with no management autonomy. The economy was without private sector if there is with a pre-determined capital ceiling not exceeding a quarter of a million birr. As a result the policies of the government were resulted in sluggish performance of the economy and macroeconomic imbalances.

Following the change of government in May 1991, the then new government, EPRDF, took various policy measures with aim of adjusting the macroeconomic imbalance and fostering sustainable economic growth, and declared a market-oriented capitalist mode of economic policy. The government at that time was faced with the twin tasks of reconstructing the economy and embarking on the transition to a market economy. As part of this process, state banks have been recognized, the role of the private sector in the financing system has been expanded, interest rate controls have been liberalized, and the central bank has been given new power of financial supervision (Addison & Alemayehu Geda, 2001). After the 1992 economic reform, a new monetary and banking law was promulgated in 1994 that resulted in the increase number of private banks among others. These days there are two public banks, twenty private banks (two of them are Islamic banking), and many more under the establishment phase. All banks are licensed and supervised by the National bank of Ethiopia (NBE). NBE is given the mandate to control and patrol all the activities of banks through regulation and supervision guidelines (proclamation no .84/1994).

Ethiopian banks are regulated by a comprehensive set of rules and regulations, anchored in relevant laws or NBE circulars. So far, the National Bank of Ethiopia endorsed various regulations and/or supervision acts that are active to steer the banking system in Ethiopia. In this period of change within the banking system, the maintenance and strengthening of communication between banks and bank supervisory agencies is critical as the core function of the central bank is to protect the stability of the banking system

DATA AND METHODS

This part provides the description of the study area, the means of data collection, the sample size, data management and administration, data processing and analysis, validity and reliability as well as the role of the researcher. This study involves the analysis of the policy of the National Bank of Ethiopia on the banking system, with due emphasis on its relationship with resource mobilization. The areas of the study; therefore, focus on laws, directives, circulars, and policies of the National Bank of Ethiopia and on its supervision of commercial banks that so far exist in the banking system of the country. In this study, qualitative approaches was used mainly to know the views of various policymakers and users of the policy.

The philosophical background followed is constructivism or social constructivism as a perspective or as an approach to qualitative research. Social Constructionist believes that individuals seek understanding of the world in which they live and work. The process of research involves emerging questions and procedures, data typically collected in the participant's setting, data analysis inductively building from particulars to general themes, and the researcher making interpretations of the meaning of the data (Creswell, 2007). Individuals develop subjective meanings of their experiences meaning directed toward certain objects or things. According to Crotty (1998), one of his assumptions is a qualitative researcher seeking to understand the context or setting of the participants through visiting this context and gathering information personally. Therefore, the goal of the researcher is to rely as much as possible on the participants' views of the situations being studied.

The target population are all banks that now operate as commercial banks from both public (Commercial Bank of Ethiopia and Development Bank of Ethiopia) and private banks (there were sixteen at the time of the study) and the National Bank of Ethiopia (the Central Bank). In this study, the primary targets were the higher-level management executives at each bank and some senior experts who may be referred by top management. In addition to the above, the target population includes ex-officials (CEOs) of banks and ex-Governors of the Central Bank, current and/or ex Board of Directors of the banks. The target population includes responsible individuals who may have been involved in the development, interpretation, and implementation of national banking policies. The views of these participants are essential inputs for the study since these groups are the main actors in the industry. Using the finite population sample size formula, the total sample size of the study was determined to be 244. The quota sampling technique was adopted to reach the 19 banks then each type of management was classified (vice presidents, department heads, ex-officials, and senior experts) to include each group. And finally, a simple random sampling was used to draw from each category to give each individual in the population an equal chance of being selected. In addition, the snowball sampling method was employed taking advantage of possible references provided by higher officials.

The data used in the study was collected through the Key Informant Interview (KII) method conducted with top bank executives and leaders. The questions used to collect relevant information for the study seek to probe into all critical areas, including resource mobilization. The questionnaire was designed to use open-ended and semi-structured questions so as collect first-hand data from the respondents. The collected data were analyzed using content analysis method.

RESULTS AND DISCUSSIONS

Policy Related To Overall Banking Operation

Establishment and Governance of Banking

The first directive on the National Bank of Ethiopia was Directive No. SBB/001/1994 issued on May 5, 1994, which was about licensing and supervision of banking business in the country. The directive provides guideline on the requirements for licensing of banking business, selection criteria and appointment of chief executive officer (CEO) and board of directors among other requirements. This directive has been amended and/or replaced by different subsequent directives, Directives SBB/003/95, SBB/39/2006, SBB/56/2013, SBB/62/2015, SBB/68/2018 and finally SBB/71/2019 issued to partially amend or replace the previously issued one. The latest directive SBB/71/2019 is named as “Bank corporate governance Directive (1^{st} replacement)” substitutes the previous directives of SBB/62/2015 and SBB/68/2018. The directive includes provisions that designed to ensure that banks are managed and directed soundly and prudently.

In addition to these another related directive is Directive No SBB/73/2020 that allowed foreign nationals of Ethiopian origin or the Diaspora community to invest in the Ethiopian Banking industry in acceptable foreign currency but the dividend payment would be in Birr and it would not be repatriated in foreign currency. The directives allowed banks to increase their paid up capital by selling to the Diaspora communities new banks that were selling share like Amhara Bank, have taken advantage of the directive.

Branch Opening and Relicensing of Microfinance institutions

Branches are the main outlet for reaching customers to mobilize resources like deposits and foreign exchanges. National Bank of Ethiopia under SBB/002/1995 issued a policy that guides banks on how to open branches. Under this directive, banks must follow certain “do and don’t do” types of procedures to open branches; for example, the law seeks approval of the central bank before a branch enters into operation. This directive, however, has been replaced by Directive No SBB/22/99, which expands the meaning of branches to include any branch office, branch agency, additional office, or any place of business at which deposits are received or cheques are paid or money is lent and other businesses are solicited. The indicated directive instructed banks to submit a feasibility study on the demand and supply analysis of the given location.

The additional directives concerning branches services are directives SBB/40/2006, SBB/58/2019, BSD/01/2011 and BSD/02/2011. Third amendment was directive SBB/01/2018 of a branch or sub-branch opening activities to effectively manage risks or to make trade finance and/or processing of loans and advances. Another directive No SBB/74/2020 sets the requirements for relicensing of microfinance institutions as a bank. As a result, three microfinance institutions Somali Microfinance, Oromia Credit and Saving Co., and Amhara Credit and Saving Co. have relicensed as banks with new name of Shebelle, Sinqe, and Tseday Bank, respectively. The relicensing of the microfinance institutions impacts the operation of the existing banks in resource mobilization and financing since they have huge financial capital and experience with micro savers and credit users.

Reserve and Liquidity Requirements

Reserve requirements are funds that a bank holds in reserve to ensure that it can meet liabilities in case of sudden withdrawal. NBE instructed all banks through directive no. SBB/4/1995, to maintain five percent of all birr and foreign deposits liabilities held in the form of demand deposits, saving deposits, and time deposits. This reserve will be kept at NBE for a longer period and this will minimize the loan able fund of banks. Besides, the central bank ordered all banks to surrender 25% of the annual profit of each bank to transfer to legal reserve until such account equals the bank's capital. When the legal reserve account equals the capital of the bank, the amount to be transferred to the legal reserve account shall be 10% of the annual net profit that will only be seen in the books of bank accounts. The central bank has issued various directives including a minimum amount of cash a must to be kept on hand but not to be lent. According to some of the respondents, this reserve requirement and other laws have an impact to increase the cost of funds to find deposits but they consider it is still important. Similar directives initially issued as SBB/06/1995 has other requirement related to computation of reserve, reserve deficiencies, and reporting.

After a year, by its Directive number SBB/14/1996 NBE amended the reserve requirement banks to maintain 5 percent of their demand deposit, saving deposits and time deposits in balance held with NBE. Another Directive No SBB/80/2021 replaces the former and dictates all banks to raise the legal reserve amount to 10 percent instead of 5 percent until November 2021. The purpose of this important but hard decision is to limit the level of credit to the business and individuals that banks are providing. However, almost in a year time, this directive was further replace by Directive No. SBB/84/2022-reserve requirement 8th replacement. The new directive reduced the amount of reserve requirement from 10% to 7% of all Birr and FCY deposit liabilities held in the form of demand, saving and time deposits.

According to senior bankers of both Public and private banks, this directive is a shock for the industry since it adds fuel to the already weak level of liquidity, as a result negatively affects on credit matters and meeting obligations to the customers although it may have short run benefit to reduce the level of inflation.

The liquidity requirement as a necessity one was initial issued at the beginning of 1995 under Directive No SBB/ 5/1995 with the intent of having a strong liquidity position which later replaced by Directive SBB/15/1996. By this law NBE clearly defines the meaning of current assets and current liabilities and imposes any operating bank to maintain a liquid asset of not less than 15 percent of its total current liabilities; to maintain at least five percent of the current liabilities in the form of primary reserve assets and ten percent of the current liabilities in the form of secondary reserve assets effective the 20th day of November 1996. According to a senior banker, the primary means cash and equity investments while secondary assets mean receivables, real estate, and other similar assets.

The NBE through its directive SBB/ 45/2012 bring about a new and upgraded liquidity requirement to be 20 percent. Nearly after two and half years on October 1, 2014 under directive No SBB/57/2014, any licensed commercial bank shall maintain liquid assets of not less than fifteen percent from earlier that of twenty percent. This directive brought another new specific requirement that a commercial bank shall establish an Asset & Liability Management Committee (ALCO) to manage its assets, liabilities, and off-balance sheet items to fully meet the bank's contractual commitments and directs a commercial bank to develop liquidity management policies. According to most senior bankers, among the different balance ratios, the most stringent one for operation is reserve and liquidity requirement.

Risk Management and Open Foreign Currency Position

Similarly, Risk Based Internal Audit Directive No SBB/76/2020 is one more directive about risk-based internal audit, as a supplemental to the risk-based supervision to enhance the soundness of the banking system to improve the effectiveness of the internal control system and enhances the corporate governance of a bank. It is also directly responsible to the Board of Directors with sufficient independence and authority in its performance.

Another related directive regarding risk management is Directive No. SBB/009/95, which indicates the manner of computation the banks have to follow while computing their risk-weighted asset to manage their risk properly. The National Bank of Ethiopia issued a directive on limitation of accommodation under SBB/010/95 where all banks shall directly or indirectly except with prior written approval of the bank, grant or permit to be outstanding unsecured loans, advances or credit facilities of an aggregate amount in excess of Birr30, 000. Such limitation according to a senior banker in the bank system helps the banking system to work with a principle of serving others and curve directors and related parties from improper utilization of the power vested upon by taking loans without sufficient collateral. In this regard, it can be said that the central bank has been proactive in the matter.

According to Directive SBB/23/97 of NBE, an open foreign currency position shall mean a situation where assets denominations in foreign currencies do not equal liabilities denominated in the same currencies and vice versa. Directive No SBB/23/97 is about the limitation of the open foreign currency position of Banks. It limits the foreign currency position under proclamation 84/1994 specifically article 36 whether it is a long position or a short position.

In accordance to the directive, a long position in a foreign currency shall mean a situation where assets denominated in a particular foreign currency exceed liabilities denominated in the same currency while a short position shall mean a situation where liabilities denominated in a particular foreign currency exceeds assets denominated in the same currency. An aggregate of all currencies on either side shall bring about an overall foreign currency position.

A bank to avoid excess or shortage of foreign currency is dictated to buying from or selling to the NBE foreign exchange to eliminate any position above the limit that has been set earlier by squaring a foreign currency position. This limits, according to an ex-official commercial bank, the capacity of each bank to use the foreign currency especially when they have a long position.

According to the vice president of operation of a private bank, this limitation has got a very serious influence on the performance of the bank since it forced to square in the next business day.

However; this directive is replaced by Directive No SBB/27/2001 changes the marginal exchange rate, instead of a window opened in the foreign department of the central bank, for the squaring purpose based on inter-bank foreign exchange market daily. This required banks to square the overall open foreign currency position by buying from or selling and if failed to do so penalty will be applied per day bases.

Paid up Capital

SBB/24/99 is a directive issued to set a minimum paid-up capital to maintain by banks. Initially, it has been 25 million birr later raises to Birr 75 million for new entrant. The existing banks were also instructed by this directive to raise the minimum capital to Birr 75 million within three years and to maintain a minimum total capital level not less than eight percent of the risk-weighted asset, weighted according to risk.

In 2011, through Directive No SBB/50/ 2011 the National Bank of Ethiopia has raised the minimum capital for all new or existing banks to five hundred million which replaced SBB/24/99. In April 2021, the National Bank of Ethiopia has issued Directive No SBB/78/2021, which further raised the minimum capital to Birr 5 billion to enter in the banking business with a provision period of five years. Those banks under formation were urged to sell their share in six months period to be established with minimum capital of Birr 500 million, and to increase to the new level within seven years period. Failing to comply with the minimum capital level may lead to dissolution through merger with other banks or any other serious measurements.

According to the vice president of corporate service of one private bank, raising the minimum capital is highly linked to the ability of an individual bank to provide loans to a single borrower since customers are highly inclined to go to the higher single loan provider. These kinds of abilities will have a tremendous impact on the real competition of banks among each other.

Entry of Foreign Banks and Establishment of Capital Market

The final decision to liberalize the banking sector for foreign banks was made by the Ethiopian Council of Ministers on September 03, 2022. Currently preparation of the necessary legislation, directives, consultative sessions with banks and other stakeholders are undergoing. The entry of foreign banks brings both opportunities and challenges for the domestic banking industry. Some of the opportunities of the entry of foreign banks are explained in the form of credit expansion, increase foreign currency supply, enhanced banking skills and technologies, marketing know-how, specialized services, enhanced competition, Increasing access to finance and business partnership and increased job opportunities in the economy. On the other hand, the opening up for foreign banks also brings potential risks and challenges such as disclosure to external shocks, loss of market, concentration of foreign ownership, cut-and-run during financial crisis, and pressure on the capacity of the regulatory body.

Through Proclamation No. 1248/2021 with the aim of supporting the development of the national economy through mobilizing capital, promoting financial innovation and sharing investment risks, the government has passed decision to establish capital market in the country. It is understood that capital market plays crucial role for long term economic growth. A well-established capital market provides in the form of enhancing liquidity, promoting private sector development, mobilizing savings for investment, redistributing wealth, creating investment opportunities for small business and start-ups, etc.

The establishment of capital market in Ethiopia brings both opportunities and challenges for domestic banks. The opportunities are given in the form of additional services banks might provide along the existing commercial banking services, which includes custodianship, depository, investment banking, advisory and wealth management services. Therefore, banks among others should focus on increasing their financial capital; strengthen their business position such as technology, human skill and marketing know-how.

Other Policy Related Directives

Banks have various alternative investment interests to participate in different portfolios. In line with this, the central bank through Directive No.SBB/12/1996 are deprived of engaging in the insurance business but they can have shares up to 20 percent but not at any time exceeding 10 percent of the bank's equity capital. Banks are not also allowed to participate directly in non-banking businesses: agriculture, industry, and commerce but strictly prohibited to have equity shares in other banks without the prior approval of the central bank.

In addition to these a bank is also deprived not to invest in any securities more than 10 percent of its net worth. A bank is not allowed to engage in a real-estate developer business beyond and above 20 percent of its net worth without prior approval of NBE. No matter what the aggregate of all investments at any given time may not exceed 50 percent of its bank net worth without prior approval of NBE. This investment limitation directive came into force in April 1996. Moreover, limitation on investment of Banks (2nd replacement) directive no SBB/65/2017 states setting limits for investments are essential tools for risk management.

The actor in the banking system argues that limitation on investment at this stage is not such important to block banks from various investments since the level of investment in Ethiopia is still at a very infant stage both in scope and depth.

The central bank of Ethiopia brings about a new directive that entails a penalty for non-compliance with any directive of NBE under Directive No. SBB/ 20/1996. Similarly, Directive SBB/21/96 also asked banks to send their periodic performance to NBE as a means of offsite monitoring tools apart from a schedule on sight examination to check the overall governance of the bank activities. Another directive by the National Bank of Ethiopia under SBB/19/96 released is on how banks appoint an independent auditor answerable to the board of directors and appointed by the general assembly. According to the respondents of my interview questions, an independent auditor gives a guarantee to the shareholders of the bank since the auditor assures whether the bank is performing in line with the law of the country and it ascertains the corporate governance of the bank utilizes the resources efficiently or not. According to one of the executives of a private bank, such kinds of directives and site examination gives many channels to NBE to patrol banks at arm's length the day-to-day activities of each bank without its presence. These directives, according to the executive of a bank make NBE the most feared Federal institution.

Policies Related to Deposits, Borrowings, and Loan Collection

Saving and Lending Rate

The level of lending and saving interest rate is one of the critical variables for loans and deposits. To this effect, the National bank of Ethiopia under the provisions of Interest Rate Proclamation No. 29/21992 Article 2&3 bank interest rates has issued directive (NBE /INT/-1/1992) that declared interest rates on deposits. Accordingly, the interest rate of saving deposits has been adjusted to be 10 percent, and that of the time deposits has been decided to be 10.5%, 11%, 11.5%, and 12% for 3months up to 60months, six months up to 12 months, 1year up to 20years and 2 years and above respectively. Besides lending interest rate has been adjusted to be a minimum of 10 percent while the maximum is 15 percent classified by different sectors and tenure of the loan.

The above directive has been replaced by directive NBE/INT/2/1994 effective September 01, 1994. This directive brings about only changes in lending rates. The aforementioned has been replaced by Directive NBE/INT/1994. The stated directive has set a new shift in the interest regime of the banking system. It has considered only the minimum deposit rate to be applicable for all types of deposits, which were 10 percent, while the maximum lending rate for commercial lending and financial institution is 15 percent. It has been also noted that the inter-banking lending rate was decided to be done by negotiation between the banks.

Later on Nov 30, 1995, under directive NBE/INT/04/1995, the regulatory body introduces a new deposit interest rate of 11 percent from that of 10 percent while the maximum lending rate has been lifted and left for the bank to be set by the respective bank's board of directors. Moreover, effective June 01, 1996, under directive NBE/INT/5/96, the rate of the minimum deposit is goes back to 10 percent from 11 percent, and the maximum lending rate is fixed to 15 percent.

Interest rate directives mentioned above that was issued between October 01, 1992, and May 30, 1995, have been replaced by directive NBE/INT/6/1996.This directive changed the deposit interest rate from 10 percent to 7 percent while the maximum lending rate by commercial banks and other financial institutions decreases from 15 percent to 10.5 percent effective from September 16th, 1996.

Another important change has been reflected as of January 01, 1998, by directive NBE/INT/7/1998. This directive forces the minimum deposit interest rate to be 6 percent while the lending interest rate to freely determine by each bank. Directive number NBE/INT/08/2001 effective July 02, 2001, allows banks to pay interest on current accounts which has been freely determined in the former directive..

Surprisingly Directive NBE/INT/9/2002, set the minimum interest rate on savings to be 3 percent, the lowest since post the 1990s. It becomes 4 percent under directive NBE/INT/10/2007 and then becomes five percent under directive NBE/INT/11/2010. Relatively speaking this deposit rate on savings has stayed long until it is replaced by directive NBE/INT/12, 2017 on October 11, 2017. By this current working directive, the minimum interest rates on savings and time deposits are 7 percent while other issues are remaining intact.

<u>Asset Classification and Provisioning</u>

The National Bank of Ethiopia has issued the first directive on asset classification and provision in 2000 under directive no. SBB/ 28/2000, which was amended at a different period under directive SBB/ /32/2002, SBB/ 43/2008, and the latest directive was SBB/69/2018. The asset classification and provisioning directive require banks to regularly review and classify their loans and advances, and to maintain provision expenses for safeguarding further failure that may be happened due to bad loans, unrecovered receivables, and the like.

The bank management has to put a provision in the balance sheet since it indicates there is a going problem that might be uncollectable and the potential to reduce the profitability of the individual bank.

Single Borrowers Limit and Loan to Related Parties

The National Bank of Ethiopia issued to limit the credit exposure of single borrowers in order to diversify banks credit risk. The first directive in this regard is Directive no. SBB/16/96 and it has been amended and replaced by directive SBB/29/2002.

The other related directive is the requirement for a person with significant influence in Bank, directive no. SBB/54/2012 and later replaced by directive SBB/ 70/ 2019. The directives aim at ensuring sound practices, stability, and long-term institutional success in the financial system in general, and the banking sector, in particular, as crucial.

Financial Inclusion

So as to encourage and enhance savings mobilization through the use of alternative and innovative financial services and delivery channels, the National bank of Ethiopia introduced the Regulation of Mobile and Agent Banking Service in 2012 through directive FIS/01/2012 later replaced by directive no. ONPS/01/2020 named as Licensing and Authorization of Payment Instrument. And further was amended by Directive ONPS/06/2022, where the amendment was mainly on the opening and operation of the electronic accounts. Another policy regarding financial inclusion was Directive ONSP/02/2020, which is about the licensing and authorizing of payment system operators, which allowed private sector to own, operate, and administer a payment system.

One more important shift in financial inclusion is the introduction of Interest-Free Banking by directive SBB/51/2011. This directive has allowed banks to introduce window-based interest-free banking in a separate window alongside conventional banking services per the Islamic Laws or Sharia principles. This directive was replaced by the new Directive no. SBB/72/2019 that allowed the establishment of an independent full-fledged interest-free banks. After this directive, two full-fledged Interest-free banks, Zamzam and Hijira bank, have commenced operation and other new such banks are in pipeline.

Other Borrowing, Deposit and Loan Related Directives

Among the directives the issuance of two bonds that is treasury and Development Bank of Ethiopia bonds (DBE) bond directives require banks to invest in bonds with a bond rate of at least 2% points higher than the minimum interest rate paid on saving and time deposit.

The government has issued a new directive MFAD/TRBO/001/2022 regarding the establishment and operation of treasury bonds effective November 1, 2022. The Treasury bond is calculated based on the monthly loans and advance disbursements i.e. 20% of the monthly disbursement. The objective of the directive is to enhance the participation of banks in supporting the balanced growth of the country’s economy. The directive is applicable for all banks in the country except Development Bank of Ethiopia and the treasury bonds will be issued to each bank on monthly basis. The treasury bonds will have a maturity period of 5 years with interest rate of 2 points higher than the minimum saving rate and the accrued interest rate will be paid by the government annually. The directive also put a limit on the portfolio of short-term loan and revolving credit facilities. Since the directive impacts the liquidity position of the bank it is reflected in the decline of loans and advance.

Furthermore the NBE issued Investment on DBE Bond on September 1, 2021 through Directive No. SBB/81/2021 in the aim of securing stable and long term funding for sustainable finance development oriented government projects. All banks must invest annually a minimum of 1% of their respective outstanding loans and advance in DBE bond until the aggregate bond holdings reached 10% of the outstanding loans and advances. The maturity of the bond is 3 years with a bond rate of at least 2% points higher than the minimum interest rate paid on saving and time deposit.

Similar to the treasury bonds, the effect of DBE bonds is also reflected in the decline of loans and advance resulting from its effect on the liquidity position of the Bank as well as the negative effect on the income generation of the banks.

In a similarly way other directives issued are like customer Due Diligence of Banks issued to safeguard the banking system from various risks concerning money laundry; Management of Unclaimed Liabilities of a Bank Directive No SBB/ 75/2020 to transfer to the NBE besides under CRB/01/2012 as of February 25th, 2012 Credit Reference Bureau was setup by the National Bank of Ethiopia to assess the creditworthiness of a borrowers for making prudent lending decisions. Besides Export Credit Guarantee Scheme directive SBB/33/2002 which was further amended by directive SBB/34/2004, SBB/38/2006, and SBB/41/2007 was another one to support exporters to get credit access against the guarantee of the National bank of Ethiopia for pre and post-export activities.

Policies Related to Foreign Exchange Management

The foreign exchange regime of the country has experienced gradual changes and openers over the past five decades, reflecting the economic setting of the country, the economic management system, the economic policy of the different governments in power, the structure and level of economic development of the country, the performance of external trade sectors and balance of payments position of the economy among others.

The government pursued a capitalist economic system up to the early 1970. But later with the change of government in 1974 that adopted a command economic management, the fixed foreign exchange regime was continued and made to suit the pursued economic philosophy of the socialist military government; the then government issued a foreign exchange control regulation in 1977, which remained in force up to 1991.

After the demise of the military government the EPRDF government, followed market-oriented economic management. As a result, numerous foreign exchange transaction liberalization steps have been undertaken. More importantly, as significant parts of the micromanagement and operation function of foreign exchange transactions have been transferred vie directive FXD/07/1998 from the National Bank of Ethiopia to commercial banks.

The current foreign exchange regulation fully liberalized current account international payments for all imports of goods, exports of goods and services and payments for services associated with these exports.

Intending to encourage and support the export sector, the foreign exchange regime allows exporters to open a retention account to hold a specified amount of their export earnings for a defined period and use their foreign exchange holdings for their own export business promotion. Furthermore, the exchange regulations allows salary remittance by foreign employees, insurance payment, re-transfer of unutilized foreign currency holdings, etc.

Foreign exchange bureaus established at commercial banks are allowed to engage in the buying and selling of major convertible currencies. In addition, business entities engaged in manufacturing or business activity whose products are sold to external markets generating foreign exchange income are allowed to have access to external financing and suppliers' credit from abroad to finance imports of input or auxiliary materials essential for their export product.

In summary, the various foreign exchange transactions described above indicate in brief the type, nature, and facts of the current foreign exchange regulations that are now in force. Those multiple foreign exchange directives issued at different times over the past thirty years are in short discussed below.

Export related Directives

In order to encourage the export sector of the country Directive FXD/28/2006 that enters into force on the 28th day of August 2006 was issued regarding flower export and foreign exchange repatriation. The floricultural development and growth in the country is assumed as promising business activity. In addition to the requirement stated under FXD/26/2004 by this new directive, exporters are required to indicate their market destination and a copy of necessary documents. Concerning repatriation of export proceed the exporter shall have the responsibility to repatriate fully the next amount earned from the market.

To meet National Exporters need to compete on an equal footing with other exporters Directive SBB/41/2007, establishes Export Credit Guarantee Scheme from the National Bank of Ethiopia to the Development Bank of Ethiopia. The directive is supportive of the export sector by availing the necessary financial resources from banks for pre and post-shipment of exports. Because of this directive, Directive SBB/38/2006 was repealed.

Foreign Exchange Bureau

In addition to export proceed and inward remittance, banks purchase foreign currency cash notes and travelers cheque to mobilize foreign currency by Directive FXD/01/1996. The directive stipulated the legal requirements needed for banks to establish foreign exchange bureaus. This directive was replaced by FXD/03/1996 and later amended by FXD/05/1996, where additional responsibilities were given for foreign exchange bureaus i.e. sales of foreign currencies for holiday travel expense, business travel expense, medical expense, and payment for publication, advertisement, examination fees and others.

Over the years, based on the changes in the economic environment, different directives are consecutively issued like FXD/09/1998, FXD /17/2001, and the last FXD/33/2007. The changes made on the consecutive directives are mainly on the payment limit of foreign currency cash notes varying with time.

Foreign Exchange Allocation

Foreign exchange is a scarce resource that should be managed carefully, allocated transparently and soundly to priority and other economic sectors so as to meet efficiency and proper utilization. Directive no FXD/ 45/2016 of Transparency in Foreign Currency Allocation and Foreign Exchange Management effective February 10th, 2016 indicates the need to ensure the roles and accountability of the board of directors, executive management, and internal audit and employee of the bank as well as customers. It is to make sure that foreign exchange is not opening room for rent-seeking behavior and malpractice.

The directive also prohibits a bank to allocate exporters from their respective foreign currency earnings for import purposes. The above directive was replaced by Directive FXD/46/2017 and later it was further amended and replaced by consecutive directives of Directive FXD/51/2017, FXD/57/2018, FXD/62/2019, FXD/67/2020, and finally FXD/77/2021. The latest directive FXD/77/2021 identifies first priority items that accounts 50 percent of the total foreign currency allocated for all imports.

External Loan and Supplies Credit

Another important directive to boost the foreign exchange reserve is of External Loan and Supplies Credit Directive no REL/O5/2002. This Directive gives chance for investors to seek a loan from overseas to run their respective investments without a shortage of working capital and import of capital goods. This directive has been amended through Directive No. FXD/47/ 2017, FXD/76/2021, and the latest FXD/82/2022.The latest directive stipulates that investors who wants to seek external loans or suppliers' credit have to be registered and approved by the National Bank of Ethiopia. The investors that are eligible to take external loan or suppliers' credit are exporter, foreign investors, manufacturing industry, agricultural sector, input importers, and LGP gas import. The repayment of the loan or suppliers' credit shall be in foreign currency since the eligible businesses are engaged in foreign currency generation.

The directive encourages investors that are engaged in foreign currency generating businesses to have easy access to credit in order to expand their businesses.

Retention and Utilization of Foreign Currency Earnings and Inward Remittance

To encourage exporters of goods and services, the National Bank of Ethiopia has allowed them to retain certain portion of their export proceed in the form of FCY through Retention and Utilization of Export Earnings Directive No. FXD/02/1996 in August 1996. Two retentions accounts (A & B) shall be opened for this purpose. This directive was first amended after two months of same year in October 1996 and the amendment was only to increase the amount of FCY retention.

The first major change in this policy emerged after two year in August 1998 through Directive FXD/11/1998 of Retention and Utilization of Export Earnings and Inward Remittances, which allowed to retain 100% of their export proceed through the two retention accounts, 10% in Account A and 90% in account B. This directive was further amended through Directive No. FXD/48/2017, where the ratio of FCY retention in the two accounts (A & B) is amended from 10:90 ratios to 30:70 ratios. Subsequently, further amendment was made in September 2020 through Directive FXD/ 66/2020.

In the past two years, there was further amendment on the directives subsequently through Directive FXD/70/2021, FXD/73/2021, and FXD/79/2022 with a different retention amounts. However, in the latest directive (FXD/79/2022), the government takes majority of the FCY proceed and this policy is issued mainly due to the existing foreign currency shortage in the country. According to the directive, banks are required to surrender 70% of the FCY earnings from export of goods and services, inward remittance, and NGOs transfer to the National Bank of Ethiopia. The customers shall retain the 20% of FCY after deduction of the 70% in the retention account and the remaining 10% shall be surrendered to the bank at the prevailing exchange rate.

This latest directive on retention of FCY has limited the operation of commercial banks in providing import services to their customers and also to cover their FCY liabilities since it is only 10% of the FCY received which is used by the banks.

Foreign Exchange Surrender

National Bank of Ethiopia set foreign exchange surrender requirement for banks in 2017 through Directive FXD/50/2017, which was amended subsequently by FXD/54/2018. Through these directives, a bank shall surrender 30 percent of its foreign exchange inflow to the National Bank of Ethiopia, which later amended to every month within the first five working days of the next month. This directive was further amended in September 2021 through Directive No. FXD/72/2021, where the amount banks are required to surrender has increased from 30% to 50% from their FCY receipt every month.

Similarly, this policy has also negative effect on the operation of commercial banks in the country as it affect their capacity to provide import services to their customers and also cover their FCY liabilities.

Banking System in Ethiopia: Challenges, Implication, and Opportunities

Public Policy and the State of the Economy

While responding to the question that aims to know whether the public policies so far issued in the banking system are in line with the state of the economy, most respondents partially agreed. Some of them believe that the policies are crafted in congruence with overall national development endeavors as manifested by regulatory requirements that govern the banking industry. They argue that starting from 1991 the state of the economy adopted in the country was a market-led economy. As a result, privately owned banks were allowed to be established and operated. However, since the economic system, the government planned to create was a state-led economy, the policies of the National Bank of Ethiopia (NBE) were mostly inflexible and reactive rather than proactive. Recently, the new government seems to shift from a state-led economy to a free market economy allowing private digital service providers, full-fledged IFB services and market-based Treasury market.

Others argue that public policies so far issued are designed taking into consideration of the country's level of development and economic policies followed by the government. NBE issued several directives that ensure the soundness of commercial banks in Ethiopia and the protection of depositors' interests. However, the lack of domestic savings opportunities and the limited available access to bank credit for small businesses restricts economic growth.

Most of the senior official in the banking system, in their response to the question of whether the major targets of the public policy are achieved or not, said most of the targets are achieved when seen in terms of building banking system of the country through government and private sector involvement and increase accessibility of banking service to the general public. This is manifested by the rising number of private banks, increasing number of banking service users, the increasing amount of savings mobilized and fund channeled to the economic sectors, the continuous improvement in banking technology based services and overall contribution of the banking industry to the economic growth. However, there are gaps that are not addressed which are related to governance and management; absence of strong self-sustain and competitiveness, pricing and allocation of credit in the interest of mass and inclusive banking.

A quite number of senior bankers argue that with all its limitations, the policy has helped in availing financial resources for investors and traders by introducing private commercial banks in addition to the government banks. Some of the respondents argue that national saving has improved significantly which is an indication of enhanced financial intermediation and expansion in investment activities. Moreover, accessibility to financial services has been improving from time to time, among others. Contrarily, quite a number of the respondents said, though there is a significant improvement in the level of financial inclusion from time to time, still the NBE fails to contain the inflation rate by a single digit.

With all limitations, however; the NBE policy has helped in availing financial resources for investors and traders by introducing private commercial banks in addition to the public banks to enhance the economic development of the country. But, still, the policies are meant to solve an existing problem, it is often observed that the problem continues to prevail and even gets worse afterward. Therefore, the policies have failed to achieve the intended purpose to the desired level such as a shortage of credit and foreign currency.

Strengths and Weaknesses of the Banking System

Almost all respondents agree that there are areas that need correction or amendment to keep the banking system safe and sound. According to the respondents, the gaps in regulations that need directives amendment are mainly the foreign exchange surrender policy, which goes only to the private commercial banks and left aside the public ones. Second, the so far regulation that prohibits foreign banks to enter and provide banking services. This hampers the incoming of new technology, product or services, and new knowledge to banking system.

As to the majority of the respondent, the National Bank of Ethiopia needs to revisit its various directives based on the changes made to the commercial code of Ethiopia which is revised recently, and get the approval of the parliament, and the international financial reporting standards as seen differences between what the reporting standard requires and NBE asset classification directive, which is not yet amended following the adoption of the reporting standard.

As per most of the respondents, looking at the number of banks, it can be said that the Ethiopian Banking system is privately dominated. But, looking at the market share in terms of resource mobilization, loan portfolio, accessibility, and other indicators, it is dominated by the public sector since majority of the fund is channeled to the economy through the public sector.

As per the respondents of the questionnaire, almost all of them agreed that the strength of the banking system can be explained by the ability to strive the economic growth and plays a crucial role in the development of the market. The strongest part of the banking system, according to some of the senior bank officials, is the banking system has stringent control on bank deposit, credit interest rate regime decisions and tight procedures and directives to safeguard public money and financial stability. The banking system in Ethiopia more or less enjoys healthy growth and is one of the most lucrative investments in the country.

The banking system has also its weakest part: it has limited innovation, and limited focus on small and medium enterprises. The market is dominated by government-owned banks and generally the banks are operationally inefficient. Moreover, the bank system fails to curb the gap between the bank exchange rate and the parallel market. Another weakest part may be an inadequately skilled workforce, lack of sufficient infrastructure, and existence of geographical concentration of individual banks as well as the reluctance of banks to join in more financial inclusion services.

In terms of products, technology and structure the banking industry in Ethiopia is characterized by uniformity in products, services, and technology, and hence there is limited innovation and differentiation. Besides, most banks focused on cities and towns leaving the unbanked part of the society.

The ownership structure, according to the respondents, is formed in the line of ethnic interest to serve some ethnical groups. As a result, according to the respondents, most of the decisions made about bank service provision are influenced by such association rather than the business motive, for example, decisions about branch expansion, fund allocation, and the like.

The Challenges of the Public Policy and Policies Influence in the Banking System

From this perspective, almost all respondents somehow agree on the challenges of public policy in the banking system. These challenges are: the policies are limiting, not flexible, not farsighted rather they focus on solving immediate problems. Furthermore, they give too much emphasis to the public sector and the regulatory body lack capacity in monitoring the appropriate implementation of the policies, limited usage of technologically to support banking services and there is still a gap in financial inclusion are the main once among others.

Moreover, Bank system policies are not well prepared and are sometimes subject to frequent amendments due to the challenges they faced during implementation. Banks are sometimes considering policies issued as bottlenecks and tend to violate them to satisfy their business needs and the respective customers' request. The existence of outdated regulations should not go parallels with proclamations and other laws of the country.

In addition to the above, other major challenges of the banking system includes low banking access, inadequate legal framework in e-banking penetration, insufficient legal framework in e-banking and e-payment, inadequate level of banking development and technology due to high rates of illiteracy, low infrastructure development and frequent power interruption.

Although there have been many influential policies in the banking system over the years, as per some senior bankers, the policy that put much influence on the banking system is the proclamation that allows private sector involvement in the banking system as it opens the door that has been closed for a long period. The banking system in Ethiopia is much influenced by the policy that prohibits foreign banks from entering the market and providing banking services. As a policy tool some still believe that the repeated devaluation of the birr fails to reduce inflation and stabilizing the macro economy.

Finally, the major challenge observed is the weakness of the governing body which is the NBE. This central bank is incapable of appropriately implementing even its directives. For instance, it issues directives regarding foreign currency control but it doesn't devise any meaningful control mechanism for the parallel market, lack of proper follow-up by regulatory organs, inadequate research in policy design and poor stakeholder consultation and the minimum paid-up capital required to establish private banks.

CONCLUSION AND RECOMMENDATIONS

Banks have long been major actors in the economic system through developing several financial services and products. The strategic role of banking system contributes a great deal to the process of economic development. And therefore becomes essential that a country has a good and sound banking system, to protect the whole economy. In this regard the role of public policy is paramount important to ensure the having a safe and strong banking system; banking service meets its strategic objectives, establish the ground role by in leveling the playing field for more competition and by moving from a regulated bases to a liberalized one based on a country's contextual condition. The issue of regulation in the financial system is important to create transparency and effectiveness of the banking sector despite they have their own flaws as they helps to mitigate the occurrence of financial chaos. This study therefore aims to conduct a thorough analysis on the public policy such as directives, regulations and supervisions of the National Bank of Ethiopia and its influence and relationship with resource mobilization efforts in connection with deposits, borrowing and loan collection on one hand, and foreign exchange reserve positions on the other hand.

In this study of the policy environment and the banking system a qualitative approaches have been utilized to know the views of various policymakers and users of the policy. A sample of 244 respondents from senior officials and experts of the banking system were selected. The data was collected through the Key Informant Interview (KII) method conducted with top bank executives and leaders and content analysis method was adopted to analyze the data collected.

The findings of the study reveal that public policies changes including the financial reforms have positively influenced the performance of the industry and had achieved their major targets. This achievement is manifested by the increasing number of private banks, branches, customers, banking services, technology, and overall contribution to the economic growth. Nevertheless, some of the policy implementation problems observed are lack of consistency, inflexibility, governance and management challenges, prioritizing the public sector and limited capacity in monitoring. Besides the Ethiopian banking system appears to have several structural vulnerabilities and weaknesses in the supervisory, regulatory and legal frameworks. Finally, the study recommends that the regulatory body should develop its capability both in formulating and implementing policies and fill the gap in financial inclusion, re-observe some policies and directives that need correction or amendment to keep the banking system safe and sound.

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