

Commercial banks priority sector lending in Ethiopia

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Abstract

Financial system development and proper credit deployment for the real economic sectors are among the major inputs for a countries' economic development, the access to a cheap and timely credit for to small holder farmers, small scale industrialist and small business enterprises these are the base for economic growth and prosperity. The financial system also influences the deployment of scarce financial resource towards productive sectors so as to promote national development agenda. Studies shows that a rapid growth of banks operation in developing countries has boosted the branch network expansion, increase in the quantum of deposits and credit deployment, thus it affects the growth of the priority sectors development. Hence this study has analyzed the credit deployment of commercial banks in Ethiopia on various sector wise and disparity wise analyzes. The study has used a secondary data sourced from national bank of Ethiopia (NBE). The major finding of the study indicates that there was a significant difference of credit deployment both sector wise and state wise. The study has recommended the review of sector wise policies so that they can attract the credit deployment of the banks in larger scale, to ensure fair credit distribution in the country government should establish national credit council (NCC) and at the same time the adoption of international best practices that promotes the wise use of the financial resource such as the lead banking scheme in India is very crucial as well.

Key words: Commercial Banks, Priority sectors, Credit deployment

Introduction

The banking sector plays a crucial role for the development a country thus, the service of the banking has a high influence in determining the economic condition of a country. A sound financial system is a symbol of sound economy. It performs the role of intermediary between savers and investors. Efficient intermediation of funds from savers to users enables the productive application of lendable resources. The greater the efficiency of the financial system in resource generation and allocation, the higher is its likely contribution to economic growth. Improved allocative efficiency creates a virtuous cycle of higher real rates of return and increase in savings, resulting in turn, in higher resource generation. Thus, development of the financial system is essential to sustaining higher economic growth. Ethiopian financial system consists of Commercial banks, insurance companies and regaled micro finance intuition and state-owned development bank of Ethiopia. The Ethiopian banking sector is dominated by the commercial banks which consists of both public owned and

private owned commercial banks. (Aderaw G.2016). In the fiscal year 2015/16 the number of banks declined to 18 from 19 due to the merger of Construction & Business Bank with Commercial Bank of Ethiopia. Corporate and government undertakings need loans for capital investment, day to day operations which are met through whole sale lending. Loans for capital expenditure are usually extended with medium- and long-term maturities, while day to day finance requirement for business use are provided through short term credit or working capital loans. Thus, banks are playing a major role in lending. In the modern economy banks are not considered only in dealers of money but they are also leaders in development. Lending is one of the two principle functions of commercial banks , not only because of social obligation to cater credit needs of different sections of the community but also because lending is the most profitable activity .By advancing loans , they increase the purchasing power in the economy and influence aggregate demand and create additional demand in various sectors .The diversification of a large fraction of bank credit from the traditional sectors to the priority sector is a remarkable feature of credit deployment mechanism .The concept of priority sector lending (PSL) is mainly intended to ensure the assistance from the banking sector flows adequately and increasingly to those sectors of the economy which has not received the full-fledged support of the financial institutions. (KulPreet Kaur 2014) . Hence, this study is expected to examine the credit structure and Priority sector lending of the commercial banks in Ethiopia, observing its operation in terms of credit distribution by sector wise so as to evaluate the performance of the credit, its growth and patter of the priority sector lending in the country.

Objective of the study

1. To appraise the pattern and distribution of credit on various components of lending in priority sectors in Ethiopia.

HYPOTHESIS OF THE STUDY

H₀: There is no significance difference of credit distribution in sector wise lending

H₁: There is significance difference of credit distribution by state wise.

Literature

India has long history of financial policies for fostering priority sectors development through various arrangement and schemes that facilitates the deployment of the financial resource towards productive sectors, similarly in the Ethiopian context, there are certain sector that are regarded as the engine for the economic growth of the country and they are extended financing privileges ad policy support, thus in this following literature both country experience is entertained.

Kamesam (2003), have conducted a study on small scale industries and their significance on national economy components such as employment creation, entrepreneurial development, skills acquisition and foreign currency earning. Hence the finding of the study shows that in the post reform period after, the financing of SSI has increased drastically. As a result of the global forces and liberalization of the economy,

the SSI have been exerted a lot energy and effort so as to make the sector combative both in global and local markets in India.

Dadhich (2004), Have examined the comparative performance of public and private sector banks in relation to priority sectors lending, the study period was between 1991 to 2003, in this context the author has underlined the existence of a disparity among the states in terms of priority sector lending and suggested the way outs for diverting credit in these sectors. The finding highlighted that the variation of the performance was wide among the banks and this is influenced by a number of factors such as bank wise ownership, branch distribution and network, specialization in the branches services, and lastly recommended inter-bank cooperation so as to boost agriculture advances and achieve allocative efficiency in the system.

Shete (2004), Similarly, has investigated, the performance of banks in relation to priority sector lending, total non-performing loans (NPLs), in the priority sector and its component during the study time between 1991 to 1995, with specific reference to public, private and foreign banks in India. The finding of the study revealed that, the priority sector lending growth rate has declined during the post reform era and at same time the author has underlined that NPLs related to priority sector lending as well as the overall NPLs in the bank credit has been significantly negatively related to the performance of the banks under study. The author has recommended, Close follow up, enhancing financial literacy, and genuine consideration of the clients' problem which are not associated negligence and diversion. **Kumar (2005)**, has also investigated, the banking service and its usage in the a comparative study on the rural and urban households in India, for the study period between 1991 to 2003. The study finding has indicated that the performance of the banks for agricultural and allied activities financing has declined in post reform era, the rural areas have registered a lower credit record compared to urban areas ,in this regard, the financial system reform has brought a higher credit service availability in the urban areas as compared to rural area ,while the deposits are higher in the rural areas but it has been transferred to urban areas for credit consumption .Banks and other financial institution were flowing to rural areas for cost wise operation.

Sahu and Rajasekhar (2005), have jointly under took a study on the growth trend of agricultural advances by the scheduled commercial banks for the study period between 1980 to 2000. The study has highlighted that, the growth of the credit shares in agricultural sector as compared to total bank credits have recoded a declining trend in all banks during the study period, particularly in the post reform period, where commercial banks have diverted to their fund towards well off farmers and other high interest income yielding activities. Furthermore, the study has underlined that, agricultural credit and government security investment has a negative relationship and justified that increase in lending rate will to reduction in agricultural loans and it affects the portfolio quality of the scheduled commercial banks. Lastly, the author has recommended, offsetting loan losses by higher interest rates is very risky thus, banks should instead improve their loan screening and flow up procedures so as to ensure proper loan repayments.

Sharma (2005), has conducted a study on significance of small-scale industries in terms of development of

production, export earning, employment creation, and removing regional inequality. The study has also outlined the challenges of SSI sector such as delay in payments, technological limitations, marketing problems, lack of working Capital and lack of collateral. Besides all this problem, the credit deployment in SSI sector had not been improved, even though there are a number of special schemes and facilities arrangements that are designed to serve the interest of this sector.

Mohan (2006), has conducted a study to review the agricultural credit in its relation with its significance to the agricultural production India, by analyzing the agricultural advance during 1950-51 to 2004. the findings indicated that rural branches have significantly increased and as a result the agricultural credit has grown in manifold, the commercial banks share has also substantially grown, despite a wide disparity among the states for agricultural lending in the rural areas. The performance of NPLs in agricultural was very high when compared with other sectors. Moreover, the institutional credit has registered a higher growth pattern over the periods of the study and lastly, the author has indicated the existence of several challenges for improving the performance of the agricultural credit, such as inadequate credit allocation for small holder farmers, lack of medium- and long-term credit schemes, and in adequate deposits mobilization. The study has suggested to revise the agricultural credit scheme policies, introducing new models for different agribusiness activities such as Agri- industry and the like for betterment of the agricultural sector performance.

A. S. and S. Sudalaimuthu, (2016), Have jointly studied commercial banks' lending in Ethiopia with a secondary data from 2003 to 2014, with the objective of analyzing the trend and growth of lending and correlation of deposits with lending. Their finding indicates that there was a mixed result for lending and growth rate for public as well as private banks. The public banks have a higher share of lending scenario in the recent years, while as the lending in the private sector banks have shown a decreasing trend from issuing of the NBE bill policy on 2011. lastly the deposit mobilization and advances disbursed had a very positive correlation.

Mitku (2014), in his study has examined the major determinates of commercial lending in Ethiopia, by using panel data of eight commercial banks by considering both internal and external factors, for period from 2005 to 2011.

Research design

This research is mainly a non- survey research type in which the data of the study has been collected and compiled from the consolidated reports of both public and private commercial banks. The research design of the study is a descriptive in nature with quantitative analysis. The study has aimed in analyzing the commercial banks' lending in relation to the sector wise of the economic units particularly the priority sectors. The target population of the study was all commercial banks both public as well as private commercial banks. Thus, as per the Ethiopian national bank report dated on (NBE,2016/2017), there are 17 commercial banks in Ethiopia, of which one bank is state owned, that is branded as Commercial banks of Ethiopia (CBE), while the remaining 16 banks are owned by private share holder who are Ethiopian citizens since foreign nationals are

restricted to invest banking sector. The sample frame of the study was selected as those commercial banks with a data track of twelve years' financial report have been included under the sample units.

Sample technique and design

As per the sample frame there were 17 commercial banks, hence in order to select the sample units, the main criteria for selection was availability of data for the study period thus, eight banks were able to provide a data track for twelve years of financial statement, hence these banks were purposively selected and included under the study, with period of 2005-2017, through purposive sampling technique.

Data Collection Methods

To analyse the lending trend of commercial banks Ethiopia with reference to priority sectors, the data was collected from the annual report of the national banks as well as bank bulletins and also intensive document analyses have been carried out. The data type is a fully secondary data source.

Data Analyses and presentation

Based on the data type of the study which is mainly secondary data, the following analyses techniques such as Annual Average growth rate (AAGR) and compound Annual growth rate analyses (CAGR) and descriptive statistics of the banks during the study period by using EXCEL 16 version. For the presentation of the data appropriate tables and graphs and charts have been adopted.

RESULT AND DISCUSSION

Credit structure by sector wise

The government of Ethiopia has been implementing for the last two five-year growth and transformation plan first (GPT-I) and second (GTP-II) national developmental in which the government has articulated clearly the sectoral policies and strategies. Hence in both plans the below addressed sectors were considered as drivers of the economy or priority sectors, thus the following analyse has been carried out so as to examine the credit structure in line with the national priority sectors and also the trend of the priority sector lending in various components. As per the below graph1.1, the agricultural sector which has been assumed to be the base of the economic growth and also the trans motor of the economy from agro led to industry led economy through agricultural input oriented industries in both national plans, but the financial investment and the credit flow of the sector has been among the lowest with compounded annual growth rate (CAGR) of 18% with a fluctuating credit flow in the sector ,where the highest percentage from the gross credit was 25% and the lowest has been 12% for the last 12 years credit trend. Similarly, as per the evaluation of the GPT-I performance, the sector has not achieved its target. However, the Industry or the manufacturing sector, which also in the second priority sector as well as the future driver of the economy of the country, has been relatively performing well and contributing to the GDP as per the target level. The credit flow to this sector has been significant with compounded annual credit growth rate of 31% which is highest among the priority sectors of the economy. Similarly, domestic trade and other priority sector unit that has been getting an increasing credit

flow during this period by having a CAGR of 23% and 29% respectively. Thus, as per the research hypothesis, Analysis of variance (ANOVA) of Singe factor has been tested. H_0 : There is no significance difference of credit distribution in sector wise lending.

TABLE 1-: ANOVA – SINGLE FACTOR RESULT:

ANOVA						
Source of Variation	SS	Df.	MS	F	P-value	F. critical
Between Groups	763431891	3	254477297	6.331628643	0.001	2.816466
Within Groups	1768423529	44	40191443.84			
Total	2531855420	47				

Source: Own computation.

From the above result of the summery of the ANOVA test, the null hypothesis is rejected since the P-Value is less than significance level which is 0.05, hence with 0.95 percent we are confident that there is a significant difference in credit deployment among priority sectors.

Graph 1:

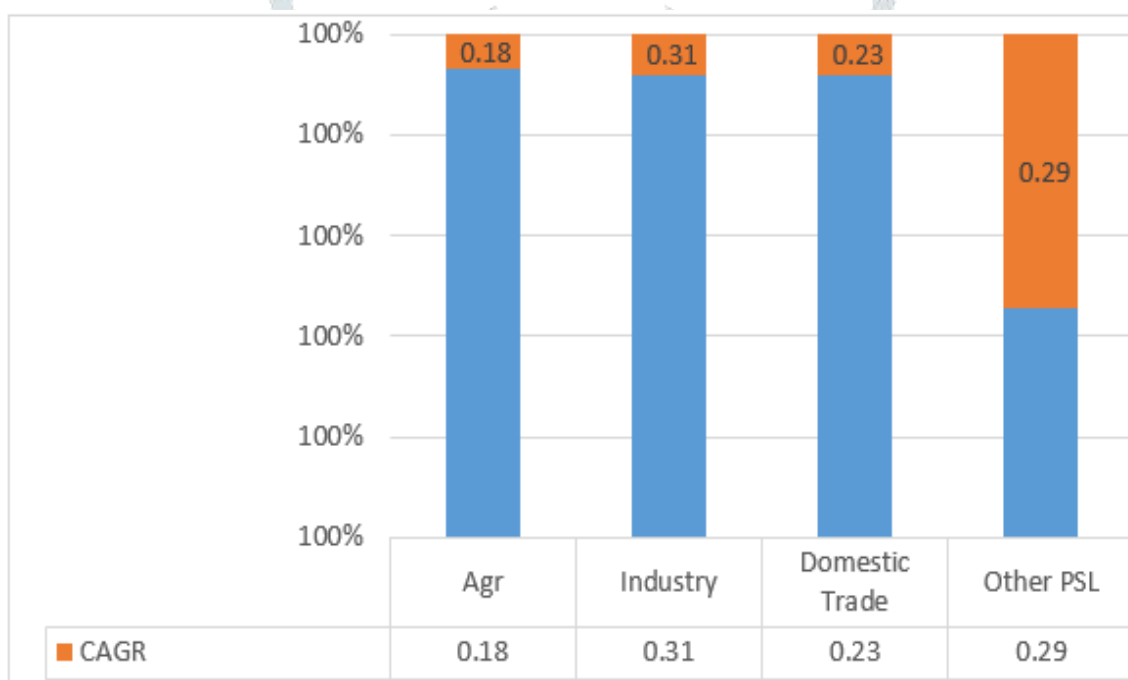


TABLE -2 ANOVA RESULT -Regional disparity:

ANOVA						
Source of Variation	SS	df	MS	F	P-value	F crit.
Between Groups	19,99,54,84,381.99	10.00	1,99,95,48,438.20	0.78	0.65	1.91
Within Groups	3,10,70,21,87,708.76	121.00	2,56,77,86,675.28			
Total	3,30,69,76,72,090.75	131.00				

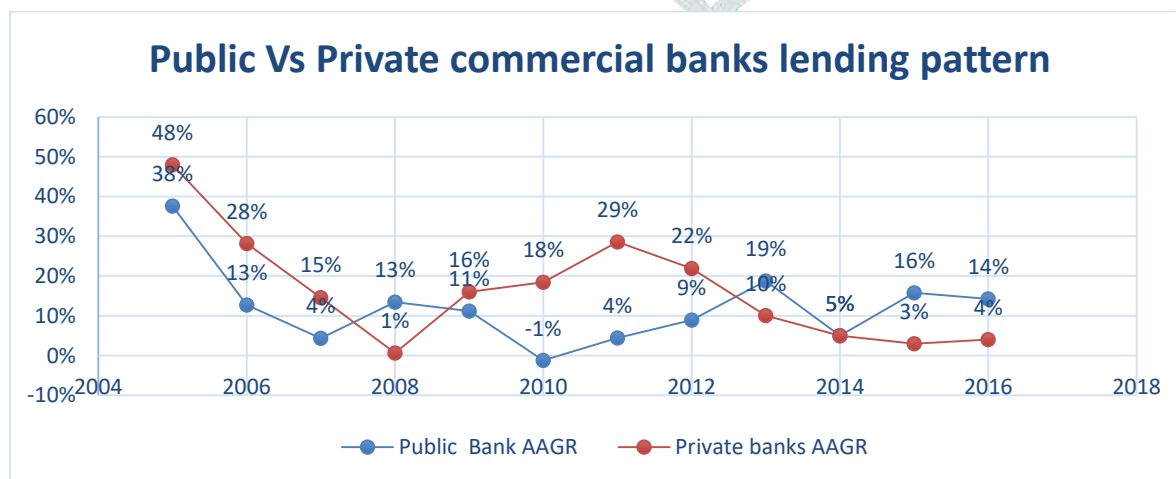
source: excel output- own Calculation.

H₀: There is significance difference in credit distribution among states/ regions Hence as per the above summery table, we fail to reject the null hypothesis, since P-value is greater than 0.05 and with this it is observed that there is disparity among the State government in terms of credit deployment. Similarly, credit distribution in region wise show us that there is a statistically significant difference among the regions, this disparity shows that the pattern of credit flow is mainly concentrated on major four regions that are in the coalition of long-time governing party, while emerging regions are lower beneficiary for credit supply.

Credit Pattern of Public commercial bank versus Private commercial banks

AS shown in the below graph3, about the pattern and growth of commercial banks’ lending in Ethiopia for last 13 years from 2005-2017 have been growing in a mixed pattern in which the lending pattern has increased for some years and decreased for others. The public commercial bank had a decreasing lending trend during the earlier period, there has been various reasons for the slow performance of credit such as lower agricultural productivity, global financial crisis and other factors, later years the lending pattern has started to recovery slowly on 2009 onwards and later on the public sector bank has mainly dominated the major lending share for the domestic credit. As of the NBE 2016/17 report the Public commercial bank alone has contributed 23.3% of fresh loan injection to the total domestic credit. Similarly, the private sector commercial banks were also performing well during the earlier period of this study where they had a good record of domestic credit deployment, having an increasing and mixed pattern of average annual growth rate of credit but later years on 2011 onwards, the private commercial bank’s credit has started to decline and the AAGR percentage had decreased pattern , this may be for various bank specific , macroeconomic factor or monetary policies but various studies in this regard such as (Semeneh & et .als,2018) shows that new monetary policy issued by the national bank of Ethiopia on 2011 commonly known as the NBE Bill 27% , which imposes the mandatory purchase of NBE bill of 27% for every single loans that private banks disburse they should purchase a 27% of that loan in the form of bill from the national bank of Ethiopia that had a maturity of 5 years.

Graph 2. Lending pattern of Public and Private banks:



Source: Own Calculation.

MAJOR FINDINGS OF THE STUDY

As per the analyses of the data the following main finding were achieved from priority sector lending trends in Ethiopia. There was a major shift of credit deployment from agriculture to Industry sector by observing the compounded annual growth rate as well as the trend of lending pattern, which is in line with national growth and transformation plan of the country, which emphasizes the development of the agriculture sector as transformation factor for the country to achieve its aspiration to become lower middle income nation by 2025 and progress of agricultural sector is considered as important input for industrialization in long run. Hence as the finding of the study shows that there is a statistically significant difference in credit deployment among priority sectors, where Industries sector had the lion share.

There has been also a wide disparity among the state governments in terms of priority sector lending and it has been observed that the major four regions in ruling collection, had the loin share of the gross domestic credit deployment, while the emerging periphery regions are less advantageous in credit supply and had high record of regional inequality in terms of fair financial distribution.

CONCLUSION

This study has been examining the credit structure and priority sectors lending trend in Ethiopia by using a secondary data. Hence based on the finding of the study it is recommended that there should be a clear target and sector wise credit allocation for the main sector of the economy that are considered as growth factors in government policy documents and in line with this, commercial banks credit should be evaluated so as to divert the scarce resource form un desirable activities in to productive sectors. Government should enhance the regional equality in terms of financial flows and financial inclusion, particularly considering the emerging region with infrastructural challenges and at same time government should establish national credit council that monitors the fair distribution of credit. The Ethiopian government can adopt international best practice in this issue, like the Lead bank scheme from the Indian experience. Review the existing financial policies that can hinder the credit development in the priority sectors like NBE bill of 27% in which studies have indicated its impact on banks' ability to extend credit.

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