

DETERMINANTS OF PROFITABILITY OF COMMERCIAL BANKS IN A DEVELOPING COUNTRY: EVIDENCE FROM ETHIOPIA

K.RAMA MOHANA RAO¹ & TEKESTE BERHANU LAKEW²

¹Department of Commerce and Management Studies, Andhra University,
Visakhapatnam, India

²Research scholar, Department of Commerce and Management Studies, Andhra University,
Visakhapatnam, India

ABSTRACT

The study was carried out to explore the key determinants of profitability of commercial banks operating in Ethiopia using unbalanced panel data set of banks over the period 1999/00-2008/09. To this end, internal and external factors to the banks are regressed against the ROAA of the commercial banks. The internal factors considered are related to the bank's capital structure, liquidity, credit risk, loan portfolio, asset quality, and expense management aspects whereas the external factors are related to the industry and the macroeconomic scenarios within which the banks operate. In this analysis the fixed effects model is used to control the unobservable bank specific characteristics. The fixed effects model is preferred to the random effect model following the Hausman test, Chi-square =27.6, and P-value =0.005. The result of the study indicates that the most determinants of bank profitability in Ethiopia are the internal factors, factors over which a bank's management has control. Though the external factors are found to be statistically insignificant, their signs have important policy implications, and thus require the attention of policy makers and bank regulators.

KEY WORDS: Capital Structure, Credit Risk, Loan Portfolio, Asset Quality And Expense Management