Effect of COVID -19 on the Banking Sector in Ethiopia

Deresse Mersha[1] and Abel Worku[2]

[1]Associate Professor, Department of Accounting and Finance, Jimma University
[2]Assistant Professor, Department of Accounting and Finance, Jimma University

The author can be reached using: deresmersha@gmail.com

Abstract

The banking industry in Ethiopia has been experiencing an unprecedented period of growth and prosperity before COVID-19. However, the pandemic has started disturbing the way our financial institutions are operating at the moment. From this study, it was anticipated that the performance of the banking sector in terms of Deposit Mobilization, Loan and Advances, International Banking and Profitability might be negatively affected. With all eyes on them, banks need to play the dual role of money transmission mechanisms and socioeconomic stabilizers. They need to do well to ensure their customers get all the supports they need. Therefore, managers should vigilantly work hard to minimize the negative effects of the Pandemic.

Key words: Banking Sector, COVID-19, Effect, Ethiopia

1. INTRODUCTION

As deposit gatherers, credit grantors, and payment facilitators, Banks play a vital role in the functioning of the economy. They are not only commercial enterprises but also responsible to provide critical financial services to individuals and organizations. Specifically, Banks sit at the heart of the economy and provide funding to institutions and individuals. Their health and continuity of their operations are therefore critical to keep the whole economic system up and running (Howell & Bain, 2000).

Banking crisis is one type of financial crisis that affects these healthy banking roles. Banking crisis is not a onetime phenomenon and it arises in a series of stages including: banking run which affect a single bank; banking panics which affect many Banks; and systemic banking crises in which a country experiences many defaults and financial institutions and corporations face great difficulties repaying loans (Paul, 2010). Banking crises begin with Bank runs that finally lead to the fail of the whole financial institutions if not managed properly. According to Paul (2010), there have been many financial crises in history which have left remarkable effects on the global economy including: the 1930 Great Depression , the 1980 Latin American debt crisis, the 1997 Asian financial crisis and the 2008 global financial crisis. He further argued that, in the Ethiopian banking sector, the impacts of all these crises were not significant since our financial system was hardly integrated with the global financial system at that time.

Currently, COVID-19 outbreak is causing widespread concern and economic hardship for consumers, businesses and communities across the globe. The situation is changing quickly with widespread impacts. Ethiopia is highly exposed to this pandemic through the large contribution by Ethiopian Airlines. In addition, recently high threat of the pandemic is rising along the different boarders of the neighboring countries including Djibouti, Eretria, Sudan, South Sudan, Kenya and Somalia. As of June 02, about 1344 cases of COVID-19 were reported in Ethiopia including fourteen deaths. This status may increase because of the threat from neighboring countries and internal transmission which may bring health crises to the nation.

In addition to its health impact, the pandemic is greatly affecting our economy. The service sector of the country especially, the banking industry is facing problems. We are facing with a unique time in the banking history in Ethiopia as a result of the pandemic than else were in the world. Banks in other countries came into this pandemic much stronger as they have learned too much from the 2008 financial crisis (Financial Stability Board, 2020). But in our case, we do not have the experience of managing such crises as compared to other countries in the world (Paul (2010). To better understand the probable effect of COVID-19 on banking services in Ethiopia, we have made desk review on the extent of the problems and its probable effects. The main objective is to shade light on the extent of the problem in the context of Ethiopian banking industry and provide possible suggestions.

2. RESEARCH METHODOLOGY

The research design adopted in this study is descriptive desk research. The study is qualitative in nature where content analysis is used to derive conclusion. Content analysis is a systematic coding and categorizing approach used for exploring large amounts of textual information unobtrusively to determine trends and patterns of variables, their frequency, their relationships, and the structures and discourses of communication. The purpose of content analysis is to describe the characteristics of the documentsô content by examining who says what, to whom, and with what effect (Vaismoradi, Turunen & Bondas, 2013). This study adopted content analysis to understand and interpret the effect of COVID-19 on banking service in Ethiopian Context.

Data for this study were gathered from Reports, Books, web contents, published articles, Magazines and local Newspapers. Then, the data collected from these sources were analyzed using qualitative content analysis. It would have been good if the study was supported with primary data, but it was not possible to collect original data because of movement restriction as a result of the pandemic. Though, this study is a desk research and descriptive in nature, it was believed to shade light on the extent of the problem and provide valuable information to public and private commercial Banksô mangers and National Bank of Ethiopia.

The remaining part of the article is structured as follows. The second section of the manuscript tries to review the performance of Commercial Banks before the pandemic. The third section summarizes the responses Banks are taking to carve the problem. The fourth part anticipates the effect of the pandemic on the banking sector performance and finally, the last section indicates suggestion to survive in this difficult time.

3. RESULTS AND DISCUSSION

3.1 Ethiopian Banking Sector Before the Pandemic

Although the history of banking system dates back to 15th century AD, modern banking in Ethiopia started in 1905 with the establishment of Abyssinian Bank in agreement with the Anglo-Egyptian National Bank. In 1932, the Ethiopian government purchased the Abyssinian Bank and renamed it as the Bank of Ethiopia which is the first nationally owned Bank on the African continent. During the five-years of Italian occupation (1936-41), all other Banks were closed and branches of Italian Banks were opened in the main towns. After the country became independent from the five year Italian occupation, Barclay Bank of Great Britain was established and remained in business between 1941 and 1943. Following this, in 1943, Ethiopian government established the State Bank of Ethiopia which had been operating as both commercial and central bank until 1963. Latter, it was re-organized into todayös National Bank of Ethiopia (NBE) and the Commercial Bank of Ethiopia. In addition, many other private Banks were established; and just before the 1974 revolution all these Banks were in operation in the country (Gedey, 2002; Addison & Geda, 2001).

All privately owned financial institutions including: three commercial Banks; 13 Insurance companies; and two non-Bank financial intermediaries were nationalized in January 1975 by the then military regime. Subsequently, the nationalized Banks were re-organized in to: National Bank of Ethiopia (NBE); Commercial Bank of Ethiopia (CBE); Agricultural and Industrial Bank which was renamed lately as the Development Bank of Ethiopia (DBE) and Housing and Saving Bank re-named lately as Construction and Business Bank which was merged with CBE few years ago. Following the regime change in 1991 and the liberalization policy in 1992, many private Banks came in to existence the first of which was Awash Bank (Obo, 2009; Addison & Geda, 2001).

As of May 2020, there are 18 Banks that are in operation out of which two are state owned and the remaining 16 are private commercial Banks. In addition, recently about eleven private Banks are in the process of establishment and they are mobilizing the capital required for banking business (NBE, 2020). All these Banks are domestic and the Ethiopian banking sector is closed to foreign influences.

Before the outbreak of Covid-19 in December 2019, the Ethiopian banking sector has been broadly safe, sound, well capitalized and profitable. The 2018/19 annual report of National Bank of Ethiopia (NBE) showed, Commercial Banks opened 807 new branches in 2018/19 alone which increased the total number of branches to 5,564 from 4,757 a year ago. The Banks also increased their deposit mobilization by 23.2 percent, loan collection by 18.1 percent and loan disbursement by 42.5 percent. Their non - performing loan was within the required ceiling of 5 percent. Further, the 2019/20 quarterly report of NBE shows that, total deposit of the banking sector reached Birr 917.2 billion by the end of September 2019, indicating a 22.2 percent annual growth. Total outstanding borrowing of the banking system stood at Birr 73.8 billion, showing 11.1 percent annual increase. During the first quarter of 2019/20, Birr 39.6 billion was disbursed in fresh loans, indicating a 31.8 percent annual increase. During the first quarter, the loan collection of the banking system reached Birr 36.6 billion and total outstanding credit of the banking system (excluding credit to government) increased to Birr 574 billion, about 28.1 percent higher than last year same quarter. Further, Development Bank of Ethiopia, which has been incurring loss for the last subsequent years, has reported profit before tax of about 950 million within six months in this fiscal year (NBE, 2019). These are some indicators that all Banks have been doing well before the outbreak of the pandemic.

3.2 Responses of Banks to The Pandemic

Though Banks are not being hit by COVID-19 directly as other trading businesses, they are at the forefront of public attention. Within few weeks after the start of the pandemic, Banks experienced a level of disruption that will change everything that had been the norm in banking services. Interview with Bank presidents by Ethiopian reporter (12 April 2020) indicates that, there has not only been a major change in the way financial institutions conduct business, but in the way employees do their work and the way clients manage their finances are changing. The number of people visiting bank branches is decreasing from week to week. People are withdrawing their cash from banks to use it for consumption purpose in case the government announces ñstay at homeò. Creditors are requesting re-scheduling of loan and waiver or reduction of interest on loan. Hence, Banks are expected to face liquidity problem in the short run and solvency problem in the long run if this pandemic is going to stay for a long time. To prevent this from happening, NBE has injected 48 billion birr additional liquidity to all commercial Banks in the country. The bulk of this money will be used to enable them to continue to offer trade financing, working-capital support and medium-term financing to private companies struggling with disruptions in the supply chains.

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Aimed at assisting businesses which will be affected by the spread of the COVID-19, the majority of the Banks including Commercial Bank of Ethiopia, Development of Bank of Ethiopia, Awash Bank, Dashen bank, United Bank, Wogagen Bank, NIB International Bank, Oromia International Bank, Oromia Cooperative Bank, Zemen Bank, Berhan Bank, Enat Bank, Bank of Abyssinia and Abay Bank have started taking actions.

The majority of these Banks are encouraging clients to use electronic banking modalities such as ATM, Mobile banking, Internet banking instead of physically going for service to branches. They made this to minimize customers visit to the branches that contributes to the spread of the virus. The Banks have increased the amount of daily cash withdrawal using ATM cards to more than10, 000 Birr from the previous 5,000 Birr. The majority of the Banks have also waived the transaction fee charged in using these electronic banking facilities.

For those organizations engaged in the import and export businesses; which are highly affected since the major market destinations in the world have closed their doors fearing the pandemic, the majority of the Banks removed commission fee in the course of extending their Letters of credit. The majority of the Banks have also re-scheduled installment payment on loans and advances for some months depending on the nature of the effect by the pandemic. For instance, Commercial Bank of Ethiopia has extended loan repayment for condominium house owners for three months. The majority of the Banks provided interest rate reduction ranging from 0.5% to 7% based on the extent of the businesses affected by the pandemic. Hotel and Horticulture industries are the largest beneficiaries of these interest rate reductions. The majority of the Banks have also promised that further supports will be provided based on the prevailing situation in the future.

Further, Banks are extending their hands and providing millions of birr to support the low income citizens and combat the challenge of the Virus. About 14 financial institutions have contributed above 71 million birr for these purpose and some Banks have also commenced an initiative to mobilize money from their employees to provide further support. The majority of the Banks are letting older employees who are over 55 years old and pregnant women employees stay home for 15 days following the corona virus preventive measures. They are spending millions of Birr for purchase of sanitary supplies for both customers and employees such as equipment for hand wash, sanitizer, alcohol and face mask. They have also started use of infrared non-contact thermo-meter for corona screening on its customers to check their body temperature (Ethiopian Reporter, 1 April 2020).

Above all, NBE is taking action that is believed to stabilize the banking sector. Following the global practice, NBE issued a new directive to limit the cash withdrawal from Banks and Microfinance institutions. The new directive has put the cash limit for individuals at 200,000 Birr daily and one million Birr monthly. For businesses, the daily cap is 300,000 Birr and the monthly cap is 2.5 million Birr, respectively. The NBEȏs rationale behind the issuance of the directive is to promote a non-cash economy, contest fraud and hoarding, reduce the risk of liquidity problems and minimize the cost of printing money. In addition to this, the directive obliges financial institutions to put in place policies and procedures that address issues including deployment of diversified non-cash based payment services, encouraging the public to use non-cash based payment through adoption of various strategies and incentives (Addis Fortune, 23 May2020).

Further, NBE has temporarily suspended commercial Banks from foreclosing on the properties of defaulted borrowers. The suspension will remain active for three months. The temporary freeze on foreclosures will be effective for non-performing loans, which the borrowers stopped servicing for three months to half a year. It will also be applied to medium and long-term loans that are past due between a year to a year and half. The suspension is expected to make the non-performing loans of Banks remain under the maximum threshold set by National Bank of Ethiopia. The circular also suspended the mandatory loan portfolio composition of borrowers, which required a 40:40:20 ratio of short-term, medium-term and long-term loans, respectively in order give breathing space to be flexible on Banksô lending terms while dealing with the shock of COVID-19 (Addis Fortune, 23 May 2020).

3.3Effect of The Pandemic on Banks' Performance

As we have seen earlier, before the pandemic, the banking industry in Ethiopia was experiencing an unprecedented period of growth and prosperity. But what is the effect of the pandemic on their performance and how long do they continue doing this if the effect of the virus stays for an extended period of time is the question at hand. It was anticipated that Banksô performance will be hit across all dimensions including: Deposit Mobilization, Loan and Advances, Revenue from international banking services, Profitability, Security threats and Challenges for new entrant banks. Off course, the effect may vary from one bank to the other because of the variation by sector and customers segment.

a. Effect on Deposit Mobilization

Because of the pandemic, customers are withdrawing their saving for personal consumption. Further, it is difficult to mobilize new deposit at this time since it is challenging to convince customers to open an account and start saving. The majority of the businesses have slowed down and organizationọs revenue has reduced and their bank deposit has decreased significantly. If this is to continue for a longer period, it could lead to cash flow challenges for Banks and their clients. As a result, they may face liquidity problem. It is with this understanding that the government has injected 48 billion birr to the financial system.

b. Effect on Loan and Advance

Although businesses have slowed down, Banks may face many more credit requests both from borrowers looking for forbearance and from would-be borrowers looking for a deal. Much higher demand for new or modified business credit is putting great strain on many Banksô lending operations, particularly as Banks themselves work in new ways in the COVID-19 era. Banks and all businesses are hunkering down to safely and soundly keep operating in light of the COVID-19 pandemic. But many businesses are particularly vulnerable and Banks are seeing a huge ramp-up of requests from them for help in staying afloat and cash flow positive. Depending on how the situation evolves, lending standards may tighten leading to more credit losses.

c. *Effect on International Banking*

The international business was highly affected since the major market destinations have closed their doors because of the pandemic. The majority of Import and export activities were temporarily stopped and clients are requesting extension of LC. As the impact of the pandemic is becoming more visible on social and economic life of the world, countries like ours are feeling the burn in terms of unprecedented decline in remittance coming through Banks, composed mostly of private and public transfers. The COVID-19 pandemic that has crippled the global socio-economic system is feared to have a significant impact on the three million Ethiopians in the Diaspora who remit hard currency back home through formal banking channels. For instance, before the pandemic, around 4.5 billion dollars is transferred in the form of remittance to Ethiopia, annually; and out of this figure, the contribution of the Diaspora, who are facing the grim realities of the COVID-19 shutdown in the Middle East, Europe and North America, is quite immense (Addis Fortune, 23 May 2020). This will bring foreign currency shortage and highly affect the revenue generated by Banks from these sources.

d. *Effect on Profitability of the Banks*

The cash flow of many consumers and businesses will collapse as lack of demand flows through into lower business revenues and employee layoffs. These in turn will cause an increase in both commercial and retail non-performing loans, as borrowers struggle to make scheduled interest and principal payments. The lending interest rates may be lower for longer period. These interest rate cuts could affect Banksô profitability. Those Banks whose revenue is tied to interest income, are already dealing with this problem. For instance, the presidents of Oromia international bank estimate that, his Bankôs income may decrease by 200 million as a result of the action they are taking to support their clients (Ethiopian reporter, 12 April 2020). Further, Wogagen Bank president has also expressed his fear that his bank may loss up to 150 million because of the decision they are taking to carve the problem (Ethiopian Reporter, 2 February 2020). Awash and United Bank estimated their profit will go down by birr 60 million and 50 million respectively as a result of the response they are taking (Ethiopian Reporter, 09 May 2020). On a more fundamental level, Banks will be watching to see if the business environment degrades enough to cause real stress for companies with good operating status. If that happens, defaults and bankruptcies will undoubtedly occur and their non-performing loan will increase. These will further affect profitability, earning per share and dividend per share of stockholders which intern leads to investorsô loss of confidence.

e. *Cyber Attack*

Since consumers fear the infection, they may switch to a cashless society and the adoption of alternative integrated payment methods may be powered by mobile wallets. Personal mobile devices will become a userôs central operating device, enabling payments to peers and to businesses. Internet banking may also become more viable as the functionality of e-banking systems grows, and customers adapt to the new ways of conducting their financial activities. E-banking has the potential to be a very rich and pleasant experience, and may provide more opportunities for Banks to develop mutually satisfying, tailor made services to enrich relationship with customers (Lukic, 2015).

However, a considerable concern rises in **cyber-attack** and fraud, as consumers, businesses and employees adapt to this new environment. Crisis and rapid change always create an opportunity for bad actors (Lukic, 2015). According to Alghazo, Zafar and Latif (2017) the most common factor for security threat is Internet banking usersô sharing of their login credentials with others knowingly or unknowingly. This may lead to compromising of the user account and may lead to security breaches. In early May 2020, the National Intelligence and Security Service (NISS) warned banks about the rising incidence of fraud. In connection to this, NISS reported about 538 cyber-attacks in the country; the majority of which occurred after coming of the pandemic. Specially, NISS reported resistor of 110 million dollar theft attempt from commercial bank of Ethiopia using cyber attach on May 10, 2020.

f. Effect on Newly Entering Banks

In addition to the existing 18 Banks in the country, about eleven private banks are mobilizing capital by issuing shares planning to join the banking industry very soon. However, it might be challenging for them to start operation at this time. It will be very difficult to penetrate the market and start providing financial services if the pandemic stays longer and as a result, shareholdersô money will be tied up.

4. CONCLUSIONS

As the banking sector pays a critical role in the countryợs economic activity, its healthy operation is mandatory. COVID-19 brought not only a health but also economic threat which is affecting every aspect of business operation. The financial services are the economic systems that are heavily affected by the pandemic. Ethiopian banking sector have been enjoying tremendous growth before the pandemic. But currently, COVID-19 has started showing its effect on every banking service including: deposit mobilization, credit management, international banking and system security.

To minimize the negative effect of the pandemic, the government and the Banks themselves are taking resilience measures. Banks have started to play a massive role in this difficult time as systemic stabilizers for their customers, their employees, and for the countryợs economy at large. They are trying to ensure that essential facilities such as cash and deposit services, credit extension and payments are not disrupted. Especially, in the current difficult time, Bank officials are trying to be vigilant in scanning the existing situation of their client and providing their support accordingly. They are trying to think strategically so that they will pass this difficult time with minimum loss. The majority of our Banks are already considering relaxed payment schedules, interest rate reduction and availability of working capital credit free of interest. Though Banks have taken some of these relief measures as part of natural-disaster response at the moment, the situation will require a much broader support to clients.

The pandemic is also providing the opportunity for Banks to prove their role as systemic stabilizers, delivering services at least in part for social good. Supporting clients in these critical times will deepen customer relationships and re-affirm the role of Banks as key enablers of the economy. Therefore, Banks should show empathy to their customers while making sound business decisions since how they respond to their customers at this difficult time could be pivotal to how Banks are seen for years to come.

5. RECOMMENDATIONS

Since, surviving through and thriving after the health crisis may be a lengthy journey, the following bit of insight may help banks to quickly and wisely think about and plan their immediate and next steps in the swift support they provide to their customers and go a long way to strengthening their relationships.

Banks should focus on re-assessing the risk profiles of their customers and particularly re-classifying borrowers affected by the Corona virus as high and low risk. They should identify which industries and segments are in most imminent danger and quickly analyze and monitor data for early warning signals. Banks should rapidly identify the most affected sectors and customers in order to decide how they can be most supportive to their clients. These will include proactively engaging with clients to understand their situation, segmenting portfolios based on expected needs, developing an internal view of where support measures will be the most effective, and adjusting risk-mitigation actions for early delinquencies and for nonperforming exposures.

Strategizing on new business opportunities is a must in this difficult time. They need to search new banking products that will fit the current situation and enhance their deposit and liquidity measures. Strong internal liquidity-management practices will be required for Banks to be maximally effective in supporting market liquidity and the changing customer borrowing needs. The severity of the crises is likely to lead to larger-than-expected drawings on credit lines. The liquidity coverage reserve per month may not be enough to capture all the risks to liquidity from a longer period contagion. Banks should remain vigilant about liquidity measures to support their customers and make sure that indicators of nonperforming loans are monitored with the right level of attention.

Digitalizing the banking service should be a must in every aspect of the services they are providing at this difficult time. For instance, usually retired employee will go to branches to collect their pension in which case they are highly exposed to the virus. They donꞌt use online banking since they are uncomfortable with recent technologies because of age. Banks need to work toward digitalizing such payments to these type of beneficiaries. Now is the time to educate and support them to use digital channels. They need to reach out and offer training on basic transactions. Also, they need to use it as an opportunity to connect and talk to this segment clients, many of whom are the most vulnerable in the community. Further, identify who is avoiding online and start helping them to master basic transactions like checking a balance and making payments for Cell phone air time bills, Electric consumption bills and Water consumption bills. Banks should further encourage and support other customers to use digital and other virtual channels, wherever possible. To encourage customers to use existing digital products, banks should launch positive and safety-oriented promotion aimed at reducing reliance on branches for services that are digitally available. Banks can also enhance their current digital offerings, identifying key functionalities that can be improved quickly; for example, they can simplify the procedures for accessing the services online.

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While digitalizing their service, Banks should not forget cyber-attack. Banks should do more by deploying Information Security policies that ensure safer Internet banking experience. Alghazo, Zafar and Latif (2017) suggest that the IT security policies should consist of items related to users and machine based learning or Artificial intelligence, which would learn usersô pattern while conducting Internet banking. For example, the Bank artificial intelligence could detect trusted devices like trusted laptop or mobile device, which the user use for his daily banking activities and if the user logged in from a different device, it will send a notification on the registered mobile number of the users. Besides, Banks should strictly inform customers and employees about being suspicious of unfamiliar phenomena in the digital system to counteract attempts of theft. Banks should inform customers to keep their e-banking cards and passwords in a very safe place. Strengthen their system using security tools to identify threats before bad actors can intrude. Fortify their endpoint protection, and make sure devices and software are hardened and patched. Banks need to ensure that their systems have sophisticated anomaly detection tools that can be configured to make sure that any urgent or unusual payment requests ï including changes to the details of an existing beneficiary, unusual amounts being paid ï are checked and automatically trapped before processing the payment. These tools can also assist in trapping duplicate transactions in the platform which could happen due to connectivity breakdown.

Since Banks are providers of essential services to customers and communities, and the markets more broadly, they will need to adopt a carefully segmented approach to workforce management. Particularly, careful attention is required for those in the workforce who provide critical services that are either customer facing or that require infrastructures that are only available at work premises. These include, for example, branch managers, customer service officers, employees in the Treasury function, as well as some facilities and custodial staffs. Further, Banks should keep on encouraging staffs and customers to sanitize themselves frequently and avail the necessary sanitary supplies to them. They should continue to limit office movement and redesign office space to increase the distance between employees. Use their IT development teams to automate routine work and avoid physical contacts (Omariba, Masese & Wanyambi, 2012).

NBE is playing its supervisory role by responding to this fast-moving and extraordinary situation. It is lowering interest rates and increasing liquidity in the financial systems through a combination of measures. It **should** further give the Banks; time to meet rules if they fall short, and hold off on implementing new initiatives so that they will remain focused on maintaining ongoing operations, given the increased difficulties of conducting such operations. NBE has to also allow and communicate clearly that capital and liquidity reserves should support continued bank lending, without adverse consequences for bank management.

All of these suggestions assume that economic activity could re-start shortly, but Banks have to also consider more adverse scenarios. Under more severely strained circumstances, Banks should have to re-think and strategically plan what they should do. As Banks grapple with the many challenges posed by the COVID-19 crisis, it becomes clear that, whatever the eventual outcome, they will learn many valuable lessons about their customers, their own capabilities, and the market as a whole. These will serve them well in the years ahead.

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