ASSESSMENT OF INTERNATIONAL BANKING SERVICE PRACTICES PROVIDED TO TRADERS: THE CASE OF PRIVATE COMMERCIAL BANKS IN ETHIOPIA

A thesis submitted to St. Mary's University, School of graduate studies in partial fulfillment of the requirement for the degree of Master of Business Administration in General Management

BY:

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St. MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

DEPARTMENT OF BUSINESS ADMINISTRATION

MBA PROGRAM

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Approved by Board of examiners:

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Dean, Graduate Studies	Signature
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Advisor	Signature
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External Examiner	Signature
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Internal Examiner	Signature

DECLARATION

I, Zelalem Hailu, declare that this project work entitled “Assessment of International Banking Service Practices Provided to Traders: The Case of Private Commercial Banks in Ethiopia” is my own original work. I have carried out it independently with the guidance and suggestions of the research advisor. And it has not been presented in St. Mary’s University or any other University and that all sources of materials used for the study have been duly acknowledged.

Declared by:

Name______________________________

Sign______________________________

Date______________________________

LETTER OF CERTIFICATION

This is to certify that Zelalem Hailu has carried out his project work on the topic of "Assessment of International Banking Service Practices Provided to Traders: The Case of Private Commercial Banks in Ethiopia" under my supervision. This work is original in its nature and it is suitable for Submission in partial fulfillment of the requirement for the award of Masters Degree in Business Administration (MBA).

Advisor : Maru Shete (PhD and Assoc. Prof.)

Signature________________________

Date______________________

St. Mary's University

June, 2017

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Zelalem Hailu

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List of Acronyms /Abbreviations

NBE	National Bank of Ethiopia
ISBP	International Standard Banking Practice
IBSD	International Banking Service Department
ICC	International Chamber of Commerce
UCP	Uniform Custom Practice
URC	Uniform Rule for Collection
URR	Uniform Rule for Bank to Bank Reimbursement
LC	Letter of Credit
CAD	Cash Against Document

Abstract

International business is a necessity in today's world. The gains for greater awareness and knowledge of international business fare immense for nations, multi-national enterprises, trading companies, exporters and even individuals. International trade exposes the trading partners to various difficulties and risks due to the physical distance between parties, different time zones and currencies, different legal rules applicable to the transaction as well as the fact that the parties may not generally know each other. Banks facilitate international commerce through a variety of products which include managing their international payments, mitigating the risks, and providing working capital. This research has the objective of assessing the practices and challenges of international banking service provided to traders by private commercial banks in Ethiopia. It aims at identifying the problems, investigate any malpractices, indicate instances of non-compliance with international standard banking practices, shed light on risk areas, and identify conceptual gaps among the bank staff. A descriptive research design using the survey method of data collection was adopted. From the research it has been found out that, most of the banks do not automatically effect payment to the remitting bank after releasing the shipping documents sent on documentary collection basis. Secondly, banks are having difficulty in managing the level of approved purchase orders due to the fact that outstanding purchase orders are not considered as liabilities of banks under the Open Position directive of the National Bank of Ethiopia. In the study, it is recommended that the banks should carefully design and well manage internal controls over international banking service operation with regards to foreign exchange transaction, and also should properly manage their assets and liabilities in foreign exchange so that they will not face liquidity problems upon settlement of letters of credits and documentary collections.

Keywords: International Trade, Cash against Document, Letter of Credit, Purchase Order, UCP, URR

CHAPTER ONE
INTRODUCTION

1.1 Background of the study

According to Glover (1986), one of the most dramatic and significant world trends in the past two decades has been the rapid, sustained growth of international business. Markets have become truly global for most goods, many services, and especially for financial instruments of all types.

World product trade has expanded by more than 6 percent a year since 1950, which is more than 50 percent faster than growth of output the most dramatic increase in globalization, has occurred in financial markets. In the global forex markets, billions of dollars are transacted each day, of which more than 90 percent represent financial transactions unrelated to trade or investment (Jean-Guillume Ditter, 2009). International business is a necessity in today's world. The gains for greater awareness and knowledge of international business fare immense for nations, multi-national enterprises, trading companies, exporters and even individuals. To go global, the first step would be to understand the international business environment. International business is nothing but extending the areas of activities of business across the boundaries (Glover, 1986).

Banks play a critical role in international trade by providing trade finance products that reduce the risk of exporting. Banks have substantially expanded their activities across borders over the past two decades (Friederike & Niepmann, 2011). This has happened in two ways. First, banks have invested more domestic capital in foreign countries, an operation which is defined as international banking. Second, they have to a much larger extent intermediated capital locally in foreign markets, an activity which is denoted as global banking. While growth in banking across borders has been similar in many countries, there has been significant heterogeneity in the extent to which banking sectors engage in international versus global banking (Aviat and Coeurdacier, 2007). According to Loranth and Morrison (2007), banks are the vehicles of international capital flows and provide intermediation services. When countries differ in their factor endowments and in banking technology, global and international banking both arise endogenously. When two countries integrate that differ with respect to their relative endowments of capital and labor and their banking sector efficiency, banking across borders occurs. As a consequence of differences in endowments and differences in efficiency, the service fee and the autarky financial interest rate vary between domestic and foreign banks. When entrepreneurs have a choice between raising capital from domestic or foreign banks, they prefer banks that demand a low interest rate and a low service fee (Cetorelli & Goldberg, 2010).

The international or "tradable" nature of banking services (and of financial services more generally) has been well established. It is difficult to identify any class of services for which an international demand or a capacity for international supply has been more clearly demonstrated. Foreign banking institutions are prominent in most financial centers of the developed world. "International banking" has become almost a cliché. But despite the apparent ease with which banking operations have crossed national boundaries in recent years, there remain important obstacles to efforts by banks to serve customers in foreign markets. Increasingly, these obstacles are becoming a focus for international debate and dispute (New, 1988).

Obstacles to international trade in banking services arise for the most part because of the special nature of banking services and the importance that all nations place on the regulation of banking operations. In every country, banking operations are subject to special regulations and restrictions. These regulations and restrictions are almost always intended to ensure the stability of national banking systems, to provide national authorities with effective instruments for economic management, or generally to encourage thrift and other social virtues. That these policies sometimes hinder the establishment of foreign banking operations or restrict the scope of such operations once they have been established is usually an unintended (although not always deeply regretted by domestic banking institutions) side effect. Having grown up in response to particular national circumstances, policies toward banking operations vary widely from one nation to another. There is no international consensus about what are and are not legitimate activities for banks, about the mechanisms required for adequate supervision of banks, or about the roles that banks are supposed to play in the larger economy. Under the circumstances, it is not surprising that there is no consensus about the rules under which banks from different countries should be allowed to compete with each Other within national markets (New, 1988).

Ethiopian commercial banks, too, have long been actively taking part in the international trade of the country by way of the trade service products that they offer. Such services are usually rendered for lucrative fees in the form of service charges and commissions which might be as high as 5% of the transaction amount. As a result, the income generation of international banking services accounts for 30 to 40% of the total income for the majority of the banks (Buyinza, 2010). However, trade service products have their own risks and challenges. Moses (2005) argued that though letters of credit are widely used payment methods, there is an irony in their use since in the majority of the cases the bank is relieved of its obligation to honor drafts due to discrepancies. The seller's documents have to strictly comply with the terms and condition of the letter of credit in order for the seller to get payment. Therefore, the overall idea of this study focuses on the first aspect in general and particularly on the practice of international banking service provision for traders as well as the challenges that the private commercial banks in Ethiopia face while delivering the services for import export traders.

1.2 Statement of the problem

In this era of globalization, with increased competition around the globe in all sectors, a strong banking industry is important in every country and can have a significant effect in supporting economic development through efficient financial services; as a result many banks in the world are modifying their strategies to reach customers worldwide more easily and cheaply. Niepmann and Eisenlohr (2014) explained that when exporters and importers engage in an international trade, they have to agree and decide on who finances the transaction and who bears which risk; and banks come in to the picture by way of providing finance and mitigating the risk involved.

Trade service products like the letter of credit have long been practiced by Ethiopian commercial banks and the income generated from these products by way of service charges, commissions and other incomes account for a significant portion of their total incomes. Local banks are being exposed to unnecessary financial risks, encountering operational problems, getting involved in some malpractices, and failing to comply with international and local standards. (Ibid). For instance, some banks have faced foreign currency liquidity problem when handling the settlement of documentary collections because too much purchase orders have been approved in excess of the foreign exchange earning capacity of the banks. Consequently, the banks have engaged in the malpractice of releasing the shipping documents to importers and thereafter delaying the related payment to the supplier for up to two or more months. As a result, some correspondent banking relationships have apparently been damaged which shall also be further investigated in the course of this study.

Literatures also shows that, some of the commercial banks do not rigorously assess the credibility of the importer and the marketability of the consignment when approving letter of credit margin facilities. As a result, there are frequent cases whereby the importer fails to settle the letter of credit and take up the documents on time. Consequently, the related consignment remains unloaded at the port of discharge for a long period of time subjecting the country to high demurrage charges.

An empirical research by Tom.M, (2014), on The role of public and private sector Banking in Ethiopia's future economic growth, find out that over the past decade, Ethiopia has achieved impressive economic growth averaging close to 11 percent annually and the development of a vibrant and active private banking system that complements existing public sector work is considered important to Ethiopia's economic progress. Again another research work conducted on Challenges of international trade on banking system by three co-researchers (Robert E. et al., 2008) found that Obstacles to international trade in banking services arise for the most part because of the special nature of banking services and the importance that all nations place on the regulation of banking operations. Another study by European investment bank (2013) which focuses solely on the challenges and opportunities of banking in sub-Saharan Africa revealed out that sub-Saharan African financial and banking systems remain underdeveloped. The banking systems in the region are highly concentrated and generally inefficient at financial intermediation; they are characterized by their small size and low intermediation, and despite little barriers to entry and exit -as evidenced by the dominant market share of foreign banks - competition is still limited. Another research finding on International Trade Risk and the Role of Banks by Niepmann Friederik, and Tim Schmidt-Eisenlohr (2015), concludes that international trade exposes exporters and importers to substantial risks. There is also another research by (Panagiotis P.et al.., 2013) on international banking system: conceptual Approach, Advantages and Risks stated out that, the cost from the internationalization of banking activities is found in the loss of income for the countries, as the internationalization of work leads to the escape of capital to countries where the committed deposits have higher interest or still, the central bank of that country keeps smaller compulsory percentage of capital from the commercial banks.

So, it appears for the researcher as there is a knowledge gap among some of the trade service staff in these local banks with regards to the international standard banking practices for trade service products and other relevant international and domestic rules, directives and procedure manuals. Therefore, this study plays a great role towards filling the existing conceptual gap by systematically investigating and examining; assessing; exploring and describing the existing realities regarding what the practice of international banking service provision for traders' by private commercial bank in Ethiopia looks like.

1.3 Research Questions

The problem statement discussed above leads to the following research questions:

1. What the practice of international banking services for traders by private commercial banks in Ethiopia looks like?

2. What are the major operational problems encountered by Ethiopian private commercial banks in the course of rendering International trade service products?

3. Are there instances of noncompliance with international (UCP600, URC522) and domestic standards and foreign exchange directives?

4. What are the possible ways of mitigating risk in association to international trade services?

1.4 Objectives of the study

1.4.1 General objective

The main objective of the study was to make critical assessment of International Banking Service Practices Provided to Traders by Private Commercial Banks in Ethiopia in order to shed light on risk areas, identify problems, expose malpractices and indicate instances of non-compliance with international standard banking practices

1.4.2 Specific objectives:

The specific objectives of the study were:

1. To assess the practice of international banking services for traders provided by private commercial banks in Ethiopia.
2. To identify any malpractices.
3. To find out instances of noncompliance with international (UCP600, URC522) and domestic standards and foreign exchange directives.
4. To recommend possible ways of mitigating risk in association to international trade services.

1.5 Significance of the study

Since trade services have become one of the most important products that private commercial banks offer owing to the significant amount of revenue derived from these products and the attraction of customers and depositors looking for these services. So, the outcome of this research paper was hopefully have close relevance to the day-to-day trade service practice of banks and helps improve such practices which are overlooked by researchers. Therefore, this research paper has a intended to fill the conceptual gap on the practices of private's commercial banks in Ethiopia on international service provision particularly for traders and significant for decision makers and academicians to provide valuable information. It was also give insights for other researcher who was conduct further and intensive study on the area. In short, the study was be significant because the result could in spite the decision makers to make policy interventions and initiate further research work. So, it was contribute to problem solving and knowledge building simultaneously.

1.6 Scope of the Study

Even though there are many types of services provided by international banking system, the scope of the research limited to trade service practices (i.e. those related to import and export transactions) private commercial banks and, thus, no attempt was made to study other international banking services.

1.7 Limitation of the Study

Like other researchers I have faced some challenges while conducting this research especially during data collection period. For instance, some research participants were not volunteer for an interview; as a researcher I have also faced different financial and time limitations to conduct this research.

1.8 Organization of the Research Report

The research report comprises of five chapters. The first chapter of the report discuses background of the study, statement of the problem, basic research questions, objectives of the study, Significance of the study ,scope of the study, limitations of the study and significance of the study. Subsequently, the second chapter presents a vast review of literature relevant to the study. The third chapter explains the type and design of the research; the participants in the study, the sources of data, the data collection tools, the procedure for data collection and the methods of data analysis used. The fourth chapter of the report summarizes the results or findings of the study, and provides interpretation of the findings. In the end, the fifth chapter presents summary of findings, conclusions, and recommendations.

CHAPTER TWO

REVIEWS OF RELATED LITERATURE

2.1 The Role of Banks in International Trade

According to Heffernan (2005) banks distinguish themselves from other types of financial firms mainly by the provision of deposits and loan products. Banks must manage these deposits, which are liabilities for them, in order to maximize profit. Thus, banks' core activity is to act as financial intermediaries between savers and borrowers. According to Niepmann (2011) trade in banking services is limited and differences in banking sector efficiency across countries cannot be fully exploited. This is because the banking services exporting country necessarily exports capital at the same time. The interest rate therefore rises in the exporting country and declines in the importing country with the volume of trade. In equilibrium, advantages in terms of efficiency of one banking sector are offset by a higher financial interest rate and vice versa until entrepreneurs are indifferent between domestic and foreign banks. When banking sectors are liberalized, banks are also allowed to raise capital in foreign markets.

Banks also conduct other types of services like the trade finance which facilitate international trade. Niepmann and Eisenlohr (2014) explained that when exporters and importers engage in an international trade, they have to agree and decide on who finances the transaction and who bears which risk; and banks come in to the picture by way of providing finance and mitigating the risk involved. In the case of open account method of payment, the exporter ships the consignment to the buyer and the later makes payment only after receiving the goods; thus, the exporter pre-finances the transaction. On the other hand, the importer effects payment in advance of shipment of the goods by the exporter in the case of cash-in-advance payment method. In both cases, however, banks are usually involved by providing working capital finance to the exporter in the first case and to the importer in the second (Niepmann and Eisenlohr, 2014).

2.2 Facilitation of International Trade

International trade, various institutions play a vital role for smooth and successful undertaking of the operation. Among these banks, Insurance company, agent, and transport companies have been mentioned. Banks facilitate International trade by providing financing and guarantees to importers and exporters (Claessens, 2014). It is impossible international trade without involving a bank for all the service they provide such as advice on financial issues and the potential risks involved. It is that one critical hurdle is the lack of information on international trade processes, documentation and banking procedures necessary to carry on with business abroad. For result oriented and cost effective international trade, one very definitely need access to accurate and timely informational and a sound knowledge of banking (Niepmann and Eisenlohr, 2014). To support the global interests of their customers, banks either have a multi-block presence or they have special arrangements with other banks operating in a region. These special arrangements are called correspondent relationships. A bank also facilitates payment, avails finance and gives professional advice for the importers and exporters. Today's world economy is supported by different world class international bank that open their door to many worldwide international business and investments. On the other hand, insurance companies give cover to different types of risks involved in the trade. Airlines, shipping lines, courier service, and postal office, and land and rail way transport companies that involve in the transportation of the goods and/or documents.

2.3 Trade Service Practices

As a banker when dealing with import, export, and we may be familiar with trade service operation. As stated before, trade service operation targets the international trading society of the country and it mainly focuses on facilitation of payments and mitigation of risks associated with international trade through a process that is compatible with customer's need and international and standards. As international trade offer some fantastic opportunities, but dealing with overseas partners has its own challenges. There is a range of risks for the exporter and importer to be considered before entering into a sales contract. There are a number of solutions aiming to mitigate these risks and to help provide assurance and protection for exporters and importers. Based on a sales contract made, reaching a decision about the payment technique/ methods of payment / will be useful for both the buyer and seller, depends on the level of risk inherent in the transaction and the risk tolerance of each party (Cetorelli & Goldberg, 2010). Hence as professional advisors, bankers should be familiarizing themselves with these issues, sales contracts, methods of payment, and be part of the solution as much as the need of the environment they are working with.

2.3.1 Sales Contracts

According to Seyoum (2009) export sales contract are central to international commercial transactions and around it revolves a series of connected, but distinct, relationships, including cargo insurance, transportation, and payment arrangements. The rules and practices governing such contacts vary from one export transaction to another, based on the agreement of the parties as well as the legal system. National legal systems on contracts may differ, but the basic principles of contracts, such as good faith and consideration are generally recognized and accepted in many countries. Sales contract concluded prior to engaging oneself in one of the international trade products. It is a legal undertaking between buyer and seller on its own and may be used outside of any trade instrument associated with it for exchange of goods ,service or property between seller and buyer for an agreed upon value in money paid of promise to pay sum . as it the initial step for trade agreement it should be unambiguous and clearly state the kind and quantity of goods, their value ,pace/port of loading and discharge ,delivery term , made of payment , article to use and place of arbitration and required documents etc.

The credit needs of the exporter depend to a very large extent on the type of sales terms. The sales contract must clearly specify the terms and conditions of the payment. The five most common trade payment methods are discussed below. The most beneficial payment terms for the seller, according to Cherunilam (2006), is when payment is received in advance of the shipment of goods, i.e. the cash-in-advance payment term. It is not common for an importer to be willing to make advance payments. However when the consignment is to be manufactured to the order of and according to the specifications outlined by the importer, advance payment is usually required by the seller.

Niepmann and Eisenlohr (2014) pointed out that under the cash-in-advance terms, the importer is actually pre-financing the transaction and the exporter receives the payment before incurring the production costs. This exposes the buyer to a risk, because the seller may fail to deliver the goods after receiving payment. The other case which gives rise to advance payment, according to Cherunilam (2006), is when the seller has a monopolistic position in the market. Here the buyer’s bargaining power is lesser and as a result he has to make payment in advance of the shipment of the goods by the seller.

According to Niepmann and Eisenlohr (2014) under the open account, the supplier first ships the goods and then the buyer effects payment. Since the exporter incurs production and distribution costs before receiving the payment, he is actually pre-financing the transaction. The risk to the exporter materializes when the importer fails to make payment for the goods after receiving them. Cherunilam (2006) also adds that under the open account scheme, the exporter delivers the goods with no financial documents to his advantage except the commercial invoice. Thus, the seller carries the entire financial burden with no documentary evidence. Since high risk is associated with the open account method, it is usually exercised between affiliated companies or when the buyer and seller have had a long standing business relationship. Under the consignment method of payment, the seller delivers the goods to his agent in the foreign land, who arranges for the sale of the goods and remits the payment to the supplier. Title to the goods remains with the exporter until the goods is sold to the ultimate buyer. Under this method, the exporter is not protected against loss that could arise if the agent or consignee fails to repatriate the proceeds to the exporter from the sale of goods (Cherunilam, 2006).

Niepmann and Eisenlohr (2014) discussed that in a documentary collection method of payment, banks handle shipping documents based on the instructions of the seller. In this method of payment the buyer can get hold of the documents only after effecting payment for the document value without which he cannot receive the goods from the customs; thus a documentary collection provides better reliability of payment as compared to an open account basis. Even with a Documentary Collection arrangement, however, Niepmann and Eisenlohr (2014) explained that the buyer may still refuse to take up the documents and the exporter may be at risk. Documentary collections are of two types: documents against payment and documents against acceptance (Niepmann and Eisenlohr, 2014). Under the D/P terms, also known as cash against documents the seller effects shipment of goods to the overseas buyer, but the shipping documents are handled through the banking channel and delivered to the buyer only against payment (Niepmann and Eisenlohr, 2014). In a similar manner, Cherunilam (2006) explained that under this method of payment, title to the goods remains with the seller until such time that the buyer pays for the value of the goods.

Under the document against acceptance method, on the other hand, the documents evidencing shipment and title of goods are passed over to the importer when he accepts the bill of exchange by way of signing it, the maturity of which may be 30 days, 60 days, or 90 days. In this method of payment, the exporter is actually extending credit to the importer and he relies on the honesty and creditworthiness of the importer. As such, this kind of payment mechanism is appropriate only to trade partners with proven business integrity and sound financial standing (Cherunilam, 2006). Documentary collections are governed by the URC 522.The URC 522 are the uniform Rules for collection. URC 522 Come to effect on 01 January 1996. The URC 522 Were first published by the ICC in 1956. Revised versions were issued in 1967 and 1978 (International Chamber of Commerce, 1996).

The Uniform Rules for Collection, 1996 Revision, ICC Publication No.522, shall apply to all collections, where such rules are incorporated into the text of the collections instruction and are binding on all parties there to unless otherwise expressly agreed or contrary to the provisions of a national, state or local law and/or regulation which cannot be departed from (International Chamber of Commerce, 1996). The URC 522 defines collection as: “Collection means the handling by banks of documents in accordance with instructions received, in order to:

1. Obtain payment and or acceptance,
2. Deliver documents against payment and/or against acceptance,
3. Deliver documents on other terms and conditions,”(International chamber of Commerce,1996, p.5).

The URC 522 distinguishes between two types of documents:

Financial Documents means bills of exchange, promissory notes, cheques, or other similar instrument used for obtaining the payment of money.

Commercial documents means invoices transport documents, documents of title or other similar documents, or any other documents what so over, not being financial documents. Clean collection means collection of financial documents not accompanied by commercial documents. Documentary collection means collection of:

1) Financial documents accompanied by commercial documents ;
2) Commercial documents not accompanied by financial documents.(International Chamber of Commerce, 1996:P.6) .

In addition, Article 3 of the URC 522 Further identified parties to a collection:

1) The principal who is the party entrusting the handling of a collection to bank;
2) The remitting bank which is the bank to which the principal has entrusted the handling of the collection ;
3) The collecting bank which is any bank ,other than the remitting bank ,involved in processing the collection
4) The presenting bank which is the collecting bank making presentation to the drawee;
5) The drawee is the one to whom presentation is to be made in accordance with the collection.(International Chamber of Commerce,1996: P.8) .

Cherunilam (2006) stated that a letter of credit is an instrument containing the undertaking of a bank to honor on it a draft drawn by a seller or beneficiary, under certain terms and conditions and up to a fixed amount. A documentary letter of credit ensures that the exporter will be definitely paid for the value of goods shipped, provided that he fulfills the terms and conditions of the credit. In addition, under this payment method, the exporter can obtain payment from a bank at his own locality by presenting the shipping documents to the bank immediately after the shipment of goods. Thus, the letter of credit covers the major part of the export and import business in the world.

Even though the irrevocable letter of credit is used most frequently in international trade, letters of credit may also be revocable allowing the exporter to obtain payment unless previously revoked by the importer. Documentary credits may be drawn at sight or at a fixed maturity date. Most letters of credit allow the beneficiary to transfer its rights to another (Folsom et al., 2005). The fundamental principle of letters of credit, also known as the autonomy principle, is that the responsibility of the opening bank to pay against drafts drawn under a credit accompanied by documents which conform to the conditions of the credit is independent of performance of any party under the underlying contract (Folsom et al., 2005).

The Uniform Customs and Practice for Documentary Credits, 2007 Revision, International Chambers of Commerce Publication no. 600 clearly states that a credit by its nature is distinct from the sale or other contract on which it may be based or related to; banks are not concerned with or bound by such contract, even if any reference to such contract is made in the letter of credit. As a result, the obligation of the issuing bank to pay under the credit is not subject to claims by the importer resulting from its relationships with the issuing bank or the exporter.

According to the Uniform Customs and Practice for Documentary Credits, 2007 Revision, as long as the stipulated documents are presented to the issuing bank and as long as they conform to the terms and conditions of the letter of credit, the issuing bank must effect payment to the presenter. Hashim (2013) discusses that the issuing bank is the party responsible to determine whether or not the presentation of documents complies with the letter of credit requirements based on the Uniform Custom and Practice for Documentary Credit (UCP 600) and International Standard Banking Practice for examination of documents. While the former is the primary rules which govern letter of credit transactions, the latter serves as guidelines for the standard interpretation within which the issuing bank must exercise a reasonable judgment in determining the documentary compliance.

There are four parties to a letter of credit: namely the beneficiary, applicant, the issuing bank and the advising bank. The beneficiary under a letter of credit is the exporter of the goods in whose favor the letter of credit is issued. The applicant, on the other hand, is the party who intends to import the goods and instructs the bank to establish the letter of credit. The bank in the importer's country that issues the letter of credit at the request of the importer is termed as the issuing bank. While, the bank in the exporter's country who is authorized by the issuing bank to advise the letter of credit to the beneficiary is referred to as the advising bank (Jain, 2014).

2.3.2 Type and Classification of L/C

Letters of credit are classified in many ways and into many different types, however in a general sense they fall into two main categories, namely the commercial letter of credit, which is a payment mechanism and a standby letter of credit which is basically a guarantee, despite the similar nature of commercial and standby letter of credit, there are major differences between the two as regards the commercial purpose , the honoring of the credit and the risk involved .The risk of fraudulent calls is much highly in standby letter of credit transaction than the in a commercial letter or credit. That is because in a commercial letter of credit, the beneficiary must provide a whole set of documents, which in general produced and issued by third parties, unlike a standby letter of credit where in general the beneficiary produces the documents (Mueller, 2013).

The standby credit may be paid against a written demand as the stipulated document or against a written demand as the stipulated document or against a demand documents specified, such as a certificate from a third party that there has been non-performance under the underlying contact (Lipton, 1998). Even though the irrevocable letter of credit is used most frequently in international trade, letter of credit may also be revocable allowing the exporter to obtain payment unless previously revoked by the importer. Documentary credit may be drawn at sight or at a fixed maturity date. Most letter of credit allows the beneficiary to transfer its right to another (Folsom et al., 2005). A confirmed L/C is one when a banker other than the issuing bank, adds its own confirmation to the credit. In case of confirmed L/C, the beneficiary's bank would submit the documents to the confirming banker. In a back to back credit , the exporter (the beneficiary) requests his banker to issue an L/C in favor of his supplier to procure raw materials, goods on the basis of the export L/C received by him. While an L/C is not a negotiable instrument, the bills of exchange drawn under it are negotiable. A transferable credit is one in which a beneficiary can transfer his right to third parties (ICSI, 1999).

Principles of letter of credit: The fundamental principle of letter of credit, also known as the autonomy principle, is that the responsibility of the opening bank to pay against drafts under a credit accompanied by documents which conform to the conditions of the credit is independent of performance of any party under the underlying contract (Folsom et al., 2005). The key element of any letter of credit , regardless of the set of rules applicable, and the reason for its widely spread use is the autonomy of the bank's obligation from the underlying contract and other related contract (Mueller, 2013) . The principle of strict compliance is contained in Article 7, 8 and 15 of UCP 600 and accords with the autonomy principle. It provides that the beneficiary must conform to documentary requirements specified in the letter of credit. The autonomy principle takes a significant role within letter of credit. The justification behind it is to obtain a particular warranty that the issuing bank's undertaking will not in any way be influenced by or interfered with any irregularity with regard to the underlying contract (Mueller, 2013) .

Issuing bank's obligation under an L/C: The issuing bank's main obligation are to issue the letter of credit at the request of the applicant, to make the credit available to the beneficially, via an advising bank; to examine the presented documents; to either accept or reject the documents; to honor or dishonor the credit and to reimburse the negotiating bank that has honored a complying presentation (Mueller, 2013). According to the Uniform customs and practice for Documentary Credits, 2007 Revision as long as the stipulated documents are presented to the issuing bank and as long as they conform to the terms and conditions of the letter of credit , the issuing bank must effect payment to the presenter. Once the letter of credit is issued by the issuing bank , the bank's liability is absolute given that the seller performs as required by the terms of the letter of credit.(Alphonse, 2010).

Parties to a letter of credit: There are four parties to letter of credit: namely the beneficiary, applicant, the issuing bank and the advising bank. The beneficiary under a letter of credit is the exporter of the goods in whose favor the letter of credit is issued. The applicant, on the other hand, is the party who intends to import the goods and instructs the bank to establish the letter of credit (Jain, 2012). The applicant is the party on whose request the credit is issued. He is obliged to lodge security as demand by the issuing bank and to reimburse and pay the issuing bank fees for payments made under the letter of credit (Mueller, 2013). The bank in the importer's country that issues the letter of credit at the request of the importer is termed as the issuing bank. While, the bank in the exporter's country who is authorized by the issuing bank to advise the letter of credit to the beneficiary is referred to as the advising bank (Jain, 2012) . A confirming bank is usually the bank in the exporter's country, who adds confirmation to the letter of credit at the request of the beneficiary, so that the latter gets payment without recourse from the confirming bank (Alphonse, 2010).

Amendment to L/C: A change made to a letter of credit after it has been issued is called an amendment. For the seller to change the terms of an irrevocable letter of credit, it must request an amendment from the buyer. The amendment process is as follows:

1) The seller request a modification or amendment of questionable terms in the letter of credit:
2) If the buyer and issuing bank agree to the changes, the issuing bank will change the letter of credit;
3) The buyer's issuing bank notifies the seller's advising bank of the amendment; and
4) The seller's advising bank notifies the seller of the amendment (Vaidya,1990).

UCP 600: The UCP 600 states that an issuing bank is irrevocable bound by an amendment as of the time it issues the amendment. A confirming bank may extend its confirmation to an amendment and will be irrevocable bound as of the time it advises the amendment. (International chamber of commerce, 2007). The uniform customs and practice for Documentary credits. 2007 Revision, ICC Publication no.600 (UCP) are rules that apply to any documentary credit when the text of the credit expressly indicates that it is subject to these rules. (International Chambers of Commerce, 2007). The UCP defines a complying presentation as: ccomplying presentation means a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of these rules and iinternational standard banking practice (International Chamber of Commerce, 2007:11).

Article 2 of the UCP provides a definition of letter of credit as: Credit means any arrangement, however named or described, that is irrevocable, And thereby constitutes a definite under taking of the issuing bank to honor a Complying presentation. Honor means:

a) To pay at sight if the credit is available by sight payment
b) To incur a deferred payment undertaking and pay at maturity if the credit is available by deferred payment.

c) To accept a bill of exchange drawn by the beneficiary and pay at maturity if the credit is available by acceptance.(International Chamber of Commerce, 2007: P.7)

ISBP 2006: In 1996 the US Council on International Banking published a paper titled ‘’Standard Banking practice for the Examination of Letters of Credit Documents’’ which provided a checklist for banks on what must be considered when inspecting the documents. The goal was to try to reduce the number of presentations rejected by the banks by providing a standard for documentary checkers. The International Banking Practice for the Examination of Documentary Letters of Credit, Commonly called ISBP, was approved by the Commission at its meeting in Rome in October 2002 (Zsuzsanna, 2006)

Article 1 of ISBP states that: the terms of credit are independent of the underlying transaction even if a credit expressly refers to that transaction. To avoid unnecessary costs, delays, and Disputes in the examination of documents, however, the applicant and beneficiary should carefully consider which documents should be required, by who they should be produced and the time frame for presentation (International Chamber of Commerce, 2006: p.5).

With regards the commercial invoice Article 58 of the ISBP holds that: The description of the goods, service or performance in the invoice must correspond with the description in the credit. There is no requirement for a mirror image. The description must reflect what has actually been shipped or provided (International Chamber of Commerce, 2006: p.9).

URR 525: The Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credit (URR 252) come in to effect on the first of July 1996. The seventeen articles of the URR525 deal with the state of affairs covered by article 19 of the UCP 500, where banks (an issuing bank, a claiming bank and a reimbursing bank) are involved. It does not alter the provisions of the UCP but sets out a detailed code for the reimbursing process (Zsuzsanna, 2006).

The URR defines reimbursement authorization as: Reimbursement authorization means an instruction or authorization, independent of the credit, issued by an issuing bank to a reimbursing bank to reimburse a claiming bank or if so requested by the issuing bank, to accept and pay a time draft on the reimbursing bank (International Chamber of Commerce, 1996:P.2).

2.3.3 Guarantee

Jain (2014) defined guarantee as a contract between the issuing bank and a named beneficiary in whose favor the guarantee has been furnished; and it is an act of trust to facilitate the smooth flow of trade and commerce in both domestic and international trade. Although the initiation of a bank guarantee begins with the primary or underlying contract between the parties, it is nevertheless, independent and autonomous. In a bank guarantee, the issuing bank binds itself to pay unconditionally to the beneficiary upon receipt of first claim. A letter of credit ensures that a transaction proceeds as planned; bank guarantee, on the other hand, are meant to reduce the loss if the transaction fails to go as planned. A guarantee is an undertaking of a bank to answer for the debt, default or non-performance of its client. A bank guarantee can be used in relation to an open account transaction under which goods are delivered to the buyer before receipt of payment by the exporter in order to guarantee against default by the buyer. In a similar way, the bank guarantees the buyer when he has made an advance payment to an exporter prior to the shipment of goods. Under a bank guarantee, the bank or the guarantor is secondarily obligated to the oblige should the primary obligor or the applicant fail in his obligation to perform (Jain, 2014).

2.4 Most common shipping documents in international trade

International trade transactions, especially those involving documentary collection and letters of credit, usually call for presentation of the four most common shipping documents which are discussed briefly as below.

2.4.1 Commercial invoice:

According to ISBP (2006) a credit requiring an “invoice” without further definition can be satisfied by any type of invoice presented (commercial invoice, customs invoice, tax invoice, final invoice, consular invoice, etc.). The description of the goods, services in the commercial invoice must correspond with the description in the letter or credit, though; there is no requirement for a mirror image. A commercial invoice should evidence the value of the goods shipped or services provided. The invoice must also show the unit prices and currency in agreement with the letter of credit. Any discounts or deductions must also be stated if required in the credit. In addition, the commercial invoice may also show a deduction covering advance payment, discount, etc., not stated in the credit (ISBP, 2006).

2.4.2 Packing list:

A credit requirement for a “Packing List” , which is a detailed list of items shipped, may be met by a document containing packing details whether titled “Packing Note”, “Packing and Weight List”, etc., or an untitled document. However, the content of a packing list or any document must appear to fulfill the function of the required document (ISBP, 2006).

2.4.3 Certificate of Origin:

A certificate of origin must be signed, dated and certify the origin of the goods. A certificate of origin should be issued by the party stated in the letter of credit. If a credit does not state party who issues the certificate, then a document issued by any party, including the beneficiary or the exporter himself is accepted (ISBP, 2006).

2.4.4 Bill of lading:

A bill of lading is a transport document issued by a carrier as a receipt for the goods. Bill of lading, like bills of exchange, may be made out to any bearer, or to a particular person or his order. If made out to bearer, they can be transferred by delivery; while if made out to order, they can be transferred by endorsement and delivery of the bill of lading. In practice, however, bill of lading made out to bearer is seldom used, as the bill of lading serves as a document of title. The attribute of the bill of lading as a document of title is in fact what makes the consignment negotiable as well. The bill of lading retains its attribute of document of title until such time that the contract of carriage by sea is completed by delivery of the goods against the bill. If the carrier, however, delivers the consignment to a person who is not, actually, the holder of the bill of lading, the carrier bears the responsibility (Folsom et al., 2005).

The negotiability quality of the order bill of lading implies that it functions as a document of title. The goods are merged with the document, and the legitimate holder of the bill of lading has title to the goods. The exporter thus, can retain control of the goods in transit by requiring the payment of the price of the goods before the bill of lading is delivered to the importer. An intermediary bank, usually referred to as the negotiating bank, that advances funds to the exporter, is protected by becoming a consignee or retaining possession of the bill of lading. If the shipping company delivers the consignment without taking up or cancelling the bill of lading, it remains liable to any party who has purchased the bill (Folsom et al., 2005).

2.5 Trade Finance

According to Committee on the Global Financial System (CGFS), banks facilitate international commerce through a variety of products which include managing their international payments, mitigating the risks, and providing working capital. The term “trade finance” is used to denote bank products which are specially tailored to facilitate international trade transactions i.e. exports and imports (CGFS, 2014).

In addition Cherunilam (2006) emphasized that the international market is characterized by stiff competition and sensitivity; and thus, the credit facilities that banks provide to the buyers are among the most important factors for the success of export business. Further Niepmann and Eisenlohr (2014) put forward that international trade exposes both buyers and sellers to substantial risks, since the trading partner resides in a foreign land and enforcing of contracts is very hard. Trade finance products are designed and offered by banks with the aim of mitigating such risk associated with international trade. Banks also play a crucial role in international commerce by offering trade finance products that can mitigate risks associated with the business of export. Further CGFS (2014) pointed out that banks also help meet working capital needs of buyers and sellers by providing trade finance loans linked either to a letter of credit or other forms of documentation related to the underlying transaction.

In a similar manner Cherunilam (2006) demonstrated that even if an exporter gets payment at the time of shipment of goods, he has to make arrangements with a bank to meet his financial needs at the pre-shipment stage. And, if the sale is on credit, the seller will still be more constrained financially. Thus, it is very important to make institutional credit available to exporters to meet their pre-shipment and post-shipment financial needs. Such credit facilities not only help exporters meet their pre-shipment working capital needs but also enable them extend credit facilities to their foreign trade partners (Cherunilam, 2006). In fact Niepmann and Eisenlohr (2014) argued that trade finance can constrain exports, especially to the poorer countries during crisis times. Owing to the reductions in the supply of LCs associated with a contraction in bank lending, the lack of trade finance can explain the collapse in exports to the smaller and poorer countries in 2008/2009.

2.5.1 Pre-shipment and Post-shipment finance:

In order to meet expenditures on the purchase of materials and components, processing, packaging, packing, marking, transactions, warehousing, etc., according to Cherunilam (2006), the export has to arrange for a pre-shipment finance from banks. As the name implies, pre-shipment finance refers to the credit extended to the exporter prior to the shipment of goods. In many cases, as Cherunilam (2006) explained, it takes the exporter a period of time-short, medium or long-even after effecting shipment of goods to get the export proceeds. As a result, the exporter seeks post-shipment finance, for the period from the shipment of the goods until payment is received from the overseas trade partner.

Cherunilam (2006) stated that post-shipment advances are granted by banks mainly by negotiating shipping documents under a letter of credit, by purchasing documents against payments, and by lending against export bills sent for collection abroad. Post-shipment advances are normally settled against the export proceeds of the related export bills or the remittances received from abroad. Due to the competitiveness of the export business, exporters, most often, are expected to extend some kind of credit to their overseas buyers. This burden of credit must be shifted from exporters to the financial institutions by extending credit to the exporters to enable them extend credit to their buyers. Under the supplier's credit, the exporter extends credit to the buyer. However, the exporter obtains payment directly from the banks upon presentation of the shipping documents. Such supplier's credit is usually granted for the purchase of capital goods. On the other hand, under the line of credit scheme, banks in the exporter's country extend credit to banks in the buyers' country which in turn extend the credit to a number of buyers. The banks in the buyers' country are the ones responsible for determining the creditworthiness of each buyer (Cherunilam, 2006).

2.6. Empirical Studies

Claessens et al. (2014) stated that while access to external funds is important for domestic production, it is especially important for exporting firms. This study shows how exporter needs to be financed in order to bring sustainable foreign currency income for one country. The study further explained that several papers indeed show that in countries with strong financial institutions firms tend to export relatively more, especially in financial vulnerable sectors (e.g., Beck, 2002). Claessens, (2014) also agree with the limitation of the study around import and export business. While banks can facilitate trade through finance, they can potentially also facilitate trade by overcoming information asymmetries and agency issues between importers and exporters. Jain (2014) observed that a bank is absolutely bound to effect payment under a letter of credit even if it is informed that the merchandise shipped is not of the quality contract for. Disputes as to the quality of the goods may arise and be litigated later between buyer and seller; but the issuing bank remains obligated to honor drafts drawn by the seller in conformity with the terms and conditions of the letter of credit. A documentary credit has an immediate legal effect. In contrast to a guaranty, which undertakes to answer for the debt, default or nonperformance of another, the issuing bank under a letter of credit is primarily liable upon it (Jain, 2014).

Though letters of credit are a widely used trade payment method, and considered to be a secure payment device, however Moses (2005) argued that there is an irony in the use of letters of credit, although they serve as effective payment mechanisms most of the time, in the majority of the cases the bank refuses to honor drafts due to discrepancies. The slightest discrepancy would relieve the issuing or confirming bank of its obligations to honor draft and documents. The principle of strict compliance is aimed at protecting the importer who has neither the opportunity to check the physical goods nor to supervise the process of loading the goods in the exporter's country due to the geographical distance. Hence, the documents are the only security available to the importer. The shipping documents evidence that the goods have been delivered in accordance with the terms and conditions in the sale contract. By the same token, the principle of strict compliance also benefits the exporter by providing immediate payment. The exporter does not have to wait until the consignment safely reaches the importer's country before getting the payment. The seller can obtain payment for the goods sold by presenting to the bank the shipping documents stipulated in the credit immediately after effecting shipment of goods to the buyer. As a result, it is necessary that the exporter's documents conform to the terms and conditions of the letter of credit; otherwise the buyer may exercise his right to instruct the bank to not to accept the documents, which are deemed to be discrepant (Hashim, 2013). He further discusses that in addition to the buyer and seller, the issuing bank also benefits from the application of the principle of strict compliance in letters of credit. The bank shall be protected against any legal repercussion as long as the payment to the exporter was effected based on strict compliance of the shipping documents. This is irrespective of the condition or the quality of the consignment received by the importer. According to CGFS (2014) data from the ICC trade register suggest that the default and loss rates for trade finance products are very low, at least for the largest banks in the world. While the mean default rate per transaction across short-term trade finance products for the period 2008-2011 is 0.02%, the related loss rate is 0.01% on average; thus, implying the rationale for the worldwide acceptability of trade finance products .

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

This chapter of the research paper presents the methodology that was employed by the researcher to conduct the study, to select the sample, to collect and analyze data used to assess the practice of international banking service provided to traders on private commercial banks in Ethiopia.

3.1 Research Design and Approach

According to Creswell (2009) research design are plans and the procedures for research that span the decision from broad assumption to detailed methods of data collection and analysis the selection of the research design based on the nature of the research problem or issue being addressed. Research designs simply the framework of the study based on the research techniques or methods. In line with the objective of the research, this is to make an assessment of the existing practice and challenges of international banking service provided to Traders of private commercial banks; this study employs descriptive research design. According to Kothari (2004) the major purpose of descriptive type of research is description of the state of affairs as it exists at present; the main characteristic of this method is that the researcher has no control over the variables; he can only report what has the practice and challenges and how to mitigate such challenges. In order to achieve the main objective of this research, the study used mixed methods approach.

3.2 Data Type and Source

To obtain data concerning the practices and challenges of international banking service of private commercial banks, the researcher used both primary and secondary data sources for the study. The primary data was collected from selected bank managers, senior bank officer through questionnaires by setting self-administered question in person and semi-structured interview. On the other hand, secondary sources of data namely banks' annual reports were used to gather data on the volume of trade service products and various literatures written on issues related to the topic.

3.3 Research Instrument

As noted by Kothari (2007), surveys are concerned with describing, recording, analyzing and interpreting conditions that either exist or existed; surveys are only concerned with conditions or relationships that exist, opinions that are held, processes that are going on. Accordingly, the survey method has been employed in the study which comprises of questionnaires and interviews.

A questionnaires was developed in line with the objective of the study to measure to assess the international banking service practice in Ethiopian private commercial banks and compare its performance against International standard banking practice set out by the International Chamber of Commerce (ICC) and the regulation of National Bank of Ethiopia (NBE) at the same time and measure the level of bank staff on international banking service knowledge. Questionnaires were used as the main instruments to collect data methods, hoping that it may provide an opportunity for obtaining reliable and valid information from large number of respondents.

3.4 Population and Sampling Techniques

A sample consisting of IBS department division managers, relationship managers, senior international bank officers, and officers from each private commercial bank on the basis of purposive sampling technique. As a result, the total sample comprises 88 international banking professionals with varying levels of experience and responsibility. The mentioned sample size was determined based on data saturation.

Table: 3.1 Population and sampling of respondent

S.No	Name of Banks	No of Respondents	Years of Established
1	Awash International Bank	6 respondents in different position	1994
2	Dashen Bank	6 respondents in different position	1995
3	Bank of Abyssinia	6 respondents in different position	1996
4	Wegagaen Bank	6 respondents in different position	1997
5	United Bank	6 respondents in different position	1998
6	Nib International Bank	6 respondents in different position	1999
7	Cooperative Bank of Oromia	6 respondents in different position	2005
8	Lion International Bank S.C	6 respondents in different position	2006
9	Oromia International Bank S.C	5 respondents in different position	2008
10	Bunna International Bank S.C	5 respondents in different position	2009

11	Zemen Bank	5 respondents in different position	2009
12	Abay Bank S.C.	5 respondents in different position	2010
13	Berhan International Bank	5 respondents in different position	2010
14	Addis International Bank	5 respondents in different position	2011
15	Debub Global Bank	5 respondents in different position	2012
16	Enat Bank	5 respondents in different position	2013

As far as data collection procedure is concerned, first contact was made with the administrative affairs head of the banks. In addition after informed consent was obtained the researcher contacted the employees including department manager and officers of the bank. After that, the participants have been informed the aim of the research. Moreover, semi-structured interviews were conducted, through telephone and in person, with 8 international banking division managers from all private commercial banks. The results of the interview helped the researcher to verify and supplement the data obtained from the questionnaires.

3.5 Methods of Data Analysis

The researcher used descriptive statistics for data analysis. Thus, the questionnaires that were answered and retrieved were coded, analyzed and presented with the help of frequency tables. To this end, the researcher employed the SPSS software (Version 20) in processing and analyzing the data.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

This chapter presents the output of data analysis. The presentations are in the form of tables, graphs, percentage and statements. The presentation is according to the objectives of the study.

Semi-structured questionnaires were distributed to 88 international banking professionals from private Commercial banks out of which 80 could have been dully filled out and returned implying response rate of 90.91% as depicted on Table 4.1 below.

Table 4.1 Number of Questionnaires Distributed and Returned

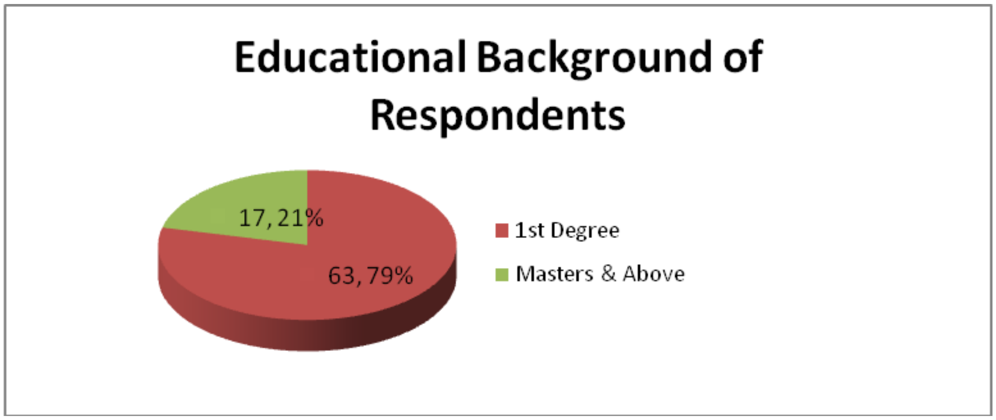
Position	Number of questionnaires distributed	Number of questionnaires returned	Approximate Percentage (%)
Division Managers	16	14	87.50%
Relationship Manager–Trade Service	18	15	83.33%
Senior International Banking Officers	26	23	88.46%
International Banking Officers	28	28	100%
	88	**80**	**90.91%**

Source: Own survey (2017)

In addition, semi-structured interviews were conducted with 8 international banking division managers and the results have been consolidated with the data obtained from the questionnaires and presented in detail.

4.1 Respondent's Demographic Characteristics

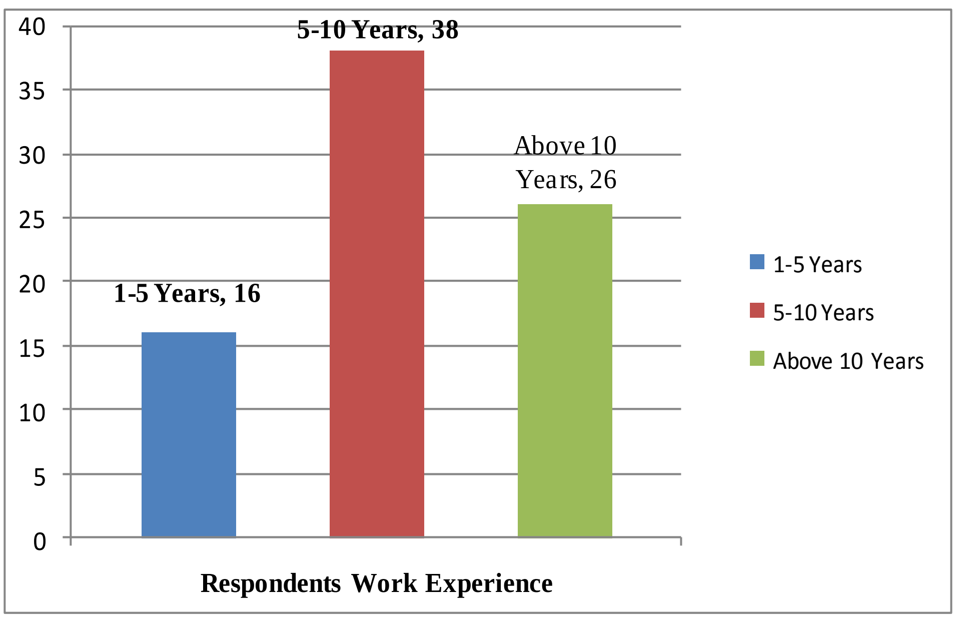
The data was solicited from banking professionals with diverse demographic characteristics. The first part of the questionnaire consists of demographic information of the participants. The variables include: sex, educational background, working experience and office positions which are summarized and presented as below.



Source: Own survey (2017)

Figure 4.1: General Information about Respondent

As depicted on figure 4.1, out of the 80 respondents, the majority which are 63 in number, (79%) had attained 1st degrees while the remained 17, (21%) had earned Master's degree



Source: Own survey (2017)

Looking into their working experience, 48% of the respondents had service years of 5 to 10 years, while 32% of them had working experience more than 10 years, only 20% of respondents have had service years of less than 5 years.

In terms of their positions, 36.25% had managerial positions, namely division managers, and relationship managers in their respective banks, while 63.75% were still professional staff comprising of senior and intermediate international banking officers

4.2 General International Banking Service Issue

Under Part II of the questionnaires, issues related to general international banking service was raised and the responses are summarized as per their respective title as follows.

The result of the survey as reflected in table 4.2 Suggest that major respondents agree there is no well managed service and effective internal controls to monitor overall foreign exchange operation with regard to foreign exchange transaction made timely with highly secured technology and the banks permit foreign currency for its traders on the basis of bank interest only like who have diaspora account and retention account instead of satisfying customer of first come first served basis. Similarly, interview responses also show that banks do not usually effective internal controls over international banking service operation. So, National bank of Ethiopia had created a database for centralized to manage trader's foreign currency request for first come first served basis and also control customers do not use multiple request for all banks.

Table 4.2: General International banking service issues

1- Never 2- Rarely 3- Sometimes 4- Often 5- Always

N= number of respondents, %=approximate percentage

Issues	1		2		3		4		5		TOTAL
	N	%	N	%	N	%	N	%	N	%	
International banking department provides foreign exchange service promptly	0	0%	8	10%	39	49%	22	27%	11	14%	80
Foreign currency operation of your bank are being performed efficiently	12	15%	31	39%	11	14%	12	15%	14	17%	80
The foreign exchange transaction made timely with	6	7%	40	50%	26	33%	8	10%	0	0%	80

highly secured technology											
The employees are highly responsible and accountable in foreign exchange service provision	0	0%	8	10%	14	17%	38	48%	20	25%	80
The employees have necessary skills in foreign banking service	0	0%	12	15%	20	25%	34	42%	14	18%	80
There is effective internal control system to monitor and control overall foreign exchange operation of traders	0	0%	46	58%	20	25%	14	17%	0	0%	80
The bank permit foreign currency for its Traders on the basis of first come first served than for those who have diaspora account and retention account	0	0%	36	45%	25	31%	8	10%	11	14%	80

Source: Own survey (2017)

4.3. Compliance Issue with International (UCP600 and URC522), Domestic Standards and Foreign exchange Directives Ethiopia

International Standard Banking Practice for the Examination of Documents under Documentary Credits (ISBP), ICC Publication 645 has evolved into a necessary to the UCP for determining compliance of documents with the terms of letters of credit. It explains how the practices articulated in UCP 600 are applied by documentary practitioners. (International Chamber of Commerce, 2006). A total of 6 questions on most relevant to assess the international banking service practice in Ethiopian private commercial banks and compare its performance against International standard banking practice set out by the International Chamber of Commerce (ICC) and the regulation of National Bank of Ethiopia .

Table 4.3: Compliance Issue with International (UCP600 and URC522), Domestic Standards and Foreign exchange Directives Ethiopia

1- Never 2- Rarely 3-Sometimes 4- Often 5- Always

Issues	1		2		3		4		5		TOTAL
	N	%	N	%	N	%	N	%	N	%	
The bank established line of authority and responsibility for its international banking services to comply with international standards like UCP and URC.	7	9%	9	11%	35	44%	16	20%	13	16%	80
Foreign exchange procedures meet the necessary standards of accuracy, promptness and completeness	0	0%	15	19%	19	24%	34	42%	12	15%	80
The bank follows international Standard Banking Practice (ISBP) when examining documents of traders.	0	0%	20	25%	17	21%	32	40%	11	14%	80
NBE is good enough in supervising foreign currency operation activities of the bank.	0	0%	0	0%	18	22%	0	0%	62	78%	80

Outstanding purchase orders approved are within manageable limit. (to secure the bank's liquidity in foreign currency)	33	41%	26	33%	21	26%	0	0%	0	0%	80
The approved foreign currency payment made as per the international practice within acceptable time limit.	15	19%	46	57%	19	24%	0	0%	0	0%	80

Source: Own survey (2017)

Out of the 80 respondents, majority of them the banks not frequently reported that managing and report to compliance, in most or all of the time, they take into account Article No. 6-42 (General Principles) of the ISBP when examining documents and determining whether the documents have discrepancy or not. Banks are not properly managing the level of approved purchase orders (which are prerequisites for documentary collections) since the National Bank of Ethiopia does not consider approved purchase order as liabilities to the banks. According to the NBE directive, on Open Position, (which is a daily report on the foreign currency assets and liabilities of the bank), only letters of credit are considered as liabilities of the bank. As a result, banks are having difficulty in allocating or reserving foreign currency needed for settlement of documentary collections.

4.4. Operational Problems and Malpractices the banks are facing on Foreign Currency Utilization

From the information by table 4.5 banks is not generating sufficient foreign currency through export and remittance to meet their demand. The major challenges banks are operating under scarce foreign exchange condition. Such situation create competition for this scarce resource among customer and caused their dissatisfaction for unfair treatment best of result in corrupt practice at worse if the process is not guided by clearly defined procedure and not enforced accordingly. This in turn result in loss of customer and reputation which ultimately culminate in significant financial loss to the bank.

On a related issue, the survey results show that in most of the cases the banks faced foreign currency liquidity problem when handling the settlement of documentary collection because too much purchase order have been approved in excess of the foreign exchange earning capacity of the banks. Delaying of payments for these international transactions may affect correspondent banks relationship.

Table 4.4 Operational Problems and Malpractices the banks are facing on Foreign Currency Utilization

Where, 1- Strong Disagree 2-Disagree 3-Neutral 4- Agree 5- Strong Agree

Issues	1		2		3		4		5		TOTAL
	N	%	N	%	N	%	N	%	N	%	
Foreign currency generated through export, remittance and other source does not meets the bank expected plan	0	0%	0	0%	20	25%	44	55%	16	20%	80
The bank generates insufficient foreign currency to meet the demand for customers(demand/supply)	0	0%	0	0	16	20%	16	20%	48	60%	80
The bank does not have a well-organized in foreign currency generation scheme	0	0%	7	9%	12	15%	42	53%	19	23%	80
The bank lacks transparency in foreign currency allocation/utilization	6	7%	10	13%	36	45%	20	25%	8	10	80
The bank does not have a dedicated staff/ committee assigned to mobilize foreign currency	12	15%	26	32%	42	53%	0	0%	0	0	80
The Bank has foreign currency liquidity problem when handling the settlement of documentary collection	0	0%	0	0%	0	0%	62	77.5%	18	22.5%	80
The bank has poorly developed foreign currency manual so as to deal with all aspect of foreign currency management process	22	28%	13	16%	30	38%	15	18%	0	0	80

The banks, foreign currency polices and procedure have limitations that facilitate misuse of foreign currency	3	3%	10	13%	16	20%	45	56%	6	8%	80

Source: Own survey (2017)

4.5 Issue Related To Risk Area of International Banking Service

With regard to foreign currency demand is more than supply most of the respondents replied that this problem addressed all private banks. Similarly, (20%) of respondents admitted that only infrequent do banks effect payment to the remitting bank automatically once the buyer takes up the documents. Likewise, results of the interviews indicate that , in most of the cases, payment to the remitting bank under documentary collections are delayed up to two or three months after settlement by the importer.

Table 4.5: Percentage distribution: Risk area of International Banking Service Measurement

Risk area Measurements	Frequency	(%)
Foreign currency demand is more than supply	18	22.5%
Delay of payments for traders in international transaction	16	20%
Malpractice regarding to foreign currency request for traders	10	12.5%
Unfair treatment of traders	6	7.5%
Corrupt practice in the utilization of foreign currency	22	27.5%
Lack of trained manpower in managing foreign currency	8	10%
Total	80	100%

Source: Own survey (2017)

One important issue raised, during the interview and under the open-end questions on the issue of documentary collections, is that banks are not properly managing the level of approved purchase orders (which are prerequisites for documentary collections) since the National Bank of Ethiopia does not consider approved purchase order as liabilities to the banks. According to the NBE directive on Open Position, (Which is a daily report on the foreign currency assets and liabilities of the bank) only letters of credit are considered as liabilities of the bank. Banks are only allowed to hold excess foreign currency up to the equivalent of 15% of their paid capital; any excess holding above that limit shall be sold out to the NBE or other banks. As a result, banks are having difficulty in allocating or reserving foreign currency needed for settlement of documentary collections. In fact, one interviewee recommended that at least 20% of outstanding purchase orders should be included in the open position report so that banks may be able to allocate some foreign exchange for the settlement of related documentary collections.

On the other hand, 12.5% and 7.5% of the respondents responded positively to the question either malpractice foreign currency request or unfair treatment risky practice for the bank. In a similar manner, most of the respondents reported that corrupt practice is also major risk area of the banks due to the stiff competition between these banks for foreign exchange request that makes ensure transparency in handling customer request.

4.6. Issue Related To Employee Commitment & Knowledge Factor

The respondents were asked to assess the degree of bank employees' familiarity with the mechanism of trade service, Uniform Rules for Collection, Uniform Customs Practice for Documentary Credits and the directive of the National Bank of Ethiopia. On average, the level of familiarity is only moderate. High staff turnover among the experienced professionals was cited, during the interview, as one of the reasons for the lack of international banking staff with sufficient job knowledge. The interviewees further indicated that training is not sufficiently provided to the international banking staff periodically.

Table 4.6: Rating: Employee Commitment & Knowledge Factors

Employee Commitment & Knowledge Factors	Frequency	(%)
I am committed to serve customers to their utmost satisfaction	18	22.5%
Good quality service has a positive effect on perceived value of the international banking service	13	16.25%
Our bank knowledge transfer through formal procedures	12	15%
I consider that employee knowledge as an organizational	15	

asset and not their own source of strength		18.75%
I clearly understand NBE directives & International Standard Banking Practice (ISBP)	15	18.75%
Our bank give training continually to fill knowledge gap of the staff	7	8.75%
Total	80	100%

Source: Own survey (2017)

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

This chapter presents summaries of the study findings as per the study objectives, conclusions based on those findings and recommendations which are based on both the study findings and other relevant literature considered necessary and vital to be used in future to improve the study situation.

5.1. Summary of Findings

The broad objective of the study was to make a critical Assessment of International Banking Service Practices Provided to Traders by Private Commercial Banks in Ethiopia in order to shed light on risk areas, identify problems, expose malpractices and indicate instances of non-compliance with international standard banking practices. In line with the objective of the research, which is to make an assessment of the existing international banking service practice of private commercial banks the researcher have the above major findings:

- Banks do not generates sufficient foreign currency through export and remittance to meet there demand. The major challenges banks are operating under scare foreign exchange condition. Such situation create competition for this scare resource among customer and caused their dissatisfaction for unfair treatment best of result in corrupt practice at worse if the process is not guided by clearly define procedure and not enforced accordingly. These in turn result in loss of customer and reputation which ultimately culminate in significant financial loss to the bank.

- In the same manner, banks are not properly managing the level of approved purchase orders (which are prerequisites for documentary collections) since the National Bank of Ethiopia does not consider approved purchase order as liabilities to the banks. According to the directive on Open Position, (which is a daily report on the foreign currency assets and liabilities of the bank) only letters of credit are considered as liabilities of the bank. As a result, banks are having difficulty in allocating or reserving foreign currency needed for settlement of documentary collections.

- On the other hand, it is found that most banks do not comply with the directives of the National Bank of Ethiopia and the international standard practice in terms of: checking the delinquent status of the customer, creating awareness among the customers of the need to submit proof of entry of goods to the NBE, making sure that the final documents are in line with the import permit or the purchase order, checking for the validity of the pro-forma invoice, taking into account international standard banking practice ISBP guidelines when examining documents.

- The degree of employee commitment and knowledge issue international banking personnel with trade service area (according To respondents) is found to be only moderate owing to the relatively high staff turnover in the banks and due to the lack or insufficiency of training on trade service practices.

Conceptual gaps in the following areas need urgent attention:

1) The mechanism of trade payment methods,
2) Uniform Rules for Collection,
3) Uniform Customs Practice for Documentary Credits and
4) The relevant directives of the National Bank of Ethiopia

5.2. Conclusion

The study, which was a descriptive type of research and which employed the survey method of data collection namely, interview and questionnaires, has enabled the researcher to come up with several findings discussed above. Based on the results, the author concludes the following:

The Existing Practice comply with International (UCP and URC), domestic standards and Foreign exchange directives:

Article 4 of the URC 522 states that banks are only permitted to act upon the instructions given in such collection instruction, and in accordance with these Rules. Banks will disregard any instructions from any party/bank other than the party/bank from whom they received the collection. Nevertheless, these finds suggest that, due to a lack of awareness of the uniform rules for collection, most bankers take action on the collection documents based on instruction received from the drawee and at times contrary to the collection instructions of the remitting bank. To illustrate, most collection instructions request the presenting bank to inform the remitting bank by SWIFT the reasons for non-acceptance of documents by the drawee before simply returning the collection documents at the instruction of the drawee. However, seldom do banks' inform the remitting bank of non-acceptance and request for further instruction.

Failure to seek instructions from the remitting bank in case of non-payment and failing to advise the remitting bank of the fate of documents can deteriorate correspondent banking relationships.

Article 26 of the URC 522, states that the presenting bank should endeavor to ascertain the reasons for non-payment and/or non-acceptance and advise accordingly, without delay, the bank from which it received the collection instruction. In contrast, the findings suggest that rarely do the banks send advice of non-payment or non-acceptance to the remitting bank in a timely manner. Such malpractice amounts to non-compliance with the international banking standard which eventually destroys banking relationships

The criticality of challenges encountered is too difficult to manage:

Those banks there is no well managed service and effective internal controls to monitor overall foreign exchange operation with regard to foreign exchange transaction made timely with highly secured technology and the banks permit foreign currency for its customer on the basis of bank interest only like who have Diaspora account, exporter instead of satisfying customer of first come first served basis.

Banks are not properly managing the level of approved purchase orders (which are prerequisites for documentary collections) since the National Bank of Ethiopia does not consider approved purchase order as liabilities to the banks. According to the directive on Open Position, (which is a daily report on the foreign currency assets and liabilities of the bank) only letters of credit are considered as liabilities of the bank. As a result, banks are having difficulty in allocating or reserving foreign currency needed for settlement of documentary collections.

Risk Areas with respect to trade service products

Trade payment methods like the documentary collection and the cash-in-advance expose the trade partners to different risks. For instance, the buyer may refuse to take up the documents sent under a documentary collection after shipment of goods has already been effected; thus, the seller might face the risk of non-payment. On the other hand, a buyer who has effected payment under the cash-in-advance method might end up losing his money if the seller turns out to be a dishonest one and fails to ship the goods as agreed. It is apparent that Ethiopian businessmen engaged in the import and export business are being exposed to risks of non-payment and non-performance by their trade counterpart due to a lack of awareness of the advantages and disadvantages of trade payment methods.

Issue related to employee commitment & knowledge factor

From the research that has been carried out, due to a relatively high staff turnover among the bank staff and the insufficiency or in some cases the lack of periodic training, the level of the job knowledge of most international banking staff is below what is considered sufficient.

Most of the malpractices and instances of non-compliance of banks, however, result from the lack of sufficient job knowledge. More than sufficient job knowledge among the staff is required in order for the bank to avoid such malpractices and violation of local and international standards and regulations.

5.3. Recommendation

Based on the findings and conclusions, the following recommendations were forwarded to alleviate or at least minimize the operational problems, correct the malpractices, avoid instances of non-compliance with standards and regulations, mitigate some of the risks and fill the Conceptual gaps.

Bank should be set up or commissioned specifically for the purpose of carrying out the exercise in to minimize malpractices

the bank examine the types and scope of existing offences and relate these to existing malpractices, with a view to suggesting the creation of new offences where desirable or the expansion or modification of existing ones.
International banking practitioners should be reminded that documents presented under a letter of credit are to be checked for discrepancy immediately and any discrepancy should be notified to the presenting bank within 5 banking days.

Bank should carefully design and well managed to internal controls over international banking service operation with regard to foreign exchange transaction made timely with highly secured technology and the banks permit foreign currency for its customer on the basis satisfying customer of first come first served basis. Banks also should properly manage their assets and liabilities in foreign exchange so that they will not face liquidity problems upon settlement of letters of credits and documentary collections.

Similarly, the National Bank of Ethiopia should revise its Open Position directive in such a way that banks would be allowed to account for 100% their outstanding approved purchase orders as liabilities. In this way, banks can reserved the necessary foreign exchange necessary for the settlement of the related documentary collections. Finally the researcher recommends periodic training should be provided to the international banking department personnel on the mechanism of trade payment methods, Uniform Rules for Collection, Uniform Customs Practice and on the relevant directives of the National Bank of Ethiopia.

APPENDEX I: Questionnaire

St. Mary's University

School of graduate studies

Department of BUSINESS ADMINISTRATION

MBA Program

Questionnaire for the ''Assessment of International Banking Service Practice Provided to Traders": The Case of Private Commercial Banks in Ethiopia

Dear respondent,

The following questionnaire is a research instrument on the **Assessment of Practice and Challenges of International Banking Service Provided to Traders: The Case of Private Commercial Banks in Ethiopia.** The research is being conducted only for academic purpose. I assure you that your responses will be kept confidential. You are not expected to write your name. Any information obtained in connection with the study will remain strictly confidential.

The quality of this research highly depends upon the genuineness of the answers you provide to this questionnaire. I, therefore, humbly urge you to give your honest and accurate responses.

Researcher Zelalem Hailu Fufa

Contact Address

Mobile no; 0917440576

E-mail zelalemhailu27@gmail.com or hailuzelalem91@yahoo.com

Thank you very much for your significant contribution to the accomplishment of the research.

- **Name of the bank………………………………………**

Instruction: -

- Please don't write your name
- Put " √ " mark as per the questions required in the box or answer in the space provided
- In case you have any question please, contact my cell phone and email address

Part one: Personal Background

1. Sex 1= Male □ 2= Female□
2. Educational Background Diploma □ Degree□ Master and above□
3. Work experience(Yeas)

1-5 □ 5-10 □ More than 10 □

4. Position 1=Division Manager □ 2=Relationship Manager □ 3= Senior Foreign Officer□ 4=Officer□

Part two: **T**his section is designed to collected relevant information regarding to **General International Banking Service and Compliance issue with international, domestic standards and directives**. Please, check "√" and rate yourself honestly based on what you are actually do given the statement using the following scales:

1= Never 2= Rarely 3=Sometimes 4= Often 5= Always

I. General International Banking Service questions

No	Description	1	2	3	4	5
1	International banking department provides foreign exchange service promptly					
2	Foreign currency operations of your bank are being performed efficiently.					
3	The foreign exchange transaction made timely with highly secured technology					
4	The employees are highly responsible and accountable in foreign exchange service provision					
5	The employees have necessary skills in foreign banking service					
6	Employees are committed in foreign banking service provision.					
7	There is effective internal control system to monitor and control overall foreign exchange operation of traders					

8	The bank permit foreign currency for its traders on the basis of first come first served than for those who have diaspora account and retention account.					

II. Compliance issue with International (UCP600 and URC522), domestic standards, and foreign exchange directives of Ethiopia

No	Description	1	2	3	4	5
1	The bank established line of authority and responsibility for its international banking services to comply with international standards like UCP and URC.					
2	Foreign exchange procedures meet the necessary international standards of accuracy, promptness and completeness					
3	The Bank follows International Standard Banking Practice (ISBP) when examining documents of traders.					
4	NBE is good enough in supervising foreign currency operation activities of the bank					
5	Outstanding purchase orders are approved within manageable limit. (to secure the bank's liquidity in foreign currency)					
6	The approved foreign currency payments are made as per the international practice within acceptable time limit					

Part three: this section is designed to collect relevant information regarding Major **challenges of foreign currency utilization and issues related to Risk area of International Banking Service.** Please, check "√" and rate yourself honestly based on what you actually do given the statement using the following scales:

1- Strong Disagree 2-Disagree 3-Neutral 4- Agree 5- Strong Agree

III. Operational Problems and Malpractices the banks are facing on foreign currency utilization

No	Questions	1	2	3	4	5
1	Foreign currency generated through export, remittance and other source does not meet the bank expected plan					
2	The bank generates insufficient foreign currency to meet the demand for customers(demand/supply)					
3	The bank does not have a well-organized foreign currency generation scheme					
4	The bank lacks transparency in foreign currency allocation/utilization.					
5	The bank does not have a dedicated staff/committee assigned to mobilize foreign currency					
6	The Bank has foreign currency liquidity problem when handling the settlement of documentary collection					
7	The bank has poorly developed foreign currency manual so as to deal with all aspect of foreign currency management process					
8	The bank's foreign currency polices and procedure have limitations that facilitate misuse of foreign currency					

IV. Risk area of International Banking Service

No	Questions	1	2	3	4	5
1	Foreign currency demand is more than supply					
2	Delay of payments for traders in international transaction					
3	Malpractice regarding to foreign currency request for traders					
4	Unfair treatment of traders					
5	Corrupt practice in the utilization of foreign currency					
	Lack of trained manpower in managing foreign currency					

Part Four : **T**his section is designed to collected relevant information regarding to **employee commitment and knowledge of trade service staffs** Please, check " √ " and rate yourself honestly based on what your actually do given the statement using the following scales:

1- Strong Disagree 2-Disagree 3-Neutral 4- Agree 5- Strong Agree

V. Employee Commitment, competency & Knowledge Factors

No	Questions	1	2	3	4	5
1	I am equipped with the necessary skills of service e provision for traders					
2	I do have and maintain a good quality of service delivery, which has a positive effect on perceived value of the international banking service					
3	I clearly understand the objectives of our bank on international trading and committed for its achievement.					
4	I am ready to take customers feedback , comment and suggestion on my service provision'					
5	Our bank knowledge transfer through formal procedures					
6	I consider that employee knowledge as an organizational asset and not their own source of strength					
7	I clearly understand NBE directives & International Standard Banking Practice (ISBP)					
8	Our bank gives for the staff a training continually to fill knowledge gap of the staff on the area of international banking service for traders.					

Finally please write your opinion to solve the above problem

1 What possible remedial solutions do you propose in order to solve the above mentioned risk area of international banking service.

____

____

____

____.

2 Do your bank have foreign currency liquidity problem when handling settlement of letter of credit and documentary collection?

Yes □ No □

3 If your answer for Q. 2 yes what is your suggestion to solve delaying of payments for international transactions?

____

____

_______________________________________ .

Thank you very much

Appendix II

Interview Questions for Managers

Part I

1. Do you have the practice of effective internal controls to monitor foreign exchange operation?
2. Do you make a close follow up the bank foreign currency request, utilization at the same time settlement?
3. What challenges, problems, malpractices and instances of non-compliance with NBE directives and international standard practice do you observe with regards to international banking service?
4. What mechanism do you employ to see that the total outstanding purchase orders approved are within manageable limit in order to secure the bank's liquidity in foreign currency?
5. How do you assess the level of job knowledge of employees at the International Banking Department especially with regards the mechanism of trade payment methods, Uniform Rules for Collection, Uniform Customs Practice for Documentary Credits, and the directive of the NBE?
6. What possible remedial solutions do you propose in order to solve risk area of international banking service?
    - Foreign currency demand is more than supply
    - Delay of payments International transaction
    - Malpractice regard to foreign currency request
    - Unfair treatment
    - Corrupt practice
    - Lack of trained manpower in the sector

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