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EFFECT OF TRADE FINANCE OPERATION ON FINANCIAL PERFORMANCE OF COMMERCIAL BANK OF ETHIOPIA

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DECLARATION

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

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ENDORSEMENT

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

Mesfin Tesfaye (Phd.)

Advisor　　　　　　　　　　　　　Signature

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Samrawit Alemu

ACRONYMS/ABBREVIATION

AIB ……………………………………………….Awash International Bank

BOA ………………………………………………Bank of Abyssinia

CBE ………………………………………………Commercial Bank of Ethiopia

CBO ………………………………………………Cooperative Bank of Oromia

DB ……………..Dashen Bank

DBE ……………………………………………….Development Bank of Ethiopia

EIU ……………………………………………….The Economic Intelligence Unit

FDI ……………………………………………….Foreign direct investments

GTP ……………………………………………….Growth and Transformation Plan

IMF ……………………………………………….International Monitory Fund

LIB ………………………………………………..Lion International Bank

NIB ………………………………………………..Nib Bank

OIB ………………………………………………..Oromia International Bank

UB ………………………………………………..United Bank

WB ………………………………………………..Wegagen Bank

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ABSTRACT

The purpose of this study was to determine the impact of trade finance operation on the financial performance of Commercial Bank of Ethiopia as representative of the commercial banking industry. Its objectives were to describe the trade finance revenue streams of the Bank and establish the relationship between the dependent variable i.e. return on asset and the independent variables,Fees and commission, interest income, Foreign exchange trading income and capital adequacy as moderating variable. Descriptive and explanatory research designs were used and the target population comprised on Commercial Bank of Ethiopia. Data was collected from reports of the CBE spans from 2006 to 2021 for sixteen years of the Bank's operations. The data was analyzed using the Statistical Package for Social Sciences (SPSS) version22. Descriptive and inferential methods helped incoming up with statistical results from the quantitative data. The findings revealed that interest income, non-interest income and foreign exchange trading income had been increasing over the years although there were slight fluctuations. The total Capital and the total assets had also been increasing over the years although there have been slight fluctuations. There was a strong, positive and statistically significant relationship between fees and commission, interest income, foreign exchange trading income with return on asset of Commercial Bank of Ethiopia. It was concluded that income sources of trade finance, that is, foreign exchange gain were key in enhancing the financial performance of CBE. The study recommends that trade finance operation shall give further attention to SME and micro customer to further leverage the performance of the Bank.

Key Words: Return of Asset, Bank Performance, Trade Finance, Small and Medium Enterprises.

CHAPTER ONE

1. Introduction

Financial intermediaries such as commercial banks, have a very vital part in the economic growth of a country (Memmel&Raupach, 2010). Commercial Banks are the key contributors of economic growth globally (Cavusgil, Knight, Riesenberger, Rammal, & Rose, 2014). They play a vital role of economic development by collecting savings from entities that have idle surplus fund. Commercial banks also render loans to entrepreneurs starting businesses, give direct loans to the government, provide managerial advices to small-scale business men, and provide payment services to their clients.

The economic development of any country is pegged on the activities of the commercial banks in the country. The banking sector globally serves both surplus and deficit units by channelizing a variety of services. As a country's economic backbone, bank performance can generate spillover effects on different sectors (Ongore&Kusa, 2013). Understanding the factors influencing performance of these banks is crucial in mitigating any eventualities of economic instability.

According to Malouche (2009), trade finance cannot be dismissed in the business world. When banks cannot give out loans, organizations seek credit from other firms in partnerships such as open account transactions and cash-in advance arrangements. Such arrangements are risky and banks only seek them because they lack other options. For instance, the cash-in-advance partnerships have constraints related to liquidity and the ability of the firm to grow and make profits. In a similar way, the open-account arrangement is hard to get as sellers view it as too risky since they are expected to offer their buyers goods on credit. This is why organizations turn to financial intermediaries to request for trade finance.

Some intermediaries include development banks and export promoting firms. Trade finance given by the intermediaries is often given off-balance sheet and often in the form flow of funds among corporations and their stakeholders who largely utilize credit facilities for capital injection, social economic development, financing operations, and capital investments (Mann, 2000). Trade finance offers better financial returns and benefits to the banks (Olsen, 2011). The trade finance business segment has remained a key segment in the generation of revenue for banks worldwide. For most banks, trade finance is a cash cow, a flag ship segment, and the largest originator of promissory notes, guarantees, bills of exchange, and letters of credit (Nguyen, VO, & Nguyen, 2015). There is no different scenario from the banking industry in Ethiopia. The industry plays a pivotal role of facilitating the treasury business, trade finance, and customers' loans and advances. As trade finance is becoming extremely competitive, banks need to place more emphasis on its relationship with financial performance (According to Global Enabling Trade Report (2014)).

1.1. Back ground to the Study

One of the coherent ways to create and improve trade finance is by creating alliances between or among countries that accept the exchange of products. Such alliances result in better relationships among nations despite differences in the economic growth, location, and trade in those countries (Azeez, Dada, &Aluko, 2014).To harness this, there is need for better relations among global players and for setting up of policies to encourage such relations. In United Nations Conference on Trade and Development (UNCTAD) is the most vital organization that speaks for trade and that can result to global growth and sustainable investments (Mishkin&Eakins2006). With the existence of the trade relation, banks provide importers and exporters with trade finance. Such finances are normally linked to request for purchases or the provisions of other information that relates to the trade at hand(Committee on the Global Financial System,2014).Trade financing enables organizations to improve their production quantities, buy capital assets, and open up new locations in other countries(Manova, 2013).

Globally, there is a movement to come up with global agreements that can help reach sustainable development goals that are mostly anchored on trade (Amiti& David,2011). This has been informed by the needs – there will always exists an unmet need for a service or product since nations are endowed differently and they specialize in the production of different products. Therefore, trade between countries enables them to get what they cannot produce (Vijayasri, 2013). Different factors inform this trade including the global financial crisis of 2007-2010 which affected national, regional, and international financial institutions (Shelburne, 2010). According to Vijayasri (2013), developed and developing nations are concerned with their trade positions and this informs their assets, capital, and capabilities that they use to champion economic growth (Vijayasri, 2013).

Karolina and Matej (2011) noted that trade finance income makes part of the key income among the banks. In an environment where banks are expected to charge low interest on their loans, trade finance has become more popular and preferred among the banks. Many banks get a high income from fees and since this is the largest on-interest income for banks, they have a hard time maintaining a fixed fee.

On the other hand, financial performance is deduced by quantifying the rate of change in the state of the firm in financial terms or the change in outcomes due to decisions made by the firm management (Dang, 2011).

According to Levine (2013), financial performance is the financial well-being of a firm over time. Factors responsible for a firm's financial performance can be grouped into internal or bank-specific, and external or macroeconomic specific (Al-Tamimi & Hassan, 2010).

The Ethiopian banking sector has been stable and has weathered many storms in the past few years. The sector is supported by supervisory and regulation initiatives and reforms in the country. In the past six months, the financial activities of the commercial banks operating in the nation has depicted considerable

Achievements from varies performance measure parameters. The major event is three full-fledged banks joined the industry raising the number of banks 21. NBE report (2021) disclosed that the annual average saving interest rate stood at 7 percent and the lending interest rate gone to 14.5 as the same period. Similarly, the total bank branches 7,344.

These 19 commercial and government policy banks mobilized a total deposit of Br. 1.35 trillion at the end of June 31, 2021. At the same time Commercial Bank of Ethiopia contributed 54.3 percent of the total industry deposit resources. The outstanding loans and advance balance of the commercial bank's lending reached Br. 1.28 trillion.

The share CBE from the total lending stood at 55.2 percent widening the gap from the rest of private commercial banks operating in the industry (NBE 2021). On the other hand, the trade balance of the country recorded negative balance of USD (10.3) billion as of June 30, 2021. The export sector performance was about USD 3.6 billion and the import operation stood USD 14.2 billion. Most of the trade finance operations were undertaken by Commercial Bank of Ethiopia.

1.2. Statement of the Problem

Banks and other firms in the financial sector are facing an unpredictable business environment characterized by the changing customer needs, many delivery choices, technological changes, and innovative products. However, in Ethiopia the banking sector has remained resilient despite the many changes. The sectors profit before tax rose to Br. 40 billion in 2021 (NBE 2021). From gross profit, Commercial Bank of Ethiopia earned BR. 20 billion as the same period. Whereas there has been improvement in commercial banks financial performance across the years, it is not clear whether this has been due to increase in trade finance in terms of fees and commission, interest income and foreign exchange trading income; hence, the need to carry out this study. Few studies have been carried out in regard to commercial banks in Ethiopia. Majority of the banks get the largest part of their income from loan interest payments but in recent years, more banks are choosing to also focus on non-interest income (Adugna, 2013). Though there is sharp increase in revenue from interest has seen, banks fall short on trade finance among other incomes to supplement their income in an effort to stabilize bank operations and also make them profitable (Hirut, 2019). Trade finance revenue is less susceptible to recessions, which may lead to loan delinquencies and losses. Trade finance revenue therefore helps in offsetting losses brought by interest income and therefore banks need to rely on trade finance income sources to diversify their revenue sources (Kahuthu, 2016). Thus it is important for commercial banks to focus on increasing trade finance in terms of fees and commission, interest income and foreign exchange trading income as a means of enhancing their financial performance. Muhammad, Amin, Anderson, and Chong (2015) studied the challenges Islamic banks were facing related to international trade and noted that banks not only play a role in the form of an intermediation but also as a partner in the business venture. However, the above was a global study and focused on the challenges facing banks financing international trade. Kelemu (2016), he focused on the effect of trade finance on the performance of Ethiopian commercial banks and noted that fees, commissions, transaction, resulted in increased return on assets. However, the current study focused on the financial performance of commercial bank of Ethiopia and used return on asset as the measure of performance. It is the researcher's view that the current study is timely to fill the research gap that exists by focusing on the effect of trade finance on the financial performance of commercial bank of Ethiopia.

1.3. Research Questions

1. What is the impact of trade finance revenue of Commercial Bank of Ethiopia on its performance?
2. What was the moderating effect of capital adequacy on the relationship between trade finance and financial performance of Commercial Bank of Ethiopia?
3. What was the overall relationship between trade finance and financial performance of Commercial Bank of Ethiopia?
4. What was the role of trade finance operation on financial performance of Commercial Bank of Ethiopia?

1.4. General Objective of the Study

The purpose of this study was to determine the effect of trade finance operation on financial performance of Commercial Bank of Ethiopia.

1.4.1. Specific Objectives of the Study

1. To evaluate the impact of trade service commission income on the overall performance of Commercial Bank of Ethiopia
2. To determine the impact of interest, fees and charges realized from trade finance operation on performance of Commercial Bank of Ethiopia.
3. Analyse the impact of other income earned from trade finance operation on the performance result of Commercial Bank of Ethiopia.
4. To examine the role of moderating variables (Capital Adequacy) on the performance of Commercial Bank of Ethiopia.

1.5. Significance of the Study

The policy makers would find this study and its findings important as they might come up with the right monetary and fiscal policies to enhance and facilitate trade finance in commercial banks. This is because the relationship between trade finance and commercial banks' financial performance, which in turn stimulates economic growth, has not been clearly established as few studies have focused on the same.

Through the policy makers, facilitating trade finance will not only improve the financial performance of the commercial banks, but also stimulate economic growth.

The study might act as a wake-up call for banks to determine their non-interest and interest income and how this affects their day-to-day operations. This is because banks need to focus on other means to raise their revenue apart from focusing on the interest income. The study would enable the commercial banks to identify ways in which they can take advantage of offering other services that can give them added non-interest income leading to improved financial performance.

The study might offer valuable contribution to theory and practice. The findings of this study might help in filling empirical literature gaps by bringing to the fore the association between trade finance and financial performance of Ethiopian based commercial banks. The study also adds on the literature by Muhammad et al. (2015) and Kahuthu (2016) who determined how trade finance relates with financial performance. The research study further contributes to the financial practice and trade finance theory.

1.6. Limitations and Scope of the Study

According to Orodho (2004), limitations are the restraints or hitches, both theoretical and practical that a researcher has little or no control over. These dynamics constrain on the generalizability of the findings. The study used secondary data from the National Bank of Ethiopia reports. While the data is verifiable since it came from National Bank of Ethiopia, but it does not mean it cannot have its challenges or errors. The study used four variables, that is, fee and commission , interest income, foreign exchange trading income; moderating variable (capital adequacy), implying that it over looked other variables that enhance the financial performance of commercial banks.

1.7. Organization of the Study

The thesis is organized as follows. Chapter I which is introduction of the work presents the background of the study, the research question, and objectives of the study, justification, scope and limitation of the study. Chapter II review the various literatures on determinants of bank competition that are relevant for the study. Chapter III looks at the research methodology and Key variables of the study are also defined. Chapter IV presents analyzes and discusses the results. The final chapter V presents the summary of findings, recommendation and conclusion are presented. In this chapter, the researcher presents the findings of the study and its attendant implications and suggests the direction for future research.

1.8. Definition of Terms

Trade finance; represents the financial instruments and products that are used by companies to facilitate international trade and commerce.

Bank performance generally refers to improvement in share price, productivity, profitability or current value in banking (Jeon& Miller, 2006)

Internal determinants of bank profitability can be defined as those factors that are influenced by the bank's management decisions and policy objectives

External determinants of bank profitability are concerned with those factors which are not influenced by specific bank's decisions and policies, but by events outside the influence of the bank

International trade is an exchange involving a good or service conducted between at least two different countries. The exchanges can be imports or exports.

A commercial bank is a for-profit financial institution that accepts deposits, offers loans and provides other financial services to its customers

Methods of payment represent the defined form of how the payment shall be made, i.e. on open account payment terms through a bank transfer, or through documentary collection or letter of credit

Terms of payment defines the obligations of both commercial parties in relation to the payment, detailing not only the form of payment and when and where this payment shall be made by the buyer, but also the obligations of the seller.

Source: Commercial bank of Ethiopia, Manual 2014 E.C

CHAPTER TWO

2. LITERATURE REVIEW

2.1.Introduction

This chapter reviews literature pertinent to the subject of study. It covers the theoretical framework and the trade finance activities of commercial banks in Ethiopia. Additionally, it covers the moderating impact of macroeconomic variables on the association between trade finance and financial performance of Commercial Bank of Ethiopia and the impact of trade finance on financial performance of CBE. The conceptual framework is also presented in this chapter.

2.2. Theoretical Framework

A theoretical framework tries to give an explanation on the phenomenon under review. In addition, theories test and broaden the available knowledge within given assumptions (Kombo & Tromp (2016). The theoretical framework in this study consists of four theories including the Keynesian economic theory, modern portfolio theory, McKinnon and Show theory, and a quantity theory of money.

2.3. Financial Liberalization Theory

Financial liberalization theory originated from studies done by McKinnon (1973) and Shaw (1973). Saving as explained by McKinnon is important as it helps one have money for future investment and growth. In growing markets, there are savings that are made but these savings are managed poorly. Since these growing markets are far apart their investments are not as productive. The accumulation of capital is not something that is encouraged as inflation rates in these markets are high. What this means is that the nominal interest rates are low and interest rates are so low becoming even negative. The banks do not have enough capital and they only deal in the provision of credit services. This means that entrepreneurs have to look for their own means to fund their projects or seek help from the informal financial providers whose interest rates are too high (Maghyereh, 2002).

According to McKinnon (1973), financial liberalization results in unified markets and the one strategy that works is to leave interest rate to fluctuate on its own. This results in interest rates being a reflection of the lack of capital and cost of information among the borrowers. If interest rates rise, then low yielding projects would be closed down. Thus, it is advisable that authorities stop manipulating the interest rates to enable the growth of the financial sector. McKinnon (1973) and Shaw (1973) noted that financial repression influences the allocation of savings to investments and this also impacts the savings returns. It also impacts the investments and savings equilibrium level. Thus, the quality and quantity of investment is negatively affected as banks will not provide funds according to the marginal productivity of investments but will use their own means to do so. This results in stagnation of the financial sector. Since deposits do not give savers good returns, savers are compelled to hold their money in form of assets rather than hold savings in banks. On the other hand, when banks are required to have high reserves, the bank supply of loans is restricted and the allocation of loans is also affected (Dietrich &Wanzenried,2011).

McKinnon (1973) and Shaw (1973) advised for a liberalized financial market in which the free market determines the allocation of credit, allowing the interest rate to adjust itself to an equilibrium level where savings and investments are balanced. This would do away with low returns investments and leading to improved investment efficiency. The theory was adopted in this study since financial liberalizations lead to unified financial markets in which allocation of loans is determined by the free market. The free market facilitates trade finance, which in turn enhances the financial performance of commercial banks through increased fees and commission, the interest income, trading income, and foreign exchange income. The financial liberalization theory was relevant in this study as it advocates for a free market and thus helped in establishing the objective of the study, that is, the effect of trade finance on financial performance of Commercial Bank of Ethiopia.

2.4. Transaction Cost Theory (TCT)

Transaction cost theory was proposed by two Nobel laureates Coase and Oliverin 1937. The two authors sought the reasons for firms' existence and why firms try to seek the help of external partners or try to expand. TCT looks at complex transactions which are characterized by risks are recurring and the players have made commitments that if reversed would lead to a high loss for the parties involved (Hagstrom, 2001).According to the theory, firms try to keep the losses incurred during exchange of resources with the environment at a minimum and try to minimize the bureaucratic costs incurred in-house during the exchange. Therefore, international traders compare the costs incurred during exchange of the resources with the environment and in house.

In case the external exchange costs are higher than the internal costs, the firm is likely to grow as its operations was less expensive (Coase&Oliver,1937). According to this theory, the markets and the firms are two different parties with different ways of coordinating and organizing transactions. In case the environmental costs are more than the in-house bureaucratic costs, the firm is able to grow as its operations are cheaper compared to the costs incurred externally. However, when the internal costs are higher than the environmental exchange costs, the firm is likely to down size and the promotion and international trade activities are then performed by banks (Dietrich&Wanzenried, 2011).

The costs incurred by the firm due to transacting with the external players are reflected by the core assets of the firm, bounded rationality, risks, opportunism, and environmental uncertainty. Such factors lead to a rise in transaction costs as the firm finds it hard to control such factors. Thus, it is cheaper for the firm to maintain the transaction in-house such that it saves its resources rather than using them incoming up with contracts with external players. Thus, in case the firm detects that the environmental uncertainty was high; it may choose not to seek external partnerships with external players such as banks. It may also choose to do the exchange transactions in-house (Diamond &Raghuram, 2000). The TCT guided the study on how banks operate in setting realistic prices for their international business services such as foreign exchange rates and charges to international payment transactions and thus helped in explaining the objective of the study, that is, the effect of trade finance on financial performance of commercial banks in Ethiopia.

2.5. General Literature Review Trade Finance

Banks that want their businesses to be sustainable and competitive in the international trade must be willing to minimize their cost, maximize their profit and successfully deal with all the currency, political, financial, and economic risks in the market. Trade financing helps to deal with one such challenge of financing. It helps investors access the financing needed for trade and commerce activities needed for the movement of products from the buyer to the seller (Kanyeke, 2014). According to Silber and Udell (2006), this source of revenue has become more important in recent times as banks are more inclined towards non-interest sources of income often referred to as fee-income. Banks prefer such sources of income because their growth is more significant compared to interest-income.

2.6. Fees and Commission or Non-interest income

Many commercial banks give loans to customers. Lending is the largest source of revenue for many of these banks. Thus, it carries the highest risk when it comes to the stability and soundness of the bank. Risks include the laxity in loan standards, loan portfolio challenges, weak economy, and poor management of the portfolio's risk (Hagstrom, 2001). If the bank is to maintain its soundness, it must be willing to effectively manage its loans portfolio. In emerging countries such as Ethiopia where the capital markets are still developing, lending is one of the core businesses performed by commercial banks. In many such economies, Ethiopia included, provision of loans has faced a lot of difficulties and controversy (Maghyereh, 2002).Portfolio managers who are doing a good job concentrate on ensuring that they follow the required process in loan approval and that they manage these loans effectively. Although such processes are important, many loan portfolio managers fail to include past credit history of the customers requiring loans (Maghyereh, 2002). Past credit risks and challenges including those observed in agricultural, commercial real-estate, and oil and gas loans given in the 1980s has put attention to the need of these managers to minimize risks (Reilly & Brown, 2011). Conventional practices emphasize on seeking credit quality measures such as risk rating, nonaccrual, and delinquency. Banks have come to realize that such measures are used as a means of giving banks enough time to make needed choices when the risk rises (Gaitho, 2010). Due to the rise in interbank costs, commercial banks have sought alternative sources of revenue. Commissions and fees are one of the low-cost ways used by banks to seek for alternative income and resources. This is a preferred source of income as ithas minimal risks compared to the income provided through lending of loans (Kirimi,2012). Commercial banks have come up with different means to help them mobilize resources. One such means is the use interest-free savings accounts to lure customers. Other banks provide discounts and giveaways to encourage customers to save with them. Banks are a higher insolvency risks if they hold impaired or toxic assets. Increase toxic assets of banks push the quality asset their profitability to decline. There is an inverse association between toxic assets and capital and any change in capital will affect bank profitability (Kipkirui,2015).

So as to bridge the gap existing in the banks' liquidity, banks lend to other banks and form inter-firm relations and markets. Unfortunately, many of these banks do this without considering the credit worthiness of other banks and this exposes them to toxic assets. If the credit is managed effectively from the start to the end of the repayment period, the bank is able to improve its profitability, get the expected returns and reduce toxic assets. Banks can seek financing by seeking funds from equity or from applying for loans. However, raising of capital from equity holders is costlier compared to use of customer deposits (Dowling, 2006). If lending is a significant service offered by a bank, the growth of deposits should see a rise in loan supply since the deposits acts as additional financing for the banks (Al-Tamimi&Hassan, 2010).

The demand for credit has increased due to growth of businesses and investments by both individuals and institutions, which means that banks ought to increase their deposits. A bank that lends to an individual or institutions does so with the expectation that it will get a good return in terms of interest income. Deposits are often the main source of financing which banks use to offer loans. Deposits are also the core source of commercial banks' profits and growth (Mahendra, 2002). Through the use of deposits, banks are able to make profits. Thus, depositors can be said to be the financiers and the disciplinarians of banks. According to Maria and Sergio (2001), depositors discipline these financial institutions by withdrawing their deposits in case the banks charge interest rates that are too high. Depository institutions such as credit banks act as financial intermediaries and aim to make big profits that can increase the shareholders' value. They achieve this goal by encouraging depositors and using these deposits to invest in profitable portfolios.

2.7. Foreign Exchange Trading Income

The foreign exchange market is used to trade international currencies. Financial institutions globally act as the intermediaries for many traders buying and selling each minute. The foreign exchange market acts as the determiner when it comes to the value of different currencies. Their biggest customers are firms that seek to exchange their local currencies to other currencies so that they can buy goods and services. Most firms trade small values compared to speculators and banks. The former impact on the market is short term. However, ensuring that trade flows flawlessly is crucial in the determination of the currency exchange market direction (Ariemba, Kiweu, &Riro,2015).

Exchange rate is an important variable of trade. When the exchange rate keeps on fluctuating then balance of trade cannot be achieved. Exchange rates that are volatile causes destabilization in trade and capital movements. Countries with high foreign exchange volatility are unlikely to get foreign investors investing in their markets as the investors will not have confidence in the said countries. The result is slow economic growth for such countries (Heckman, 2003). Sustained and high economic growth ofany nation is influenced by the macroeconomic policies that are aimed at making the economy stable. One of the instruments that help in stabilizing prices and managing an economy is the exchange rate. This rate is an influencing factor when it comes to spending and making investment decisions (Heckman, 2003).

Competition on the global scene is tight and this has also led to a high demand and supply of foreign exchange services. Foreign exchanges transactions are bound to rise as international transactions increase and banks have an opportunity to make more money as they are the major providers of foreign exchange businesses. The foreign exchange rate is the rate used in currency exchange for another currency (Razi, Shafiq,&Khan,2012). It is how much one currency costs provided in another nation's currency. The exchange rate is made up of the domestic and foreign currency and it's provided directly or indirectly. When it comes to direct quotation, the cost of one unit of the foreign currency is provided in terms of the domestic currency. When the quotation is indirect, the domestic currency price per unit is expressed in terms of the foreign currency. If the exchange rate does not have the domestic currency as one of the currencies, the rate is called cross rate or cross currency (Dowling, 2006).

The foreign exchange market is international and focuses on the trading of foreign currencies. Some of the services offered include buying, selling, and exchange of currencies. This market is the largest globally and its main players are large global banks. Financial institutions globally are the facilitators of trade among domestic and international traders. Trading happens every minute so banks cannot be substituted in this market. The foreign exchange market is not the determinant of the values of the foreign currencies but provides the value of one currency relating to its demand in the market (Kajirwa, 2002).

Kirimi (2012) explained that the exchange rate is one of the tools used to bring adjustments to an economy. This is also one of the major debatable and challenging economic tools. The researcher also argued that a fall in the exchange rate only protects the economy if its production costs are increasing at a lower rate than the depreciation rate and the imported equivalent prices rises by the same amount as that of depreciation. Ongore and Kusa (2013) argued that this rate determines the price of products in different nations and this allows for price comparison. When the exchange rate is fluctuating, it impacts a country’s exports and imports since it affects the relative prices of domestic goods and services. As global trade grows, foreign exchange demand and supply also rises. This results in increased foreign exchange transactions which presents an opportunity for banks to make more profits as they are the largest players in the foreign exchange market.

It is without doubt that foreign exchange is a major source of trade globally. Banks are important service providers in this market as they provide finances and foreign exchange services to traders involved in both domestic and international trade. Change in the foreign exchange markets affect banks since they are key players in foreign exchange transactions (Nyokabi, 2018). The banking sector in any economy is an important player in the provision of finance and foreign exchange services. Thus, banks are a key part of the foreign exchange market and the monetary system in any economy providing the transmission and exchange of domestic and international currency (Nyokabi, 2018).

Internationally, transactions in foreign exchange are an important aspect of bank operations and are linked to the difference in countries’ exchange rates. Thus, banks have given great importance to services that are characterized by currency swaps by having a unit that oversees all the foreign currencies’ activities. This is crucial in ensuring that operations among merchants go on without hiccups while also enabling this market to become an enabler of economic growth and one of the largest sectors that facilitates the balance of payment (Razi et al., 2012).If it is to achieve its goals as one of the sector facilitating economic growth, Sansui (2012) noted that the banking sector must play its role of being a mediator between customers and finances and ensure that individuals and firms gain access to financing that can help in ensuring domestic and international trade.

2.8. Capital Adequacy

Capital adequacy helps determine how well a bank can meet its risks and liabilities (Archer & Haron, 2013).

It protects the bank against potential risks and losses and ensures that the depositor's savings are safe (Poudel, 2007). Capital is regarded as adequate when the bank has enough capital that it can absorb losses and the assets of the bank are enough to cater for future expansions and current operations (Jagirdar, 1996). A bank that has adequate capital should be able to fund the regulatory amount and the capital ratios required for the business operations to continue. The funds should also be enough so that the bank can operate safely, retain the people confidence in the institution in spite of losses, and buy the needed infrastructure to ensure that it does not close down (Farag, Harland, &Nixon, 2013).

Capital adequacy ratio (CAR) helps to determine the capital adequacy of an organization. It is expressed as the total capital of the bank as a percentage of the risk weighted assets (Wanjohi & Njeru, 2016). Capital can be grouped as tier 1 capital, which can absorb the bank losses without the need to stop the banks operations. Tier two capital is the capital that takes care of the losses in case the bank is wound up and thus gives the depositors protection against losses of investment. The assets owned by banks differ in risk and their weighted risk is different (Jagirdar, 1996). CAR helps to adjust for less risky assets by allowing the discounting of assets that are low risk. Capital adequacy is related to how well a bank can stand in times of crisis. It also affects the bank's profitability as it helps provide the institution's ability to expand to risky but profitable investments (Hasan, Rana, & Islam, 2019).

Commercial banks' capital adequacy can be quantified in terms of log of total assets (LTA), loans to assets, loan loss provisions to total loans, tax to operating profit before tax, non-interest income to total assets, over head expenses to total assets, shareholders' equity to total assets, and total revenue to employees (Otwani, Simiyu, &Makokha, 2017).

Ogboi and Unuafe(2017) indicated that capital adequacy favorably impacted the profitability of banks, but loans and advances were established to negatively impact profitability. Thumbi (2013) noted that capital adequacy, working capital ratio, and credit risk had a direct relation with the bank size. Thumbi's study also came to the conclusion that capital adequacy is positively correlated to banks' working capital. A study by Reruand Bichanga(2015) showed a favorable and strong correlation between capital adequacy and bank performance. This is a confirmation that it is important for banks to meet the regulations put up by the Central Bank of Ethiopia as these regulations; especially those that touch on capital favorably impacted the banks performance.

2.9. The Effect of Trade Finance on Financial Performance

Win (2015) indicated the importance of trade finance to banks as follows: It helps the bank in achieving product diversification through provision of different and many products and therefore gives it a competitive advantage against its competitors. Since trade finance products do not take lengthy processes as the main loan products, it provides a avenue for short-term financing opportunities and also boosts the achievement of the bank's lending targets. The provision of trade finance products also enables banks to obtain off-balance sheet revenues from the transactional charges levied on trade finance products. This helps the composition and distribution of the bank's assets. According to Marc (2017), the confirmation of documents by banks is assure way of helping banks to minimize risks and that makes it a cheaper method of landings incest does not expose the bank to un necessary risks.

Rasaq (2013) noted that trade finance's role cannot be ignored especially when it comes to facilitation of international trade and the competitiveness of different countries' currencies. Trade finance is vital to the banking sector as banks get a lot of revenue from commissions, foreign exchange, and fees from foreign exchange services. Reviews of foreign exchange services offered by banks indicate that the financial institutions in a bid to make profits focus on change in rates (Babazadeh & Farrokhnejad, 2012). Thus, banks are able to gain revenue from foreign exchange transactions by taking advantage of volatility in exchange rates. The variations in this rates lead to speculation among investors as they expect that the exchange rate will improve. Focusing on the maturity of the currency denominations of the economy's liabilities and assets, extremely volatile exchange rate can lead to low cash at hand and lead to high impact on balance sheet activities (Babazadeh & Farrokhnejad, 2012).

The profitability of banks based on their exchange rate transaction is determined by a myriad of factors. Some of these factors are internal or specific to a particular bank, while others are external or macroeconomic factors that are in form of regulations and legislation. The external factors are based on the economy behavior and include GDP, inflation rate, interest and exchange rate (Karl, Ray,&Shannon,2009). Exchange rates have an impact on profitability and interest rates.

The impact on profitability is indirect as it affects the bank through the cost of funds available to be loaned (Owoeye & Ogunmakin (2013).

When it comes to profitability that comes from foreign exchange transactions, banks focus on buying low and selling high, and on the fees, commissions, and interests that come from these transactions. Ojo and Alege (2014) noted that the exchange rates affect prices of goods and services directly and this impacts on resources' allocation for the short term.

According to the Central Bank of Ethiopia, the rise in exchange rate is as a result of the differences in interest rate, especially among developed and developing economies. The former has benefited from the almost zero policies from growing economies. There is a need to understand the role played by the change of currencies and foreign exchange to the economy and inter-firm relationships who are active in the foreign exchange market (Babazadeh & Farrokhnejad,2012). Banks are important in the foreign exchange transactions as they act as financial brokers and monitor any changes in the exchange rates which results to profitability if banks take good advantage of these changes. Razi et al. (2012) explained that businesses that have foreign direct investments are likely to have greater profitability during changes in exchange rates and their risks and uncertainty increases if they have foreign investment. According to Wong and Leung (2016), losses that are incurred in foreign exchange transactions are due to fluctuations in the rates and can be detrimental to many banks' operations as they cause great losses and closure of banks. Banks that want to make profits need to let their managers and bankers learn the trade finance concepts and how these affect the foreign exchange operations. They should also determine how the fluctuations in foreign exchange rates impact their revenue and reserves so that they can determine amount of risk they can take in order to maximize their profits and shareholders' returns. The fluctuations in exchange rates affects the competitiveness of the domestic market in comparison to the foreign market, and results in risks and uncertainties in both the local and international market. There is hence need for bankers to look into the risks and uncertainties seriously. Because of incurring losses from fluctuations in foreign exchange rate, many countries have at onetime come up with reforms related to exchange rates and have taken up different systems in an effort to sustain their economic growth (Bakare,2011).

2.10. Empirical Literature Review

Paul (2015) study focused on the Dhaka Bank foreign trade instruments: Costper click (CPC) trade operations in Bangladesh. Some of the bank products included foreign trade financing, cooperate banking, Islamic banking, SME banking, and consumer banking. The conclusion made by this study is that the effective use of foreign trade financing and other instruments, abiding to the set rules and regulations, and constant monitoring of the bank's operations has led to efficient and effective trade activities and has resulted in strong relations between the trade parties leading to continuous provision of trade financing by the bank. It was also shown that in the future, the trade operations related to CPC will greatly influence the Bangladesh economy as it will ensure that there is inflow and outflow of other currencies in the economy. However, the above study was a global one and was limited only to foreign trade instruments and it did not link their effect on financial performance, whereas the present study sought to examine the effect of trade finance on financial performance. Garralda and Vasishtha (2019) used novel data to determine the determinants of trade financing intermediated by banks. The data was sought from 10 banks. The research looked at both the influence of country-specific and international factors on trade financing. The outcomes of the study showed that factors that were specific to a given country such as availability of funds to banks; the development of trade flows, and international factors, that include the growth of imports globally, and the financial conditions in the globe all determined the growth of trade finance. The outcomes were shown to depend on the model specification. The study also noted that trade financing was highly affected by international financing factors compared to other bank activities. The current research's focus was on trade financing.

Ramli, Latan, and Solovida (2019) studied the determinants of capital structure and firm financial performance from Malaysia and Indonesia. The data analysis approach used was a component-based semi-equation modeling (SEM), where the partial least squares-structural equation modeling (PLSSEM) method was selected. The results showed that capital structure determinants directly affected firm financial performance. The Malaysian sample had a positive significant correlation between firm leverage and firm financial performance. The results also showed that firm leverage played a mediating role in Malaysia but not for the Indonesian sample. The asset structure, growth opportunities, liquidity, non-debt tax shield, and interest rate are the attributes that were indirectly influenced by firm leverage on firm financial performance (Ramlietal.,2019). The coefficients in the determinants of capital Structure and firm financial performance were significantly different between Malaysia and Indonesia. However, the above study wasa global study and its focus were on capital structure while the current study was on the effect of trade finance on financial performance.

Ugwuegbe and Ugwuoke(2016) looked at the influence of foreign exchange activities on the Nigerian banks' performance. The study used a regression model based on pooled panel data and estimation focused on ordinary least square (OLS) method. According to the findings, income from foreign exchange unfavorably impacted the banks' financial performance. The conclusion made was that the banks sampled did not focus too much on the revenue from foreign exchange to remain relevant and profitable in their operations. The study recommended that central banks among other regulatory institutions should put up regulations to see that banks do not makeover the top premiums from foreign exchange transactions. The study also found out that that the bank's assets have a favorable association with the bank's profitability. Thus, a conclusion was made that banks should ensure that they build their assets since building of assets leads to increased profits for these financial institutions. Nevertheless, the above study was a regional study and was limited only to foreign exchange activities and it did not look at other aspects of trade finance activities, whereas the current study sought to examine the effect of trade finance on financial performance. While analyzing the effect of corporate governance on the financial performance of commercial banks in Ghana, Owiredu and Kwakye (2020) used a random effect model to analyze the data. The results established foreign ownership had a positive relation with performance.

Nthenge and Ringera (2017) studied the effects of trade finance on the financial performance of banks, a case of Family Bank Limited. The targeted population was 66credit supervisors of Family Bank limited, one from each branch. Stratified sampling method helped select 33 credit supervisors. On the effects of letters of credit (LC) on the financial results of banks, it was evident that the LC affected the banks' performance. This was evidenced by the high asset value, liquidity, and earnings recorded. This was also evidenced by the increased revenues that the bank made from offering letters of credit. The lack of additional collateral/security was a main hindrance to access of most trade finance products. Though, the above study was a local study its focus was only on the letters of credit as trade finance revenue and was limited to Family Bank limited, whereas the current study sought to examine the effect of trade finance on financial performance. Kahuthu (2016) determined the influence of trade finance on the Ethiopian banks' performance. The study adopted a descriptive survey and data was collected from the banks' annual reports that were submitted to the Central Bank of Ethiopia (CBE) annually. The data findings were summarized and presented in the form of regression, standard deviations, correlations, charts, and tables. The outcome of the study indicated that the fees and commission mean was higher than the mean of other variables. The standard deviation of the dividend income was the highest, while the foreign exchange transactions showed the highest positive correlation. There was also a favorable correlation for commissions and fees related to performance. The regression model led to the conclusion that a unit rise in commissions, fees, dividend, and foreign and trading income led to improved returns. The above study was a local study it did not consider other variables that had a moderating effect on financial performance of commercial bank such as capital adequacy and bank size.

Otieno (2017) studied the influence of foreign currency exchange rates on the financial performance of the banking sector in Ethiopia. The data was purely secondary, which entailed data on the external factors impacting the commercial banks and their financial performance records. The study used quantitative analysis techniques to get data on the study variables and multiple regression analysis was employed. The outcome was that exchange rates have a significant favorable influence on the financial performance of the banking industry in Ethiopia. Findings also indicated that size and interest rates also had a favorable influence on the commercial banks' financial performance whereas inflation has an unfavorable effect. The study thus concluded that the performance of the banking industry is highly influenced by the current currency exchange rates in the country. The study recommended that policies made should focus on the control and stabilization of the changes in the foreign exchange rate. Though, the above study was a local study its focus was on foreign currency exchange rates, the current study sought to examine the effect of trade finance on financial performance.

Nyokabi (2018) focused on the effect of forex trading on the Ethiopian banks' financial performance. Descriptive research design and secondary data were used. The study established that the fore trading variables investigated by the study, namely spot trades, forwards, swaps, options, firm size, liquidity ratio, and capital adequacy had been constantly changing throughout the research period. The study concluded that no stability existed in forex trading variables in Ethiopia, which may have been caused by numerous factors. This results in the banks having different levels of performance at varying periods. The study also established that fore trading variables do have significant and favorable effect on the financial performance (ROA) of the banking industry. The study recommended that the issues related to foreign exchange trading should be considered to enhance the banks foreign exchange transactions and hence performance. Though, the above study was a local study its focus was on fore trading, whereas the present study sought to examine the effect of trade finance on financial performance.

Okello and Muturi (2018) considered how non-interest income impacted the performance of Nairobi Securities Exchange (NSE) listed banks. The study used descriptive study design, regression and correlation analysis. The conclusion reached was that non-interest income favorably related to the financial performance of the listed banks. The study further concluded that the commission on advances and loans favorably and significantly influenced the performance of the banks. Another inference made was that trading income from foreign exchange significantly and favorably impacted the performance of listed banks. Yet another conclusion was that income from investment transactions unfavorably influenced the performance of the NSE listed banks. Accounts related and bank transactions incomes were further shown to favorably affect the NSE listed banks financial performance. Even though the above study was a local study, its focus was on non-interest income and was limited to NSE listed banks, whereas the present study sought to examine the effect of trade finance on financial performance.

Anachoni and Jagongo (2020) focused on short-term financing decisions and financial performance of commercial banks in Ethiopia. The study adopted a descriptive research design. The multiple regression function was used to analyze the relationship between the independent and dependent variables. The study analyzed the panel data using Pearson’s correlation and fixed effects regression.The findings were consistent with the pecking order theory which explains that companies rely on internal funds first before going for external funds (Anachoni & Jagongo,2020).However, a gap exists as the above study focused on short-term financing decisions, whereas the current study sought to examine the effect of trade finance on financial performance.

2.11. Conceptual Framework

A conceptual Framework is a diagnostic tool that diagrammatically describes the relationship between the research variables. The independent variable was tradefinancemeasuredintermsoffeesandcommissionmobileandforeignexchangetrading income. The intervening variables were inflation and GDP growth while the **dependent variable** was financial performance measured in terms of **return on asset**.

Independent Variable

Trade Finance

- Fees and Commission income , interest income
- Foreign Exchange Trading Income

Moderating Variables

- Capital Adequacy

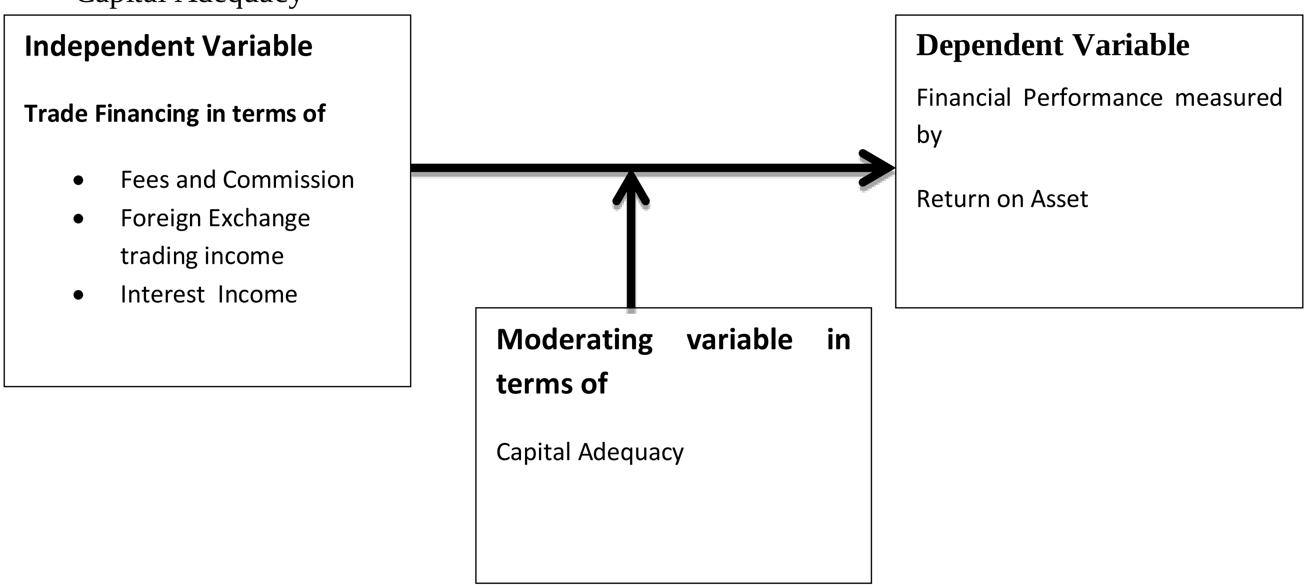


Figure2.1:Conceptual Framework

Source:Ndung'u(2020)

CHAPTER THREE

3. RESEARCH DESIGN AND METHODOLOGY

Kothari(2014) pointed out that a research design is a road map that the researcher uses to investigate the research questions in a bid to get the needed answers. Descriptive and longitude in all research designs were adopted in effort to come up with statistical conclusions on the effect of trade finance on financial performance of commercial banks of Ethiopia.

An explanatory research design was used since it enabled the analysis of various study variables at the same time. The design was also used to come up with frequency distributions, tables, percentages among the various variables and also determine the degree to which such variables are relatable. In addition, the approach will enable the researcher to determine the cause and effect nature of independent variables i.e. the interest income, foreign exchange trading income and fees and commission. The role of controlling variables was assessed from the model fitted in order to identify the variability explained by the independent variable on the performance of Commercial Bank of Ethiopia.

3.1. Population

Kombo and Tromp (2016) defined a study population as a set of elements, individuals, services households that are well defined and are under study. The population should be homogenous and studies that use population are more representative as each member of the population can be chosen to be part of the sample used. The research population was made up of 19 Ethiopian Commercial Banks (NBE report, 2021).

3.2. Target Population

Kothari (2014) notes that the target population should be characterized by traits that can be observed and which help the researcher make generalizations on. The population that is targeted for the research is 19 commercial banks operating in the country. Actually, there are two categories of banking services in the country. The first one is the usual conventional banking service where credit services are based on interest charges against principal loans disbursed to customers. The second category is the interest free banking services mainly on profit sharing concepts and approaches. The study mainly targets the conventional sector to obtain interest fees and charges over long period of time to fit regression model on relationship between the dependent and independent values.

3.3. Sampling Techniques

Sampling refers the process of selecting sufficient items from the population so that a study of the selected sample represents the population adequately (Chandran,2004). By collecting data from a sample, it is assumed that it is possible to draw a feasible conclusion about the population. The sampling method that was employed was the purposive method whereby the entire population was 19 commercial banks comprised the respondents. Purposive method is selected for the reason that the market structure of the Banking industry can be explained by single bank dominated monopoly structure. Therefore, the trade finance activities and the resulting performance of the Commercial Bank of Ethiopia can deduced to the rest of bank operating in the industry. Accordingly, the study focused on Head Quarter International Banking department for purposive data collection.

3.4. Sample Size

As put forward by Mugenda and Mugenda (2012), a sample refers to a sub-Group of the population selected to represent the characteristics of the entire population. There are around 19 banks operating in the industry. Nevertheless, Commercial Bank of Ethiopia has higher concentration of resources contributing more than 50 percent of the industry deposit and loans and advances and more than 60 percent of foreign trade financing. For this study, one big bank, namely Commercial Bank of Ethiopia-CBE is selected. Therefore, the sample size is one for aforementioned reason. On the other hand, there are around 240 employees in Head Quarter IBD department for day to day routine execution of the vast international trade facilities. For small target population size smaller than 300 it is advised to take the whole target population as survey member. Therefore, the study included the all of the staff working around in Head Officer IBD catchments.

3.5. Data Collection Instruments

According to Kombo and Tromp (2016), data is in two types of data, which are primary and secondary data. The former is that information gathered directly from respondents while the latter is the data that has already been gathered and is already available in other recordings. The study used data inform of panel data where it was collected using a data collection sheet. Data was collected from reports of the National Bank of Ethiopia-NBE and covered 16-year duration from 2006 and 2021. This duration was ideal as many changes had been observed in the Ethiopian economy that had to do with changes in the policies set up by the government which affect bank financial performance. For each of the variables the data to be collected was in quantitative form.

Data analysis helps to inspect, clean, change and model the collected data by use of analytical and logical tools to make reliable inclusions from the analysis (Bryman & Bell, 2003). Data was collected, tabulated and analyzed for purpose of clarity and analyzed using SPSS. Descriptive and inferential statistics helped incoming up of statistical information. Specifically, correlation and regression analysis was conducted. For easier comparison and analysis, tables were used to present the outcomes.

3.6. Data Sources

Due to costs associated with other collection methods and personal preferences of staff incorporated into the survey, structured questionnaire were employed to collect the data.

3.6.1. Primary Source

The researcher used the following instruments, primary and secondary data was used, the self-administered questionnaire. The questionnaires are the main primary source of data collection tools. The identified sample was served with the questionnaire directly by the researcher. To obtain quantitative data, one set of questionnaires was used for all respondents. The questionnaire is intended to be filled in by managers and trade finance experts in the department.

3.6.2. Secondary Data

In addition to primary data, secondary data was used in this study. Several books, journals, articles, annual reports, progress reports , monthly, quarterly, semi-annual and annual bulletins, magazines was used for proper data supplies. The Bank has long historical and time series data convenient for analysis purpose. The researcher intended to capture these secondary data for the purpose of analyzing the impact of trade service operation on the performance of the Bank so far.

3.7. Correlation Analysis

Correlation analysis helps determine the relation and its level between the two variables (Bryman& Bell, 2003). This analysis determines the relationship between the dependent and independent variables. Correlation values ranges from 0 to ±1.0, a value of 0 is an indication that there is no relation between the variables, when the correlation is at ±1.0 it shows a perfect favorable or perfect unfavorable relation between these variables or a perfect positive or perfect negative association (Bryman& Bell, 2007).The relationship was considered as weak when $r = \pm 0.1$ to ± 0.29, a medium relationship was between the values of $r = \pm 0.3$ to ± 0.49, $r \pm 0.5$ to ± 0.74 was strong and when $r = \pm 0.75$ and higher, the association is extremely strong.

3.8. Model Specification (Regression Model)

The regression model is in the form of panel data regression model and will include all the variables used in this study as indicated below;

The panel data regression model for this research was as shown below:

$\boldsymbol{Y_t}$**=β0 +** $\boldsymbol{X_t\beta + \varepsilon_t}$------------------------- (3.1)

Where Y_t is the dependent variable that represents financial performance of a CBE at time *t*, where *t* is the time period *t* =2011, 2021,for t = 1, 2, …., 11; X_t denotes a vector of independent variables *β* are estimated coefficients,*β0* is a constant term, and *εt* is the error term. In order to examine the effect of trade finance on financial performance of Commercial Bank of Ethiopia, the following regression model was estimated using panel data techniques:

$Y_{t=}\ \beta_{0+}\ \beta_1 x_{1t}+\ \beta_2 x_{2t}+\ \beta_3 x_{3t}+\ \beta_4 x_{4t}+\varepsilon_t$-------- (3.2)

Where: Y_t=Financial performance of Commercial Bank of Ethiopia *at* time *t* X_{1t}=Fees and commission of CBE at time *t* x_{2t} = Foreign exchange trading of a CBE at time *t* X_{3t} =Capital adequacy of CBE at time *t*

X_{4t} =Dividend income *t*

ε_t= Composite error term

β_0=Constant term

β'*s*= Coefficients of the explanatory variables and were used to estimate the effect of each of the independent variables on financial performance of CBE .Statistical significance of each coefficient was conducted using the usual t-test approach.

3.9. Diagnostic Tests

A diagnostic test in statistics helps in regression analysis to determine how valid the model is in various ways. The study undertook the following diagnostic tests; test for auto correlation, multicollinearity and normality.

3.10. Multicollinearity

This is mostly present in cases where the data used is in form of time series since variables being studied may follow a particular pattern. These variables might decrease or increase over the given duration. Multicollinearity results to in determination of the regression coefficient. Multicollinearity as well renders standard errors infinite. The degree is the key thing when measuring multicollinearity (Gujarati,2004). The researcher will employ VIF test for determining whether there is adequate and sufficient evidence that multicollinearity is present and if it is an issue of concern. The prediction for VIF is 10, that is in case the VIF value is higher than 10 or incase the tolerance is deduced to be lessthan 0.1then the model has signs of multicollinearity.

3.11. Test for Normality

In any model the error term represents the variables which are independent affecting specifically the dependent which is not part of the model. It should be having a normal distribution, constant variance and the mean being zero. It is often assumed that where there is omission of variables will have minimal impact on the dependent variable. If OLS is to be used, the error term should be deemed to be normal (Gujarati,2004). To determine that in this case the error term is abnormal or normal, the researcher used Shapiro-Wilsk test and Kolmogorov-Smirnov test.

3.12. Ethical Consideration

The following measures was undertaken to ensure the study complied with all the ethical issues. Permission was sought from the human resource department and management of CBE as well as management of the various branches was contacted for their approval and consent. The management, staff or respondents was assured of their utmost confidentiality with regards to information provided. Data obtained was treated with confidentiality. Those who participated in the study will not coerce but did so voluntarily. The consent of the respondents was obtained before they participated in the research. As a much as possible, the researcher will exercise a great deal of circumspection and objectivity throughout the research period.

3.2 RELIABILITY AND VALIDITY

3.2.1 RELIABILITY

Reliability reflects stability and dependability over time moreover; it is seen as the degree to which test is free from measurement errors. Since the more measurement occurs the less reliable the test.

Accordingly, Alpha reliability was used to measure the internal consistency of the items at the time of administration of the questionnaire. The measurement of Cronbach's Alpha is specified as number 0 and 1. Hence, Cronbach's Alpha has better consistency within items in the scale if the coefficient that closer to 1. George and Mallery (2003) provides the following rules of thumb: >0.9-Excellent, >0.8-Good, >0.7-Acceptable, >0.6-Quesstionable, >0.5-Poor, <0.5-Unacceptable (as cited in Gleam and Rosemary, 2003).

Table 3.1: Reliability Statistics

No	Dimensions	Cronbach's Alpha	Number of Items
1	Effect of International Trade Service Operations on lateral Deposit and Credit services	0.755	5
2	Trade Finance Operation contributions	0.802	5
3	Prices of trade finance operations	0.76	5
4	International trustworthiness of CBE	0.779	5
5	International trade Instruments and Income realization	0.753	5
6	Trade Finance Customers Privileges and Banks Policy	0.788	5
7	Overall Trade Finance operation on CBE Performances	0.787	2
	Average Cronbach's alpha	0.766	32

Source: SPSS Output from survey result, 2022

3.2.2 VALIDITY

Bond (2003) comments that validity important test method for researchers to measure the instrument. From the quote we can understand the trustworthiness and accuracy is core element on research study. It denotes to the suitability of the implication made about the result of an assessment inference being (Messick 1989). Secondly, validity is a matter of degree and not a specific value thirdly, validity applied for a specific purpose or use and therefore is not valid for all-purpose. Fourthly, validity is seen as a unitary concept of meaning that there is a different type of validity. Lastly, validity is apprehensive with evaluative judgment about an assessment (Gregory, 2000). Accordingly, Pilot testing distributed 6 % the questionnaire is distributed to respondents prior to the actual data collection. Valid outcomes are insured from questionnaires collected revealing measurements taken are in consistency with expected results.

CHAPTER FOUR

4. DATA ANALYSIS, PRESENTATION AND INTERPRETATIONS

4.1. INTRODUCTION

This chapter consists of the presentation, analysis and the interpretation of data gathered through structured questionnaire. The data considered in this chapter is obtained by using questionnaire instrument. In addition to this, background information of respondents is presented. Finally, the statistical methods of analysis were discussed, which included a descriptive analysis, a correlation analysis, and a multiple regression analysis through SPSS version 20.

4.2. RATE OF RESPONSE

Response rate refers to the proportion of questionnaires that were returned and filled during the study. A total of 240 questionnaires were distributed to the target respondents of which 234 aggregate questionnaires were returned which indicates the return rate is about 97 percent. But, among returned questionnaires' 2.5 percent or 6 are not usable for different reasons. Therefore, the exact number of usable questionnaires returned during the collection period is 228 which are 95 percent of the total balance. This is acceptable from several theoretical literature point of view which recommends up to 55 percent response rate.

4.3. GENERAL INFORMATION ABOUT THE RESPONDENTS

The first part of the questionnaire consists of general information about the respondents and it requested a limited amount of information related to the personal and professional characteristics of the respondents. Demographics information of the respondents was presented by gender, age, educational level, and respondent's experience. Accordingly, the following variables about respondents were summarized and described.

The general information of respondents comprises of the gender, age, work experience and position of staff working in CBE international Banking functions. Accordingly, the following summary of their area practices are presented.

Table 4.1: General information about the respondents

Gender of respondents		Frequency	Percent	Valid Percent	Cumulative Percent
	Male	130	57	57	57
	Female	98	43	43	100
	Total	228	100	100	
Age of respondents	18-22	3	1.3	1.3	1.3
	23-27	112	49.1	49.1	50.4
	28-32	85	37.3	37.3	87.7
	33-37	19	8.3	8.3	96.1
	38 and above	9	3.9	3.9	100
	Total	228	100	100	
Experience of respondents	2-5 years	6	2.6	2.6	2.6
	6-10 years	119	52.2	52.2	19.3
	11- 15years	65	28.5	28.5	47.8
	More than 15 years	38	16.7	16.7	100
	Total	228	100	100	
Education level of respondents	Technique	24	10.5	10.5	10.5
	Masters	51	22.4	22.4	32.9
	Degree	108	47.4	47.4	80.3
	Diploma	16	7	7	87.3
	Others	29	12.7	12.7	100
	Total	228	100	100	
Working Position	Non Clerical	85	37.3	37.3	37.3
	clerical	100	43.9	43.9	81.1
	Managers	43	18.9	18.9	100
	Total	228	100	100	

Source: SPSS Output from survey result, 2022

Table 4.1 above depicts that 57 percent of respondents are male and remaining 43 percent are female workers. The gap is close to each other revealing the abundance of women professional on international trade service. Similarly, staff in age group 23-28 years of age contributed about half of the function followed by of workers in the age group of up to 33. This reveals that the international trade service area is populated with relatively young workers. Experience wise, more staffs have working experience between six and ten year with percentage value of 52.2. Staff with working experience 11-15 years in IBD area accounted about 28.2 percent of the total respondents. Again, from the area experience demands, the composition of employee experience in international trade function is good blend of staff mix. From educational background prospective, the trade service office embrace necessary proportions of Masters, first degree, diploma and other lower level professional to execute the day to day routines. Fortunately, the number of first degree graduate workers is higher in it percentage share compared to other level of education contributing 47.4 percent of staff in the area followed by master level educational preparation contributing 22.4 percent. Position wise, 43 percent are clerical staff while 37.3 are non-clerical staff. The remaining staffs are managers at different managerial level. Importantly, here, we can see the international trade department is moving more to professionalism both in the educational preparedness and level of experience gained on the job practically.

4.4. CBE TRADE SERVICE CHARACTERISTICS

4.4.1. TRADE FINANCE SERVICES IN CBE

The Bank offers diversity international trade finance operation to wide customers of the Bank. As table below depicts CBE is engaged on letter of credit, trade payment guarantees and operations of availed bills though most of its operations are issuing import and export letter of credit (37.3%)

Table 4.2 . CBE Trade Finance Services

		Frequency	Percent	Valid Percent	Cumulative Percent
	Letter of Credit	85	37.3	37.3	37.3
	Trade payment Guarantees	100	43.9	43.9	81.1
	Availed bills	43	18.9	18.9	100.0
	Total	228	100.0	100.0	

Source: Researcher Analysis from Primary Data

Similarly, the bank finances more to energy and manufacturing sector relative to other commercial sector and gives priority to export of agricultural and manufacturing products.

Customers prefer Commercial Bank of Ethiopia for its services relying on it cost attractiveness, safety of international trade instruments and efficiency of these tools. Accordingly 43.9 percent of customers approach the bank to avoid risk of international trade. Significant number is also considering prices of international trade for import and export commissions.

Table 4.4. CLIENT PREFERENCE OF THE BANK					
		Frequency	Percent	Valid Percent	Cumulative Percent
	Cost Effectiveness	85	37.3	37.3	37.3
	Safety of instrument	100	43.9	43.9	81.1
	efficiency of instrument	43	18.9	18.9	100
Valid	Total	228	100	100	

Source: Researcher Analysis from Primary Data

4.5. INTERNATIONAL TRADE FINANCING AND ITS EFFECTS ON CBE PERFORMANCE

4.5.1. INTEREST INCOME EARNED AND CBE PERFORMANCES

There are junctures between international trade finance operations and domestic activities. The service efficiency of import and export financing is poor with mean score value of 2.8 and the responses concentrated at mean score value at 0.9 standard deviation dispersions. In addition, the same service is offered at longer turnaround time which affected expected income from trade financing as justified by 3.0 mean score value. On contrary, the Bank is using its trade finance operations to enhance its domestic resource mobilization from deposits. The mean score value of 3.02 is depicted supporting above average confidence of respondents which revealed that the Bank is leveraging the domestic resource mobilization operation through liked trade service financing. On contrary, the trade service operation is not capable of sustaining domestic competitive position in domestic commercial banking industry. Further, the customer base widening is not supported with the international trade financing services as it is evidenced from 2.6 mean score result with significant standard deviations to justify the dispersion.

Table 4.5. Interest Income earned and CBE Performances

	N	Mean		Std. Deviation
	Statistic	Statistic	Std. Error	Statistic
CBE Provides import and export term loans and advances at reasonably turnaround time to support domestic operations related to international trade finance operations	228	2.8114	0.06621	0.99976
CBE Provides export term loans and advances at reasonably turnaround time to boost income from related international trade finance operations	228	3.0219	0.06414	0.96842
Trade financing operation has considerable impact on domestic deposit mobilization efforts and is beneficiary of income generated from disbursing resource mobilized	228	3.0263	0.0714	1.0781
Trade financing has contribution to maintain competitive position in the industry leveraging interest income from credit services	228	3.3772	0.06271	0.94697
Trade finance operation in CBE brought increased customer base from deposit, loans and advances and digital channel operations which	228	3.6491	0.07302	1.10252
Valid N (list wise)	228			
Grand mean		3.18		

Source: Researcher Analysis from Primary Data

On the other hand, the grand mean on interest income earned and CBE performance indicates that, income generated from the interest steam leveraged the overall performance of the company at mean score value of 3.18 which is a little more than expected average mean score value of 3.0 of range taken. From theoretical background as depicted by Maghyereh, 2002, the findings are similar and the contribution of interest income is positively related with bank's performance.

4.5.2. NON-INTEREST INCOME EARNED AND CBE PERFORMANCES

The effect of international trade service is also reflected on the income earned by the Bank and ultimately the profited realized from derivative operation with trade finance. Accordingly, regarding the wallet share of export proceeds from industry performances, the CBE is not expected to maintain its position in the coming years which is justified by mean score result of 2.6 and 1.02 standard deviations. But, within the Bank income enhancement, service charge and commission income earned from trade finance operations leveraged the total income of CBE with evidence of 3.3 mean score value at 0.96 standard deviations. Again, the notion of trade financing operations are sources for diversified income streams and reliable sources of income at minimum risk is not accepted as the mean score result of 2.7 and 2.8 values.

Opposed to the theoretical narration Maghyereh, 2002, the grand mean of non-interest income earned is below expected average score value of 3.0. The result obtained reveals that the non-interest income realized by CBE is barely contributing to the performance of the Bank and moderately affecting it as a result.

Table 4. 6 .Non-Interest income earned and CBE Performances

	N	Mean	Std. Deviation
The bank takes higher wallet share of export proceeds and the trend is continuous over the coming years generating related non-interest income for CBE	228	2.6491	1.02379
Trade finance operations helped higher income from commission and service charges more than the same earned from domestic operations	228	3.2895	0.96843
The trade operation services helped the CBE to obtain diversified income stream relative to domestic operations which can be categorized as other income particulars	228	2.1404	1.01424
Trade finance operations provide reliable income to CBE continuously with less risk compared to domestic operations	228	2.7105	1.03867
The international trade finance operation helped to leverage income realized from domestic sources in different situations including non-interest income scenarios	228	2.8991	0.94024
Grand mean	228	2.74	

Source: SPSS Output from survey result, 2022

In summarization, the relationship between international trade finance operations of Commercial Bank of Ethiopia is not enhancing the domestic trade income activities as expected from theoretical background.

4.4.3 Prices of trade finance operations as proxy to performance and Capital Adequacy of the Bank

Commercial Bank of Ethiopia implemented an average level of prices during confirmation of international documents and related supplementary international trade services. In fact the mean score value of 2.3 reveals that the terms and tariffs for trade finance operations are not significantly high compared to domestic operation and relative to competitors price schemes. Nevertheless, trade finance enhanced the domestic operation interlinking the price discounts on loans and advanced disbursed in exchange to export proceeds generated during international trade finance operations.

Table 4.7 Prices of trade finance operations as proxy to performance and Capital Adequacy of the Bank

	N	Mean	Std. Deviation
CBE Confirmation pricing provided at a reasonable international level	228	2.9939	1.06467
Commission and Service Charge prices are relatively high compared to domestic operations and contributed significantly to the profitability of the bank	228	3.3991	0.90198
Existing price scheme in the international trade finance operations are helpful to promote domestic operations interlinking foreign trade operation with domestic ones.	228	3.7544	0.87109
There is considerable price waiver in some international trade finance operations which helped the bank to attract more customers who earn FCY to the bank	228	3.0746	1.01037
The international trade finance prices in CBE are relatively competitive vis-à-vis industry scheme which helped the ROA, ROE and profitability of the Bank	228	3.2763	1.0013
Grand Mean	228	3.30	

Source: SPSS Output from survey result, 2022

Similarly the income generated from international trade service with competitive price set has leveraged CBE's performance from return on asset and return on equity parameters measures. This can be justified by mean score value of 3.2 with standard deviations of 1.

As expected from the theoretical back grounded ponded by Archer &Haron, 2013, the grand mean on capital adequacy is above the mean of the range hitting as high as 3.30. The alignment of the theoretical background and the outcome of this research are similar and supported the effect of the moderating variable on total performance achievement of the Bank.

4.5.4 International trustworthiness of CBE

International trustworthiness is crucial aspect of trade finance operation in international trades. Several domestic banks were penalized for transgression of both international and national level.

Table 4.8 International Trustworthiness of CBE

	N	Mean	Std. Deviation
The Bank has strong and sound relationship with pioneer internationally banks to process payments	228	3.0439	1.06519
The Bank is trustworthy on its commitments compared to other domestic banks	228	2.6535	.99697
The bank maintained significant balance of foreign currency in correspondent banks which enhanced its profitability over years	228	3.3947	.98104
The Bank always adheres to national and international laws which avoids penalty and maintained strong reliance on its operations	228	2.8070	.94684
CBE has diversity of trade finance instruments compared to competitors in the industry	228	3.0702	1.11631
Grand Mean	228	2.99	

Source: SPSS Output from survey result, 2022

The Bank has strong and sound relationship with well-known correspondent's banks worldwide. The Bank is confirmed to have reliable and trust full payment commitments with these banks confirmed with 3.04 mean score value. As the same time, the foreign currency reserve of the Bank is sufficient and is not depleted to support trade finance operations. 3.3 means score value reveals that the balance at correspondents' banks is adequate to settle payments for which the bank is issuing bank. Further, the Bank adheres to national and international directives and acts to avoid penalties and image of the Bank.

Even though the expected outcome from trustworthiness of the Bank on international forum of trade service financing is positive, but contrary to the theoretical background, the trustworthiness of the Bank does not have positive or negative impact on the performance achievement in general as justified by the grand mean score value of 2.99 which is close to neutral mean value of 3.0.

4.5.5 INTERNATIONAL TRADE INSTRUMENTS AND INCOME REALIZATION

Form score mean value of respondents, i.e. 3.3 which much larger than average, indicates the bank is realizing improved foreign currency from export letter of credit operations. In addition, higher foreign currency proceeds is earned through documentary collections operations which in turn enhanced income generated as derivative trade finance activities.

Table 4.9 International trade Instruments and Income realization

	N	Mean	Std. Deviation
The Bank has better earning from export letter of credit as an advice bank	228	3.3026	1.05388
The Bank realize improved and relatively higher income from documentary collections and negotiations to export services	228	3.4298	.95234
Incoming transfer supported the income stream of the bank at large	228	3.2544	1.07688
The bank offers discounted bill advance to customers to attract more clients and widen customer's bases.	228	3.0132	1.05145
Grand Mean	228	3.10	

Source: SPSS Output from survey result, 2022

Incoming transfer operations also supported the income stream of the Bank channelling additional foreign currency stock which was used for resource mobilization to leverage income and profit of the Bank. In this regard, 3.2 mean score points analysed results depicted the position of the Bank to use trade finance instruments such as exchange bills or sales contract to discount and pitch credit services for domestic operations. in aggregate, the grand mean score value of 3.10 exhibits that the international trade instrument adopted in the Bank have leveraged the performance in general and the income sect of the Bank in particular indicating coherent conclusion with theoretical deduction by Babazadeh&Farrokhnejad,2012

To summarize, from research results analysed, mean score value of 3.69 was depicted supporting trade finance operation contribution to the return on asset ratio of Commercial Bank of Ethiopia. The Bank has leveraged international trade finance resources to increase its profit from the area by dedicating resources attained from international trade service operations.

The results of the analysis indicated that mean score value of 3.1 registered supporting existence real supports from trade service operation on the profitability of the Bank. In addition the mean score value of 3.1 also helps us to verify the capital adequacy of the Bank is showing sound and prudent position by the contribution of international trade finance operation at different price setups which finally supported growth in asset and capital growth of CBE.

Table 4.11. CBE Performances Results					
	N	Minimum	Maximum	Mean	Std. Deviation
Return on Asset and Return on Asset of the Bank significantly attributed from foreign operation of the Bank	228.000	1.000	5.000	3.693	0.935
Profitability of CBE highly leveraged by resources earned from international trade finance operations	228.000	1.000	5.000	3.132	1.002
Capital Adequacy of the Bank is sustainable and maintained growth pattern in the last ten years	229.000	1.000	5.000	3.118	1.072
The Bank has depicted growth in its size and increased total income generated from various operations.	229.000	1.000	5.000	3.507	0.963
Commercial Bank of Ethiopia has large customer base and the number of customers is growing at increasing rate	227.000	1.000	5.000	3.300	1.055
Grand Mean	227.000			3.3500	

Source: SPSS Output from survey result, 2022

The trade service operation also supported the Bank to increase its accessibility by branch expansion to serve trade serve operation in several places to enjoy the return of the operation at customer proximity. To summarize, the parameterized performance outcome of Commercial Bank of Ethiopia with respect to study variables revealed the achievements are visible and the grand mean score value of 3.35 also bold the underlying condition there.

4.6. Descriptive Statistics, Correlation and Regression Model

This section the data analysis exhibits the analysis related with secondary data obtained from annual reports of Commercial Bank of Ethiopia. The objective here is to show the relationship between trade financing operations and accompanied performance of Commercial Bank of Ethiopia in the past sixteen years of operation. Here, closer view is given to descriptive statistics from central tendency and dispersion of data set collected in the study period. In addition Pearson Correlation coefficient is calculated to determine existing affinity among study variables. Finally, the regression model was fitted to measure significance of relation among dependent and independent variable in presence of moderating variable i.e. capital adequacy of the Bank.

4.6.1 Secondary Data Organization

The mean, median, maximum, minimum and standard deviation of the collected data is present. Sixteen years data is collected on interest income from loans and advances, other income, gain from trade service operation, income earned from CBE investments in another companies i.e. dividends, return on asset result to measure performance of CBE and capital adequacy results as a moderating effect. In summary, interest income, other income and gain from trade service operations are independent variables. Return on asset (ROA) is the dependent variable and the capital adequacy (CA) is a moderating variable in the regression model relating the dependent and independent variables.

Table 4.12 Panel Data of CBE Financial Performance Indicators from 2006-2021

S.n	Year	Interest Income	Other income	Gain from Trade Service Operations	ROA %age	Capital Adequacy %age
1	2006	826,800,000	639,800,402	329,358,687	3.1	11
2	2007	1,036,500,000	770,449,693	454,831,763	2.7	28
3	2008	1,697,189,584	878,164,245	485,358,738	2.3	23
4	2009	2,357,879,167	985,878,796	515,885,712	3.2	14
5	2010	2,742,815,001	1,248,763,845	502,624,350	2.7	17
6	2011	4,081,381,987	1,921,814,494	990,667,018	2.5	21
7	2012	6,703,454,535	3,418,672,923	1,921,814,494	3.4	24
8	2013	9,539,165,769	3,181,395,370	1,156,912,579	3	13
9	2014	11,996,706,897	4,643,086,557	1,006,895,954	2.8	13
10	2015	16,769,723,731	4,481,511,752	1,961,819,280	2.9	13
11	2016	21,442,871,096	4,878,745,883	1,360,298,026	2.4	13
12	2017	25,977,121,538	5,445,061,042	827,034,544	1.57	28
13	2018	37,328,464,816	5,466,708,599	-3,847,440,979	1.03	30

14	2019	45,675,245,455	8,120,063,274	479,230,584	1.76	27
15	2020	53,769,762,801	14,822,203,661	-3,384,126,273	0.96	22
16	2021	65,312,958,955	16,642,213,423	1,730,792,677	1.18	21

***Source Annual** Report CBE 2006-2021*

4.6.2 DESCRIPTIVE STATISTICS

Descriptive statistics mainly focuses on measures of central tendency and dispersion of the data. On this regard, the minimum, maximum, mean and standard deviation of the panel data is presented in table 4.12. The data is smoothed in to billions of digit figure to avoid jargon of several digits layout. Accordingly, the mean value of interest income is Br. 19. 2 million at average dispersion or standard deviation value of 20.7. Similarly, the non-interest income of the study has Br. 4.8 billion proceeds in the sixteen year operation and gain from trade service finance operations has mean value of 0.406 billion.

Table 4.13 Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Interest Income	16	0.83	65.31	19.2044	20.7622
Non-interest Income	16	0.64	16.64	4.8469	4.77098
Gain From Trade Finance operations	16	-3.85	1.96	0.4063	1.65959
Return on Asset	16	0.96	3.4	2.3438	0.79945
Capital Adequacy	16	11	30	19.875	6.47945
Valid N (list wise)	16				

Source: Researches Analysis-2022

4.6.3. Correlations Analysis

Correlation analysis is a method of statistical evaluation used to study the strength of a relationship between two, numerically measured, continuous variables (Fikre et al, 2009). According to Mooi and Sarstedt (2011), the calculated value of the correlation coefficient ranges from -1 to 1, where -1 indicates a perfect negative relation (the relationship is perfectly linear) and 1 indicates a perfect positive relationship.

The correlation between dependent and independent variables along with the causal effect was analysed using Statistical Package for Social Science (SPSS). The correlation matrix indicated below shows the correlation between variables in the questionnaire with a Pearson Correlation coefficient to show the strength of the relationship among the variables considered in the study. Accordingly, it is observed that the dependent variable ROA and the other four independent variables are found to be correlated strongly though the correlation between interest income and ROA is -.853 showing the two is moving on opposite direction which is different scenario from theoretical expectations. But, gain from trade finance operation is positively correlated with ROA as expected from reviewed literature insights

Table 4.14.Correlation Analysis

		Interest Income	Non-interest Income	Gain From Trade Finance operations	Dividend Income	Return on Asset	Capital Adequay
Interest Income	Pearson Correlation	1					
	Sig. (2-tailed)						
	N	16					
Non-interest Income	Pearson Correlation	.953**	1				
	Sig. (2-tailed)	0					
	N	16	16				
Gain From Trade Finance operations	Pearson Correlation	-0.363	-0.262	1			
	Sig. (2-tailed)	0.167	0.328				
	N	16	16	16			
Return on Asset	Pearson Correlation	-.853**	.754**	.622*	.796**	1	
	Sig. (2-tailed)	0	0.001	0.01	0		
	N	16	16	16	16	16	

Capital Adequacy	Pearson Correlation	0.351	0.215	-0.403	0.404	-.583*	1
	Sig. (2-tailed)	0.182	0.423	0.122	0.121	0.018	
	N	16	16	16	16	16	16

4.7. Testes for Regression Assumption

4.7.1 Normality Test

A normal distribution is one of the importance assumed statistical procedures. Normal distributions take the form of asymmetric bell-shaped curve. The standard normal distribution is one with a mean of 0 and a standard deviation of 1 (Garson, 2012). The study employed the relevant normality tests.

As we have seen in the below figure (Figure 4), Bera-Jarque statistic has a P-value of 0.954 implying that the data were consistent with a normal distribution assumption and the assumptions of simple linear regression have been met and we can assume that the model is accurate and can probably generalize to the population.

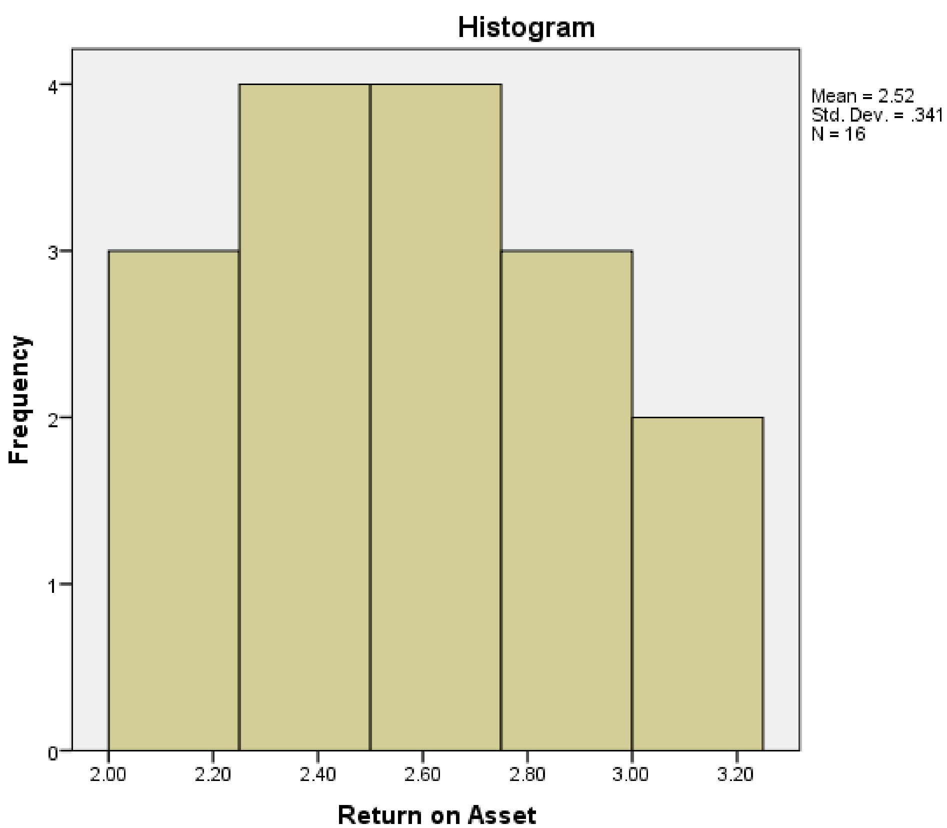


Figure 4.1: Normality Test

Source: SPSS Output from survey result, 2022

Table 4.15 Tests of Normality

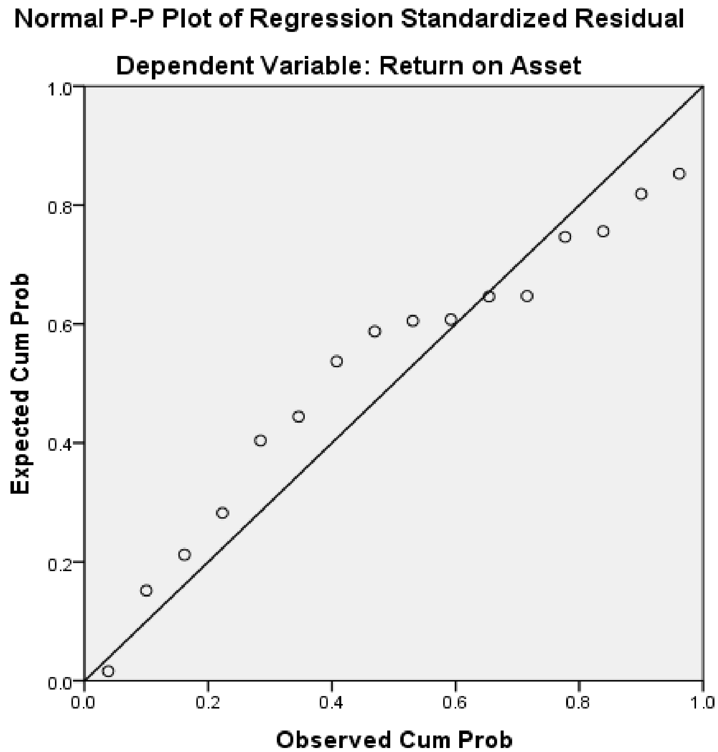
	Kolmogorov-Smirnov[a]			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Return on Asset	.209	16	.059	.954	16	.549

a. Lilliefors Significance Correction

Source: SPSS Output from survey result, 2022

7.7.2. LINEARITY TEST

Garson (2012) pointed out; simple inspection of probability plot (P-P) is a common method for determining if nonlinearity exists in a relationship. Consequently, the researcher run probability plot to see if there is a linear relationship exists between the variables.



Source: SPSS output (2022)

Figure 4.2: Normally distributed errors

The straight line in this plot represents a normal distribution, and the points represent the observed residuals. Therefore, in a perfectly normally distributed data set, all points will lie on the line (Field, 2009). Likewise, as we have seen in the above figure (figure 4.2), the dots are closely plotted to the straight line, which indicates a small or no deviation from normality and there are no extreme cases observed. Therefore, the assumptions of simple linear regression have been met and we can possibly assume that the model is accurate and can probably generalize to the population.

4.7.3 MULTICOLLINEARITY TEST

Multicollinearity is a situation where two or more explanatory (predictor) variables in a multiple regression model are related to each other and also with the response variable. (Akimande et al, 2015). If there is Multicollinearity in the model, the estimated coefficients possess large standard error, which means the coefficients cannot be estimated with great precision or accuracy (Gujarati, 2009). To alleviate this problem one or more of the correlated variables must be dropped from the model. Therefore, the study checks for the presence of Multicollinearity in the model. The collinearity statistics result for all independent variable constituents were performed on SPSS and presented as follows.

Table 4.16: Multicollinearity Test

Coefficients

	Model	Un standardized Coefficients		Standardized Coefficients			Co linearity Statistics	
		B	Std. Error	Beta	t	Sig.	Tolerance	VIF
	(Constant)	1.331	0.479		2.781	0.019		
	Interest Income	0.014	0.022	0.534	0.614	0.553	0.106	8.695
	Non-interest Income	0.042	0.094	0.378	0.449	0.663	0.1064	7.641
	Gain From Trade Finance operations	0.009	0.08	0.028	0.113	0.913	0.733	1.364
	Capital Adequacy	0.053	0.022	0.641	2.378	0.039	0.623	1.606
1	Capital Adequacy	0.053	0.022	0.641	2.378	0.039	0.623	1.606

Source: SPSS Output from survey result, 2022

The values of Variance Inflation Factor (VIF) for all independent variables or factors are less than 10 (Gareth James, 2013). Hence, there is no multi- co-linearity among independent variables. Therefore, it is possible to use correlation and multiple regression analysis.

4.7.4. MULTIPLE REGRESSION ANALYSIS

Linear regression estimates the coefficients of the linear equation, involving one or more independent variables that best predict the value of the dependent variable (Field, 2005). It includes many techniques for modelling and analyzing several variables, when the focus is on the relationship between a dependent variable and one or more independent variables. More specifically, regression analysis helps one understand how the typical value of the dependent variable changes when any one of the independent variables is varied, while the other independent variables are held fixed.

Table 4.17: Model Summary

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.740[a]	.548	.322	.43945

a. Predictors: (Constant), Capital Adequacy, Non-interest Income, Gain From Trade Finance operations, Dividend Income, Interest Income

b. Dependent Variable: Return on Asset

SPSS Output from survey result, 2022

R – Indicates the value of the multiple correlation coefficients between the predictors and the outcome, with a range from 0 to 1, a larger value indicating a larger value explained by the model and representing an equation that perfectly predicts the observed value (Pedhazur, 1982). The model summary (R = 0.740) indicates that the linear combination of the four independent variables strongly predicts the dependent variable.

R-Squared is the proportion of variation in the dependent variable which can be explained by the independent variables. The R-squared in this study was 0.548, the weighted combination of the independent variables explained in the model summary are affect approximately 54.8% of the variance of financial performance and the remaining 45.3% is by extraneous uncontrollable variables. This result also indicates that there may be other variables that could have been neglected by the current study in predicting factors affecting financial performance.

Table 4.18: Analysis of Variance

ANOVA[a]

Model	Sum of quares	Df	Mean Square	F	Sig.
Regression	341	5	468	22.424	.0109[b]
Residual	931	10	193		
Total	272	15			

Source: SPSS Output from survey result, 2022

a. Dependent Variable: Return on Asset
b. Predictors (constant), non interest income, gain from trade finance operation, interest income

ANOVA is used to assess the statistical significance of the result by testing the Null hypothesis that multiple R in the population equals 0 (Pallant J. 2005). The model of this study hence proves to be statistically significant by showing .0109 significances. The above ANOVA table shows the acceptability of the model. The p-value is less < 0.05 i.e. 0.0109. From the ANOVA table, it has been determined that F = 22.424 and Sig. is .0109 which confirms that the independent variables have a significant impact on financial performance,

Table 4.19 : Regression Coefficients

Model		Un standardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.331	0.479		2.781	0.019
	Interest Income	0.014	0.022	0.534	0.614	0.553
	Non-interest Income	0.042	0.094	0.378	0.449	0.663
	Gain From Trade Finance operations	0.009	0.08	0.028	0.113	0.913
	Capital Adequacy	0.053	0.022	0.641	2.378	0.039

Source: SPSS Output from survey result, 2022

Based on the result, the regression equation that predicts financial performance based on linear combination.

Regression Equation

Y = a + b1X1 + b2X2 + b3X3 + b4X4+b5X5

Where “a” is an intercept dependent value for zero values of independent variables.

bi is coefficient of variables depicting relationship between dependent and independent variables.

ROA = 1.33 +.534 II + .378NI + .028TF + .641CA

Where, ROA = Return on Asset

II= Interest Income

NI= Non-interest Income

TF= Trade Finance income

CA= Capital Adequacy

CHAPTER FIVE

5. SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1.Introduction

From the analysis and data collected, the following discussions, conclusion and recommendations were made. The responses were based on the objectives of the study. The researcher had intended to determine the effect of trade finance on the performance of Commercial Bank of Ethiopia (CBE).

5.2.Summary

The objective of this study was to determine the effect of trade finance on the financial performance of commercial banks in particular the case of CBE. On the correlation of the study variables, the researcher conducted a Pearson correlation. From the findings on the correlation analysis between trade finance and performance, the study found that there was a strong positive correlation coefficient between trade finance and performance as shown by correlation factor of 0.624. The study also found a positive correlation between foreign exchange and performance as shown by correlation coefficient above 0.7. Hence all the derivatives had a strong position relationship with return on assets as a measure of financial performance of commercial bank of Ethiopia as measured by return on assets.

There is strong and positive relationship between interest incomes, non-interest income and capital adequacy, and gain from trade service and the return on assets variable to measure the overall performance of the Bank. Results from the interviewed pool helped to conclude the existence of strong alignment between foreign trade operations and performance of the Bank one leaning on the other.

The regression results depicted that the existence of linear and positive relationship among study variable. In addition, the magnitude of leverage is significant showing the evidence of strong cause and effect relationship.

5.3. Conclusions

The findings showed that the mean of fees and commissions is relatively moderate as compared to other variables while foreign exchange trading had the intermediate standard deviation. This show that the trade finance operation has considerable impact on the performances of Commercial Bank of Ethiopia. In addition, the interest income and non-interest income portions have depicted very large proposition of contribution on the profitability of the Bank which is measured through return on asset ratio over sixteen years operation. From study objective prospective, it is possible to conclude the foreign trade operation explained by gain from foreign trade activities influenced the operations of the bank through different faces. The measure contribution of trade service operations is its role on realizing commission and service charge income from area achievements which directly impacted the performance of the Bank proxy by return on asset. On the second hand, the foreign trade financing operation leveraged domestic operation by helping resource mobilize ion like fund raising and contributed to the domestic income parameter explained by interest income. Similarly, investments in other companies brought performance boost to CBE adding amounts to return on asset percentage growth. The non-interest income of the Bank is also supported the achievement of the Bank with significant amount of push which is reflected on return on asset steady growth over years.

Similarly, the correlation among dependent and independent variables of the study depicted strong but negative or positive relations among themselves. The result of the interview also indicted presence of strong verification that trade finance operation contribution to overall performance of the Bank. This can be explained by domestic resource mobilization leverages, setting domestic price scheme by levying compulsory agreements and other several issues discussed in the study.

5.4. Recommendations

The study sought to determine the relationship between trade finance and performance commercial banks in Commercial Bank of Ethiopia. The study recommends that; trade finance practices should always be taken in to account to improve the bank's net interest income and hence overall performance of the bank.

Policy makers should undertake factors affecting trade financing both from domestic and customers abroad. Similarly, domestic resource mobilization is highly interlinked with international trade financing. Therefore, the Bank shall take the advantage to recruit the trade finance customer as well as value chain actors working together. It is also highly recommended that the Bank shall avoid losses from incidents connected with foreign currency translation and transaction through enhanced trade financing activities rather than maintaining large foreign currency balance in correspondent's banks which may hurt it from recurring devaluation decisions by government.

The study recommends that CBE should engage in foreign trading where the returns are highly maximized since investments in capital projects involve huge investment capital. The banks management should put structures in place so as to enhance returns on capital and assets and in turn maximize returns to the CBE.

5.5. Suggestions for Further Study

This study sought to determine the effect of trade finance on the financial performance of commercial banks in Ethiopia. A study can be done on the implications of risk management practices on non-funded income of financial institutions.

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QUESTIONNAIRE

Dear Respondent:

My name is Samrawit Alemu; I am currently studying my Master of Accounting and Finance (MAAF) degree at St. Mary University. The purpose of this questionnaire is to collect primary data for conducting a study on the topic, "**The Effect of Trade Finance Operations on Financial Performance of Commercial Bank of Ethiopia"** as partial fulfilment for the completion of a MASTERS at St. Mary University. I am kindly requesting the respondent to provide honest, reliable information, which is to the best of your knowledge so that the information provided will be a valuable asset in the success of this research. Please note that all information gathered as a result of this questionnaire will be used for academic purposes only and kept confidential. Thank you for your cooperation.

Directions

- Please don't write your name
- Please answer all questions with options provided by putting a tick-mark (√) in the appropriate box.
- Please answer open ended questions by providing your opinions in the space provided.

Part I - Respondents Profile

1. Sex: Male ☐ Female ☐

2. Age: 18-22 ☐ 23-27 ☐ 28-32 ☐ 33-37 ☐
38 and above ☐

3. Highest level of educational achieved: PHD ☐
MA/MSC ☐
Degree ☐
Diploma ☐
Other __

4. Years of experience related to your current position: Less than 2 ☐ years
2-5 years ☐
6-10 years ☐
More than 10 years ☐

5. Occupation: Clerical Staff ☐ Non-clerical staff ☐ manager ☐
6. Your bank's Trade Finance Services (you can choose more than one option)

a Letters of Credit

b Trade payment guarantees,

c Availed bills,

d Collections,

e Open account (bank transfers)

f Others.

7. Approximately what percentage of your country‘s total trade import volumes does your bank handle?

a. 50
b. 20
c. 40
d. 30
e. Below 10

8. Which client sectors do you target/which client sectors use your trade finance services?

A. Agricultural
B. Manufacturing
C. Horticulture
D. Mining
E. Entertainment
F. Others

a. For cost reasons,
b. Efficiency of instruments ,
c. Safety of instruments ,
d. The request of the exporter

Part II - Questions on Trade Finance operations effect on performance of CBE

Listed below are statement of Trade Finance operations in your CBE, consider each statement and mark the answer that indicates the extent to which you agree with the statement.

No.	I. Interest Income earned and CBE Performances	1	2	3	4	5
1	CBE Provides import and export term loans and advances at reasonably turnaround time to support domestic operations related to international trade finance operations					
2	CBE Provides export term loans and advances at reasonably turnaround time to boost income from related international trade finance operations					
3	Trade financing operation has considerable impact on domestic deposit mobilization efforts and is beneficiary of income generated from disbursing resource mobilized					
4	Trade financing has contribution to maintain competitive position in the industry leveraging interest income from credit services					

Please use the following to indicate you answer:

1= strongly disagree, 2= Disagree, 3= Neutral, 4= Agree and 5=strongly agree

5	Trade finance operation in CBE brought increased customer base from deposit, loans and advances and digital channel operations which					

No.	**II. Non-Interest income earned and CBE Performances**	1	2	3	4	5
1	The bank takes higher wallet share of export proceeds and the trend is continuous over the coming years generating related non-interest income for CBE					
2	Trade finance operations helped higher income from					

	commission and service charges more than the same earned from domestic operations					
3	The trade operation services helped the CBE to obtain diversified income stream relative to domestic operations which can be categorized as other income particulars					
4	Trade finance operations provide reliable income to CBE continuously with less risk compared to domestic operations					
5	The international					

	trade finance operation helped to leverage income realized from domestic sources in different situations including non-interest income scenarios					
	III. Prices of trade finance operations as proxy to performance and Capital Adequacy of the Bank					
1	CBE Confirmation pricing provided at a reasonable international level					
2	Commission and Service Charge prices are relatively high compared to domestic operations and contributed					

	significantly to the profitability of the bank and capital accumulation					
3	Existing price scheme in the international trade finance operations are helpful to promote domestic operations interlinking foreign trade operation with domestic ones which helped profit and capital adequacy ratio.					
4	There is considerable price waiver in some international trade finance operations which helped the bank to attract more customers who earn FCY to the bank					
5	The international trade finance prices in CBE					

	are relatively competitive vis-à-vis industry scheme which helped the ROA, ROE and profitability of the Bank					
	IV. International trustworthiness of CBE					
1	The Bank has strong and sound relationship with pioneer internationally banks to process payments and settlements					
2	The Bank is trustworthy on its commitments compared to other domestic banks					
3	The bank maintained significant balance of foreign currency in correspondent banks which					

	enhanced its profitability over years					
4	The Bank always adheres to national and international laws which avoids penalty and maintained strong reliance on its operations					
5	CBE has diversity of trade finance instruments compared to competitors in the industry					
V.	**International trade Instruments and Income realization**					
1	The Bank has better earning from export letter of credit as an advice bank					

2	The Bank realize improved and relatively higher income from documentary collections and negotiations to export services					
3	The Bank offers credit services on the basis of sales contract or exchange bills which has brought enhancement to finance import dealings					
4	Incoming transfer supported the income stream of the bank at large					
5	The bank offers discounted bill advance to customers to					

	attract more clients and widen customer's bases.					
VI.	**CBE Performances Results**					
1	Return on Asset and Return on Equity of the Bank significantly attributed from foreign operation of the Bank					
2	Profitability of CBE highly leveraged by resources earned from international trade finance operations					
3	Capital Adequacy of the					

	Bank is sustainable and maintained growth pattern in the last ten years					
4	The Bank has depicted growth in its size and increased total income generated from various operations.					