

## CHAPTER - I

### **An Over view of Banking In Ethiopia :**

The agreement that was reached in 1905 between Emperor Minilik II and Mr.Ma Gillivray, representative of the British owned National Bank of Egypt marked the introduction of modern banking in Ethiopia. Following the agreement, the first bank called Bank of Abysinia was inaugurated in Feb.16, 1906 by the Emperor. The Bank was totally managed by the Egyptian National Bank and the following rights and concessions were agreed upon the establishment of Bank of Abyssinia. The capital of the Bank was agreed to be Pound Sterling 500,000 and one-fifth was subscribed and the rest was to be obtained by selling shares in some important cities such as London, Paris and New York.

The Bank was given full rights to issue bank notes and monitor coins which were to be legal tender and all the profits there from a ruling to the bank and freely exchangeable against gold and silver on cover by the Bank as well as to establish silver coins and abolish the Maria Theresa.

Land was given to the Bank free of charges & permitted to build offices and warehouses. Government and public funds were to be deposited with the bank and all payments to be made by checks.

The government promised not to allow any bank to be established in the country within the 50-year concession period. Within the first fifteen years of its operation, Bank of Abyssinia opened branches in different areas of the country. In 1906 a branch in Harar (Eastern Ethiopia) was opened at the same time of the inauguration of Bank of Abyssinia in Addis Ababa. Another at Dire Dawa was opened two years later and at Gore in 1912 and at Dessie and Djibouti in 1920. Mac Gillivray, the then representative and negotiator of Bank of Egypt, was appointed to be the governor of the new bank and he was succeeded by H Goldie, Miles Backhouse, and CS Collier were in charge from 1919 until the Bank's liquidation in 1931. The society at that time being new for the banking service, Bank of Abyssinia had faced difficulty of familiarizing the public with it. It had also need to meet considerable cost of installation and the costly journeys by its administrative personnel. As a result, despite its monopolistic position, the Bank earned no profit until 1914. Profits were recorded in 1919, 1920 and from 1924 onwards.

Generally, in its short period of existence, Bank of Abyssinia had been carrying out limited business such as keeping government accounts, some export financing and undertaking various tasks for the government. Moreover, the Bank faced enormous pressure for being inefficient and purely profit motivated and reached an agreement to abandon its operation and be liquidated in order to dis engage banking from foreign control and to make the institution responsible to Ethiopia's credit needs. Thus by 1931 Bank of Abyssinia was legally replaced by Bank of Ethiopia shortly after Emperor Haile Selassie came to power.

The new Bank, Bank of Ethiopia, was a purely Ethiopian institution and was the first indigenous bank in Africa and established by an official decree on August 29, 1931 with capital of £750,000. Bank of Egypt was willing to abandon its on cessionary rights in return for a

payment of Pound Sterling 40,000 and the transfer of ownership took place very smoothly and the offices and personnel of the Bank Of Abyssinia including its manager, Mr. Collier, being retained by the new Bank. Ethiopian government owned 60 percent of the total shares of the Bank and all transactions were subject to scrutiny by its Minister of Finance.

Bank of Ethiopia took over the commercial activities of the Bank of Abyssinia and was authorized to issue notes and coins. The Bank with branches in Dire Dawa, Gore, Dessie, Debre Tabor, Harar, agency in Gambella and a transit office in Djibouti continued successfully until the Italian invasion in 1935. During the invasion, the Italians established branches of their main Banks namely Banca d'Italia, Banco di Roma, Banco di Napoli and Banca Nazionale del lavoro and started operation in the main towns of Ethiopia. However, they all ceased operation soon after liberation except Banco di Roma and Banco di Napoli which remained in Asmara. In 1941 another foreign bank, Barclays Bank, came to Ethiopia with the British troops and organized banking services in Addis Ababa, until its withdrawal in 1943. Then on 15th April 1943, the State Bank of Ethiopia commenced full operation after 8 months of preparatory activities. It acted as the central Bank of Ethiopia and had a power to issue bank notes and coins as the agent of the Ministry of Finance. In 1945 and 1949 the Bank was granted the sole right of issuing currency and deal in foreign currency. The Bank also functioned as the principal commercial bank in the country and engaged in all commercial banking activities.

The State Bank of Ethiopia had established 21 branches including a branch in Khartoum, Sudan and a transit office on Djibouti until it ceased to exist by bank proclamation issued on December, 1963. Then the Ethiopian Monetary and Banking law that came into force in 1963 separated the function of commercial and central banking creating National Bank of Ethiopia and commercial Bank of Ethiopia. Moreover it allowed foreign banks to operate in Ethiopia limiting their maximum ownership to be 49 percent while the remaining balance should be owned by Ethiopians.

The National Bank of Ethiopia with more power and duties started its operation in January 1964. Following the incorporation as a share company on December 16, 1963 as per proclamation No.207/1955 of October 1963, Commercial Bank of Ethiopia took over the commercial banking activities of the former State Bank of Ethiopia. It started operation on January 1, 1964 with a capital of Eth. Birr 20 million. In the new Commercial Bank of Ethiopia, in contrast with the former State Bank of Ethiopia, all employees were Ethiopians.

There were two other banks in operation namely Banco di Roma S. C. and Bank o di Napoli S.C. that later reapplied for license according to the new proclamation each having a paid-up capital of Eth. Birr 2 million. The first privately owned bank, Addis Ababa Bank Share Company, was established on Ethiopians initiative and started operation in 1964 with a capital of 2 million in association with National and Grindlay Bank, London which had 40 percent of the total share. In 1968, the original capital of the Bank rose to 5.0 million and until it ceased operation, it had 300 staff at 26 branches. There were other financial institutions operating in the country like the Imperial Savings and Home Ownership public Association (ISHOPA) which specialized in providing loans for the construction of residential houses and to individuals under the guarantee of their savings. There was also the Saving and Mortgage Corporation of Ethiopia whose aims and duties were to accept savings and trust deposits account and provide loans for

the construction, repair and improvement of residential houses, commercial and industrial buildings and carry out all activities related to mortgage operations. On the other hand, there was a bank called Agricultural Bank that provides loan for the agricultural and other relevant projects established in 1945. But in 1951 the Investment Bank of Ethiopia replaced it. In 1965, the name of the bank once again hanged to Ethiopian Investment Corporation Share Company and the capital rose to Eth. Birr 20 million, which was fully paid up. However, proclamation No.55 of 1970 established the Agricultural and Industrial Development Bank Share Company by taking over the asset and liability of the former Development Bank and Investment Corporation of Ethiopia.

Following the declaration of socialism in 1974 the government extended its control over the whole economy and nationalized all large corporations. Organizational setups were taken in order to create stronger institutions by merging those that perform similar functions. Accordingly, the three private owned banks, Addis Ababa Bank, Banco di Roma and Banco di Napoli Merged in 1976 to form the second largest Bank in Ethiopia called Addis Bank with a capital of Eth. birr 20 million and had a staff of 480 and 34 branches. Before the merger, the foreign participation of these banks was first nationalized in early 1975. Then Addis Bank and Commercial Bank of Ethiopia S.C . were merged by proclamation No.184 of August 2, 1980 to form the sole commercial bank in the country till the establishment of private commercial banks in 1994. The Commercial Bank of Ethiopia commenced its operation with a capital of Birr 65 million, 128 branches and 3,633 employees. The Savings and Mortgage Corporation S.c and Imperial Saving and Home Ownership Public Association were also merged to form the Housing and Saving Bank with working capital of Birr 6.0 million and all rights, privileges, assets and liabilities were transferred by proclamation No.60, 1975 to the new bank.

Proclamation No.99 of 1976 brought into existence the Agricultural and Industrial Bank, which was formed in 1970 as a 100 percent state ownership, was brought under the umbrella of the National Bank of Ethiopia. Then it was reestablished by proclamation No. 158 of 1979 as a public finance agency possessing judicial personality and named Agricultural and Industrial Development Bank (AIDB). It was entrusted with the financing of the economic development of the agricultural, industrial and other sectors of the national economy extending credits of medium and long-term nature as well as short-term agricultural production loans.

The financial sector that the socialist oriented government left behind constituted only 3 banks and each enjoying monopoly in its respective market. The following was the structure of the sector at the end of the era.

- The National Bank of Ethiopia (NBE)
- The Commercial Bank of Ethiopia (CBE)
- Agricultural and Industrial Development Bank (AIDB)

Following the demise of the Dergue regime in 1991 that ruled the country for 17 years under the rule of command economy, the EPRDF declared a liberal economy system. In line with this, Monetary and Banking proclamation of 1994 established the national bank of Ethiopia as a judicial entity, separated from the government and outlined its main function.

Monetary and Banking proclamation No.83/1994 and the Licensing and Supervision of Banking Business No.84/1994 laid down the legal basis for investment in the banking sector. Consequently shortly after the proclamation the first private bank, Awash International Bank was established in 1994 by 486 shareholders and by 1998 the authorized capital of the Bank reached Birr 50.0 million. Dashen Bank was established on September 20,1995 as a share company with an authorized and subscribed capital of Birr 50.0 million. 131 shareholders with subscribed and authorized capital of 25.0 million and 50 million founded bank of Abysinia. Wegagen Bank with an authorized capital of Birr 60.0 million started operation in 1997. The fifth private bank, United Bank was established on 10th September 1998 by 335 shareholders .Nib International Bank that started operation on May 26, 1999 with an authorized capital of Birr 150.0 million. Cooperative Bank of Oromia was established on October 29,2004 with an authorized capital of Birr 22.0 million. Lion International Bank with an authorized capital of Birr 108 million started operation in October 02,2006. Zemen Bank that started operation on June 17, 2008 with an authorized capital of Birr 87.0 million. The last bank to be established to date is Oromia International Bank that started operation on September 18, 2008 with an authorized capital of Birr 91 million. On the other hand, modern forms of insurance service, which were introduced in Ethiopia by Europeans, trace their origin as far back as 1905 when the Bank of Abysinia began to transact fire and marine insurance as an agent of a foreign insurance company. According to a survey made in 1954, there were 9 insurance companies that were providing insurance service in the country. Except Imperial Insurance Company that was established in 1951, the rest of the insurance companies were branches or agents of foreign companies. The number of insurance companies increased significantly and reached 33 in 1960. At that time insurance business like any business undertaking was classified as trade and was administered by the provisions of the commercial code. This was the only legislation in force in respect of insurance except the maritime code of Ethiopia that was issued to govern the operations of maritime business and the related marine insurance. The minimum paid-up capital required to establish an insurance company was as little as 12,500 Ethiopian dollars as stipulated in the commercial code. There was no restriction on foreign insurers.

The first remarkable event that the Ethiopian insurance market witnessed was the promulgation of proclamation No. 281/1970. This proclamation was issued to provide for the control & regulation of insurance business in Ethiopia. It is peculiar in that it created an Insurance Council and an Insurance Controller's Office.

The controller of insurance licensed 15 domestic insurance companies, 36 agents, 7 brokers,3 actuaries & 11 assessors in accordance with the provisions of the proclamation immediately in the year after the issuance of the law.

The law required an insurer to be a domestic company whose share capital (fully subscribed) to be not less than Ethiopian dollars 400,000 for a general insurance business and Ethiopian dollars 600,000 in the case of long-term insurance business and Ethiopian dollars 1,000,000 to do both long-term & general insurance business. Non-Ethiopian nationals were not barred from participating in insurance business. However, the proclamation defined 'domestic company' as a share company having its head office in Ethiopia and in the case of a company transacting a general insurance business at least 51% and in the case of a company transacting life insurance business, at least 30% of the paid-up capital must be held by Ethiopian nationals or national companies.

Four years after the enactment of the proclamation, the military government that came to power in 1974 put an end to all private entrepreneurship. Then all insurance companies operating were nationalized and from January 1, 1975 onwards the government took over the ownership and control of these companies & merged them into a single unit called Ethiopian Insurance Corporation. In the years following nationalization, Ethiopian Insurance Corporation became the soleoperator.

Following the change in the political environment in 1991, the proclamation for the licensing and supervision of insurance business heralded the beginning of a new era. Immediately after the enactment of the proclamation private insurance companies began to flourish. Currently There are 18 private and 3 government-owned banks, 14 private and 1 government owned insurance companies, and 31 MFIs.

### **Introduction :**

A bank is an institution which deals with money & credit. It accepts from the public, makes the funds available to those who need them, & helps in the remittance of money from one place to another.

The word 'Bank' is said to have been derived from the French word 'Banco' or 'Bancus' which means a 'Bench'.

Bank is a financial institution that undertakes the banking activity i.e.it accepts deposits and then lends the same to earn certain profit.

Today banks have become a part and parcel of our life. There was a time when dwellers of city alone could enjoy their services. Now banks offer access to even a common man and their activities extend to areas neither to untouched. Banks cater to needs of agriculturists, industrialists, traders and to all the other sections of the society.

### **Meaning of Banking:**

“collects money from those who have it to spare or those who are saving it out of their incomes, and it lends this money to those who require it.” ..... ‘Crowther’

In simple words, Banking can be defined as “the business activity of accepting and safeguarding money owned by other individuals and entities, and then lending out this money in order to earn a profit. However, with the passage of time, the activities covered by banking business have widened and now various other services are also offered by banks. The banking services these days include issuance of debit and credit cards, providing safe custody of valuable items, lockers, ATM services and online transfer of funds across the country / world.

It is well said that banking plays a silent, yet crucial part in our day-to-day lives. The banks perform financial intermediation by pooling savings and channelizing them into investments through maturity and risk transformations, thereby keeping the economy’s growth engine revving.

Banking business has done wonders for the world economy. The simple looking method of accepting money deposits from savers and then lending the same money to borrowers, banking activity encourages the flow of money to productive use and investments. This in turn allows the economy to grow. In the absence of banking business, savings would sit idle in our homes, the entrepreneurs would not be in a position to raise the money, ordinary people dreaming for a new car or house would not be able to purchase cars or houses.

### **Definition:**

According to banking regulation Act, 1949 sec. 5 (b) defines the term Banking company as a company which transacts the business of banking in India and the term Banking has been defined as 'Accepting for the purpose of lending and investment of deposits of money from the public, repayable on demand, order or otherwise and withdraw able by cheque, draft order or otherwise'.

### **Banking System:**

Banking systems can be defined as a mechanism through which the money supply of the country is created and controlled.

### **Types of Banks:**

Banks can be classified into various types on the bases of their functions, ownership, domicile, etc. The following are the various types of Banks:

1. **Commercial Banks:** The Banks which perform all kinds of banking business and generally finance trade and commerce are called commercial banks. Since, their deposits are for a short period, these banks normally advance short term loans to businessmen and traders and avoid medium and long term and long term lending. However, recently, Commercial banks have also extended their areas of operation to medium term and long term finance.
2. **Industrial Banks:** Industrial banks also known as investment banks mainly meet the medium term and long term financial needs of the industries. The main functions of Industrial banks are:
  - a. They accept long term deposits
  - b. They grant long term loans to industrialists to enable them to purchase land, construct factory buildings, purchase heavy buildings, etc.
  - c. They help sell or underwrite the debentures and shares of industrial firms.
  - d. They can also provide information about the general economic position of the economy:  
Example: Industrial Development bank of India (IDBI); Industrial Finance Corporation of India (IFCI); State Finance Corporations (SFC)
3. **Agricultural Banks:** Agricultural credit needs are different from those of Industry and Trade. The Agriculturists require:
  - a. Short term credit to buy seeds, fertilizers and other inputs.
  - b. Long Term credit to purchase land, to make permanent improvements on land, To purchase agricultural machinery and equipment, etc.

4. **Exchange Banks:** Exchange banks Deal in foreign exchange and specialize in financing foreign Trade. They facilitate international payments through the sale and purchase of bills of exchange and thus play an important role in promoting foreign trade.
5. **Savings Bank:** The main Purpose of saving banks is to promote saving habits among the general public and mobilize their small savings. In India, postal saving banks do this job. They open accounts and issue postal cash certificates.
6. **Central Bank:** Central bank is the apex institution which controls, regulates and supervises the monetary and credit system of the country. The Important functions of the central bank are:
  - a. It has the monopoly of note issue.
  - b. It acts as a banker, agent and financial advisor to the state.
  - c. It is the custodian of member banks reserves.
  - d. It is the custodian of national reserves of international currency.
  - e. It serves as the lender of the last resort.
  - f. It serves as the bank of central clearance, settlement and transfer
  - g. It acts as the controller of credit.
7. **World Bank:** World Bank refers to an institution which provides financial assistance to the member countries of the world. After the world wide depression and World War II, two institutions were founded in 1944, a) International Monetary Fund (IMF), b) International Bank of Reconstruction and development (IBRD) or popularly known as the World Bank. While the IMF was established to provide short-term loans to overcome the balance payments difficulties, the World Bank aimed at providing long term loans for the purpose of (a) reconstructing the war-damaged economies and (b) developing the less developed economies.
8. **Classification on the Basis of Ownership:** On the basis of ownership, banks can be classified into three categories:
  - a. **Public Sector Banks:** These are owned and controlled by the government: In India, the nationalized banks and the regional rural banks come under these categories.
  - b. **Private Sector Banks:** These banks are owned by the private individuals or corporations and not by the government or co- operative societies.
  - c. **Co-operative Banks:** Cooperative banks are operated on the co-operative lines. In India, co-operative credit institutions are organized under the co-operative society's law and play an important role in meeting the financial needs in the rural areas.