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College of Business and Economics

Impact of NBE's purchase of foreign currency regulation on private banks
performance

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Administration in Finance

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Declaration

I, BIRHANNE NEGASH, hereby declare that the thesis work entitled “**Impact of NBE purchase of foreign regulation on private banks performance**” I Submitted for the award of the degree of Masters of business administration in finance at Addis Ababa University in Ethiopia. It is my original work and it has never been presented in any university. All sources and materials used for this thesis been duly acknowledged.

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CERTIFICATION
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This is to certify that the thesis prepared by **BIRHANNE NEGASH** entitles: ‘**Impact of NBE purchase of foreign regulation on private banks performance**’ and submitted in partial fulfillment of the requirements for the degree of masters of Science in accounting and finance compiles with the regulations of the university and meets the accepted standards with respect to originality and quality.

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Acronyms

AMEL	Asset quality management earning and liquidity
CAMEL	Capital, Asset, Management, earning and liquidity
CBOT	Chicago Board of trade
CFDS	Contract for differences
CLRM	Classical linear regression model
EVA	Economic value added
FDIC	Federal deposit insurance corporates
FX	Foreign exchange
FXD	Foreign exchange Directive
GDP	Gross domestic products
IBD	International banking department
NBE	National bank of Ethiopia
OLS	Ordinary Least Squares
ROA	Return on Asset
ROE	Return on Equity
UN	United nations
USD	United states Dollar

ABSTRACT

In every economic developmental theory, financial institutions are the center role player. If there is a catastrophe on the operation and administration of the institutes, the adverse impact on GDP of the countries development. The healthy and stable economic flow managed by effective regulation and policy with right application of the stakeholders. One of the main foundations of banking business is the management and resource of foreign currency. The unbalanced foreign trade of import and export has its own shifting force on the economy. This thesis paper focused on the assessment of purchased foreign currency regulation of NBE related with the performance of private banks. The study used balanced panel model and collect non-probability sampling from six private banks covering the period of six (6) consecutive years, 2014-2019. The study used two dependent variables return on asset (ROA) and return on equity (ROE) to measure the performance of the bank and independent variables that are sources of foreign currency, export, remittance, diaspora accounts. To evaluate and to assess their impact on selected banks performance, the governing NBE's regulations of surrender policy and allocation of foreign currency are the whole center of the research. Explanatory research method used with tabular, graph, and diagram presentation with the data collected interpretation. Through the research 30% surrender policies impact and the stiff competition on purchase of foreign currency added with high scarcity on the market, has negative significant impact on the performance of the bank. The informal black market and current exchange rate has also its own contribution on the scarcity of the foreign currency. Even if bank industry is one of high profitable investment field, still the performance found affected by the above independent variables and the researcher comment on the findings and recommends NBE to revising the regulation of surrender policy by decreasing the percentage or/and by adjusting the exchange rate amount. The other recommendation is the regulatory body to review the floating rating to market led to tackle the informal and illegal bodies.

Key words:-*Surrender, Return on Asset, Return on Equity*

CHAPTER ONE

1. INTRODUCTION

Banks play an important role in the basic economy activity of any country. Banks are the main intermediaries between those who have an excess of money and categorized as depositors and the others are those individuals and businesses with feasible projects but requiring money for their security are creditors. Their functions could be lending money, depositing others' money, transferring money locally or globally and working as paying agent.

The word "Bank" is assumed to be derived from the German word "Banc" that means a 'joint stock firm'. Some theory says that the word derived from 'banco' or 'banque', which means 'a bench'. In Rome and Greece pawnbrokers were called "benchers" as they used to keep their coins on the bench for the purpose of changing one kind of money into another. Banking in the medieval period mostly connected with money changing business. The merchants, goldsmiths and moneylenders can be regarded the ancestors of present day bankers, goldsmiths used to hold considerable stocks of valuable metals (Heffernan, 2005).

They used to receive and issue receipts as claims against the stocks held by goldsmiths. They became prominent in England during the 17th century. Even in the ancient and medieval periods, they used to accept deposits of precious metals from the public for safekeeping. With the passage of time, they offered some interest on deposits to attract more deposits. They used to charge higher rates of interest by lending these deposits to make profits. Thus, right from ancient times, banking was a business activity and was carried on by some members of the society.

Earliest of all banking institutions was the Bank of Venice founded in 1157. Thus, the first banking institution came into existence in Italy. The bank of Barcelona was established in 1401 and the Bank of Genoa in 1407. The Bank of Venice and the Bank of Genoa could survive only until the end of the 18th century. In 1609 the Bank of Amsterdam and in 1690 the Bank of Hamburg were established. The Lombards of Italy who migrated to England and other parts of Europe were mainly responsible for the planning and development of modern banking. Lombard Street in London represents the locality where the Lombards have settled. During the reign of Queen Elizabeth-I, goldsmiths, merchants, private moneylenders, and money

exchangers came into prominence. With the seizure of large gold hoards from the London merchants in 1640 by King Charles-I, the merchants were scared to keep their surplus funds with them. Their surplus funds deposited with goldsmiths who were doing the modern commercial banking operations. The goldsmiths' business suffered greatly during the reign of Charles-II, who imposed several restrictions on the business of goldsmiths and ordered them to deposit their funds in the "Exchequer". The businesses of goldsmiths finally ruined, when the king closed the "Exchequer" without making any repayment. A large number of private bankers replaced the role of goldsmith. Though in 1694 the Bank of England came into existence, the growth of joint stock commercial banking was actually started with the passage of the Banking Act of 1833 in England. Thus in the 19th century the seeds were sown for growth of the modern joint stock commercial banking in different countries (Eiteman, 2011).

2. Origin of Banks in Ethiopia

Banking is relatively new concept on the beginning of modern Ethiopia. The time traced back to 1905 when the first bank of Abyssinia established on the premises of the present AAU compass. (NBE, 2016) While National Bank of Ethiopia was retain as a separate institution, all other commercial banks merged with the commercial bank through an act. "Bank" means a company licensed by the National Bank to undertake banking business or a bank owned by the government. Its prohibited to transact banking business in Ethiopia without obtaining banking license from the National Bank. / Federal Negarit Gazeta No. .57 25th August, 2008/

Private commercial banks are a recent phenomenon in the Ethiopian economy. They came into existence after the downfall of the Dergue regime. After the downfall of the Dergue private commercial banks were allowed to operate and they started to have market share, and now they have some growing market share in the Ethiopian economy and are some of the major players in the Ethiopian economy. Their number is also growing from time to time and currently new commercial banks are joining the market.

One of the main objectives of financial institutions is mobilizing resources (in particular domestic saving) and channeling them to the would-be investors. This intermediation role of financial institutions takes different forms in different economic systems. Ethiopia's history of the last three decades clearly shows the validity of this statement.

A national bank of Ethiopia defined as “the bank in any country to which has been entrusted the duty of regulating the volume of currency and credit in that country”. According to Kisch and Elkin, " a national bank of Ethiopia is that bank the essential duty of which is maintenance of stability of the monetary standard which involves the control of the monetary circulation". According to M.H. Dekock a national bank of Ethiopia is a bank which constitutes the apex of the monetary and banking structure of its country and which performs several functions in the national economic interest. According to Kent, it is an institution, which is charged with the responsibility of managing the expansion and contraction of the volume of the money in the interest of general public welfare

A national bank of Ethiopia, Reserve bank, or Monetary authority is an institution that manages state's currency, money supply, and interest rates. The word "Reserve" is also often included, such as the Reserve Bank of India, Reserve Bank of Australia, Reserve Bank of New Zealand, the South African Reserve Bank, and U.S. Federal Reserve System. In addition, national bank of Ethiopia is known as monetary authorities such as the Monetary Authority of Singapore, Maldives Monetary Authority and Cayman Islands Monetary Authority. Many countries have state-owned banks or other quasi-government entities that have entirely separate functions, such as financing imports and exports.

National bank of Ethiopia also usually oversees the commercial banking system of their respective countries. In contrast to a commercial bank, a national bank of Ethiopia possesses a monopoly on increasing the monetary base in the state, and usually prints the national currency, which usually serves as the state's legal tender. The national bank of Ethiopia has the right to set its own policy goals, whether inflation targeting, control of the money supply, or maintaining a fixed exchange rate. While this type of independence is more common, many national bank of Ethiopia prefer to announce their policy goals in partnership with the appropriate government departments. The primary function of a national bank of Ethiopia is to control the nation's money supply (monetary policy), through active duties such as managing interest rates, setting the reserve requirement, and acting as a lender of last resort to the banking sector during times of bank insolvency or financial crisis. national bank of Ethiopia usually also have supervisory powers, intended to prevent bank runs and to reduce the risk that commercial banks and other financial institutions engage in reckless or fraudulent .

Functions of national bank of Ethiopia may include implementing monetary policies, determining Interest rates, controlling the nation's entire money supply, the Government's banker and the bankers' bank ("lender of last resort"), managing the country's foreign exchange, gold reserves and the Government's stock register, regulating and supervising the banking industry.

Setting the official interest rate used to manage both inflation and the country's exchange rate and ensuring that this rate takes effect via a variety of policy mechanisms. In some countries, national bank of Ethiopia may have other tools that work indirectly to limit lending practices and otherwise restrict or regulate capital markets. For example, a national bank of Ethiopia may regulate margin lending, whereby individuals or companies may borrow against pledged securities. The margin requirement establishes a minimum ratio of the value of the securities to the amount borrowed. (AAU, 2019)

3. Statement of the Problem

In Ethiopia, the financial institutes get high margin of profit year per year. Currently there are 16 private banks in the country, which they are emerging on the last three decades. In accordance with Article 55(10) of the constitution of the Federal Democratic Republic of Ethiopia, the NBE established to control the financial system and monetary policy of the country. Therefore, the NBE announces different regulations, rules, policies, procedures, guidelines and memos all the time for those banks.

Regulation defined as the public administrative policing of private activities based on a set of rules that developed in the public interest. 'Bank regulations try to provide this stable framework which seeks to assure certainty and safety to users of the banking payment system which is critical for the wellbeing of the economy. Moreover, apart from maintaining public confidence, banking regulations also try to create a regulatory environment where banks are expected to be efficient and competitive; and are expected to provide reasonable levels of banking services throughout the economy

Bank Regulation is one of the external factors that could influence banks performance, it may affect individual banks directly and/or indirectly (Martin and Mauer, 2003). Regulation is implemented with the aim of restricting or limiting banking activities, the banks' conduct of business and the efficiency with which they operate will be affected. This in turn could induce

banks to engage in riskier activities and /or to invest in ways to circumvent regulation; it could even ultimately affect economic growth (Jalilianet, 2007).

The objective of the bank regulations differ in different countries on their emphasis and jurisdiction. The most common objectives are prudential, systematic risk reduction, to avoid misuse of banks, to protect banks confidentiality, credit allocation etc.

Thus, the process consists of intentional restrictions over a subject's choice courses of operations by an entity not directly involved in that activity. Those regulations have their impact on the bank's performance. The government controls the monetary policy, lending limits, setting interest rate...etc. The performance of the bank mainly depends up on those government procedures. For instance under NBE Directive No MFA/NBE Bills/001/2011 dated April 4, 2011 has issued a directive requiring all private commercial banks to invest 27% of their every new loan disbursement to NBE bills for five years at 3% interest rate. In addition, on the recent directive the interest adjusted to 5%, still far below from what banks pay as an interest for the deposit. On this directive until year 2018/19, the national bank collects more than 95 billion birr from those private banks (Yewondwesen, 2019).

Different researchers was assessing and studies about the effect of those directives, Yodit (2012) assess the implication of NBE bill purchase on the performance of private commercial banks in Ethiopia using qualitative research method and she concluded that the performances of private banks are affected because of the requirement of NBE bill purchase. Additionally the empirical research conducted on the impact of policy measure on the performance of private banks in Ethiopia: in the case of government, bill purchase by Tesfaye (2014) using panel data from 2007 to 2013 of eight middle size private banks and ROA as a measure of profitability. The study finds that exposure to government bills has negative and significant relationship with the performance of private banks. In the same year Eden (2014) examine the impact of National bank regulation on the performance of private banks using panel data from 2004 to 2013 of six private banks and the result indicate that NBE Bill and Credit cap had negative and statistically significant impact on banks profitability but reserve requirement had negative and insignificant impact on profitability. Shimels (2016) also has a study on the impact of bank regulation and their performance shows that income diversification (ratio of non-interest income to total asset) had positive and significant impact on return on asset. Therefore, private

commercial banks should search other fee generating sources, which can positively contribute for profitability to offset the impact of the requirement on their performance. Zegeye (2018) was one of the researcher on the finding study for ROA model revealed that NBE Bill Purchase and Legal reserve requirement have negative and significant effect on performance of private commercial bank in Ethiopia, whereas equity investment, capital requirement, bank size and capital adequacy are positive and significant effect on performance of private commercial bank in Ethiopia.

Even though, those researchers conducted in different impacts areas of bank's regulation on their performance. This research will cover other area of Foreign currency contribution of private banks and the impact of NBE regulation on private bank's performance and implementation of directives on private banks, because one of the major problem on the financial institution activity is the scarcity of foreign currency. The source of scarcity is beyond the capacity of the financial institutes but discloses all over the country's economy which has direct impact on GDP. One business centered and profit oriented organization need to work on the problem of the scarcity and tackle for aggregated development strategy of the country. On this ground, this thesis focused on the limitation of the government on NBE's regulation about foreign currency issues and assessing the implication on the financial institutions performance. Finally the thesis gives an input for the researcher about the relationship between the NBE regulation on foreign currency and its implication on the performance of banks. Accordingly NBE directive no SBB/23/1997 and SBB/27/2001, FXD/50/2017, FXD/5/2018 and FXD/62/2019 enforces banks to report and NBE controls their foreign currency position in maximum of +/- 15% of the total capital reserve at close of daily basis unless the penalized the bank. Above the limit the national bank of Ethiopia collect the foreign currency on buying rate plus some amendment made after a while and other regulations are the focus point of the paper. Specially this research emphasis on: Foreign currency has greater impact especially on the economy of the country's development, (Eiteman, 2011) however NBE's surrender policy /regulation creates its own scarcity on the private banks foreign cash deposit. Moreover, Banks performance is the aggregated outcome of different services provided to the customers and IBD /international business department/ is one of the shares, even if this is true private banks lose huge amount of profit because of surrender regulation. (Lelisa and Kuhil, 2018). In

addition, Private Banks as any business field has their own challenges, but the NBE regulation treat those private banks to compete with the government owned banks especially on foreign currency allocation.

The complexity and the variety players of foreign currency purchase process on the economy prevails high scarcity and uncontrolled black market expansions vitiate. The countries foreign business is highly fragile on the foreign currency availability and scarcity. That exposure affects the domestic markets without drought. The financial institutions are the most exposed investment and the same time main player on the purchase of foreign currency. Because of that the performance of the bank also affected positively or negatively with the situation of the currency. In addition with that there are different stakeholders over the wheel like NBE, the inland revenue, Ethiopian investment bureau, police and courts, and the Informal's like black marketers, transferors, transistors are increases the environment conditions directly.

Therefore, the researcher makes an effort to show those problems and comment on the tribulations with the sympathetic recommendation.

4. Research question

Different studies advance an issue of NBE's regulation on the diverse prospective. Because of that, they raised many questions to attain their target. As mentioned in the above research questions of this study will escalate the listed below questions.

From the point of studying the impact of NBE regulations on the performance of private banks, this research tries to answer the following research questions.

- i. What is the problem of the regulation on surrender policy that affects the position of foreign currency?
- ii. What is the impact of NBE's surrender policy or open position policy of the bank on performance of private banks?
- iii. What are the solutions that the regulation put as a solution for the scarcity of foreign currency?
- iv. How unlawful parties affect permissible investments of financial institutes?

5. Objective of the study

5.1- General objective

The general objective the research is to show impact of NBE purchase of foreign regulation on private banks performance on private banks in Ethiopia.

5.2- Specific objective

The specific objective of the research is as follows.

- 1- To examine the effect of surrender policy/regulation of NBE on purchase of foreign currency
- 2- To show how the surrender or open position policy affect the performance of the bank
- 3- To reveal if there is any remedies on the problem of scarcity of foreign currency that the government/ NBE took place
- 4- To illustrate how the private financial institutions are affected by informal bodies

Those objectives of the research entertained by the collected secondary data and analysis are given with recommendations

6. Significant of the study

The study has the following significances for policy makers, companies and other stakeholders:

- a) National Bank of Ethiopia can use the study or the recommendations for its financial reformation included in this paper as a base to improve its policy/regulation after carefully evaluating its effect.
- b) The results of this study will create improvement for banks about the effect of NBE regulation on their performance and give the opportunity to influence NBE by providing feedback during policy formulation and implementation.
- c) In addition to this it could put as a reference for further study on the field and
- d) Banks could use the analysis to enforce the government on its financial policy reformation.

7. Scope and Limitation of the study

The national bank regulation effect is so vast with in its category and depth. The private banks controlled and guided by those regulations that has impact on their performances. Different studies cover the issue in different aspects and views. In this research the study take the uncovered part of the foreign currency collection of NBE to private banks, the monetary

policy, and the implementation of regulation on export to china on private and government bank are the variables that have direct impact on private banks performance. So the independent variables emerges from the regulation of NBE itself which is the surrender policy, the remittance and foreign exchange regulation, and the performance evaluators of ROA, ROE are taken as dependent evaluates.

This research cover randomly selected six private banks namely Awash bank, Hibret bank, Nib Bank, Dashen Bank, Zemen bank and Berhan Bank out of sixteen private banks. Because 37% of them taken as a sample size by considering the central government governs all he banks in equally and harmoniously. The history of current private banks is no longer back than 25 years and their entry to the market is gradual. So this research take six years through the time of year 2014 to 2019 to consider the current situation concerning subject matter that this thesis raises 25% service year included. In addition, the best research methods taken are explanatory and descriptive researching method to make the finding to be very eloquent.

The researcher takes as limitation for this research are:

On the field of Ethiopian banks regulation and performance dispute doesn't have enough compiled data or research on the issue this researcher focused. The informal bodies that affect the foreign currency circulation are not found and studied correctly and deeply, so it is so difficult to get reference. The performance of the bank is aggregated

8. Organization of the study

The research paper organized in to five chapters. Chapter one is an introduction part where back ground of the study, statement of the problem, objectives of the study, scope, significance and limitation of the study are presented. Chapter two is review of literature in which theories, empirical evidence and conceptual frame work are identified. Chapter three contained research methodology where research design, research approach, population, sampling method, sample size, sources of data, instruments, data analysis technique, model specification, variable definition and hypothesis development were covered. Chapter four focused on the results and discussion in which the findings results that are interpreted. Finally, Chapter five brought of research to an end with summary, conclusion and possible recommendation.

CHAPTER TWO

2. LITERATURE REVIEW

This thesis focused on the impact of national bank regulation on the performance of private banks. Second chapter of the thesis all about the literature part of the study and contains definition of terms, meaning and explanation of theories, different research and scholars views and national bank of Ethiopia regulation regarding the statement of the problem allotted on the proposal of chapter one.

Bank is the finance industry and the basic economic backbone for one country. Different scholars and researchers define the term bank in many ways and times. The history of bank in the world also has its own figure and flow. Generally bank is basically deal with money. Money is also an important term to discuss about financial institution. Money is, therefore, anything that is used as a means of facilitating transaction and exchange in a given community. The economic development and increasing transaction, institutions and government plays great role to give a shape of well-developed financial foundations. The history of bank has shown there was a cyclic and progressive change on money management root. Then in different country and economic level institutes emerge to control, manage, rule and administer the economy by positioning themselves as national bank of Ethiopia. This chapter will focus on defining that important national bank of Ethiopia matters with foreign currency issues and its impact on private banks performance into two categories. Theoretical and Empirical reviews.

2.1. Theoretical review

2.1.1. National bank of Ethiopia and commercial bank

The National Bank of Ethiopia established by Order No. 30/1963 shall continue to exist as an autonomous institution and shall henceforth be governed by this Proclamation. The National Bank shall have its own juridical personality, and, in particular the capacity to: Contract, Sue and be sued and Acquire, own, possess and to dispose its property by sale or in any other manner. The National Bank shall be accountable to the Prime Minister of the Federal Democratic Republic of Ethiopia (proclamation, 2008)

Money is anything generally accepted as a medium of exchange. It is anything used to pay for goods and services or settle debts, or it is anything that is generally recognized and accepted as payment in the exchange process. So on modern money economy which transaction and

exchange made through the medium of money. Accordingly, money is defined in different ways. There are different approaches used to define money. The traditional Definition of money /Conventional approach/ according to the conventional approach money is defined as currency and demand deposits, and its most important function is to act as a medium of exchange (Lelisa and Kuhil, 2018).

Friedman's definition of money / the monetarist or Chicago view According to this approach, money is the sum of currency plus all adjusted deposits in commercial banks such as savings and time deposits. The main function of money, to this view, is to serve as a temporary abode/store/ of purchasing power. According to The Red Clift definition, money is "note plus bank deposits". It includes as money only those assets, which commonly used as a media of exchange.

The Gurley show definition: This approach is similar to Chicago approach in its objective. However, it is different in the fact that it includes in the list of close substitutes for the means of payment the deposits of and the claims against all types of financial intermediaries. Such as bonds, securities, debentures, bills of exchange, treasury bills, insurance policies, etc. This definition recognizes that, the total money supply in a country can be determined by converting the value of this financial intermediaries by multiplying them against their liquidity rate and adding them up with the most liquid assets such as currency and demand deposits (cheque and drafts). Money supply is regulated by the monetary authorities. The quality of money demanded by the society depends on different factors such as the transaction motive, the precautionary motive, the speculative motive. The money supply is also depends on such factors as: the monetary base, the community's choice, cash reserve ratio, level of monetization, government's budgetary policy. Even if there are lots of theories, functions, terms and definitions about money here to emphasis on institutional management of money bank was the genre (Eiteman, 2011).

2.1.2. BANK

"Bank" means a company licensed by the National Bank to undertake banking business or a bank owned by the Government. Commercial banks are one form of banks that any country can have. They perform all kinds of banking business. They generally finance trade and commerce. They usually accept short-term deposits and advance short-term loans to the businessperson

and traders and avoid medium term and long term loans. Their functions could be categorized in to accepting deposits, advancing loans, agency service, creation of credits, etc.

2.1.3. Bank capital management

Like other corporations, banks must determine the level of capital that they should maintain. Bank operations are distinctly different from other types of firms because the majority of their assets (such as loans and security holdings) generate more predictable cash flows. Thus, banks can use a much higher degree of financial leverage than other types of firms. The Federal Deposit Insurance Corporation (FDIC), which insures depositors, bears most of the risk in the event of failure. Depositors that are fully insured may not penalize banks for taking excessive risk, which could encourage some banks to use a high degree of financial leverage.

Banks must also consider the minimum capital ratio required by regulators. This minimum could possibly force the bank to maintain more capital than what it believes is optimal. To please shareholders, banks typically attempt to maintain only the amount of capital that is sufficient to support bank operations. If they have too much capital as a result of issuing excessive amounts of stock, each shareholder will receive a smaller proportion of any distributed earnings. A common measure of the return to the shareholders is the return on equity (ROE), measured as

$$\text{ROE} = \frac{\text{Net profit after taxes}}{\text{Equity}}$$

The term equity represents the bank's capital. The return on equity can be broken down as follows:

$$\text{ROE} = \text{Return on assets (ROA)} \times \text{Leverage measure}$$
$$\text{Net profit after taxes} = \frac{\text{Net profit after taxes}}{\text{Assets}} \times \frac{\text{Assets}}{\text{Equity}}$$

The ratio (equity) is sometimes called the leverage measure, because leverage reflects the volume of assets a firm supports with equity. The greater the leverage measure, the greater the amount of assets per dollars' worth of equity.

2.1.4 National bank of Ethiopia

National bank of Ethiopia of Ethiopia /NBE/ is the only governmental institutes that could control, guide, manage, regulates the country's financial sector. On the proclamation 2008 its clearly stated that 'Purpose of the National Bank- is to maintain stable rate of price and exchange, to foster a healthy financial system and to undertake such other related activities as are conducive to rapid economic development of Ethiopia. The main objective of National Bank of Ethiopia is to foster the monetary stability. It also ensures sound financial system and exchange rate stability. The bank operates in such a way that the economy performs better and post growth. (Eiteman, 2011)

One of the objectives of National Bank of Ethiopia is to regulate the issue of bank notes and operate the currency and credit system of the country to its advantage. This bank was found necessary to achieve monetary stability, internal and external as it has the right to issue currency notes and the authority to adopt credit policy suitable for the country. The national bank of Ethiopia has to help the commercial banks in case of need and public should have full confidence. The national bank of Ethiopia is necessary to remove the structural instability of the banking system. Without national bank of Ethiopia, each commercial bank has to maintain enough cash reserves to ensure its own liquidity position. Multiple system under which each bank is required to keep huge cash reserve is highly disadvantageous when compared to single reserve system. The centralized reserves could be used for helping the particular bank that is facing financial difficulties.

In order to follow credit policy national bank of Ethiopia is necessary. It can exercise control over the banks for the creation of credit. As a bankers bank, national bank of Ethiopia has control over the cash reserves of commercial banks and hence can influence their power to create credit further, a national bank of Ethiopia is armed with various weapons of credit control through which it can control the credit situation in the country.

The purpose of national bank of Ethiopia is to co-ordinate between monetary and credit policies of the country and the financial policies of government.

The bank attempts to achieve monetary stability mainly by maintaining inflation at low level, although this strategy is highly influenced by exogenous factors such as weather conditions and the level of inflation in Ethiopia's major trading partners, both of which are beyond the control

of bank. The bank also uses reserve requirement, interest rate, re-discount facility, banking regulations, moral suasion and to a certain extent sale of treasury bills and Government bonds etc.

The National Bank of Ethiopia (NBE) provides banking services to the Government and commercial banks and acts as lender of last resort to all commercial banks.

The NBE undertakes prudential supervisory and regulatory functions in order to attain a sound and stable financial system. The bank ensures that commercial banks meet the prudential standards with respect to their capital adequacy, asset, quality management, earning and liquidity (AMEL). The bank also monitors that commercial banks comply with stipulated reserve requirements and limits related to the foreign exchange exposure to avoid excessive risks. It ensures insurance companies and micro finance institutions comply with specific rules and regulations issued to monitor their safe operations.

NBE ensures that there is adequate supply of notes and coins in circulation and withdraws from circulation those notes which are damaged and soiled for destruction through appropriate means. It injects new notes and coins to replace those that go out of circulation.

NBE focuses on maintaining exchange rate stability and ensuring the external competitiveness of the country. It implements this policy through daily inter-bank foreign exchange market and other prudential regulations. The bank strives that the country maintains, to the extent possible, adequate international reserves, despite constant pressures that arise due to fluctuation in the flow of foreign currency from various sources. The bank continues to manage the foreign exchange reserves in a manner that generally meets the country's liquidity portfolio demand and investment needs to maximize returns. NBE provides advice to the government with regard to exchange rate policy and involves itself in wide range of issues that are related to the exchange rate policy, trade taxes and financial sector.

Bank regulation: is a form of government regulation which subjects banks to certain requirements, restrictions and guidelines, designed to create market transparency between banking institution and the individuals and corporations with whom they conduct business among other things. Bank regulations are designed to prevent commercial banks from becoming too risky and thus maintain public confidence in the financial system. Bank regulators typically conduct an on-site examination of commercial banks at least once a year. During the

examinations, regulators assess the bank's compliance with existing regulations and the bank's financial condition. In addition to on-site examinations, regulators periodically monitor commercial banks with computerized monitoring systems, based on data provided by the banks to regulators on a quarterly basis.

Bank Regulation is one of the external factors that could influence banks performance, it may affect individual banks directly and/or indirectly (Martin and Mauer, 2003). Regulation is implemented with the aim of restricting or limiting banking activities, the banks' conduct of business and the efficiency with which they operate will be affected. This in turn could induce banks to engage in riskier activities and /or to invest in ways to circumvent regulation; it could even ultimately affect economic growth (Jalilianet, 2007).

2.1.5 Foreign currency

"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 has declared to be acceptable for payment in Ethiopia. "foreign exchange" means any foreign currency, cheque, bills of exchange, promissory notes, drafts, securities, and other negotiable instruments, expressed in foreign currency as well as bank balances in account held in foreign currency or assets 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, 2016)

The sources of foreign currency for banks are remittance, diaspora accounts, exporters and NBE provision are some of the sources. Especially now a days diaspora accounts are the entertained on the field. Diasporas are Ethiopians who are living abroad and those Ethiopians by birth and with different nationalities. Those Diasporas could open an account on foreign currency and could use it for importing purposes or else. Foreign exchange market is the market in which different currencies are bought and sold for one another. In these markets, individuals, corporations, banks and governments interact with each other to convert one currency into another for any number of purposes. Foreign exchange markets exist and grow to provide the following three major services.

The first service is providing a mechanism for transferring purchasing power from individuals who normally deal in one currency to other people who generally transact business using a different monetary unit. Importing and exporting goods and services are facilitated by this

conversion service because the parties to the transactions can deal in terms of medium of exchange instead of having to rely on bartering.

The second service is providing a means for passing the risk associated with changes in exchange rates due to professional risk takers. This “hedging” function is particularly important to corporations in the present era of floating exchange rates.

The third service is the provision of credit. The time span between shipment of goods by the exporter and their receipt by the importer can be considerable. While the goods are in transit, they must be financed and Foreign exchange markets are one device by which these financing and related currency conversions can be accomplished efficiently and at low cost. (Heffernan, 2005)

2.1.6 Surrender policy /open foreign currency position policy/

The National Bank shall monitor foreign exchange transactions of banks, insurance companies and other financial institutions through on-site inspection and off-site surveillance. The National Bank may buy, sell and hold foreign currency notes, coins and such other documents and instruments using various media as are customarily employed in international payments or transfers of funds. (Kagan, 2020)

Open position:-Open position means an excess of assets (including off balance sheet forward purchase contracts) over liabilities (including off-balance sheet forward sales contract) a long position held by a financial institution denominated a foreign currency, or an excess of liabilities over asset. Short position held by financial institutes denominated a foreign currency.

2.2.7 Declaration of Foreign Exchange

Any person non-resident of Ethiopian who enters to the country and carry foreign currency cash notes exceeding USD 3,000 or equivalent in any other convertible currency shall declare the foreign currency in their possession by using foreign currency Customs Declaration form prepared for this purpose on arrival.

2.1.8 Remittance

The following are the major transfer types contained in the international remittance transfer:-
Personal transfers. Money to be used for investment
International cash donation
Deposit and service payments
Temporary and permanent migrants transfer. The Ethiopian official also said the government will seriously consider all the recommendations by the study

to increase remittance. The flow of remittance to Ethiopia was 1.9 billion USD in 2010, USD 2.4 billion in 2012/13, USD 2.9 billion in 2013/14 and USD 3 billion in 2014/15 and 2016/17 5.72 billion in 2017/18 5.9 billion and in 2018 /19 6 billion.

The Population Division of the UN Department of Economic and Social Affairs estimates that there are 1.3 million Ethiopian migrants across the globe. Annually, Ethiopia receives USD 5-6 billion largely from its diaspora in the US, Europe, and the Middle East. Private individual transfers, including remittances, are the single most important category of foreign exchange for Ethiopia, covering 35% of imports. This is almost three times that of the country's goods exports. (Lelisa and Kuhil, 2018)

Surrender of Foreign Exchange :- Under the national bank of Ethiopian directive no FXD/62/2019 'Transparency in foreign currency allocation and foreign Exchange Management' the allocation of foreign currency priorities a Bank shall give priority for the categories as listed priority, second priority, and third priority on import items and payments as firms come first serve bases. (NBE, 2016)

After the details of lists of priorities of foreign currency allocation the bank by any means shall not be less than 50% of the total foreign currency allocation for all import of goods and services at any time. However, in case less of 50%, the bank is obliged to surrender the difference to NBE within the first five working day of the next month.

The national bank of Ethiopia shall credit the payment and settlement account of the bank with equivalent amount in birr at the prevailing mid exchange rate. In the other hand NBE regulation says, the bank shall allocate foreign exchange receipt of an exporter in line with the "retention and utilization of export earnings and inward Remittance". Ethiopian and Residents of Ethiopia shall surrender through an authorized foreign exchange bureau All foreign currencies in their possession against payment to them of the equivalent sum in Birr within 45 days from the date of acquisition. Any resident of Ethiopia found in possession of foreign currency and that do not have evidences to justify holdings shall be punished under the penal code of Ethiopia and the money shall be confiscated.

Banks were challenged in the year just ended with a big demand-supply gap of foreign currencies to address the ever-growing requests of importers, fierce competition for resource

mobilization, various tight regulatory requirements like the credit ceiling and 30% foreign currency surrender requirements. The devaluation of the Birr has escalated the budgeted expense vided items as a result of which it was practically challenging to honor commitments for purchase of goods and services. (2014-2019)(BANK,AWASH)

2.1.9. HEDGING

Hedging is a risk management strategy employed to offset losses in investment by taking an opposite position in a related asset. The reduction in risk provided by hedging also typically result in reduction in profits.

A study by Koppenhaver² found evidence that banks whose liabilities are more rate sensitive can benefit considerably from hedging with interest rate futures contracts. This study found that interest rate futures can reduce the variability of profits by as much as 80 percent. Commercial banks can hedge interest rate risk by engaging in an interest rate swap, which is an arrangement to exchange periodic cash flows based on specified interest rates. A fixed-for-floating swap allows one party to periodically exchange fixed cash flows for cash flows that are based on prevailing market interest rates.

Daily currency fluctuations are usually very small. Most currency pairs move less than one cent per day, representing a less than 1% change in the value of the currency. This makes foreign exchange one of the least volatile financial markets around. Therefore, many speculators rely on the availability of enormous leverage to increase the value of potential movements.

Hedging techniques generally involve the use of financial instruments known as derivatives, the two most common of which are options and futures. Keep in mind that with these instruments, you can develop trading strategies where a loss in one investment is offset by a gain in a derivative. Hedging is one of the common strategies used by corporations to deal with financial risks. The use of hedging as a strategy for risk management is still a controversial topic with pro and against theories.

Hedging is the official statement of offsetting risks in order to increase the company's wealth but this is done at the expense of the perfect outcome. One of the major aims of risk managers is to decrease discrepancy of outcomes. By managing financial risks, a corporation wants to fulfill stockholders' earnings expectations. Though, this brings the need to control a firm's

earnings volatility and particularly when the firm is exposed to financial risks. The most important argument for using hedging strategies is that hedging reduces the company's cost during financial distress. When the value of a company's liabilities is higher than the value of its assets, the company may encounter difficulties in paying back its transactional obligations and loans as planned. Insolvency is a critical factor for companies since it presses their financial situation and may lead to their bankruptcy. Therefore, companies have to take measures that keep them away from such a kind of situation. (Karimunda, 2009) There are external and internal hedging instruments.

2.1.9.1. The external hedging instruments

The external hedging instruments are used for hedging and protect the firm's cash flow against cash flow. The hedging is done when the firms uses financial derivatives whose value is derives from the underlying assets. The common external instruments are currency forward, currency future, currency option, currency swaps, and contracts for difference (CFDs)

Currency Forward & Future: - A currency forward is an obligation to sell or buy a currency at maturity. Agreement between two parties to sell or buy an asset at certain future time for a certain price.(hull 1997). Forwarded and delivery price are the same and equal. With time forward price is liable to change and may vary with the maturity of three, six, and twelve month contract. If the foreign currency exchange increases, it will give a positive value of holding a long position and negative value of holding a short position. The pay off of holding a long position on one unit of currency is given by the difference between the spot rate and forward rate at a maturity of the contract, whereas the payoff holding a short position is given by the difference between the forward rate and the spot rate at maturity. The high intrinsic leverage characterized future makes them attractive for speculative, and basically mean that the capital needed to open position is much lower than the value of the position.

Currency option: - have gained acceptance as invaluable tools in managing foreign exchange risk. It's a contract which gives the option buyer the right but the obligation to buy or to sell the underlying at stated date and at the stated price. The call option gives the right to buy and the put option gives the right to sell. The firms have the possibility to choose between options that vary by amount, strike price, and maturity.

Currency swap: - after being introduced on the global scale in the early 1980's currency swaps has grown to be one of the largest financial derivatives markets in the world. Currency swaps are way to transform a loan in another currency swaps are 'off balance sheet transactions. They are privately negotiated customized transactions. 'Foreign exchange swaps involve the sale or purchase of currency on one date and the offsetting purchase or sale of the same amount on the future date, with both dated agrees when transaction is initiated' (Levisio, 2005)

2.1.9.2 Internal hedging instrument

Internal hedging instrument technique minimizes the currency risk within the company itself. The internal hedging methods modify business and are simple in operation. A company can internal hedge some exposure and supplement the remaining one with derivatives. Some techniques are:

Choice of invoice currency:- to avoid the total currency risk is to make invoices in the domestic currency. However, the currency risk is in the way only transferred to the foreign importer. On the agreement of both parties the risk of foreign currency rate volatility could fall on both parties.

Netting: - a netting strategy involves netting out exposures in currency. If a firm has receivables and payable in different currencies they can net out the exposure in each currency by matching receivable with payable. Companies that have foreign currency cash inflow and outflow can identify currency exposure by making cash forecast for each currency. If there is a cumulative gap between cash inflow and outflows, then hedging could be needed. (Horcher,2005)

Matching:- one way to offset an anticipated continuous long exposure to a particular currency is to acquire debt denominated in that currency Matching currency cash flows is a way to an hedge an operational cash flow by creating a financial cash outflow and rather than to manage the exposure with contractual financial instrument such as forward contracts.

Back –to- Back Loan:- they are known as credit swaps or parallel loan. Back to back loan occurs when two business firms in separate countries arrange to borrow each other's currency for specific period of time (Eiteman et al, 2011). They return the borrowed currencies at agreed terminal date.

Disadvantages of Hedging

Every hedge has a cost, so before you decide to use hedging, you must ask yourself if the benefits received from it justify the expense. Remember, the goal of hedging isn't to make money but to protect from losses. The cost of the hedge, whether it is the cost of an option or lost profits from being on the wrong side of a futures contract, cannot be avoided. This is the price you pay to avoid uncertainty.

2.1.10. Bank risk Management

The single most common cause of bank failure is poor management. Unfortunately, no reliable measure of poor management exists. Therefore, the federal deposit insurance companies (FDIC) of united state rates banks based on five characteristics, together comprising the CAMEL ratings (so named for the acronym that identifies the five characteristics examined are Capital adequacy, Asset quality, Management, Earnings and liquidity).

2.1.11. Capital Adequacy

Because adequate bank capital is thought by regulators to reduce the risk of the bank, the capital ratio (typically defined as capital divided by assets) is determined. Regulators have become increasingly concerned that some banks do not hold enough capital and have increased capital requirements. If banks hold more capital, they can more easily absorb potential losses and are more likely to survive. Banks with higher capital ratios are therefore assigned a higher capital adequacy rating. However, a bank with a relatively high level of capital could fail if the other components of its balance sheet have not been properly managed. Thus, the FDIC must evaluate other characteristics of banks in addition to capital adequacy.

Asset Quality

Each bank makes its own decisions as to how deposited funds should be allocated, and these decisions determine its level of default risk. The FDIC therefore evaluates the quality of the bank's assets. The difficulty in rating as asset portfolio can be illustrated with the following example. A bank currently has 1,000 loans outstanding to firms in a variety of industries, each loan with specific provisions as to how it is secured (if at all) by the borrower's assets. Some of the loans have short-term maturities, while others are for longer terms. Imagine the task of

assigning a rating to this bank's asset quality. Even if all the bank's loan recipients are current on their loan repayment schedules, this does not guarantee that the bank's asset quality deserves a high rating. The economic conditions that have existed during the period of prompt loan repayment may not persist in the future. Thus, an appropriate examination of bank's asset portfolio should incorporate the portfolio's exposure to potential events (such as a recession). The reason for the regulatory examination is not to grade past performance, but to detect any problem that could cause the bank to fail in the future. Because of the difficulty involved in assigning a rating to a bank's asset portfolio, it is possible that some banks will be rated lower or higher than they deserve.

Management

Each of the characteristics examined relates to the bank's management. Yet, the FDIC specifically rates the bank's management according to administrative skills, the ability to comply with existing regulations, and the ability to cope with a changing environment. The evaluation of this characteristic is clearly subjective.

Earnings:-although the CAMEL ratings are mostly concerned with risk, earnings are very important. Banks fail when their earnings become consistently negative. A commonly used profitability ratio to evaluate banks is return on assets (ROA), defined as earnings after taxes divided by assets. In addition to assessing a bank's earnings over time, it is also useful to compare the bank's earnings with industry earnings. This allows for an evaluation of the bank relative to its competitors.

Liquidity:-Some banks commonly obtain funds from some outside sources (such as the discount window or the federal funds market), yet regulators would prefer that banks do not consistency rely on these sources. Such banks are more likely to experience a liquidity crisis whereby they are forced to borrow excessive amounts of funds from outside sources. If existing depositors sense that the bank is experiencing a liquidity problem, they may withdraw their funds, compounding the problem.

2.1.12. NBE regulatory

The regulatory structure of the banking system in the United States is dramatically different from that of other countries. It is often referred to as the dual banking system because it

comprises two regulatory systems—federal and state. There are more than 12,000 separately owned commercial banks in the United States, supervised by three federal agencies and 50 state agencies. The regulatory structure in other countries is much simpler. Recently, there was a proposal for consolidating the regulation of commercial banks and savings institutions. Based on the proposal, the federal deposit insurance companies would focus on obtaining insurance premiums and closing poorly managed commercial banks. The Fed would focus on monetary policy and would continue to operate the payments system. The Comptroller of the Currency would assume the role of day-to-day regulation for all commercial banks and savings institutions. The proposal was met with some opposition but was a first step in an attempt to reduce regulatory overlap.

2.1.13. Foreign currency crises:-

Foreign exchange Risk is the risk associated with an investment's value changing due to changes in Currency Exchange Rates. For any adverse unanticipated movement of Exchange Rates, Scheduled Commercial Banks might have to close a long or a short position in foreign currency at a loss. Due to such a risk, any appreciation or depreciation of exchange rate driven by the market conditions can lead to a change in the value of an Asset or Liability for a bank, whereby its balance- sheets valuation can get impacted.

Commercial banks in Ethiopia have a shortage of foreign currency in their history. The export is always less with imported goods. The other issue of the NBE regulation is its priority set up on the foreign currency allocation on those private banks. For instance, the government forced the allocation of the purchased foreign currency by any means of collection, shows that the banks couldn't allocate their source of foreign currency on their business interest rather it says 'banks give priority to the following import items and payments among them. On the first come first serve base, imports the essential goods that is fuel, fertilizer and other agricultural inputs, pharmaceutical product, factories' request for procurement of machineries, equipment, spare parts, raw materials and accessories import of nutritious food for babies. Payments on imports freight and transit service...etc.

Hedging dynamics: Hedging derivatives initially developed globally. Also, the Rice Market of Japan had the first sign of future market development in 1650. The farmers feared the future

price of rice to fall. They entered into standardized future contracts to lock in the price. Henceforth, the trading of forward Contracts on various commodities established in 1848 by the Chicago Board of Trade (CBOT). Since 1848, future contracts remained the same as they are today. Interest Risk Hedging Strategies through Derivatives

Interest Rate Forwards -Interest Rate Futures - Interest Rate Swaps - Interest Rate Floors - Interest Rate Collars -Options (OTC) - Net Interest Income Smoothing Strategy - Volume Strategy affecting - Interest Rate Pricing Strategy Ideal Portfolio Creation using Fixed and Floating Rates (NSE Papers, dealers Module, 2011)

While it is tempting to compare hedging to insurance, it is far more precise. With insurance, you completely compensated for your loss (usually minus a deductible). Hedging a portfolio isn't a perfect science and things can go wrong. Although risk managers are always aiming for the perfect hedge, it is difficult to achieve in practice. (NSE Papers, dealers Module, 2011)

2.2. Empirical review

The performance of the bank evaluated through different aspect and systems by different scholars in different banks and countries financial systems. According to altered researchers the performance of the bank could evaluated on their lending capacity, deposit mobilization, availability of foreign currency, modern technology adaptability and so forth. This research is more concerned with the purchase of foreign currency challenges and opportunities concerning the NBE's regulation impact on the performance of private banks. To show the impact NBE regulation on the performance of banks the following empirical reviews' are covered as a base for this research and their summarized points are listed.

Yodit (2012)- on her thesis the evaluation of bank performance on the exploratory research investigates that the 27% bond purchase has impact on the nature of loan, liquidity problem and the overall profitability of the bank. But taking into consideration the deposit structure of the banks into account if the banks shift to loan term maturing loan in order to avoid the aggravated problem of liquidity with such revolving loans the banks would be faced with asset liability mismatch. On her findings suggests that the amount of loan disbursed is declined through time and

the amount of interest collected also decreased as the same time the performance of the bank also has an impact.

Shimelis Yesuf (2014):-on his research the objective was to find out the impact of NBE regulation on the performance of the bank by evaluating the requirement to purchase NBE bill, and analyzed its impact on profitability and liquidity of private commercial. The panel used the banks eight year's data and sixty four observation of eight private banks. Data were presented by using descriptive statistics, balanced correlation and regression analysis for profitability and liquidity ratios were conducted.

The major objective of the study was to examine the impact of National Bank of Ethiopia's directive on the profitability and liquidity of private commercial banks. The study has taken one of the top issues; the requirement to purchase NBE bill, and analyzed its impact on profitability and liquidity of private commercial. The panel data were used for the sample of eight commercial banks in Ethiopia from 2007 to 2014 with a total of 64 observations. Data were presented by using descriptive statistics, balanced correlation and regression analysis for profitability and liquidity ratios were conducted. On his findings the purchasing NBE bill has had a negative and significant impact on the profitability of private commercial banks. Also in addition with that the researcher mentions the requirement of purchasing NBE bill had negative and significant impact on the liquidity position of private commercial banks in Ethiopia.

The 27% bill collection sever damage could compared like freezing the banks deposit for five years for the reason of billing of two to three years maturity period. The regulation has an impact on the capital investment from own capital and to fulfill requirement set by NBE.

Recommendation puts by the researcher are puts like NBE bill requirement impact is not as such sever and hasn't collateral damage but it has an impact on the banks performance on long run. As mentioned the liquidity problem also occurred on the regulation that NBE issues. So the first remedy is to minimize the percentage of the bill collected from the loan disbursed which is 27% is too much. And the second recommendation the researcher suggest is that to increase the interest rate that set for bill purchased.

Another major problem which the researcher has identified is the liquidity problem because of maturity mismatch. Private Banks collect savings mostly at two to three-year maturity and even shorter in some cases and fulfilling the 27 percent requirement. Finding and developing other

means business stream to boost the profit in order to improve their liquidity position depending on the nature, severity and duration of the liquidity shock and potential sources of funding.

Nahom (2015) conducts on his research about the performance of the bank by assessing in different angle of variables like bill purchase, liquidity, capital adequacy, asset quality, GDP growth rate, annual inflation rate as independent variables. On his assessment those independent variables has direct impact on the performance of the bank. Descriptive researching method was used for his data and a panel data from 2009-2014 fiscal year for six private banks. The independent variables have significant impact on the performance of the private banks annual performance. So those big financial factors should manage on technical manner, smart economic determinants, inclusive policy set up are some of the remedies to tackle the danger for the performance of those private banks.

Zegeye Tadesse(2018)- as the researcher mentioned on his thesis the performance of the bank evaluated through the regulation of the NBE's regulation he raises two basic indicators ROA and ROE. Based on those two indicators the controlled variables were, NBE Bill, equity investment, legal reserve requirement and capital requirement. The panel data was taken from year 2011 to 2016 with a total often banks and 60 observations by using descriptive statistics; balanced correlation and regression analysis for performance ratios were conducted and the results showed that all the tests are satisfactory in all regressions requirement. Capital adequacy and bank size was also taken into consideration as a control variable.

The study finds that purchasing NBE bill has had a negative and significant effect on the performance of private commercial banks measured through both Return on Asset and return of equity because they have been offered very low interest rate (3%) by NBE which is less than cost of collecting saving on average 5.38% NBE (2015/16) from the public. This even makes private commercial banks to incur net loss of 2.38%. Not only incurring a net loss of 2.38% but also the interest rate calculated on the bills is far less than the market lending rate which is 12.75% on average NBE (2015/16) having 9.75% difference. This difference made private commercial banks to loss substantial amount of income.

The size of the bank and capital requirements, has also a positive significance on the performance of the bank which shows the capital requirement has direct relationship with banks performance.

Equity investment has positive and significant effect on the performance of private commercial banks that implies investing on non-banking sector could boost the profit of the bank. Capital adequacy has a positive and significant effect on the performance of private commercial banks. This implies that an increase in capital adequacy ratio, certainly increasing in performance of private commercial banks.

In general, NBE bill purchase and Legal reserve requirement show negative and significant association with performance of private commercial banks where equity investment and capital requirement has positive and significant effect on performance.

At last recommendation of the researcher after explain and briefing the findings decreasing the percentage of the bill purchase is one solution or the other recommendation puts on increasing the interest rate of the bill collected by NBE. The private banks also recommended to work aggressively on interest free banking skim and branch expansion with deposit mobilization target.

Eden Kebede (2014): On the researcher thesis takes the panel data from 2004-2014 a sample of six private commercial banks in Ethiopia. . Data was presented by using descriptive statistics, the balanced correlation and regression analysis for two performance measures was conducted. Before performing OLS regression the models were tested for the classical linear regression model assumptions, the models fulfill all assumptions of the CLRM. On the researcher finding the bill purchase has negative significant on the performance of the bank by assessing the measurements of ROA and ROE. Also change on the reserve requirements has negative and significant effect on the banks cost of intermediation measured throughnet Interest Margin. In addition with that Credit cap has negative and statistically significant effect on banks performance measured through both Return on Asset and Net Interest Margin.

Based on the findings of the research and the conclusions made the researcher recommend that banks they need to exert their maximum effort to mobilize deposit and use aggressive branch opening strategy. In order to mobilize substantial amount of deposits and increase their market share and it is advisable to open many branches in strategic areas of both in the capital city and outline areas of the country. About the credit cap the researcher clarifies the higher the cost of finance, the higher its effect on investment would be. Due to this the country at large would be

affected. If investment becomes worse because of increase in cost of finance, production and employment opportunity will be affected negatively.

Tsigemariam Legesse(2015) – the researcher computed the NBE regulation of bill purchase with the performance of the bank by the panel data from 2007-2014 with eight private banks. Accordingly, the finding indicated that exposure to government bills has a weak negative association with performance. Considering the output of the research, broadening of income basis, introduction of new products to reach the society that never used bank products and branch expansion so as to mobilize deposit, revision of government policy imposed on private banks and further exploration on the long run impact of the requirement is recommended.

The study has taken one of the top regulatory issues, the requirement to purchase 27% bill, and analyzed its impact on bank performance. The general objective of the study was to assess the relationship between regulations and the performance of private banks in Ethiopia. Whereas the specific objectives of the study are to assess the impact of the captioned, regulatory measure on the profitability and liquidity of private commercial banks. Panel data from 2007-2014 of eight private banks which were operational on and before 2006 were used in analyzing the impact. These eight private banks were selected using cluster-sampling technique and the cluster selected using purposive sampling considering the experience of banks in the industry. To draw a feasible conclusion and recommendation, primary data also collected from 16 top executives of private banks using unstructured interview. Multiple linear regression method, correlation, means and standard deviation was used to analyze

Secondary data and the primary data was presented in narration. Nevertheless, the magnitude is not severe. Moreover, the pre and post policy periods comparison revealed a relatively better profitability record for private banks during times of policy restrictions. Therefore, the bill seems to contribute positively to performance via mopping the excess liquidity holding of banks or to invest excess funds in earning government securities than the customary practice of holding liquid assets in zero earning accounts at NBE. In general, the result of the study shows that the effect of the policy measure is mitigated by the excess liquidity standing of banks during the policy formulation, the likely possibility to expand to other fee generating services, stable liability prices and banks' discretion to adjust their asset prices. Nevertheless, the decline trend

in the share of loans from the total asset could have negative effect on the long run which in fact to some extent will be moderated by the maturity of part (but significant sum) of the bills in few years' time. Considering the output of the research, widening of income basis, introduction of new products to reach unbanked society and branch expansion to mobilize deposit, revision of government policy imposed on private banks.

DR. ZgarnI Amina AND DR. Hassouna Fedhila(2018) on their study the impact of the regulation on the accounting performance of Tunisian banks. Liquidity ratio and solvency ratio are the independent variables to measure the performance of the banks (ROA). They also consider of robustness test that prudential regulation measured by the solvency ratio favors accounting performance measured by return on equity (ROE). And found that the liquidity ratio and solvency ratio considered as catalysts for the banks performance. Even if the both ratios are showing their benefits in the conduct of banks, with in the limitation the research has as they mentioned, the bank (Islamic) sector still suffers from maladjustment to the new prudential standards required. In addition, the present work is far from exhaustive. Indeed, other aspects of performance (stock market) or other measures such as the Economic Value Added (EVA) may be of considerable interest to decide on the issue of the effectiveness of prudential regulation in the market banking industry.

Isaac Ndachibwairimy(2015):- On his thesis the national bank of Kenya's prudent regulation against the performance of the bank was covered. There are about 43 commercial banks in Kenya and three of them are governmental and the rest mortgage finance institutions are private owned till 2017. Primary data collected and descriptive research method used with the variables of capital adequacy, liquidity management, restriction on money laundry,, and ownership of share capital of institution as an independent variables has an effect on the performance of the banks. The researcher suggests that the prudent regulation of the Kenya national bank of Ethiopia has positive impact on the performance of the commercial banks and they better look the regulation as a safe guard rather to breaking the laws.

The general observation of the empirical review discloses that the majority of the researchers are basically related the NBE's regulation assessment and its impact on the performance of the private bank is on the bill purchase imposes. Some of the researchers are tries to look other factors of liquidity appearance, accessibility of loan facility, deposit mobilization. The banks

performance is aggregated result of day-to-day activity of the bank. The bank's duty and purpose is not only as mentioned above lists that convey the profitability of the bank rather its deep and professional field of business. The management and the board, the business strategy, the capacity of the financial institute, the customer capacity and marketing strategy has an impact on the performance of the bank. The internal strength and weakness and the external environment opportunity and threat have the rudimentary angles that need deep assessment to reach the conclusion on to maximize the profitability of the bank.

Why this Research

On this research to fulfill the gap of the study especially about the NBE's regulation impact on the performance of the bank raised different aspects but here one important component is entertained, Purchase of foreign currency. So the bank performance is measured through its capacity to perform in all its business fields. Foreign currency is the basic instrument to execute banks profit target policy in higher degree of share. The source of the foreign currency may vary indifferent country but in Ethiopia the sources are limited and known. This thesis tries to cover some of the sources of foreign currency on the generalized term 'purchase of foreign currency'. The sources could be gain from export, remittance for financial institutes and loan, donation, investments.....etc, on government level. But for this thesis purpose will cover the financial institutes sources of foreign currency and related to it with NBE directive that has an impact on the performance of the bank. The purchase of foreign currency execution and limitations with tabular and graphic representations would describe on the rest of the paper. The performance of the bank is aggregated outcome of all activities of the financial institutes and mainly purchase of foreign currency is the initial target for this research. and there is no as such work the researcher found on the field. Therefore, this was the means to do this thesis to fulfill the gap of the academic knowledge.

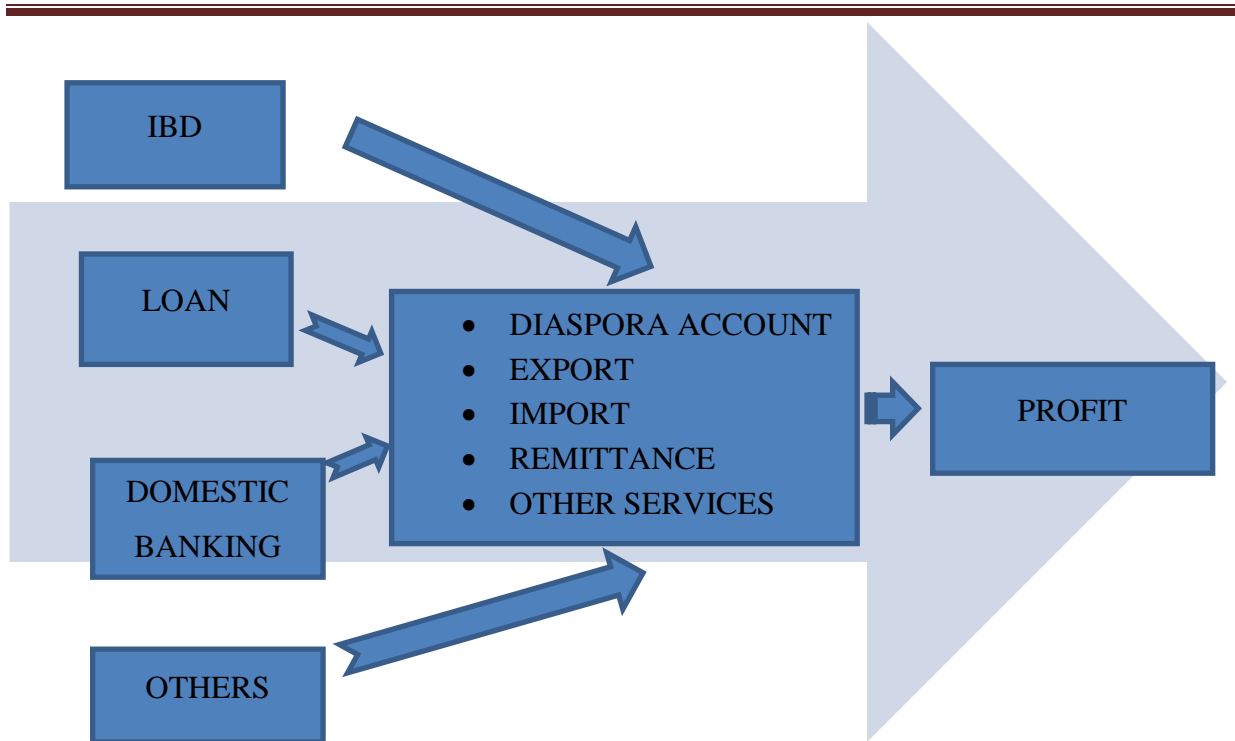


Fig. 1 Variable description

The variables not clearly correlated in any of the secondary data that used, but the researcher tries to show the impact of the independent variables over the dependent one also their impact on the economy. The variables (due to their limitations) are not the only measurement for the performance of the bank rather they are profit catalyst and have a significant role on the profitability of the finance sector.

CHAPTER THREE

3. RESEARCH METHODOLOGY

This chapter deals with research methodology that used to carry out the research. The chapter is organized in eight sub sections. In its first part there is a research design, then after it presented subsequently about research approach, population, sample and sampling technique, data type, sources and instruments, data analysis and model specification. The final two parts presented variables selection and hypothesis developments. Finally, operationalization variables are presented.

3.1. RESEARCH DESIGN

Identifying the right research design is crucial for good research. A research design is the arrangement of conditions for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure.” In fact, the research design is the conceptual structure within which research is conducted; it constitutes the blueprint for the collection, measurement and analysis of data. As such, the design includes an outline of what the researcher will do from writing the hypothesis and its operational implications to the final analysis of data (Kothari, 2004). Therefore, on the study of this thesis focus on the explanatory research design covers from the start to end, what is the study about, the type of data required the sample design, the technique of data collection, and the analysis part with and other detail be presented.

3.2. RESEARCH APPROACH

Quantitative research based on the measurement of quantity or amount. It is applicable to phenomena that can be expresses in terms of quantity. So the research of this thesis approach is not verbally expressed rather quantify in number. Explanatory Research is conducted because in order to help us find the problem that was not studied before in-depth. Explanatory research is not used to give us some conclusive evidence but helps us in understanding the problem more efficiently. When conducting the research, the researcher tries to adapt himself to the new data and the new insight

3.3. Population of the Study

There are currently 16 private banks in Ethiopia. There are also more than a dozen new entrants are on the way to join the industry. The private banks entrance in to the market is not

as such long period if we study the countries private financial banks history as mentioned above. But relative to the previous decades new entrants are under formation. To assess what the market and the foreign currency options the researcher considered the last six years of data for better understanding the situation and to use as input for further research and prediction. When considering the number of commercial banks option of purchasing foreign currency, there is monotonous and equal opportunity of market availability. The other thing considered to limit the sampling size from the population is that NBE is a centralized autonomous regulatory body which governs all the private banks equally. That's to show the regulations which are static character for years and the banks are almost use the same strategy for their performance limits the number and year of this study.

3.4. Sample and Sampling Techniques

The population of the research is almost 16 private banks. Their features regarding the source of foreign currency, the rule and regulation that govern etc. are almost the same. To identify the sample of the research random sampling technique is used with panel data method and 37.5% sample is covered which are six prominent banks with their last six years data from year 2014-2019. Those years are taken as a sample because the regulation governs the whole private banks equally and to evaluate their performance 40% of sample period from their establishment and to get current status the sample period believed to be enough. The data collected are from their annual report and NBE's report. Those selected samples are Dashen bank, Hibet bank, Awash bank, Zemen bank, Berhan bank and NIB bank.

3.5. Data Type and Source

This research is fully uses secondary data are collected from those six private banks annual report and NBE's reports and financial statements with panel data for the last consecutive six years. Different regulations, procedures, guidelines, amendments, memorandum, are some of the sources of the research data resources. In addition with that lot of books, internet sources, different researches made for academic and else regarding this thesis are tried to be covered to get adequate information and tangible data and to point the problem with their remedies. . The quantitative research method clearly uses nonverbal and numeric data. So that the data

collected are presented in tabular forms and some technical calculations are used to show the target that the thesis stands for.

3.6.. Data analysis and model

The explanatory research method user on this research depends on secondary data resource with panel uses the analysis of disrobing and tries to show the gap between the data collected. The main characteristic of this method is that the researcher has no control over the variables; he can only report what has happened or what is happening. (Kothari, 2004)

Therefore the dependent variables are identified and the independent variables are also clearly reveals. ROA is measured using the ratio of the net income divided by asset and ROE is measured using the ratio of the net income divided by equity are the dependent variables that shows the performance of the bank that could measure. According to this research mainly focused on the purchase of foreign currency regulations impact on performance of the bank is inside reveals the sources of foreign currency (export, remittance, and diaspora foreign accounts), the regulation about foreign exchange are the independent variables. So, to show the purchase of foreign currency which is backbone of the economy and its impact of regulation of national bank of Ethiopia on the performance of the bank.

Model:-For analyzing time series, we usually have two models; multiplicative model; and additive Model. (Kothari, 2004). So this research is using the additive model because additive model considers the total of various components resulting in the given values of the overall time series which is the independent variables summation effect on the dependent one can be stated as:

$$Y = B_1X_1 + B_2X_2 + \dots + B_kX_k + A \text{ (Kothari, 2004)}$$

Where Y dependent variable = the performance of the bank / ROA,ROE/

B₁, B₂, B_k =Coefficient values of independent variables

X₁, X₂.... = Independent values / *export, diaspora accounts, remittance/*

A = Constant

3.8. Why Explanatory Research?

The Explanatory Research allows the researcher to provide deep insight into a specific subject, which gives birth to more subjects and provides more opportunities for the researchers to study new things and questions new things.

The deep study of subjects creates a cycle and, the critical thinking/study of the subject creates more questions and those questions lead to more ways for the researchers to study more things related to that subject

3.9. Variables description

Under descriptive model and the nature of the research the researchers analysis the data collected on panel and find outs the relation of those dependent and independent variables to describe their impact on the overall performance of the bank. There are normally two types of variables which are dependent and independent.

Dependent variables

- Return on asset ROA and Return on equity ROE

Independent variables

Sources of foreign currency specially

- Export
- Remittance
- Diaspora accounts

NBE regulation on foreign currency management Surrender policy

3.10. Operationalization of study variables

The variables are operated by collecting from secondary data believed that to show the study in meaningful manner. Those collected data picked in each of the year from each of the selected bank and rearranged in to table, pi-chart, and quantified data turns into measurable calculation to analyze them. So the researcher tries to show the effect of foreign currency purchase challenges, sources and impacts on the performance of private banks

CHAPTER FOUR

4.1. DATA PRESENTATION ANALYSIS AND DISCUSSIONS OF RESULTS

The following data rearranged and compiled to fulfill the objective of this research. The subsequent data are collected from each of the sample banks Dashen bank, Hibret bank, Awash bank, Zemen bank, Berhan bank and Nib banks financial annual report. It tries to show their annual profit that the indicator of performance (dependent variable) and their inflow of foreign exchange in terms of USD and their transfer (Surrender) amount to NBE. But we know that the performance of the bank is aggregated result of different bank operation.

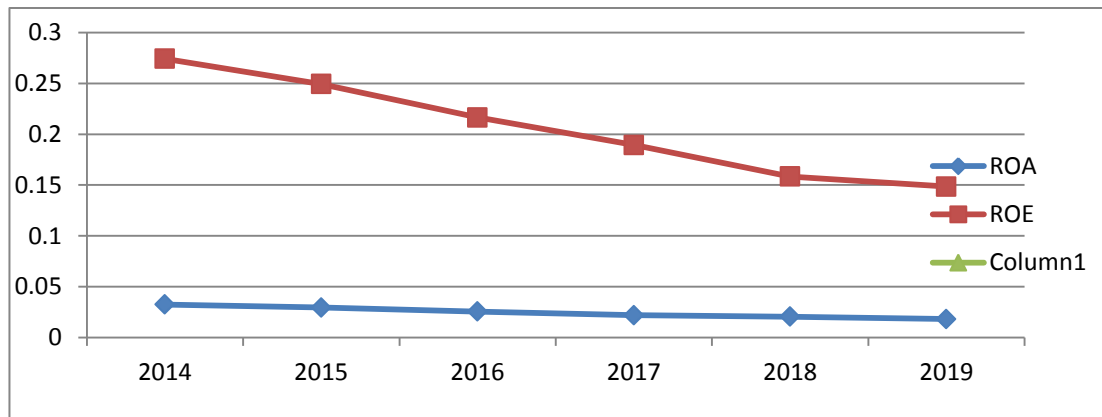
Bank's profit graph shows the ups and downs of their profit per year have different factors for the reason. One of the factors for their profit is the capacity of the bank to facilitate import and export. Most of the income of the banks generates from international banking transactions.

The other factor for the profit or performance of the bank is concerning with foreign currency is the remittance and swift transactions. The difficulty to evaluate and quantify the net performance with those sources is incoherent. The following data are collected to show how purchase of foreign currency position is contributed to the performance of one bank and the effect of NBE's regulation.

Let's look the performance of the banks that taken as a sample for the last six years.

4.2. BANKS PERFORMANCE

CHART 1 Dashen bank performance

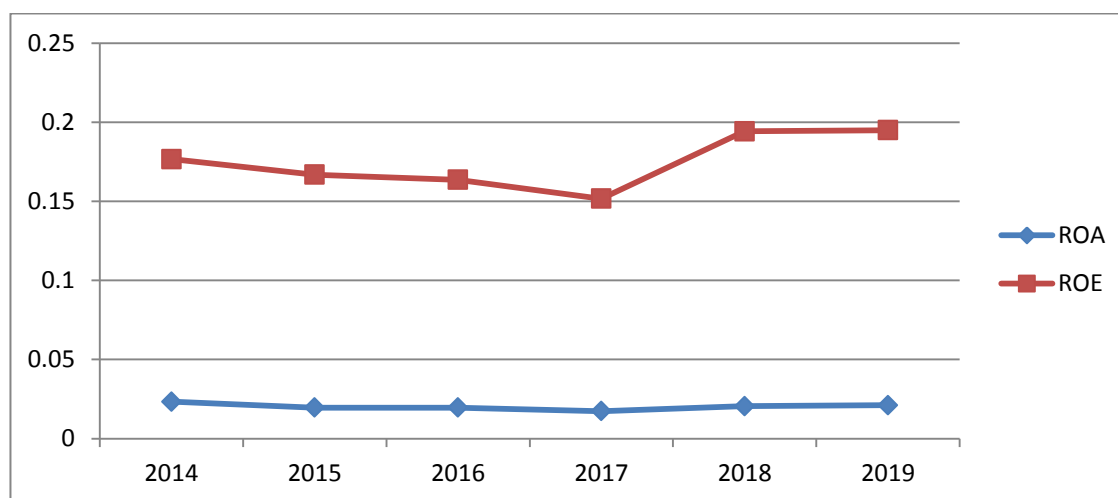


The dependent variable of ROA and ROE on the above Dashen bank reveals that for every 1 birr of asset the bank benefited a maximum of birr 3.20 and a minimum of birr 1.80. The equity

of the bank shows declining through time to time. ROE of Dashen bank shows 27.43 birr for every 1 birr of equity in 2014 and 14.85 birr return in 2019.

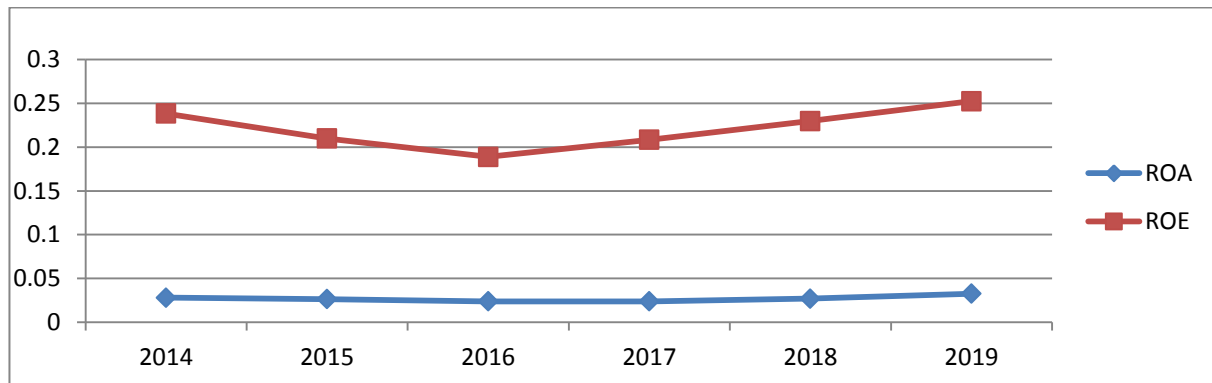
The performance of the bank shows declining through as panel data reveals when we measures the standard of ROA and ROE. The asset and equity of the bank increasing through the panel period and simultaneously the profit of the bank increased. But the return on asset and equity doesn't increase through time to time rather it shows decreasing. What it shows is that with the amount of asset and equity of the bank increased the return of the bank expected to increase correspondingly, but it decreased gradually. So the increasing profit range of the bank shows with the decreasing amount of ROA and ROE expected.

CHART 2 Hibret bank performance



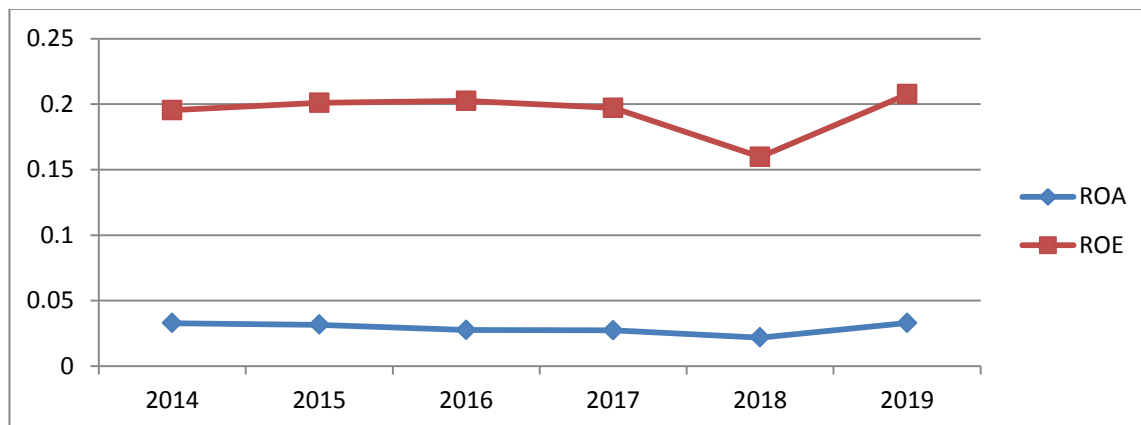
Hibret bank's profit measurement on ROA shows the maximum of birr 2.34 for every 1 birr of asset and a minimum of birr 1.74 also the maximum of birr 19.49 for 1 birr of equity and a minimum of birr 15.17 on return of equity. It demonstrates on time frame of the banks profit decreasing range and back again to increasing for the last two financial year. Also the net profit of the bank, asset value and equity performance is increase in increasing range year to year.

CHART 3 Awash bank performance



Awash bank's performance data shows the maximum of birr 3.26 profits per each 1 birr of asset on the ROA evaluation and a minimum of birr 2.38 returns. On the other hand on the evaluation of return on equity the maximum of birr 25.25 and a minimum of birr 18.90 returns on the evaluation of ROE. As the graph shows the performance of the bank decrease gradually and raise up for the last two years. The same is true here is that the net profit of the bank is increasing year to year. The increasing of the profit concurrently increases the asset and equity of the bank. But increasing range of the bank is on decreasing rate according to the evaluation of ROA and ROE measurement.

CHART 4 Zemen bank performance

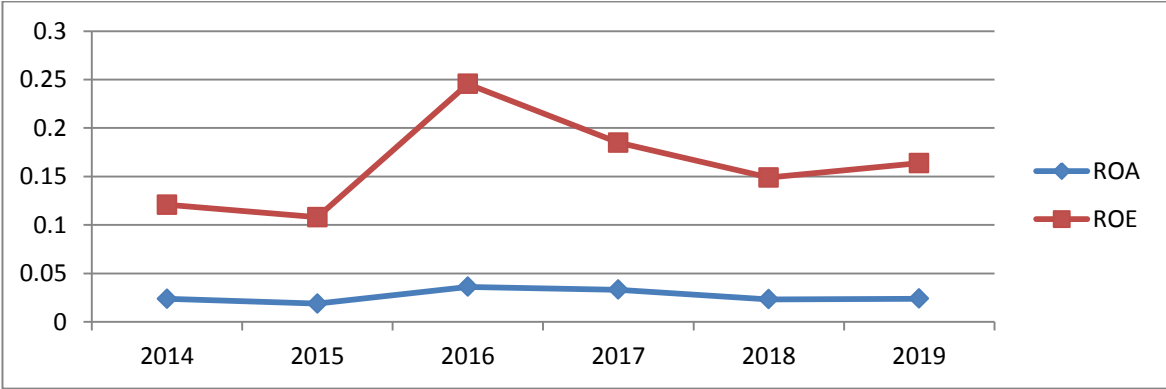


Zemen bank's profitability chart reveals that on the last six years of data the maximum ROA is birr 3.29 and the minimum of birr 2.18 per 1 birr of asset and on the evaluation of ROE the 20.74 is the maximum and birr 15.97 is the minimum gain per 1 birr of equity.

The data shows ups and down of returns and on 2018 the bank in decreasing range on both ROA and ROE measurements but on the next year 2019 the scale is up with the maximum returns ever records.

When we look up the amount of profit recorded for the last six years, all the net profit, asset of the bank and equity are increasing ranges.

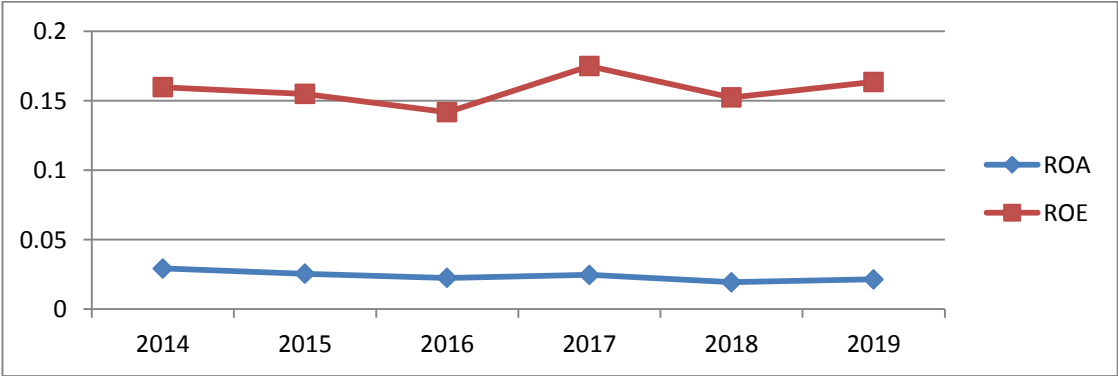
CHART 5 Berhan bank performance



Berhan bank’s performance evaluation shows that there was a maximum gain of 3.6 per 1 birr of asset and a minimum of birr 1.88 for the evaluation of ROA. When we look up on the ROE, 24.54 maximum returns on each birr of equity and a minimum of birr 10.79 for each birr of equity.

The graph shows that the ups and down of ratio through time to time and profit, asset and equity also on increasing rate except 2018’s data presents.

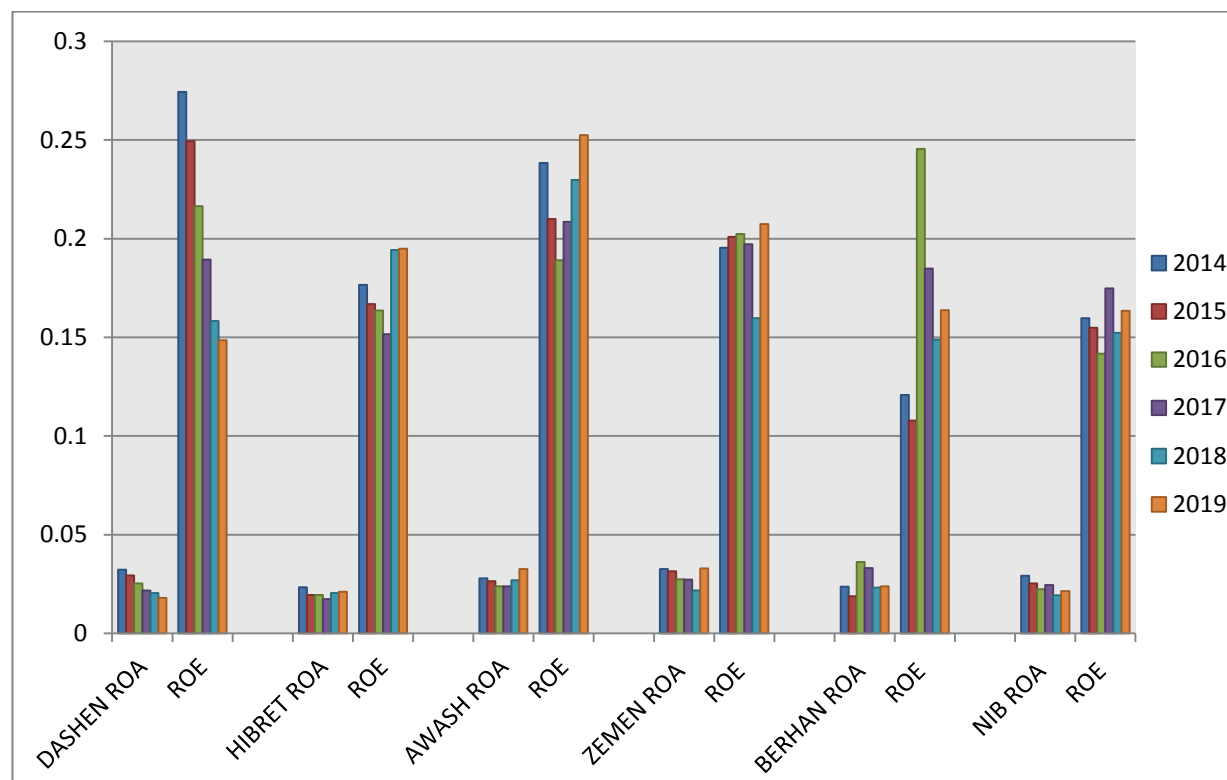
CHART 6 . Nib bank performance



Nib bank's profitability graph shows there was a maximum ROA of birr 2.92 and a minimum of birr 1.93 for each birr of asset. For the equity returns of birr 17.48 was the maximum and birr 14.17 was the minimum return on each birr of equity.

It shows the bank is on decreasing range on both ROA and ROE scale except on year 2017. Even if the bank profit, asset and equity increases as the other banks does but the measurement of the performance on ROA and ROE are decreasing time to time.

CHART 7 the performance of six banks for six years



The sample banks assembled chart of performance for the last six years is reveals as shown. For each year and bank, the performance is vary as explained above.

4.3. PRIVATE BANKS COLLECTION OF FOREIGN CURRENCY

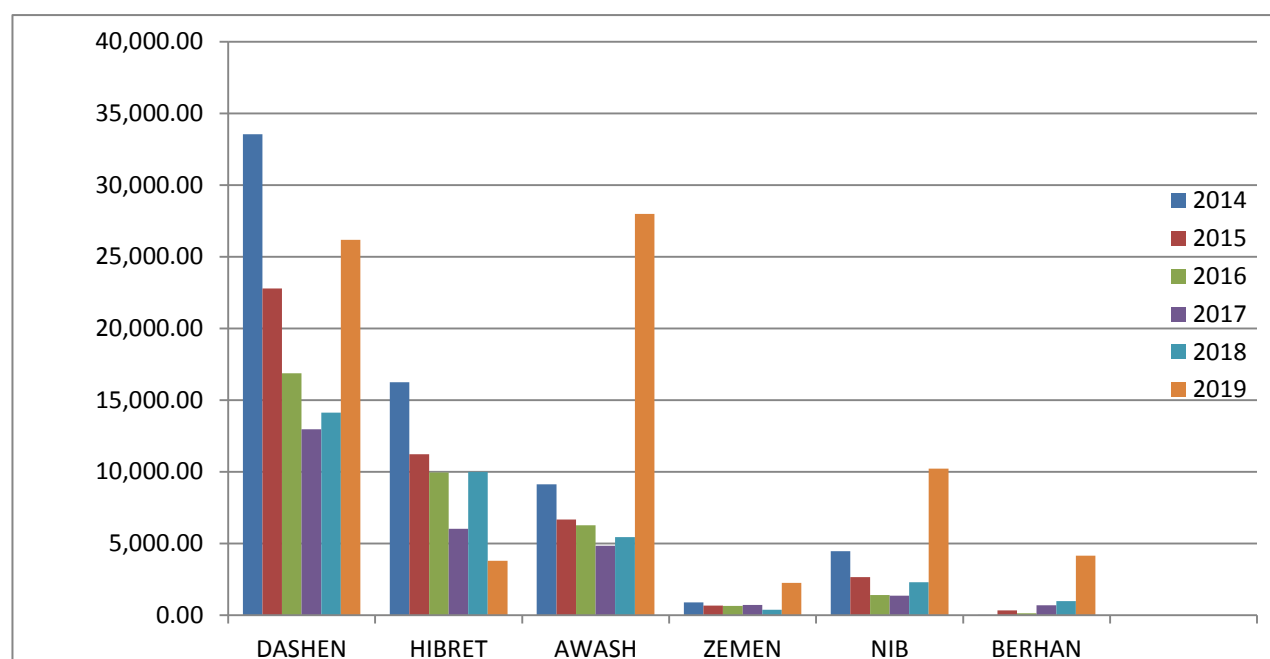
The following data are collected from NBE's annual reports and selected and arranged by the researcher. The purpose of the data is to show the regulation of NBE through its directive those private banks obligation to surrender 30% of their foreign currency to NBE. Those collection

of foreign currencies are used by the government for the development of the country's infrastructure development, health sector, agriculture and industry input and else.

Table 1 Banks FX collection USD in Thousands

FOREIGN EXCHANGE TRANSACTION	TOTAL COLLECTION OF FX FROM LISTED BANKS					
	2014	2015	2016	2017	2018	2019
	4,039,400.00	4,881,600.0	6,428,600.00	5,485,300.00	6,074,800.00	6,375,400.00
DASHEN	33,550.00	22,800.00	16,870.00	12,970.00	14,120.00	26,190.00
HIBRET	16,250.00	11,220.00	9,960.00	6,030.00	10,000.00	38,000.00
AWASH	9,130.00	6,680.00	6,280.00	4,850.00	5,440.00	27,990.00
ZEMEN	900.00	670.00	650.00	720.00	370.00	2,250.00
BERHAN	10.00	330.00	140.00	680.00	980.00	4,140.00
NIB BANK	4,470.00	2,660.00	1,400.00	1,350.00	2,290.00	10,230.00

Source: NBE annual reports



source: Rearranged by researcher

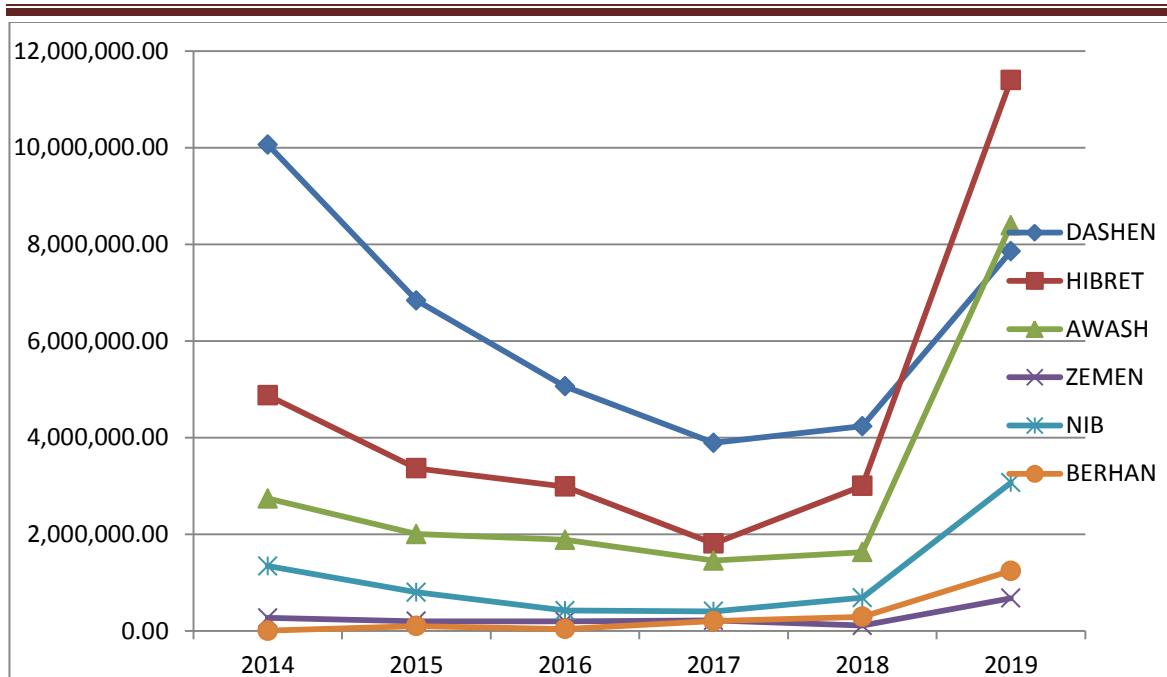
The total foreign exchange of private banks listed above are shown their foreign exchange amounts on the bounded of time. NBE data shows the total records of sixteen banks transaction made through those periods. The transaction includes the whole foreign exchange data like export, SWIFT, diaspora accounts and any other foreign exchanges. The total amount of transaction illustrates with the declining rate from 2014 to the coming years till 2018 and rose again in the next year 2019 on general term. The scarcity of foreign currency is apparent in the country's economy. The data shows a sign of falling of foreign currency amount from year to year and the sum of selected banks distinct figure also shows there is declining.

4.4. DATA OF SURRENDER

The NBE collects foreign currency from those private banks by its regulation. The government foreign expenditure is budgeted from those collected currencies. So invests in agriculture, medicine, manufacturing and huge mega projects as needed. The unbalanced foreign trade affects the economy specially the imported trade of the country.

Table 2 Table of surrender

Surrender VALUES	2014	2015	2016	2017	2018	2019
DASHEN	10,065,000.00	6,840,000.00	5,061,000.00	3,891,000.00	4,236,000.00	7,857,000.00
HIBRET	4,875,000.00	3,366,000.00	2,988,000.00	1,809,000.00	3,000,000.00	11,400,000.00
AWASH	2,739,000.00	2,004,000.00	1,884,000.00	1,455,000.00	1,632,000.00	8,397,000.00
ZEMEN	270,000.00	201,000.00	195,000.00	216,000.00	111,000.00	675,000.00
NIB	1,341,000.00	798,000.00	420,000.00	405,000.00	687,000.00	3,069,000.00
BERHAN	3,000.00	99,000.00	42,000.00	204,000.00	294,000.00	1,242,000.00



Resource:- rearranged by the researcher

SUMMARY OF SURRENDER

Transferred amounts of foreign currency from panel period of all private banks to NBE are collected and rearranged as the above table shows 30% of surrender in the panel time frame has commonly decreasing characteristics in all banks and relatively an increasing rate in the year 2019. Berhan and Zemen banks are the list banks that transfer the amount to NBE with USD 3,000.00 and 111,000.00 simultaneously compared to others. The maximum amount transferred to NBE is USD 11,400,000.00 from Hibret bank in year 2019 and the minimum of USD 3,000.00 from Berhan bank in 2014.

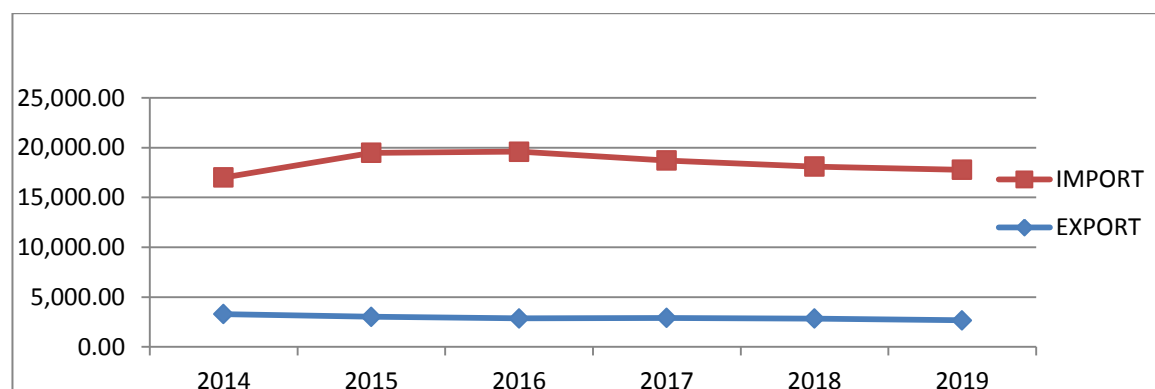
4.5 IMPORT AND EXPORT

Table 3 Import and export

(USD IN MILLIONS)

	2014	2015	2016	2017	2018	2019
IMPORT	13,712.3	16,458.6	16,725.2	15,802.7	15,255.3	15,112.0
EXPORT	3,300.1	3,019.3	2,867.7	2,907.5	2,839.8	2,666.5

SOURCE: NATIONAL BANK OF ETHIOPIA

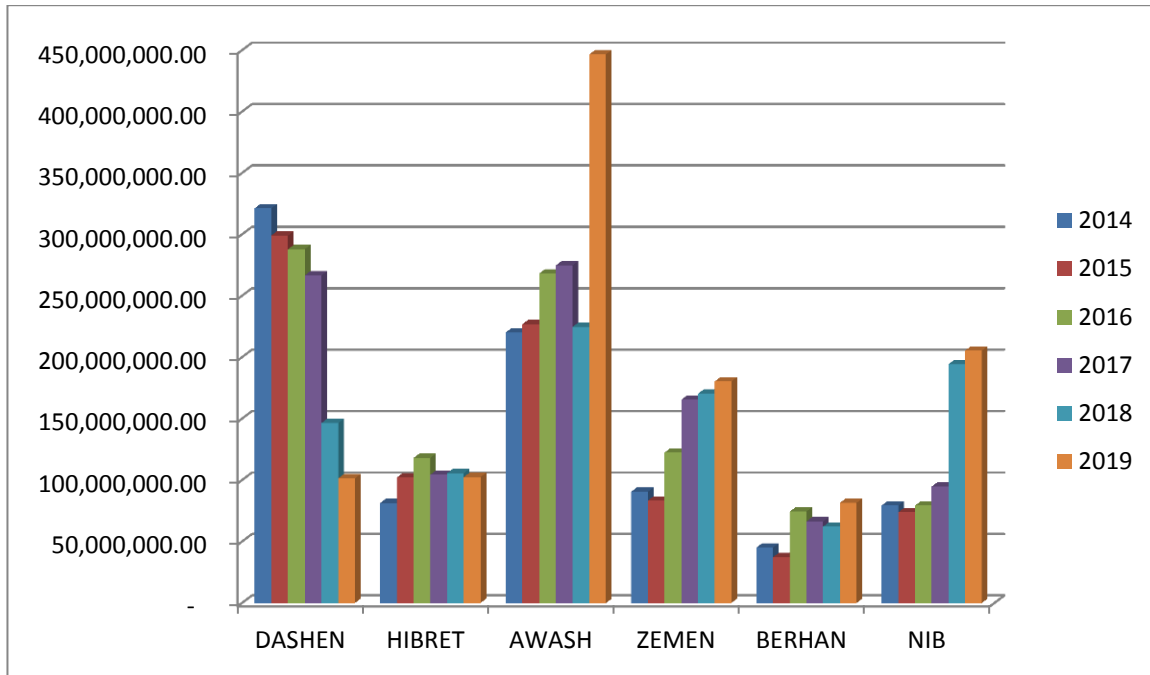


The above data shows the NBE report for Ethiopia’s import and export statistic of the last six years. As it illustrates the graph has downward slope of import and gradual growth of import with a immense amount difference between them. The minimum amount imported and exported on the specified years are 13,712.30 (in millions) and 2,666.5(in millions) respectively. And the graph also reveals that the maximum of 16,725.20 and 3.300.10 (in millions) respectively with the average (mean) of 15,511.12 of import and 2,933.48 (in millions) of export in USD over the last six consecutive years.

4.6. GAIN OR LOSS FROM FOREIGN EXCHANGE

Table 4 FX gain or loss

GAIN OF FOREIGN EXCHANGE RECOGNIZED IN PROFIT OR LOSS						
Gain or Loss	2014	2015	2016	2017	2018	2019
Dashen bank	321,169,185.00	299,054,415.00	287,919,185.00	266,558,000.00	146,418,000.00	101,417,000.00
Hibret bank	81,346,555.00	102,134,892.00	118,041,330.00	104,350,000.00	105,578,000.00	102,433.345.00
Awash bank	220,069,900.00	226,855,000.00	268,100,000.00	274,729,000.00	224,617,000.00	446,697,000.00
Zemen bank	90,547,868.00	83,338,900.00	122,377,291.00	165,366,979.00	170,289,456.00	180,278.213.00
Berhan bank	45,066,238.00	37,288,012.00	74,433,866.00	66,377,421.00	62,151,000.00	81,462,000.00
Nib bank	79,297,567.00	73,785,217.00	79,297,567.00	94,787,647.00	194,239,977.00	205,356,459.00



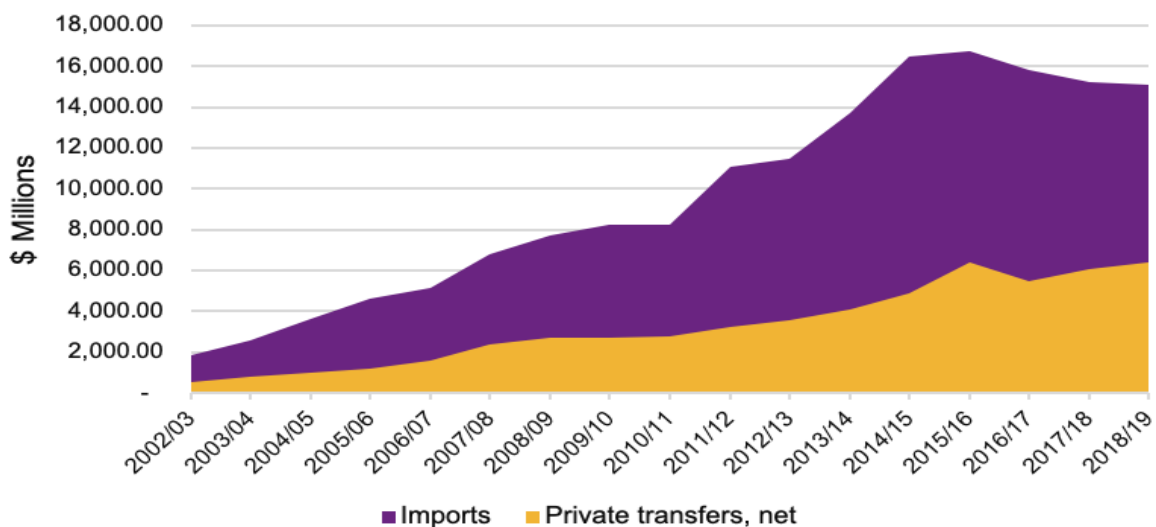
The data shows gain of foreign exchange recognized in profit or loss of those selected banks through the specified time period. The import, export, remittance guarantee or any other foreign currencies recognize in profit implicates that highly decreased in some banks like Dashen bank which was over 30million on 2014 and decline to 100 million after five years on 2019. In contrast Awash bank increasing in 2019 with 450 million from 2014 which was round 220 million of profit. The others reveals that except Hibret bank which is moderate than others are increasing with progressive level but in less in amount than the others.

Generally gain of foreign exchange recognized in profit or loss data indicates that the total profit of every bank has highly predisposed to the purchase power of the bank. In any means the bank has high amount of foreign currency means directly the profit or performance of the bank increased.

4.7. Remittance vs. Import

The NBE report for the last 17 years data shows an increasing rate but the import rate is higher and higher that the private transfer which is remittance. Remittance is one of the economic sources for a country like Ethiopia. Many nations live in with the support of their cousin, relative, family, or any once support who lives abroad. This economic support has an impact on

the country's financial situations. The financial institutes are also targeting to boost the amount of remittance exchange process on their banks by providing prizes and competing in each other. This is directly shows the limitation of foreign currency in all over the country.



Source: National Bank of Ethiopia

Foreign currency transactions that are denominated, or that require settlement, in a foreign currency are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. On-monetary items carried at fair value that are denominated in foreign currencies retranslated at the rates prevailing at the date when fair value was determined. Non-monetary items that measured in terms of historical cost in a foreign currency not retranslated. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized through profit or loss.

Foreign currency cash note purchase

Walk – in customer or anybody who has a foreign currency on hand could exchange the cash on bank. The source of the foreign currency could be travelers entered the country, diplomats, tourists, Diasporas, immigrants who return from different countries. Daily updated exchange

buying rate shows an average of 0.08 cents difference between days and those customers who has the foreign currency of USD, EURO, and POUND are the only currencies that accepted for exchange. Other currencies exchanged on NBE exchange window.

Black market is directly affecting the cash note purchase of banks. Those persons who have cash note goes to those illegal shops and exchange with high rate. The difference is huge and the NBE or government could not make relatively closest rate setting for a years. There was birr devaluation strategy done but now a time the problem is significant.

4.8 CAUSES OF SCARCITY OF FOREIGN CURRENCY

The scarcity of foreign currency has direct impact on the profitability of financial institutes, and in all over the economic development of the country. The result of collected features that rise from the development of the economy, the political view the country follows the productivity of domestic products, the marketing activity, the global situation and other internal and external environment could affect directly or indirectly.

The other source of scarcity and illegitimacy cases could be black market; illegal inflow transfer and contraband are very challenging foreign currency black holes. The government and legal bodies were fighting for long but their ways become so sophisticated and become out of control. The researcher beliefs that the amount of foreign currency involved in legal economy is less than the illegal foreign currency rotation on the market. To illustrate the idea

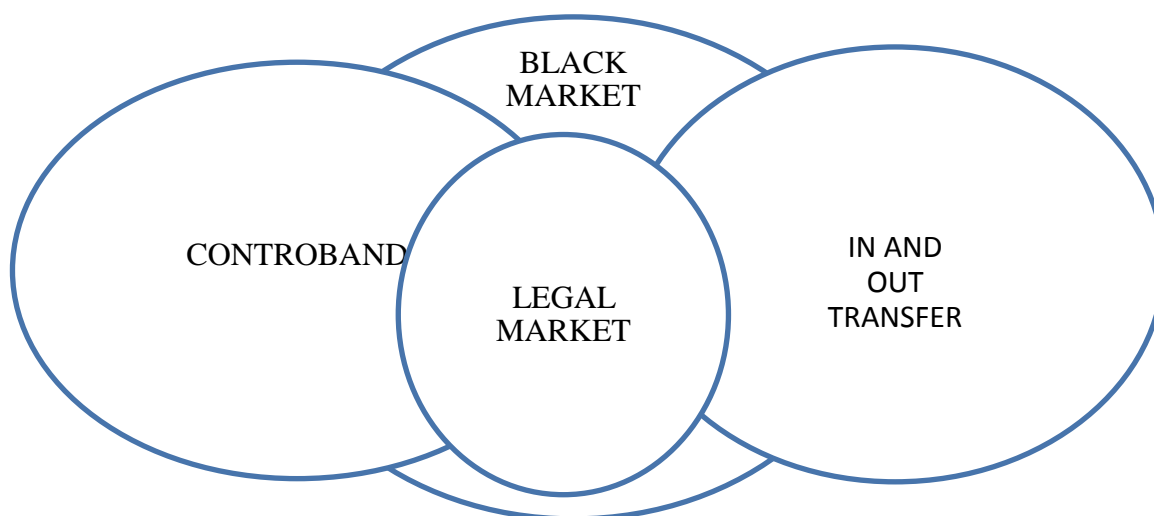


Fig.2 unlawful parties that cause the scarcity.

4.9 Summary of finding

The performance of bank is accumulated result of different bank activities. One of the prominent departments is the import export and international trade department, which is partially the center of this thesis. In the other hand, the scarcity of foreign currency has many extractions and one of the roots is NBE's foreign currency regulation. The regulation enforces private banks to surrender 30% of its foreign currency which is found in any bank's business way. The performances of the banks were growing year to year when we look at it in amount of cash. However, when we evaluate with ROE and ROA measurements, most of banks in general are in the increasing of profit in decreasing range

The amount of collected foreign currency from private banks is also varying year to year. However, if the banks confine the foreign currency amount for themselves, the profit margin would be increase significantly. The countries foreign trade is hence weak and the Import Export margin always in deviate each other and so the scarcity of foreign currency sustained for long period and continues. The diaspora account, which is one of the sources of foreign currency, also does not show progress in meaningful way. They use their currency for importing purpose rather to directly invest on their country. The remittance, which is also the other source of foreign currency for the banks performance likewise, it has its own problem for the banks. The rate setting by the NBE is vary from the black market and so the senders are prefer to send their cash through illegal transferees. The illegal parties' involvement on the country's foreign currency exchange is huge and the police report always provokes.

The performance of the bank could not be measure from the purchase of foreign currency's side only, but it is the result of all the activities of the bank. Even if it is difficult to show specifically the impact of NBE's foreign currency regulation on the performance of the bank, this thesis tries to show that on the way mentioned above. The collected data also has its own limitation to show the impact particularly, however, the known scarcity of foreign currency has its own impression on the performance of the bank. That impression is comes from NBE's purchase of foreign currency regulation and all those points could not stand alone as the whole countries economic policy and strategy, but this thesis tries to show only its impact on the performance of the bank side.

CHAPTER FIVE

5. CONCLUSION AND RECOMMENDATION

5.1 CONCLUSION

The economy of the country's GDP mostly measured with the value of the import export balance. Those measurements are facilitated through financial institutes. Those banks are regulated by national bank of Ethiopia or national bank of Ethiopia. The matrix is not complex that the increasing of export than import brings higher foreign currency reservation on the country's economy and the reverse is true. The financial institutions performance also depends on the many variables including the degree of purchase of foreign currency that the country gains. The regulation governs the degree of role and duty with responsibility of those private banks to achieve the economic development of the country. This research tries to focus only on the flow of foreign currency through the bank and its limitations because of the regulation that the NBE issued on their performance. The data shows there is a gap of bank performance caused by the regulation of NBE. The following are the findings

1- The regulation of NBE forced banks to transfer 30% of their foreign currency to the national bank of Ethiopia account. The purpose of the surrender is clear.

Eligible exporters of goods and services (other than those excluded under Art. 11 here under), shall have the right to retain thirty percent (30%) in foreign currency of their export earnings. The remaining seventy percent (70%) of their export earnings shall be surrendered to the National Bank of Ethiopia via local banks at the prevailing marginal exchange rate within two days of the receipt.

On the above regulation, mentioned exporters 30% of their foreign currency inflow shall be retained by the national bank with the prevailing marginal exchange rate and the rest 70% of purchased foreign currency will circulated in to Import goods. Even though the purpose of the surrender is for importing medical and agricultural equipment, for huge governmental industry inputs, for gigantic construction materials and else, the finance role players which are banks are also the victims of the regulation indirectly. Because the exporters discouraged with the regulation and their demotivation declines the amount and frequency of export of good with other things being constant. The service charge, gain of

purchased foreign currency, and amount of deposit will affect negatively. The data analysis also shows that each private bank only enforced to the applicability of the regulation and the NBE collect 4 to 6 billion dollar collected from all private banks.

Therefore, the surrender policy of the NBE has negative impact on the performance of the bank. Even if the purpose of the regulation has its own goal and achievement set by the government, and it's the obligation of all the nations as a whole, but private banks couldn't gain from the regulation rather if the foreign currency gained from the export 100% the profit gained from the export and related will grow by plus 30%.

- 2- The foreign exchange allocation and priority regulation of FXD/45/2016 also has its own law of commitments and obligations. The remittance flow is not as expected and declines time to time. Because of the sets floating rate and the black market rate difference aggressively vary and contraband simultaneously boosting till it's over under control. Different police reports and Mass Medias cover the case every time but there is no a solution puts for it. Under those serious financial crises the government enforce the private banks purchased foreign currency allocation through its prioritized import items only. The amount of import is always more than export items and the unbalanced exchange economic feature couldn't bring the sustained development to the country.
- 3- The diaspora accounts highly encouraged by all the banks with their benefit skims like loan facility. It is different from the local borrower with repayment period, interest sets, the settlement schedule are some of altered facility provided. The computation among banks to gain the foreign currency reveals imposed the domestic market in all diversified features provides. Even if the banks are highly encourage diasporas to open and activate diaspora accounts, on the economy the illegal parallel stream creates its way to divert the flow of foreign currency in to black market discloses the decreasing deposit rate. Now in the time, banks are allowed to utilize the foreign currency they deposit for import purpose their 70% of deposit and the rest 30% will deposit in local currency after a month. The 30% surrender policy is applicable on the account and if the diaspora utilizes 100% of the forex deposited the surrender amount become the obligation of the bank. So, on this stiff market

competition banks are in forced to pay the 30% foreign currency from their deposit to handle the customer and the others puts the policy applicable as it is.

The issue here is the 30% surrender policy of national bank is hindering the market competition between those private banks to suffering and exposed to unfairness. So the researcher found that import and export graph shows unjustified flow of income with foreign currency gain or loss data among the banks. The general import export amount gap over the whole country shows there is high limitation of currency and the economy miserable stream goes for decades.

5.2 RECOMMENDATION

Foreign currency is a vital financial instrument for economic integration with international market. In Ethiopia financial institutes profit a substantial amount of profit per year shows there is unsatisfied market demand relative to the coverage of the service. Even if the profit by itself doesn't show there is accessibility of foreign currency, still the banking industry is the most profitable investment for the shareholders.

This research mainly focused on the resource, rules and regulations of NBE, and its limitations on purchase of foreign currency. The statement of the problem focused on three basic altars of the paper. The first rotates with the surrender policy and its implication, the source of foreign currency and its limitation and

The country's economic status is known and categorized under poverty. The reformation of economy and administration of the current politics could face difficulty that happened for more than decades. The cure for the financial institutions problem could be diversified and needs different. On the finding of this research the surrender policy which collect 30% of every banks foreign currency collection to national bank of Ethiopia aim is to strengthen and keeping the balance and stability of the economy. More over the country's huge construction and investment that runs by the government is highly dependent of imported products and machineries. Therefore, the position balance of currency collected from every private bank looks right on behold of the authorities. But those the above problems of private banks, as any business investment, banks are profit oriented and the NBE's regulations with other

economic conditions hindering the profit margin in somehow. So the following recommendation is suggested by the researcher.

1. The regulatory body could decrease the amount of percentage surrendered to NBE is a big deal like if the percentage is adjusted to 25% or 20% of collecting of foreign currency transfer to NBE. The amount of exchange in selling shows increase and the performance of the bank will also rise.
2. The surrendering rate is one of the issues raised on the paper and NBE exchange the collected foreign currency through the mediate rate. Which is if the banks sold the foreign currency for import or any other business with selling rate the profit margins is definitely rise in huge amount. So the hedging exchange scheme should applicable to subsidize the loss that private banks confronted.
3. Scarcity is the disease for the foreign currency exchange economy of the country. Because of that the illegal parties has a great influence of the economy, police and all legal bodies should work together by setting a strategy with enthusiasm . The floated rate policy is criticized in different groups and academicians which is its unfavorable for the development of the country's economy. It's advisable that the government changes the regulation in to market lead rate system to combat and control the illegality of exchange root and boost the economy.
4. The diaspora accounts and remittance centered policy and maximization strategy need to an act and applied persuasively. Fighting illegality is not the only solution but work on awareness of society how it kills the country's economy.

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