EVALUATION OF FINANCIAL PERFORMANCE OF BANKING ENTERPRISES; THE CASE OF CONSTRUCTION AND BUSINESS BANK OF ETHIOPIA

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Abstract: This study is proposed to evaluated the financial performance of Construction and Business Bank (CBB) of Ethiopia. The study emphasized on financial performance measurement ratios such as asset utilization/efficiency ratios, deposit mobilization, loan performance, liquidity ratio, leverage/financial efficiency ratios, profitability ratios, solvency ratios and coverage ratios to evaluate the bank's financial performance. For this study, the researchers dominantly relied on secondary data; eight years (2002/2003 to 2009/2010) from most recent audited financial statements of the bank. Primary data was also colleted by the researchers using unstructured personal interview from key officials; the Planning and Business Development manager and the finance section manager and with the aid of observation as well. The data were cross validated with information from secondary sources; eight years financial statements and other relevant records so as to avoid premature conclusions. Findings of the study revealed that the bank's financial performance had been almost progressing over the operational periods considered for the study. It is concluded after trend analysis that some important financial ratios computed for analysis of the financial performance of the company are in a going up pattern excluding loan deposit ratio, assets turn over ratio and the long term debt to equity ratios. The commendable performance in profitability of the bank is attributable to such factors as, relocation of the some of the banks outlying branches to better bankable areas and the gradual penetration of the bank in to foreign banking activities. The bank achieved significant hike in revenues over the periods while the cost of operation showed only slight increase comparatively with the increase in revenues. The major problems to be cited for the downside performance in some other ratios were resulted from inherited monopolistic operation system of the bank during the command economic system for which the bank failed to take remedial action and subsequently reported significant declines in receivables and failed to keep available resources revolving following the 1991 semi-liberalization economic policy reform by Ethiopian government that invited competitors(private banks) to the market in the areas previously under monopoly by the share company. The insensitivity of responsible financial experts towards timely observation of financial performance measures and remedial actions had also contributed its part.

JEL classification: G21, G28

Key words: banking enterprises, evaluation, financial, performance

1. INTRODUCTION

Organizational control is the process whereby an organization ensures that it is pursuing strategies and actions which will enable it to achieve its goals. The measurement and evaluation of performance are central to control and means posing four basic questions: What has happened? Why has it happened? Is it going to continue? What are we going to do about it? The first question can be answered by performance measurement. Management will then have to hand far more useful information than it would otherwise have in order to answer the other three questions. By finding out what has actually been happening, senior management can determine with considerable certainty which direction the company is going in and, if all is going well, continue with the good work. Or, if the performance measurements indicate that there are difficulties on the horizon, management can then lightly effect a touch on the tiller or even alter course altogether with plenty of time to spare

As to the selection of a range of performance measures which are appropriate to a particular company, this selection ought to be made in the light of the company's strategic intentions which will have been formed to suit the competitive environment in which it operates and the kind of business that it is. For example, if technical leadership and product innovation are to be the key source of a manufacturing company's competitive advantage, then it should be measuring its performance in this area relative to its competitors. But if a service company decides to differentiate itself in the marketplace on the basis of quality of service, then, amongst other things, it should be monitoring and controlling the desired level of quality. Whether the company is in the manufacturing or the service sector, in choosing an appropriate range of performance measures it will be necessary however to balance them, to make sure that one dimension or set of dimensions of performance is not stressed to the detriment of others. The mix chosen will in almost every instance be different. While most companies will tend to organize their accounting systems using common accounting principles, they will differ widely in the choice, or potential choice, of performance indicators

Performance Measurement can be best understood through considering the definitions of the words 'performance' and 'measurement' according to the Baldrige criteria: Performance refers to output results and their outcomes obtained from processes, products, and services that permit evaluation and comparison relative to goals, standards, past results, and other organizations. Performance can be expressed in non-financial and financial terms. Measurement refers to numerical information that quantifies input, output, and performance dimensions of processes, products, services, and the overall organization (outcomes). Performance measures might be simple (derived from one measurement) or composite. The challenge for organizations today is how to match and align performance measures with business strategy, structures and corporate culture, the type and number of measures to use, the balance between the merits and costs of introducing these measures, and how to deploy the measures so that the results are used and acted upon. To address this challenge organizations are advised to devise a performance measurement system that provides a set of rules or guidelines for selecting and deploying performance measures. All organizations measure performance to some extent. However, there is a large disparity among organizations in terms of which performance measures are used with many primarily focusing on financial measures. There has however, been a general move away from financial measurement since the early 1980's. This was accelerated in the 1990's and 2000’s by

the worldwide acceptance of business excellence models and performance measurement frameworks that addressed all stakeholders' needs.

Financial vs. Non-Financial measures

In many companies in the UK, as in the USA, the familiar cry "everything here is viewed in terms of the bottom line!" can be heard. In this sort of corporate environment, financial indicators remain the fundamental management tool and could be said to reflect the capital market's obsession with profitability as almost the sole indicator of corporate performance. Opponents of this approach suggest that it encourages management to take a number of actions which focus on the short term at the expense of investing for the long term. It results in such action as cutting back on research and development revenue expenditure in an effort to minimize the impact on the costs side of the current year's P & L, or calling for information on profits at too frequent intervals so as to be sure that targets are being met, both of which actions might actually jeopardize the company's overall performance rather than improve it. In general terms, the opponents of "the bottom line school" state that because of the pre-eminence of money measurement in the commercial world, the information derived from the many stages preceding the preparation of the annual accounts, such as budgets, standard costs, actual costs and variances, are actually just a one dimensional view of corporate activity. Increasingly, over the past decade, they have been emphasizing that executives should come to realize the importance of the non-financial type of performance measurement

Research in support of this approach has come up with new dictums for the workplace: "the less you understand the business, the more you rely on accounting numbers" and "the nearer you get to operations, the more non-financial performance indicators you realize could be valuable aids to better management"; or "graphs and bars carry much more punch than numbers for the non-financial manager". But there is still a lot of resistance. Executives tend to avoid using multiple indicators because they are difficult to design and sometimes difficult to relate, one to another. They have a strong preference for single indicators of performance which are well tried and which produce ostensibly unambiguous signals. But the new school lays great emphasis on the fact that multiple indicators are made necessary by the sheer complexity of corporate activity

William Davids (2004) identified five types of financial performance measures: Liquidity, Solvency, Profitability, Financial efficiency and Repayment capacity.

Liquidity: **-** refers to the degree to which debt obligations coming due in the next 12 months can be paid from cash or assets that will be turned into cash. This is measured by the current ratio and the amount of working capital. A more thorough analysis of liquidity can be made with a cash flow budget.

Solvency**: -** refers to the degree to which all debts are secured, and the relative mix of equity and debt capital used by the firm. The total debt-to-asset ratio is one of several ratios used to measure solvency, all of which are based on the same relationship of assets, liabilities and net worth. The primary measure of solvency is a net worth statement

Profitability: refers to the difference between income and expenses. One important measure of profitability is net farm income. Annual rates of return on both equity capital and total assets can be calculated, also, and compared to interest rates for loans or rates of return from alternative investments. The primary measure of profitability is an income statement

Financial efficiency: - ratios show what percent of gross from revenue went to pay interest, operating expenses, and depreciation, and how much was left for net farm income. The asset turnover ratio measures how much gross income was generated for each dollar invested in land, livestock, equipment and other assets

Repayment capacity: - measures show the degree to which cash generated from the firm and other sources will be sufficient to pay principal and interest payments as they come due

Tarawneh (2006) found that the bank with higher total capital, deposits, credits, or total assets does not always mean that has better profitability performance. Financial performance of the banks was strongly and positively influenced by the operational efficiency and asset management, in addition to the bank size. According to Jahangir and etal. (2007), the traditional measure of profitability through stockholder's equity is quite different in banking industry from any other sector of business, where loan-to-deposit ratio works as a very good indicator of banks' profitability as it depicts the status of asset-liability management of banks. But banks' risk is not only associated with this asset liability management but also related to growth opportunity. Smooth growth ensures higher future returns to holders and there lies the profitability which means not only current profits but future returns as well. So, market size and market concentration index along with return to equity and loan-to-deposit ratio grab the attention of analyzing the banks' profitability. X. Chen et all (2005) applies frontier analysis (X-efficiency) using DEA to examine the cost, technical and a locative efficiency of 43 Chinese banks over the period 1993 to 2000. In this paper the input used are interest expenses, non-interest expenses (which includes the price of labor), price of deposits (interest paid on deposits divided by deposits), and the price of capital (non-interest expenses are divided by fixed assets); Outputs used are loans, deposits and non-interest income. Results show that the large state-owned banks and smaller banks are more efficient than medium sized Chinese banks. In addition, technical efficiency consistently dominates the locative efficiency of Chinese banks.

Chowdhury (2002) observed that the banking industry of Bangladesh is a mixed one comprising nationalized, private and foreign commercial banks. Many efforts have been made to explain the performance of these banks. Understanding the performance of banks requires knowledge about the profitability and the relationships between variables like market size, bank's risk and bank's market size with profitability. Indeed, the performance evaluation of commercial banks is especially important today because of the fierce competition. The banking industry is experiencing major transition for the last two decades. It is becoming imperative for banks to endure the pressure arising from both internal and external factors and prove to be profitable. siddique and Islam (2001) pointed out that the Commercial Banks in Bangladesh, as a whole, are performing well and contributing to the economic development of the country. The average profitability of all Bangladeshi banks collectively was 0.09% during 1980 to 1995 which means that a profit of TK 0.09 was earned by utilizing assets of TK 100. In every aspect of profit, banking sector contributes the national economy as well as to the individual organization. Despite overall growth of the banking sector being positive, the performances of different categories of banks were not equally attractive.

Brief History of the Bank

Construction and Business Bank (CBB) is the successcer of Housing and Saving Bank which was established by the merger of two financial institutions, the Savings and Mortgage Corporation of Ethiopia S.C (SMC) and the Imperial Savings

and Home ownerships Public association (ISHOPA), which were nationalized in 1975 at the onset of the socialist era of Ethiopia.

The savings and Mortgage Corporation of Ethiopia S.C was established in July 1965 with a capital of birr 3,000,000. Share holders were the Commercial Bank of Ethiopia, Ethiopian Airlines, Cement Corporation, Ethiopian Electric light and power authority and Agricultural and Industrial Development Bank.

And the Imperial Savings and Home ownership public association was founded on April 30, 1962 with a capital of Birr 1,000,000 out of the total 50% of the capital was emanated by the Ethiopian Government in the form of capital donation and remaining 50% by the US government in cash.

The main reasons for the establishment of Housing and savings bank (HSB) were to encourage and further accelerate the rate of housing development for the improvement of the living standard of urban dwellers. In 1992, an economic reform program was initiated by the government in order to stabilize the economy and deregulate economic activity characterized by central planning. As a result, in the financial sector, new laws providing the autonomy of the National Bank, which is the central bank of the country and the establishment of private banks and insurance companies by domestic private investors, were promulgated. In connection to this, Housing and Saving Bank become Construction and Business Bank in September 1994. Consequently, Construction and Business Bank prepared a series of internal restructuring plans covering all aspects of its operations. Accordingly, CBB has ventured into commercial banking operations. In the effort to develop itself into a full-fledge universal bank, the bank introduced new products/services such as short and medium term credit facilities, foreign banking and foreign bureau services and western union money transfer services to the existing lines of business, commercial and residential construction financing. The bank was converted to share company as of September 2001.

Statement of the Problem

Ethiopian Construction and Business Bank (CBB) is a government owned enterprise engaged in the banking services required by users. Till the economic system transformation, the change from command economic system to free market economic system, the bank had been facing little challenge for there were only two other banks operating along side. At that time, there were no competitors in the market in engaged in the provision of similar services. Thus, it had been the monopoly supplier setting its own price for the services to be provided without interference of competitors in the area generating revenues in hundreds of millions resulting in tens of millions of profit. Since the semi liberalization of economic policy reform in 1991, however, the bank was forced to operate in a free market economic system. In free market economy, the financial performance of enterprises is dependent on how far they are competent in the market as well as their capacity to make the available assets revolving. In other words, having sufficient working capital is vital for running ordinary operational activities. The importance of working capital is even more rationalized for service giving enterprises like Construction and Business Bank for the fact that they need to make millions of Birr remittances to depositors and borrowers so as to keep in touch with customers. Otherwise they will loose sales of millions of Birr and also probably their customers for ever to competing banks. To this end, Construction and Business Bank (CBB) had not given emphasis to keeping the available assets revolving because of its strategy of voluminous loaning for real estate expansion. This resulted in huge working capital

deficit as compared to long-term advances and loans that overshadowed the net income as well as the profitability of the company.

The financing strategies and policies of enterprises would have impact up on the capital structure and financial performance of their operational activities. For instance, a company having huge amount of debts maturing during the current period should generate sufficient income so as to cover the maturing interest and principal. Otherwise, the company will be forced to finance its debts from its employed capital and this will inevitably affect the financial performance of the company for the subsequent periods. With this regard the capital structure of Ethiopian Construction and Business Bank (CBB) has been dominated by credit financing; both short term and long term.

So, this analytical study basing its inception in these observed facts would try to foresee the financial performance of the bank and will opt for appropriate operational and financing strategies suitable in line with the banking realm.

2. OBJECTIVES OF THE STUDY

This analytical survey on evaluation of the financial performance of Construction and Business Bank (CBB) is intended to evaluate the general performance of the bank in financial terms. The survey has the following specific objectives:

- To evaluate and critically analyze the deposit mobilization and loan performance of the bank.
- Assessing and evaluating the working capital structure and liquidity of the bank.
- Evaluating the profitability of the bank.
- General assessment about the capital structure and repayment of debt.
- Analyzing the solvency and financial efficiency as well as the suitability of the financing strategies adopted by the bank to efficiently compete in the free market scenario.

Significance of the Study

The researchers hope that this analytical research will play its part in giving the bank's management and users of financial reports birds-eye- view towards the financial performance of the bank. It will benefit Construction and Business Bank (CBB) in selecting appropriate financing and operating strategies so as to become competent and successful in its operational endeavors. It is also an essential input for the decision of users of financial reports of the bank so far as their business transaction with the bank is concerned for. The data used in this study were merely drawn from audited financial statements on longitudinal basis.

The research can also be used as a base line by researchers interested in industrial level financial performance evaluations.

Materials and methodology

This analytical study was conducted in Construction and Business Bank (CBB) which is located in Addis Ababa along side the premises of Commercial College of Addis Ababa.

Data and data collection Techniques

The research was conducted within four weeks time. Both secondary as well as primary data sources are sought by the researchers in conduct of the survey. The principal researchers collected secondary data about the accounting reports of the company deemed essential for the study. The basic collected information needed to compute the financial measures were:

- Asset, liability and equity values were analyzed from audited financial position statements of the bank.
- Scheduled principal and interest payments on long-term debt were compiled from disclosures made to the financial statements.
- Gross revenue, operating expenses and income from other sources and net income data were obtained from the audited financial statements; income statement.

The survey had employed unstructured personal interview with the investment and accounts section manager and the planning and business development managers of the bank. In order to supplement this, actual observation of the bank's financial reports was made by the principal researchers.

The use of these data collection techniques is not without justification. The main objective of employing unstructured interview is to elicit facts depending on the situation encountered at the time of interview. So, here there is a possibility of generating new ideas relying upon the respondents' initiation. The use of observation is in exploring facts about the bank in the view of neutral observers (researchers) that might have been actually hidden by the internal bodies. Incorporation of facts from secondary data sources like company reports, seminar papers, audited financial statements, magazines and annual published materials etc., is to regenerate tangible evidences about the financial performance conditions of the bank.

Sample Design

The researchers emphasized on the head office for it is deemed to provide the bank's overall financial performance. So, in the data collection process this sampled representative functional unit was assumed to impart the essential primary as well as secondary evidences. Officials from each sampled unit; planning and business development, and the investment and accounts managers are called for the in-depth unstructured interview. Regarding secondary data sources, the researchers go beyond the above samples and tried to get non- financial reports and documents through the help of the finance department from planning and business development unit.

Data Presentation, Analysis and Interpretation

After relevant data is compiled, the researchers had computed various financial ratios which are measures of financial performance. The ratios calculated were:

Liquidity ratios: cash ratio, current ratio, and the acid test ratio or the quick ratio.

Profitability ratios: Profit margins before tax and interest ratio, net income ratio, return-on- equity and return- on- investment/return –on- total assets.

Leverage/financial efficiency ratios: loan-deposit ratio, total assets turn over ratio, fixed assets turn over ratio, current asset turn over ratio, long term debt to equity ratio, long term debt to total capital employed and total debt to total capital employed ratio.

Coverage ratios: only interest coverage ratio was calculated.

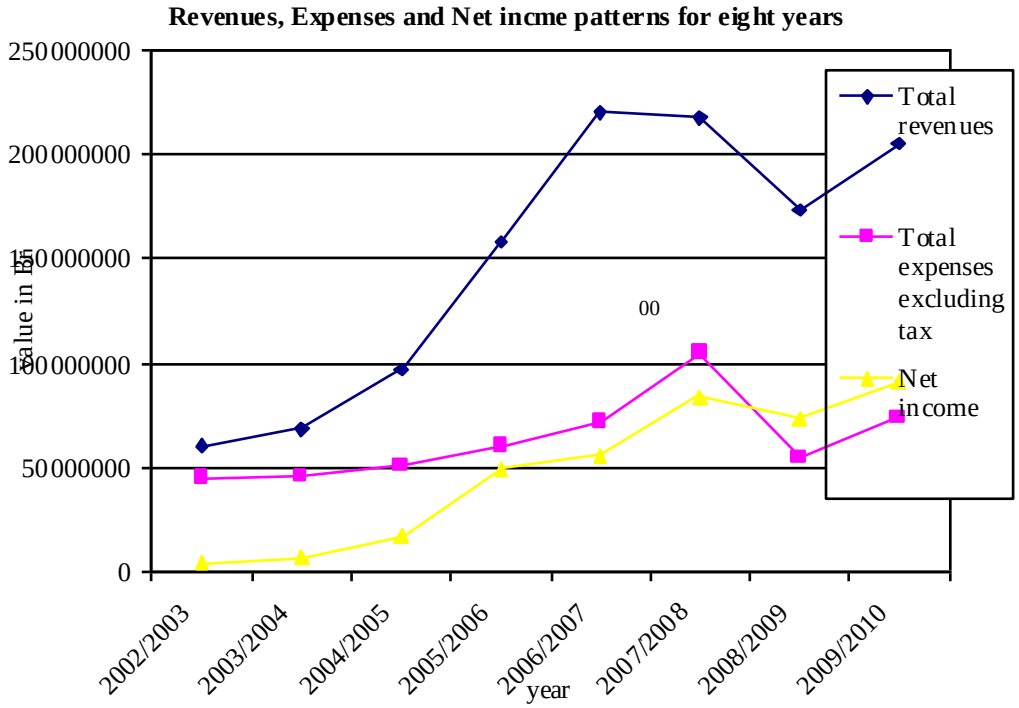
The researchers reported the outcomes of their analysis in lieu of the financial performance of the bank reached after ***cross sectional and trend analysis*** of the four years financial statements and unstructured personal interview held with officials of the bank. In the process, the collected primary as well as secondary data values are edited, summarized, categorized, and possible generalizations and inferences were made by the principal researchers so as to minimize premature conclusions and interpretations. As data processing is the critical part of any research regardless of its type, great care and effort have been invested by the investigators to the maximum possible extent.

Lastly, careful analysis of the acquired information was embarked upon to avoid premature conclusion and reach at sound evaluation for recommending purpose

in terms of professional assessment of the existing conditions and what must be done. It is unquestionable that the results of the finding have to be communicated to concerned bodies and the community in general.

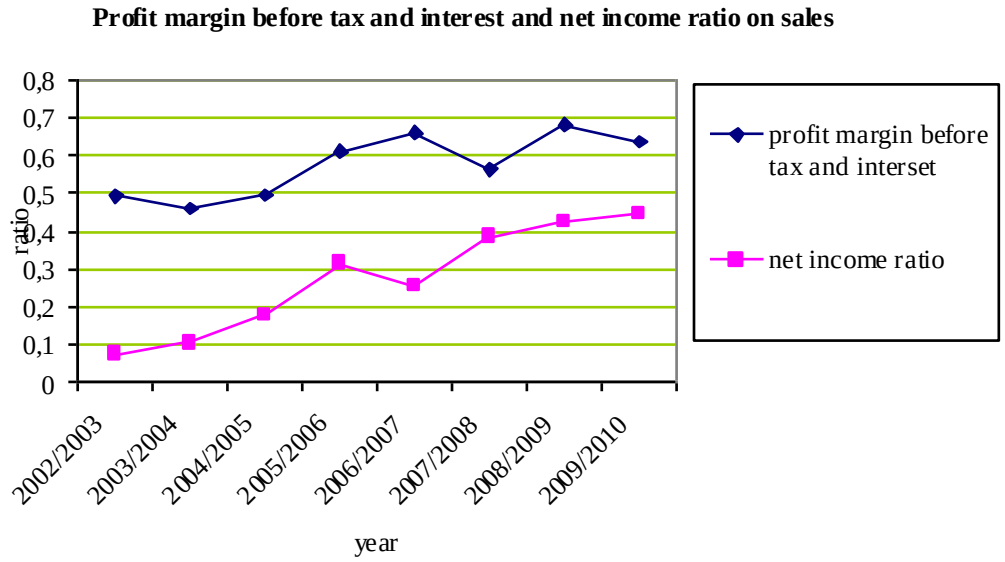
Data Analysis Results and Discussions

After embarking up on the tangible data sources, the principal investigators have conducted a detailed analysis and interpretation of the data at hand. The general description of the findings was phrased in the proceeding paragraphs.



Source: analysis of income statement/statement of profit and loss

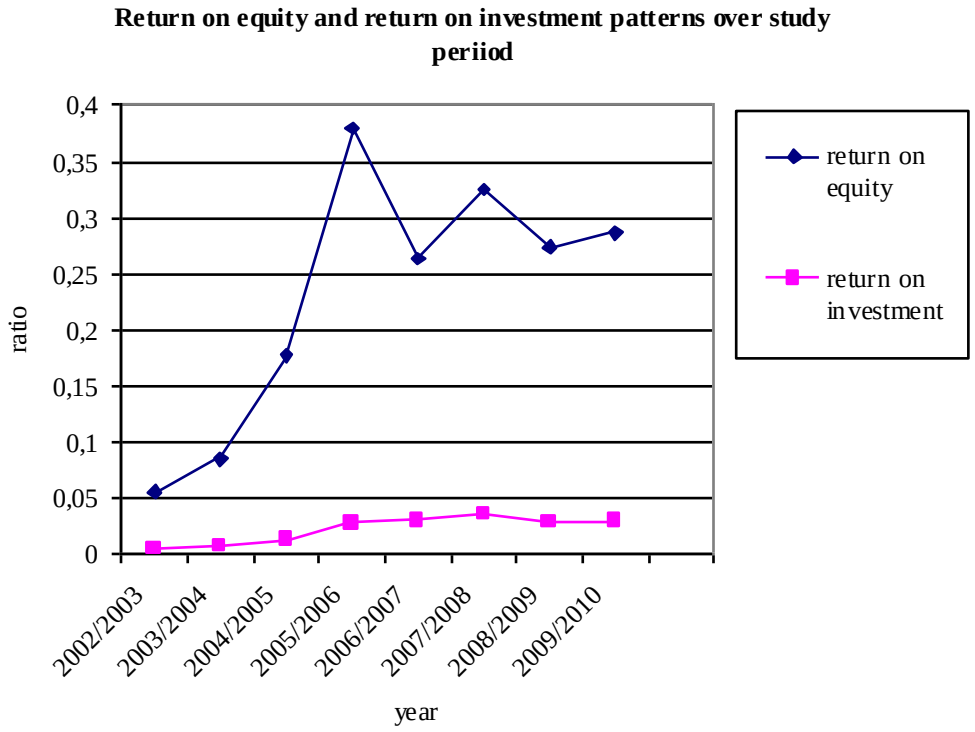
The preceding graph depicts that revenues, expenses and net income were in an increasing trend over the study period commencing 2002/2003 up to 2006/2007. The maximum revenue during the period under study was Birr 221 million recorded in 2006/2007 and the minimum was that of 2002/2003 accounting period. In a similar fashion, the maximum expenses and net income were that of 2007/2008 and 2009/2010 respectively amounting to Birr 105 million and Birr 91,526470 respectively. The result of these data indicates that the revenues and expenses were in the same pattern over the eight years with revenue increasing at higher rates than did the expenses. The hike in revenues of the bank is attributable to the pursue of international banking operations since 2002/2003 while mobilizing the local market as well that resulted in to higher profitability over the years. The relocation of the some of the bank's outlying branches to better bankable areas and the gradual penetration of the bank in to foreign banking activities are the major factors attributable to this commendable performance (*See: Construction and Business Bank Annual Reports Of 2003/2004 and 2005/2006).* From this it can be understood that the company was pursuing the strategy of increasing revenues while decreasing the cost of operation to maximize its profit.



Source: analysis of income statement/statement of profit and loss

The profit margin before tax and interest of the bank as shown in the above chart was in an increasing pattern except for the years 2003/2004 and 2007/2008 when it slightly falls. The profit margin before tax and interest ratio was determined to be 49.35%, in 2002/2003, 66.122% in 2006/2007 and 65.78% in 2009/2010. The increases in profit margin before tax and interest ratios were resulted from the hike in revenues at a greater rate than the operating expenses. That is the profit margin before tax and interest was increasing following the hike in revenues for revenues and expenses were increasing for varying amounts from year to year. From the analysis it can be inferred that the profit margin before tax and interest ratio on sales of Br.1.00 was rising over the periods of this study excluding the aforementioned two periods.

The net income ratio of the bank was also in an increasing trend over the years except for 2006/2007. It was 7.39% in 2002/2003, and 31.48% in 2005/2006 and 44.5974% in 2009/2010. From the analysis of the anatomy of the eight years' income statements, it was determined that both revenues and net income were hiking; both for varying amount. The increases in net income at a higher rate than the increase in revenue lead to the increase in net income ratio. This implies that the bank management is effective in controlling its overhead costs so that increase in revenue contributes to profitability



Source: analysis of income statement/statement of profit and loss

The return on equity of the bank as indicated on the preceding chart was in an increasing fashion because of the fact that the net income was increasing at a higher rate than that of the equity of the bank over the first four years operational periods. After wards the ratio indicates series of fluctuations up to the end of the study period mainly because of fluctuations of the equity balance although the net income has shown rising. The return on equity was 5.45%8 in 2002/2003 and reached 37.95% the maximum of the study period in 2005/2006 after continuous increases period after period. For 2006/2007 operational period the return on equity declined to 26.34% but increased to 32.47% the next period.

Regardless of the increasing balance in total assets over the years (i.e. *from balance sheet of the bank*), the return on investment as shown on the above chart, was in a going up pattern before up to 2007/2008. The ratio of the return on investment was determined to be 0.47% in 2002/2003, 2.75% in 2005/2006 and 3.513% in 2007/2008; the maximum of the study period. Slight decline was observed for the last two years of the study period with return on investment of 2.84% in 2008/2009 and 2.89% in 2009/2010. The slight increases in return on investment in the years were the effect of the increase in net income at comparatively higher rate than the total assets/total investment. It can be implied from this evidence that the management of the bank has been improving its capacity of using the assets investments to generate income.

Table 1. Liquidity Ratio of the Bank over Four Years Period

	2002/2003	2003/2004	2004/2005	2005/2006	2006/2007	2007/2008	2008/2009	2009/2010
Current ratio (CA/CL)	0.4071	0.4829	0.6107	0.4331	0.479145	0.389024	0.506705	0.551508
Quick ratio QR/CL)	0.3486	0.3979	0.4609	0.3643	0.479145	0.389024	0.506705	0.551508
Absolute liquidity ratio (CS/CL)	0.3229	0.3847	0.4516	0.3457	0.276449	0.331888	0.417394	0.447917

Source: analysis of the balance sheet of years; 2002/2003 to 200901/20.

A higher current ratio indicates a good probability that the enterprise can retire current debts. A ratio of 1.5 or higher is a comfortable financial position for most enterprises as suggested by financial management professionals. As it can be seen from the above table the bank's current ratio never hit 1.5 or more values (i.e. the industry ratio) for the periods under study. The maximum amount of the current ratio is 0.6107 for the year 2004/2005. The minimum amount is 0.389 in the year 2007/2008. The interpretation of these ratios which are lower than 1:1 for the entire periods indicates the fact that the bank has been operating with very low working capital.

It can be seen from the above table that, the bank's quick ratio is less than 0.5 for the four consecutive years under study. A healthy enterprise will always keep this ratio at 1.0 or higher (i.e. industry ratio). The maximum figure on quick ratio is 0.4609 in the year 0.5515 in 2009/2010 while the minimum figure is 0.3486 in the year in 2002/2003. These ratios imply that the bank needs to convert its non-cash current assets in to cash or near-cash resources to finance its maturing debts.

The above table also indicates that the cash ratio for the bank is less than 0.5 for the entire periods under study. A ratio below 0.5 mean there may be cash flow problems, possibly because of a significant backlog in accounts receivable. The maximum figure in the table is 0.4479 in 2009/20010 and the minimum is 0.276 in 2006/2007 fiscal years. It can be inferred from this table that the amount of cash available for financing the current debts is very low.

The trend analysis of these three liquidity ratios as it can be observed from the table above revealed that the ratios were slightly increasing excluding over the study period and this inevitably have impact on the profitability of the bank in the subsequent periods.

Leverage ratios indicate the level of utilization of internal as well as borrowed funds. They are also called as capital structure ratios. These ratio types in general mention the mix of available funds. The major benefit of leverage ratios is in highlighting risk associated with debt financing. High capital gearing is harmful to the enterprise as the potential of fixed charge (interest on debt) escalates. Firms in general prefer lower gear situations.

Table 2. Leverage/Debt Management Ratio Patterns over Eight Years

Item	2002/2003	2003/2004	2004/2005	2005/2006	2006/2007	2007/2008	2008/2009	2009/2010
Debt ratio (TL/TA)	0.914	0.983	0.970	0.904	0.870	0.892	0.896	0.899
Debt to equity ratio TL/AE))	10.580	11.724	17.640	12.485	7.743	8.243	8.611	8.874
Long term debt to equity ratio (LL/AE)	1.935	1.7550	1.1830	0.6779	0.419	0.853	0.253	0.183
Interest coverage ratio	1.3130	1.5940	2.1678	4.0220	3.982	3.597	3.208	3.142

Source: analysis of the balance sheet of years; 2002/2003 to 2009/2010.

These ratios are used to judge the long-term solvency of a firm. The most commonly used ratios are – Debt-to- Equity ratio (total debt divided by total equity), Long-term debt- to -equity ratio (long term debt divided by equity). While the accepted norm for debt -equity ratio differs from industry to industry, the usual accepted norm for debt to equity is 2:1. It should not be more than this. For certain industries, a higher debt to equity is accepted, e.g., in banking industry, a debt equity ratio of 12:1 is acceptable because of the intermediation nature of banking services.

The above table depicts that the long term debt to equity ratio which measures the relationship between long-term external financing and net worth of a company has been declining over the study period. Here, a lower value is assumed in general to be functional for a firm. The ratio of Construction and Business Bank (CBB) relating to long-term debt and net worth shows a favorable trend over the four years. The ratio declines in a constant fashion from year to year. The bank has no exaggerated outstanding long-term debts when compared to magnitude of equities. The long term debt to equity ratios of the bank were 1.9350 in 2002/2003, 0.6779 in 2005/2006 and reached 0.183; the minimum for the study period in 2009/2010. From this evidence it can be implied that the bank has been reducing the financing of its operation with long term borrowings. This fact is supported by the existence of available sufficient internal funds to pay for outstanding debts and finance operations. As the evidence collected from the investment and accounts manager indicates, there was no law suit filed against the bank for inability of disbursing debts acquired in running operations. In general, it can be said that the long term credit risk is high for the bank as it has been carrying unbalanced ration of long-term debts and internal financial amounts.

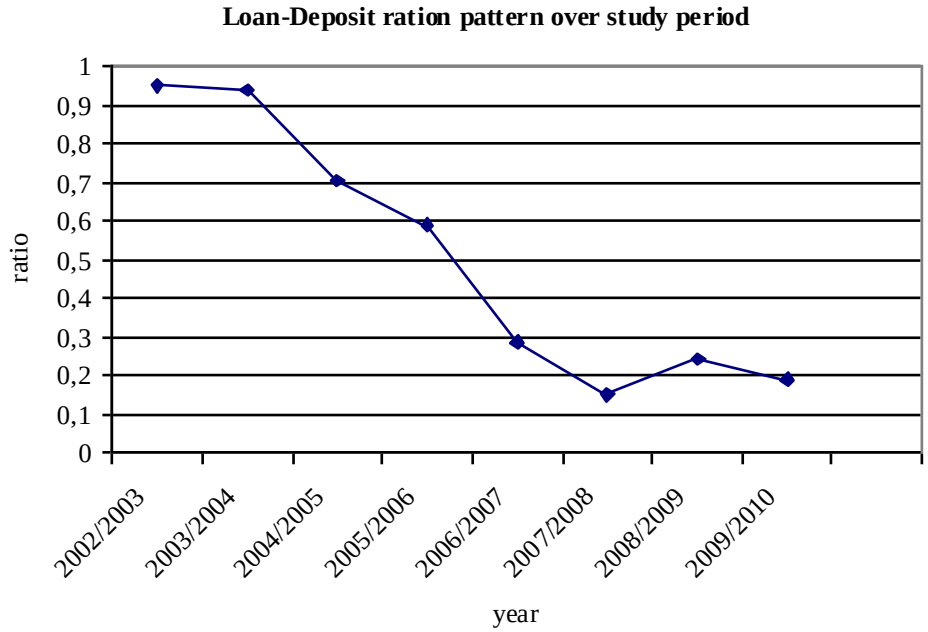
Debt ratio represents liabilities divided by assets/investments. Investments in to assets are the value of the assets that contribute to a company's ability to generate revenue. The aforementioned bank is not good at this consideration. The ability of its assets to cover its liabilities and contribute to generating revenue is somewhat following

a consistent trend. Nevertheless, the point worth mentioning here is that the bank is in a safer side if this ratio takes a reasonable lower magnitude although it is evidenced in international banking experience that more than 90% of assets investments are supported with debts. This does not mean there exists high insolvency risk because it is the intermediation services of banks which results in debt dominated capital structure. As can be seen from the table, the debt ratio is 91.36% in 2002/2003, 98.28% in 2003/2004, 90.41% and 87% the minimum value for 2006/2007. For having a protection, the bank has to lower this value. The debt proportion to ability of assets in generating revenue is not commendable and safe. There is strong indication of high debt over revenue generating ability of assets (after deduction of current liabilities). It is expected from the bank that the position of capital employed must be enhanced in relation to total liabilities observed.

The above table depicts that the debt to equity ratios of the bank were 10.580 in 2002/2003, 11.724 in 2003/2004, and 17.640 for 2004/2005 the maximum value for the study period. The minimum record is for the year 2006/2007 of 7.743. For the last three years it has been increasing consistently and reached 8.874 times in 2009/2010. These ratios seem unacceptable if compared with the proposed usual industry averages ratios, but for the firm is in the banking sector these ratios are not indicators of poor financial performance except for the year 2004/2005 where the ratio is 17.64.

Owing to coverage ratios, though not exhaustively listed, the rate of interest coverage ratio is not worth mentioning specially in the first two consecutive years. Here in our country case, there is no accepted industry average adopted by National Bank of Ethiopia. But for generalized reference, we can account for the proportion as adopted in international institutions. As most financial management professionals set forth, the interest coverage ratio is known to be 2:1. In this case, the bank is not able to keep the ratio at least to this ascribed proportion consistently over the first two years of the analysis periods. From the years considered, the last six are in compliance with this accepted criterion. In total, the interest coverage ratio is showing increasing trend and reached maximum of 4.0220 times in 2005/2006 from 1.313 times in 2002/2003.From 2005/2006 through 2009/2010 the interest coverage ration has been declining and observed to be 3.142 in 2009/2010. This decrease was partly because of the credit ceiling imposed by the national bank in addition to 25% liquidity requirement and 15% reserve requirement for inflation mitigation purpose which hampered the earning capacity of the bank and partly because of failure of the bank management to invest the 60% of the deposit collected that could be loaned.

Deposit Mobilization and Loan Performance



Source: analysis of audited financial statements of years; 2002/2003 to 200901/20.

Regarding deposit mobilization, the crude figures show an increasing trend in all of the deposit categories (demand, saving and time deposits). As evidenced from the annual audited financial statements, the growth in deposit is attributable to the relocation of some of the bank's outlying branches to better bankable areas and the gradual penetration of the bank in to foreign banking activities. By the same token, if we observe the actual figures owing to magnitude of approved loans, there is a commendable performance in the areas of loan approval for residential construction purpose, varied business premises construction, and for short-term and medium-term business loans. The main accountable factor for this dramatic increase in the amount of approved loans is associated with the increase in the financing demand for new business premises construction and the better efficiency registered in the bank's engineering services and credit processing and analysis. Owing to loan collection, the actual figure collected from old outstanding balance and fresh loans disbursed during the reporting periods were some what worth mentioning. Improvements observed in the bank's loan recovery efforts and credit risk assessments are the major factors for the better performance over periods considered for analysis.

However, it is foolish to perceive that an actual increase or decrease without relative comparison is sufficient for making wise financial decisions. For instance, here the responsible bodies of the aforementioned bank are reporting from year to year a promising tendency in loans and deposits without observing whether the ratio is conformable with the industry average set out by National Bank of Ethiopia. If we critically observe the loan-deposit ratio for the consecutive recent years, it is showing a deteriorating trend as presented in the above graph. The record shows 95.12% in 2002/2003 and fell to 15.87 % in 2007/2008 the minimum value for the study period after series of declines. It indicates a negative deviation from the standard (1:1) as

adopted by National Bank of Ethiopia for all banking institutions in the country. The decrease in loan to deposit ratio is attributable to the rise in the deposit mobilized bank at an accelerated rate as compared to the increase in the loan approved. The implication of this result is that the bank is not successfully investing the deposit collected from savers into borrowers of financial resources. This would hamper the profitability potential of the bank as the deposit interest expense rises with the rise in deposit accepted when the deposit is not reinvested in to productive capital seekers. In general, for an accurate analysis and decision making scenario, it is essential to know the proportion of loans approved and deposits accepted in reference to the industry standard.

Asset Turnover Ratio Analysis for the Selected Years

	2002/2003	**2003/2004**	**2004/2005**	**2005/2006**	**2006/2007**	**2007/2008**	**2008/2009**	**2009/2010**
Total asset turnover	0.0641	0.0677	0.0665	0.0873	0.1167	0.0910	0.067	0.0649
Fixed asset turnover	1.6864	1.9825	2.8572	4.3351	0.1923	0.1322	0.12	0.1262
Current asset turnover	0.2168	0.2016	0.1345	0.1819	0.2962	0.2926	0.152	0.1337

Source: analysis of audited financial statement of years; 2002/2003 to 200901/20.

These measure whether the bank is making sufficient sales in relation to investment on assets. CBB Share Company has possessed current as well as fixed assets. Even though, the lion's share of assets in the bank is mainly attributable to cash on hand, bank balances, deposits and balances due from customers; there are assets under fixed, long-term and other categories. Typically, the buildings available for service provision, storage, and for similar purpose, property and equipments are the categories under fixed assets. In broadly speaking, asset turnover magnitudes measure efficiency of a company by depicting the utilization rate of assets held irrespective of specific sub-classifications. The following are the major ones under this categorical ration.

The ratios of asset utilization efficiency are calculated distinctively for fixed assets, current and comprehensive (total) assets. This categorical dealing of turnover ratios over four years gives a critical insight in making decisions regarding asset composition and efficiency (deployment of assets possessed). Thus, internal managers and external users for prospective ties will take decisions. The ratios act as a means of judging strength in performance of the bank. Let us now look deeply in to the four years period asset categorical ratios. As an accepted rule, high asset turnover represent efficient utilization. The term 'high' is interpreted in terms of type and size of the entity dealt with. However, inversely, an exaggerated low magnitude pinpoints inefficient asset utilization.

The total asset turnover ratios of CBB Share Company over the study period indicate fluctuation between maximum of 11.67% in 2006/2007 and minimum value of 6.41% in 2002/2003. That means the company is not that much curious of utilizing assets held. There is a possibility of deterioration of efficiency from time to time owing to investment on assets as far as a formulated decision is embarked upon the scenario depending on the magnitude of asset proportion in relation to other financial statement elements. As the consistent uncontrolled ratio indicates, the containment of more assets through time will have a negative impact on the performance of the enterprise. Low asset turnover implies more assets held in custody where by the assets if they are fixed category lead to loss of investment on assets because of obsolescence, deterioration and in general, exposure to risky conditions as time goes on. In addition, unbalanced possession of more liquid assets will be again subject to loss of value due to inflationary factors over time which acts in adverse of the bank. This unjustifiable slightly constant asset turnover ratio lends itself to emergence of new and fierce competitors paralleled with the economic policy change of the country. Therefore, this scenario stresses the importance of undertaking proper reactions to this end.

The fixed asset turn over has showed a continuous increase for the fist four years of the stud period followed by subsequent decrease for the next four years. This type of asset turnover ratio gives emphasis to assets that are permanent in nature (long-term assets). It can be said that greater loss is associated with existence of high fixed asset composition than do current ones. Since the bank is not mainly engaged in inception and redistribution of capital items, more attention may not be imparted to this type as compared to other major asset components. However, the analysis and adjustment of decisions accordingly matters a lot for having competitive edge over other competing banks in the country.

The current asset turn over that relates to the return rate in investment of more liquid assets has been varying between maximum 29.62% of 2006/2007 and minimum of 13.37% for 2009/2010. Having a reasonable margin of safety regarding liquidity is a crucial point worth mentioning here. Debts are to be settled from current assets because of ease of conversion to cash. Therefore, having higher value of such rates is positive for a company. On the other hand, excessive possession of such type of assets might have a detrimental effect in wealth of an enterprise. The magnitude of current asset turnover ratio indicates whether the investment on such assets is sufficient relative to sales volume achieved. Current asset turnover ratio says something about stock outs. Low current asset turnover ratio may be because of accumulation of inventories that cannot be put in to current operations, which in turn give rise to high stocking costs. Besides, Lower trend of current asset turnover ratio is attributable to high emphasis given to long-term assets as compared to liquid ones. Very high current asset turn over ratio represents serious situations of stock outs with their associated costs. Even though it may not lead to acute disruption of production as the share company is a banking institution, it can have adverse impact on customer satisfaction because of shortages which are persistent or short lived ones. In total, it can be inferred that the company's stand regarding assets efficiency is not appreciable. The exhibition of deteriorating asset turnover ratio is indicator of poor performance or unwise decision-making scenario on the management's side.

3. CONCLUSIONS AND RECOMMENDATIONS

Conclusions

The findings of the analysis of the liquidity ratios of the bank revealed that the current ratio, the acid- test ratio and the cash ratio are by far lower than the industry ratio as suggested by financial analysts and financial management professionals. The bank has been operating with very low working capital for the current ratio was almost below 0.5. The trend analysis of the four years ratios indicated that these three liquidity ratios had been in a decreasing pattern.

The profitability ratio analysis indicated that the profit margin before tax and interest and the net income ratios of the bank were in an increasing trend. The relocation of some of the banks outlying branches to better bankable areas and the gradual penetration of the bank in to foreign banking activities since 2002/2003 along with the increase in the number of deposit customers are the major factors attributable to this commendable financial performance.

Return-on-equity and return-on- investment/assets is also in a hiking pattern over the four years as revealed by the data analysis so far as these ratios are concerned. These ratios were increasing because the net income of the bank has been increasing at an accelerated rate than the increases in assets and equities.

It is a fact that a reasonable high asset turnover ratio is indication of better efficiency while the opposite acts adversely. The CBB share company's efficiency ratios are not satisfactory in general for saying that the bank is utilizing its assets effectively. The computed ratios ascribing to total asset turnover, fixed asset turnover and current asset turnover are showing unsatisfactory trend over time. This in general implies downside growth in performance. It is observed that the bank has relative balance in property and equipments as it is not primarily engaged in manufacturing sectors rather in provision of services. Thus, it is some what good in fixed asset utilization rate. Paralleled with asset utilization ratios, it is a fact that there will be expected association of overall performance efficiency in granting loans and satisfying depositors by complying with their requirements in terms of interest payments. Owing to low current asset turnover ratio, it is major indicator of illiquidity and insolvency of the bank if the trend goes as observed at times passed. That means, depositors interests may be satisfied from current assets in some situations. Therefore, if there is deficiency to do so, it will dissatisfy customers (depositors and/or borrowers).

Regarding deposit mobilization, the crude figures show an increasing trend in all of the deposit categories (demand, saving and time deposits). Similarly, with regard to loan collection, the actual crude figures collected from old outstanding balances and fresh loans disbursed during the reporting periods were some what worth mentioning. And, at the same time improvements are observed in the bank's loan recovery efforts and credit risk assessments. But, the relative proportions are in general not indicating a healthy trend for times ahead. Thus, this fact pinpoints the necessity of undergoing some interventions so as to keep in line with an accepted trend. A balanced and normally accepted loan-deposit proportion has to be kept in order to function without risk for future periods.

Leverage ratios on the other hand imply the cautiousness of the enterprise in balancing borrowed funds and internal funds though not worth mentioning. It can be seen from the financial statement analysis of the bank that it is aware of the consequences of higher capital gearing (much reliance on borrowed funds). The ratios calculated separately for long-term debt to equity, debt to assets, and debt to equity are

following a constant rate. But in practical terms, even though they are not escalating time and again, the actual values indicate problems associated with total control over them. The long-term debt to equity ratios of the bank was declining over the study period except for 2007/2008. This indicates to long term creditors that the long term solvency risk is high for the equity of the bank is not sufficient enough to cover the long term creditors' claims. The total debt to equity ratio of the bank over the study period also revealed that there exist problem in establishing the capital structure of the bank as the debt is so high ranging between 10.580 times and 17.640 times.

The scenario regarding interest coverage ratio is also a pattern that necessitates some adjustment on a timely manner so as to win the satisfaction of depositors and creditors in general. It must be kept at a reasonable magnitude in order to assure the repayment or compensation of depositors for using their money in all other investment areas and also to reward lenders for utilizing their money in the bank towards the supportive enhancements of the nation's developmental activities in many sectors.

To conclude, the bank's financial statement analysis in line with deposit mobilization, loan performance, asset utilization, and internal-external fund balance and interest debt disbursement capability showed weak side. So, the bank's ambition of staying in business and becoming competitive in the dynamic and fierce prevailing market arena is will a challenge the bank leadership.

Recommendations

Based on the overall assessment of the bank's financial performance owing to asset utilization, deposit mobilization, loan performance, leverage and coverage ratios, the following suggestions are drawn by the principal investigators and urge the implementation of necessary timely corrective measures for efficiency and survival of the aforementioned bank at times ahead.

It is supportive to say that the bank is engaged in activities like; financing housing cooperatives, industrial projects service, residential houses construction, and in general it supports the expansion of the real estate sector in regional towns. Even though, granting loans to help development of the country is probation, the decision must not be made in a premature manner to the extent it questions the existence of the bank in the market. As far as the excessive loans over available deposits questions the financial strength of the bank and ultimately impacts depositors, a precaution must be taken to maintain the loan-deposit proportion to an acceptable limit rather than passing decisions without in-depth insight about the long-term effects.

Furthermore, emphasis should be given to minimizing credit risks and facilitating loan collections in the contemplated time in a win-win situation so as to act to the positive of depositors, borrowers and also to the bank. This is made a reality by having a balanced proportion of loans to deposits and meeting the legal reserve requirement ratio in relation to deposits received.

The asset utilization rate in relation to sales made is not promising. It is a dried fact that maintaining a reasonable high asset turnover ratio is deemed to have a positive implication and impact for any company. The total asset turnover ratio for CBB Share Company is showing a slight consistent insufficient trend, having potential for deterioration in asset usage efficiency from time to time. This ascribes to unawareness and loose emphasis given to asset utilization in line with categories of assets and sales volume achieved. Unless and otherwise, the mix of assets held in relation to sales made is balanced, the productive assets will cause a loss margin in a reciprocal manner because of random usage. Possessing a voluminous asset is nothing if not properly and

timely deployed in to the area where it can be utilized to the good of the society (production processes or redistribution premises). So, the bank should urge for keeping proportion of assets used up and held in custody with sales revenue generated as it is a worth mentioning point for efficiency.

Regarding fixed assets turnover, the bank's results are showing a favorable condition. Because, the asset categories under fixed (relatively permanent nature) represent in some circumstances huge investment, a sensitive over look is deemed to be essential since such assets are subject to obsolescence, loss of value because of inflation, agedness (depreciation), or to other risky situations (uncollectibility, damage, firing, and so on). In total, the investigators stressed the effective utilization of such asset categories in order not to lose the investment made on them through taking timed measures felt necessary by knowing the usage rate through carrying out the necessary analysis by the bank's financial experts or responsible bodies.

More to the point, a deep analysis is also exerted upon the condition of current assets. The results revealed that investment on current assets as compared to sales made is not showing a promising scenario. Since the bank's liquidity and solvency is measured depending on the state of current asset composition, the bank should strengthen its position in this regard. A reasonable high proportion of current assets must be kept paralleled with balanced turning over of such assets as far as exaggerated high or low rates are not good as a whole.

The findings of analysis of ratios revealed that the profit margin before tax and interest ratio and net income ratio; the profitability ratios in general including return- on -equity and return- on- investments of the bank had been increasing over the study periods considered. Thus, the bank should broaden its customer base and services so as to maintain its value and profitability. The bank should strengthen strategy of increasing its revenues while maintaining its cost of operation to the minimum possible level.

The liquidity ratios computed indicated that, the bank has been operating with very low working capital (i.e. with current ratio, quick ratio and absolute liquidity ratio of lower than 0.5). Although it seems impossible for a business to generate profit with such a liquidity ratio pattern, the bank has been profitable for most of the assets held can easily be tuned over in to cash. With limited working capital it will remain day dream for enterprises to generate as much profit as they should for they can not expand their services to new markets and even in the existing markets. Therefore, the bank should pursue long term financing strategy rather than short term financing strategy so as to have sufficient working capital that enable the bank to be successful in attaining organizational goals. Specifically, long term financing strategy of longer period of maturity should be adopted by the bank for the fact that the bank need not use current assets for repayment of the debts.

The existence of unsatisfactory capital gearing ratios over time indicate ineffectiveness of the bank's financial experts and other concerned bodies to have acceptable mix of internal and external financial sources. To be precise, more is expected from the bank to hold down these ratios at a reasonable lower magnitude by strengthening its internal capital base. The dependency on external financing must be looked from many aspects (interest to be paid, sustainability of the external source and associated benefits to be derived). The need for maintaining an optimal lower leverage ratio is unquestionable.

The interest coverage ratio must be kept at an accepted ratio of 2:1 or at least near to this ration. Any unfavorable deviation is indicator of poor financial management

practice in the area. Therefore, if possible it is better for the bank to look in to such critical ratios rather than blindly rely on crude figure to talk about favorable progresses or unwanted downsides in the financial performance analysis and decision making process. Thus, depending on the status of the bank with regard to this ratio a timely decision and corrective action can be relied on to balance loan approvals with their interest bearings and deposit reception in line with their associated costs in the form of fees (interest charges) to ultimate depositors and principal creditors.

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