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A CASE STUDY

Management of commercial banks in Ethiopia from the perspective of financial inclusion

■ GIRMA

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ABSTRACT

Financial inclusion is the process of ensuring access to appropriate financial products and services needed by vulnerable groups such as weaker sections and low-income groups at an affordable cost in a fair and transparent manner by mainstream institutional players like banks. Expectations of poor people from the financial system is security and safety of deposits, low transaction costs, convenient operating time, minimum paper work, frequent deposits, and quick and easy access to credit and other products, including remittances suitable to their income and consumption. Several countries across the globe now look at financial inclusion as the means to more comprehensive growth, wherein each citizen of the country is able to use earnings as a financial resource that can be put to work to improve future financial status and adding to the nation's progress. Initiatives for financial inclusion have come from financial regulators, governments and the banking industry. NBE should encourage expansion of bank branches, especially in rural areas and semi urban areas resulting in multifold increase in branch network, spread across the length and breadth of the country, because a significant proportion of the households, especially in rural areas, still remained outside the coverage of the formal banking system. Engaging business correspondents can permit banks to engage business facilitators (BFs) and business correspondents (BCs) as intermediaries for providing financial and banking services. The BC model allows banks to provide doorstep delivery of services, especially cash in-cash out transactions, thus addressing the last-mile problem in reaching the remote villages. To sum up, financial inclusion is the road that Ethiopia needs to travel toward becoming a stimulant player in the economic development of the country.

Key words **:** Financial inclusion, Use of ICT, Commercial banks, Management

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Financial inclusion is the process of ensuring access to appropriate financial products and services needed by vulnerable groups such as weaker sections and low-income groups at an affordable cost in a fair and transparent manner by mainstream institutional players like banks.

Financial inclusion has become one of the most critical aspects in the context of inclusive growth and development. The importance of an inclusive financial system is widely recognized in policy circles and has become a policy priority in many countries.

Unrestrained access to public goods and services is an essential condition of an open and efficient society. It is argued that as banking services are in the nature of a public good, it is essential that the availability of banking services to the entire population without discrimination should be the prime objective of public policy of any country. Expectations of poor people from the financial system is security and safety of deposits, low transaction costs, convenient operating time, minimum paper work, frequent deposits, and quick and easy access to credit and other products, including remittances suitable to their income and consumption.

It is now well understood that commerce with the poor is more viable and profitable, provided there is ability to do business with them. The provision of uncomplicated, small, affordable products can help bring low-income families into the formal financial sector. Taking into account their seasonal

AUTHOR FOR CORRESPONDENCE

GIRMA, College of Business and Economics, Adi Haqi Campus, Mekelle University, MEKELLE, ETHIOPIA

inflow of income from agricultural operations, migration from one place to another, and seasonal and irregular work availability and income, the existing financial system of inclusion needs to be designed to suit their requirements. Mainstream financial institutions such as banks have an important role to play in this effort, not only as a social obligation, but also as a pure business proposition.

Financial inclusion in some important countries:

Several countries across the globe now look at financial inclusion as the means to more comprehensive growth, wherein each citizen of the country is able to use earnings as a financial resource that can be put to work to improve future financial status and adding to the nation's progress. Initiatives for financial inclusion have come from financial regulators, governments and the banking industry.

The banking sector has taken a lead role in promoting financial inclusion. Legislative measures have been initiated in some countries. For example, in the US, the Community Reinvestment Act (1997) requires banks to offer credit throughout their entire area of operation and prohibits them from targeting only the rich neighborhoods. In France, the law on exclusion (1998) emphasizes an individual's right to have a bank account. The German Bankers' Association introduced a voluntary code in 1996 providing for a so-called 'everyman' current banking account that facilitates basic banking transactions. In South Africa, a low-cost bank account, called Mzansi, was launched for financially excluded people in 2004 by the South African Banking Association. In the UK, a Financial Inclusion Task Force was constituted by the government in 2005 in order to monitor the development of the process.

Several African countries have harnessed the unique aspects of mobile banking to drive financial inclusion. A G-20 (Group of Twenty) Financial Inclusion Experts Group has been launched. The Principles for Innovative Financial Inclusion serve as a guide for policy and regulatory approaches with the objectives of fostering safe and sound adoption of innovative, adequate, low-cost financial delivery models, helping provide conditions for fair competition and a framework of incentives for the various banking, insurance, and non-banking entities involved and delivery of the full range of affordable and quality financial services.

National commitment:

Moving towards universal financial inclusion has been both a national commitment as well as a public policy priority for any country. To achieve the ultimate objective of reaching banking services to all the villages, financial inclusion has to become a viable business proposition for the banks.

Developments in financial sector in ethiopia:

The major financial institutions operating in Ethiopia are banks, insurance companies and Micro-finance institutions. The number of banks operating in the country are 15.In terms of ownership, twelve were private commercial banks, and the remaining three state-owned. The total branch network in the country is 681. As a result, bank branch to population ratio improved to 117,474 (taking total population 80 million) by the end of 2009/10.In India there is a bank branch for every 15,000 population during the same period, indicating high degree of financial inclusion.

As Cooperative Bank of Oromia, Oromia International Bank and Dashen Bank aggressively expanded their branch networks, the share of private banks grew from 57 per cent last year to 60 per cent by the end of 2009/10. About 39 per cent of the bank branches are concentrated in Addis Ababa, which is the capital and major business centre of the country. (National Bank of Ethiopia (NBE) 2009/10 annual report).

NBE should encourage expansion of bank branches, especially in rural areas and semi-urban areas resulting in multifold increase in branch network, spread across the length and breadth of the country, because a significant proportion of the households, especially in rural areas, still remained outside the coverage of the formal banking system.

Engaging business correspondents (BCs):

The NBE can permit banks to engage business facilitators (BFs) and business correspondents (BCs) as intermediaries for providing financial and banking services. The BC model allows banks to provide doorstep delivery of services, especially cash in-cash out transactions, thus addressing the last-mile problem in reaching the remote villages.

Road map for providing banking services in unbanked villages with a population of more than 50,000: Banks should be advised to draw up a road map to provide banking services in every unbanked village having a population of over 50,000 by the next five years. NBE can advise banks that such banking services need not necessarily be extended through a bricks and mortar branch, but could also be provided through any of the various forms of ICT (Information and Communication Technology)-based models like ATMs (automated teller machines).

Long way to go; In Ethiopia there is a long way to go, to cover many villages to be provided with banking services. The financial inclusion for the underprivileged will lead to hosts of downstream opportunities with many jobs for the participants to work as BCs at remote villages.

In a properly networked Ethiopia in which banking services are to be extended to many villages, ultimately, enabling micro-ATMs reducing the dependence on cash and lowering transaction costs. The task is gigantic, but definitely achievable by following a systematic approach:

Banks should prepare comprehensive plans to cover all villages, through a mix of branchless banking and bricks and mortar branch banking. They should speed up enrolment of customers. It envisages putting in place a system that enables routing of all social benefits to bank accounts electronically.

The success of the BC model is highly dependent on the kind of support provided by base branches, especially for cash management, documentation and redressal of customer grievances. Hence, it is necessary that a bricks and mortar structure is available to support about 8-10 BCs at a reasonable distance of 20-30km. These branches can be low-cost intermediary simple structures comprising minimum infrastructure for operating small customer transactions and can act as an effective supervisory mechanism for BC operations.

Capital base of the banks:

Following significant capital injection by the private banks mainly Wegagen Bank, Awash International Bank, Dashen Bank, Nib International Bank and Berhan International Bank, the total capital of the banking industry showed a 16.7 per cent increase to Birr 12.9 billion by the end of June 2010. As a result, the share of private banks in total capital of banks rose to 40.2 per cent from 36.5 per cent last year.

Despite the continuous increase in the capital base, and branch network the Ethiopian banking industry is still very small even by African standard suggesting the need for further efforts to enhance financial intermediation and inclusion in the country.

Ethiopia has seen historic progress and growth in the past decade in the banking industry. While the growth story has been impressive, there are causes for concern on other dimensions. It has a long way to go in addressing concerns of absolute poverty. Low-income Ethiopian households in the informal or subsistence economy often have to borrow from friends, family or usurious moneylenders. They have little awareness and practically no access to banking and insurance products that could protect their financial resources in unexpected circumstances such as illness, property damage or death of the primary breadwinner.

Resource mobilization:

Spurred by remarkable branch expansion, deposit liabilities of the banking system were Birr 98.6 billion reflecting annual growth rate of 26.2 per cent. Component wise, savings deposits registered a significant increase of 29.3 per cent followed by demand deposits 23.8 (National Bank of Ethiopia 2009/10 annual report per cent), and time deposits (18.8per cent). Saving deposits accounted for 48.7 per cent of the total deposits followed by demand deposits (46.8 per cent) and time deposits (4.5 per cent). CBE(Commercial Bank of Ethiopia) alone mobilized 58 per cent of the total deposits due to its large branch network. More number of branches of banks more deposits mobilization. Higher percentages of saving deposits in the total deposits indicate lower weighted average cost of funds in the banking sector. NBE indicated that on savings bank deposits a minimum of 4 per cent interest has to be paid.

The total resources mobilization by the banking system in the form of net deposits, collection of loans and net borrowings increased by 28.3 per cent and reached Birr 48.1 billion at the end of 2009/10.

Borrowing by the banking industry is not an important source of resource mobilization as most of the banks are sufficiently liquid due to higher deposit mobilization and collection of loans.

However, total outstanding borrowing at the end of the fiscal year reached Birr 5.6 billion from Birr 3.0 billion a year earlier. Of the total borrowing, domestic sources accounted for 82.7 per cent, while foreign sources took the remaining balance. On the other hand, loan collection by the banking system reached Birr 25.1 billion showing a 14.1 per cent increase. About Birr 15.0 billion (59.4 per cent) of the total loan collection was attributed to the private banks.

Broader financial inclusion:

NBE should recognize the social and economic imperatives for broader financial inclusion and should make an enormous contribution to economic development by finding innovative ways to empower the poor.

Increasing the role of the public sector banks, imposing priority sector lending requirements for banks, establishment of leader bank for a region, establishment of a Rural Bank at the national level, following service area approach, financing self-help groups etc. are some of the ways to increase access to the poorer segments of the society.

The major barriers to serve the poor, apart from socio-economic factors such as lack of regular income, poverty, illiteracy, etc., are the lack of reach, higher cost of transactions and time taken in providing those services. Besides the products designed by the banks are not tailored to suit the needs of low-income families. The existing business models do not pass the test of scalability, convenience, reliability, flexibility and continuity.

National commitment:

Moving towards universal financial inclusion should be both a national commitment as well as a public policy priority for any country. To achieve the ultimate objective of reaching banking services to all the villages, financial inclusion has to become a viable business proposition for the banks.

For this to happen, the delivery model needs to be devised carefully so as to move from a cost-centric model to a revenue-generation model. This will help in providing customers with quality banking services at their doorstep and at the same time generating business opportunities for the banks. This is sustainable only if delivery of banking services, at the minimum, includes the following four products:

– A savings-cum-overdraft account
– A remittance product for electronic benefits transfer (EBT) and other remittances
– A pure savings product, ideally a recurring deposit scheme
– Entrepreneurial credit in the form of a farmer credit card (FCC) or a general credit card (GCC).

NBE should undertake financial inclusion initiatives in a mission mode through a combination of strategies ranging from provision of new products, relaxation of regulatory guidelines and other supportive measures to achieve sustainable and scalable financial inclusion.

The NBE should initiate some measures to achieve greater financial inclusion, such as facilitating no-frills accounts and GCCs for small deposits and credit. Some of these steps can be:

Opening of no-frills accounts:

Basic banking no-frills accounts with nil or very low minimum balance as well as charges that make such accounts accessible to vast sections of the population. Banks can be advised to provide small overdrafts in such accounts looking at the performance of the account.

Relaxation on know-your-customer (KYC) norms:

KYC requirements for opening bank accounts can be relaxed for small accounts, thereby simplifying procedures by stipulating that introduction by an account holder who has been subjected to the full KYC drill would suffice for opening such accounts. The banks should be permitted to take any evidence as to the identity and address of the customer to their satisfaction.

Use of technology:

Recognizing that technology has the potential to address the issues of outreach and credit delivery in rural and remote areas in a viable manner, banks can be advised to make effective use of ICT, to provide doorstep banking services through the BC model where the accounts can be operated by even illiterate customers by using biometrics, thus ensuring the security of transactions and enhancing confidence in the banking system.

– Awareness in general, coupled with financial awareness on opening and operating accounts, must accompany the financial inclusion initiative.

– As mentioned earlier, banks must provide a minimum four products—a no-frills savings account with an overdraft facility, a pure savings product, entrepreneurial credit and remittance services, and new products tailored to income streams of poor borrowers and according to their needs and interests. Banks must be able to offer the entire suite of financial products and services to poor clients at attractive pricing.

– It is important that adequate infrastructure such as digital and physical connectivity, uninterrupted power supply, etc., is available. All stakeholders will have to work together through sound and purposeful collaborations. Local and national-level organizations have to ensure that these partnerships look at both commercial and social aspects to help achieve scale, sustainability and impact.

– This collaborative model will have to tackle exclusion by stimulating demand for appropriate financial products, services and advice with the appropriate delivery mechanism, and by ensuring that there is a supply of appropriate and affordable services available to those that need them.

– Mindset, cultural and attitudinal changes at grass roots and cutting-edge technology levels of branches of banks are needed to impart organizational resilience and flexibility. Banks should institute systems of reward and recognition for personnel initiating, ideating, innovating and successfully executing new products and services in the rural areas.

Conclusion:

Empirical evidence shows that economic growth follows financial inclusion. Boosting business opportunities will definitely increase the gross domestic product, which will be reflected in our national income growth. People will have safe savings along with access to allied products and services such as insurance cover, entrepreneurial loans, payment and settlement facility, etc.

Our dream of inclusive growth will not be complete until we create millions of micro-entrepreneurs across the country. All budding entrepreneurs have to face these challenges and find solutions. People working in the social sector should work for filling up the deficit existing in the economic and social arena.

To sum up, financial inclusion is the road that Ethiopia needs to travel toward becoming a stimulant player in the economic development of the country. Financial access will attract market players to the country and that will result in increasing employment and business opportunities. Inclusive growth will act as a source of empowerment and allow people to participate more effectively in the economic and social development process.

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