



ADDIS ABABA UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
DEPARTMENT OF ACCOUNTING AND FINANCE

**ASSESSMENT ON THE CHALLENGES OF NATIONAL BANK FOREIGN
EXCHANGE SURRENDER REQUIREMENT ON PRIVATE
COMMERCIAL BANKS IN ETHIOPIA.**

BY
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Declaration

I hereby declare that this thesis is my original work prepared under the guidance of Degefe Duressa (Ph.D.) and this thesis has not been presented for a Degree in any other University. Also, all sources of materials used for this thesis have been duly acknowledged.

Date _____

Signature _____

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List of Acronyms

BOP Balance of Payment

FCY Foreign Currency

FOREX Foreign Exchange

FXD Foreign Exchange Directive

IBD International Banking Department

NBE National Bank of Ethiopia

SWIFT Society for Worldwide Interbank Telecommunication

Abstract

The main objective of the study was to examine the challenges of the national bank of Ethiopia's foreign exchange surrender requirements on commercial banks. Due to the surrender amount is substantial which is seventy percent of foreign exchange earnings, commercial banks faced different challenges as a result of surrender requirement imposed by National Bank of Ethiopia. The study used a mixture of exploratory and descriptive research designs to get an in-depth understanding of the challenge of the surrender requirement on banks, and a combination of qualitative and quantitative methods were applied to the study. Primarily the study used primary data sources through structured interviews and self-administered questionnaires to examine the real challenges of the surrender requirement. A total of 124 professional employees and 4 senior managers from the IBD department participated in the study. Questionnaires were distributed to IBD professionals and interviews were made with IBD senior managers to explore their understanding of the challenge of the surrender requirement on commercial banks. To analyze the quantitative data descriptive statistics was used whereas, data obtained from interviews were analyzed qualitatively. Accordingly, the findings of the study showed that the surrender requirement reduced the forex mobilization capacity of banks, it leads to adverse customer relationships and it has financial loss to commercial banks. As a result, the findings suggested that commercial banks should encourage customers to open foreign currency accounts such as diaspora account and foreign currency saving account which are not subjected to the surrender requirement so as to minimize the effect of the surrender requirement.

Key words: Surrender Requirement, NBE Directives, Foreign Exchange, Challenges

CHAPTER ONE

INTRODUCTION

The first chapter of this study introduces the area of study, providing an introduction to the study. This chapter is organized under different sections in which the background of the study, statement of the problem, basic research questions, the objective of the study, research scope, and limitation of the study then finally the structure of the paper are presented.

1.1 Background of the Study

Commercial banks facilitate international transactions through their international banking divisions, and foreign exchange is the main concept in international banking services. Without foreign exchange, international banking would be impossible as it represents the financial part of commercial transactions which is conducted through the payment and settlement systems of the banks (Franklin and Elena 2008).

Foreign currency means any currency other than Ethiopian legal tender which is legal tender in any country outside Ethiopia as to which the National Bank of Ethiopia has declared to be accepted for payment in Ethiopia (NBE, 2017). Foreign exchange also means any foreign currency, cheques, bills of exchanges, promissory notes, drafts, securities, and other negotiable instruments expressed in foreign currency as well as bank balances in an account held in foreign currency or asset in the form of foreign account crediting or set-off arrangements, expressed or payable in foreign currencies provided they are acceptable by the National Bank (NBE, 2017).

Both the state and private banks in Ethiopia do not have enough foreign currency deposits to meet the rising demand for imports. Private Banks used to purchase hard currency through auctions from the National Bank of Ethiopia (NBE), but the practice has been suspended by the central bank due to the country-wide scarcity of foreign currency reserves and the liquidity risk of private banks. Therefore, all banks have to compete to gain foreign currency from the existing limited market sources. Sources of foreign currency are areas in which economic and financial transactions between countries affect exchange rate levels (Nicholas, 2014). Major sources of foreign currency can differ from country to country, but the common ones are Export, foreign direct investment, tourism, and remittances (Nicholas, 2014).

The government of Ethiopia uses different directives regarding foreign exchange regulations for commercial banks. Among them are foreign exchange control, foreign currency surrender requirement, transparency in foreign currency allocation, and retention and utilization of foreign currency.

In Ethiopia, commercial banks are forced to deliver a portion of their foreign currency earnings to the national bank of Ethiopia. This surrender policy was initially introduced in 2017 and it includes most sources of foreign currency earnings to help the government's hard currency demand for different payments including debt service. However, after four years of duration, the policy was amended by another directive (directive no. FXD/72/2021) which exempted some sources of foreign currency earning sources such as foreign direct investment, diaspora accounts, and the like from the surrender policy while the surrender from export, inward remittance, and NGO transfers increased from 30 % to 50% (NBE, 2021)

The National Bank of Ethiopia undertakes activities of regulating the foreign exchange market by setting foreign exchange exposure limits and foreign exchange surrender requirements on commercial banks. Due to foreign exchange being a scarce resource in Ethiopia, it should be managed carefully to ensure its efficient and proper allocation. In addition to surrendering requirements, the National Bank of Ethiopia also ensures that there is transparency in foreign currency allocation and foreign exchange management. Due to this, each commercial bank is required to have transparent and sound foreign currency allocation and foreign exchange management guidelines or procedure manual which shows accountability of each employee of a bank who is involved in a foreign exchange transaction (NBE,2021).

As per the national bank directive, the main reason for the surrender requirement and other similar directives is the shortage of foreign currency in the country and sharing of the government burden of the hard currency problem. As a result, the surrender requirement is required in order to sustain economic conditions and to facilitate basic public goods and services which need hard currency like fuel fertilizer and repayment of public debt (NBE, 2022)

Accordingly, to get a better understanding and insight regards the subject matter, and to contribute to the researcher's study in the field and due to there were no prior studies conducted in the subject area, the researcher is interested to conduct a study to examine the challenge of national bank of foreign exchange surrender requirement on private commercial banks.

1.2 Statement of the Problem

Multiple studies Focused on foreign exchange control. Its main objectives are to prevent an adverse balance of payments position on national accounts and to manage the value of the local currency. However, in Ethiopia, no prior studies were conducted on foreign exchange surrender requirements. Its objective is to share the foreign exchange earnings from commercial banks to NBE in order to support the government foreign exchange reserve.

Foreign currency plays an important role in the operation of commercial banks. Especially in Ethiopian commercial banks where there is unbalanced demand and supply of foreign currency in country. Due to this problem, Ethiopian commercial banks used foreign currency not only to get a profit from speculative selling and getting commission from selling but also, they used it as a means of customer handling and customer satisfaction objective.

However, currently, commercial banks are under the restriction imposed by the national bank of Ethiopia, which requires the banks to surrender a substantial portion of the bank's foreign currency earnings to the national bank at the prevailing buying rate on that day and failure to surrender leads to a penalty. Moreover, the volatility of the surrender requirement from time to time itself may have an impact on the smooth operation of commercial banks.

Along with the surrender requirements, other related national bank of Ethiopia regulations like a forex allocation and retention directives also have an affected on commercial banks. According to the foreign currency allocation directive, (FXD/77/2021), commercial banks are prohibited from allocating foreign currency earnings from export to import business. In addition, banks are forced to allocate foreign currency in the categories of first priority, second priority, and third priority imported goods with first come first serve criteria.

Although the surrender requirement lasts six years and the NBE announced the directive to commercial banks, no prior studies conducted on the subject matter. Accordingly, this study was conducted to describe the concept of foreign exchange surrender requirements and to examine its challenges on commercial banks.

1.3 Research Questions

Based on the above-stated problem, the study is focused on the following research questions.

- 1) What is the challenge of the surrender requirement for banks on forex mobilization and utilization?
- 2) What is the challenge of the surrender requirement for banks on customer relationships or customer experience?
- 3) How the surrender requirement leads financial loss to the commercial banks?

1.4 Research Objective

1.4.1 General Objective

The main objective of this study is to examine the Challenges of National bank foreign exchange surrender requirements on private commercial banks in Ethiopia.

1.4.2 Specific Objectives

The specific objective of the study is to:

- To examine the challenge of surrender requirements for banks on forex mobilization and utilization.
- To assess the challenges of the surrender requirement for banks on customer relationships or customer experience.
- To examine how the surrender requirement leads financial loss to commercial banks.

1.5 Significance of the Study

Due to not enough studies conducted on this topic, this study will an important contribution to the field. The outcomes and results of this study will have a potential value to interested readers, especially, bank employees who do not have enough awareness regards to the subject matter so as to understand the challenges of the surrender requirement on their forex utilization and mobilization, customer relationship, and its effect on banks profitability. In addition, this study will help decision-makers like top management of bank officials, bank stakeholders, and other

professionals who have a direct relationship with banks. Finally, this study is also expected to help upcoming researchers who will be interested to conduct further studies on similar aspects.

1.6 Scope of the Study

Initially, this study is focused on four private commercial banks which are Dashen Bank, Abyssinia Bank, Nib international bank, and United Bank to assess the Challenges of the National Bank foreign exchange surrender requirement on private commercial banks in Ethiopia. Although there are many other private commercial banks in the country, the researcher believed that selected private commercial banks are enough to conduct the study because the surrender requirement is the same for all private banks and the effect is expected to be similar across the bank industry. Second, the study will use employees of banks who are under the international banking department at the Head office level as target respondents. This is due to employees who work in the international banking department will have a better understanding and information access on the subject matter relative to other employees of the banks.

1.7 Limitations of the Study

The study is restricted to access to only four private commercial banks. It was better if other private commercial banks are included in the study to reach a better generalization about the impact of the NBE's surrender requirement. In addition, because of the unavailability of related research work on the current topic in the Ethiopian context, the study has focused on materials from the national bank's directives and websites.

1.8 Organization of the Thesis

The research paper is divided into five chapters. Chapter One presents the introduction part, which contains, the background of the study, statement of the problem, research questions, objectives of the study, significance of the study, scope of the study, and limitations of the study. The second chapter is containing a literature review. Chapter three is about the methodology of the study. Chapter four is data analysis and presentation. The final part chapter five summarizes the findings, concludes the paper, and forwards some recommendations based on the findings.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents the literature reviewed in order to provide a basis for the study. In addition, information about various aspects of previous works which are related to the study was assessed and presented. Empirical studies thereby illustrate the research gap after which it presents the summary of the empirical literature.

2.2 Theoretical Review

2.2.1 The Concept of Banking

The term Bank in modern times refers to an institution that: (1) deals with money; accepts deposits and advance loans (2) deals with credit; it has the ability to create credit, (3) is a commercial institution; it aims at earning profits, and (4) creates a demand deposit which serves as a medium of exchange, and as a result, the Bank manages the payment system of the Country. A Bank as a financial institution is the creator of money in the form of Credit money i.e., cheque. (Emebet et al 2016). Banking is defined as accepting money from the public, for the purpose of lending, or investment of deposits, repayable on demand or otherwise, and withdrawing by cheque, draft, or order. Thus, we can say that a Bank is a financial institution that deals with deposits and advances and other related services. It receives money from those who want to save in the form of deposits and it lends money to those who need it. It bridges the gap between savers and borrowers. The provision of deposit and loan products normally distinguishes Banks from other types of financial firms. Deposit products pay out money on demand or after some notice. (Emebet et al 2016). 3 Currently the Ethiopian Banking industry is highly protected from outside competition through the ban on foreign Bank entry and the entrance of new local Private Banks into the market was very restricted. Since the 1991 measure, there appears a growth in the number of Banks but regulation remained tight with the sector entertaining various reform and regulatory measures from the National Bank of Ethiopia. Despite the regulator's intent to ensure a robust financial system, it is apparent that some of its measures will have implications for the performance of Banks. (Lipczynski et al.2013). They confirmed that regulation (like the ban of foreign Banks, entry capital increase, etc.) has a significant impact on the performance and efficiency of Banks.

Nevertheless, the effect of regulation on performance is not widely assessed in empirical studies. For instance, previous studies and studies in Africa do not account for the regulatory and institutional factors that are likely to shape competition.

Banks play a role of considerable Economic significance as intermediaries in mobilizing public savings and canalizing the flow of funds for productive purposes, keeping on the process of the economic growth of the country (Bagyalakshmi, 2014). Banks channel part of their fund to exporters which enables the Banks and the exporter in good shape. Export is one of the growth drivers of all growing economies. The expansion of Exports is well appreciated and takes a major place in Government Policy (Kumar, 2013). Exports are major factors in the development of an Economy, particularly in developing nations (Bagylakshmi, 2014). According to (Aworemi, 2011) most Countries and Companies considered export performance as a tool to boost corporate growth, strengthen the competitive edge, and ensure company survival in a highly competitive marketplace. Exporting is extremely attractive to most national governments because it allows the accumulation of foreign exchange reserves, enhances societal prosperity, and helps national industries to develop, improve productivity and create new jobs.

2.2.2 The Concept of Foreign Exchange Surrender Requirement

Surrender requirement implies the obligation of commercial banks to sell a portion of their foreign exchange earnings within a specified time and at a specified exchange rate to the central bank of that country (NBE, 2017). The proceeds of foreign currency are mostly from export and inward remittance, and non-governmental organization transfers from abroad (NBE, 2021) It is a part of the foreign exchange control mechanism but its purpose is limited relative to exchange control. This is due to the foreign exchange control having a wide monetary policy objective but the foreign exchange surrender requirement's main objective is to increase central banks foreign reserve.

2.2.3 Concepts of Exchange Control

The spirit of economic revolution forced every country to look primarily to its own economic interests. Nowadays, various mechanisms have been adopted to control international trade and regulate international indebtedness arising out of international workings and dealings. Foreign Exchange control is one of the devices adopted for the purpose. Various definitions were provided for foreign exchange control. The most common definitions were provided by Crowther (2001)

and Haberler (2007). Foreign Exchange control is a system in which the government of the country intervenes not only to maintain a rate of exchange that is quite different from what would have prevailed without such control. The government of a country intervenes directly or indirectly in international payments and undertakes the authority to purchase and sale of foreign currencies. It requires the home buyers and sellers of foreign currencies to dispose of their foreign funds in particular ways. It is a method of state intervention in the imports and exports of the country, so that the adverse balance of payments may be corrected. Exchange controls are government-imposed controls on restrictions on private transactions conducted in foreign currency. The government restricts the free play of inflow and outflow of capital and the exchange rate of currencies.

According to Haberler (2007), Foreign Exchange Control in the state regulation excludes the free play of economic forces for the Foreign Exchange Market. The government regulates the payments dealings in foreign exchange and import-export of currencies through foreign exchange control. In the exchange control state regulation exchange, the free play of economic forces from the foreign exchange market. The Government regulates Foreign Exchange dealings by Consideration of national needs. It is the monopoly of the government in the purchase and sale of foreign currencies in order to restore the balance of payments equilibrium and disregard the market forces in the decision of the monetary authority. Exchange controls are legislative limitations on the purchase and sale of currencies. When tariffs and quotas do not help in correcting the adverse balance of trade and balance of payments the system of Foreign Exchange Control is restored to by Governments. The principal objective of most systems of exchange control is to prevent the negative balance of payments by limiting foreign-exchange purchases to an amount, not in the surplus of foreign-exchange receipts. These controls consent to countries a better degree of economic constancy by limiting the amount of exchange rate instability due to currency inflows/outflows (Haberler, 2007).

According to Cole (2005), the exchange is controlled by the state, central bank, or any other agency with the free play of market forces that determine the foreign exchange rate and amount. In this system, the government dominates the foreign exchange market. Exchange control deals with the balance of payments difficulties disregards market forces, and substitutes for them the arbitrary decisions of government officials. The essence of exchange control is that the possessor of the controlled currency has no right, without special leave to convert it into foreign currency. The

government's major purpose of exchange control is to manage or prevent an adverse balance of payments position on national accounts. It involves ordering all or part of foreign exchange received by a country into a common pool controlled by exchange control authorities, typically the central bank.

According to the articles of agreement by the International Monetary Fund (IMF), only countries who changing their economy from centrally planned economy to a market economy can apply exchange controls. Several Western nations employed exchange control measures soon after World War II but gradually left them out before the 1980s as their economies strengthened over time. The phasing out of exchange controls was also necessitated by trends towards globalization, free trade, and economic liberalization in the 1990s, which do not co-exist with the application of exchange controls. Presently, exchange controls are mostly utilized by developing countries with weak economies, low exports, import-dependent, and with low foreign currency reserves (IMF, 2016).

The system of exchange control is characterized by the monopoly of the government in the foreign exchange business and the government exercises full control over the foreign exchange market. Based on this role the government officially fixes the rate of exchange and the market forces of demand and supply have no effect on its determination. Further, the government centralizes all foreign exchange operations in the hands of the central bank which administers various foreign exchange regulations. In the exchange market, the exporters have to deposit their all-foreign exchange earnings with the central banks, and the imports of a country are regulated and the importers are allocated foreign exchange at the official rates to enable them to make payments for the goods imported. Further, the government or the central bank determines the priorities in the allocation of scarce foreign currencies. As a result of exchange control, the volume of imports gets automatically reduced and there is a favorable impact on the country's balance of payments (Cole, 2005).

2.2.4 Objectives of Exchange Control

There have been varied objectives for adopting the system of exchange control by governments. According to Haberler (2007), the system may be adopted mainly to achieve the following objectives.

Restore Adverse Balance of Payments:

A country may implement the system of exchange control when it faces a deficit in its balance of payments and does not want to leave the process of adjustment either at the mercy of the automatic mechanism of fluctuating foreign exchange rates or on deflation. The main objective of introducing exchange control regulations is to correct the balance of payments equilibrium. The BOP needs realignment when it is sliding to the deficit side due to greater imports than exports. Hence, controls are put in place to manage the dwindling foreign exchange reserves by limiting imports to essential items and encouraging exports through currency devaluation. By adopting exchange control, imports are restricted to the level permitted by the availability of foreign exchange reserves and, thereby, the balance of payments equilibrium is established (Haberler, 2007).

Protect the value of the national currency

Exchange control is adapted to stabilize the rates of exchange. Fluctuating exchange rates harm commerce and industry. The government, therefore, adopts exchange control measures to stabilize the exchange rates by announcing conversion at the official fixed rates of exchange. The government may also adopt exchange control to check fluctuations in the rate of exchange. Fluctuations in the rate of exchange are the normal feature in a free exchange market and cause disequilibrium in the economic life of a country. These fluctuations can be checked by officially fixing the exchange rate at a predetermined level (Haberler, 2007).

Prevention of Capital Flight

Another objective of exchange control is to prevent the flight of capital from the country. Exchange control may be adopted to prevent the flight of capital from the country. Flight of capital refers to the action of the citizens of a country to convert their cash holdings (i.e., short-term securities and bank deposits) into foreign currencies. Flight of capital may be the result of speculative activities, economic fluctuations, and political uncertainty. Gold and capital funds cannot be exported without the permission of the exchange control authority. The latter may totally ban such movements or give specific purposes. In this way, exchange control not only prevents the flight of capital but also conserves foreign exchange. The government may observe increased trends of capital flight as residents and non-residents start making amplified foreign currency transfers out of the country. It can be due to changes in economic and political policies in the country, such as high taxes, low-interest rates, increased political risk, pandemics, and so on (Haberler, 2007).

Protection of Domestic Industries

Exchange control is resorted to for giving protection to domestic industries against foreign producers. The exchange control authority controls the imports of such commodities which compete with domestic producers and thus protects them from foreign competition. Exchange control may resort to protecting the home industry from foreign competition. For this purpose, the government restricts imports through foreign exchange controls and thus provides an opportunity for domestic industries to develop without any fear of international competition. The government may resort to exchange control to protect the domestic industry from competition by foreign players which may be more efficient in terms of cost and production. It is usually done by 14 encouraging exports from the local industry, import substitution, and restricting imports from foreign companies through import quotas and tariff duties (Haberler, 2007).

Conserve Foreign Exchange:

The government may intend to increase foreign exchange reserves to meet several objectives, such as stabilizing local currency whenever needed, paying off foreign liabilities, and providing import cover. One of the objectives of exchange control is to earn and conserve foreign exchange for the purpose of repaying the principal and interest charges on foreign debt. Therefore, exchange control may be used to conserve a country's foreign exchange reserves through exports. These reserves are restricted to paying off external debt, importing essential goods for economic development, and purchasing defense materials (Haberler, 2007)

Make imports of preferable goods

Exchange control forms an integral part of economic policy in a planned economy. Planned economic development requires expansion, conservation, and proper use of foreign exchange reserves of the country according to the national priorities. Here the exchange control is intended to make imports of preferable goods possible by making the necessary foreign exchange available (Haberler, 2007). Exchange control helps the process of planning by controlling the non-essential and wasteful expenditures on imports and encouraging the flow of exports. The exchange control authority encourages the inflow of essential raw materials, capital goods, and technical know-how by allocating scarce foreign exchange resources. Such imports are needed for the execution of

planned projects. Exchange control is also needed to check the import of certain non-essential, harmful, and socially undesirable goods in the country.

Policy of Differentiation:

The Government may also adopt the policy of differentiation by exercising exchange control. If the Government may allow international trade with some countries by releasing the required foreign currency the Government may restrict the trade import and exports with some other countries by not releasing the foreign currency. Exchange control helps a country to follow a policy of discrimination in international trade. The government fixes favorable rates of exchange for the countries with which it wants to strengthen its trade relation (Haberler, 2007).

2.2.5 Foreign Exchange Trading in Commercial Banks

Foreign exchange business means any facility offered, business undertaken, or transaction executed with any person involving a foreign currency inclusive of any account facility, credit extension, lending, issuance of guarantee, counter-guarantee, purchase or sale by means of cash, cheque, draft, transfer or any other instrument denominated in a foreign currency (CBK, 2011). Speculation is the backbone of foreign exchange business, in this line of reasoning; Géczy et al (2007) argue that a major motivation behind speculation is the belief that it is profitable. Foreign exchange exposure refers to the sensitivity of a firm's cash flows, the real domestic currency value of assets, liabilities, or operating incomes to unanticipated changes in exchange rates (Adler & Dumas, 1984). The adoption of a floating exchange rate regime, the rapid globalization of national economies, and the attempts by multinationals to seek investment opportunities and markets beyond their immediate borders account for the increased exposure of firms to foreign exchange risk in recent times. Consequently, and according to CBK, authorized banks are licensed to buy, sell, borrow, or lend in foreign currency or transact any other business involving foreign currency.

2.2.6 Relationship between Foreign Exchange Trading and Financial Performance of Banks

Commercial Banks partake in the Forex market to assist in international trade and investment hence they are exposed to Forex risk which is simply the risk that profit will change if forex rates change. Exchange rate fluctuations affect operating cash flows and firm value through translation, transaction, and economic effects of exchange rate risk exposure (Choi & Prasad, 1995). Based on

this FX risk banks trade in the forex market to hedge themselves against such adverse volatility. Chamberlain et al (1995) argued that foreign exchange rate fluctuations affect banks both directly and indirectly. The direct effect comes from banks' holdings of assets (or liabilities) with net payment streams denominated in a foreign currency. Foreign exchange rate fluctuations alter the domestic currency values of such assets. This explicit source of foreign exchange risk is the easiest to identify, and it is the most easily hedged. The indirect sources of risk are subtler but just as important. A bank without foreign assets or liabilities can be exposed to currency risk because the exchange rate can affect the profitability of its domestic banking operations. For example, consider the value of a bank's loan to a Kenyan importer. An appreciation of the dollar might make it more difficult for the importer to compete against foreign firms. If the appreciation thereby diminishes the importer's profitability, it also diminishes the probability of timely loan repayment and, correspondingly, the profitability of the bank. In this case, the bank is exposed to foreign exchange risk: a stronger dollar decreases its profitability. Any time the value of the exchange rate is linked to foreign competition, to the demand for loans, or to other aspects of banking conditions; it will affect even "domestic" banks. Therefore, there exists a positive relationship between Forex trading and financial performance. Several theories have been put forward by different theorists with conclusions on the subject matter.

Allayannis & Weston (2001) indicate that firms that use derivatives have a higher market value whereas Graham & Rogers (2002) also allude that firms that use derivatives are highly leveraged. Modigliani-Miller paradigm (Miller & Modigliani, 1958) states conditions for the irrelevance of financial structure for corporate value. This approach stipulates also that hedging leads to the lower volatility of cash flow and therefore lower volatility of firm value. Rationales for corporate risk management were deduced from the irrelevance conditions. The ultimate result of hedging, if it indeed is beneficial to the firm, should be higher value- i.e., a hedging premium. Thus, Forex trading as portfolio risk diversification has no effect on financial performance. Chamberlain et al (1995) argued that assessing banks' foreign exchange risks can be obtained from an analysis of banks' equity returns. Equity returns reflect changes in the value of the firm as a whole. So, if the value of a bank as a whole is sensitive to changes in the exchange rate, the bank's equity returns will mirror that sensitivity. Whether from direct or indirect sources, foreign exchange exposure will be reflected in the behavior of returns. Thus, the exchange rate sensitivity of a bank's equity returns provides a positive comprehensive measure of its foreign exchange exposure.

2.2.7 Customer Experience and Banks

Customer experience is the stimulation done by the company against the senses of consumers. The company can control the stimuli that have been given to the senses of consumers. Therefore, the company can control the reaction of consumers resulting from the stimulation process; thereby, the company can steer the acquisition of the customer experience as expected by the company (Andajani, 2015).

Customer experience or consumer experience has been defined in a diverse context in marketing. Grewal et al. see it as including every point of contact at which the customer interacts with the business, product, or service (Grewal, Levy, & Kumar, 2009). From the marketing point of view, Pine & Gilmore stated that experience is personal and exclusive for every individual, which is recollected and memorable over time (Andajani, 2015; Pine & Gilmore, 1998). “The experience may involve emotional, physical, intellectual, or even spiritual aspects of the individual” (Andajani, 2015)

Customer Experience is communication between an organization and a customer. It is a blend of an organization’s physical performance, the senses stimulated and emotions evoked, each intuitively measured against customer experience across all moments of contacts (Shaw & Ivens, 2002).

Customer experience is unique and personal to each customer. Even though the service is highly uniform and standardized, each customer perceived their own experience. Customer experience creation is two-way. The service provider creates part of it, and another part will be created and perceived by the customer to whom the service is provided. So, the memorable, good experience made them revisit or repurchase their Service or product. (Jaziri, 2018). Customer experience will be a separating factor for every service provided; It serves as a competitive edge (Gentile et al., 2007) (Shaw & Ivens, 2002). Due to the high individuality of each customer, measuring and providing a unique experience to the customers is quite a challenging job ((Bolton et al., 2018; McLean & Wilson, 2016).

Export Business

Export as an essential economic activity of firms and a means of economic development of a nation has broadly been acknowledged. However, many firms do not export even though it is regarded as inevitable in the increasingly integrated world markets (Pinho & Martins, 2010). This is even more so for developing Countries like Ethiopia. Studies conducted in Sub-Saharan Africa indicated that there are only a few firms that export and sell outputs in foreign markets (Van Biesebroeck, 2005; Rankin, Soderbom & Teal, 2006; Milner & Tandrayen, 2007). According to Tesfom and Lutz (2006), the reason behind low export involvement in developing Countries“ firms is that they encounter a multitude of barriers when they attempt to expand export activities.

Export Strategy

Exporting has become an important internationalization strategy for companies and the development of national economies in the global markets (Koksal, 2006). Ural (2009) posited that global liberalization, assimilation, and competition in the world’s economies have been contributing to the growing commitment of firms to export operations. In the growth of world economies, exporting activities of Small and Medium Enterprises is more important for the continued survival, growth, and long-term prospect of a business (Ramdane & Khalil, 2009). Exporting is usually a less “resource-laden” operation relative to other foreign market entry and expansion modes because it requires minimum business risk, needs a low commitment of resources, and presents high flexibility of movements (Neupert et al., 2006 & Korez-Vider, 2007). According to Tesfom and Lutz (2006) explanation, international trade is especially important for developing countries because it produces employment opportunities and provides foreign exchange with imports. 7 In developing Countries, export strategy is recognized as an important means for growth and improving profitability for Small and Medium Enterprises (Kazem & Van Der Heijden, 2006). Ahmed et al. (2004) clarified that a common objective in less developed countries is to discover ways to boost exports. At the macro level, the involvement of more firms in exporting activities is believed to be an effective way of managing trade deficit problems plus a technique to improve the accumulation of foreign exchange, generating spillover effects such as societal prosperity and support for local industries to increase productivity, and driving economic growth (Morgan & Katsikeas, 1997). While at the micro level, exporting can offer individual businesses with opportunities to grow, boost profits, stabilize demand, improve the utilization of

production capacities, develop superior management capabilities, enhance innovation in product and process and strengthen financial performance (Lages & Montgomery, 2004). Since exporting activities can make such attractive advantages in international businesses and because of their growing significance in industrialized Countries, an understanding of the exporting barriers has become mainly a significant concern in today's business environment (Kuada, 2006 & Pinho & Martins, 2010). According to Pinho & Martins (2010) and Leonidou (2004) explanation, the effectual way of inspiring local Small and Medium Enterprises to go into foreign markets is to make out the major barriers that are faced by Small and Medium Enterprises in going and operating effectively in international markets. Rocha et al. (2009) mentioned that understanding barriers to exporting can help implement government policies to inspire domestic firms to export and reduces the major impediments. This objective can be accomplished either by motivating exporting firms to export a large number or by encouraging non-exporters to begin exporting.

The role of Government Policy in promoting Export International trade has played a crucial role in the historical development of the third world. In the second half of the 20th century, the tremendous economic performance of the "four tigers"- South Korea, Taiwan, Hong Kong and Singapore has been largely attributed to the performance of the external sector where the export sector was given a greater emphasis. Strong political commitment towards export promotion and the application of appropriate policies together with efficient institutional mechanisms helped these Countries to attain a higher growth rate of exports and hence of the overall economy. 8 Over the past two decades, developing countries have progressively increased their share in global trade from just less than one-quarter to about one-third. Asia and particularly China account for most of the change, which has been facilitated by the diversification of exports. While developing Asia's shares in total world exports increased from 11.7% in 1985 to 21.5% in 2005, Africa's share decreased from 4.3% to 2.9% over the same period (Bacchetta, 2007).

Export incentives as Export promotion instruments Returns from the trade sector depend on the accelerating growth of exports. According to the orthodox classical economists as well as the modern liberal economists' trade is equivalent to the engine of economic growth. Export promotion strategy is often in accordance with the principles of comparative advantage, when a country specializes in a product, which it can produce competitively. The goods become available to the community of the world at cheaper prices. In the outer layer, putting more emphasis on the promotion of exports would permit the optimal allocation of the Country's resources. (Krueger

(1997). Export Performance and Promotion Policies in Ethiopia Like Other African Countries, Ethiopia has faced deep-rooted structural problems, weak policy frameworks and institutions, and protection at the domestic level and abroad for a long time. For instance, in 1983, the Provisional Government of Socialist Ethiopia noted that the basic constraints for Ethiopian exports include the low volume of exportable products, the limited degree of diversification of exports mainly due to unprocessed primary products, the frequent economic crisis which substantially reduce the demand for and prices of primary products, artificial trade barriers by trading partners, etc. (Abay and Zewdu, 1999).

2.2.8 Surrender Requirement in Ethiopia

The requirement was started in 2017 with directive number FXD/54/2017 which requires all commercial banks to surrender thirty percent of their foreign exchange earnings to the national bank of Ethiopia at the buying rate within the first five working days of the next month. In addition, failing to surrender as per the NBE directive results in a penalty for each day of delayed surrender up to a maximum of five working days following the final date of surrender. However, after three years of the first directive, it was amended with FXD/72/2021 which increases the surrender portion from 30 percent to 50 percent in a similar manner of implementation effective from September 2021. The recent surrender requirement directive was significantly increased from the previous thirty and fifty percent to seventy percent as per the directive number of FXD/78/2022 which is entitled “foreign exchange requirement of banks” effective on January 2022.

2.2.9 Retention and Utilization of export earnings and inward remittance in Ethiopia

According to NBE’s directive number FXD/66/2020 which was effective on September 2020 directive for retention and utilization of export earnings and inward remittances, exporters of goods and services, as well as recipients of inward remittance, had the right to retain thirty percent (30%) in retention account “A” for an indefinite period and seventy percent (70%) in retention account “B” up to 28 days. However, after 28 days the balance is automatically converted in the next working day to the local currency by the customer’s bank by using the buying rate on that day. But the customer shall be a regular recipient of foreign exchange remittance from abroad as well as an

exporter of goods and services and their name not found in the delinquent list of national banks of Ethiopia. The above directive was amended with the second directive number FXD/70/2021. In this directive, exporters of goods and services as well as recipients of inward remittances in hard currency have the right to retain forty-five percent of their hard currency in retention accounts after the deduction of thirty percent surrender requirement from their total earnings to the national bank of Ethiopia. Whereas, the remaining fifty-five percent of foreign currency earnings was delivered to the respective commercial bank at the day's prevailing buying rate and the respective commercial bank must be made the equivalent payment in birr to the customers' separate birr account immediately. But the above directive was replaced by the new directive number FXD/79/2022 which was effective on January 2022 (Mehrteab & Getu, 2022)

2.2.10 The Recent Surrender and Retention Requirement of Ethiopia

Commercial banks are required to surrender seventy (70%) of foreign currency earnings from remittance, export earnings from goods and services, and non-governmental transfers to the national bank of Ethiopia. Customers who are exporters of goods and services and recipients of inward remittance have the right to retain twenty percent (20%) of their earnings in foreign currency in their retention account after the deduction of the seventy percent surrender requirement from total earnings. However, the remaining ten percent is belonging the respective bank at the prevailing buying exchange rate immediately on the day of the respective but the bank effect the equivalent amount in birr to the respective customer. The commercial bank deposit the amount in the customer retention account only if the customer had written authority.

The customer can hold the portion of foreign currency in his retention account for an indefinite period and use the balance for the import of goods and services without restriction provided that the account holder has the required business license. However, account holders have the right to sell all or a part of foreign currency held in the retention account at any time on a negotiation rate but not exceeding the selling rate of the day to their respective bank. Commercial banks are required to send the report of the aggregate balance of foreign currency held in the retention account each month and violation leads to a penalty amount of five thousand dollars per violation (Mehrteab & Getu, 2022)

NBE New Directive on Retention and Utilization of Foreign Currency Earnings from Export and Inward Remittance

The National Bank of Ethiopia issued a new directive (Directive No. FXD/79/2022) governing on the retention and utilization of foreign currency earnings from export and inward remittance. Previously the area was regulated by the Directive No. FXD/73/2021.

For three years, the foreign currency management regimes of the national bank of Ethiopia were regulated by the Retention and Utilization of Export Earnings and Inward Remittance Directive No. FXD/48/2017 entered in to effective on October 3, 2017, and was effective until replaced by the Retention and Utilization of Export Earnings and Inward Remittance Directive No. FXD/66/2020 was effective on 16 September 2020. The later Directive introduced a few changes regarding the deposit of funds into retention accounts for local businesses or entities licensed by the national bank of Ethiopia and the manner of using foreign currency available in Retention account ‘A’ and retention account ‘B’. Under both these directives, an exporter or a foreign currency remittance beneficiary had the right to maintain 30% of the foreign currency earnings in Retention Account A for an indefinite period of time and the remaining 70% would be retained in Retention Account B for a period of 28 days and before the lapse of the 28 days it was possible to use the currency for importing of specified and licensed items. However, one year later the national bank of Ethiopia changes the surrender amount and also the regulation regarding retention of account A and Retention of account B with directive No. FXD/70/2021 (Mehrteab & Getu, 2022)

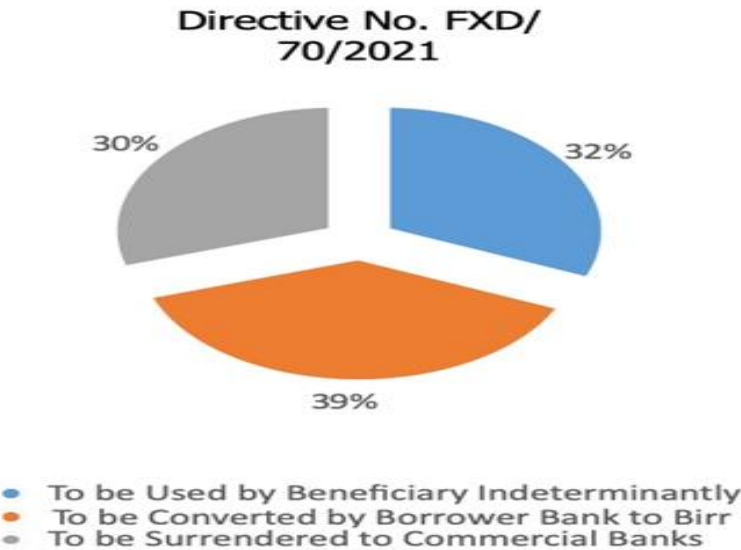


Fig 2.1. pie chart for showing NBE directive FXD/70/2021 forex retention

NBE issued Directive No. FXD/70/2021 by replacing Directive No. FXD/66/2020. The new Directive No. FXD/70/2021 was effective as of March 09, 2021. This Directive brought about significant changes by, among others, eliminating the Retention Account “A” and Retention Account “B” and recognizing only one Forex Retention Account, establishing a mandatory surrender requirement where all the beneficiaries are required to surrender 30% of the foreign currency earning to NBE, and reduced the number of earnings to be retained in the retention account to 45% (of the remaining currency after the 30 percent surrenders to NBE) and it requires customers to the sale of 55% (of the remaining currency after the surrender) of the foreign currency earning to the respective banks immediately on the day of receipt at the prevailing buying exchange rate. It also changed the requirements for utilization of the foreign currency permitting beneficiaries to use the foreign exchange for the importation of goods and services without restriction as long as it has a business license to import these goods and services (Mehrteab & Getu, 2022)

Effective September 01, 2021, NBE again replaced Directive No. FXD/70/2021 and issued Directive No. FXD/73/2021 to govern the retention and utilization of foreign currency earnings from export and inward remittance. This Directive introduced the 50% - 40% - 10% allocation requiring exporters and remittance earners to surrender 50% of their total earnings to the national bank, permitting the retention account holders to retain 40% of their foreign currency earnings for an indefinite period in retention account and to sale the remaining 10% to the respective commercial banks.

However, Directive No. FXD/73/2021 was a short-lived one and it was replaced by a New Directive (Directive No. FXD/79/2022 that takes effect from January 06, 2022. The major changes introduced by the New Directive were:

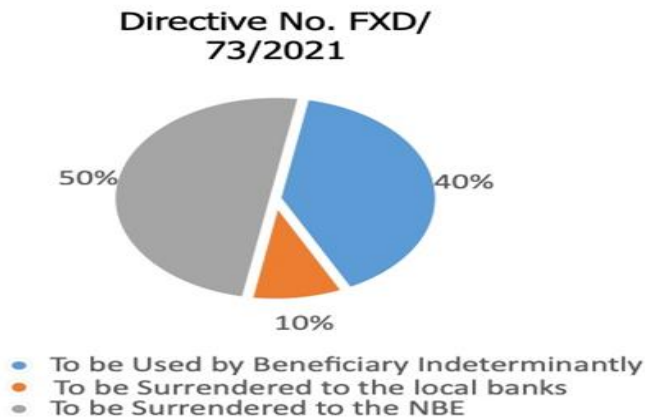


Fig 2.2. pie chart for showing NBE directive FXD/73/2021 forex retention

The total surrender amount was significantly increased:

Under the New Directive, exporters and inward remittance earners are forced to surrender 70% of their earnings to NBE. Previously, exporters and inward remittance earners were required to surrender 50% of their total earnings to the national bank of Ethiopia (Mehrteab & Getu, 2022)

The amount of proceeds to be retained in the retention account was significantly decreased:

Under the Old Directive, retaining 40% of the total foreign currency earnings for an indeterminate period of time in a retention account was permitted after the deduction of the 50% surrender requirement. The remaining 10% of the foreign currency amount was required to be surrendered to the respective commercial banks based on the prevailing buying exchange rate. Under the New Directive, the amount of foreign currency to be surrendered has increased significantly. Retention account holder on behalf of their commercial banks is required to surrender 70% of the total foreign currency earned from export and remittance earnings to the national bank of Ethiopia. Under this directive, customers have the right to retain only 20% of their total earnings, and the remaining 10% of the foreign currency amount is required to be surrendered to the respective commercial banks based on the prevailing exchange rate and using the buying rate (Mehrteab & Getu, 2022)

In simple narration, the New Directive changed the allocation to 70% - 20% - 10% (70 percent to NBE, 20 percent to the retention account for the benefit of exporters and inward remittance earners, and 10 percent to commercial banks).

**The New Directive
(Directive No. FXD/
79/2021)**

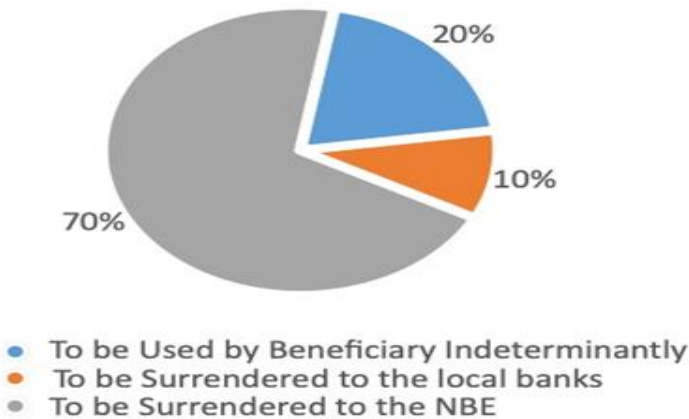


Fig 2.3. Pie chart for showing NBE directive FXD/79/2022 forex retention

The retention and utilization of export earnings and inward remittances directives no. FXD/79/2022 which was amended and made effective on January 6, its article 4.1 stated that banks are required to surrender 70 percent of the foreign currency earnings from the export of goods and services, private transfer, and NGO transfer to the NBE.

Article 4.2 of the directive stated that exporters of goods and services and recipients of inward remittance shall have the right to retain 20 percent of their export earnings in foreign currency indeterminately in a retention account after the deduction of the 70 percent surrender requirement from the total earnings. It added that the remaining 10 percent shall be surrendered to the respective bank (Mehrteab & Getu, 2022)

The prior directive that was revised early last budget year gave a right for the national bank of Ethiopia to take half of the foreign currency earnings and the remainder to exporters and banks. However, experts argued that the retention directive has affected the export business since it does not motivate both exporters and financial firms in engaging and expanding their businesses (Mehrteab & Getu, 2022)

In the past budget year unlike the previous experience, the government's inflow of foreign currency which mainly comes from global partners in the forms of assistance and loan has almost dried out. Nonetheless, the debt settlement commitments have been concluded smoothly.

Following the conflict in the northern part of the country, global partners, mainly Western nations or organizations driven by them froze their pledged funds to put pressure on the central government against national interest (Mehrteab & Getu, 2022)

NBE amends foreign exchange management directive: allocation, priorities

The National Bank of Ethiopia (NBE) issued a new directive, amending an earlier directive in use since October 2020. The NBE explained that the new directive would enable it to carefully manage its scarce reserve foreign exchange and ensure its efficient and proper allocation. The directive also laid out foreign exchange allocations and priorities in Three categories.

The national bank in the amended directive indicated that there is a need to ensure foreign exchange is allocated in a transparent and sound manner to priority and other economic sectors without opening room for rent-seeking behavior and malpractice. The NBE through its newly amended directive titled “Transparency in Foreign Currency Allocation and Foreign Exchange Management, also identified as directives No. FXD/77/2021 is issued repealing its predecessor directive No. FXD/67/2020 has similarly categorized which sectors the banks should prioritize when it comes to the allocation of foreign exchange for import items.

This directive, which includes practices similar to previous directives, sets out the details that bank board directors and executives need to implement while the allocation of foreign exchange. Like the former, this directive states that the allocation of foreign currency by a bank shall give priority to three categories. However, it has amended and reshuffled the priority listings within the categories where import items and payments are to be served on a first come first served basis.

The new directive put as a first priority comprises pharmaceuticals; like medicine, inputs for manufacturing of pharmaceuticals, and laboratory reagents, while it has newly inserted inputs for manufacturing of edible oil, which has not been listed in any of the three priorities previously is now set in the first category of the priorities in the new directive along with liquefied petroleum.

As a second priority, it put inputs for agriculture and inputs for manufacturing including fertilizer, Seed, pesticide, and Chemicals. Its third priority arrays a broader spectrum of listings including motor oil and lubricants; agricultural inputs and machinery; pharmaceutical products; manufacturing industries requests for procurement of machinery, equipment, spare parts, and accessories; import of nutritious food for babies; spare parts for construction machinery for own

use construction companies whose total values not exceeding USD 50,000 and educational materials. Profit and dividend transfer; transfer of excess sales of foreign airlines and sales from shares and liquidation of companies by FDI are also to be prioritized under this category, the new directive implies.

The directive similarly states that the total foreign currency allocated for imports listed in the three categories shall not be less than 50 percent of the total foreign currency allocated for all imports of goods and services at any time. Another notable change in the directive is the increase of 5 percent (Now 15 percent) allocation for the first priority, the decrease of 5 percent (Now 40 percent) allocation for the third priority but maintaining the 45 percent for the second priority and unlike its predecessor which stood at 10, 45, 45 respectively.

Similar to previous directives, the new directive states that the bank is obliged to surrender the difference to the National Bank every month within the first five working days of the next month while imposing the surrender of the utilization of allocated foreign currency the difference to NBE every six-month in the case of utilization of allocated foreign currency.

The directive explained that pharmaceutical inputs, edible oil inputs, and fuels are listed as the first priority to mitigate the shortage of foreign currency in those sectors, especially for oil companies that have been running under capacity. The directive generally requires each bank to have transparent and sound foreign currency allocation and foreign exchange management guideline or procedure manuals which shows the accountability of each employee of a bank involved in the foreign exchange transaction.

2.3. Empirical Literatures Review

Impacts of Exchange Control on commercial banks

Although exchange controls can be effective in some instances, they can also come with negative consequences. It leads to an ongoing debate about whether exchange controls are effective or not. In spite of the fact that a large number of nations, especially the less developed countries, have resorted to the exchange control system, International Monetary Fund (IMF) strongly opposes the adoption of exchange control by the member countries because of its serious defects. There are various defects suggested by IMF (2011). First, the system of exchange control is not based on the sound comparative cost principle of international trade according to which every country tends to

specialize in the production and export of that commodity in which it enjoys a comparative natural advantage. In addition, it leads to a reduction in the volume of international trade and a contraction of the world's welfare because it encourages bilateral trade and deprives the country from the gains of multilateral trade. Thus, it is an arbitrary system that encourages retaliation and restrictive tendencies. Therefore, under the exchange control system, the advantages of international specialization are sacrificed and economic resources are not optimally utilized.

Second, exchange control interferes with the competitive working of the economy and distorts its economic structure by diverting the resources in less economical and less efficient areas of production which do not represent a maximum natural advantage. As a result, exchange control has undesirable effects on the internal economy of the country, and restrictions on imports may lead to an inflationary rise in prices due to the scarcity of restricted goods. Needy traders use all types of illegal methods to obtain the desired amount of foreign exchange which has been rationed by the government. Often, they lead to the emergence of black markets or parallel markets in currencies. The black markets develop due to higher demand for foreign currencies that is greater than the supply in the official market (Taiwo & Adesola, 2013).

Third, exchange control provides only a temporary remedy to the problem of disequilibrium in the balance of payments. Instead of basically solving the problem, it prevents the situation from becoming worse. It involves great social costs and does not lead to the maximization of the community's welfare by hampering private transactions. In addition, it causes large administrative costs to enforce the exchange controls; resource waste in the process of trying to evade the controls or of applying for foreign exchange licenses; and psychological costs of the inevitable perceived injustices created by the controls or their evasion. The exchange control system is also morally undesirable because it breeds corruption in the country. They impose welfare losses on society (Taiwo & Adesola, 2013).

Empirical studies

Cecilia and Gekara (2016): examining the impact of foreign exchange control on the performance of commercial banks in Kenya. According to the study, as a developing country Kenya suffers from a foreign exchange shortage and the government prioritized foreign currency allocation in the country. The study was conducted by using secondary data from commercial banks and used the proportion of foreign exchange used by banks to priority sectors and the proportion of foreign

exchange provided by the bank's own interest to measure the effect of central bank intervention. The study revealed that foreign exchange control negatively affects the performance of commercial banks and suggested that the higher-level high portion to priority sectors results in low performance of banks and banks could not provide foreign exchange to long-term customers.

Kalsi Sarabjit Singh (2013): studied how exchange trading influences commercial banks' financial performance. The study used currency swaps, currency forwards, and currency spot to determine the financial performance of banks and the study covered 42 commercial banks by adopting survey research. The study concluded that currency swaps and currency forwards are negatively related to financial performance whereas, currency spot is positively related to financial performance.

Dereje, S. (2019) studied the challenge of the NBE directive on forex utilization of commercial banks which was mainly focused on the retention and utilization of earnings and transparency in foreign currency allocation. The study was conducted by using 103 samples from six private commercial banks in Ethiopia. Accordingly, the study revealed that there is a negative impact on the forex utilization of banks. The directive prohibits Banks from allocating FCY collected from exporters for the import business of the same outside of the proper procedures and discouraged exporters not to expand their business. Restrictions on Retention accounts which limits the period of time in which exporters can use their proceeds also affect their performance.

Yonatan, T. (2018): conducted a study entitled Assessment of foreign currency mobilization on the Performance of private commercial banks. The study assessed factors that hinder private commercial banks in the mobilization of foreign currency evidence from five private commercial banks. The study used a descriptive research design with a qualitative approach. Accordingly, the study revealed that the major problems to the decline of foreign currency mobilization are the increasing bargaining power of exporters, the price decline of export items in the international market that forces exporters to keep their export product in store instead of sell, lack of genuine exporter customers, limited exportable items in the country, the existence of informal and parallel markets, private banks failure to maintain a better relationship with foreign correspondent banks.

Asrat, A. (2021): Studied to examine foreign currency exchange control in Ethiopian commercial banks. its study was mainly focused on the national bank of Ethiopia's directive of transparency in allocation and foreign exchange control which was implemented in 2016. The study used 16 commercial banks and used panel data. According to his study, the directive restricts the allocation

of at least 50% of foreign currency to priority import items, and then commercial banks were not allocated foreign currency according to their business focus. Finally, his study showed that the allocation of foreign currency to priority imports has a positive effect on the performance of banks. On the other hand, the allocation of foreign currency to non-priority imports has a negative effect.

Henok, G. (2021): Studied the impact of foreign currency exchange fluctuation on the performance of commercial banks in Ethiopia. The study attempted to identify how foreign exchange rates along with other factors such as interest rate spread, inflation rates, and size of the bank affect the financial performance of banks. The study was conducted using an explanatory research design and a quantitative approach. The study included 6 private commercial banks by using secondary data from the annual financial statements of banks. The outcome of the study showed that there were negative and significant relations between the foreign exchange rate and the financial performance of commercial banks, and the study recommended Government to put measures to increase the country's exports and foreign direct investment and the NBE should adequately take measures to safeguard the value of the domestic currency

Tadesse (2015): studied the impact of foreign exchange rates on commercial banks' profitability. In Ethiopia using panel data from banks covered from 2000-2014. The finding of the study revealed foreign exchange rate has a statistically negative impact on the profitability of commercial banks.

2.3 Research Gap

As shown in the empirical literature, different studies were conducted to identify the effect of foreign exchange control on the financial performance of commercial banks. Some studies were conducted to examine the foreign exchange rate impact on the profitability of banks and some others studied factors that affect the foreign currency mobilization capacity of commercial banks but they excluded foreign currency surrender requirement which is another significant factor to commercial banks in mobilization and utilization of foreign currency. However, the studies missed the effect of the NBE foreign currency surrender requirement on commercial banks which is an essential factor in determining the commercial banks' forex utilization and then the performance of commercial banks in Ethiopia. In addition, the effect of the surrender requirement as well as other related foreign exchange control regulations were also affecting commercial banks in their customer relationship beyond financial performance. As a result, there is a strong relationship

between the banking industry and the demand for foreign currency in the country, and there are not enough studies conducted on the study area, this study was conducted to assess the challenges of NBE's foreign currency surrender requirement on private commercial banks in Ethiopia to fill the current literature gap in the field.

Accordingly, this study conceptualizes the challenge of NBE's surrender requirement from three dimensions: its effect on the mobilization and utilization of commercial banks, its effect on the bank's customer experience, and the effect on the bank's profitability.

2.4 Conceptual framework

A conceptual framework is a tool researchers use to guide their inquiry. It implies a set of ideas used to structure the research, a sort of map (Kothari, 2004). It is about the researchers own position on the problem and gives direction to the study. Therefore, conceptual framework helps to show the direction of the study and the relationship of different constructs that needs investigation. Accordingly, this study conceptualizes the challenge of NBE's surrender requirement from three dimensions: its effect on the mobilization and utilization of commercial banks, its effect on the bank's customer experience, and the effect on the bank's financial loss.

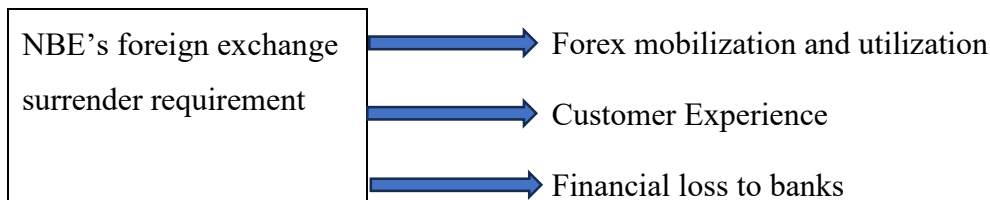


figure 2.4 conceptual framework

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

Designing an appropriate research methodology is a prerequisite in order to conduct good research work. A research design is the arrangement of conditions for the collection and analysis of data in a manner that aims to combine relevance to the research objective, keeping in view the objective of the research and the availability of staff, time, and money. It constitutes the blueprint for the collection, measurement, and analysis of data (Kothari, 2004).

Accordingly, this chapter focuses on the methodology the researcher used to conduct this study. Thus, the research design, research approach, target population, sample size, sampling technique, source of data, method of data collection, and method of data analysis are presented below respectively. It also includes the validity and reliability of the instruments used to conduct the study.

3.1 Research Design and Approach

To conduct this study, a mixture of exploratory and descriptive research designs is used. The exploratory design is used to get new insights and a better understanding with regard to the challenges of the surrender requirement on commercial banks since there was no prior study conducted on the topic. In addition, the descriptive design is used to describe and analyze the major challenges of the surrender requirement to commercial banks. and adapt a survey study by using questionnaires and interviews to gather responses from the target respondents.

In order to achieve the objective of the study and to answer the research questions, this study used a combination of both quantitative and qualitative approaches. A quantitative approach is mainly used for the data collection techniques such as questionnaires and data analysis techniques like descriptive statistics. On the other hand, a qualitative approach is used for data collection techniques such as interviews and for data analysis techniques in the form of narrative analysis.

3.2 Type and Source of Data

Primarily this study used primary data sources obtained from questionnaires and interviews in order to get relevant information and address research questions. Whereas secondary data were

also used to supplement the study which are obtained from National bank directives, articles, websites, related literature reviews from previous studies, and reports of the banks.

3.3 Target Population

The target population of this study includes international banking department employees of four private commercial banks at the head office level. The reason for selecting Head Office Employees is due to the major forex transactions are took place at the Head office of each selected bank. In addition, all employees of the IBD from the officer level up to managers are used as a target population. However, the study excludes other non-professional employees of the department because they are not believed to have awareness in the field and do not have practical knowledge of the forex business.

Table 3.1 Distribution of professional working in IBD at head office

NO.	Selected private banks	Total population
1	Dashen bank	58
2	Abyssinia bank	66
3	Nib international bank	43
4	United bank	56
	Total population	<u>223</u>

Source: researcher compilation 2023

3.4 Sample Size

Sample size implies a portion of individuals from the total population who are selected to participate in the study. This study used two methods to determine the required sample size. One senior manager from the IBD department was purposely selected from each selected private bank for an interview. Whereas, to distribute questionnaires, a formula is applied to calculate the required sample size. To determine the required sample size from the target population for this study, Yamane's formula (1967) was used. Therefore, the researcher used the following formula to determine the sample size: after determining the required sample size, the researcher proportionate the sample size to selected private banks based on their weight in the population.

$$n = N / (1 + Ne^2)$$

were,

n = Sample Size

N = Target Population Size

e = The Level of Precision = $\pm 5\%$ (0.05) Significance Level

$$223 / (1 + 223 * 0.05^2) \quad n = \underline{143}$$

in addition, four senior managers were selected for the purpose of an interview

Therefore, total sample size selected for the study was $143 + 4 = \underline{147}$

Table 3.2 Distribution of Sample Size to selected private commercial banks

No.	Selected private banks	Total population	Weight	Sample size For Questionnaire	Sample size for Interview
1	Dashen bank	58	26%	$143 * 0.26 = 37$	1
2	Abyssinia bank	66	30%	$143 * 0.30 = 43$	1
3	Nib international bank	43	19%	$143 * 0.19 = 27$	1
4	United bank	56	25%	$143 * 0.25 = 36$	1
	Total	223	100	<u>143</u>	<u>4</u>

Source: researcher compilation 2023

3.5 Sampling Technique

The study used a purposive sampling method to select samples from the total population of each selected bank based on their sample size. The reason for choosing this sampling method was due to there were unprofessional employees in the department who were not capable to answer the question. In addition, the purposive sampling method was used to select international banking department senior managers for the purpose of an interview.

3.6 Method of Data Collection

Primary data are obtained through questionnaires and Interviews. Due to this, a self-administered questionnaire was used that was distributed to professionals in the department. In addition, structured interviews were held with IBD senior managers from each selected bank to obtain

further information regarding the study. Furthermore, Document review is used to get supportive information from secondary sources such as NBE forex directives. Annual reports of selected banks, bank websites, etc....

3.7 Method of Data Analysis and Interpretation

After the collection of data, both quantitative and qualitative methods of data analysis were used to interpret the data. Accordingly, data collected from questionnaires were analyzed and interpreted quantitatively, and data collected through interviews were interpreted qualitatively.

Descriptive statistics such as percentages and frequencies and tables were used to analyze the data obtained from questionnaires. These descriptive statistics were used due to their ability to convey information to a good number of people easily because they are relatively simple to understand and interpret. On the other hand, narrative analysis was used in order to interpret and present information obtained from the interview.

3.8 Validity and Reliability of Data

3.8.1 Validity

According to Kothari (2004), Validity is the most critical and it indicates the degree to which an instrument measures what it is intended to measure. Because all research questions were prepared by the researcher, mini-interviews with some senior managers were made before preparing and distributing questionnaires to professional respondents and also before maintaining the main interview. This helps the researcher to obtain more information about the subject matter and to formulate relevant and suitable questions for the study. Furthermore, after the questionnaire was constructed, pre-testing was made with some random professionals in the department so as to check they have enough knowledge in the field by allowing them to read and comment on the questionnaire.

3.8.2 Reliability

Data reliability implies collected data were accurate, complete and consistent across researches. Accordingly, data obtained from the respondents are valid, complete and unique and then the researcher trusted for analysis and results from the study.

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS, AND DISCUSSION

4.1 Introduction

This Section presented the findings and discussions gathered information from primary data collection techniques. Accordingly, information gathered from questionnaires is presented and analyzed by using different descriptive analysis tools like tables, percentages, and so on. On the other hand, data obtained from structured interviews are presented and analyzed through qualitative analysis

Table 4.1 Questionnaire response rate

	Number	Percentage
Total Distributed	143	100%
Collected & filled	124	87%
Uncollected	19	13%
Used	124	87%

Source: researcher's own survey 2023

As per the above table, a total of 143 questionnaires were distributed to selected sample respondents. Of those, 124 which is 87% were valid and collected whereas, 19 questionnaires or 13% were not collected or not filled properly. Due to the response rate being good, the researcher believed the data collected was sufficient to conduct the study and enough for the conclusion.

4.2 Demographic Profile of Respondents

Table 4.2 Gender of respondents

Gender of respondents	Frequency	Percentage
Male	70	56%
Female	54	44%
Total	124	100%

Source: own survey 2023

The table shows that 70 of the respondents representing 56% are males and the remaining 54 respondents representing 44% are females. The distribution shows that male staffs are relatively larger than female staff.

Table 4.3 Level of education

Educational Qualification	Frequency	Percentage
BA	89	72
MA	35	28
PHD& above	-	-
Total	124	100%

Source: own survey 2023

According to the table, 89 respondents, representing 72% are 1st-degree holders and the remaining 35, respondents, representing 28% have master holders but there are no respondents that have Ph.D. or above educational qualifications. Therefore, the majority of respondents are degree holders in the sample.

Table 4.4 work experience in the bank industry

Year of experience	Frequency	Percentage
Less than 5 years	32	26
5 – 10 years	71	57
Above 10 years	21	17
Total		100

Source: own survey 2023

As shown in the table, the majority of respondents, representing 57% have a work experience of between 5 to 10 years. 32 respondents, which accounted for 26% have a work experience of below 5 years, and the remaining 21 respondents, which represents 17% have above 10 years' experience. Therefore, the majority of respondents show senior Employees.

Table 4.5 Job position

Job position	Frequency	Percentage
Manager & above	12	10
IBD heads	22	18
Officers	89	72
Total	124	100

Source: own survey 2023

As shown in the table, the predominant employees are officers which represents 72%. Next, IBD heads accounted for 18%, and manager and above positions represent 10%. Even though the majority of respondents are officers, their work experiences are mostly above 5 years as the data shows in Table 4.4 and they are senior employees that have enough knowledge in the field.

4.3 Data Presentation and Analysis

4.3.1 The challenge of surrender requirement on Forex mobilization and utilization of banks

Table 4.6 The surrender requirement mainly targets the main forex sources of banks

Level of agreement	Frequency	Percentage
Strongly agree	45	36
Agree	67	54
Neutral	7	6
Disagree	4	3
Strongly disagree	1	1
Total	124	100

Source: own survey 2023

As shown in the table, 112 respondents accounted for 90% agreed or strongly disagreed. 7 respondents that represent (6%) neither agreed nor disagreed and only 5 respondents (4%) disagreed.

Due to the majority of respondents perceived that the surrender requirement of the national bank of Ethiopia targeted the main forex sources for commercial banks. Forex earnings from the export business, remittance recipients, and NGO transfers are the principal sources while mobilizing foreign exchange in banks but all of them are subjected to the surrender requirement of NBE. Therefore, the result implies that the national bank of Ethiopia seems get more hard currency from commercial banks so as to increase its Foreign exchange reserve by forcing banks to surrender portion of earnings from principal sources.

Accordingly, this finding implies commercial banks encounter a challenge while mobilizing foreign currency due to their capacity is highly affected as they surrender their earnings from major sources.

Table 4.7 The surrender requirement significantly reduces the forex mobilization potential of banks

Level of agreement	Frequency	Percentage
Strongly agree	72	58
Agree	43	35
Neutral	5	4
Disagree	4	3
Strongly disagree	-	-
Total	124	100

Source: own survey 2023

According to the above table, 115 respondents that represent 93% agreed as well as strongly disagreed. Whereas, 5 respondents that accounted for 4% are neutral and the remaining 4 respondents (3%) disagreed.

Therefore, the surrender requirement significantly reduced the forex mobilization capacity of commercial banks. Because the surrender requirement targeted the main sources of foreign currency to banks it is expected that the forex mobilization of banks reduced and then the responses shown above support the argument. The surrender requirement accompanied with other factors such as the low foreign currency generating capacity of the country, the informal market influence and the scarcity of foreign exchange limits the commercial banks potential of mobilizing foreign currency.

Table 4.8 The surrender requirement significantly affects the forex utilization of banks

Level of agreement	Frequency	Percentage
Strongly agree	38	31
Agree	51	41
Neutral	19	15
Disagree	10	8
Strongly disagree	6	5
Total	124	100

Source: own survey 2023

As per the table shown above, 89 respondents accounted for 72% agreed or strongly agreed. 19 respondents which represents 15% were neutral and the remaining 16 respondents which represents 13% disagreed.

As a result, the surrender requirement affected the forex utilization of commercial banks. As far as there is a challenge while mobilizing foreign currency in banks, forex utilization is also affected. Then, banks may utilize their limited forex earnings for most priority obligations.

Table 4.9 The 70% surrender contribution is unfair to commercial banks

Level of agreement	Frequency	Percentage
Strongly agree	48	40
Agree	44	35
Neutral	21	17
Disagree	8	6
Strongly disagree	3	2
Total	124	100

Source: own survey 2023

As shown in the above table, 92 respondents accounted for 75% agreed or strongly agreed. Whereas, 21 respondents represent (17%) neither agreed nor disagreed and the remaining respondents that represent 8% disagreed.

In comparison with the previous thirty percent surrender contribution which was lasts five years from the date of regulation started, to the current amended regulation, the recent seventy percent surrender portion is very high to commercial banks and the response supported the argument. Accordingly, the national bank of Ethiopia’s directive on the 70% surrender requirement was not fair to commercial banks. The surrender portion is reversed from the previous 30% this implies the national bank considers its advantage but it increases the burden of commercial banks.

Table 4.10 The surrender portion is high in comparison with other countries

Level of agreement	Frequency	Percentage
Strongly agree	17	14
Agree	56	45
Neutral	34	27
Disagree	11	9
Strongly disagree	6	5
Total	124	100

Source: own survey 2023

As can be seen in the above table, 73 respondents accounted for 59% agreed. On the other hand, 34 respondents that represent 27% were neutral or they have not any idea about other countries experiences. The remaining 17 respondents representing 14% disagreed.

Although the majority of responses agreed on the question, there also high neutral responses as shown in the table. This implies those respondent have not information to other countries for making a comparison.

However, the surrender requirement is not common in developed countries that have enough capacity to generate foreign currency and good foreign currency reserve in central banks. It is limited to countries with low potential of generating foreign currency and a wide gap negative balance of payment like our country Ethiopia.

Therefore, the surrender amount is high relative to other countries that had surrender requirement practices. This implies Ethiopia is the only country that exercises unfavorable control on commercial banks and which contradicts the economic freedom of banks as the response also supported the argument.

Table 4.11 The increment of surrender requirement implies the demand for NBE ‘s hard currency increased.

Level of agreement	Frequency	Percentage
Strongly agree	62	50
Agree	47	38
Neutral	7	6
Disagree	5	4
Strongly disagree	3	2
Total		

Source: own survey 2023

As per the above table, 109 respondents which accounted for 88% agreed as well as strongly agreed, only 7 respondents forwarded neutral responses, and the remaining 8 respondents which represented 6% disagreed.

As standing from the above result, due to various reasons, such as the wide negative gap balance of payment, accumulated foreign debt payment of the country, the rising volume of of basic imported items, and the current political and economic condition of the country contribute to the increment of foreign currency demand for the government.

Therefore, the recent surrender requirement of the national bank of Ethiopia implies that the forex demand for NBE, as well as the country, is increased in order to compensate or to minimize the scarcity problem through surrender policy from commercial banks.

4.3.2 The challenge of surrender requirement on the customer experience of banks

Table 4.12 The surrender requirement discourages bank customers who involve in the export business

Level of agreement	Frequency	Percentage
Strongly agree	54	43
Agree	48	39
Neutral	11	9
Disagree	6	5
Strongly disagree	5	4
Total	124	100

Source: own survey 2023

The above table shows that 102 respondents which accounted for 82% agreed or strongly agreed that discourages export customers. 11 respondents which represents 9% neither agreed nor disagreed. Whereas, the remaining 11 respondents (11%) disagreed.

Because of most customers of banks who involve in export business have retention account in their respective banks so as to their foreign currency earnings to licensed separate import business as per the national bank of Ethiopia guideline. But no a day's exporters are not benefited because of the surrender a substantial portion of their earnings to national bank of Ethiopia.

As a result, the surrender requirement discourages the customer of banks who involve in the export sector and this results in commercial banks lose the benefit along with their exporter customers because exporters are the main forex source of commercial banks in foreign currency mobilization.

Table: 4.13 The surrender requirement discourages bank customers who involve in the import business

Level of agreement	Frequency	Percentage
Strongly agree	41	33
Agree	46	37
Neutral	22	18
Disagree	6	5
Strongly disagree	9	7
Total	124	100

Source: own survey 2023

As it can be shown in the above table, 87 respondents which accounted for 70% agreed or strongly agreed, whereas 22 respondents which represents 18% neither agreed nor disagreed. The remaining 15 respondents (12%) disagreed.

like export sector customers, the surrender requirement also affects as well as discourages the bank customers who involve in the import business. As commercial banks do not have enough forex reserves, they are unable to satisfy the forex request of their importer customers. As a result, importers are forced to satisfy their forex needs from the parallel black market then banks lose their customers.

As a result, this leads to customer of banks who involved in import business have less connection and transaction with commercial banks rather the shifted to parallel informal markets to satisfy their foreign currency needs.

Table 4.14 The surrender requirement has an effect on individual customers who receive money through international money transfers agents

Level of agreement	Frequency	Percentage
Strongly agree	3	2
Agree	10	8
Neutral	19	15
Disagree	64	52
Strongly disagree	28	23
Total	124	100

Source: own survey 2023

As shown in the above table, only 13 respondents which represent 10% agreed that the surrender requirement affects individual customers who received money through international money transfer agents. Whereas, 92 respondents which accounted for 75% disagreed and the remaining 19 respondents (15%) have neutral responses.

This result implies that the surrender requirement does not affect individual customers of banks who receive money through international money transfer agents such as western union, money gram, express money, etc. This argument is true as far as customers need only local currency and the used the banks only as an intermediary for getting the service. In this case, the surrender requirement effect belongs to banks. Therefore, commercial banks relationship with such customers is not directly affected but it may be affected indirectly if those customers request back.

Table 4.15 Surrender requirement has an effect on individual customers who sold hard currency to banks.

Level of agreement	Frequency	Percentage
Strongly agree	7	6
Agree	17	14
Neutral	5	4
Disagree	71	57
Strongly disagree	24	19
Total	124	100

Source: own survey 2023

As per the above table, 24 respondents which represent 20% agreed on the effect of the surrender requirement on customers who exchange forex with banks. On the other hand, 95 respondents accounted for 76% disagreed, and the remaining 5 respondents (4%) were neutral. Therefore, the surrender requirement does not affect customers who exchange foreign currency in bank branches or forex bureau.

Like individual remittance recipients' customers who exchange their foreign currency for local currency are also not affected by the surrender requirement but again the effect is on banks. In general, the above-mentioned customers are not directly affected by the surrender requirement but they may be affected indirectly when they request foreign currency back from their respective commercial banks.

Therefore, the surrender requirement does not affect commercial banks in relationship with customers who exchange foreign currency in bank branches or forex bureau. But argument is similar to bank customers who receive inward remittance from abroad and needs service only.

Table 4.16 The surrender requirement hinders commercial banks to supply forex for customers.

Level of agreement	Frequency	Percentage
Strongly agree	43	35
Agree	67	54
Neutral	4	3
Disagree	7	6
Strongly disagree	3	2
Total	124	100

Source: own survey 2023

As it can be shown in the above table the majority (110) of respondents that accounted for 89% agreed as well as strongly disagreed. Only 4 respondents (3%) have neutral responses and the remaining 10 respondents which represents 8% disagreed.

The response implies that in combined with other constraints of foreign exchange shortage, commercial banks encounter greater challenges to satisfy their customer demand for foreign currency. Here, the effect of surrender requirement is very high compared to other factors as there is a substantial volume of Foreign currency surrendered to national bank of Ethiopia.

As a result, the surrender requirement hinders commercial banks to supply foreign currency to their customers. This is a greater impact on commercial banks as they mainly depend on the customers.

4.3.3 The challenge of surrender requirement on the financial loss to banks

Table 4.17 Commercial banks lose income from foreign currency spread due to surrender requirement

Level of agreement	Frequency	Percentage
Strongly agree	51	41
Agree	56	45
Neutral	12	10
Disagree	5	4
Strongly disagree	-	-
Total	124	100

Source: own survey 2023

As shown in the above table, the majority of respondents accounted for 86% agreed or strongly agreed, and 12 respondents (10%) neither agreed nor disagreed. Whereas, only 5 respondents which represent 4% disagreed.

Commercial banks are surrendering their foreign currency earnings at the prevailing buying rate on the next working day. Due to this commercial banks to lose foreign currency spread income (income from the difference between foreign currency buying rate and foreign currency selling rate). The above response supported the information obtained from the interview. Commercial banks lose income from foreign exchange spread equivalent to the proportion of their earning surrendered to national banks.

In addition, commercial banks also lose foreign currency income from speculative selling in the future that is perceived income from higher selling exchange rate in the future date compared to exchange rate today. Accordingly, this result helps to address one of the studies objective of to evaluate whether the surrender requirement have financial loss to commercial banks or not.

Table 4.18 Commercial banks’ expenses increase as a result of the surrender requirement

Level of agreement	Frequency	Percentage
Strongly agree	18	15
Agree	61	49
Neutral	27	22
Disagree	14	11
Strongly disagree	4	3
Total	124	100

Source: own survey 2023

As per the above table, 79 respondents that represent 64% agreed as well as strongly agreed. Whereas, 27 respondents accounted for 22% neither agreed nor disagreed, and the remaining 18 respondents, or 14% disagreed.

The response shown above supports the information obtained from an interview. Accordingly, commercial banks spend more costs to get additional foreign currency to solve the shortage of their foreign currency reserve which is highly affected by the surrender requirement.

However, after scarifying such costs, commercial banks are not benefited from foreign exchange transaction income because of the national bank of Ethiopia not sharing such costs with commercial banks rather it only shares the foreign exchange earning without scarifying any costs.

Therefore, the surrender requirement increases the expense of commercial banks.

Table 4.19 Commercial banks incur costs while mobilizing foreign currency

Level of agreement	Frequency	Percentage
Strongly agree	59	48
Agree	49	39
Neutral	7	6
Disagree	4	3
Strongly disagree	5	4
Total	124	100

Source: own survey 2023

As per the table, the majority (108) of respondents that accounted for 87% agreed as well as strongly agreed. 7 respondents (6%) were neutral and the remaining 9 respondents which represents 7% disagreed.

Commercial banks are incurring costs to mobilize foreign currency. They incurred various costs such as advertising costs, operational costs, and operational costs while mobilization of foreign currency but the national bank of Ethiopia forced banks to surrender a high portion of their earning without the consideration of their spending costs. This results in financial loss to commercial banks because of banks are not benefited from income parallel to their costs incurred.

Table 4.20 the surrender requirement increases the opportunity cost of banks to mobilize forex

Level of agreement	Frequency	Percentage
Strongly agree	25	20
Agree	47	38
Neutral	31	25
Disagree	15	12
Strongly disagree	6	5
Total	124	100

Source: own survey 2023

As shown in the above table, 72 respondents which accounted for 58% agreed as well as strongly disagreed. Whereas, 31 respondents that represent 25% neither agreed nor disagreed and the remaining 21 respondents (17%) disagreed.

The surrender requirement increases the opportunity cost of commercial banks. The scarcity of foreign exchange due to the surrender requirement tends commercial banks to focus on customers who are the sources of banks, loans at low interest rate compared from other customers, and other privileges are primarily given to those customers. this causes opportunity costs to banks because they give less attention to other customers.

As a result, the commercial bank's opportunity cost increases and this implies the commercial banks financial loss increased as a result of the surrender requirement.

4.4 Analysis of information obtained through interview

The challenge of surrender requirement on the forex mobilization and utilization of banks

a. How surrender requirement reduces forex mobilization potential?

Almost all senior IBD managers explained that foreign currency mobilization to banks is affected as a result of the requirement. This is due to a sound portion of earnings from export and inward remittance and NGO transfers from abroad being immediately surrendered to the National Bank of Ethiopia. the surrender requirement accompanied by other factors such as the low foreign currency generating capacity of the country and the uncontrollable parallel black market accelerates the scarcity of foreign exchange in commercial banks. Therefore, the forex mobilization potential of commercial banks is significantly reduced as a result of the surrender requirement.

b. Does the surrender requirement mainly target the main forex sources of banks?

The majority of respondents said yes and explained that export and inward remittance are the major sources of hard currency in commercial banks, in addition, NGO transfers are also good in the country. Accordingly, the concludes that the requirement targeted principal forex sources of commercial banks.

c. How the surrender requirement affects the forex utilization of banks?

Most respondents argue that due to the forex mobilization of banks reduced by the surrender requirement, their forex utilization is also similarly affected. This is because of limited forex resources; banks are unable to utilize their foreign currency for all customers. Instead, they are used primarily on priority sectors and less on non-priority sectors as identified by the national bank of Ethiopia.

d. Do you think that a 70% surrender contribution is unfair compared to previous 30% contribution to banks?

Regards to this question, all respondents believed that it is not fair because of its high compared to the previous 30% surrender requirement. A long time from the start date of the surrender

requirement it was 30% and it was increased to 50% for nearly six months and after that boomed to 70% until now. Therefore, the 70% surrender volume is high and not fair.

e. Do you think that the surrender portion is high in comparison with other countries?

Most respondents argue that the recent 70% surrender is very high compared to other similar countries which have limited sources of foreign currency. Most countries that implement such requirements are less developed countries and have a shortage of hard currency but not common in developed countries that have enough hard currency reserves and high forex-generating capacity. However, some respondents said that they are not information for other countries in order to make a comparison regards to the question asked.

f. Do you think the increment of surrender requirement indicates the demand for NBE hard currency increased?

All respondents believed that due to the country's political condition was not good in the last two years, increasing imported basic public items like fuel and food items, and accrued external debt, the demand for hard currency from the government is increased. In addition, they believed that the wide negative gap balance of payment of the country was also another factor in the increased surrender requirement.

g. Does the surrender policy include other forex sources of banks over-listed on NBE directive FXD/78/22?

Respondents explained that except for diaspora accounts and foreign currency saving accounts all other sources of foreign currency are subjected to surrender requirements. Such as direct hard currency purchases in branches as well as in the Forex bureau, private remittance through SWIFT, and international money transfer agents like western union, money gram, world remit, and so on. Accordingly, they argue that the national bank of Ethiopia targets almost all principal sources of foreign currency of commercial banks.

The challenge of surrender requirement in the customer experience of private commercial banks.

a. Does the surrender requirement discourage the bank customers who involve in the export business?

Respondents argue that the surrender requirement definitely discourages exporters. This is because most customers of banks who involve in the export business have retention accounts in order to use their hard currency in the import business. However, according to the recent surrender requirement of the national bank of Ethiopia, the retention account holder only used 20% of their foreign currency earning. 70% of their earning are surrendered to the national bank of Ethiopia and 10% is surrendered to the respective commercial banks. Therefore, as a result of the surrender requirement exporters are highly affected and discouraged.

b. Does the surrender requirement discourage the bank's customers who involve in the import business?

Respondents respond that due to import and export businesses being interrelated, the surrender requirement also affects customers who involve in the import business. As foreign currency reserve is low in banks, importers are not able to get hard currency to import goods and services. In addition, in Ethiopia, most traders who involve in the export business have also import business as a sister company. Therefore, customers who involve in the import business are affected as well as discouraged in a similar way to the export business.

c. Does The surrender requirement have an effect on individual customers who receive money through international money transfers and who sold hard currency to banks?

Respondents explained that the surrender requirement does not affect individual customers, who sold foreign currency in bank branches as well as forex bureaus. Furthermore, it does not also affect customers who receive international remittances either in SWIFT or international money transfer agents as far as they need only Ethiopian birr. In general, such customers mostly need only the bank service while conversion of their hard currency to Ethiopian birr, and the surrender requirement does not affect those individual customers.

d. Which customers are mainly affected by the surrender requirement and which are not affected as a result of the requirement?

Respondents explained that customers who have retention account holders who are involved in import and export business, hotel and tourism service are mainly affected by the surrender requirement due to 80% of earning of hard currency is subjected to surrender (70% to the national bank of Ethiopia and 10% to respective commercial banks). Whereas, other customers such as diaspora account holders in the form of non-resident foreign currency accounts (NRFCY), foreign currency saving account holders, and other normal saving and current account holders are not affected by the surrender requirement.

e. Do banks suffer challenges to supply foreign currency to customers due to surrender requirements?

Respondents explained that because a high portion of forex earnings is surrendered to the national bank of Ethiopia, they left limited foreign currency on hand. As a result, commercial banks are encountered a major challenge to supply hard currency when the demand from their customers, and this leads commercial banks to experience negative relations with their customers.

In general, as per the information obtained the surrender requirement affect banks in customer relationship for the following reasons:

First, commercial banks suffered from a high shortage of foreign currency due to the surrender requirement and other factors. As a result, they are unable to supply foreign currency to their customers. this results in the low retention of potential customers.

Second, importers shifted to the black market to satisfy their foreign currency needs due to this most importers have no more connection to banks and they are not making a deposit in commercial banks rather they paid the equivalent sum to black market dealers.

Third, banks also encounter challenges to supply small foreign currency requests from their normal customers when customers need forex for medical expenses abroad, education fees, vacations, etc. because their forex reserve is severely affected by the surrender requirement. As a result, banks have adverse relationships with customers.

The challenge of surrender requirement on the Bank's profitability

a. What are the major challenges of the surrender requirement to the bank's profitability?

According to the respondent's explanation, the surrender requirement has the following challenges. First, banks are surrendering their foreign currency at the prevailing buying rate on the next working day. As a result, commercial banks are not realizing income from selling foreign currency in the future date. Second, commercial banks surrender their forex earnings at the prevailing buying rate to the national bank of Ethiopia but if they sold the customer, the sell-by-selling rate. So commercial banks lose foreign currency spread as the result of the surrender requirement. In general, respondents argue that banks' profitability is highly affected as a result of the surrender requirement, and their profitability decrease as the national bank of Ethiopia increases the volume of surrender requirement.

b. Do commercial banks' expenses increase as a result of the surrender requirement?

Respondents explained that the surrender requirement by itself does not increase the bank's expenses. However, they spend expenses while mobilizing foreign currency but they lose profit due to surrender requirements. Therefore, the surrender requirement does not directly increase the bank's expenses but banks are not obtaining foreign exchange income parallel to their resource spending to mobilize foreign currency.

c. Do commercial banks incur costs while mobilizing foreign currency?

Banks incur costs such as advertising costs, administrative costs, and operational costs while mobilizing foreign currency. Nowadays, banks advertise a lot of services they deliver to customers. From those promotions for foreign currency mobilization has a prominent share including attractive incentives to encourage mobilization. So, banks incur all those costs when they mobilize foreign currency.

D. Does the surrender requirement increase the opportunity cost of banks to mobilize forex?

Some respondents argued that opportunity cost increases as banks tried to get more foreign currency earnings to compensate for the surrender amount given to the national bank of Ethiopia. For example, banks give loans at a low-interest rate to customers who generate foreign currency for the bank, they increase incentives and advertising levels. On the other hand, some other respondents believed that it does not increase or decrease the opportunity cost of banks because of they applied the same procedure either surrender requirement volume increase or decrease.

4.5 Discussion of Findings

Discussion with Research Objectives

The first objective of the study was to examine the challenge of the surrender requirement for commercial banks on their foreign exchange mobilization and utilization. Accordingly, findings of the study revealed that both the forex mobilization and utilization as a result of the surrender requirement. The main reason behind to this is because of the surrender portion is substantial the exporter customers are also similarly subjected to the surrender requirement.

The second objective was to assess the challenges of the surrender requirement for banks on customer relationships or customer experience. Therefore, the finding obtained from the study showed that commercial banks experience negative relationship to their customers due to the following reasons: first banks are not able to satisfy foreign currency needs of prominent customers like exporters because the surrender large portion of earnings to NBE. Second, banks are not experience good relationship with importers as well as other normal customers because those customers fulfilled their foreign currency needs from informal markets.

The third objective of the study was to assess whether the surrender requirement have financial loss or not to commercial banks. Accordingly, the findings showed that the surrender requirement leads financial loss to commercial banks because of the following reasons. First banks loss foreign exchange spread because of banks surrender with buying rate to national bank. Second, banks also lose foreign exchange income from speculative gain due to banks surrender within the next working day of after earning. Finally, commercial banks incurred various cost to mobilize more foreign currency to minimize the surrender effect and this results financial loss.

Discussion with Empirical Literatures

One of the findings of this study revealed that the surrender requirement is one of the major challenges to mobilizing foreign exchange in commercial banks. As a result, this finding added an additional factor that reduces the forex mobilization of banks from the previous research conducted by Yonatan Tadesse in 2018. He studied factors that hinder foreign currency mobilization in Ethiopian commercial banks and his finding showed that the existence of informal markets, the price decline of export commodities in the international markets, and limited exportable items in the country are the major challenges to foreign exchange mobilization but its finding was not

included the surrender requirement which is another significant factor that affects commercial banks forex mobilization capacity. Therefore, its study identifies the general macroeconomic conditions that affect forex mobilization. However, this study is focused on the challenge emanating from government policy.

This study also shows the foreign exchange surrender requirement is the main challenge for banks from the perspective of customer relationships. According to this study, the surrender requirement is the major cause for commercial banks to have adverse customer relationships. But the previous studies such as Cecilia and Gekara (2016), Dereje S. (2019, and Asrat (2021) showed that the allocation of foreign currency to priority and non-priority sector requirements is the main factor in the bank-customer relationship.

Furthermore, this study results in the foreign exchange surrender requirement is a factor that affects the financial performance of commercial banks. However, previous studies such as Henok (2021), and Tadesse (2015), revealed that commercial banks' foreign exchange rate fluctuations, and foreign exchange regulations imposed by the national bank of Ethiopia, were factors that determine the financial performance of commercial banks and they omitted the surrender requirement from their factor from their studies.

Finally, as per the finding of this study, the national bank of Ethiopia formulated a policy to solve its foreign currency scarcity through the surrender requirement of banks and customers who have retention accounts. However, this results in an indirect problem for the national bank of Ethiopia itself. This is because commercial banks are not able to mobilize the required level of forex due to most earnings from export and remittance are channeled into informal markets as a result of the surrender requirement.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION, AND RECOMMENDATION

5.1 Summary of Findings

The primary objective of this study is to get an understanding of the challenges of the National Bank of Ethiopia's surrender requirement on commercial banks. Accordingly, mainly primary data in the form of structured interviews and questionnaires were used so as to collect better information relevant to the study. Descriptive statistics were used to analyze the information obtained from the respondents. Whereas, narration analysis was made to put the information obtained from the interview. Accordingly, the stud shows the following major results:

- The surrender requirement reduced the forex mobilization capacity of commercial banks. This was due to commercial banks surrendering a sound portion of their foreign currency earnings from various sources to the national bank of Ethiopia.
- The National Bank of Ethiopia's surrender requirement targeted the main forex sources to commercial banks.
- The recent seventy percent surrender contribution to the national bank of Ethiopia lacks fairness in the context of commercial banks.
- The surrender requirement discourages the customer of commercial banks who involve in the export business sector.
- However, the surrender requirement does not affect customers who receive money from abroad through SWIFT, international money transfer agents as well as who exchange foreign currency in the forex bureau as far as they only need local currency at that time.
- The surrender requirement also affects commercial banks' profitability due to banks surrender by forex buying rate to the national bank of Ethiopia, they lose foreign exchange spread income (difference between selling exchange rate and buying rate)
- In addition, the surrender requirement forced commercial banks to surrender the required portion on the next working day of their earnings. So, banks again lose foreign currency exchange income speculative in the future date.
- Commercial banks encounter adverse customer experiences as they are unable to satisfy their customer's need for foreign currency which mainly emanates from the surrender requirement.

5.2 Conclusion

As the objective of the study was to examine the challenges of NBE surrender requirement on commercial banks, with three dimensions. Accordingly, the results of the study revealed that the challenge of foreign exchange surrender requirement on commercial banks is multidimensional.

It reduced the forex mobilization capacity of banks and it also affect their utilization of foreign exchange which is emanated from low mobilization. It also reduced bank - customer relationship due to banks were not satisfied customer demand because of forex scarcity. In addition, it leads to financial loss to commercial banks due to they lost foreign exchange spread and income from speculative selling.

Finally, the study also provides important insights for interested readers who want to know the challenges of the surrender requirement on commercial banks.

5.3 Recommendation

Based on the findings of the study, the study forwards the following recommendations.

As the surrender volume is substantial for banks and for customers who get foreign exchange from exports and inward remittance, the study advised Banks to encourage their customers to open diaspora accounts in the form of non-resident foreign currency accounts and foreign currency saving accounts to minimize the burden of the surrender requirement. Because those accounts are exempted from the surrender requirement.

Currently Commercial banks retain only thirty percent of their foreign exchange earnings. Due to this the study suggests banks to used best efforts to mobilize more foreign currency by formulating different mechanisms so as to minimize the effect of surrender requirements and at the same time they also effectively controlling costs while mobilizing foreign exchange.

Upcoming researchers could study the subject matter by using different research methodologies and by widening the scope of their study.

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**Challenges of National bank foreign exchange surrender requirement on
private commercial banks in Ethiopia.**

Annex

Dear respondents:

The objective of this questionnaire is for conducting the research entitled “Challenges of national bank of foreign exchange surrender requirement on private commercial banks in Ethiopia.” Accordingly, your response in this regard helps a lot to undertake the study smoothly, and then accurate, Consistent, and value-added information is expected from each respondent in order to meet the objective of the study. Finally, I confirm that the information obtained will be kept confidential and only used for research purposes.

Thank you in advance for your cooperation.

Yonas Zelelew Worku

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Part one: personal information

Please put a tick mark (√) in the space provided for each question.

1. Gender: Male Female
2. Education level: BA MA PHD& above
3. Work experience in the bank:
less than five years 5 up to 10 years above 10 years
4. Your job position in the department:
IBD Officer IBD head Manager & above

Part Two: questions about the challenges of NBE surrender requirement on private banks

Instruction: In this section, the researcher is asking about your perception of the challenges of NBE’s surrender requirement on private commercial banks. So, please read each question carefully and select your level of agreement for the following statement. Then put a tick mark (√) under the appropriate space.

SA = strongly agree A = agree N = neutral D = disagree SD = strongly disagree

No.	1. The challenge of surrender requirement on Forex mobilization and utilization of banks	Level of agreement				
		SA	A	N	D	SD
1	The surrender requirement mainly targets the main forex sources of banks.					
2	The surrender requirement reduces the forex mobilization potential of banks.					
3	The surrender requirement affects the forex utilization of banks.					
4	The 70% surrender contribution is unfair to commercial banks.					
5	The surrender portion is high in comparison with other countries.					
6	The increment in surrender requirement indicates the demand for NBE ‘s hard currency increased.					

No.	2. The challenge of surrender requirement on the customer experience of banks	Level of Agreement				
		SA	A	N	D	SD
1	The surrender requirement discourages bank customers who involve in the export business					
2	The surrender requirement discourages bank customers who involve in the import business					
3	The surrender requirement has an effect on individual customers who receive money through IMT agents					
4	The surrender requirement has an effect on individual customers who sold hard currency to banks					
5	The surrender requirement hinders commercial banks to supply forex for customers.					

No.	3. The challenge of surrender requirement on the profitability of banks	Level of Agreement				
		SA	A	N	D	SD
1	Commercial banks lose income from foreign currency spread due to surrender requirement					
2	Commercial banks' expenses increase as a result of the surrender requirement					
3	Commercial banks incur costs while mobilizing foreign currency					
4	The surrender requirement increases the opportunity cost of banks to mobilize forex					

If you have any additional comments -----

Thank you for your cooperation!!

Interview questions about the challenge of NBE's surrender requirement on private commercial banks

A. Challenges Related to Forex Mobilization and Utilization

1. Does the surrender requirement reduce forex mobilization potential?
2. Does the surrender requirement mainly target the main forex sources of banks?
3. Do you think that the surrender requirement affects the forex utilization of banks?
4. Do you think that a 70% surrender contribution is unfair to banks?
5. Do you think that the surrender portion is high in comparison with other countries?
6. Do you think the increment of surrender requirement indicates the demand for NBE hard currency increased?
7. Does the surrender policy include other forex sources of banks over-listed on NBE directive FXD/78/22?

B. Challenges Related to Customer Experience

1. Does the surrender requirement discourage the bank customers who involve in the export business?
2. Does the surrender requirement discourage the bank's customers who involve in the import business?
3. Does The surrender requirement have an effect on individual customers who receive money through international money transfers and who sold hard currency to banks?
4. Which customers are mainly affected by the surrender requirement and which are not affected as a result of the requirement?
5. Do banks suffer challenges to supply foreign currency to customers due to the surrender requirement?

C. Challenges Related to banks financial loss

1. What are the major challenges of the surrender requirement to the bank's profitability?
2. Do commercial banks' expenses increase as a result of the surrender requirement?
3. Do commercial banks incur costs while mobilizing foreign currency?
4. Does the surrender requirement increase the opportunity cost of banks to mobilize forex?