St. MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

CHALLENGES OF EXPORT SECTOR EXCHANGING: A CASE OF DASHEN BANK SHARE COMPANY

BY

HAILEYESUS TESFAYE

JUNE 06, 2016

ADDIS ABABA, ETHIOPIA

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SGS/0365/2007A

A THESIS SUBMITED TO St. MARY'S UNIVERSITY, SCHOOL OF GRADUATE STUDIES IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF BUINESS ADMINISTRATION

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APPROVED BY BOARD EXAMINERS

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Internal Examiner	Signature & Date

DECLARATION

I, the undersigned, declare that this is my original work; prepared under the guidance of Mesfin Lemma (PhD).All sources of materials used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher institution for the purpose of earning any degree.

Name	Signature

St. Mary's University, Addis Ababa June 06, 2016

EDORSEMENT

This thesis has been submitted to St. Mary's University, School of Graduate Studies for examination with my approval as a university advisor.

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Advisor   Signature

St. Mary's University, Addis Ababa   June 06, 2016

Table of Contents page

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List of acronyms

LC	Letter of credit
GDP	Gross Domestics product
IMF	International Monetary Fund
CBE	Commercial Bank of Ethiopia
GTP	Growth and Transformation Plan
ETB	Ethiopian Birr
USD	United States Dollar
SSA	Sub Saharan Africa
FSIs	Financial Soundness Indicator
DBE	Development Bank of Ethiopia
UNDP	United Nations Development Progrmme
SMEs	Small and Medium Enterprises
FCY	Foreign currency
IBD	International Banking Department
CAD	Cash against document
TT	Telegraphic Transfer

List of tables **Page**

List of figures **Page**

Abstract

This study was conducted to examine the challenges of export sector exchanging in the case of Dashen Bank S.C. A descriptive study was employed to achieve the goal of this research. The study was conducted on the basis of opinion survey from randomly selected bank professionals working in supervisory position in Dashen Bank. In order to get relevant data from the target population questionnaire and interviews were used. Questionnaire was administered to the bank professionals and interviews were conducted with senior managers. The data collected through questionnaire were analyzed using frequency, percentage and presented using tabulation and appropriate statistical graphs. Furthermore, data collected using interviews were used to triangulate the results found from the questionnaire. The findings generally indicate that, government policies, regulations & NBE directives, and not responding appropriately to the market dynamism have increased the challenges of export sector exchanging. As a result, the study recommends to easing of collateral requirement for exporters, expanding product breadth, introducing fee income for the service already introduced, taking calculative risk as per the market condition, participating in value chain financing for exportable items, devising a policy that encourage professional exporters & participating in tourism & hospitality industry that generate foreign currency.

Key words: Challenges, Export, Export sector exchanging.

CHAPTER ONE

INTRODUCTION

This thesis empirically examines Challenges of Export Sector Exchanging: A case of Dashen Bank S.C.This chapter specifically provides background information of the thesis and it's organized in ten sections. The first two sections deal with background information and followed by statement of the problem. Research question and Objectives of the study are presented in the fourth and fifth section respectively. The sixth part describes the significance of the study. Section seven and eight discusses scope of the study and limitation of the study followed by definition of key terms . The final section presents organization of the research report.

1.1. Background of the study

Banks are very important organizations which aid in the execution of socioeconomic activities undertaken by individuals, business organizations and even sovereign states. They serve primarily as a medium which bridges the gap between surplus and deficit spending units in an economy. This fundamental function of banks generate interest income which has over the years being their major source of revenue, since loans form a greater portion of the total assets of banks. In recent times however, advancements in information and communication technology, increased competition among banking companies as well as the diversity and complexity of businesses and their demands for financial services have compelled banks to consider other banking activities which offer diverse services to clients and beef up revenue generation through fee income (Basil, Olivia & Albert, 2014).

According to Damankah, Anku & Abubakar (2015) the banking business around the world plays a major role in the business of financial intermediation and has grown over the years, resulting in the diversity and complexity of its operations. Based on this development, banks have advanced from what used to be their normal line of business, which is, mobilizing deposits and making loans, to other financial non-interest earning intermediation services such as the provision of financial guarantees, derivative arrangements and the like.

DeYoung and Rice (2003) indicate that commercial bank business models have evolved over the past two decades, and today banks generate an increased portion of their income from no intermediation and/or noninterest activities. For example, between 1980 and 2001 noninterest income in the U.S. commercial banking system increased from 0.77 percent to 2.39 percent of aggregate banking industry assets, and increased from 20.31 percent to 42.20 percent of aggregate banking industry operating income. They also found that increases in noninterest income tend to be associated with higher profitability, higher variation in profits, and a worsened risk-return tradeoff for the average commercial bank during this time period.

Non-interest incomes are basically incomes earned from sources other than returns on advances to bank clients. They are usually fee-generating activities which range from underwriting activities to cash management and custodial services as well as derivative arrangements (Basil *et al*. 2014)

Christos and Geoffrey (2013) also stated that Banks also receive fee income from a number of off-balance sheet items including loan commitments, note issuance facilities, letters of credit, foreign exchange services, and derivative activities (contracts for futures, forwards, interest rate swaps, and other derivative contracts). Letters of credit include standby and commercial letters of credit.

Due to the pressure rest on profitability of traditional banking activity, fee earning activities have greatly increased their contribution to bank profitability. This implies that, for banks to remain competitive with the industry, they need to expand their product breadth and improve sales, relationships, servicing, and investment know-how (Christos and Geoffrey, 2014).

It is taken for granted that financial support from banks to support the export sector is as equally important as getting a market opportunity in the international trade. Therefore, banks, be it private or government, are playing their bridging role through which proceeds from export is channeled. Banks, in turn, collect service charges and/or interest income for the financial service provided, contributing to for the generation of profit for the Bank.

The African Economic outlook (2015) indicated that While the value of Ethiopia's exports have hovered around the USD 3 billion mark since 2011/12, exports as a proportion of GDP have been steadily contracting (from 8.6% in 2011, to 6.5% in 2013 and to 5.6% in 2014). Coffee and gold, which are the country's largest exports, have decreased in both value and volume since 2013 (with coffee down 14.7 percent and gold down 25 percent) due to both external and domestic factors that include poor international prices, and structural supply and logistical challenges. Coffee remains the largest export and continues to account for 22 percent of all export receipts, followed by oil seeds (20%), gold (14%), chat (9%) and pulses (7.7%).Imports have, by value, increased by 20 percent in 2014 to USD 13.7 billion from USD 11.5 billion the previous year, driven by strong demand for fertilizers, petroleum products, and capital goods. This had a deleterious effect on the trade deficit bringing it to USD 10.5 billion (19.1% of GDP) in 2013/14 from USD 8.4 billion (17.7% of GDP) in 2012/13.

As indicated in IMF report of Ethiopia (2013) the country's banking sector comprises one state-owned development bank and 18 commercial banks including two state-owned, with one dominant, CBE, with assets representing about 70 percent of the sector total as of May 2013. The investment requirements of the GTP I are large and securing the associated financing remains a challenge. Due to this Public enterprises continue to provide an expansionary impulse, absorbing much of available credit and foreign exchange. It also stated that Export performance suffered from a decline in prices and weak external demand conditions, growing only 3.2 percent (in nominal terms), while continued infrastructure and industrial investment and higher fuel importation contributed to an increase in imports by 6.3 percent. The worsening of foreign exchange shortage that will results in difficulties in financing imports have been indicated as one of the key risk facing the country.

This situation is compounded by the government's direction, via the CBE, to focus lending and investment to public enterprises generally and the regulatory requirement that a substantial portion of private sector banking's already limited lending capacity be used to purchase NBE bills equivalent to 27 percent of any new loan disbursements thus removing the possibility of investing or lending these funds (Global Center on Cooperative Security, 2014).

The above government policy of directing finance to public enterprises result in the decline of profit obtained through interest income for the private commercial banks. These situations compel private commercial banks to shift their attention to generate non-interest income. One of the major sources of obtaining non-interest income in the banking industry is performing import activities. The decline in export performance of the country is also result in foreign exchange shortage.

Therefore the situation forces commercial banks to compete for channeling of export proceeds through their banks which is the major assets to perform import activities.

Income generated from import activities constitute the major share of the profit obtained by Dashen Bank S.C. One of the main sources of this income is a foreign currency generated by Exporters who make their foreign transactions through Dashen Bank S.C.

Table 1: Comparison of total income versus foreign income of Dashen Bank S.C. ('000) Birr

Year	2010/2011	2011/2012	2012/2013	2013/2014	201/2015
Total interest income	603,677	897,730	1,020,736	1,140,821	1,414,219
Service income-foreign	65,770	148,744	123,880	173,331	189,744
Letter of credit opening charge	46,136	100,001	105,509	156,143	169,131
Net profit	337,991	489,009	455,067	534,363	546,850

Source: Annual report of Dashen Bank S.C.

As shown on the table above the share of non-interest income generated from international banking transaction has grown from 33 percent on 2010/2011 to 65 percent on the year 2014/2015.

Thus, a challenge will occur to Dashen Bank in the process of attracting Exporters to exchange their foreign currency proceeds with provision of different credit facilities and other incentives in order to generate profit.

1.2. Background of the study Area

Dashen Bank S.C. is a privately owned company established in 1995 in accordance with the "Licensing and Supervision of Banking Business" Proclamation No. 84/1994,now superseded by Proclamation No. 592/2008,"A Proclamation to Provide for Banking Business" to undertake commercial banking activities(Annual Report of Dashen Bank S.C., 2011/12). Because of the peculiar natures of the financial sector industry, Banking in Ethiopia is highly regulated by NBE being subject to a separate banking business proclamation unlike to other industries which are formed according to the commercial code of Ethiopia. NBE has issued different directives relevant to the banking industry in response to the economic and market conditions that need to account for domestic and international factors of economic, political-legal, socio-cultural and technological phenomenon.

1.3. Statement of the problem

Most of the profit earned by commercial banks in Ethiopia are generated from loans and advance extended to business from fund mobilized from the public in the form of deposit. However, recently the liquidity of private commercial banks has come under pressure due to various reasons. Also export proceeds channeled to Private Banks from Exporters have severely decreased as a result of measure taken by NBE. Due to this the profit obtained from interest income activities are decreased.

Due to this decrease of profit, private commercial banks are highly involved in channeling of export proceeds through them, which is the major source of generating foreign currency to beef up their non-interest income through import activity. This involvement creates high competition among banks in order to attract exporters by providing different incentives. Therefore, as a bank professional, I wonder to identify the root cause of this competition with concrete evidence and to suggest variable ways to minimize the challenges.

The Growth and Transformation Plan I and the subsequent directives issued by NBE that dictates the activities of commercial Banks have brought significant shift in the way banks doing business.

The NBE directive that compels all exporters shipping items to China should make their transactions through Commercial Bank of Ethiopia reduces the amount of export proceeds shared by private banks. It also dictates commercial Banks not to give export permit to a business organization who took export loan from Development Bank of Ethiopia.

The April 2011 directive requiring private commercial Banks to hold 27 percent of new loan disbursements in low-yield NBE bills resulted in the shortage of loan able fund and an increase in interest expense.

The NBE directive requiring banks to hold NBE bills equivalent to 27 percent of their lending has triggered unnecessary portfolio adjustment by banks. Since the directive initially did not discriminate short-term from long-term loans, private banks adjusted their portfolios toward long-term loans to avoid high NBE-bills purchase due to higher turnover of short-term loans. They also raised fees and commissions to make up for lower returns on NBE bills holding. The subsequent amendment to the NBE directive also requires banks' short-term loans to be at least 40 percent of total loans at any given time.

The constraints on private banking activities and allocation of foreign exchange to priority public investment projects, have contributed to the recent foreign exchange shortages, especially for the private sector. The subsequent amendment also restrict banks' to limit their selling rate not exceeding 2 percent from NBE interbank foreign exchange market indicative buying rate of the day.

The impact of these policy measures has been to crowd out private sector credit even if commercial banks are currently enjoying high profitability from higher non-interest income and interest rate spreads which is further squeezing out the private sector.

Due to the above stated reasons, private commercial banks' objective of establishment i.e. profit maximization come under pressure and they are looking a means to expand their income earning stream. One of these areas is to actively involve in export sector activities that will help them to increase their profit. In this activities of export exchanging, private commercial banks face different challenges. Dashen Bank S.C. is among the private commercial Banks that face these challenges.

Therefore, the purpose of this research paper is to assess and describe challenges of export sector exchanging a case of Dashen Bank S.C.

The researcher found one research work done in Ethiopia concerning Export Trade Financing which was done by Meseret Tadele (2015) entitled with “Assessment of Export Trade Financing practices of commercial Banks in Ethiopia” Her major finding indicates that, lack of finance has been the a major problem to the growth of Export trade. But her finding did not looking for and giving attention to the challenges faced by commercial Banks in attracting Exporters in order to obtain foreign currency. Hence, apart from this conducted research work that has been mentioning above, the researcher believes that dealing with the extent to which the challenges that has been faced by commercial Banks in export sector exchanging (the case of Dashen Bank S.C.) is worth discussing and addressing issue.

1.4. Basic Research Questions

In line with the above statement of the problem, the following research questions are formulated to be answered as a result of the research study.

- What are the major challenges encountered by Dashen Bank S.C. in the course of attracting export sector exchanging?
- What instances exist in non-compliance with policies, procedures and directives while performing export sector exchanging?
- What are the risks faced by the bank with respect to Export sector Exchanging?
- What could be done to improve export sector exchanging?

1.5. Objective of the study

1.5.1. General Objective of the study

The objective of the study is to examine the challenges of export sector exchanging by Dashen Bank S.C.

1.5.2. Specific objective of the study

- To assess the existing export sector exchanging practice of Dashen Bank S.C.in order point out its major challenges.
- To identify the reasons for systematic interpretation of policies, procedures and directives associated with Export sector exchanging.
- To investigate the risks associated with export sector exchanging.
- To suggest strategies for improving the export sector exchanging practice.

1.6. Significance of the study

Due to the trade deficit gap observed in our country foreign business, export sector activities becomes one of the key areas that commercial banks participate, owning to the benefit obtains from the foreign currency generated by such business. It helps commercial banks to increase their deposit, customer base, profitability and position in the banking industry. This study is therefore significant to:

- Commercial Banks–to develop suitable strategy to handle the problem systematically.
- NBE – to understand the real situation and to make necessary corrective action.
- Scholars – it will initiate further research over the impact of export sector exchanging on the country.

1.7. Scope of the study

1.7.1. Area Delimitation

The scope of the research is limited to challenge of export sector exchanging case of Dashen Bank S.C. Staffs of the banks who develop experience and professionalism in the field of export financing and export and import activities are the target respondents. Due to the confidentiality nature of the Bank’s to access information, the study limited its breadth to professional personal perceptions and officially disclosed financial data of the Bank.

1.7.2. Subject Delimitation

This study is restricted to assess, identify and investigate issues about challenges of Export sector Exchanging case of Dashen Bank S.C. Since, there has not been much research executed with the issue of export sector exchanging in Ethiopia, the research forced to use other countries studies to review most of the literature.

1.8. Limitation of the study

Due to the confidentiality nature of banking business, there is a limitation to access documents and data. In addition, there is not much research done in the area in the Ethiopia context there was no enough secondary data which could supplement the primary data. Time concern is also one of the limitations that limit the scope of the study.

1.9. Defintion of Key terms

Bills Receivable: A comprehensive term that includes the total of all notes and trade acceptances given by customers, usually in payment of merchandise, which the debtors must pay at maturity (Gagan, 2001)

Deposit: An amount of funds consisting of cash and /or checks, drafts, coupons, and other cash items that may be converted in to cash upon collection (Gagan, 2001)

Foreign Exchange: The instruments used for international payments (i.e. currency, checks, drafts, and bills of exchange) (Gagan, 2001).

Exchange: Any exchange for trading in securities or commodities (Gagan, 2001).

Export Credit Guarantee: An assurance usually provided by a government agency that safeguards banks against losses that could be arise from financing export transactions (OECD, 2009).

Export: To ship an item away from a country for sale to another country (Gagan, 2001).

Loan: A business transaction between two legal entities where by one party (the lender) agrees to “rent” funds to the second party (the borrower).The funds may be “rented” with or without a fee. This fee is called interest or discount (Gagan, 2001).

Pre-shipment finance: Financing advance to the exporter to support the costs of activities undertaken prior to shipment of the goods (i.e., purchase of inputs and components, payment of salaries, wages and overhead, etc.) (Asiedu-Appiah, 2005).

Post-shipment finance: Credit covering the company’s financial needs for the period following the shipment to ensure sufficient liquidity until the shipped products have reached the purchaser and payment has been received (Asiedu-Appiah, 2005).

1.10. Organization of the Paper

The research report has five chapters, which includes:

The first chapter dealt with background of the study, the basis upon which the study was made (problem statement), definition of terms, and delimitation of the study, significance and purpose of the study as well as study objectives and research questions.

The second chapter contained basis of the study by reviewing the existing knowledge and literature about challenges of export sector exchanging as mentioned by various several scholars, authors and academicians.

Chapter three presented the methods and procedures that will be used in sample selection, data collection, analysis and presentation. It includes; sampling techniques, data collection methods, study population, sources of data, sampling and sample size, and data presentation and analysis methods.

Chapter four focused on analysis and interpretation of the data collected through questionnaire and interview.

Chapter five comprised four sections, which include summary of findings, conclusions and recommendations.

CHAPTER TWO

RELATED LITERATURE REVIEW

This chapter of the paper explains, discuss and present facts and theories that are reasons for challenges of Export sector exchanging. The first section explain the facts that are manifested on the Ethiopia banking industry, export activities, economy and the impact of GTP-I. The second part presents the basic theories and reasons that create challenges on export sector exchanging.

2.1. Overview of Banking History in Ethiopia

Belay (1987) stated that modern banking began in Ethiopia, when the Bank of Abyssinia was first established in Addis Ababa under a 50-year franchise agreement with the then British owned National Bank of Egypt. Later, in 1931, the Bank of Abyssinia was legally replaced by Bank of Ethiopia shortly after Emperor Haile Sellasie I came to power. Bank of Ethiopia was purely owned by the government and members of the Ethiopian aristocracy, which make it the first indigenous bank in Africa. It was also authorized to issue notes and coins and to act as the government's bank. The Bank of Ethiopia was in operation for a few years until 1935, and ceased to function because of the Italian invasion. However, during the period of the Italian occupation (1936-41), many branches of the Italian Banks such as Banco d'italia, Banco de-Roma, Banco Di-Napoli and Banco Nazianali del lavoro were operational in the main towns of Ethiopia.

Following this, in 1943, the Ethiopian government established the 'State Bank of Ethiopia'. The establishment of this Bank by Ethiopia was a painful process since Britain was against it. This bank was operating both as commercial and central bank until 1963. Then, later the Ethiopian monetary and banking law that came into force in the year 1963 separated the functions of the State Bank of Ethiopia in to central and commercial banking by establishing the National Bank of Ethiopia (NBE) and the Commercial Bank of Ethiopia (CBE) respectively (Habtamu, 2012). CBE performed commercial banking activities such as current and saving account, issuance of drafts, mail and telegraphic transfer, opening of letter of credit and granting of loans. The bank was also solely performed foreign currency and foreign exchange dealing. The NBE was re-established in 1976 (Alemayehu, 2004).

The 1963 law allowed for other commercial banks to operate, including foreign banks provided that they were 51% owned by Ethiopians. The first private commercial Bank, Addis Ababa Bank was established by Ethiopians and started its operation in the year 1964 with a capital of Birr (ETB) 2 million in association with National and Grindlay Bank, London which had 40 percent of the total share (Habtamu, 2012).

Following the fall of the imperial government in 1974 and implementation of command economy, all privately owned financial institutions including three commercial banks,thirteen insurance companies and two non-bank financial intermediaries were nationalized on 1 January 1975 (Alemayehu, 2004). The nationalized banks were then re-organized and one commercial bank, the Commercial Bank of Ethiopia; two specialized banks - the Agricultural and Industrial Bank , later renamed as the Development Bank of Ethiopia (DBE) and the Housing and Savings Bank (HSB) later named as the Construction and Business Bank (CBB) currently merged with CBE; and one insurance company, the Ethiopian Insurance Corporation were formed (Alemayehu, 2004).

After the removal of the Derg Regime in 1991 and the liberalization policy in 1992, Ethiopia began its transition to a market oriented economic policy. The Monetary and Banking proclamation No.83/1994 and the Licensing and Supervision of Banking Business Proclamation No.84/1994 had allowed the establishment of private commercial banks and laid down the legal basis for investment in the banking sector, which has marked the beginning of new era in the Ethiopian banking sector development. Subsequent to issuance of the new proclamation for establishment of private banks, many private banks became operational in the Ethiopian banking sector. The National Bank of Ethiopia was also re-established by Proclamation No. 591/2008 which gives the power to license and supervise banks under article 5(7). Furthermore, it has the right to exercise such other powers and functions to execute its purposes as central bank customarily perform (Habtamu, 2012).

Although the banking industry in Ethiopia has about hundred years of experience, the sector is not yet well developed and is still in its growing stage. The commercial banking sector in Ethiopia is providing the most basic banking products including credit facility (lending),deposit Service, international banking services, fund transfers, and other Services like card payment, and automatic tailor machine (ATM) services. Recently, most of the banks are striving to improve their service delivery through introduction of different IT solutions (NBE, 2010).

Mobile banking and agency banking is also under way by most banks as per the directive issued from National Bank of Ethiopia. Recent trends also indicate that banks are competing in the market on the basis of branch expansion, advertisements, raising capital bases, improved service delivery, and investment on IT software and infrastructure to enhance their resource mobilization process. However, these technological innovations are still at their infant stage and the sector needs further enhancement to meet its customer expectations (NBE, 2010).

According to annual reports of National Banks of Ethiopia (2012), the development progress of banking sector in Ethiopia is witnessed in current situations. This development is described in terms of numbers of banks and their branches, total assets, deposits, employment creation etc. The total numbers of commercial banks reached 18 with aggressive expansion of branches though there is still huge unbanked population in the country.

2.2. Export sector activities

Export is positively influenced the economic growth of the country through generating foreign currency and facilitating interaction among different nations. Ethiopia has been engaged in international trade through exporting and importing of different commodities. Recently due to the direction of government policy and development of the privet sector the exportable items have increased in size and number.

Despite the fact that Ethiopia generates foreign currency from aid, loan from world financial institutions, grant, remittance, etc, proceeds earned from international trade plays its own role in making up the entire national income. The government has also committed to bring about significant result towards boosting export income by creating conducive environment for exporters as well as upholding farmers that supply exportable products. The GTP document also addresses the need to focus on export sector so as to realize the enthusiasm of lining up to the level of middle income countries. Export is, therefore, the potential growth area that has been given great attention by the government.

In light of the opportunity opened up in the export sector, many private investors are engaging themselves in this area. It is taken for granted that financial facility from banks to support the export sector is as equally important as getting a market opportunity in the international trade. Therefore, banks, be it private or government, are playing their bridging role through which proceeds from export is channeled. Banks in turn obtain commission and service charges by selling the foreign currency obtained from the exporters to various importers.

Export proceeds help banks to increase profit and their overall competitiveness in the industry, thus commercial banks are aggressively engaging in attraction of Exporters by providing different incentive mechanisms. Attracting and retaining exporters give rise to generation of foreign currency, which in turn makes foreign currency available for import sector. Hence, export and import are two sides of the same coin. The need to boost export financing is therefore a determining factor for existence of import.

Therefore, banks used different strategies of attracting exporters to obtain export proceeds that will help them to gain more income by selling it to the importers. Some banks used a method of converting exporters' export proceeds with mid-rate of the prevailing exchange rate, others convert the proceeds of the exporters' with the selling rate of the prevailing exchange rate that will increase the local currency credited to the exporters account. They also made a deal with the major exporters to allocate part of their export proceeds either to the exporters themselves or to other customers presented by the exporters in order to import goods. Others also provide different kinds of export loan with attractive interest rate, terms of payment, with lower collateral requirement and clean basis. Banks also arrange a loan facility for customers of the exporters who buy their imported goods.

Due to the practice of banking is in its infant stage and the supervision capability of the NBE is not able to make early prevention of the activities performed by commercial banks ,NBE has issued at different times different letters and directives that deter banks from such practices . However considering the basic formation of banks and exporters i.e. generating profit, export financing remains a challenge unless the trade deficit of the country comes to at acceptable level.

2.3. Commercial Banks activities in Ethiopia

A number of theories have been advanced to explain why banks, and more generally financial intermediaries, exist. In most of these theories, banks exist because they mitigate a host of problems that otherwise prevent liquidity from flowing directly from agents with excess liquidity (depositors) to agents in need of liquidity (borrowers). These problems arise because of informational asymmetries, contracting costs, and scale mismatches between liquidity suppliers and liquidity demanders. Intermediation-based theories of financial institutions see banks as the solution to these problems because: banks have a comparative advantage at gathering information on borrower creditworthiness; banks are better able than individual lenders to monitor borrowers; banks provide increased liquidity by pooling funds from many households and businesses and by issuing demandable deposits in exchange for these funds; and banks diversify away idiosyncratic credit risk by holding portfolios of multiple loans (DeYoung and Rice, 2004).

Banking industry liberalization is a key consideration in a range of countries, from large economies such as India to regional neighbors such as Uganda. Furthermore, the 2008 global financial crisis has raised some important questions about the merits of uncontrolled banking industry development (Global Center on Cooperative Security, 2014).

In Ethiopia Banking industry financial services have been improving and the total number of bank branches reached 2 208 in 2014 (about 34 percent of which are located in Addis Ababa), bringing the ratio of bank branches to population from 49 675 to 39 834 (Zerihun, W., Haile K., and Wakaiga, J., 2015).The banking system is expanding and the structure of its liabilities and assets is evolving. Growth in deposits has been robust, as commercial banks have branched out in previously unbanked areas (IMF, 2014). However, Out of a population of nearly 90 million, only 7.1 million have deposit accounts, i.e., less than 8 percent of Ethiopians had a banking account (IMF, 2013).

As described by Global center on cooperative security (2014) Compared to most countries, Ethiopia has taken a cautious approach toward the liberalization of its banking industry. For all intents and purposes, its industry is closed and generally less developed than its regional peers. The industry comprises one state- owned development bank and 18 commercial banks, two of which are state-owned, including the dominant Commercial Bank of Ethiopia (CBE), with assets accounting for approximately 70 percent of the industry's total holdings. The banking industry's nonperforming loan ratio is commendably low, and profitability is good, but the dominance of public sector banking certainly restricts financial intermediation and economic growth. It contrasts with regional and international peer countries where banking industries have a much higher share of private sector and foreign participation.

Zerihun, *et al*. (2015) stated that the total capital of the banking system is ETB 25.6 billion (USD 1.28 billion), of which private banks account for 53.9 percent. The Commercial Bank of Ethiopia, the biggest state-owned bank, accounted for 34.2 percent of the total capital of the banking system. However, the financial sector remains shallow with a limited range of services. The financial sector remains closed to foreign participation and capital markets are non-existent. Lending is mainly collateral based and the vast majority of small entrepreneurs lack the necessary collateral.

In addition, IMF (2014) described that the share of savings and time deposits in total deposits has risen and competition for time deposits has pushed up interest rates on them. Banks are tapping to new areas of electronic and mobile banking to increase profitability and maintain the market share. The initial focus of this expansion is on further deposit mobilization as opposed to money transfer and other transactions.

Ethiopia intentionally has used tools such as low interest rates, currency appreciation, and targeted usage of credit and foreign exchange to support public enterprises and drive economic growth. The lack of domestic savings opportunities provided by private banks and the limited available access to bank credit for small businesses dramatically restricts economic growth potential. Public sector banks will inevitably lead investment in key developmental projects such as those involving infrastructure, but broad-based development is required in order to create sustainable economic growth, and this investment typically comes from private sector banks as their deposit base grows. This strategy has succeeded but led to the neglect of private sector development, a low national savings rate, a loss of international competitiveness, and an increase in the trade deficit. The expansion of private sector banking, as well as a more realistic foreign exchange control regime, will be key to addressing these issues and to maintaining growth in economic development (Global Center on Cooperative Security, 2014).

The banking sector's total assets in Ethiopia increased by 13.3 percent over the one-year period up to June 2014, but financial intermediation remains low. Three public banks constitute 77 percent of total assets of the banking sector. Within this group are the Commercial Bank of Ethiopia (CBE) and the Development Bank of Ethiopia (DBE). CBE holds 80 percent of the total outstanding loans and investment used to finance public investments and DBE is a large holder of treasury bills. Consequently, financial intermediation remains low and on a declining trend. The share of private sector credit of the total banking sector credit has consistently been declining from 66.5 percent in 2007/08 to 40.1 percent in 2013/14. Similarly, the ratio of private sector credit to GDP declined from 15.4 percent in 2003/04 to 10.9 percent in 2013/14, and remained below the SSA averages for the period reviewed. Overall, credit as share of GDP is on a downward trend and below the SSA average since 2008. This finding is consistent with the trend of demonetization observed for Ethiopia in the 2013 Ethiopia Economic Update (World Bank, 2015).

In addition, Global Center on Cooperative Security (2014) described that as per the 2012 Ethiopia Enterprise Survey highlights access to finance as the major developmental constraint for small (38 percent of those surveyed) and medium-sized (30 percent) businesses. This compares to a sub- Saharan African average of 21 percent and 15 percent, respectively.

The financial soundness indicators (FSIs) do not indicate immediate risks to the health of the banking sector. Although FSIs based on aggregated information can mask potential vulnerabilities in individual banks, on average the banks appear to be well-capitalized and profitable. The system-wide capital adequacy ratio stood at a comfortable 17.5 percent at the end of March 2014, as opposed to the 8 percent minimum required. Return on assets and return on equity showed comfortable performance, at 3.1 percent and 44.6 percent, respectively. Asset quality has also improved over time, with nonperforming loans at less than 3 percent of banks' total loan portfolio at the end of March 2014. On the other hand, banks' operating costs appear to have increased and their liquidity buffers have shrunk. At the end of March 2014, the system-wide liquidity ratio was only slightly above the 15 percent minimum requirement. Notwithstanding the satisfactory FSIs, the systemic importance of the CBE is growing with its role in mobilizing the resources and financing the public sector investment program (IMF, 2014).

Also World Bank (2015) stated that on average, banks appear to be well capitalized and profitable. Compared with 2013, total capital of the banking industry increased by 13.2 percent and reached Birr 26.4 billion by the end of June 2014. The liquidity situation however is showing some signals of stress in the system: at the end of March 2014, the system-wide liquidity ratio (liquid assets to total assets) was only slightly above the 15 percent minimum requirement. Global Center on Cooperative Security (2014) stressed that the underdevelopment of the financial sector restricts economic growth because it dramatically reduces the ability of the banking industry to offer savings products, which in turn hinders greater bank lending to business and entrepreneurial developments.

2.4. Influence of Government plans, policies and Directives in the Banking Sector

Banks have faced increased competition in retail markets due to deregulation. Well-managed banks responded to these competitive pressures by becoming more cost-efficient and more revenue-efficient. This included offering customers an expanded array of new and/or nontraditional fee-based products, selling increased amounts of existing fee-based products, pricing fee-based products more efficiently (DeYoung and Rice , 2003).

Bhattacharya, Boot & Thakor (19980 stated that, since the mid-1980s, dramatic changes in regulation demand composition and technology have modified the structure and the boundaries of credit markets. Albertazzi and Gambacorta (2009) also explained that all these changes have strengthened competition, especially in traditional lending activity, reduced intermediation margins and encouraged banks to diversify their sources of revenue and increase efficiency in production and distribution.

Financial stabilization and deregulation have had important implications on the income statements of banks. There has been a shift from net interest income to non-interest income not dependent on traditional financial intermediation. The decline in interest margins has changed the traditional role of banks and has forced them to search for new sources of revenue. Structural changes such as industry deregulation, new information technologies and financial innovation have also increased the importance of fee income. Financial sector regulators have a keen interest in the banking industry due to the costs associated with insolvency, systemic risk, and potential disruptions in the allocation of credit. Similarly, borrowers, and investors remain concerned about the diversification of banking operations which are expected to yield mutual benefits (Damankah, *et al*. 2015).

As indicated on Global Center on Cooperative Security (2014) the development of a vibrant and active private banking system that complements existing public sector work is considered important to Ethiopia's economic progress by a range of experts, including the World Bank, the African Development Bank (AfDB), and the International Monetary Fund (IMF). These bodies view the expansion of the private banking system in a prudent and controlled manner as key to the success of Ethiopia's "Growth and Transformation Plan (GTP)," an ambitious five-year development plan launched in 2010 to assist the country in reaching "middle income" status.

The Global Center on Cooperative Security (2014) also indicate that the Growth and Transformation Plan" (GTP) spans 2010/11–2014/15 and is aimed at sustaining rapid, broad and equitable economic growth, and achieving the Millennium Development Goal (MDG). The longer-term objective is to eradicate poverty, bring about structural transformation of the economy and reach a middle-income status by 2020–25.The GTP projects an average growth rate of 11.2 percent over the 5 year plan period in the base case. The plan seeks to ensure sustainability of growth by pursuing its objectives within a stable macroeconomic framework. The structural transformation of the country is pursued through scaled-up public investments, such as in roads, railroads, hydro-electric generation plants, sugar factories, housing, and other projects.

This situation is compounded by the government's direction, via the CBE, to focus lending and investment to public enterprises generally and the regulatory requirement that a substantial portion of private sector banking's already limited lending capacity be used to purchase NBE bills equivalent to 27 percent of any new loan disbursements, thus removing the possibility of investing or lending these fund (Global center on cooperative security, 2014).

IMF (2013) revealed that Developments in the first two years (2010/11–2011/12) of the GTP suggest that the required external financing is not materializing, and the investment drive in the priority projects through directed domestic credit is squeezing the availability of credit and foreign exchange for the rest of the economy.

Also IMF (2014) indicated that Public enterprises continue to provide an expansionary impulse, absorbing much of available credit and foreign exchange. They borrowed heavily from the banking system and externally to finance their investments. Banking system credit flow to public enterprises in the first ten months of 2013/14 was some 4 percent of GDP, not taking into account non-bank financing of the Grand Renaissance Dam.

Ethiopia's overall doing Business 2015 ranking is 132nd out of 189 economies, down from 129th the previous year. Access to credit and financial services and working premises remain areas of weaknesses. The lack of a level playing field between state-owned and party-affiliated firms and private firms is also a hindrance to competition (Zerihun, *et al*. 2015) .

The reserve requirement ratio has been further lowered recently (March 2013) from 10 percent to 5 percent, following an earlier (January 2012) lowering by 5 percentage points, and NBE sterilized the resulting liquidity injection through the sale of certificate deposits, reflecting lack of clarity in monetary policy decision-making (IMF , 2013).

Also IMF (2014) stated that the NBE bill purchase requirement continues to severely constrain private commercial bank operations. The measure, introduced in 2011, requires commercial banks to purchase NBE bills equivalent to 27 percent of the new loan disbursements. It was intended to fund the Development Bank of Ethiopia (DBE) to provide project financing in priority areas at preferential interest rates, but it has only been partially effective in this regard given that a significant proportion of such funding has been invested by DBE in treasury bills. In the presence of the reserve requirement, the liquidity requirement, and an additional requirement for banks to hold 40 percent of their loans in short-term credits, this measure remains a major distortion in financial intermediation.

UNDP (2014) indicated that the central bank pursued a tight monetary policy in 2011/12, where the reserve money showed 4.4 percent annual decline, which have contributed to the decline in inflation. But there are signs that the bank is pursuing expansionary monetary policy as reserve money registered a growth of 13.6 percent in 2012/13; this is in contrast to a decline of 4.4 percent in the preceding year. In addition the bank lowered reserve requirements ratio of commercial banks further to five percent in March 2013 from 10 %.

The financial system remains bank-centric and dominated by one state-owned bank, the CBE. Although the number of privately-owned institutions and their share of total assets are gradually increasing, the banking sector remains highly concentrated and segmented, and the CBE's dominant position creates an uneven playing field in the industry (IMF , 2014).

Current policies, including constraints on private banking activities, directed lending with artificially low real interest rates and allocation of foreign exchange to priority public investment projects. Some of these policies undermine the authorities' growth objectives and have contributed to the recent foreign exchange shortages, especially for the private sector (IMF, 2013)

The requirement for commercial banks to hold NBE bills remains a distorting measure that adversely impacts the cost and quantity of private sector credit provided by commercial banks, notwithstanding their current high profitability (IMF, 2014).

The NBE directive requiring banks to hold NBE bills equivalent to 27 percent of their lending has been distortionary and has triggered unnecessary portfolio adjustment by banks. Since the directive initially did not discriminate short-term from long-term loans, private banks adjusted their portfolios toward long-term loans to avoid high NBE-bills purchase due to higher turnover of short-term loans. They also raised fees and commissions to make up for lower returns on NBE bills holding. The subsequent amendment to the NBE directive also requires banks' short-term loans to be at least 40 percent of total loans at any given time (IMF, 2013).

Huge public investments with focus on infrastructure and pro-poor sectors explain much of the economic performance from the expenditure side. Government investments have mainly been carried out from domestic resource mobilization and augmented by external resource inflows. Domestic savings has been growing significantly in the past few years from 12.8 percent of GDP in 2010/11 to 17.7 percent of GDP in 2012/13. The newly introduced savings instruments (bonds) and expansion in financial services through the aggressive opening of banking branch networks have contributed to the surge in the domestic savings (UNDP, 2014).

However, as indicated on IMF (2013) the Ethiopian's authorities disagreed with IMF staff assessment of the impact of the 27 percent NBE bill requirement arguing that private banks remain highly profitable. They disagreed that private banks are raising fees and commissions to make up for lower returns on NBE bills holding. The authorities indicated that NBE was vigilant in taking actions to mitigate any risks that would emerge. They had adopted risk-based supervision and assigned a desk officer to each bank and were holding monthly prudential meeting with banks as well as conducting quarterly credit and liquidity risk stress testing.

Ethiopia has registered remarkable economic performance with annual growth averaging 10.9 percent over the past ten years (UNDP, 2014).

Zerihun, *et al*. (2015) stated that Supported by a slowdown in global commodity prices, the Government of Ethiopia succeeded in containing annual consumer price inflation to 7.1 percent in December 2014 (down from 39.2 percent in 2011) by pursuing a tight monetary policy and using base money as its nominal anchor.

The controlled unleashing of private sector banking should bring significant benefits: greater savings, increased supply of credit to businesses, and support for start-up activity. It will also bring secondary benefits, such as greater exports and an increased tax base, which will create a virtuous cycle of economic growth and employment (Global Center on Cooperative Security, 2014).

2.5. Impact of Ethiopia's Export and Import activities on the Banking Industry

Under the new Ethiopia reform program, foreign trade and exchange rate regimes were liberalized; prices of domestic inputs and finished goods were decoupled from arbitrary government regulation and interference; public sector reform that accorded autonomy to the state owned enterprises (SOEs) was implemented; some enterprises were privatized; the financial market was reformed to allow private sector participation in commercial banking, insurance and micro credit services; export tariffs were abolished; export subsidies to domestic, export-oriented firms were eliminated and were replaced by incentives that provided the duty-free importation of raw materials (Wondemhunegn e., n.d).

Despite import-related demand for foreign exchange, the exchange rate adjusted only gradually, in line with the NBE's managed float policy. While the premium in the parallel market remained modest (4.6 percent in May), the gradual nominal depreciation was likely insufficient to address excess demand for foreign exchange, and prevent an appreciation of the real effective exchange rate and loss of competitiveness (IMF, 2014).

Most important, in October 1992, Ethiopia's national currency, the Birr, saw a major free fall when it was devalued by 242 percent from its pegged rate of 2.07 per US dollar to 5 per US dollar, signaling the first major onslaught on the value of Birr which since then has been virtually in a slippery slope. The authorities defended and justified such massive, one-time devaluation by pointing to the high premium on the parallel market which was close to 238% on the eve of the devaluation measure. In May 1993, the transitional government also introduced a, Dutch auction system for foreign exchange with the objective of liberalizing the foreign exchange market. The auction system operated side by side with the official exchange rate until the two were finally unified in July 1995. Before the unification, the dual-exchange rate regime was maintained by an amalgam of government decree (relevant for the official rate) and quasi-market mechanism (which applied to the auction rate)(Wondemhunegn e., n.d).

While the value of exports has hovered around the USD 3 billion mark since 2011/12, exports as a proportion of GDP have been steadily contracting (from 8.6 percent in 2011, to 6.5 percent in 2013 and to5.6 percent in 2014). Coffee and gold, which are the country's largest exports, have decreased in both value and volume since 2013 (with coffee down 14.7 percent and gold down 25 percent) due to both external and domestic factors that include poor international prices, and structural supply and logistical challenges. Coffee remains the largest export and continues to account for 22 percent of all export receipts, followed by oil seeds (20%), gold (14%), chat (9%) and pulses (7.7%) (Zerihun, *et al*. 2015).

IMF (2013) indicated that the external current account deficit widened slightly to US$3 billion in 2012/13 from US$2.8 billion in 2011/12, reflecting a weaker trade balance, although it improved as a ratio of GDP from 6.6 percent to 6.4 percent. Export performance suffered from a decline in prices and weak external demand conditions, growing only 3.2 percent (in nominal terms), while continued infrastructure and industrial investment and higher fuel importation contributed to an increase in imports by 6.3 percent. Transfers brought in a net inflow of around US$5 billion due to a surge in net private transfers that more than offset a decline in official transfers.

In addition UNDP (2014) described that the foreign reserve of the country, measured by months of imports cover, has deteriorated in the past two years. The gross reserve reached 1.9 months of imports in 2012/13 against 3.1 months of imports in 2010/11 and target of 3.0 months of imports. This is mainly because of Ethiopia's export continued to be primary agricultural commodities (70 %) indicating that export diversification is still low and the earnings from the sector has not been growing as planned as it vulnerable to price fluctuations. Agricultural products such as coffee, oilseeds, khat, leather and leather products, pulses, cut flower, fruits and vegetables and live animals constitute 70 percent of Ethiopia's exports. Coffee continues to be the leading export item accounting for 24 percent of total export values, followed by gold (19%), oil seeds (14%), Khat (9%), pulses (8%), flower (6%) and live animals (5 %). These leading seven export items account for over 85 percent of export earnings of the country indicating that export diversification efforts need to be harnessed. Secondary sector exports, especially manufacturing, are still low although increasing. In recent years, there has been rapid growth in non-traditional exports with the share of non-coffee exports rising to 75.8 percent in 2012/13 in contrast to 40 percent in 1997. The destinations of Ethiopian exports were mainly Europe (43.6%) followed by Asia (30.3%) and Africa (21.3%).

IMF (2014) further emphasized that The current account deficit, nonetheless, is estimated to have widened from US$2.8 billion (6.0 percent of GDP) in 2012/13 to US$3.5 billion in 2013/14 (7.1 percent of GDP). It was financed largely by concessional and non-concessional inflows as well as by foreign direct investment (FDI). Substantial inflows on the capital account also facilitated a modest build up in the NBE's reserves.

In 2012/13 due to continued vulnerability to international commodity price fluctuations, export values suffered a marginal decline by 2.3% while imports increased by 4.1%. Private transfers, specifically remittances, continued to surge, while there have been a declining trend in official transfers since 2010/11. Official transfers however, have rebounded in the first quarter of 2013/14 to reach US$538.8 million compared to US$184.1 million in the same quarter of the previous year. Meanwhile, remittances increased by 5.3 % and stood at US$619.6 million in the first quarter of 2013/14(UNDP, 2014).

Merchandise exports expanded in value by 5.6 percent in 2013/14, to reach USD 3.25billion, although their GDP share decreased from 6.5 percent to 5.9 percent year on year. Imports, mainly from Europe and Asia, rose from USD 11.5 billion in 2012/13 to USD 13.7 billion in 2013/14, causing the trade deficit to deteriorate (from USD 8.4 billion to USD 10.5 billion). The country faces a challenge to rebuild its foreign exchange reserves however, as these have fallen to less than two months' import cover (Zerihun, *et al*. 2015)

In the first six months of 2013/14, the total export goods valued at US$1.3 billion which was 21.3 percent lower than the value earned in the preceding six months of the previous year. On the other hand, the total import payment has reached US$6.4 billion in the same period indicating a 13.3 percent increase compared to same period last year (UNDP, 2014).

The weakening of trade balance reflects a sharp decline in the price and volume of Ethiopia's main commodity goods (coffee and gold) due to subdued external demand conditions. This was offset, however, by solid volume growth in other exports such as oilseeds, pulses, leather products, live animals, and flowers. Demand for imports remained strong, driven by the investment-led economic growth. Imports of goods are estimated to increase by 12.7 percent in 2013/14, led by fertilizers, petroleum products, and capital goods (IMF, 2014).

Though still fragile and vulnerable to the vagaries of nature and aid money, the export sector in Ethiopia has shown tangible improvements since the country abandoned the fixed exchange rate regime in 1991 and implemented a series of macroeconomic stabilization and adjustment programs (Wondemhunegn e., n,d**).**

Despite continued efforts to increase volume of exports in 2012/13, value of exports declined by 2.3 percent, once again underlining the vulnerability of Ethiopia's export to commodity price fluctuations. The price of most of the country's export commodities, including coffee, has declined, and the gain in export of leather and leather products and pulses was not high enough to compensate for the decline. Meanwhile, import has increased by 4.1 percent, mainly due to the increase in the imports of capital goods which constituted about 31 percent of the total import value. Accordingly the trade deficit has widened by 9 percent (UNDP, 2014).

Imports have, by value, increased by 20 percent in 2014 to USD 13.7 billion from USD 11.5 billion the previous year, driven by strong demand for fertilizers, petroleum products, and capital goods. This had a deleterious effect on the trade deficit bringing it to USD 10.5 billion (19.1 percent of GDP) in 2013/14 from USD 8.4 billion (17.7 percent of GDP) in 2012/13. The effect on the overall balance of payments deficit was not as pronounced however as surpluses in non-factor services (USD 559.5 million) and the capital account (USD 3.9 billion) had a mitigating effect. Significant private transfers of USD 4.04 billion also offset the rise in import costs, with remittances reaching USD 3 billion (up 23%)(Zerihun, *et al*.(2015).

For instance, real export receipts have increased fivefold between 1992 and 2009. The export industry has also seen significant diversification away from its dependence on coffee. In 1991, when the reform package was launched, coffee brought more than 55% of the country's total export revenue but by the end of 2009 its share declined to less than 35% while the shares of other goods such as chat, flower, leather and leather products have increased substantially. The flower industry represents the major success story, whose share registered remarkable growth from less than 1% at the beginning of the 2000s to about 10% a decade later. Though much of this diversification is within the same industry, the overall result shows a significant departure from the traditional, mono-crop dominated export sector (Wondemhunegn e., n.d).

Ethiopia's global competitiveness suffers from weak export productivity. A key factor is trade costs where Ethiopia lags substantially behind its peers. Based on the World Bank's Logistics Performance Index—which measures the efficacy of a country's logistics based on efficiency of customs clearance process, quality of trade and transport-related infrastructure, ease of arranging competitive shipments in terms of price, quality of logistics services, ability to track and trace consignments, and frequency with which shipments reach the consignee within the scheduled time—, Ethiopia ranks at the lower end of the surveyed countries in all the six key dimensions of logistics covered by the index (IMF , 2014).

(Wondemhunegn e., n.d) Stated that following the surprise 16 percent devaluation of Birr against the US dollar on September 1, 2010, has written extensively on how recurrent devaluation could not solve many of the longstanding structural problems associated with the country's limited capacity of domestic production. In his explanation he underscored the malignant consequences of the numerous party-owned-and-operated business companies that stifle competition and hinder the development of a vibrant private sector-led economy. He further emphasized Ethiopia will not be able to gain competitive edge and devaluation will not be a magic potion for the structural (political and economic) problems of the country and the continuous manipulation of the Birr will unlikely correct the general economic malaise.

Despite a generally positive outlook, Ethiopia is subject to risks. These include: (i) constraints on the financing of a large public sector investment program; (ii) sustained decline in commodities prices and the re-emergence of foreign exchange shortages; (iii) slower recovery in advanced economies and growth slowdown in the major emerging market countries; and (iv) weather-related shocks, particularly a drought in the Horn of Africa (IMF ,2014) .

Therefore, many of the impediments to Ethiopia's export growth are institutional and structural and need to be assessed and addressed within the wider context of its geographic location, lack of access to the sea, slow pace of regional integration and limited market opportunities for its products, as well as its poor technological progress and increased dependence on agricultural commodities which are vulnerable to wide price fluctuations, etc (Wondemhunegn e., n.d).

2.6. Export Financing

Export financing is a means of helping local producers process their products for a better market abroad. It is designed to make funds available for local producers to seek for market abroad. The essence of every productive business is to sell to a wider range of customers to reduce cost and continue in business. Oftentimes, it is propelled by the desire to increase the market share, and thus, the clientele. Export financing is loan meant for shipping of products outside a country or region (Emeka, C.U., 2011).

The followings are types of short term loan i.e. a loan having a repayment period of up to four years, export financing provided by commercial banks in Ethiopia (Meseret, 2015).

i. Pre-shipment Export Credit Facility

Pre-shipment Export Credit is an advance extended to exporters to bridge their temporary working capital requirement such as for purchase of exportable items, processing transporting, warehousing/ packing until such time the goods are shipped and export proceeds are credited to the loan account

ii. Revolving Export Credit Facility

A Revolving Export Credit Facility is an advance extended to exporters upon presentation of acceptable export documents, except a bill of lading. The facility should be advanced against valid export documents.

iii. Advance on Export Bills Facility

Advance on Export Bills Facility is a post-shipment export credit extended to exporters, upon presentation of all relevant export documents, to finance the working capital need between the shipment of goods and the realization of proceeds.

Banks also provide project finance loans to be repaid from five years to ten years that will help the exporters to establish or purchase factory or goods that have a capital nature that relate with their export activities.

Emeka, C.U. (2011) noted that exporters naturally want to get paid as quickly as possible, while importers usually prefer to delay payment until they have received or resold the goods. Because of the intense competition for export markets, being able to offer attractive Payment terms customary in the trade are often necessary to make a sale. Exporters should be aware of the many financing options open to them so that they choose the most acceptable one to both the buyer and the seller. In many cases, government assistance in export financing for small and medium-size businesses can increase a firm's options.

According to Emeka, C.U. (2011) the following factors are important to consider in making decisions about Export financing:

i.The need for financing to make the sale

In some cases, favorable payment terms make a product more competitive. If the competition offers better terms and has a similar product, a sale can be lost. In other cases, the buyer may have preference for buying from a particular exporter, but might but might buy your product because of shorter or more secure credit terms.

ii.The length of time the product is being financed

This determines how long the exporter will have to wait before payment is received and influences the choice of how the transaction is financed.

iii.The cost of different methods of financing

Interest rates and fees vary. Where an exporter can expect to assume some or all of the financing costs, their effect on price and profit should be well understood before a pro forma invoice is submitted to the buyer.

iv.The risks associated with financing the transaction

The riskier the transaction, the harder and more costly it will be to fiancé. The political and economic stability of the buyer's country can also e a issue, to provide financing for either accounts receivable or the production or purchase of the product for sale, the lender may require the most secure methods of payment, a letter of credit (possible confirmed) or export credit insurance or guarantee.

v.The need for pre-shipment fiancé and for post-shipment working capital

Production for an unusually large order, or for a surge of orders, may present unexpected and severe strains n the exporter's working capital. Even during normal periods, inadequate working capital may curb an exporter's growth.

However, inadequate assistance in working capital may curb an exporter's growth. However, assistance is available through public and private sector resources.

vi.Extending Credit to Foreign Buyers

Foreign buyers often press to get extended credit on the purchase they make (Emeka, C.U.,2011).

2.7. Deposit Mobilization and liquidity in the Banking sector

Economic forces have led to financial innovations that have increased competition in financial markets. Greater competition in turn has diminished the cost advantage banks had in acquiring funds and has undercut their position in loan markets. As a result, traditional banking has lost profitability, and banks have begun to diversify into new activities that may bring higher returns (Christos, and Geoffrey, 2013).

As in many developing economies, domestic savings in Ethiopia are low. Small and medium enterprises (SMEs) have very limited access to bank credit or other financial services. Over the first 10 months of 2012/13, 79 percent of total loans issued by the banking sector were allocated to the big public enterprises, with only 21 percent going to the private sector. Not surprisingly, in various business climate surveys, access to finance has been identified as one of the key obstacles to doing business. Enhancing access to credit (especially for agriculture and SMEs) will require efforts in many areas, including the elimination of the 27 percent NBE bill directive; training for entrepreneurs in the preparation of adequate business plans; improving credit reporting systems; and strengthening enforcement of lenders' rights over collateral (IMF , 2013).

The underdevelopment of the banking industry can be seen in the small proportion of the population that has a deposit account, less than 8 percent (Global Center on Cooperative Security, 2014).

Based on IMF (2014) report, export diversification and competitiveness lag behind those of other African countries. The relatively low GDP per capita means that the scope for substantial mobilization of domestic savings in the short run is limited. At the same time, the government's policy of keeping the real interest rates negative is not conducive to saving and distorts financial intermediation. Experience in the first three years of the GTP suggests that large scale public investment financed domestically squeezes the availability of credit for the rest of the economy. Thus, an adjustment in policies to establish better balance between the public and private sectors is warranted. There is also a risk that the investment levels envisaged under the development strategy may run up against the absorptive capacity of the economy.

UNDP (2014) also stated that, while the minimum bank saving rate was controlled at 5 percent, average saving rate was 5.4 percent and lending rate at 11.88 percent in 2012/13. Real saving rates remained negative as the inflation rate is still higher than the nominal interest rate. The relatively insensitive nature of savers to interest rate, due to the absence of alternative financial instruments, has allowed the banks to hover around the minimum deposit rate.

Commercial banks continue to be subject to the April 2011 directive requiring them to hold 27 percent of new loan disbursements in low-yield NBE bills (IMF, 2013).

As stated by UNDP (2014) report, In 2012/13 domestic liquidity, measured by broad money supply, had increased by 24.2 percent. Reserve money also increased by 13.6 percent and net foreign assets built up by 14.7 percent, following two consecutive years of sterilization measures. In the same period credit to government increased by 1.9 percent and credit to non-government sectors (including public enterprises) went up by 26.2 percent.

In addition IMF (2013) described that, External competiveness has eroded and foreign exchange reserves cushion remains modest considering that foreign exchange sales are used to sterilize liquidity. Improved competitiveness—as a result of exchange rate adjustments in 2009/10 had fully given way by end of 2011/12, with the exchange rate currently estimated to be overvalued by 10–14 percent.

The fact that banks are still required to allocate 27 percent of their loan portfolio in central bank bonds has been a constraint on the private commercial banks liquidity and is one of the reasons limiting credit access to the private sector. Commercial banks were able to increase their deposit mobilization by 22 percent in the first 10 months of the year under review (2012/13). However, disbursement of new loans shrunk from Birr 56 billion to Birr 53 billion in 2012/13, this trend has continued in the first quarter of 2013/14 where commercial banks disbursed Birr 9.6 billion fresh loans, 28 percent lower compared to the same quarter of the previous year. Agriculture, trade and transport and communication suffered most of the decline while the industry sector took the lion's share (35.8 percent of the newly disbursed loans) in 2012/13 and 29.1 percent in the first quarter of 2013/14. However, only 21 percent of the total bank loans went to the private sector during the first quarter of 2013/14(UNDP, 2014).

IMF (2013) also stated that, the impact of 27 percent holding of NBE bills by commercial banks policy measure has been to crowd out private sector credit even if commercial banks are currently enjoying high profitability from higher non-interest income and interest rate spreads which is further squeezing out the private sector. The banking sector remains highly profitable despite a slowdown in overall credit extension to the economy. Owing to increased lending rates and net interest margins, profitability in the banking sector remains strong with return on assets of 3.1 percent and return on capital of 47 percent as of March 2013.

On IMF (2014) report the Ethiopian government pointed to their efforts towards further savings mobilization through various saving schemes and indicated that they were considering measures to promote consolidation of private banks and scale of operations that could meet the borrowing needs of businesses.

IMF (2013) suggested that allowing more market-based movement of exchange rate with a view toward enhancing competitiveness and eliminating the spread between the parallel and official foreign exchange markets would be helpful.

2.8. The changing sources of bank income

2.8.1 The regulatory, technological, and strategic drivers of non-interest income

Over the past two decades, the banking industry has been transformed by sweeping deregulation and rapid technological advances in information flows, communications infrastructure, and financial markets. Deregulation fostered competition between banks, nonbanks, and financial markets where none existed before. In response to these competitive threats and opportunities, many banks embraced the new technologies that drastically altered their production and distribution strategies and resulted in large increases in noninterest income (DeYoung and Rice ,2003).

Also Damankah, *et al*. (2015) stated that, while the basic functions of banks and other financial service companies have remained relatively constant over time, the specific products and services through which these functions are provided have changed. Economic forces have led to financial innovations that have increased competition in financial markets. Greater competition in turn has diminished the cost advantage banks had in acquiring funds and has undercut their position in loan markets. As a result, traditional banking has lost profitability, and banks have begun to diversify into new activities that may bring higher returns.

On the other hand Christos and Geoffrey (2013) argued that as the profitability of traditional banking activities has, for a wide variety of reasons, come under pressure in recent years, fee-earning activities have greatly increased their contribution to bank profits. It is therefore important to see whether these new activities offset fluctuations in other sources of earnings as successfully as did traditional fee-earning work.

But deregulation allowed banks to achieve the scale to use these new technologies more efficiently, and the increased competition induced by deregulation provided banks with the incentives to adopt and adapt these new technologies. Many of these new technologies have emphasized noninterest income while de-emphasizing interest income at banks. Banks can extract fee income from customers willing to pay a “convenience premium” for doing their banking at ATMs or over the Internet. Banks can earn loan origination, loan securitization, and loan servicing fees to offset the interest income that they lost with the disintermediation of consumer lending (e.g., mortages, credit cards) (DeYoung and Rice , 2004) .

As per Damankah, *et al*. (2015) technology has also brought about a complete paradigm shift in the functioning of banks and delivery of banking Services.

2.8.2 Non-interest income and financial performance

The profitability of traditional banking activities such as business lending and raising deposits has diminished in recent years. As a result, banks have increasingly turned to new, non-traditional financial activities as a way of maintaining their position as financial intermediaries. The changes are of importance for financial stability. The reason is straightforward. The more unstable is a bank’s (or any other firm’s) earnings stream, the more risky the firm is. A paper by Hoggarth, Milne and Wood (1998) drew attention to an example of this, comparing banking sector profitability in Britain and Germany. It was observed that banking profitability in Germany was lower than in Britain, but also less variable, suggesting that the systems had pursued alternative routes to stability (Christos, S. and Geoffrey W. ,2013).

Commercial banks typically increased diversification by moving into fee-based businesses whilst banks with already strong fee-based revenues expanded into trading activities Damankah, *et al*. (2015).

According to Rogers (1998) the aggregate percentage of intermediated assets held by banks in the US has fallen from 36 percent in 1965, to 22 percent in 1996, while fee income as a percentage of total bank income has risen from 7.6 percent to 17.2 percent over the same period.

Also DeYoung and Rice (2003**)** stated that, Noninterest income comprises a larger portion of commercial bank income today than in 1984. This is not just a U.S. phenomenon: Kaufman and Mote (1994) found that noninterest income ratios increased in the banking sectors of virtually all developed countries between 1982 and 1990.

Moreover, according to DeYoung and Rice (2004), banks are increasingly exploiting nontraditional avenues of generating income, to the extent that in recent times, almost half of banks' incomes in the US are obtained from nontraditional activities and this reflects not only a diversification of banks into nontraditional activities, but also a shift in the way banks earn money. As margins and fees tended to tighten in many domestic banking markets during the 1980s and 1990s, many banks responded by implementing strategies of product diversification, merger and overseas expansion in an attempt to defend their profitability and promote efficiency.

Since the 1980s, incomes from nontraditional activities have played a more important role in improving total bank operating income. US banks are becoming increasingly reliant on fees, fiduciary income, service charges, trading revenue, and other types of non-interest income. They reported that the industry as a whole, earned 42 percent of its net operating revenue from non- interest sources in 2004, a marked increase from 32 percent in 1990 and 20 percent in 1980. Although a relevant component of total bank earning, non-interest generating activities may increase the overall risk of banks via income volatility (Basil, *et al* , 2014).

On the other hand, Christos and Geoffrey (2013) stated that Banks also receive fee income from a number of off-balance sheet items including loan commitments, note issuance facilities, letters of credit, foreign exchange services, and derivative activities (contracts for futures, forwards, interest rate swaps, and other derivative contracts).

Recent dynamics in the banking business have made it necessary for banking companies to be proactive and innovative in their operations. In the view of Nachane and Ghosh (2007) an important dimension of this financial innovations process has been an upsurge in off-balance sheet (OBS) activities of banks. Such activities, though not entirely new from a historical perspective, have expanded considerably in range and scope in recent years. While the basic functions of banks and other financial service companies have remained relatively constant over time, the specific products and services through which these functions are provided have changed (Smith, Staikouras & Wood, 2003).

While growth through product and geographic diversification reduce bank risk, efficiency tends to improve as a result of geographic diversification (Hughes, Lang , Mester & Moon , 1999). Diversification of banking activities also includes venturing into off-balance sheet activities. Such activities, though not entirely new from a historical perspective, have expanded considerably in range and scope in recent years. According to Nachane and Gosh (2007), a popular reason for the dramatic growth of bank off-balance sheet activities has been that banks may have used them as a means of augmenting earnings to offset reduced spreads on traditional on-balance sheet lending business (Damankah, et al. ,2015).

DeYoung and Rice (2003) stated that well- managed banks rely relatively less on noninterest income; that banks which stress customer relationships and service quality tend to generate more noninterest income; and that the development of new financial technologies such as cashless transactions and mutual funds are associated with higher levels of noninterest income in the banking system. We also find that increases in noninterest income tend to be associated with higher profitability, higher variation in profits, and a worsened risk-return tradeoff for the average commercial bank during this time period.

The across-the-board growth of noninterest income at commercial banks suggests that intermediation activities are becoming a less important part of banking business strategies. At large banks, service charges on deposit accounts have comprised a relatively stable portion of total noninterest income In contrast, the composition of noninterest income at small banks has remained remarkably unchanged since 1984 (DeYoung and Rice , 2003).

Banking is the management of risk. Banks accept risk in order to earn profits. They must therefore balance the alternative strategies in terms of their risk/return characteristics with the goal of maximizing shareholder wealth. In doing so, banks recognize that there are different types of risk and that the impact of a particular investment strategy on shareholders depends on the impact of the total risk of the organization (Damankah, *et al*., 2015).

Banks, like other firms, generally seek to reduce their risks by diversifying across various lines of business, although there is usually some degree of specialization (Christos and Geoffrey, 2013).

DeYoung and Rice (2003) showed that, the results indicate that well-managed banks expand more slowly into noninterest activities, and that marginal increases in noninterest income are associated with poorer risk-return tradeoffs on average. These findings suggest that noninterest income is co-existing with, rather than replacing, interest income from the intermediation activities that remain banks' core financial services function.

2.8.3. Nature of non- interest income

Financial services diversification allows managers to offer a wider range of services and spread the risks of lending across a larger number of asset categories, reducing monitoring costs (Diamond, 1984). Diversification which serves as a means adopted by banks and investment companies to reduce their exposure to risk seem to have taken a different dimension when it comes to the business of banking as Lepetit, Nys ,Rous & Tarazi (2007) stressed that diversification does not necessarily imply lower risk, and may on the contrary increase bank risk.While off- balance sheet (OBS) activities generate fee income for the banks, they also potentially increase bank risk which may affect their profitability in various ways (Koppenhaver and Stover 1991; Avery and Berger 1991). But Smith *et al*. (2003) also maintain that banks generally seek to reduce their risks by diversifying across various lines of business, although there is usually some degree of specialization.

While, it is well known that large banks and banks with specialized strategies, (e.g., credit card banks, mortgage banks) rely more heavily on noninterest income than do small banks with traditional business strategies (DeYoung and Rice, 2003)

Christos and Geoffrey (2013) stated that in broad outline fee-earning income is less stabilizing than seems generally believed; indeed, fee-earning income is actually more variable for most categories of banks than traditional interest income. It does, however, help in most cases to stabilize profit streams.

DeYoung and Roland (2001) suggested and explained three reasons why non-interest income may increase the volatility of bank earnings. First, loans that are held in a bank's portfolio—especially loans to businesses—are relationship based. Second, a bank that shifts its product mix from traditional asset-based interest-generating activities to nontraditional fee-based activities tends to increase its "degree of operating leverage". Third, most fee-based activities require banks to hold little or no fixed assets, so unlike interest-based activities like portfolio lending, fee-based activities like trust services, mutual fund sales, and cash management require little or no regulatory capital. According to them, this allows banks to finance a greater amount of their income-generating activities with debt, which increases fixed interest expenses. In other words, fee-based activities allow banks to use a greater "degree of financial leverage" than lending activities. According to Rogers (1998) the exclusion of nontraditional activities in the estimation of bank efficiency actually understates it. Lozano-Vivas and Pasiouras (2010) investigated the relevance of non-traditional activities in the estimation of bank efficiency levels and found that, on average, cost efficiency increased irrespective of whether income from non-interest sources were used, although the results for profit efficiency were mixed. This signifies the relevance of bank's non-interest earning activities in assessing their efficiency.

As noninterest income trended up during the 1990s, it was generally believed that shifting banks' income away from intermediation-based activities (in which bank income was subject to credit risk and interest rate risk), and toward fee-based financial products and services, would reduce banks' income volatility. Moreover, it was conventionally believed that expansion into new fee-based products and services reduced earnings volatility via diversification effects. But recent empirical studies indicate that neither of these beliefs holds on average (DeYoung and Rice, 2003).

A bank benefits from diversification given that it's income from interest and non-interest earning activities results in relatively stable overall financial performance/profits. In other words, minimum fluctuations in earning streams could be an indication of diversification returns (Damankah, *et al*., 2015).

As per Basil, *et al*. (2014), the choice of the Bank in non-interest income earning and/or in traditional activities of interest income earning depends on the following factors:-

Bank size (S)

The size of a bank is obviously likely to influence the magnitude of its engagement in both interest and non-interest earning activities. Participation in nontraditional activities according to Rogers (1998) varies greatly across banks due to differences in size, and other characteristics. According to Rogers and Sinkey (1999), the most obvious factor related to the level of nontraditional activities is firm size. They posit that participation in certain nontraditional activities generally requires some degree of specialization for the bank which may be achieved through the recruitment of staff with special knowledge as well as the

Interest income (INI)

The availability of funds to a bank from its traditional activities may also influence the level of its engagement in non-interest earning activities. By inference, once a bank is making relatively higher profits from its margin returns, its involvement in other activities could be reduced to avoid possible exposure to excessive risk. This is because in most cases, non-interest income is meant to augment possible shortfalls in interest income. By this premise, a negative relationship between interest and non-interest income is expected. Interest income is measured as the ratio of net interest income to total assets.

Customer deposits (Cd)

As provided by Rogers and Sinkey (1999), the level of nontraditional activities at a bank might also be related to its liability structure. As a bank is able to mobilize more deposits, there is a higher propensity of it making more loans, hence a higher level of involvement in traditional activities. The contrary becomes the case where the bank’s core deposits are limited hence its attraction to other revenue sources. They posit that, if a bank is constrained in the volume of core deposits it can attract, it may produce a larger quantity of nontraditional activities concurrently with finding other sources of funds. Prevailing (low) interest rates and risk of non-performing loans (NPLs) may also discourage banks from engaging in the lending business even with higher levels of customer deposits and rather concentrate on other sources of revenue such as acquisition of government securities, securitization of existing assets (loans) or engagement in derivatives. From the foregoing arguments, it is clear that non-interest income may be related to the level of customer deposits at a bank and this relationship could be either positive or negative depending on the peculiar situation of each of the banks in question. This variable is expressed as the ratio of deposits and current accounts to total assets (TA).

Exposure to Risk (ExpR)

According to Rogers (1998), participation in nontraditional activities varies greatly across banks due to differences in risk and other characteristics. Risk is a very important consideration of most banks in the conduct of their business in both traditional and nontraditional activities hence the relevance of its inclusion in our estimations. In principle, a bank's capacity to absorb unforeseen losses determines its level of risk (Goddard et al., 2004). Loan-loss provisions are the traditional way that banks manage their credit risks or non-performing loans (NPLs). The ratio of provisions for loan losses to total assets (TA) is used as a measure of bank's exposure to risk.

Bank Liquidity (LIQ)

Another uncertainty faced by a bank is liquidity risk, which takes the form of unexpected deposit withdrawals and unexpected loan demand. A bank with relatively more liquid assets is better placed to meet these unforeseen contingencies (Rogers and Sinkey, 1999). A highly liquid bank could be described as one with adequate cash to meet ensuing demands for withdrawals and loans. This liquidity, according to Rogers and Sinkey (1999) serves as a cushion or buffer against losses arising from the "fire-sale" of assets to meet liquidity needs since all things being equal, a bank is safer where it has enough reserve liquidity. This liquidity however results in idle funds which turn to reduce returns to shareholders. A bank holding a relatively high proportion of liquid assets is unlikely to earn high profits, but is also less exposed to risk (Goddard, Molyneux & Wilson, 2004). If banks need more liquidity to engage in higher levels of non-interest earning activities, the empirical relationship between these activities and liquidity would be positive. Otherwise, some moral-hazard behavior may exist as captured by less-liquid banks having more nontraditional activities (Rogers and Sinkey, 1999). This variable will be represented by the ratio of cash and short-term investments to total assets (TA).

In addition, Basil, *et al*.(2014) examined and established some factors common to banks with more engagement in non-interest earning activities and it was found that interest income (INI), exposure to risk (ExpR), and liquidity (LIQ) are the main driving factors of bank's engagement in non-interest earning activities in Ghana. Our findings also established that smaller banks with lower levels of deposits, banks with higher anticipated loan losses and high liquidity are mostly engage in non-interest earning activities.

As a result of the increased importance of activities generating non-interest income, banks' operational, reputation and strategic risks seem to be heightened. The increased relevance of these categories of risk has made banks' risk management activity, and, accordingly, the task of the supervisors, more complex and requires a focus on these other categories of risk. As regards the current view of capital adequacy these results may support arguments in favor of specific capital requirements for other categories of risk in addition to credit and market risks (Christos and Geoffrey, 2013).

Damankah, *et al*. (2015), emphasized on income diversification by banks in Ghana , and its impact on overall financial performance and profit stability. We found that non-interest revenue is becoming increasingly relevant and contributes to bank profit stability. The increasing reliance of banks in Ghana on nontraditional income however comes with volatility in their earnings. Banking sector supervisors and regulators not only be aware of the role a particular bank plays in each line of business, but must understand the risk management strategy of the whole banking organization in order to evaluate the risk exposures of a particular bank. Stevens (2000) described that giving the current levels of income diversification and its concomitant revenue volatility. Considering the diversity and complexity of banking operations in recent times, the Central Bank ought to continuously strengthen its controls by closely monitoring and assessing the increasing levels of risks assumed by banking companies and require the requisite capitals to protect the interest of all stakeholders in the industry.

2.9. Empirical review

As far as challenges of export sector exchanging to increase non-interest income is concerned many researchers have identified that profit maximization, increased competition among commercial banks and deregulation have the factors contributing to it.

According to Basil, Olivia and Albert (2014) increased competition among banking companies as well as the diversity and complexity of businesses have compelled banks to consider other banking activities which other diverse services to clients and beef up revenue generation through fee income.

DeYoung and Rice (2003) indicated that commercial bank business models have evolved over the past two decades, and today banks generate an increased portion of their income from no intermediation and/or noninterest activities.

Christos and Geoffrey (2014) said that due to the pressure rest on profitability of traditional banking activity, fee earning activities have greatly increased their contribution to bank profitability. This implies that, for banks to remain competitive with the industry, they need to expand their product breadth and improve sales, relationships, servicing, and investment know-how.

DeYoung and Rice (2003) indicated that banks have faced increased competition in retail markets due to deregulation. Well-managed banks responded to these competitive pressures by becoming more cost-efficient and more revenue-efficient. This included offering customers an expanded array of new and/or nontraditional fee-based products, selling increased amounts of existing fee-based products, pricing fee-based products more efficiently.

Bhattacharya, Boot & Thakor (19980) stated that, since the mid-1980s, dramatic changes in regulation demand composition and technology have modified the structure and the boundaries of credit markets. Albertazzi and Gambacorta (2009) also explained that all these changes have strengthened competition, especially in traditional lending activity, reduced intermediation margins and encouraged banks to diversify their sources of revenue and increase efficiency in production and distribution.

Christos and Geoffrey (2013) stated that economic forces have led to financial innovations that have increased competition in financial markets. Greater competition in turn has diminished the cost advantage banks had in acquiring funds and has undercut their position in loan markets. As a result, traditional banking has lost profitability, and banks have begun to diversify into new activities that may bring higher returns.

DeYoung and Rice (2003) indicted that over the past two decades, the banking industry has been transformed by sweeping deregulation and rapid technological advances in information flows, communications infrastructure, and financial markets. Deregulation fostered competition between banks, nonbanks, and financial markets where none existed before. In response to these competitive threats and opportunities, many banks embraced the new technologies that drastically altered their production and distribution strategies and resulted in large increases in noninterest income.

DeYoung and Rice (2004) stated that banks can earn loan origination, loan securitization, and loan servicing fees to offset the interest income that they lost with the disintermediation of consumer lending (e.g., mortages, credit cards).

2.10. Summary of literature & Research gap

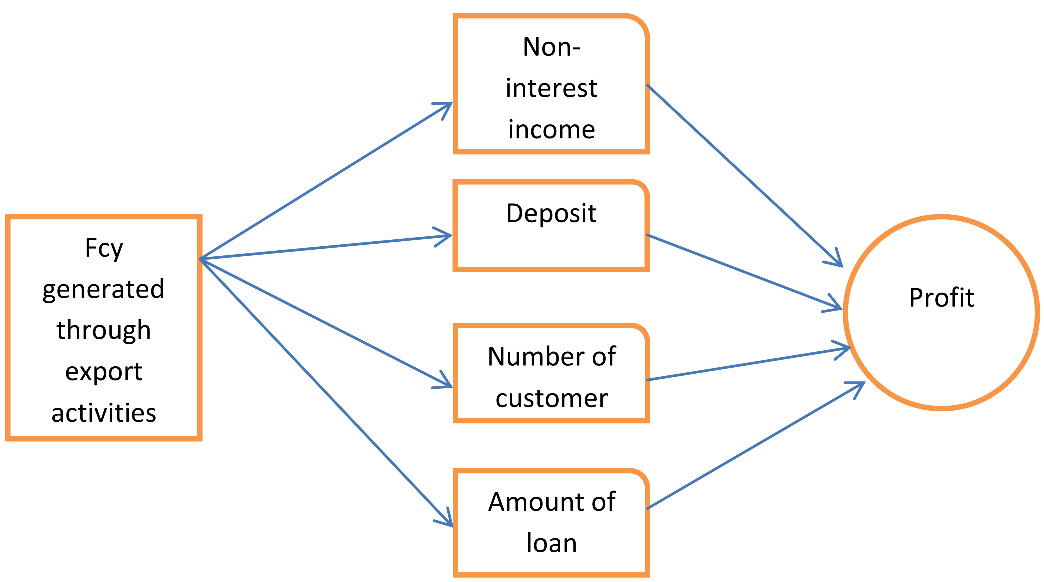
The chapter covered literature on different factors that contributed for the challenges of export sector exchanging. It first started by reviewing overview of banking history in Ethiopia and indicating the commercial banks activities in Ethiopia. In this part, it was explained that, due to government policies, regulations & NBE directives the profit obtained from interest income comes under pressure.

The study further reviewed the empirical studies: for instance Basil, Olivia and Albert (2014) indicated that increased competition as well as diversity and complexity of business have forced banks to consider other means of income generation. Christos and Geoffrey (2014) stated that fee earning activities have greatly increased their contribution to bank profitability due to the pressure rest on profitability of traditional banking activity. Albertazzi and Gambacorta (2009) aid that dramatic changes in regulation reduced intermediation margins and encouraged banks to diversify their sources.

The review of literature clearly found a research gap in Ethiopia as the study done in the area had focused on the practice of export trade financing of commercial banks. In this study, factors contributing for the challenges of export sector exchanging a case of Dashen bank S.C. were discussed. The independent variables foreign currency & deposit are chosen to show their impact on the dependent variables profit due to the fact that these variables have influenced the profitability of the banking sector as being illustrated in the literature review. There was therefore a gap in literature as regards to the impact of foreign currency and deposit that affect Dashen's bank profitability. The current study therefore contributed towards this research gap by identifying factors that contribute for the challenges of export sector exchanging a case of Dashen Bank S.C.

2.11. Conceptual framework

The conceptual framework indicates the crucial process which is useful to show the direction of the study. The study shows the relationship between foreign currency generated during involvement in export sector exchanging activity and its impact on the profit of the bank by increasing non-interest income, deposit, number of customers and amount of loan. Also the study focuses on the profit of the bank which is the prime objective of its establishment.



Source: researcher's own design

CHAPTER THREE

RESEARCH DESIGN AND METHODS

This chapter presents methods used in carrying out the study. In particular, this study was employed in order to describe the challenges that has faced by Dashen Bank Share Company in the course of Export Sector Exchanging. It presents the research design, data source, population, sample and sampling techniques, data collection procedure, method of data analysis and ethical consideration.

3.1. Research Design

The type of research employed for the purpose of this study is descriptive in nature, because the researcher has no control or effect on the variables of the study. It is intended only to investigate the challenges of Export sector exchanging a case of Dashen Bank Share Company.

As stated in Creswell (2009) research design is plans and procedures for research that span the decision from broad assumptions to detailed methods of data collection and analysis. The selection of the research design is based on research problem or issues being addressed, the researcher's personal experience and the audiences of the study.

Based on the objective of the research, which is to make an assessment of the existing challenges of export sector exchanging case of Dashen Bank S.C., the author employs a descriptive type of study. As described by Kothari (2007) the major purpose of descriptive research is description of the state of affairs as it exists at present; the main characteristic of this method is that the researcher has no control over the variables; he can only report what has happened or what is happening.

Moreover, due to qualitative nature of the data to be collected, qualitative characteristics of the items that construct the research questions, data analysis to be used is qualitative analysis that does not involve application of the descriptive statics analysis.Hence, descriptive qualitative research design will be suitable for the study.

The survey method is considered as the most appropriate way for any descriptive study. As described by Kothari (2007) survey method is concerned with describing, recording, analyzing and interpreting conditions that either exist or existed. Surveys are only concerned with conditions or relationship that exist, opinions that are held, processes that are going on.

Due to the fact sated above, the survey method has been employed in the study which comprises of questionnaires and interview.

3.2. Data Source

Both primary and secondary source were used to capture the data. Primary data was collected through structured questionnaire which were filled by Bank professionals who are Department Heads, District Managers, Division Heads, Team Leaders and senior experts for capturing variables on Export Sector Exchanging A case of Dashen Bank S.C. Also interview was held with selected Bank professionals. Secondary data, which obtained from publicly available information like annual report of the bank, proclamations and directives issued by NBE to monitor and supervise the banking business were used. Moreover, literatures related to the subject were used for the study. Both instruments were qualitative in nature so as to gain an insight and understanding into the operations of the exporters and the banks surveyed. The questionnaires were designed based on open and closed ended questions.

3.3. Population

Since the study was undertaken in order to describe the challenges that has faced by Dashen Bank S.C. in the course of export sector exchanging, the target population for the research was 40/forty/ Bank professional staffs of Dashen Bank's S.C.

3.4. Sample and Sampling Techniques

The data that is collected to answer the research questions are limited only to Dashen Bank S.C. The target populations for the research are International Banking Department, Credit Department, District Mangers, Branch Managers and senior officer employees of the Bank. The target populations for the research involve about 56 staffs. However, only 40 of them have long term experience, frequent exposure and direct involvement on the Export sector of the Bank. Therefore, the data collection of the research focused on those experienced staffs of 40 employees in order to get reliable and balanced response. From the selected population to strength the response obtained from the questionnaires one Department Manager, one District Manager, one Branch Manager and one senior officer were interviewed from the population based on their experience and high exposure. Accordingly, no specific sampling technique used as all of the population size has taken.

3.5. Data Collection Procedures

Structured questionnaire and interview were developed and distributed to sample participants to collect the primary data. The objectives and research questions were formulated in a way that showed the direction of the study. A total of 40 questionnaires were distributed. Out of the circulated questioners 39 were returned representing about 98% of response rate, which deemed fair enough considering the short time given to these respondents.

3.6. Method of Analysis

The data collected was categorized and summarized in a table form according to the research variables, and presented for analysis. Then after the summarized data was analyzed using purposive sampling method were used. The results of the analysis were presented in the data analysis and discussion part as depicted in the next chapter.

3.7. Ethical Consideration

A researcher must consider points of ethical consideration because the law of ethics on research condemns conducting a research without the consensus of the respondents. So, before the research was conducted on the selected bank, the researcher informed the Participants of the study about the objectives of the study, and was consciously consider ethical issues in seeking consent, avoiding deception, maintaining confidentiality, respecting the privacy, and protecting the anonymity of all respondents.

CHAPTER FOUR

DATA PRESENTAION, ANALYSIS AND INTERPRETATION

The data collection for this study was done basically through the usage of questionnaire & interview in order to understand the challenges of Export Sector Exchanging in the case of Dashen Bank S.C. The research was targeted to a sample of forty bank professionals who have long term experience, frequent exposure and direct involvement in the export sector activities of the Bank.

Out of the 40 questionnaires circulated, 39 were returned representing about 98% response rate. The breakdown of the result is as indicated in the table shown below.

4.1 Respondents characteristics

All the respondents have in a supervisory position. Out of the 40 respondents, 19 or 48%, 6 or 15 percent and 5 or 13 percent are in the Branch Manager, Credit Supervisor and Credit team leader position respectively. The rest are Division Heads, District Managers, and IBD Team Leaders & Department Manager. Also, 17 or 44 percent, 13 or 33 percent, 6 or 15 percent and 3 or 8 percent of the respondents have above 15 years, 10-15 years, 5-10 years and 1-5 years of experience respectively in the banking sector as shown in table 2 below.

Table 2: Position in the organization & Year of Experience

Position	Frequency	Percentage (%)
Department Manager	1	3
Branch Manager	19	48
Division Head	3	8
Credit Team Leader	5	13
District Manager	2	5
Deputy Department Manager	1	3
IBD Team Leader	2	5
Credit Supervisor	6	15
Total	40	100
Year of experience	Frequency	Percentage (%)
1-5 years	3	8
5-10 years	6	15
10-15 years	13	33
Above 15 years	17	44
Total	39	100

Source: Survey 2016

4.2 Descriptive Analysis

This section explains and discusses the results of findings based on a descriptive qualitative analysis technique. The results of the study were discussed by triangulating the different instruments i.e. questionnaires, interviews and the literature survey results. In doing so, the data gathered through the questionnaires were presented in tables & graphs. Apart from this, the data collected through interview were merged together and interpreted with the result of the questionnaires. The discussion attempt to accomplish the objectives of the study and answer the research questions. The questionnaires were structured in the way that allows multiple answers; except for the “Yes” & “No” questions, a respondent could respond more than one option depending on his exposure of the question.

4.2.1 Reason for Involvement in Export Financing Activities

Table 3: Response for the organization involvement in Export Financing Activities

Involvement in Export Financing Activity	Frequency	Percentage
Yes	39	100
No	0	
Total	39	100

Source: Survey 2016

Respondents were asked about their organization involvement in export financing activities and the reasons for its involvement. As indicated above respondents confirmed their organization involvement in export financing activities.

For respondents who confirmed their organization involvement in export financing activity, questions were raised to indicate the reasons. The justification given by the respondents about their organization involvement in the export financing is depicted in the following bar chart:

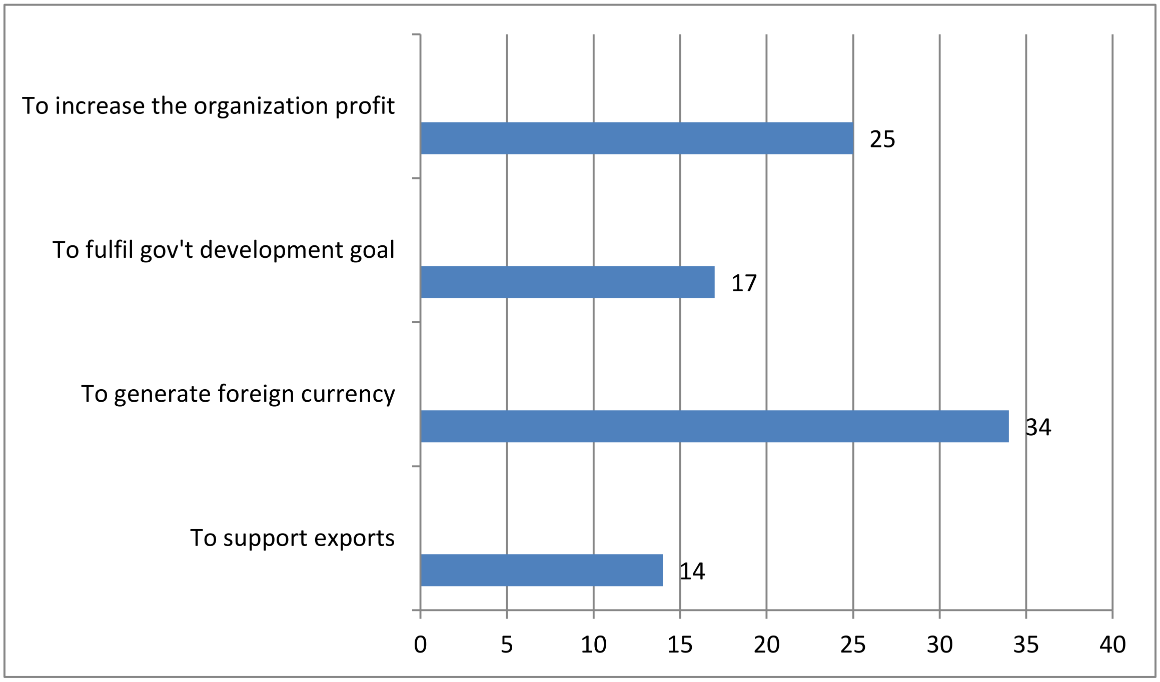


Figure 1: Frequency Distribution of Reason for Involvement in Export Financing Activity

Due to the pressure rest on profitability of traditional banking activity, fee earning activities have greatly increased their contribution to bank profitability.

According to Basil, Olivia & Albert (2014),increased competition among banking companies, issuance of different regulations as well as the diversity and complexity of businesses and their demands for financial services have compelled banks to consider other banking activities which offer diverse services to clients and beef up revenue generation through fee income .

In this respect, the survey indicated that all of the respondents confirmed their organization involvement in export financing activity. Concerning the reason for its involvement, 34 respondents and 25 respondents responded that to generation of foreign currency and increase in profit is the reason of its involvement respectively. On the other hand 17 and 14 respondents answered that to fulfill government development goal and to support export were that reasons for its involvement respectively. Supporting export also indirectly help the bank to increase its profit. This means that majority of the respondents revealed that profit is the reason for the bank involvement in export financing activity.

4.2.2 The Impact of Government Policies, Regulations & NBE Directives on Export Sector Activities

Respondents were asked to reflect their opinion whether the government bond purchasing policy and the 40/60 requirement increase their organization involvement in export sector activities. As depicted in the table below 24 or 62 percent staffs responded that the NBE bill purchase and 40/60 requirement does not increase their organization involvement in export sector activities and 15 or 38 percent of the respondents agreed that the NBE bill purchase and 40/60 requirement increase their organization involvement in export sector activities.

Table 4: Response for NBE bill purchase and 40/60 requirement increase involvement in export sector activities

NBE bill purchase and 40/60 requirement increase involvement in export sector activities	Frequency	Percentage
Yes	15	38
No	24	62
Total	39	100

Source: Survey 2016

IMF (2013) indicated that, the NBE bill purchase requirement continues to severely constraint private commercial banks operation. The directive requiring banks to hold NBE bills equivalent of 27 percent of their lending initially did not discriminate short term and long term loans. In order to avoid high NBE bill purchase due to high turnover, private banks adjusted their portfolios towards long –term loans. However, the subsequent amendment on the NBE directive also require banks short term loans to be at least 40 percent of total loans at any given time.

The return on the NBE bill is 3 percent which is less than by 2 percent as compared to the interest paid to the saving deposit i.e. 5 percent. So banks raised fees and commission to make up for lower returns on NBE bill holding.

In this respect, the survey showed that most of the respondents i.e. 62 percent don't think that the bill purchase and 40/60 requirement are the reasons for their organization involvement in export sector activies.However,38 percent of the respondents responses that indicate the NBE bill purchase and 40/60 requirement increase their organization involvement in export sector activities high light that the factors can be considered as one of the reason for the organization involvement in export sector activities.

Those staffs who responded NBE bill purchase and 40/60 requirement increase their organization involvement in export sector activities were asked to indicate the reason for the involvement and the response obtained is summarized in the bar chart below.

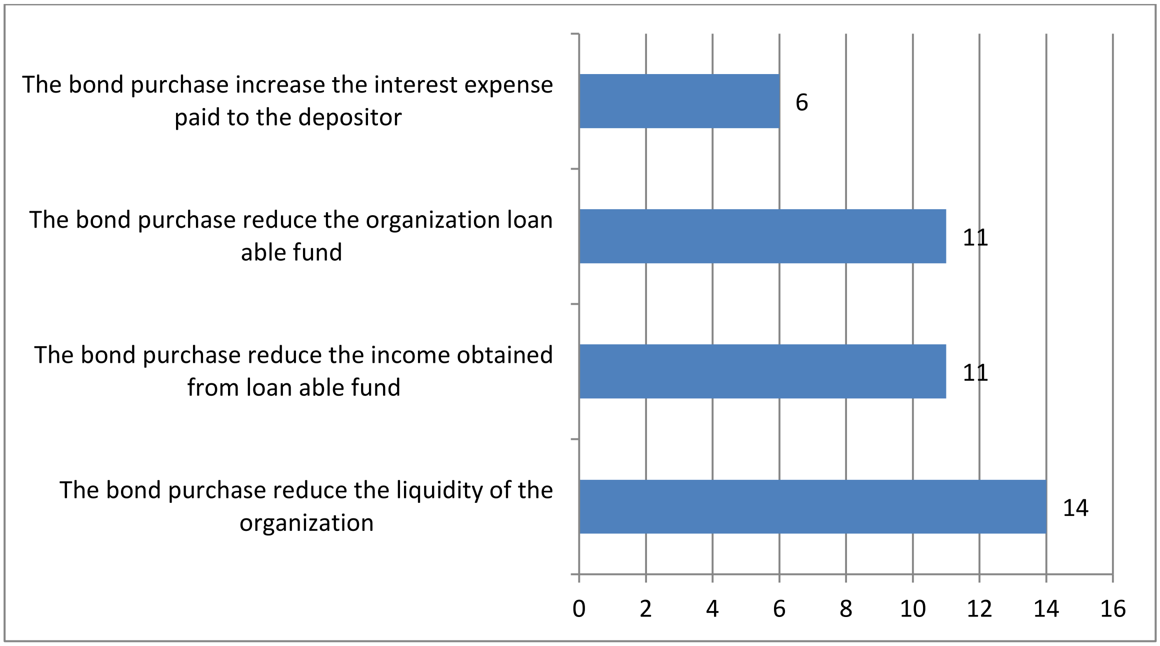


Figure 2: Reason for involvement in the export sector activities

As shown above out of the 15 respondents who said “yes”, 14 of them indicted that their organization increase its involvement in the export sector activities due to the fact that the bond purchase reduced the liquidity of the organization. Eleven of the respondents responded that since the bond purchase reduce the organization loan able fund and the income obtained from the loan able fund, it increases their organization involvement in the export sector activities. Six of the respondents answered that the bond purchase increase the interest expense paid to the depositor.

IMF (2013) stated that, the government policies and regulations that allow targeted usage of credit and foreign currency to support public enterprises and drive economic growth, the non-materializing of the required external financing during GTP I and the investment drive in the priority projects through directed domestic credit are squeezing the availability of credit and foreign currency for the rest of the economy.

Respondents were asked to express their views whether the government policies, regulations and NBE directives force Dashen Bank to find ways of increasing its non-interest income and their responses are summarized in the table below.

Table 5: Response for factors that force Dashen Bank to find ways of increasing its non-interest income

Government policies ,regulations and NBE directives force Dashen Bank to find ways of increasing its non-interest income	Frequency	Percentage
Yes	34	87
No	5	13
Total	39	100

Source: Survey 2016

Result from table 5 above indicate that 34 or 87 percent of the respondents answered "Yes" and 5 or 13 percent of the respondents answered "No" for the question that the Government policies, regulations and NBE directives force Dashen Bank to find ways of increasing its non-interest income.

The bar chart depicted below shows the frequency of the reasons identified by the respondents who said "Yes" to the question that the Government policies, regulations and NBE directives force Dashen Bank to find ways of increasing its non-interest income.

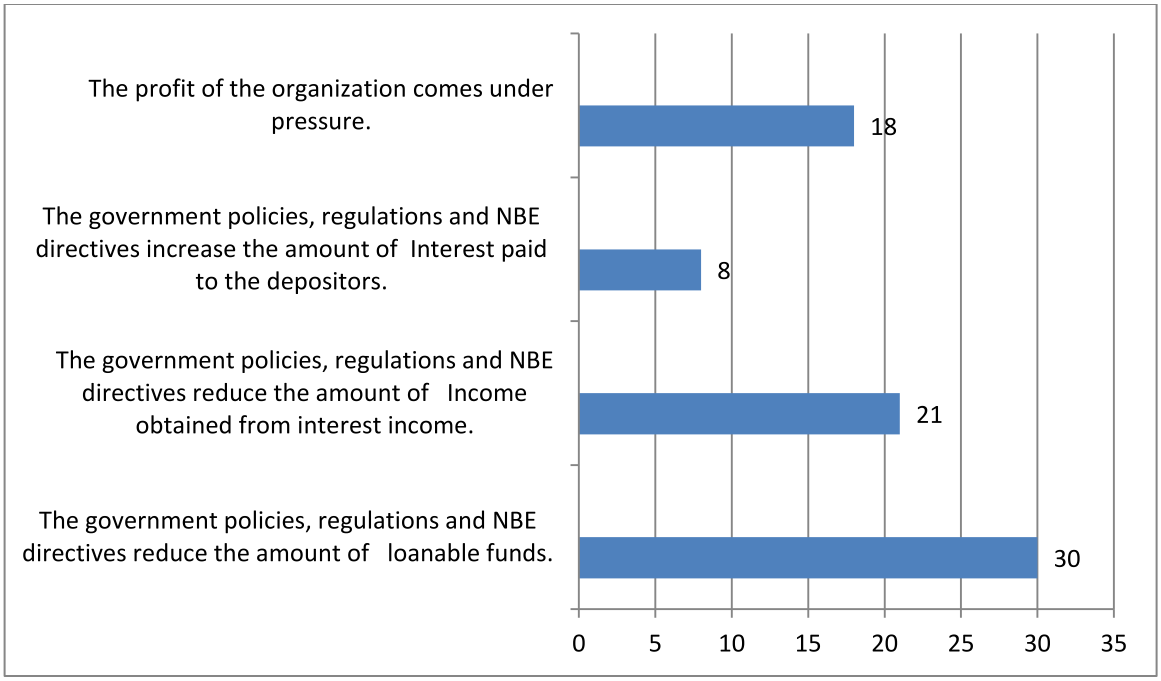


Figure 3: Reasons that force Dashen Bank to find ways of increasing its non-interest income

Figure 3 above shows that out of the 34 respondents that agreed the idea that the government policies, regulations and NBE directives force Dashen Bank to find way of increasing its non-interest income 30 of them stated that the main reason for this was that the government policies, regulations and NBE directives reduce the amount of loan able fund and 21 of them sated that the reduction in the amount of income obtained from interest income forces Dashen Bank to find ways of increasing its non-interest income. On the other hand 18 and 8 respondents mentioned the increase in the amount of interest paid to the depositors and the pressure rests on the profit of the organization forces Dashen Bank to find way of increasing its non-interest income respectively.

In this respect, the survey indicated that 34 or 87 percent of the respondents indicated that the reduction in amount of loanable fund, reduction in income obtained from interest income and the pressure rests on the profit of the organization due to government policies, regulations and NBE directives force Dashen Bank to find ways of increasing its non-interest income.

4.2.3 Request of the Exporters' to channel their Export and Handling of their request

In this regard respondents were asked to identify the challenges facing their organization, when their organization approach Exporters to export through their organization and the result is presented as follows.

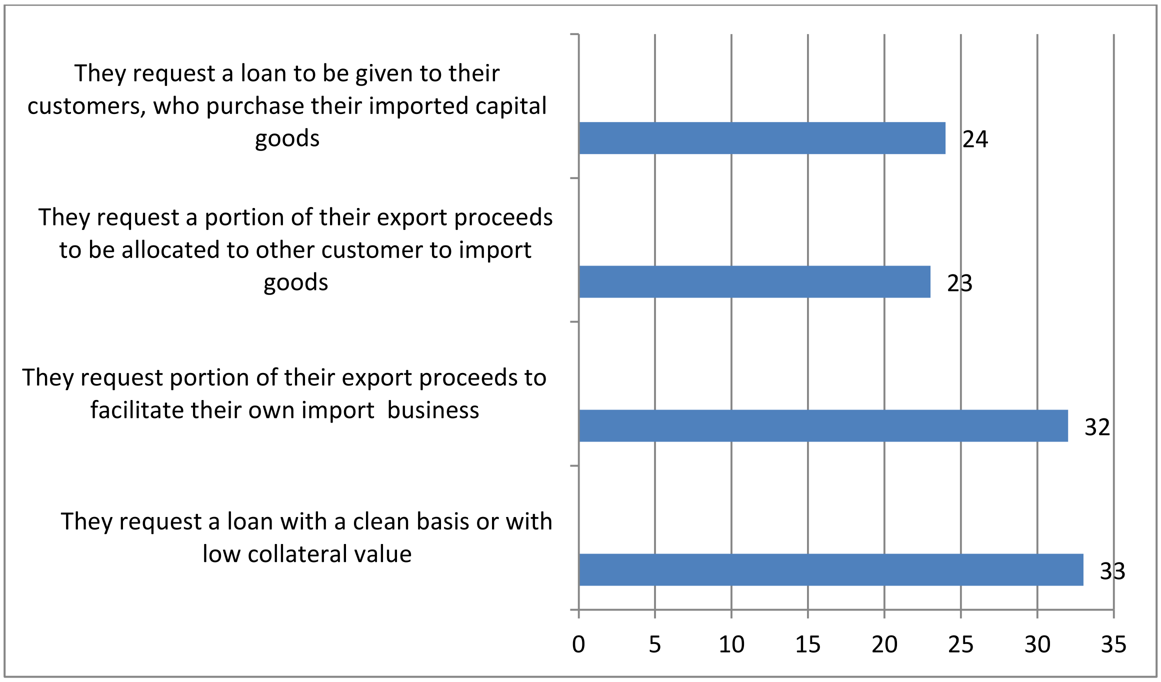


Figure 4: Reasons that force Dashen Bank to find ways of increasing its non-interest income

The above bar chart shows that 33 of the respondents responded that the Exporters request a loan with a clean basis or with low collateral value. The other challenge indicated by 32 respondents is that while approaching Exporters to export through their Bank the Exporters request portion of their export proceeds to facilitate their own import business. On the other hand 24 respondents and 23 respondents indicated that the Exporters request portion of their export proceed to be allocated to other customer to import goods and Exporters request a loan to be given to their customers, who purchase their imported capital goods were the challenges faced while their organization approach Exporters.

For the questions raised concerning that the above request of the Exporters are in line with their organization policy and procedure 18 or 46 percent of the respondents answered that it is not line with the organization policy and procedure. Whereas 18 or 46 percent of the respondents responded that some are in line and the others are not in line with their organization policies and procedures. The rest i.e. 3 or 8 percent of the respondents responded that the requests are in line with their organization policy and procedures, as shown in the table below.

Commercial banks in Ethiopia have faced increased competition in retail market due to deregulation. The government policy of directing finance to public enterprise result in the decline of profit obtained through interest income for the private commercial banks. These situation compel private commercial banks to shift their attention to generate non-interest income .one of the major sources of obtaining non-interest income in the banking industry is performing import activity.

The huge trade deficit, decline in export performance and the government growth strategy results in foreign currency shortage, especially for the private commercial banks. Therefore, this situation forces commercial banks to compete for channeling of export proceeds through their bank which is the major assets to perform import activity.

Through this process, owning to the scarcity of foreign currency, exporters demand many kinds of benefit from banks as a prerequisite in order to channel their export proceeds.

In this respect, the survey indicated that due to acute shortage of foreign currency that help banks to increase their profit, exporters request huge benefit as a pre requisite in order to channel their export proceeds.

Table 6: Response for request of the Exporters

Dose the request of the Exporters in line with your organization policy and procedure	Frequency	Percentage
Yes	3	8
No	18	46
Some are in line the other are not	18	46
Total	39	100

Source: Survey 2016

The response obtained from the respondent concerning whether their organizations entertain the exporters request reveals the following:

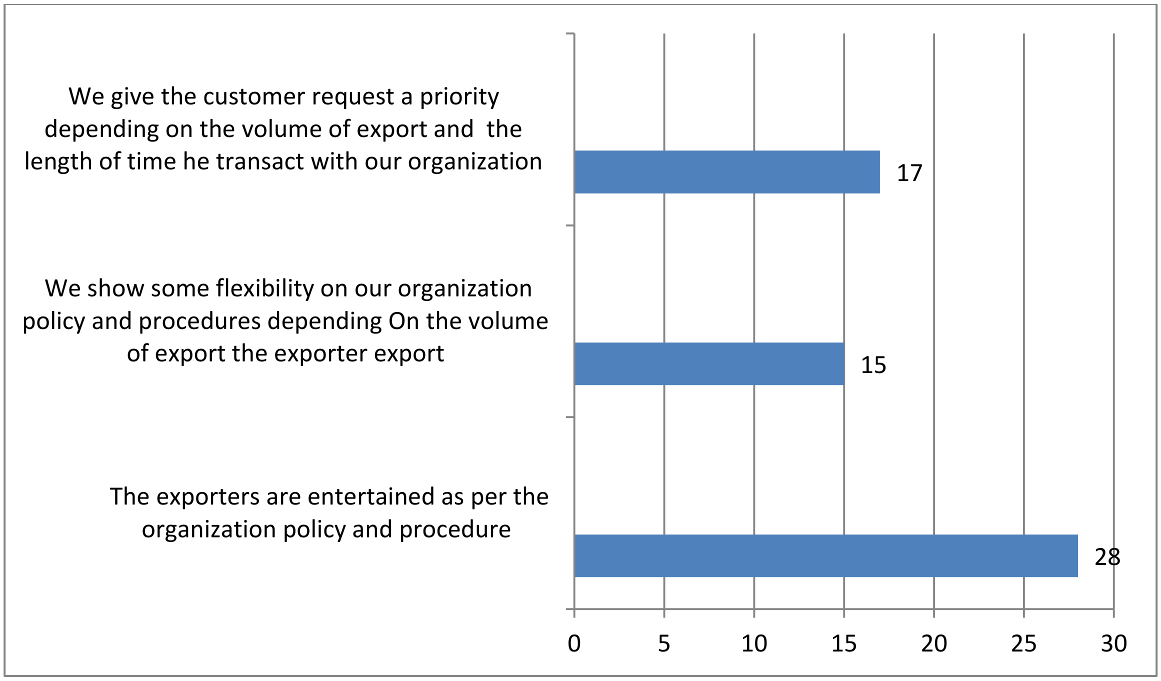


Figure 5: Treatment of the Exporters' request

The bar graph above shows that 28 of the respondents responded that the Exporters are entertained as per the organization policy and procedure. While 17 respondents were indicted that their organization give the customer request a priority depending on the volume of export and the length of time the Exporter transact with their organization .On the other hand 15 respondents responded that their organization show some flexibility on the organization policy and procedure depending On the volume of export the exporter export.

Interviews made with the bank professionals revealed that high expectation of exporters & excessive credit requirement and portfolio financing by exporters are the major challenges faced in the course of attracting exporters. In addition the interviews result on the question regarding what are the reason for the challenges of export sector exchanging in the case of Dashen Bank S.C. showed that shortage of foreign currency is the major challenge.

4.2.4 Competition among Commercial Banks to Attract Exporters

The pressure embarked on banking activity in Ethiopia due to the government policies has resulted for liquidity problem and shortage of foreign currency for private commercial banks. This in turn has an impact on the profitability of banks. Owning to this fact, banks in Ethiopia compete each other to attract export so as to increase their profit.

Concerning this respondents were asked whether their organization has faced competition from other commercial banks in attracting exports and the result is depicted in the following table.

Table 7: Response for Competition faced by other Commercial Banks

Competition from other Commercial Banks in attracting export	Frequency	Percentage
Yes	38	97
No	1	3
Total	39	100

Source: Survey 2016

The above table shows that 38 or 97 percent of the respondents responded that their organization face competition from other commercial banks in attracting exporters and 1 or 3% respondent replied that his organization does not face competition from its competitor in attracting export.

Respondents were also asked to identify the mechanism of competition in attracting exporters. Accordingly the following bar graph shows the result obtained.

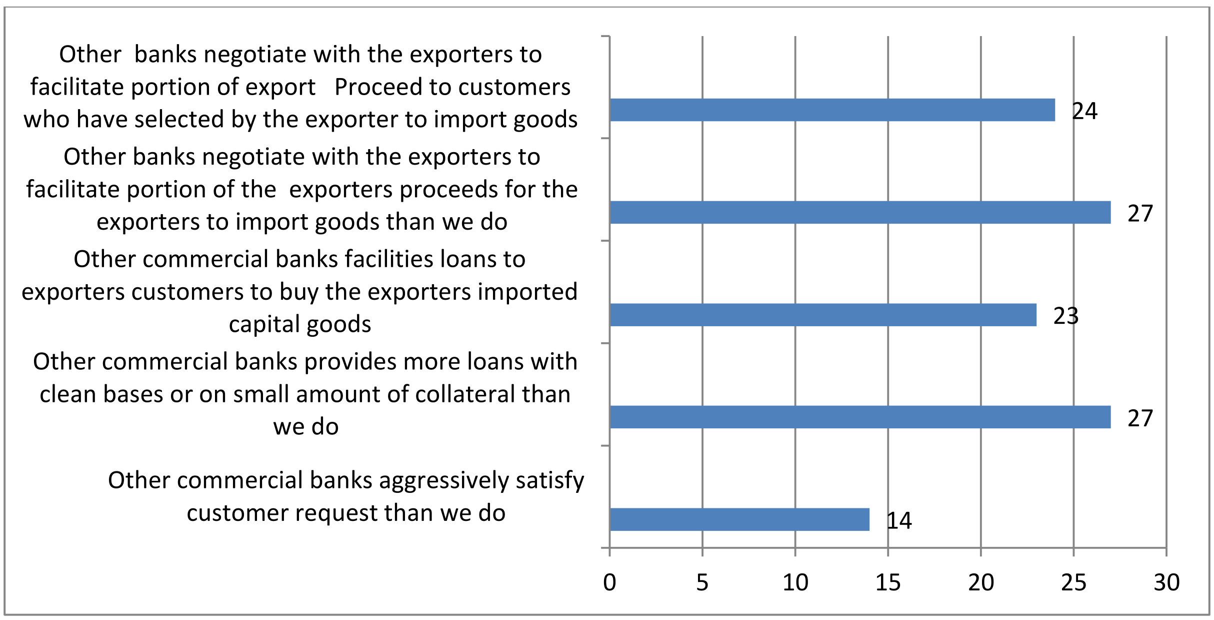


Figure 6: Reason for completion among commercial banks in attracting exporters

From the above bar chart it is observed that 27 respondents answered that Other commercial banks provides more loans with clean bases or on small amount of collateral than we do & Other commercial banks negotiate with the exporters to facilitate portion of the exporters' proceeds for the exporters to import goods than we do .On the other hand 24 respondets,23 respondents and 14 respondents were indicated that Other commercial banks negotiate with the exporters to facilitate portion of export Proceed to customers who have selected by the exporters' to import goods, Other commercial banks facilities loans to the exporters customers to buy the exporters' imported capital goods and Other commercial banks aggressively satisfy customer request than we do are the mechanism of competition by other commercial banks in attracting export respectively.

4.2.5 Systematic interpretation of NBE Directive

The liquidity problem and shortage of foreign currency that have impact on banks profitability forces commercial banks to look for ways that help them to increase their earnings. One of the areas that have room for this benefit is participating in exchanging of foreign currency proceeds directed to the country through export. So, commercial banks use loop holes of the NBE's directives to attract export in order to increase their benefit, though NBE has issued subsequent amendments on several occasions in order to close the loop hole.

Accordingly respondent were asked whether their bank interpret systematically every loop holes of NBE's directives and apply in attracting exporters in order to obtain maximum benefit. Based on the response 33 or 85 percent of the respondents indicated that their organization does not interpret every loop holes of NBE's directives and apply in attracting exporters in order to obtain maximum benefit. On the other hand 6 or 15 percent of the respondents responded that their organization interpret every loop holes of the NBE's directive and apply in order to obtain maximum benefit in attracting exporters, as shown in the table below.

Table 8: Response for systematically interpreting every loop holes of NBE's directives to attract Exporters

Systematically interpreting every loop holes of NBE's directive to attract Exporters	Frequency	Percentage
Yes	6	15
No	33	85
Total	39	100

Source: Survey 2016

The interviews made with bank professionals showed that their Banks' are interpreting NBE's polices & procedures in their face value in the course of undertaking export sector exchanging.

Regarding to express their views on the reason for systematic interpretation of NBE's policies and procedures, the interviewees said acute shortage of foreign currency is the reason. In addition the in interviewees said credit (settlement) risk, market risk, shift of non-satisfied exporters to other banks and loss of business or profit are the risks associated in the course of export sector exchanging in the case of Dashen Bank S.C.

From the respondent who answered "No" 19 of them stated that their organization anticipation of long term sustainable benefit than short term gain is the reason for their answer and 27 of them responded that their organization does not want to take risk in interpreting NBE's Directives is the reason as depicted in the bar chart below.

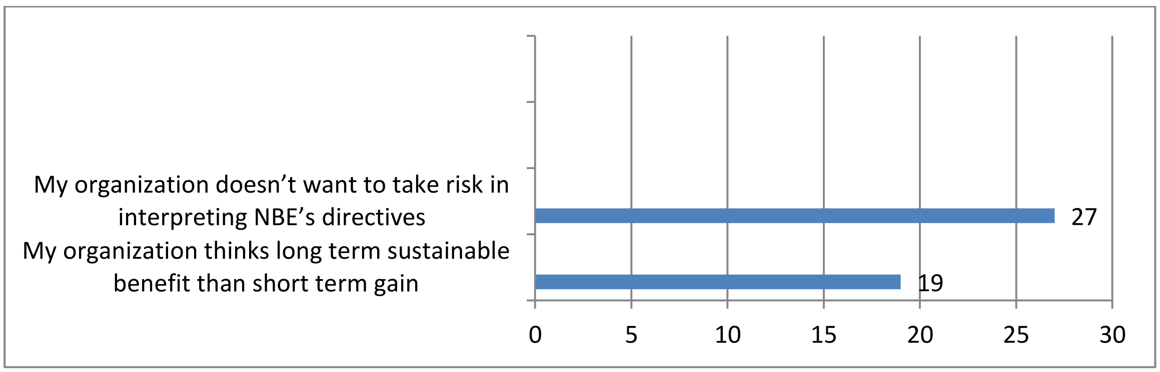


Figure 7: Reason for not interpreting every loop holes of NBE's Directives in order to attract Exporters

4.2.6 NBE Directive that Dictate all Export to Chain should entertain through CBE

Export proceeds help banks to increase profit and their overall competitiveness in the industry. The NBE directive that compels all exporters shipping items to China should make their transactions through Commercial Bank of Ethiopia poses a serious challenge on the competitive advantage of private banks as China is one of the major destinations of Ethiopian export goods.

Concerning these respondents was asked whether the NBE directives that dictate all export to china should entertain through CBE reduce the amount of export proceed shared by private banks. The results obtained from the respondents were presented in the table below.

Table 9: Response on NBE Directive that Dictate all Export to Chain should entertain through CBE

Entertaining all export to china through CBE reduce the amount of export proceed shared by private banks	Frequency	Percentage
Yes	38	97
No	1	3
Total	39	100

Source: Survey 2016

As shown in the table above 38 or 97 percent of the respondents agreed that the NBE's directive that dictate all Export to China should entertain through CBE reduce the amount of export proceed shared by private banks and 1 or 3 percent of the respondent indicated that the NBE's directive does not decrease the amount of export proceed shared by private banks.

UNDP (2014) indicated that the destinations of Ethiopian exports were mainly Europe (43.6%) followed by Asia (30.3%) and Africa (21.3%).

In this respect, the survey indicated that the challenging of export proceeds from China through CBE reduce the amount of export proceed shared by private commercial banks and that lead to the increase search of export proceed to compensate it.

4.2.7 The role of FCY in Deposit, amount of Loan able fund and Customer growth

Respondents were asked that the availability of foreign currency by any commercial banks will increase its deposit and the amount of loan able fund, and having enough foreign currency enable their organization to attract deposit and new customers. The following tables reveal the responses obtained from the respondents.

Table 10: Increase export proceed versus Profitability

Availability of FCY increase deposit , loan able fund & customer growth	Frequency	Percentage
Yes	35	90
No	4	10
Total	39	100

Source: Survey 2016

From the total respondents on the above table 35 or 90 percent of the respondents were indicated that the availability of FCY increase deposit and amount of loan able fund. On the other hand 4 or 10 percent of the respondents were responded that the availability of FCY does not increase deposit and the amount of loan able fund of their organization.

Due to the trade deficit gap observed in our country , export sector activities becomes one of the key areas that commercial banks participate, owning to the benefit obtains from the foreign currency generated by such business. It helps commercial banks to increase their deposit, customer base, profitability and position in the banking industry.

In this respect, the survey indicated that 35 or 90 percent of the respondents respond that the role of foreign currency in deposit, amount of loan able fund and customer growth is high. They in turn have the major players in profit of the bank. So, commercial banks compete hard to attract foreign currency that indirectly helps them to achieve their objective.

Table 11: Relationship between Foreign currency availability with deposit & customer attraction

Foreign currency availability will result Deposit & customer attraction	Frequency	Percentage
Yes	37	95
No	2	5
Total	39	100

Source: Survey 2016

As shown on the above table 37 or 95 percent of the respondents responded that their bank will attract deposit and new customer, if it has enough foreign currency. The rest of the respondents i.e. 2 or 5 percent were responded that they don't think that the availability of foreign currency will attract deposit and new customer to their organization.

Those respondents who answered "yes" on table 12 above asked to indicate the reasons for their answer. Accordingly 33 of the respondents responded that foreign currency is scarce and needed by all customers .On the other hand 19 of the respondents responded that there is a shortage of imported goods and customers need to make a profit by importing the goods as shown in the bar chart below.

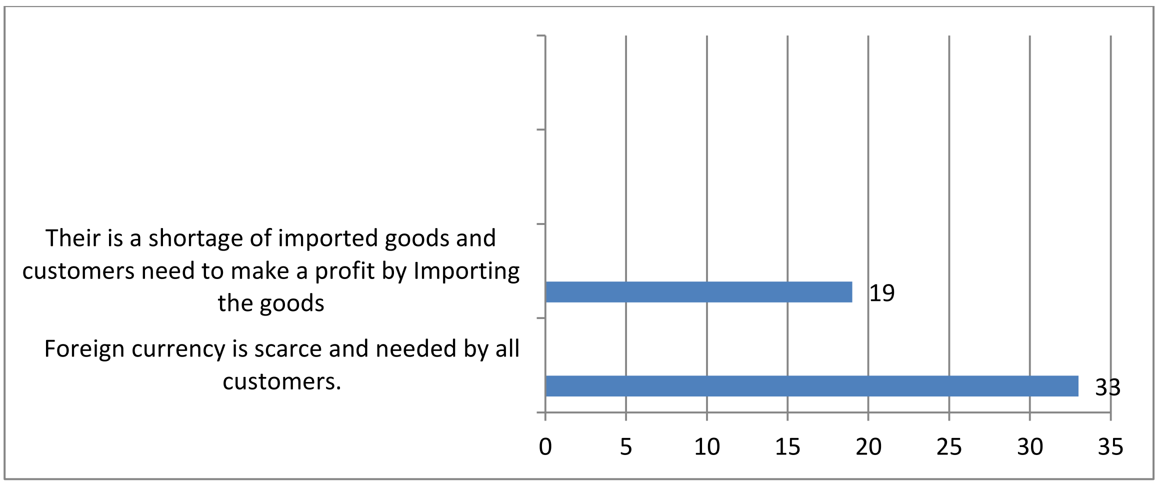


Figure 8: Reason for relation between foreign currency &, deposit and customer attraction

4.2.8 The impact of FCY Availability on Profit

The decline in interest margins has changed the traditional role of banks and has forced them to search for new sources of revenue. The NBE directives and the government policies force private commercial Banks to raise fees and commissions to make up for lower return. Increase in non-interest income tends to be associated with higher profitability. Income generated from import activities constitute the major share of the profit obtained by Dashen Bank S.C. One of the main sources of this income is import service activity made as a result of a foreign currency generated by Exporters who make their foreign transactions through Dashen Bank S.C.

Accordingly respondents were asked to respond on the relationship of export proceeds, non-interest income and financial performance. They also requested to indicate the trend of terms and tariff revision. The results of the respondents are depicted below.

Table 12: Response on the relationship between export proceeds & profitability

Increase in export proceeds results in profitability	Frequency	Percentage
Yes	35	90
No	4	10
Total	39	100

Source: Survey 2016

As shown above 35 or 95% of the respondents indicated that an increase in export proceeds has a direct relationship with profitability of their organization.4 or 10% of the respondents answered that an increase in the export proceed of their organization does not directly link with the profitability of their organization.

Concerning the question that their organization has made upward terms and tariff revision on import service activities, 36 or 92% of the respondents conformed that their organization has made upward terms & tariff revision on import activities and 3 or 8% of the respondents responded that their organization do not made the revision, as shown in the table below.

Table 13: Response on revision on terms and tariff of import activities

Is there an upward terms % tariff revision on import service activities	Frequency	Percentage
Yes	36	92
No	3	8
Total	39	100

Source: Survey 2016

Respondents who answered "Yes" in the above table requested to indicate the revenue stream on which terms and tariff revision is made. Accordingly the following responses were obtained.

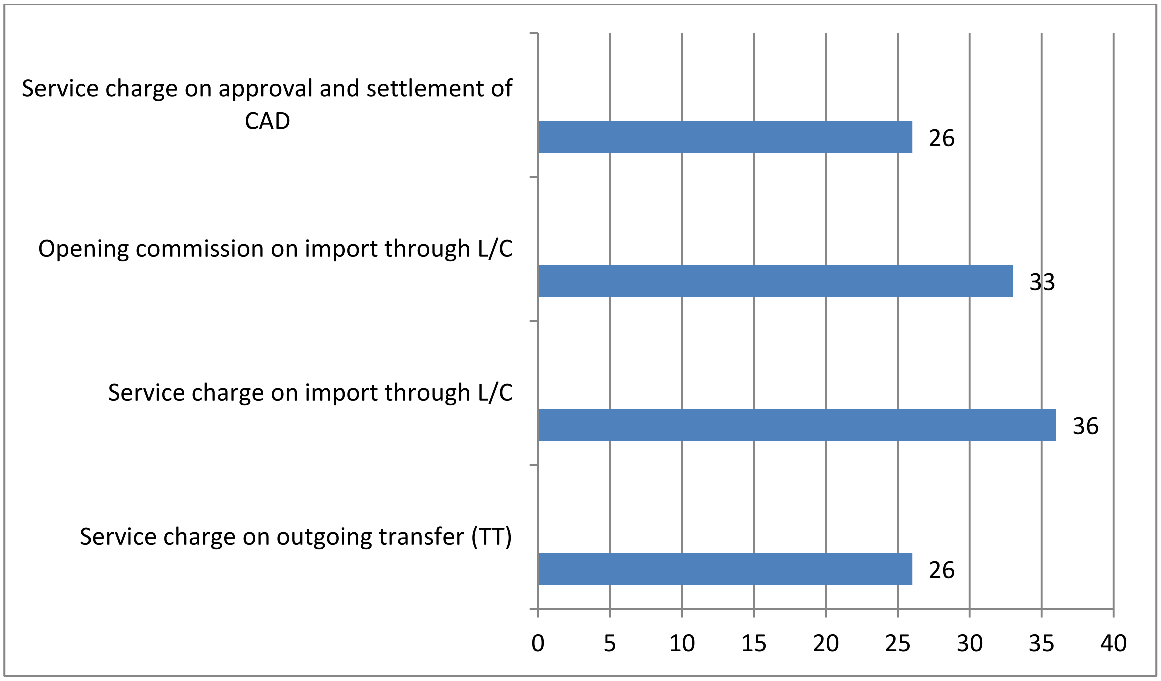


Figure 9: Revenue stream on which terms & tariff revision is made

As depicted on the bar chart above, 36 of the respondents answered that service charge on import through L/C is the one stream on which terms & tariff revision is made.33 of the respondents indicated that opening commission on import through L/C is the other revenue stream for which the revision is made. On the other hand 26 of the respondents said that Service charge on approval and settlement of CAD & Service charge on import through L/C is the revenue streams on which the terms & tariff revision applied.

On the question forwarded to the respondents concerning the relationship of non-interest income and and financial performance, 33 or 85 percent of the respondents indicated that there is a direct relationship between non-interest income & financial performance. On the other hand 6 or 15 percent of the respondents indicated that there is no direct relationship between non-interest income & financial performance, as shown in the table below.

Table 14: Relationship of non-interest income & Financial Performance

Is non-interest income & Financial performance directly related	Frequency	Percentage
Yes	33	85
No	6	15
Total	39	100

Source: Survey 2016

4.2.9 Reduce Dependence on Interest Income

The decrease in amount of loan able fund due to government policies and NBE directives pressure commercial banks to find other sources of revenue stream to compensate the reduction in interest income.

Respondents were asked whether the government policies, regulations and NBE directives force Dashne Bank to make a strategic shift of its dependence on interest income or not. Accordingly 28 or 72% of the respondents answered "Yes" for the question above and 11 or 18% of the respondents responded "No" to the question as depicted here under.

Table 15: Response for reduce dependence on interest income

Is government policy & NBE directive force Dashen Bank to make a strategic shift	Frequency	Percentage
Yes	28	72
No	11	18
Total	39	100

Source: Survey 2016

Those respondents who answered "Yes" for the question above asked to indicate the reason for the shift on the strategy and the following responses were given by the respondent as shown in the Bar chart below.

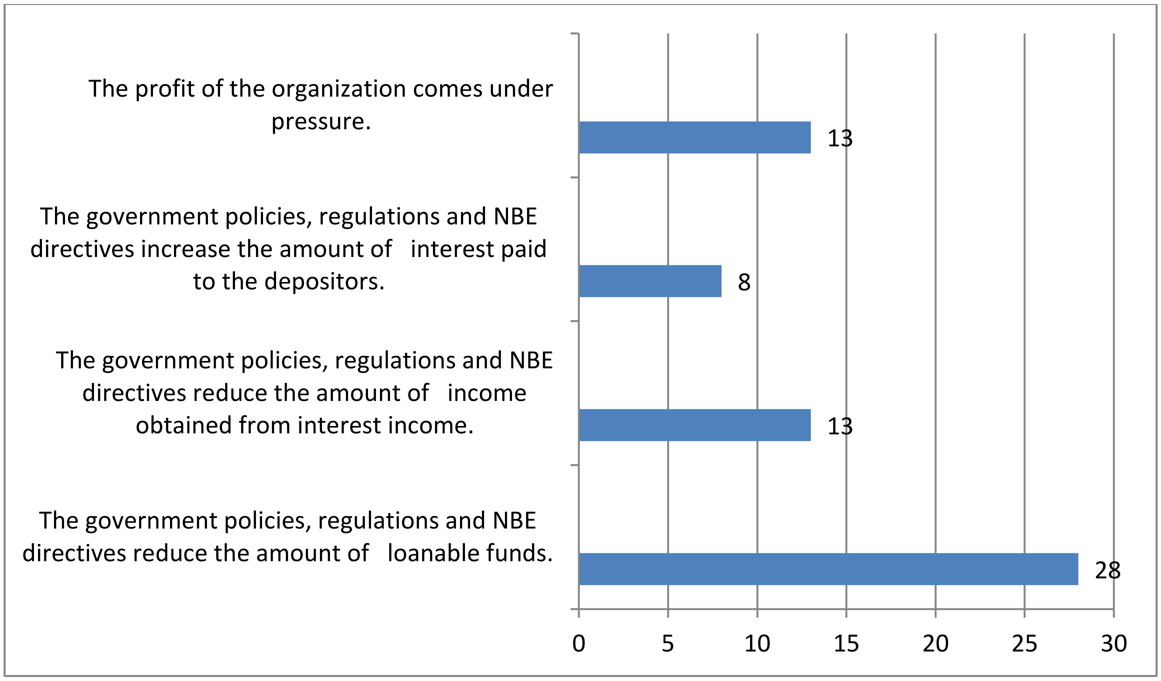


Figure 10: Reasons for Strategic Shift of Dependence on Interest Income

As shown above, 28 of the respondents answered that reduction in the amount of loan able fund due to the government policies, regulations & NBE directives compelled the Bank to make a strategic shift of its dependence on interest income. On the other hand 13 respondents answered that due to the government policies, regulations and NBE directives there is a reduction in the amount of income obtained from interest income & the profit of the organization comes under pressure, and they forced the bank to make a strategic shift. The rest of the respondent i.e. 8 of them chosen the increase in the amount of interest paid to the depositor due to the government policies, regulations and NBE directives forced the Bank to make a strategic shift to reduce its dependence on interest income.

4.2.10 Risk of involvement in Export sector Exchanging

Accordingly respondents were asked to indicate the type of risk faced by their organization while involving in export sector exchanging activities. The following table shows the responses obtained.

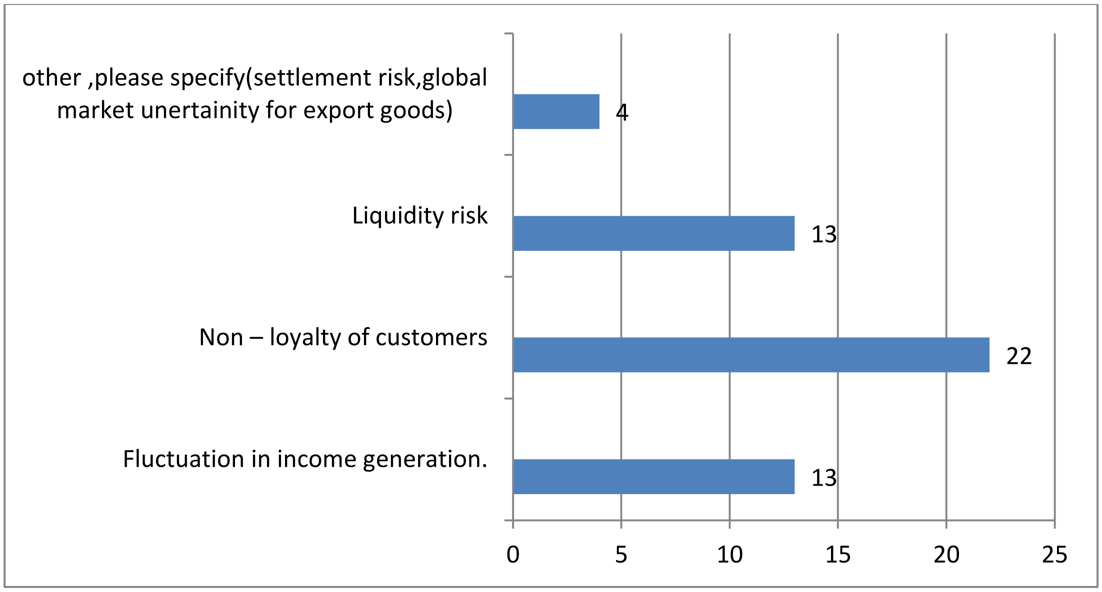


Figure 11: Responses for the risk faced by the Bank while involving Export sector exchanging activities

As shown in the above bar chart 22 of the respondents answered that non-loyalty of customers are one of the risk faced by their organization while involving in export sector exchanging activities. On the other hand 13 of the respondents indicated that liquidity risk & fluctuation in income are the type of risk encounter while involving in export sector exchanging activities. Other respondents gave their opinion that settlement risk & market uncertainty for export goods are the kind of risks facing while involving in export sector exchanging activities.

Increase in non-interest income tends to be associated with higher profitability, higher variation in profit, and a worsened risk-return tradeoff for the average commercial bank. Export sector exchanging activity which is the major source of non-interest income generating activities of commercial banks in Ethiopia may increase the overall risk of the banks via income volatility. Loans that are held in a bank's portfolio, especially loans to business, are relation based.

In this respect, the survey indicated that involvement in export sector exchanging associated with liquidity risk, non-loyalty of customer and fluctuation in income.So, the bank has to devise ways that help to mitigate them.

4.2.11 Suggestion to Improve Challenges of Export Sector Exchanging

Several suggestions were forwarded by the respondents on the question of what could be done to improve the challenges of Export Sector Exchanging. Out of these the important points are summarized & presented below.

- Using the bankers association as a tool, commercial banks should be reached to a common consensus in order to avoid granting informal privilege for the exporters.
- Government by forming a special expert group should help exporters to increase their knowledge about foreign market, create awareness on how to deal with marketing exportable items.
- Exporters should increase their involvement in value adding export activities and the quality of exportable items.
- Systematically encourage potential investors that have a relation to the international market to engage in the export business.
- Increase the number of exportable items.
- Develop the capacity of exporters to upgrade their exportable items in to capital goods from agricultural products and semi-finished materials.
- The government has to levy higher tax or systematically restrict import of goods which could be produced in the country.
- Work hard to develop other sectors like hospitality service, hotel service & tourism to generate FCY.
- Government intervention to support exporters by availing smooth infrastructure, transport and searching buyers of our county product in the world market.
- Increase the regulatory body capacity i.e. NBE capacity in order to create a fair ground competition among commercial banks in attracting exporters.
- Involving in value chain financing of activities that has linkage with export.
- Government support to farmers and producers to produce quality agricultural products and get fair price.
- Availing flexible and favorable loan products /facilities to exporters.
- Introducing fee income for the service provided by bank.

Christos and Geoffrey (2013) also stated that Banks also receive fee income from a number of off-balance sheet items including loan commitments, note issuance facilities, letters of credit, foreign exchange services, and derivative activities (contracts for futures, forwards, interest rate swaps, and other derivative contracts). Letters of credit include standby and commercial letters of credit.

Due to the pressure rest on profitability of traditional banking activity, fee earning activities have greatly increased their contribution to bank profitability. This implies that, for banks to remain competitive with the industry, they need to expand their product breadth and improve sales, relationships, servicing, and investment know-how (Christos and Geoffrey, 2014).

IMF (2013) indicated that private commercial banks also raised fees and commissions to make up for lower returns on NBE bills holding.

Therefore, the survey result indicated that in addition of making effort to support and expand the export sector ,banks have to look for other fee income and foreign currency generation activities   to increase their profit and reduce the challenges of export sector exchanging.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

This chapter deals with conclusions and recommendations respectively. Hence, the major findings of the study were analyzed and discussed in chapter four give a way to draw a conclusion. Finally, possible recommendations for the major problems found from the study are forwarded on the basis of the findings of the study.

5.1 Summary of the findings

According to the discussion and analysis of the data presented in chapter four, the following findings were drawn with regard to reason for involvement in Export financing activities, the finding revealed the following findings.

The bank has involved in export financing activities & the main reasons for its involvement are to generate foreign currency & to increase the organization profit.

The findings of the study concerning impact of government policies, regulations & NBE directives on export sector activities revaled that, the bond purchase reduces the liquidity of the organization, the income obtained from loan able fund & the organization loan able fund. In addition the government policies, regulations and NBE directives reduce the amount of loan able funds, reduce the amount of income obtained from interest income and due to the above cases the profit of the organization comes under pressure.

Concerning the requests of the Exporters to channel their export and handling of their request by commercial banks, the respondents indicated that the Exporters request a loan with a clean basis or with low collateral value, the Exporters request portion of their export proceeds to facilitate their own import business, the Exporters request a loan to be given to their customers, who purchase their imported capital goods & the Exporters request a portion of their export proceeds to be allocated to other customer to import goods.

The finding on the response given by the Bank's for the exporters' request listed above indicated that half of the respondents responded that the exporters are entertained as per the organization policy and procedure. On the other hand the rest i.e. half of the respondents responded that the bank show flexibility on the organization policy and procedure depending on the volume of export the exporter export & the bank gives the customer's request a priority depending on the volume of export and the length of time the customer transact with their organization.

The interview results showed that high expectation of exporters & excessive credit requirement and portfolio financing by exporters are the major challenges faced in the course of attracting exporters. It also revealed that shortage of foreign currency is the reason for challenges of export sector exchanging in the case of Dashen Bank S.C.

About competition among commercial banks to attract Exporters, almost all respondents agreed that there is competition from other commercial banks in attracting exporters.

Regarding the mechanism for the competition in attracting exporters between commercial banks the respondents said that other commercial banks provide more loans with clean bases or on small amount of collateral than we do, negotiate with the exporters to facilitate portion of their export proceeds for the exporters to import goods than we do & negotiate with the exporters to facilitate portion of their export Proceed to customers who have selected by the exporter to import goods.

Regarding compliance to NBE directives, majority of the respondents answered that the bank does not systematically interpret every loop holes of NBE's directives and apply in order to obtain maximum benefit in attracting exporters. The reason given by the majority of the respondents who said "No" was that their organization doesn't want to take risk in interpreting NBE's directives. And the other respondents who said "No" responded that their organization think long term sustainable benefit than short term gain

On NBE directive that dictate all export to Chain should entertain through CBE almost all of the respondents responded that the directive reduce the amount of export proceeds shared by private Banks.

Regarding the role of FCY in deposit, amount of Loan able fund and Customer growth majority of the respondents responded that the availability of FCY by any commercial bank will increase its deposit and amount of loan able fund & almost all the respondents indicated that the bank able to attract deposit and new customers, if it has enough foreign currency.

The reasons given by the respondents for the question above were foreign currency is scarce and needed by all customers, & there is a shortage of imported goods and customers need to make a profit by importing the goods.

Regarding the impact of FCY availability on Profit, majority of the respondents said that the increase in export proceeds directly link with profitability of their organization.

Respondents also asked about their organization upward terms and tariff revision & responded that their organization made upward terms and tariff revision on import service activities. As per the response of respondents the activities that involve the upward terms & tariff revision are service charge on import through L/C ,opening commission on import through L/Service charge on outgoing transfer (TT) & service charge on approval and settlement of CAD.

On the relationship of non-interest income & financial performance majority of the respondents responded that non-interest income and financial performance are directly related.

Response on reduce dependence on interest income, most of the respondents said that government policies, regulations and NBE directives force Dashen Bank to make a strategic shift of its dependence on interest income. Regarding the reason for the shift, respondents answered that the government policies, regulations and NBE directives reduce the amount of loan able funds, the government policies, reduce the amount of income obtained from interest income & as a result the profit of the organization comes under pressure.

About risk of involvement in export sector exchanging, respondents indicated that the following are the risk involved while participating in export sector exchanging, non – loyalty of customers, fluctuation in income generation & liquidity risk.

5.2 Conclusion

Banks serve primarily as a medium which bridges the gap between surplus and deficit spending units in an economy. This primary function of banks generates interest income which constitutes their major source of revenue. In recent times however, the government policies, regulations and NBE directives have compelled private commercial banks in Ethiopia to consider other banking activities that beef up revenue generation through fee income.

One of this activity that private commercial banks in Ethiopia involve in order to increase their revenue is attracting exporters through various mechanism in order to channel the export proceed through them. In this respect the findings portrayed that commercial banks have faced many challenges in the process of involving in the export sector exchanging.

Regarding involvement in export financing activities, the study discloses that the bank has involved in the activity in order to generate foreign currency thereby increasing its profit. It was also found from the study that the bond purchase reduces the liquidity of the bank, the income obtained from loan able fund & reduces the organization loan able fund. The study also reflected that the government policies, regulations & NBE directives reduce the amount of loan able fund; the amount of income obtained from interest income & due this the profit of the bank come under pressure.

Concerning the request of the exporters, the study found out that the exporters request a loan with clean base or with low collateral value, they request portion of their export proceeds to facilitate their own import business, they request a loan to be given to their customers who purchase their imported capital goods as a prerequisite to channel their export proceeds through the bank. The study revealed about the treatment of the request by the bank that the bank entertained the request on most of the time as per the organization policy & procedure, however there are instance that the bank shows flexibility on the organization policy & procedure depending on the volume of export the exporters export & the banks give a priority depending on the volume of export and the length of time the customer transact with the bank.

About the competition among commercial banks in attracting exporters the study reflected that other commercial banks provide more loan with clean base or on small amount of collateral, negotiate with the exporters to facilitate portion of the exporters proceeds for the exporters to import goods & negotiate with the exporters to facilitate portion of export proceeds to customers who have selected by the exporters to import good than the bank do.

The study found out that due to the risk factor and on assuming long term sustainable benefit the bank doesn't systematically interpret every loop holes of NBE's directive & apply in attracting exporters, in order to obtain maximum benefit.

The study found that the NBE directive that dictates all export to chain should entertain through CBE reduced the amount of export shared by private commercial banks.
Due to acute shortage of FCY, the study revealed that the availability of FCY at any commercial bank increase the amount of deposit, loan able fund & customer and profit of the organization. It also indicates that non-interest income & financial performance are directly related.

It is also found that commercial bank made an upward revision of terms & tariff for service provided in connection with import of goods and service.
Regarding shift of dependence on interest income, it was found that the government policies, regulations & directives force the bank to make a strategic shift of its dependence on interest income.

It was found that non-loyalty of customers, fluctuation in income generation & liquidity risk are the risk facing during involvement in export sector exchanging.

5.3 Recommendation

Based on the major findings of the study and the conclusions drawn, the researcher suggested the following recommendations.

The main objective of any business organization is maximization of share holders' wealth which is maximization of profit in our country case. Private commercial banks in Ethiopia also established in a view of this objective.

Commercial banks compelled and look various ways to increase their income when their traditional revenue generating activity comes under pressure due to various reasons. One of the mechanisms chosen beef up non-interest income by commercial banks in Ethiopia is participating in export sector exchanging activities. However, there are challenges in performing these activities. As a result, the following points are suggested as recommendation for the existing problems.

- Since involvement in export financing activity is one of the major sources of revenue for commercial banks, the bank should ease its collateral requirement in order to attract exporters.
- The bank has to look a new source of non-interest income in order to reduce its challenge of generating revenue. So, the bank needs to expand its product breadth and improve sales, relationship, and servicing and investment know-how.
- There are many services that the bank provides to the customer without fee, which could benefit the bank, if proper service charge is collected. In this regard, the bank should introduce fee income charge from a number of off –balance sheet items and other activities for which the bank already give services.
- When doing business, it is a customary practice to use the loop holes of the directives to one's advantage. Accordingly, the bank should apply a practice of systematic interpretation of every loop holes of the NBE's directives and apply it in order to increase its revenue.
- Maintaining the sustainability of any export proceeds is vital to any commercial banks. So the bank should device a mechanism in order to participate in value chain financing of exportable goods.

- ❖ To increase the amount of export proceeds and to reduce risk, the bank has to introduce a policy that will attract professional exporters i.e. those exporters who have knowledge & majorly involve in export business.
- ❖ The bank should device a mechanism to attract the hospitality and tourism service that generate foreign currency.

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Appendix A:

St.MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

FACULTY OF BUSINESS

Questionnaire filled by Respondent

Dear Respondent,

I am a master's degree student in Business Administration at St.Mary's University. Currently, I am conducting a study on "Challenges of Export sector exchanging in the case of Dashen Bank S.C.".Hence, to gather information, kindly request your assistance in responding the questions listed below. Any information you present will be kept confidential and will only be used for academic purpose. Your cooperation and prompt response will be highly appreciated. Thank you very much in advance for your kind assistance.

Haileyesus T.

Section A: Background Information (please tick as appropriate)

1. Your position in the organization.

- ☐ Department Manager
- ☐ District Manager
- ☐ Deputy Department Manager
- ☐ Branch Manger
- ☐ Division Head
- ☐ IBD Team Leader
- ☐ Credit Team Leader
- ☐ Credit supervisor

2. How long have you worked in the organization?

- ☐ 1-5 Years
- ☐ 10-15 Years
- ☐ 5-10 Years
- ☐ Above 15 years

Section B: challenges of Export Sector Exchanging Related questions (multiple answer is possible)

1. Does your organization involve in Export Financing activities?

Yes☐ No☐

2. If yes, which one is the main reason for its involvement?

- ☐ To support Exporters
- ☐ To generate Foreign Currency
- ☐ To fulfill government development policy
- ☐ To increase the organization profit

Other, please specify ____

3. Do you think that the government bond purchasing policy and the 40/60 requirement increases your organization involvement in Export Sector activities?

Yes ☐ No ☐

4. If yes, which one is the reason for the involvement?

- ☐ The bond purchase reduce the liquidity of the organization
- ☐ The bond purchase reduce the income obtained from loan able fund
- ☐ The bond purchase reduce the organization loan able find
- ☐ The bond purchase increase the interest expense paid to the depositor

Other, please specify ____

5. Which one is/are the challenges facing your organization, when you approach Exporters to Export through your organization?

- ☐ They request a loan with a clean basis or with low collateral value
- ☐ They request portion of their export proceeds to facilitate their own import business

☐ They request a portion of their export proceeds to be allocated to other customer to import goods

☐ They request a loan to be given to their customers, who purchase their imported Capital goods

Other, please specify ______________________________________

6. Does the above request of the exporter in line with your organization policy and procedures?

Yes ☐ No ☐ some are inline others are not ☐

7. How does your organization entertain the exporters' request to obtain loan or foreign currency?

☐ The exporters are entertained as per the organization policy and procedure

☐ We show some flexibility on our organization policy and procedures depending On the volume of export the exporter export

☐ We give the customer request a priority depending on the volume of export and the length of time he transact with our organization

Other, please specify --

8. Do you think that the NBE directives that dictate all export to china should entertain through CBE reduce the amount of export proceed shared by private banks?

Yes ☐ No ☐

Other, please specify ____

9. Do you think that the availability of FCY by any commercial bank will increase its deposit and amount of loan able fund?

Yes ☐ No ☐

Other, please specify ____

10. Do you think that the increase in export proceeds directly link with profitability of your organization?

Yes ☐ No ☐

Other, please specify --

11. Does your organization made upward terms and tariff revision on import service activities?

Yes ☐ No ☐

Other, please specify____

12. If yes, on which one is /are the revision applied?

☐ Service charge on outgoing transfer (TT)

☐ Service charge on import through L/C

☐ Opening commission on import through L/C

☐ Service charge on approval and settlement of CAD

Other, please specify ---

13. Do you think that your bank able to attract deposit and new customers, if it has enough foreign currency?

Yes ☐ No ☐

Other, please specify --

14. If yes, which one is the reason?

☐ Foreign currency is scarce and needed by all customers.

☐ There is a shortage of imported goods and customers need to make a profit by Importing the goods

Other, please specify --

15. Does your organization systematically interpret every loop holes of NBE's directives and apply in order to obtain maximum benefit in attracting exporters?

Yes ☐ No ☐

Other, please specify --

16. If No, which on is / are the reason/s?

☐ My organization thinks long term sustainable benefit than short term gain

☐ My organization doesn't want to take risk in interpreting NBE's directives

Other, please specify ---

17. Does your bank encountered competition from other commercial banks in attracting exports?

Yes ☐ No ☐

Other, please specify ---

18. If yes, which one is /are the reason?

☐ Other commercial banks aggressively satisfy customer request than we do

☐ Other commercial banks provides more loans with clean bases or on small amount of collateral than we do

☐ Other commercial banks facilities loans to exporters customers to buy the exporters imported capital goods

☐ Other commercial banks negotiate with the exporters to facilitate portion of the exporters proceeds for the exporters to import goods than we do

☐ Other commercial banks negotiate with the exporters to facilitate portion of export Proceed to customers who have selected by the exporter to import goods

Other, please specify ---

19. Do you think that government policies, regulations and NBE directives force Dashen Bank to make a strategic shift of its dependence on interest income?

Yes ☐ No ☐

20. If yes, what do you think is / are the reason/s?

☐ The government policies, regulations and NBE directives reduce the amount of loanable funds.

☐ The government policies, regulations and NBE directives reduce the amount of income obtained from interest income.

☐ The government policies, regulations and NBE directives increase the amount of interest paid to the depositors.

☐ The profit of the organization comes under pressure.

Other please specify, --

21. Do you think that government policies, regulation and NBE directives force Dashen Bank to find way of increasing its non-interest income?

Yes ☐ No ☐

22. If yes, what do you think is/are the case/s?

☐ The government policies, regulations and NBE directives reduce the amount of loanable funds.

☐ The government policies, regulations and NBE directives reduce the amount of Income obtained from interest income.

☐ The government policies, regulations and NBE directives increase the amount of Interest paid to the depositors.

☐ The profit of the organization comes under pressure.

23. In your opinion, which one is/are the type of risk faced by your organization while involving in export sector exchanging activities?

☐ Fluctuation in income generation.

☐ Non – loyalty of customers

☐ Liquidity risk

Other, please specify___________________________________

24. Do you think that non-interest income and financial performance are directly related?

Yes ☐ No ☐

25. In your opinion, what could be done to improve the challenges of Export Sector Exchanging?

____
____
____

Thank you,

Appendix B --- Interview Guide for Bank professionals

St.MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

FACULTY OF BUSINESS

Dear Respondent,

I am a master's degree student in Business Administration at St.Mary's University. Currently, I am conducting a study on "Challenges of Export sector exchanging in the case of Dashen Bank S.C.".Hence, to gather information, kindly request your assistance in responding the questions listed below. Any information you present will be kept confidential and will only be used for academic purpose. Your cooperation and prompt response will be highly appreciated. Thank you very much in advance for your kind assistance.

1. In your opinion, what do you think is/are the reason for the challenges of export sector exchanging in the case of Dashen Bank S.C.?

2. In your opinion, what are the major challenges faced in the course of attracting exporters in the case of Dashen Bank S.C.?

3. In your opinion, do you think that NBE policies and procedures are properly applicable in the course of undertaking export sector exchanging in the case of Dashen Bank S.C.?

4. In your opinion what is /are the reasons for non-compliance with NBE policies and procedures in Undertaking export sector exchanging?

5. In your opinion, what is /are the risk associated in the course of export sector exchanging in the case of Dashen Bank S.C.?

6. In your opinion what measures or actions will be taken by Dashen Bank S.C., NBE and other stake holders to reduce the challenges of export sector exchanging in the short and long term?