

Addis Ababa
University
(Since 1950)



ADDIS ABABA UNIVERSITY
COLLEGE OF LAW AND GOVERNANCE STUDIES
SCHOOL OF LAW
LL.M. PROGRAM IN BUSINESS LAW

**“CONVERSION OF MFISTO BANKS IN ETHIOPIA:-EXPLORING
THE ENTRY CHALLENGES AND SOLUTIONS”**

By: Abdissa Dashura.....GSE/4896/12

Advisor: Fekedu Petros (Asst. Prof.)

**A Thesis Submitted in partial fulfillment for the requirements of degree of Master of
Law (LLM)**

May 2023

Addis Ababa University,

Ethiopia

DECLARATION

I, Abdissa Dashura, hereby declare that this thesis is original and has never been presented in any other institution. To the best of my knowledge and belief, I also declare that any information used has been duly acknowledged.

LLM Candidate Name: Abdissa Dashura

Signature: _____

March, 2023

Signed Approval Sheet by the Board of Examiners

Conversion of MFIs to Banks in Ethiopia:-Exploring the Entry Challenges and Solutions

This thesis has been submitted for examination with my approval as University supervisor.

Approved by Board of Examiners

1. _____

Chairman of the college of law Signature Date

2. Fekadu Petros(Ass. prof) _____

Advisor Signature Date

3. _____

Examiner Signature Date

4. _____

Examiner Signature Date

Acknowledgment

No work of this type can be done by oneself alone. It is in the nature of the work that its accomplishment demands a thorough engagement of many persons. I am indebted to many individuals who assisted me in the course of conducting this study.

First and foremost, I humbly extend my heartfelt gratitude to Fekadu Petros (Asst. prof) for his insightful and engaging comments and corrections in the course of discharging the demanding task of supervision of my thesis. My sincere thanks also go to Dr. Girma Gizaw and Dr. Tokuma Daba in their valuable contribution of providing relevant comments and suggestions.

As always, I thank my lovely wife Chaltu Aduna, for her tolerance during my study; and my daughters Bontu and Fenet Abdissa; and my son Milki Abdissa from the bottom of my heart. My sincere thanks also go to all personalities who have been voluntarily reacting to my interviews for their valuable suggestions which made the paper more comprehensive.

Many thanks to all who wished for my success!!!

Table of Contents

Declaration	I
Signed Approval Sheet by the Board of Examiners	II
Acknowledgment	III
Acronyms	VII
Abstract	Error! Bookmark not defined.
Chapter One.....	1
1. Introduction	1
1.1. Background of the study.....	1
1.2. Statements of the problems.....	4
1.3. Literature Review	6
1.4. Objectives	7
1.4.1. General Objective:	7
1.4.2. Specific Objectives.....	7
1.5. Research Questions	7
1.6. Research Methodology.....	8
1.7. Limitations of the study.....	8
1.8. Scope of the study	9
1.9. Significance of the Study.....	9
1.10. Organization of the Paper	9
Chapter Two	11
2. The Origin, Evolution and Regulatory Framework of Microfinance institution in Ethiopia. 11	
2.1. Overview of Financial Regulation in Ethiopia	11
2.2. The Evolution and development of Microfinance in Ethiopia	12
2.3. Regional Governments Saving and Credit Institutions	13
2.3.1. Oromia saving and credit share company.....	13
2.3.2. Amhara Credit and Saving Institution Share Company	14
2.4. The Roles and Activities carried out by Microfinance institutions	15
2.5. The Regulatory framework of Microfinance institutions in Ethiopia.....	16
2.5. 1. Introduction.....	16
2.5.2. Rational for Regulation	17
2.5.3. The Regulatory and Supervisory body of Microfinance institution	18
2.5.3.1. The Regulatory body	18
2.5.3.2. Microfinance Supervision Directorate in NBE.....	19

2.6. Prudential Regulatory Requirements of Microfinance institutions.....	19
2.6.1 Entry Regulations.....	19
2.6.1.1. Registration, licensing and branch requirements	19
2.6.1. 2. Institutional form and Legal personality	20
2.6.1.3. Minimum Capital Requirements.....	20
2.6.1.4. Ownership spreading and restriction.....	21
2.6.1.5. Business Plan and Organizational Structure.....	21
2.6.1.6. Management and Ownership Quality.....	22
Chapter Three	23
3. The challenges of conversion of Microfinance institutions to banks implemented in light of banking entry requirements	23
3.1. Overview of the concept of conversion of Microfinance institution's to Banks	23
3.2. The objectives and purposes of conversion.....	23
3.3. Regulator and Purposes of bank regulation/supervision	24
3.4. Applicable laws for ConvertingMicrofinance institutions as Banks	25
3.5. Business Planning and Initiation.....	26
3.6. Prudential entry regulations of the conversion:-challenges and implementations.....	28
3.6.1. Registration and relicensing Requirements	28
3.6.1.1 Stage one: Approval and Registration of Name.....	28
3.6.1.2. Stage two: Application for License and Documentation.....	29
3.6.1.3. Stage three: Letter of Intent/commitment.....	30
3.6.1.4. Stage four: - Issuance of new license	31
3.6.2. Formation and Legal personality	32
3.6.3. Branching requirements.....	33
3.6.4. Minimum Capital Requirements.....	33
3.6.5. Ownership spreading and Share Restriction.....	37
3.6.6. Business Plan and Organizational Structure.....	40
3.6.7. Management and Ownership Quality.....	41
3.7. Professional Employee required	42
3.8. MF Products continued under the bank:-As separate subsidiary or as a unit.....	43
Chapter Four.....	45
4. Entry problems arising from Microfinance institution conversion to old customers of the converted entities and ways of mitigating the risks.....	45
4.1. Major problems/risks of entry regulations and its mitigationso	45

4.1.1. Mission drift and information irregularity; and its mitigations	46
4.1.2. Regulatory/Legal problems/risk and its mitigations	47
4.1.3. Problems of capital Inadequacy and its risk mitigations	49
4.1.4. Problems of Information Communication Technology and Digital banking; and its risk mitigations	50
4.1.5. Problems of geographical and infrastructural remoteness.....	51
Chapter Five	53
5. Conclusion and Recommendations	53
5.1. Conclusion	53
5.2 Recommendations	Error! Bookmark not defined.
Bibliography	53
Appendix	60

Acronyms

AASCI	Addis Ababa Saving and Credit Institution
ACSI	Amhara credit and saving Institution
AoA	Article of Association
BoM	Board of Members
CEO	Chief Executive Office
FG	Federal Government
ICT	Information Communication Technology
MCR	Minimum Capital Requirement
MF	Micro Finance
MFI	Micro-financing Institution
MoA	Memorandum of Association
NBE	National Bank of Ethiopia
OSCI	Oromiasaving and credit Institution
RG	Regional Government
SB	Siinqee Bank
TBTseday	Bank
SCSI	Somale Credit and Saving Institution
SOE	State Owned Enterprise

Abstract

The main objective of converting microfinance institutions into fully-fledged banking industries is to meet the legal requirements of banking regulations and conduct banking activity. To meet the requirements, the author identifies the challenges and risks/problems associated with the conversion of microfinance entities into banks, as well as risk mitigation techniques, especially in entry regulations. The research was conducted using data from in-depth interviews with participants from the two converted entities (Siinqee Bank and Tseday Bank) and the regulatory authority engaged in the process. Legal provisions, additional literature, and primary and secondary data sources were all qualitatively analyzed to achieve better findings. The state's policy of emancipating microfinance institutions into fully fledged banking operations has already resulted in the conversion of certain regionally owned microfinance institutions into banks, despite challenges and risks. However, there is currently a lack of administrative cooperation and a competent manager who can help with the conversion, a lack of clear microfinance and banking business lines inclusive of rules for conversion, dissatisfied infrastructure and premises for accessing and functioning the branch, inconvenient minimum capital requirements for private/small microfinance institutions, and Regional Governments share overriding via a lack of transparency in allocating residual shares. For converted entities, losses of profit tax and court fee exemptions and their employees' inexperience with digital banking services are arising as problems/risks. Also, former microfinance institution customers are susceptible to the problems/risks of information and communication technologies, digital banking services, asymmetry in information about conversion, and distance-related bank outreach. The Regional Government's tax authority is no longer able to collect taxes or other sources of revenue from the converted entity, which harms the authority's income. Finally, the author makes a recommendation to the National Bank of Ethiopia to amend or improve the market entry challenges and problems mentioned.

Keywords: microfinance institution, Converted Microfinance institutions to banks, National Bank, Siinqee Bank, Tseday Bank and Directive..

Chapter One

1. Introduction

1.1. Background of the study

Compared to the various financial sectors in the business world, MFIs are small-scale financial sectors that help small business firms save and obtain credit. The process of "conversion" is a change in how MFIs are run and how efficient they are in terms of serving more low-income people with a bigger range of financial products at better rates.¹The transformation of full-fledged banks needs to be regulated to prevent a systemic failure of the financial system and protect customers.²

From an institutional perspective, the primary reasons of microfinance institutions choose to transform the offering of additional products to their customers and to gain access to capital (both debt and equity), and in so doing, expand their outreach.³However, Ethiopia hosts a banking industry that is far below African and international standards, with low coverage of banking services, excessive urban concentration, and an inefficient and ineffective central bank.⁴It is also characterized by poor infrastructure; an undeveloped payment system, and a shortage of skilled human power.⁵

The fundamental decisions to develop the microfinance institutions for the banking business plan emanated from the internal force to ensure current growth and the acquisition of technology's 'core banking system' to carry out market competition and compatibility with the fast-changing business environments.⁶The external force is to recognize the interest of the Regional Governments and Federal Government to increase the number of financial Institution to realize the intended financial inclusions.⁷Conversion is expensive and requires a substantial amount of money to acquire software, set up systems, adopt systematic branch, and develop a business plan and feasibility study.⁸

¹Alex Silva, Mohammed Khaled, Karen Beshay: Transforming MFIs in the Arab World Opportunities, Challenges, and Alignment of Interest (2018), p-2

² WB Group & IMF, "Financial Sector Assessment; A Handbook" (2010), WB Publications.197

³ Alex, supra note 1, p-12

⁴ Gebrehiwot Ageba and Derk Bienen, 'Ethiopia's Accession to the WTO and the FSs Sector (2008) p, 6-7.

⁵ ibid

⁶ OCSI now transitioning to SB develop its first five years Strategic Plan (2022-2026).p-2

⁷ ibid

⁸ ibid

The number of microfinance institutions in the sector goes down when dominant microfinance institutions become banks. Some of the microfinance institutions in Ethiopia are controlled by Regional Governments even larger than some of the privately owned real banks. Some of them are now changing their structure to provide full-fledged banking services. Thus, four former MFIs, like Oromia Credit and Saving Institution, Amhara Credit and Saving Institution and Sidama Credit and Saving Institution have been transformed into banks in the names of Siinqee Bank, Tseday Bank, and Sidama banks, respectively, and Somale Credit and saving institution was changed to Shebelle Bank, which is an interest free bank.⁹ According to the NBE's latest economic evaluation analysis, following the conversion of these four micro-financing institutions to banks, the numbers of microfinance institutions has declined from 40 to 36 in the reporting quarter of the year 2022.¹⁰

Procl/No/626/2009 is the enabling law that has been empowering and encouraging the transformation of microfinance institutions into banks conducted by the NBE.¹¹ Though the NBE's, the country's central bank, that has designed the requirements for relicensing an micro-financing institution, banks are required to operate in a safe and sound manner to ensure public confidence.¹² Accordingly, micro-financing institutions seeking to transform into banks could meet a set of specific requirements, including: Minimum capital requirement, restricting Regional Government to holding more than 70 percent of the shares; an institutional business plan and organizational structure; holding a capital adequacy, asset quality, management competence, earnings, and liquidity rating of at least three out of five; and management and ownership quality. The requirements of the directive set by the NBE should be applied to micro-financing institutions that desire to be relicensed as banks, irrespective of the type, kind, and nature of the micro-financing institutions.¹³

The legal procedure that paved the way for the formation of banks from microfinance sectors shows that the converted entity has continued to offer microfinance products as one line of banking business to protect the customers (i.e., the depositors and borrowers).¹⁴ The regulatory framework provided that institutions could transform their products with the option of becoming

⁹<https://nbe.gov.et/banks/>, accessed on 16/02/2023

¹⁰NBE: Quarterly Bulletin of 3rd Quarter of 2021/2022 Fiscal Year Series Addis Ababa 2022.

¹¹. MFB/Procl/No/ 626/2009, Federal Negarit Gazette of the FDRE 15th Year No 33, Addis Ababa, 12th May 2009, art.21(1)

¹²Banking Business Requirements for relicensing a MFI as a Bank, Directive No/SBB/74/2020, the preamble

¹³ Ibid, Art.4

¹⁴ Procl/No/626/2009, Supra note 9 art.21(2), and ibid Art.4(6)

micro-finance banks in addition to converting into conventional banks. Before beginning business as a bank, a microfinance institution must get a new banking license. During the two-year transitional period following the date of the new banking license, the microfinance institution must comply with all applicable laws and directives.¹⁵

Microfinance is a powerful tool to fight poverty, through the provision of basic financial systems, including credit, savings, insurance, and the transfer of funds.¹⁶ On the other hand, banks are owned by outside shareholders whose main objective are making profit and are different from financial institutions in that they offer lending, deposit-taking, payment services, and money transfers.¹⁷ According to the NBE 1st quarter Bulletin report of 2022/2023 year, the number of banks in Ethiopia reached 30, of which 28 were private and 2 were state-owned.¹⁸ These banks have opened 563 new bank branches during the first quarter of 2022/23 that maximize the total number of bank branches to 9,507. As a result, the ratio of population to bank branches stood at 11,062.0,¹⁹ of the total bank branches, 32.6% were located in Addis Ababa. This covers 1/3 of banks that are found in Addis Ababa.

Most countries subject their banks and microfinance institutions to meet market specific entry requirements, like branching, legal form, initial capital, ownership spreading and restriction, business plan and organizational structure, management and ownership quality. The international organizations, including Ethiopia, recommend the adoption of licensing regimes that include many of these requirements in its banking and microfinance regulations.²⁰ As there is banking experience in microfinance institution's services, the conversion of microfinance institutions to banks becomes easier if the organization is well settled.

The research assignment entails Siinqee Bank and Tseday Bank as its hosts in the rapidly expanding banking market, while identifying challenges and their solutions pertaining to the market entry of converted microfinance institutions.

¹⁵ Directive No/74/2020, Supra note 12, Art.5

¹⁶ Supra note at 11, Art.2(10) and art.3(2)(d)

¹⁷ By Lâma DAHER and Erwan LE SAOUT, Shifting goals in MF: from social performance to financial performance(2017) p-6

¹⁸ NBE: Quarterly Bulletin of 1st Quarter of 2022/2023 Fiscal Year Series Addis Ababa 2022, page 29

¹⁹ Total population is 105,166,000 as CSA Estimation for 2022/23

²⁰ S. Abay, financial market development, policy and regulation: international experience and Ethiopians need for further development (dissertation)(Amsterdam: Faculty of law, 2011) p.6

1.2. Statements of the problems

With the growth of MFIs in the country since the ownership of the private business sector, there have been prudential regulations to ensure the soundness of financial intermediaries. This research work explores financial development, control risks, holds adequate capital as defined by capital requirements, control supervisory processes and address customer satisfaction.²¹ The transformation of micro-finance institutions into banks should be transparent and in compliance with banking regulations. Financial regulations should be adequately clear, rational and help to achieve the goal of conversion in the overall activities of banks, so that there will be no ignorance or abuse of regulations. With the laws and regulations done to operate a bank or the transition that was made from micro-finance institutions into banks in the Financial Institutions, consumers and stakeholders clearly know about the reasons and objectives of conversion importance and what it contributes as a legal instrument used.²²

The objective of the conversion of microfinance institutions to banks should be expected to comply with the banking business. Banking and microfinance business proclamations have defined their own entry, ongoing, and exit requirements. In the conversion of microfinance institutions to banks, improving the relicensing procedure, mobilizing the nature of capital, increasing customer satisfaction, and adjusting ownership and governance structures are the basic requirements. In the same way, other related factors, like improving management information systems and improving internal control overall, are a basic prerequisite to complying with banking. The successful conversion of micro-financing institutions to banks is not an easy task that requires careful planning and entry requirements.

Though, in converting microfinance institutions to banks to comply with banking business, challenges/risks are inevitable, and it needs an intensive assessment and investigation. These challenges and problems/risks are taken as subjects of the study. The steps and some of the examples are seen and acknowledged as:

First, there were no instances of microfinance institutions being transformed into community-focused banks in Ethiopia. The former microfinance institution has been transformed into a

²¹ Morris, CHR, the Law of Financial Services Groups (2019) P-57

²² Yigrem Kassa, Regulation and Supervision of MFB in Ethiopia: Achievements, Challenges and Prospects, Paper presented at the International Conference on Microfinance Regulation in Bangladesh (2010) p.13-14

bank, although it still offers micro-financing and banking business services in accordance with the licensing criteria for banks. The converted entity now undertakes banking and micro-financing operations on an equal level. Therefore, the research's focus is on how and by whom conversion is carried out as well as whether the name "bank" and procedural standard are appropriate for the MF business line.

Second, micro-financing institutions that have become banks must maintain the same performance, accountability, and transparency requirements as legitimate banks. Therefore, it is necessary to evaluate whether branching's entry requirements are compliant with banking requirements in addition to all of these issues with institutional form and legal personality, business and organizational structure, as well as management and ownership qualities.

Third, Directive No/74/2020 applied to microfinance institutions that intend to relicense as banks. The Regional Government in Ethiopia and the private/small microfinance institutions under Directive No/74/2021 and Directive No/78/2021 dealt with a single appropriate minimum capital requirement for the conversion of microfinance institutions to banks. Frankly speaking, the microfinance institutions owned by the Regional Government have complied with the minimum capital requirement to be relicensed as banks. But private/small micro-financing institutions refrain from relicensing because of an insufficient minimum capital requirement. Therefore, the evaluation of the demanding situations related to a strictly one-size-fits-all minimum capital requirement for conversion of private/small microfinance institutions and the approach to requiring relicense can be some other component of this study.

Fourth, the NBE's regulatory functions are to restrict the acquisition of shares by Shareholders. Procl/No/592/2008, art. 11, states that "No person other than the Federal Government may hold more than 5% of a bank's total shares, provided that this is done to restrict influential shareholders from undue dominance in banks. Based on art.11 (2) of Procl/No/592/2008, the NBE issued Directive No/74/2020 that restricts Regional Governments from holding more than 70% of shares to be re-licensed as banks.²³The directive lacks clarity in allowing up to 70% shares to Regional Governments and allocating of remaining 30 % of shares. Therefore, it is appropriate to examine the converted entities to determine whether they comply with the company's rules/business practices for the assignment of shares. This means individual,

²³Procl/No/626/2009, Supra note 11, art.4(3)

corporate, and stakeholder shares, whether based on legal instruments under the country's law, would be assessed.

Finally, risks/problems with converted and former customer entities are tested and determined. In order to achieve the conversion, the risks and problems encountered by converted entities and former clients of microfinance institutions could be identified, and mitigation techniques could be assessed.

With the aforementioned problem statements in mind, this thesis aims to close any gaps, challenges and problems/risks by providing solutions, focusing particularly on entrance requirements.

1.3. Literature Review

Most of the literature reviews were written and focused on the legal and regulatory reforms of MFIs and banks rather than the research topic. Among the foreign literatures, "the issue of the transition from MF into formal banking in Kenya is notable. The main objective of the study was to establish the factors influencing the transformation from microfinance to formal banking in Kenya. The study addresses serious challenges the micro-financing institutions face in transformation.²⁴ Though it found MFIs lack proper government policy and poor customer care. Another research work and study that was conducted and entitled Transforming microfinance institutions in the Arab World Opportunities, Challenges, and Alignment of Interest is another one.²⁵ The study is' deeply examined into transformation in the Arab context, and discusses the benefits, costs, challenges, and opportunities associated with transforming a not-for-profit into a for-profit entity, not necessarily a bank. The paper explores the advantages of access to capital, increased outreach, improved efficiency, and governance, as well as disadvantages in relation to the legal paradigm and scenario of the country.

In the domestic sphere, there is a research paper conducted by Mahdot Solomon (2016):- On the Issues of the Distinction between the Regulation of Commercial Banks (CBs) and MFIs under the Laws of Ethiopia. In general, the paper analyzed the distinction between the regulation of CBs and microfinance institutions and identified the challenges, opportunities as well as their

²⁴John Mageto Mokoro: mokoro2001@yahoo.com, Richard Bitange Nyaoga, Peterson Obara Magutu, Odipo Martine Khoya & Cliff Ouko Onsongo, The Transition From MF Into Formal Banking Among The MFI In Kenya(2010)

²⁵Alex, Supra note 1

contribution to the reduction of poverty and the promotion of overall economic growth. Specifically, the study found that the absence of a clear distinction between regulation, regulatory overlap, and a single institution subjected to the provisions of different legal frameworks which contradict each other; and regulatory ambiguity, whereby some institutions might be left with uncertainty as to the laws.²⁶ But this research work is different from the research previously done that talk about different regulations, whereas this study is about converting MFIs to the same regulations as banks. It paves a way for how microfinance institutions entered, grew and advanced into the banking sector.

1.4. Objectives

1.4.1. General Objective:

The General objective of this thesis is:-

- ❖ Assessing the challenges of entry requirements surrounding the conversion of microfinance institutions to banks and suggesting its solutions under Ethiopian law.

1.4.2. Specific Objectives

Specifically, the study seeks:-

- ❖ To investigate the conversion microfinance institutions to banks implemented in light of banking entry regulations and the main challenges.
- ❖ To review the entry problems and risks arising from microfinance institutions conversion for the converted entity and former microfinance institutions customers and ways of mitigating the risks.

1.5. Research Questions

- ❖ How is the conversion of microfinance institutions to banks implemented in light of banking entry regulations, and what are the main challenges?
- ❖ What are the entry problems and risks arising from microfinance institutions conversion for the converted entity and former microfinance institutions customers, and are there ways of mitigating the risks?

²⁶Mahdot Solomon, Distinction between the Regulation of CB and MFI under the Laws of Ethiopia(2016)

1.6. Research Methodology

In the course of the study, the researcher employed two techniques. First, analyze the legal provisions of laws concerning banking and microfinance businesses and directives issued by NBE relevant to the study. The study also went through the data and information source theoretical framework of regulations that address relicensing microfinance institutions as banks obtained from different published and unpublished books, journals, and articles are reviewed.

The second source of data was collected via key informant interviews. Among the four (Siinqee Bank, Tseday Bank, Shebelle, and Sidama Bank) converted microfinance institutions to banks, the target banks for this study, namely Siinqee Bank and Tseday Bank, are selected based on their scale of operation. As the newly emerging banks they have already started banking businesses during the research conducted, with access to the information representing 50% of the total converted entity. The key informants were purposefully selected from NBE and the head offices of Siinqee Bank and Tseday Bank. So, interviews have been conducted with the MF executive supervisor, the MF head director, the principal bank executive supervisor, the bank executive examiner, and the Chief Acting Legal Expert. Among the regulated entities, Siinqee Bank's Legal Directorate Director and legal expert and from Tseday Bank's, the legal head and loan recovery director are selected to obtain direct information for the interview questions. The required primary source interview questions were structured and open-ended to get the necessary information. Though, the key informants are purposely selected because they are parties involved in the processes or those who have more information about the converted micro-financing institutions into banks.

Thus, the study employed a doctrinal research method with qualitative data analysis involving a search of legal documents, devoted on reasoning or logical arguments of legal provisions and different literatures. Finally, the information gathered from the sources (primary and secondary dates) were compiled in ways that are easy to manage, analyze and interpret qualitatively.

1.7. Limitations of the study

This study was limited to different factors related to many limitations. Lack of a time limit and a workload hindered the writer from discovering all material sources and key experts on the topic. Some limitations with the regulator and regulated entity as staff to cooperate on certain interview questions appeal confidentiality. The converted entities (Siinqee Bank and Tseday

Bank) are new businesses that lack experience, lack documented materials, and are new to the banking business. This has hindered the writer from collecting adequate information. However, the writer hopes that the focus on the Siinqee Bank and Tseday Bank, the conclusions, and the recommendations made thereon, can be analogically applied to others.

1.8. Scope of the study

The study examined the conversion of microfinance institutions to banks in accordance with the Directives and the requirements of conventional banks that converted entities must meet to be licensed as banks. Some microfinance institutions already possess their NBE certificates. There are obstacles, gaps, and risks related to the converted entities that arise during the entry of converted microfinance institutions into banks. When converting microfinance institutions to banks, requirements that adhere to banking business practices are not seen as entry challenges; rather, it is necessary to provide an example of how the conversion complies with banking regulations. Thus, the study investigates the challenges, and problems/risks together with its mitigations associated with converting microfinance institutions to banks, focusing on the entry requirements.

1.9. Significance of the Study

The study contributes significance for interested investors to invest in the area and financial institutions to enforce the law. It also needs to revise or change the entry requirements that are not complying with banks to make effective and competitive financial markets. It also addresses a notice to NBE about the challenges/problems/risks of converting microfinance institutions to comply with banks. The study has the basis of literature and it may serve as source material.

1.10. Organization of the Paper

This research paper is structured into five chapters. The first chapter is all about the introduction to the study. The second chapter has presented the origin, evolution, and history of microfinance institutions in Ethiopia. The role, regulations, and entry requirements of microfinance institutions have also been discussed. Chapter three has provided a brief discussion about the main challenges of entry regulations and implements to convert microfinance institutions. Objectives of conversion and regulations, planning and initiation, as well as entry requirements, have been discussed in this chapter. Chapter four is about a discussion of the problems/risks to

the converted entity and old microfinance institutions customers, and ways of mitigating such risks. Finally, the last chapter provides the concluding remarks along with major findings and recommendations.

Chapter Two

2. The Origin, Evolution and Regulatory Framework of Microfinance Institution in Ethiopia

2.1. Overview of Financial Regulation in Ethiopia

In Ethiopia, the establishment of an efficient financial system with proper regulation remains a challenging task.²⁷ Major regulatory changes have been made since 1991, including the financial sector's deregulation, the elimination of foreign exchange controls, the repeal of the prior interest rate control, and the development of a new regulatory framework for banks and MFIs. Additionally, the nation has moved toward relative economic liberalization as a result of the government's commitment to combating poverty and promoting overall economic growth.²⁸ MF has been a development activity in developing countries for low income people who do not have access to formal FIs.²⁹ On the other hand, MF can be about more than lending: it can be seen by a bank as an opportunity to develop a full banking relationship, which may consist of a broad range of banking services, such as credit services, savings products, current accounts, payment services, and funds transfer.³⁰

The Government of Ethiopia has designed a framework of laws to enable the involvement of financial institutions. Accordingly, the enabling laws that have been put into force include Procl/No/626/2009, Procl/No/592/2008, and Procl/No/746/2009. The regulatory framework that governs the financial system, among others, consists of NBE has been established by Procl/No/591/2008. Banks opened 563 new bank branches during the first quarter of 2022/23, thereby increasing the total number of bank branches to 9,507.³¹ As NBE reports during the 1st quarter of 2022/23 OCSI, ACSI, SCSi, and Sidama Credit and Saving Institution, which are the biggest among other MFIs, have been transformed into banks, thereby raising the total number of bank loans and reducing savings, outstanding credit, and total assets of MFIs.³²

²⁷Tony Addison and Alemayehu Geda:-Ethiopia's New Financial Sector and Its Regulation (2001); Discussion Paper No/2001/55, UN University, p-1

²⁸ Mekonen Kassahun Hagos and Melesse Asfaw, "FR and Supervision in Ethiopia" Journal of Economics & Sustainable Development(2014), Vol.5, No.17, p- 64

²⁹ The performance of MFIs in Ethiopia: A case of six MFIs by A.Yirsaw (2008) p.3-5

³⁰ Microfinance within the EU banking industry: policy and practice(2010) p-3

³¹ NBE, Supra note 18

³²Ibid

As the central theme of the study, Procl/No/626/2009 addresses the conversion of MFIs to banks that have to operate in a safe and sound manner.³³ However, MFIs briefly discussed its evolution and development, role, and functions in Ethiopia as follows.

2.2. The Evolution and development of Microfinance in Ethiopia

Muhammad Yunus, an economist, co-winner of the Nobel Peace Prize in 2006 with the Grameen Bank, which was established to help the underprivileged in Bangladesh, has been MFI's most well-known advocate in Asia.³⁴ He was an economist by profession started to lend small amount of money to poor women from his own pocket.³⁵

Both in the rural and urban areas, the formal MF business started in Ethiopia in 1994/1995.³⁶ The Association of Ethiopian MFIs, which was established in 1999, has grown to become the nation's largest network of MFIs with a license.³⁷ Before the coming in to effect of Procl/No/40/1996, credit extension to saving services was mainly undertaken by cooperatives and NGO Microcredits. However, NGO based microcredit was characterized by highest rate of non-repayment, fragile governance structure, only limited to credit delivery and unsustainable designed.³⁸ NBE took the lead in developing a prudential regulatory framework for MF to supply financial services to the poor in a sustainable and growth-oriented manner by Procl/No/40/1996. The MFI laws prohibit NGOs and any other institutions from offering financial services.³⁹ The government's led MFIs have register outstanding performance, while targeted lending by state resulted in a distorted market.⁴⁰

Procl/No/40/1996 was replaced by Procl/No/626/2009 which defines microfinance business as the provision of financial services such as accepting savings, extending credit and provision of money transfer services.⁴¹ Different directives have been issued and a number of micro-financing institutions, including those based in RG, were created and licensed by NBE.

³³ Procl/No/626/2009, Supra note 11, Art.21

³⁴ African Development Bank: -Microfinance Policy and Strategy for the Bank Group, Operations Policies and Review Department, (May 2006) p.2-4

³⁵ B. Armenda'riz and J Morduch, The economics of microfinance (2nd edn). MIT.Press(2010) p.10

³⁶ Procl/ No/40/1996

³⁷ MF Transparency, Promoting Transparent Pricing in the MF Industry, Country Survey: Ethiopia, (2011)p-8

³⁸ Fite, M. D, "Strengthening Regulation and Supervision of Microfinance sector for Development in Ethiopia", (2013), Law, Soc Just & Glob Dev J. 13

³⁹ The first groups of few MFIs were established in early 1997 following the issuance of Procl/No/40/1996 in July

⁴⁰ Wiedmaier-Pfister, " access to finance in Ethiopia; sector assessment study (2008), GTZ Report, 2.44

⁴¹ Procl/No/626/2009, Supra note 11, Art 2(10)

2.3. Regional Governments Saving and Credit Institutions

The RGs used MFIs as tools to implement the regional development plans and address the social and economic problems of their regions. Although there is no direct budget support from the RGS, the MFIs can count on the RGs to get additional capital and support when needed.⁴²The Ethiopian MF market is dominated by government-affiliated RG Share Companies. Among them, the top five largest MFIs, namely Amhara, Dedebit, Oromia, Omo, and AACSI, accounted for 85 percent of the total capital.⁴³So the Regional Government MFIs of OSCI to SB and ASCI to TB, SSCI to Shabale Bank, and Sidama Credit and Savings to Sidama Bank have been converted.⁴⁴ Among them, OSCI and ASCI's are the largest MFIs taken as a study.

2.3.1. Oromia saving and credit Share Company

Following the issuance of Procl/No/40/1996, the licensing and supervision of OCSI were established on August 4, 1997, to give MF service by obtaining an operational license from the NBE and commercial registration from the Federal Ministry of Trade and Industry.⁴⁵The five founders and shareholders of the company were Oromia National Regional State, Oromo Self-Help Organization, Dinsho Trading PLC, Oromia Development Association, and the late president of Oromia Regional State, Alemayehu Atomsa. The company started its operation with 5.2 million, which in the last 23 years has grown to 7 billion, while its assets have reached birr 15.4 billion in this fiscal year. The paid-up capital of Oromia Credit stood at 679 million birr as of October 2020.⁴⁶

The change came through Procl/No/626/2009 and Directive No/SBB/74/2020, which allow MFIs to evolve into commercial banks, by which the transformation of OSCI to SB was effected. The name Siinqee is sourced from the cultural institution of Oromo women. The primary goal of the relicense is to realize inclusive services for all, with the MF service

⁴² Wolday Amha, Corporate Governance of the Deposit Taking MFIs in Ethiopia(2008) p-21

⁴³E Deribie, G Nugussie, and F Mitiku, (2013), fill the breach: Microfinance. Journal of business and Economic management 1(1)

⁴⁴ Supra note 11

⁴⁵ <https://www.capitalethiopia.com/2021/05/31/the-transition-to-sinqe-bank>, accessed on 16/02/2023

⁴⁶ ibid

targeting job creation and financing for the poor while incorporating larger financial seekers as well.⁴⁷

Currently, the OSCI has more than 400 full-fledged branches. Since it became operational, the bank has started providing its services through these branches.⁴⁸ Having these huge branches to meet the human resource needs, the bank needs premises, the ICT adopted, and the costs of transactions at this early stage are so difficult. These factors will be discussed in Chapter 3. OCSI is the second MFI to initiate the transition into a bank, following the ACSI conversion to TB.⁴⁹

2.3.2. Amhara Credit and Saving Institution Share Company

The operation of ACSI can be traced back to 1995, when it was initially started by the Organization for Rehabilitation and Development in Amhara (ORDA), an indigenous NGO engaged in development activities in the Amhara Region. ACSI had undertaken its pilot activities in 1996 and was licensed as an MFI in April 1997.⁵⁰ ORDA was established in 1991 to provide relief to people affected by drought and the war against the previous Dergue regime.⁵¹ In a move to depart from the more usual direct provision of relief, the NGO created a department to supply small amounts of credit to rural people on a pilot basis. That department grew into a separate institution, and ACSI was licensed as a micro-financing institution in April 1997 with the primary mission of improving the economic situation of low-income, productive poor people in the Amhara region through increased access to lending and savings services.⁵² Its primary mission was to improve the economic situation of the low-income, productive poor in the Amhara region, primarily through increased access to lending and savings services. ACSI has also provided four types of financial products: credit, saving, money transfer, and pension fund management.⁵³

⁴⁷<https://www.capitalethiopia.com/2022/3/21>, accessed on 16/2/2023

⁴⁸ *ibid*

⁴⁹ *Supra* note at 45

⁵⁰ The ACSI, Institutional Profile, Current Status and Future Strategy; Bahir Dar (2004)

⁵¹ ACSI: Ethiopia, USAID AMAP Financial Services Knowledge Generation – State Owned Retail Banks(2006)P.14

⁵² *ibid*

⁵³ *Ibid*, p-17

ACSI has positioned itself and aligned its mandate to feed into government policy. It has become a strategic vehicle for government policies, and they receive the required government support, irrespective of the political inclinations of the government of the day. It is also noted that ACSI's financial strength and independence have greatly contributed to the successful relationship that exists between state and institution. As ACSI is not dependent on the state for funding, it can, to a large degree, withstand political pressure to undertake functions that would be detrimental to the health of the organization.⁵⁴

ACIS was initially established with the ownership structure of MFI RG 25%, Amhara Development Association (ADA) 20%, Amhara Women's Association (AWA) 10%, and TIRET 10%.⁵⁵ ACSI, as a government body, started with an initial capital of only 3 million Ethiopian birr and was operating at zone level in the region. Now, after conversion to TB, it has a total of 11.3 billion birr in registered capital, of which 7.75 billion birr has already been paid.⁵⁶

2.4. The Roles and Activities carried out by Microfinance Institutions

MF plays a critical role in poverty reduction, economic development and social empowerment of community participation.⁵⁷ On a small-scale, the financial service, including the provision of small loans and savings services to low-income clients who cannot access conventional bank credit.⁵⁸ It has also strengthened domestic economic life of poor by increasing capital, production, and exchange and consumption.⁵⁹ It expanded deposits, loans, payment services, money transfers and insurance to the poorer and low income segments and their micro-projects.⁶⁰

Furthermore, it also collects deposits and extends credit to rural, urban farmers, entrepreneurs and similar activities.⁶¹ The current operational regulation noticeably provides that legitimate for

⁵⁴ Ibid, p-30

⁵⁵ <https://www.fanabc.com/English/Amhara-Credit-and-Saving-Institute-turns-a-bank>, accessed on 12/02/2023

⁵⁶ <https://borkena.com/2022/9/27/Tseday-bank-operational-with-over-11-billion-Ethiopian-birr-capital/> accessed at 17/02/2023

⁵⁷ African Development Bank, Supra note 34, p-1

⁵⁸ Bornstein D, "the price of a dream: the story of the Grameen Bank and the idea that is helping the Poor to change their lives," (1996), UNIV CHIK Press 26. I.

⁵⁹ David Hulme and Thankom Arun "What's Wrong and Right with Microfinance" Vol. XLVI (48) Economic & Political Weekly(2011)23-26, p.24

⁶⁰ Ibid

⁶¹ Procl/No/626/2009, Supra note 11, Art.2 (10) and Art.3(1)

the MFIs to accept both voluntary and compulsory savings.⁶² Other services such as insurance and local money transfer are additionally allowed to be provided by the MFIs.⁶³

The 1996 proclamation was restricted only to group loan methodology without the prerequisite for property collateral.⁶⁴ The 2009 version allows both groups and individuals and without collateral, secured by collateral or secured by group or individual guarantees as suitable and at the judgment of the institution.⁶⁵ Group lending methodology customarily prevailed in the Ethiopian MF industry, nowadays; there is a growing focus on individual lending style which has helped MFIs in expanding their service supply.⁶⁶ It indicates that the service is growing into a banking business.

MF activities are also extended to drawing and accepting drafts payable within Ethiopia; purchasing income generating financial instruments; rendering managerial, and providing local money transfer services.⁶⁷ It has also providing financial leasing services to lessees and capital goods leasing business.⁶⁸ Despite its limitations, the prudential regulation of MFIs in Ethiopia has reduced market distortions, improved entry into the MF industry, encouraged saving mobilization, and improved performance, transparency and trust of MFIs.⁶⁹ These MFIs roles and activities are whether transformed with the converted Micro-finance institution to bank shall be examined in the next chapter.

2.5. The Regulatory Framework of Microfinance Institutions in Ethiopia

2.5. 1. Introduction

Regulation is a distinct set of rules or laws designed to govern certain conduct through creating limits, constraints, duties or responsibilities.⁷⁰ Regulation aimed specifically responsibilities safeguarding financial system stability in general and protecting the safety of small deposits in

⁶² Ibid, Art.3(2) (a))

⁶³ Ibid, Art.3(2) (d & j)

⁶⁴ Procl/No/40/1996, Art.3(2) a))

⁶⁵ Procl/No/626/2009, Supra note 11, Art.16

⁶⁶ Supra note at 30

⁶⁷ Procl/No/626/2009, Supra note 11, Art.3(2)

⁶⁸ Procl/No/1164/2019 Federal Negarit gazette, Year 15th Aart.3(2) (I, j, k)

⁶⁹ Yigrem Kassa, Supra note 22

⁷⁰ Biwott Kevin, The Effect of Regulation by SARSA on Performance of Small SACCOs in Kenya, MA Thesis, Kabarak University(2014) p.3,

individual institutions, it becomes prudential regulation.⁷¹ Different countries apply different instruments of prudential regulation in order to regulate the entry, operation and exit phases or areas of institutions.⁷²

Despite the variation in type and scope of the regulations, the two frequently adopted instruments are preventive and protective regulation.⁷³ Preventive regulation is the regulatory actions that aim to control the risk exposure of the institution or to reduce the probability of failure, and it includes the various requirements related to market entry, operation and exit.⁷⁴ Protective regulation, on the other hand, refers to rules and regulations that address post-crisis situations, and it comprised deposit insurance schemes, access to a lender of last resort, as well as reforming the institution affected by the crisis.⁷⁵ There is also risk based approach that deals with assessing and identifying the greater prudential and operational risks of firms and take supervisory measures on the selected risks and institutions.⁷⁶

2.5.2. Rationale for Regulation

Regulation redresses the information imbalance that exists between consumers and financial services, and overall attempts to strike a balance of protecting the markets without stifling legitimate business.⁷⁷ This may be achieved through preventing business failures by imposing capital and internal control requirements, such as ensuring that entities have sufficient liquidity to meet their obligations.⁷⁸

Transformation of MFIs from mere credit delivery institutions into full-fledged financial institutions necessitated prudential regulation in order to prevent a systemic failure and protect depositor's savings. However, an inappropriate regulatory approach leads to misallocation of scarce resources in the attempt to impose prudential standards and requirements.⁷⁹ Rather than

⁷¹ Onafookan O. Oluyomba, *Cooperative Finance in Developing Economies*, Soma Prints Limited, Lagos, Nigeria, 2012, p.64

⁷² *ibid*, P-16

⁷³ Rodrigo and Claudio, *Principles of Regulation and Prudential Supervision*(1992), P-24

⁷⁴ *Ibid*

⁷⁵ Onafookan O. Oluyomba, *Supra note 71*, p-42

⁷⁶ *Ibid*

⁷⁷ Quintyn, M and Michael W and Taylor, *should financial sector regulators be independent?* (IMF Economic issues 2004)

⁷⁸ *Ibid*

⁷⁹ WB Group & IMF, "Financial Sector Assessment; A Handbook" (2010), WB Publications.197

providing one size that fits all types of regulation for all varieties of MFIs, introduction of tiered regulation based on the nature and risk bearing potential of MFIs is significant.⁸⁰

Tiered regulation involves different tiers of financial institutions with different degrees of regulatory requirements based on risk bearing competition and outreach in which different levels of risk begs for different levels of regulation.⁸¹ In Ethiopia the setup of prudential regulations of entry, branch inaccessibility, and capital requirements shall adopt irrespective of the risk bearing potential of particular MFIs.

The prudential regulation for any financial institution originates from the need to protect the depositors from the loss of their savings and to protect the public confidence and strengthen the financial system.⁸² Traditionally, MFIs have depended on donor funds and subsidies.⁸³ Today, however, there are considerable rising scope of financial activities provided by institutions and their customers.

2.5.3. The Regulatory and Supervisory body of Microfinance Institution

The regulatory and supervisory body has the powers and responsibilities to take legal and administrative measures against MFIs who do not comply with regulations. Directly connected to regulation, the concept of supervision is defined as the prompt ensuring of the execution of norms incorporated in the regulation and controlling the possibility of a market failure.⁸⁴

2.5.3.1. The Regulatory body

NBE is conferred with the powers of licensing, inspecting, examining and sanctioning the FI. It also authorizes it to finance its regulatory functions by its own funds except in cases where it has been fixed by law.⁸⁵ NBE is the sole regulator of financial institutions and also regulates MFIs with a direction of bank regulation.⁸⁶ NBE is a regulator and supervisor of formal

⁸⁰Patrick Meagher, "MF regulation in South Africa: A comparative perspective"(2002) p, 48–52

⁸¹Hennie Van Greuning et al., "Framework for Regulating MFIs", (Dec. 1998), I,

⁸² Mamiza Haq, Mohammad Hoque and Shams Pathan "Regulation MFIs in Asia: A Comparative Analysis" Vol. 4(2) International Review of Business Research Papers(2008) p.423

⁸³ Ibid, p-422

⁸⁴Gianfranco Vento "The Role of Regulation", in Mario La Torre and Gianfranco A. Vento (edn) Microfinance, Palgrave Macmillan, New York, (2006) p.133

⁸⁵ S. Abay supra note 20, p-375

⁸⁶Wiedmaier-Pfister, Supra note 40

banks.⁸⁷ NBE regulates MFIs with a direction and mind setup of bank regulation that mainly aspires for financial soundness, profitability and risk avoidance on the cost of developmental goals.⁸⁸

2.5.3.2. Microfinance Supervision Directorate in NBE

NBE is the sole regulator of financial institutions in Ethiopia with separate banking and MF business supervision directorates.⁸⁹ In the same manner with banks the directorate tries to ensure safety and soundness of MFIs, efficiency and compliance of MFIs with the rules and regulations to protect customer interest. The office gives different services for licensing new MFIs, renewal of business licenses and approval of external auditors, BoMs and CEOs appointment, approval of MoA and AoA amendments, approval of new products and services, provision of information and advisory services to the institutions.⁹⁰

2.6. Prudential Regulatory Requirements of Microfinance Institutions

Ethiopia subjects their banks and MF to market entry, ongoing and exit requirements.⁹¹ The study is focused on entry regulations.

2.6.1 Entry Regulations

Both the regulatory framework of Procl/No/626/2009, Procl/No/1164/2019 and directives issued by NBE includes entry requirements of registration, institutional legal form, initial capital, ownership restriction, business plan and by law, management and ownership quality.

2.6.1.1. Registration, licensing and branch requirements

Many countries used to have geographic and branching limits to facilitate registration of names, prevent the continuity of risk, promote division of labor, and/or reflect a tradition of federalism. Banks and MFIs are established by FG laws and their formation requirements are under the federal laws and get their licenses from the NBE.⁹² It requires registration and authentication of name both at federal and Regional commercial registry.⁹³ Also, MFIs get

⁸⁷ Procl/No/591/2008, Art.5(7)

⁸⁸ Wiedmaier-Pfister, Supra note 40

⁸⁹ Procl/No/592/2008, Federal Negarit Gazette, 14th year, No. 57

⁹⁰ Supra note at 11, Art.6, 7, 11 and 17 respectively.

⁹¹ S. Abay, supra note 20, p-375

⁹² Ibid, p-30

⁹³ The Commercial Code of the FDRE, Procl/No/1243/2021, Art.70 and 71

branching permits from the NBE and notify their branching to the latter. Disclose the addresses of their principal offices and branches to the NBE and the commercial registers of the places where their branches are located; changing or closing their places of businesses with written consent of the NBE.⁹⁴

It is prohibited to engage in micro-finance business without obtaining a license from the NBE; provided, however, that banks licensed under the appropriate law may engage in MFIs without a separate Microfinance business license as per art.4 of Procl/626/2009. Requirements to obtain a Microfinance business license have three phases: pre-application, application and commencement.⁹⁵ Therefore, RG based MFI's registration and its authentication of name shall conduct at their respective RG by regional law; whereas National based MFIs (established in two or more Regions) registration and its authentication of name shall conduct at FG by Federal Law.

2.6.1. 2. Institutional form and Legal personality

All MFIs are required to be formed in a SC format.⁹⁶ MFIs shall establish with strict observance a SCs.⁹⁷ However, as SCs their capital has to be fixed in advance and divided into shares, and their liabilities are to be met only by the assets of the companies owned under the New Commercial Code.⁹⁸ The finding is that MF in Ethiopia has not yet well attracted private and commercial capital.⁹⁹ Ethiopia allows only SCs to undertake MFI that can facilitate financial regulation by fixing capital, limiting liability, separating ownership and control, allowing ownership flexibility, and imposing strong capital and governance structures.¹⁰⁰ Both OSCI and ACSI were formed and licensed under SC.

2.6.1.3. Minimum Capital Requirements

NBE requires the MFIs to have fully subscribed and partly paid up share capital before commencement of operation. The required capitals allocated by the government, 25% to be

⁹⁴ Procl/No/626/2009/, Supra note 11, Art.4

⁹⁵ Requirements for Licensing and Renewal of Microfinance Business Directives No/MFI/23/2013, art 5 and 6

⁹⁶ Robert Peck Christen & Richard Rosenberg, The Rush To Regulate: Legal Frameworks For Microfinance, (2000), Occasional Paper No. 4, CGAP, Washington, DC

⁹⁷ Procl/No/1243/2021, Supra note 92, art.245(1)

⁹⁸ Procl/No/626/2009/, Supra note 11 art.2(3(a) b)) and Ibid, Art.245

⁹⁹ Wolday, A., A decade of MFIs development in Ethiopia: Growth, Performance, Impact and prospect (2008 – 2017), Occasional Paper No. 21

¹⁰⁰ S, Abay, supra note 20, p-33

paid. MCRs shall be set by the NBE from time to time and to be maintained by MFIs shall be determined by directives of NBE.¹⁰¹The previous MCR for MFI set by the NBE is 10 million.¹⁰²This is for the second time that has been raised in recent years, after the NBEbounced it up from two million Birr to 10 million. Now, the MCR to obtain a Microfinance business license shall be Birr 75 million, which shall be fully paid in cash and deposited in a bank (s) in the name and to the account of the MFI under formation.¹⁰³The provisions of this Directive shall be applicable to an existing MFI in the process of share subscription and in the process of licensing.¹⁰⁴However, MCR is a criterion to graduate or relicense MFIs to banks. Now, RG based MFIs fulfilled the MCR to be converted.¹⁰⁵Therefore, MCRsin Ethiopia focused primarily on one size fits than risk run to MFI.

2.6.1.4. Ownership spreading and restriction

The ownership structure of MFIs includes RG, NGOs, clients, associations, and private individuals and other companies.¹⁰⁶The ownership structure of MFIs is mixed: - The big are practically owned by RG and the other small ones are owned by NGO's and privates as provided under section 2.3.The restrictions under bank are justified to prevent undue dominance of the institutions by few shareholders, whereas MFI not imposed such a restriction. They need to be relaxed.¹⁰⁷The NBE at the initial stage has shown more flexibility in allowing a SH to own more than 20 % of the total capital of the MFIs.¹⁰⁸The country, however, needs to make sure that the restrictions are not too muchto limit investment choice. Basically, MFI owned by RGis a government affiliated toward socialinclinationrather than financial objectives.

2.6.1.5. Business Plan and Organizational Structure

In our country MFI business license to provide the NBE with information of costs and liabilities, feasibility studies, projected financial statements, proposed organizational structures

¹⁰¹ Procl/No/626/2009, Supra note 11, Art.14 (1)

¹⁰² MFI Directive No/27/2015, Art.4(1)

¹⁰³ MCR and Capital Adequacy Requirements of MFIs Directive No/ MFI/36/2023, Art.4(1)

¹⁰⁴ Ibid, Art.3

¹⁰⁵ NBE: Quarterly Bulletin of 1st Quarter of 2022/2023 Fiscal Year Series Addis Ababa 2022 compared with directive No/74/2020

¹⁰⁶ S. Abay, Supra note 20

¹⁰⁷ ibid, p-37

¹⁰⁸ Procl/No/40/96

and functions, curriculum vitae, certificate ownership of assets; and evidences of paid up capitals, valuations of contributions in kind and insurance coverage, if any.¹⁰⁹The feasibility study applies for branching permit to the NBE also required that do not need to present and defend.¹¹⁰Thus, the supervision directorate MFI of the NBE does not, however, sufficiently appraise the feasibility studies of the applicants in practice.

2.6.1.6. Management and Ownership Quality

The NBE exercises its responsibilities issued directive and Requirements for Persons with Significant Influence soundly and prudently managed a MFI.¹¹¹The minimum requirements knowledge for MFIs board of members shall be diploma, 3 year working experiences and at least 25 years old to be approved by NBE.¹¹²A chief executive officer shall hold a degree knowledge minimum requirement, 5 years working experience and 3 year experience in managerial position to be approved by NBE.¹¹³NBE bars persons declared bankrupt or making a composition with creditors and persons convicted of an offense involving dishonesty or fraud from managing the MFI without prior written approval of the NBE.¹¹⁴Therefore, the challenge encountered by the board and CEO in MF governance is to meet two expectations: the social expectation to reduce poverty and the financial expectation to maximize profit.

¹⁰⁹S. Abay, Supra note 20

¹¹⁰ *ibid*

¹¹¹MFI Directive/No /21/2012

¹¹²*ibid*, Art, 5.1.1

¹¹³ *Ibid*, Art. 5.1.2

¹¹⁴ *Ibid* and Procl/No/626/2009, supra note 11, Art.11(1-3)

Chapter Three

3. The Challenges of Conversion of MFIs to Banks Implemented in Light of Banking Entry Requirements

3.1. Overview of the Concept of Conversion of Microfinance Institution to Banks

Transformation refers to the changes in the legal status of MFI or the shifts in the relationship between original MFIs and converted MFIs and bank customers. It can also be seen in the changes in the internal structure as well as the kinds of financial services that they offer to clients.¹¹⁵The conversion of a business organization from one type into another does not cause the creation of a new legal person but only an amendment to the MoA.¹¹⁶The members who made a shift from MFIs to banks may, as the case may be, decide on conversion unanimously or by the majority required by MoA or the law.¹¹⁷The law provides that the dissenting SC has the right to withdraw from selling their shares to the organization as provided under Article 403 of the Code.¹¹⁸

During the conversion of MFIs to banks, the regulator should consider an adjustment of prudential requirements.¹¹⁹Accordingly, the NBE provided a prudential regulation that is safe and sound to process the conversion of MFIs to banks in Ethiopia.¹²⁰Thus, the most important factors for the conversion of MFIs to banks are good governance, working with a strict regulatory framework, raising funds, managing exponential growth, institutional restructuring, training and retraining staff, revisiting the mission and vision, and also developing new products.¹²¹

3.2. The objectives and purposes of conversion

The objective of the conversion of MFIs is to improve the legal status of the converted entities through the process of bank licensing procedures that comply with banking business. The

¹¹⁵ Gianfranco Vento, Supra note 16

¹¹⁶ Procl/No/1243/2021, Supra note 93, Art.546(1)

¹¹⁷ Ibid, Art.547(2)

¹¹⁸ Ibid, Art, 546(3)

¹¹⁹ Gianfranco Vento, Supra note 16

¹²⁰ Directive No/74/2020, Supra note 12

¹²¹ S. Abay, Supra note 20, p-27

primary reasons MFIs choose to be converted to banks are to offer additional products to clients and to gain access to capital. The conversion also went through improvements in governance and ownership structure, upgrading the converted entity's capacity to reach many clients on a sustainable basis.¹²² The conversion can also be seen as a helpful mechanism that helps private banks to compete with state-owned banks.¹²³ The main motive is to access more public deposits, grow and hold deposits for customers, and enhance profitability and sustainability. It can also offer a wider range of financial services and products, increase competition, and improve customer satisfaction.¹²⁴ It also calls for changes in measures for giving loans, optimizing business volume, understanding organizational exposure, and operating efficient processes.¹²⁵ To attain the technology of core banking, identifying the interest of RGs and FG financial inclusive services, targeting job creation and financing the poor, and incorporating larger financial seekers as well.¹²⁶ Moreover, it is also the one that facilitates access to foreign exchange through foreign currency-generating activities that allow bank transactions to raise profit.¹²⁷

3.3. Regulator and Purposes of Bank Regulation/Supervision

Regulators have three main tools to regulate banks: promulgate rules, supervise compliance, and enforce reprimands.¹²⁸ Supervision refers to monitoring and examining banks, imposing reporting requirements, and instructing banks to modify their behavior. It also evaluates and promotes the safety and soundness of individual banks and the banking system as a whole. In addition, regulators evaluate bank compliance with other statutory requirements, including consumer compliance supervision.¹²⁹

Banks require comprehensive regulation to ensure safety and sound establishment, including deposit insurance, access to reserves, and payment guarantees.¹³⁰ It also creates incentives for

¹²² Ibid

¹²³ WBG policy research working paper [2018]/ <http://www.researchgate.net>, accessed on 25/04/2022

¹²⁴ George Koome Rukaria:-Challenges Affecting Transformation of MFI into Deposit Taking FIs in Kenya (2015) p-8

¹²⁵ Tony A. and Alemayehu G., Supra note 32, p.64-65

¹²⁶ Zewde Tefera, chairperson of the SB on SHs annual meeting held on Monday, May 24, 2021 at Sheraton Addis hotel

¹²⁷ Interview with Mr. Efreem Barak, Chief Acting legal expert of NBE, 23rd May, 2022 and 8th February, 2023

¹²⁸ <https://sgp.fas.org/crs/misc/ifi10055.pdf>, accessed on 13/2/2023

¹²⁹ ibid

¹³⁰ <https://www.minneapolisfed.org/article-2004/banking-regulation-the-focus-return-to-the-consumer> accessed, on 19/02/2023

banks to take larger risks than they otherwise would, since the deposit insurance fund-and ultimately taxpayers-will incur the losses if those risks don't pay off. The reason behind all these things is that the government provides the safety net; it has avested interest in ensuring that banks operate in a safe and sound manner. Moreover, one reason that bank supervisors regulate and make supervision to carry out what was/and is to limit the potential moral hazard.¹³¹ Consumer protection regulation lacks clarity of purpose due to difficulty evaluating financial information, leading to less optimal credit utilization.¹³² The second justification for consumer protection regulation is that financial markets may not allocate credit in a way that is reflective of full and impartial access to credit markets.¹³³

3.4. Applicable laws for Converting Microfinance Institutions as Banks

There are laws and regulations that govern the conversion of MFIs to banks. Thus, converting MFIs to banks has two options. The first is to be licensed under banking laws and existing regulations. It follows the steps the former MFI equity building society took as they got registered under the banking law to become a bank.¹³⁴ Banks licensed under the appropriate law may engage in microfinance business without a separate MFB license.¹³⁵ But there was no scenario that MFIs carry out banking business except relicensing. So that Procl/No/592/2008 of Art.4 and Directive No/78/2021 of Art.4 can be applicable for this option.

The second applicable method works with the NBE regulation providing MF conversion to banks.¹³⁶ However, legal gaps and challenges are inevitable when it comes to the conversion of MFIs into banks. Ethiopia practically proceeds with the second option, where the license shall be offered after the issuance of directive No/SBB/74/2020. The OCSI to SB, SCSi to Shebelle bank, ACSi to TB and SSCI to Sidama bank have all been relicensed.¹³⁷ In addition to the above-mentioned institutions like, Harar, Dire and AASCI microfinance institutions are in the process to transform within the legal framework into banks. Art. 21 is the salient feature of

¹³¹ Ibid

¹³² ibid

¹³³ ibid

¹³⁴ George Koome Rukaria, Supra note 124, p-39

¹³⁵ Procl/No/626/2009, Supra note 11, Art.4(1)

¹³⁶ Ibid, Art.9

¹³⁷ [MFIs – National Bank \(nbe.gov.et\)](https://nbe.gov.et), accessed on 22/2/2023

Procl/No/626/2009 talking about conversion of MFIs. From the outset, the conversion of MFI to banks criteria set by the NBE.¹³⁸

According to Addise, the NBE's directive N0/74/SBB/2020 does not cover the MF business line because the converted bank performs the MF function, which is not included in the definition of "bank" in the NBE.¹³⁹ The procedural rules that govern the conversion, of MFIs to banks do not entirely cover the policies for the conversion given their context. For instance, Addise states that it is preferable to accommodate MF business services under the regime of old regulations like MCRs and low-income people's service procedures (loans, collateral, and subsidies).

The conversion of MFIs to banks as a result, as well as the availability of requirements, has been in compliance with the laws governing the banking sector. However, conducting MF and banking operations is a part of MFIs' development into financial institutions. Due to the microfinance business processes and actions that are exposed in order to carry out the company name as a banking organization, there is, however, a knowledge gap regarding the conversion. Therefore, the requirements for planning, initiating, and prudential entry are addressed below.

3.5. Business Planning and Initiation

The provision in the conversion of MFIs to banks says that an MFI that meets the criteria set by the NBE can be converted into a bank "upon request."¹⁴⁰ Directive No/74/2020 did not clearly mention how the regulator and regulated entities cooperatively and separately led or administered the process from initiation to conversion. Before the conversion of MFIs to banks, convincing shareholders, BoMs, and the management of the MFIs will play an important role in the transformation plan. Planning secures an agreement from the Shareholders by the board, which is entrusted with the responsibilities of providing the overall guidance and policy directives, while the General Manager is responsible for the day-to-day management activities.¹⁴¹ Based on the business planning and initiation clue, the board can assign the key executives to process the transformation, assess the readiness to transform, appoint a transformation manager, prepare a transformation plan, and make initial consultations with

¹³⁸ Procl/No/626/2009, Supra note 11, Art.21(1)

¹³⁹ Interview with Addise Gemechu, New, SB, legal directorate director, on 16th February, 2023

¹⁴⁰ Procl/No/626/2009, Supra note 11, Art.21(1)

¹⁴¹ Efrem, supra note 127

NBE. For SB and TB their legal directorates were processing the activities in line with directive No/SBB/74/2020 of art.1. However, the law does not provide the legal directorates with this power. An interview from the appropriate organ shows the fact that there were delays in the organization of the general meeting; the minutes were not signed properly, there was no clear mission or goal indication, and there was a lack of full evidence of holding a capital adequacy, asset quality, management competence, earnings, and liquidity rating.¹⁴² These are backlogs and time-consuming tasks considered challenges to effect the conversion in time.

The idea of initiation comprises factors such as the name and re-incorporation of the business, re-application for a license, documentation, as well as those that can fit and properly test the fulfillment. On the other hand, feasibility studies and business plan preparation are a problem of time and cost. Accordingly, the process of conversion from OSCI to Siinqee Bank's proposed business plan to the NBE itself is a procedural challenge that delays the conversion.¹⁴³ In making an initiation, a consultation with the NBE is a decisive measure for successful relicensing to reduce the challenges.¹⁴⁴ Kenya has also endorsed consultation with the central bank to mitigate challenges.¹⁴⁵

The management of the MFI, with the consensus of Shareholders, has to determine how best to use the newly converted business sectors of the MFI as a bank. In conversion, there is a fear that the MFIs will drift from their original mission of serving the poor.¹⁴⁶ Converting MFI to banks needs consensus; shareholders include a statement of company mission. Accordingly, the MFI governing body (BoM) in SB has easily realized the conversion without delay, but TB takes time.¹⁴⁷

The BoM immediately welcomed those who brought up the conversion issue before the management bodies approved the criteria, and the technical committee was also tasked with looking at the business plan. The conversion is something that RG is interested in, and the applied pressure to get the shareholders to endorse it at general meetings.¹⁴⁸ On approval of the

¹⁴² Interview with Mr. Merga Waqoya, NBE, MFIs directorate 14th March, 2023

¹⁴³ Interview with Mr. Bekele Tola, Directorate of Legal Director of SB, 23rd May, 2022

¹⁴⁴ Efrem, supra note 127

¹⁴⁵ George K., Supra note 123, p-39.

¹⁴⁶ Interview with Kurnde Tesgera, NBE, Principal MF Executive supervisor, 12th May, 2022

¹⁴⁷ Efrem, supra note 127

¹⁴⁸ Bekele, supra note 143

conversion, two delegated bodies of the NBE were presented and held the process.¹⁴⁹ Others believe that it is the legal framework of the business market and the government's policy initiation that come from the RG direction.¹⁵⁰ As a policy plan, the RG had to push the NBE to convert MFIs to banks.¹⁵¹ A manager is a champion to lead the process of planning; however, internal power and politics make it difficult for organizations to quickly agree on whom the change agent should be.¹⁵² In short, the initiation of the conversion shall be made by the Shareholder and facilitated by a competent manager. To sum up, conversion shall be made at the Extraordinary General Meeting of the SC.¹⁵³ So, RG intervention for the conversion is inevitable and taken as the necessary and fatal measure to be taken.

3.6. Prudential Entry Regulations of the Conversion: -Challenges and Implementations

3.6.1. Registration and relicensing Requirements

Registration requirements include approval of name, license, and documentation, issuance of a letter, and finally licensing. However, the NBE has, accordingly, re-engineered its procedures for relicensing by applying banking license directives.

3.6.1.1 Stage one: Approval and Registration of Name

The procedures for registering banking licenses could be applicable to relicensing MFIs as the primary prerequisite for banks.¹⁵⁴ The Ministry of Trade empowered a central commercial and trade name, register, whereas the Investment Commission may undertake the same as delegated to the RG by the Ministry of Trade.¹⁵⁵ The NBE needs evidence of registration of trade names from the Federal Trade Ministry or Regional trade bureaus.¹⁵⁶ Though Ethiopia follows the Federal State Structure, in the political ruling system, the formation and registration of converted MFIs into banks are also decentralized. The NBE-licensed department office was challenge SB; registration should be conducted at the Federal Trade Ministry and approval of

¹⁴⁹ *ibid*

¹⁵⁰ Interview with Sintayehu Dasita, NBE, principal bank executive supervisor and Interview with Frewot Kiros, NBE bank examiner, 20th May 2022

¹⁵¹ Merga, *Supra* note 142

¹⁵² *Supra* note at 134, p-40

¹⁵³ Procl/No/1243/2021, *Supra* note 93, Art.400(4)

¹⁵⁴ Directive No/SBB/56/2013 and Directive No/74/2020, *supra* note 12, Art.4(9(a))

¹⁵⁵ Commercial Registration and Licensing Proclamation No. 980/2016, Art 4(1 and3)

¹⁵⁶ Directive No SSB/56/13, *Supra* note 154, Art 5.1.1

the name that should be at Authentication and Registration of Documents.¹⁵⁷ With the option to RG, Addis Ababa and Dire Dawa established their regional commercial registers that undertake commercial registration.¹⁵⁸ Though the FG and RG can perform and carry out commercial registration separately, the registry is part of the central commercial register administered by the Ministry of Trade and Regional Integration.¹⁵⁹ It shows that the RG registration steps were based on the circulation, measures, and criteria of the part.

The conversion didn't address the process or the way of changing the mother name of MFIs to the bank's business name. However, the trade name of a SC shall be decided by the shareholders pursuant to the New Commercial Code or by an extraordinary general meeting without amending the MoA.¹⁶⁰ That is why registration should be the requirement that AACSI has faced to delay its plans to re-establish itself as a bank after NBE instructed them to change the proposed moniker (name) to "Bank of Addis" to avoid confusion with a bank already in business.¹⁶¹ To avoid confusion, trade name registration made with the consultation of NBE should be necessary. Now AACSI is in the process of relicensing to come up with the new name, Haset Bank.¹⁶² Thus, names may have close similarities to the existing institutions, which are free from offending the public or leaning towards religious, political, or ethnic inclinations. Names were selected to prevent public offense due to the commercial market.

The converted entity's business name, which basically dwells in RG, was registered at the respective Regional trade bureau, and its approval was conducted at the RG bureau.¹⁶³ Prior registration of a trade name does not prevent others from using the same trade name.

3.6.1.2. Stage two: Application for License and Documentation

The copies of documents to be attached include the Certificate of Incorporation, ownership certificate, assets of the company, influential shareholders who acquire more than 2% shares and all information about the CEO as well as shareholders. Similarly, other issues are related to

¹⁵⁷ Bekele, supra note 143

¹⁵⁸ Procl/No/1243/2021, Supra note 93, arts.70–71, 265–266

¹⁵⁹ Ibid, art.70 and 71

¹⁶⁰ Ibid, art. 400(6)

¹⁶¹ <https://addisfortune.news/change-name-national-bank-tells-bank-aspirant-addis-microfinance>; accessed March 5, 2023

¹⁶² Efrem, supra note 127

¹⁶³ Authentication and Registration of Documents' Procl/No/922/2015, art.3

the TIN Certificate, a registered MoA, and the company's registered place of business. In addition to the entire above, applicant has prepared and submitted evidences to meet the MCRs (e.g., a bank statement).¹⁶⁴

The Directive No/SBB/74/2020 addresses banking business licenses. The MoA and AoA shall be approved by the NBE before registration. Accordingly, SB prepared MoA and AoA. The NBE argues that the AoA has no place within the concept of a new commercial Code and recommended dropping the business plan. The SB counter argues that they applied their business plan before the enactment of the new commercial Code and even the new directive that includes the AoA. After a long period of conversation, SB convinced the NBE.¹⁶⁵ Moreover, before the adoption of a new commercial Code, the Directive stated that the MFI plan to be relicensed as bank that shall present signed minutes of Shareholders and amended MoA and AoA along with attendance sheet attesting their approval of the plan of MFI to be converted as a bank.¹⁶⁶ However, the NBE that has to remove out or ignore AoA from the directive.

3.6.1.3. Stage three: Letter of Intent/commitment

The letter of intent/commitment can be taken into account as it simplifies the next steps of approval to commence operations. These include the payment of license fees, preparation of premises for inspection and approval, moving capital funds to the company, fit and proper forms and supporting documents for purposes of vetting and approval of proposed officers. On 24th May 2021, OCSI was transformed to SB to provide both the MF and banking services before being licensed.¹⁶⁷ On the other hand, TB has officially begun operations of the same thing that was done on September 24, 2022.¹⁶⁸ The converted entities provided both MF and banking business services, disregarding the name of the MF business. Practically, it provided the services of MFIs when converting from MF to a formal banking system. Society is not recognizing the existence of MF services. That is why the appropriate name of the converted entity should be recognized. The (NBE) has to clearly establish a conversion criterion that encompasses MF services for society within the converted entity.

¹⁶⁴ Directive No/SBB/56/2013, supra note 154, Art.5 (2); Directive No/74/20, supra note 12 Art.4 (9(b)) and Procl/No/1243/2021, supra note 93 Art.255

¹⁶⁵ Interview with Dereje Bayera, Legal Expert of SB, 16th march 2023 and 20th May 2022

¹⁶⁶ Directive No/74/20, supra note at 12, Art.4(1)

¹⁶⁷ Bekele, supra note 143

¹⁶⁸ <https://banksethiopia.com/news/seday-bank-officially-launches-operations/> accessed at 17/02/2023

3.6.1.4. Stage four: - Issuance of New License

The licensing process consists of the ownership structure and governance, including the acceptance and confirmation of the degree to which it can meet the suitability and propriety of BoMs and senior management, its strategic and operating plan, internal controls and risk management, and its projected financial condition, including its capital base.¹⁶⁹ After the application is duly made, just like banks, the list of name, nationality, address, number, and value of subscribed shares of founders to be published in the newspaper helps to detect and find out who shall not apply to engage in the relicensed MFI as banks.¹⁷⁰

In the process of converting MFIs to banks, the period for relicensing under Directive No/74/2020 and No/78/2021 has been analyzed. Banking Regulation states that MFIs can be transformed into banks, and the NBE is expected to be issued a license within 6 months.¹⁷¹ The directive on converting MFIs to banks shows a transitional period that permits at least two years, or it requires 24 months.¹⁷² The process has a short (relative) time of period in Directive No/78/2021 and long (substantive) period in Directive No/74/2020. The period for conversion under both regulations presents a challenge in applicability due to the complex nature of organizational performance as a whole. In directive No/78/2021, the MFI is able to apply for conversion after the effective date of the directive. In addition to fulfilling the requirements under Art, 4 of Directive No/74/2020, it shall be allowed to be converted as a bank with a minimum of birr 5 billion paid up. Directive No/74/2020 shows that prior to the commencement of the operation of MFIs as banks in compliance with the provisions of all relevant laws and NBE directives took 24 months to be relicensed. Looking at its literal message, the short period may be applicable after the fulfillment of Art. 4 of Directive No/74/2020, whereas the long period shall be applicable to obtain full or formal conversion by converted MFIs to banks, where all law provisions and directives are in compliance with bank regulations and the country's law of bank formation.

¹⁶⁹Banking Business Procl/No/592/2008, A.art.6

¹⁷⁰Directive No/74/2020/, Supra note 12, Art.4(9(b))

¹⁷¹Directive/No/SBB/78/2021, Art.5 (4)

¹⁷²Directive No/74/2020/, Supra note 12, art.5

A bank must, before commencing operation, fulfill sound information management and internal control systems, risk management policies and procedures, human resource organization, and other essential obligations determined by the NB to commence its operation within 12 months from the date of the issuance of the license.¹⁷³ The conversion of MFIs to banks must comply with these requirements within 2 years of the conversion. Though, SB on February 16, 2022, officially received its license from the NBE to start operations, starting the process from May 2021.¹⁷⁴ TB has stayed up to September 24, 2022 to fulfill the requirements for conversion. The process of conversion needs to be clear, and the NBE could direct it properly. Therefore, the periods for licensing and converting need a clear procedural rule to be administered under a single law.

3.6.2. The Formation and Legal Personality

The formations of converted MFIs to banks legal personalities, as banks need formal bank typologies. The conversion of an MFI to a bank follows the strict observance of the requirements of a SC as provided under the new commercial Code.¹⁷⁵ However, they converted MFIs into banks to handle the MF, the banking business line, and its formation and legality in the name of banks.¹⁷⁶

There are different questions raised, and among them is whether the converted MFIs become privately owned or Government (public) owned. Looking at its social services and observing a huge share owned by the Government as well as its governance, the vote of the majority determines the owner, even if it carries out profit-making enterprises that can be called public banks.¹⁷⁷ Others are also considered as private banks by taking the RG as a Government-owned bank to address social services and profit-making.¹⁷⁸ The NBE in its 1st quarter 2022/2023 report lists RG based converted MFIs as private bank.¹⁷⁹ However, the RG own great share, as one shareholder entity, it is called a private bank.¹⁸⁰ Since it engages in social and financial objectives that also have 30% of its shares owned by privates and 70% by RGs, it can be called a private

¹⁷³ Procl/No/592/2008, Supra note 168

¹⁷⁴ Supra note 46

¹⁷⁵ Commercial code, Supra note 93, Art.194

¹⁷⁶ Procl/No/626/2009, Supra note at 11, Art.21 (2), and Directive No/74/2020, supra note 12, Art. 4(6)

¹⁷⁷ Frewot, Supra note 150

¹⁷⁸ Bekele, Supra note 143

¹⁷⁹ NBE, Supra note 18

¹⁸⁰ Interview with Mulalem Zawudie, Tsehay Bank, Legal head and loan recovery director, 17th February, 2023

public enterprise bank.¹⁸¹ Thus, public enterprise law can be recognized as the state-owned SC and the net total assets or capital assigned to the enterprise by the state at the time of its establishment.¹⁸² It is possible to conclude that it is a public bank since the fate of its destiny is determined by a majority vote or BoM represented by RG.

3.6.3. Branching Requirements

Directive No/SBB/66/2018 recognizes that the opening and operation branches and sub-branches of active banks require NBE approval.¹⁸³ But such a sub-branch has not allowed processing loans and advances.¹⁸⁴ On the other hand, the NBE authorizes and the converted MFI to bank sub-branch can process loans and advances.¹⁸⁵ It seems asymmetric regulation is offered for converted MFIs to banks. How and why does the law offer regulatory autonomy, converting MFIs to banks? We can understand from directive No/SBB/74/2020, the licensed MFIs as banks shall handle MF and banking as the core major line of their business.¹⁸⁶ This shows that the NBE imposes a duty on the converted entity to offer products of MF with banking activities to make it accessible for poor customers. Though, a bank can compete on prices/costs or by locating branches near clients, taking advantage of the fact that clients place value on being near appropriate services.¹⁸⁷ Another potential disadvantage to consumers is the one that was made via competition through branching, which can lead to a higher-than-optimal number of branches compared with the perfectly competitive equilibrium.¹⁸⁸

But the branch and the sub-branch of the converted MFI to bank shall not operate MF business because of the entity that they got as a bank from their origin. It is too stringent to comply with banking regulations.¹⁸⁹ Though converted MFIs to bank branches and sub-branches are typically seen as a barrier to entry since they involve administrative barriers, large fixed costs, labor-intensive ICT and digital banking network scarcity, and a lack of infrastructure and premises requirements.¹⁹⁰ Thus, there is an entry requirement that branch and sub-branch challenges with

¹⁸¹ Dereje, Supra note 165

¹⁸² Public Enterprise Proclamation Procl/No/25/1992, Art, 2(1)(5)

¹⁸³ Directive No/SBB/66/2018, Art.4

¹⁸⁴ Ibid, Art.5

¹⁸⁵ Directive No/74/2020, Supra note 12, Art.4(12)

¹⁸⁶ Ibid, Art.4(6)

¹⁸⁷ Carol Ann Northcott: -Competition in Banking: A Review of the Literature(2004), p-25

¹⁸⁸ Ibid,

¹⁸⁹ Sintayehu, supra note 150

¹⁹⁰ Dereje, Supra note 165

inconvenience of infrastructure, premises, and funds to fully-pledged branches of converted MFIs to banks like banking business.

3.6.4. Minimum Capital Requirements

MCR is to improve the capacity to serve the growing needs of their customers, mobilize resources for the national growth economy and new competitors' sustainable financial services, and protect banks from losses and risks they expose. A 75 million birr MCR license was thus issued at first. The paid-up capital has increased to 500 million birr after twelve years.¹⁹¹ The NBE has updated a regulation that has been in place for ten years to grasp five billion birr, or ten times more than the original basic basis when this regulation was established.¹⁹² It is a new large MCR and a challenge for converting MFIs to banks. The Proclamation No/626/2009 acknowledges the conversion of MFIs to banks two years prior to the issuance of the act providing an item; however, the NBE did not regulate MCRs for those desired MFIs converted to banks under Directive No/SBB/50/2011.

Therefore, the MFIs that desire to become banks have three options: First, automatic license: where the MFI without mandatory requirements subscribes fully or pays in cash and deposits 5 billion birr or more in a bank, the NBE automatically grants a bank license.¹⁹³ The OCSI and ACSI have mobilized 7 billion and 7.7 billion as SB and TB, respectively.¹⁹⁴ The second is a mandatory requirement implies that an MFI that applied for banking business after six months of the effective date of this directive, provided under Art. 4 of Directive No/74/2020 subscribed to or paid up to 5 billion birr, can get its license. The third is an ongoing requirement that was seen as optional, and it is met through the requirements of Directive No/74/2020 Art.4 and Directive No/78/2021, Art.5 (4), which fulfills its MCR within 7 years. In short, to be relicensed MFIs as banks, one should have to subscribe for a minimum payment of 500 million birr, and the NBE has required meeting a MCR of 5 billion by ongoing adequacy requirements within 7 years.¹⁹⁵

¹⁹¹ directive No/50/2011

¹⁹² MCR and Capital Adequacy Requirements of banks Directive No/SBB/78/2021, Art.5(4)

¹⁹³ Ibid, Art.4

¹⁹⁴ Supra note 47 and 57

¹⁹⁵ Procl/No/1243/2021, Supra note at 12 and supra note 12 Art.4(2))

Directive No/SBB/78/2021 was come into force on April 12, 2021, whereas Directive No/74/2020 came into effect on August 15, 2020. So, what is the MCR for those that applied before the coming into force of Directive No/78/2021 within the meaning of Article 4(2) of Directive No/74/2020? Within this question, the ongoing capital based on Directive No/50/2011 was different from Directive No/78/2021. The first problem that was observed is that the MFI that applies for banking after six months from the effective date of Directive No/78/2021, up to the mandatory requirement provided under Art.4 of Directive No/74/2020, and subscribes or pays up to 5 billion birr, can get a license. However, any converted MFIs applied before the directive become equal to those applied after the issuance of Directive No/78/2021. As a bank, the MCR needed is the same, and the latter directive is applicable with the text of Arts.4 and 5 of Directive No/78/2021.

The second entry challenge that was seen and detected was that private or small MFIs could not afford MCR to be converted from MFIs to banks like RG-owned MFIs.¹⁹⁶ Unlike newly-formed banks, MFIs with more than half a billion birr in paid-up capital are assigned within two years to meet the requirements set by the NBE, including the new capital threshold.¹⁹⁷ Because of the high capital requirements, they did not need to attract private or small MFI to fulfill the MCR.¹⁹⁸ According to Directive No/MFI/36/2023, the initial MCR for small or private MFIs seeking a MFI license is Birr 75 million. An existing MFI whose paid-up capital is less than Birr 75 million must increase it by the end of January 2028. The possibility of turning small/private MFIs into banks is still too remote.

MCRS are applicable to all types of MFIs, irrespective of whether they are deposit-taking or mere credit delivery institutions. However, the increase in the MCR may be burdensome for new entrants to this sector, and it may not pose a significant impact on already established big MFIs like ACSI, OCSI, and AASCI.¹⁹⁹ So by what rapid progressive capacity did the small and private MF sectors and firms require 5 billion birr to be relicensed? This can hasten or slow down the conversion motive of small and private MFIs. Private/small MFIs are hindered from competing in the banking industry.

¹⁹⁶ Kunde, Supra note 146

¹⁹⁷ Directive No/74/2020, Supra note 12

¹⁹⁸ Kunde, Supra note 146

¹⁹⁹ *ibid*

The Ethiopian MFI that became a bank has kept track of the banks' MCR compliance. MFIs have limited capacity to raise capital. They have the option to question the ability to enter conversion. How may these questions about how private/small MFI conversions adhere to banking requirements be addressed? As a result, several mechanisms might be offered to comply with the MCRs of the banking industry:

First, by cross-referencing Directive No/MFI/36/2023 with Directive No/78/2021, a licensed bank may engage in voluntary merger and acquisition transactions with another financial institution before the expiration of the specified period under Subsections 5.1, 5.2, 5.3, and 5.4 of Directive No/SBB/74/2020 if it becomes difficult to meet the MCR as required. However, such transactions must only be carried out with the NBE's agreement and approval.²⁰⁰ Whether merger and acquisition deals are used to reclassify MFIs as banks is up for debate. Article 6(2) of directive No/78/2021 addresses licensed MFIs as banks, provided that such transactions should be carried out before the lapse of the mentioned period. The period mentioned under Art. 5(4) of the directive address that, period for MFIs that are able to apply for a banking business license. So that merger and acquisition transactions shall apply to the converted MFIs as banks. One can address the acquisition and the transaction that are convenient to attain the amount of MCR to convert MFIs to banks. The limitation period that was mentioned under Art. 5(4) of the directive address that period for MFIs that are able to apply for a banking business license. So that merger and acquisition transactions shall apply to the converted MFIs as banks. One can address the acquisition and the transaction that is convenient to attain the MCR to convert MFIs to banks; however, it may create challenges for employees and customers.²⁰¹ This was taken from the interview made by Efrem.

Second, even though the MCRs may be lower than those for converted MFIs to banks, MFIs that can meet the same prudential criteria can be converted to commercial banks and are still allowed to operate. Notably, tiered-base financial regulation is not recognized by Ethiopian banking legislation, but it is also not forbidden.²⁰² It is possible to re-license as specialized bank with MCR levels lower than those for conventional banks.²⁰³ But the problem is that NBE is not interested in escalating the number of banks because it is difficult to supervise and regulate

²⁰⁰ Procl/No/1243/2021, Supra note 193, aAt.6(2) and Procl/No/592, Art 3(3(c))

²⁰¹ Efrem, Supra note 127

²⁰² Addise Gemechu, supra note 139

²⁰³ Efrem, Supra note 127

owing to a scarcity of resources and a lack of professional human resources from NBE.²⁰⁴ As a result, it might be suggested as a solution to use a tiered system, which is a gradual regulation to raise MCR through rearranging its organizational design depending on its size and risk exposure.

The third and final permission, which dealt with the capital required for relicensing, was interpreted to mean that an extraordinary general meeting had given its blessing. The capital may be raised by issuing new shares or by raising the par value of existing shares.²⁰⁵ This may depend on the earnings when compared to the new Shareholder that the corporation had in mind.

3.6.5. Ownership Spreading and Share Restriction

The concern of developing ownership and spreading the idea of gaining a share can be seen first. Ownership pattern in the Ethiopian banking sector, provided a maximum SH limit of 5%, states that “No person, other than the FG of Ethiopia, may hold more than five percent of a bank’s shares either on his own or jointly with his spouse or with a person who is below the age of 18 and related to him by consanguinity to the first degree.”²⁰⁶ The logical extension might lead us to conclude that the aggregate share of a company and its subsidiaries should not exceed 5% of shares in a bank. A requirement for ownership diversification is almost intended to prevent "capture" of bank licenses by individuals or groups.

What was the response to the question about how to comply with the RG share amount and shareholders in the transformed MFIs as banks? The law gives NBE the right to set a limit on the RG share volume coming from an MFI.²⁰⁷ Accordingly, the NBE limits the RG not to holding more than 70% of share in MFIs seeking to become banks in directive No/SSB/74/2020.²⁰⁸ The NBE permitted maximum is up to 70% by rule; nonetheless, several objections over the percentage the RGs have to be owned.²⁰⁹ Therefore, RG’s debt of up to 70% represents a sizable portion of that impact in judgments made against voiceless shareholders.²¹⁰ Due to its significant shareholder; the RG is able to have an impact on CEOs

²⁰⁴ *ibid*

²⁰⁵ Procl/No/1243/2021, *Supra* note 92, Art.422(1)(2)

²⁰⁶ Procl/No/592/2008, *Supra* note 89, Art.11(1)

²⁰⁷ *Ibid*, Art.11(2)

²⁰⁸ Directive No/74/2020, *Supra* note 12, Art.4(3)

²⁰⁹ Bekele, *Supra* note 143

²¹⁰ *ibid*

and BoMs in this regard.²¹¹Therefore, if huge shareholders conspire with managers to expropriate small investors' benefits in the company, a practice known as "tunneling," then concentrated ownership has negatives.²¹²Thus, a heavy hand of government in business is illogical.

Regional development organizations must have at least one endowment company to operate enterprises.²¹³On the other hand, RG owned up to 70% of the converted MFIs of the banks, which enabled the government to put political pressure on them to undertake functions that would be detrimental to the social objectives of society. Most of the time, we are faced with both artificial and natural catastrophes.²¹⁴Unlike private banks Shareholders, the RG has a responsibility to protect society from emergencies. Private Banks run by people and certain Shareholders with private registrations may not care about the victims in favor of thinking about their revenues.²¹⁵

The remaining 30% of the share is not defined by the directive and is seen as how a transfer can be made. This may cause challenges of transparency, in transferring the remaining share. So how do the converted entities transfer the residual share in compliance with banking regulation? SB distributes 30% of the remaining share to the SOEs.²¹⁶The directive excludes SOE from the RG.²¹⁷RG companies are allowed to own and manage private property enterprises that compete with the private sector, although it is not clear how the initial capital of these companies was paid.²¹⁸The OSCI to SB formation identified the bank's shareholders as transportation, forest, seedling, and beverage enterprises.²¹⁹How much of a percent of shares each SOE should own doesn't get explained by key informants appealing confidentiality. However, when converted MFIs become banks, hereinafter called "banks", some argue that each SOE shall own equal to

²¹¹Efrem, Supra note 127

²¹²Okpara, J. O. Perspectives on Corporate Governance Challenges in a Sub-Saharan African Economy, *Journal of Business & Policy Research*, 5(1), (2010), P-111

²¹³Toward the Competitive Frontier: Strategies for Improving Ethiopia's Investment Climate, Document of the WB, Report No. 48472-ET, June 2009, p-55

²¹⁴Dereje, Supra note 165

²¹⁵Ibid

²¹⁶Bekele, Supra note 143

²¹⁷Directive No/74/2020, Supra note at 12, Art.2(6)

²¹⁸Milkias, P. Ethiopia, TPLF and Roots of the 2001 Political Tremor, A paper presented to the Proceedings of the International Conference on Contemporary Development Issues in Ethiopia; Ethiopian American Foundation, Western Michigan University, Aug. 18, 2001, p-18

²¹⁹Dereje, Supra note 165

the number of individuals owned in banks.²²⁰ Others argue that, given the nature of MFI, restrictions on shares like those of banks may diminish the investment in new businesses, and it is possible to have more.²²¹ Further, due to the nature of the bank as a public enterprise, the RG can allocate the remaining 30% to any interested party without limiting it to 5%.²²²

There is a question of whether the remaining portion has been allocated to a private individual or a private firm. In this regard, TB has handed the remaining 30% share to chosen staff who have been serving for a long time, as well as clients who have been continuously served in the institution for a long period of time.²²³ It demonstrates that TB has transferred the remaining portion to individuals. Before the MFI was converted into SB, just one individual had a negligible share of OSCI.²²⁴ As a result, transferring the remaining share to the converted entities is not consistent across the two entities. SB has been controlled by RG representatives both before and after conversion. The BoM is structured as their Shareholder amount in order to preserve the interests of the RG, which purposefully distributed the remaining share to the SOEs. The development of SOEs represents the collaboration of government and private sector enterprises to maximize profits.²²⁵ This implies that the SOEs have an attachment to RG in terms of fusion of power and economic integration. On the other hand, some limitations in organizational leadership performance can also be detected. The remaining share was curbed, provided that the SOEs carried out their duties under the control of the RG.²²⁶ Therefore, the remaining 30% share allocation lacks clarity. Within the law there is a gap to undertaking to transfer the remaining share.²²⁷ However, the law extended protection for the minority Shareholders from injury provided that a general meeting may not pass resolutions that affect or give undue benefit to some shareholders.²²⁸ Under such circumstances the NBE has a duty to control and regulate it.²²⁹

In general, the blending of politics and business can bias expert judgments that are largely motivated by political rationale rather than sound business principles. The RG's heavy hand in

²²⁰ Supra note n(143 and 145)

²²¹ Kunde, Supra note 146

²²² Addise, Supra note 139

²²³ Mulalem, Supra note 180

²²⁴ Dereje, Supra note 165

²²⁵ Ibid

²²⁶ ibid

²²⁷ Procl/No/1243/2021, Supra note 93, Art.508 and the following

²²⁸ Ibid, Art.364

²²⁹ Efrem, Supra note 127

bank ownership and management, however, raises questions regarding the fair treatment of private and government-affiliated institutions from the perspective of a vibrant free market. The influence of RG was significant from the point at which residual shares were formed and distributed.

3.6.6. Business Plan and Organizational Structure

Each converted MFI to bank shall state in its business plan the mission of the organization, internal bylaws, and business models about the provision of MF services as one of its core services and put in place the required resources.²³⁰ The mission is the balance between the social and commercial objectives of the institution, and the shareholders or board of directors discuss during their meetings the proper balance between financial and social goals. First, the converted MFIs should have included in their MoA a mission statement, internal guidelines, and a business model in line with the provision of business line services, ensuring that customers continue with MF services.²³¹

The entity can also determine its internal affairs under internal law. With the agreements of the shareholders or board of members of the poor customers (women, low-income farmers, and rural enterprises) determined by internal law, how they can remain with MF business preferred lending and interest rates.²³² For any bank on the market sector to grow more dealing or working on loan is mandatory got prior activities to be carried out. The board must ensure that the institution complies with its articles of incorporation, bylaws, and internal policies and procedures.

Organizational structure and functions are the arrangements of an organization's work force according to job responsibility and ranking to ensure their proper functioning.²³³ In this regard, the SB organizational structure indicates and suggests the presence of shareholders, nine board members, a CEO, including the president, six vice presidents, and three appointed executives in charge of corporate banking, corporate strategy and business growth, and banking and MF operations. Additionally, TB owns Shareholders, seven members of the board, the CEO, including the president, and six vice presidents with roles equivalent to SB's. However, the

²³⁰Directive No/74/2020, Supra note 12, Art.4(5)

²³¹ Bekele, Supra note 143

²³² Efrem, Supra note 127

²³³<https://www.wallstreetmojo.com/Organizational-Structure/>:accessed on 16th March, 2023

transformed firms have adhered to the organizational structure and business strategy presented by NBE.

3.6.7. Management and Ownership Quality

Ethiopia authorizes the NBE to enact qualification, fitness, and propriety criteria for influential shareholders of the banks, the directors, and the chief executives of the banks. A fit and proper person is a person of integrity who has a good record of business and the requisite knowledge and ability for the position the person holds or proposes to hold.²³⁴

This study shows that the influential shareholders in converted MFIs can be divided into two entities. The Public and the private banks have influential shareholders. An argument that is provided under Section 3.6.5, limited to 2%–5% of the private banking limitation, does not abide the public owned enterprise within the meaning of directive No/SBB/74/2020, Art.4(3) and Procl/No/592/2008, art.11(1, 2) that the RG and FG being by themselves own the share in monopoly.

The BoM those run as the head management bodies has recently been restructured to incorporate the necessary skills with the responsibilities of providing overall guidance and policy directives rather than political motives.²³⁵ RG owned MFIs have the motive to assign influential politicians as members of the board to protect the RG interests. However, as the core regulatory mandates, the NBE is to monitor compliance with relevant provisions on the appointment and the responsibilities of the BoM.²³⁶ So that the NBE regulates its mixture of core competencies such as banking, accounting, finance, management, economics, legal, business administration, auditing, information technologies and investment managements as well as their adequate experience with an age of 30 years minimum requirements.²³⁷ The BoM assigned from the remaining 30% share as a minority Shareholder, the possibility to deserve the standard of proper and fit protection is so difficult.²³⁸

The chief executive and senior executive officers should have banking experience during their work and experience of the fit with proper assessment.²³⁹ Thus, a chief executive officer and

²³⁴ Procl/No/592, Supra note at 89, Art.14(1)

²³⁵ Directive No/SBB/79/2019

²³⁶ Procl/No/592, Supra note 89, Art.14-16 and ibid

²³⁷ Directive No/79/2019 Art, 5.1.1

²³⁸ Addise, supra note 139

²³⁹ Directive No/79/2019, Art.4(10)

senior executive officer hold a minimum of a first degree, and both of them have 12 and 10 years of experience in banking, respectively. According to their alleged experiences, they shall serve at least 5 years as senior executives and 4 years as department managers or equivalent, respectively.²⁴⁰The directive strictly sets similar chief executives and senior executive officer requirements for both converted MFIs and banks. So, there are no entry/regulatory challenge requirements for CEOs. That is why the NBE has approved the appointment of Neway Megersa Lenjiso, as the first president of SB, who meets the requirements of experience. On the other hand the company appointed Zewdie Tefera, who has been working as acting president of the bank as the Chief Operating Officer.²⁴¹Why Zewdie has been as acting is that OSCI has been a changed president from time to time so that he is not fulfilling the requirements of the post.²⁴²On the other hand, the NBE approved president of TB former ACSI head who has been serving a long period. But many managers and branch managers who have a skill and experience do not fulfill the post due to their unfit educational background.²⁴³The data that was gathered from an interview indicated that it was transparent due to the agreement and negotiation made between the two parties.

3.7. Professional Employee Required

Professional employees were required for any organization or service sector. The majority of employees in MFIs before the entity converted to banks were experienced in dealing with a mono-product and group lending structure.²⁴⁴Thus, the converted entity would have to hire employees with banking experience. This would mean a team of new employees joining the team and affecting the existing organizational culture. This would require a change in profession so that the older force does not feel threatened by the new additions to the team and adjusts to the 'culture'. In one way or another, other way professional team is very important to encounter the tasks required for bank work.

The requirements of employees are not governed by directive No/74/2020 as the standard of proper and fit requirements, but it is an internal guideline.²⁴⁵The labor law is applicable in a manner that the transfer of ownership of an undertaking shall not have the effect of modifying a contract of employment.²⁴⁶The question was frankly addressed: how do SB and TB employees

²⁴⁰ Ibid, Art, 5.1.2 and 5.1.3

²⁴¹ <https://www.capitalethiopia.com/2022/3/21>, accessed on 16/02/2023

²⁴² Supra note 143

²⁴³ Mulalem, Supra note 180

²⁴⁴ Addise, Supra note 139

²⁴⁵ Dereje, supra note 165

²⁴⁶ Labor law Procl/No/1156/2019, Art 16

have an experience of banking business? There is a minimum requirement for each position that has to be filled, and the names must be approved beforehand. The operation of a new market in the country, especially in the banking sector, may require skills, changes in staff roles, and responsibilities, including high quality experiences. Such gaps are filled through training and educating employees. That is why Directive No/74/2020 gives a two-year transitional period for commencement. SB has trained many employees at Adama to familiarize themselves with the business nature, job, culture, and financial transactions to adjust to the banking business for two years.²⁴⁷

3.8.MF Products Continued under the Bank:-As Separate Subsidiary or as a Unit.

The newly converted MFIs to banks are required to continue their MF products without any reservations. The question that needs an answer is: how could this be implemented, and how could the MF product be re-licensed under the bank? Is it a separate subsidiary or a unit within the converted bank? And there was also another question that shows and tells us what challenges MF products converted with the converted entity. These questions were answered as the product continued and was taken into the possession of the newly emerged banks, from MFIs to main banks.

MF is a powerful tool to serve products to fight poverty through credit, savings, transfer of funds, and insurance (credit life and micro-insurance) businesses without an additional license but with the help of product approval.²⁴⁸ Such involvement is for the well-being of their clients, to protect the poor and to ensure social protection, whereas banks shall not offer such activities for customers.²⁴⁹ The newly converted MFIs to banks are required to continue their MF products as a unit under the bank, rather than as a separate subsidiary or separate license.²⁵⁰ However, the converted MFIs to bank culture are seen as friendly and taken as helpful to the poor who is characterized more by personal services. SB and TB have served their customers through banking and MF line of businesses/ two business sectors under one entity.²⁵¹

On the other hand, Banks are financial intermediaries to encouraging economic growth.²⁵² Bank is not interested to offer Micro/credit life insurance services and no regulations force for its

²⁴⁷ Efrem, Supra note 127

²⁴⁸ Procl/No/626, Supra note 11, art.3(2)

²⁴⁹ Dereje, Supra note 165

²⁵⁰ Efrem, Supra note 127

²⁵¹ Procl/No/626/2009, Supra note 12 Aart.4(8)

²⁵² Andreas Busch Banking Regulations and Globalization Oxford University Press 2009, p-23

customers/clients the bank to offer such products.²⁵³ However, the converted MFI as a bank offer credit-life/micro-insurance through the MF line business to serve the poor client, whereas commercial products are carried out by the banking line business to serve the profitable traders.²⁵⁴ So, directive No/74/2020 recognizes both the MF and banking line businesses to serve the poor and businessmen. There is a substantial difference between the two business lines in terms of procedural norms for serving customers, human skills, technological understanding, and client or customer pleasure or demand. As a result, an MF-line business line operating in the name of banking is illogical.

There are entry challenges for products continuing with the converted entity as a unit. First, the main purpose of an MFI shall be to collect deposits and extend credit to rural and urban farmers and people engaged in micro- and small-scale rural and urban entrepreneurship. In carrying out such activities, MFIs prefer tax exemption, but after conversion, banks do not prefer tax exemptions like MFIs.²⁵⁵ Second, the converted MFIs can be sued on behalf of MF businesses to incur liability. Thus, a converted entity as a unit may transfer liability from MF to the converted entity.²⁵⁶ Third, MF businesses may not have their sub-companies; the line of train or progress forms a corporate group without varying degrees of ownership.²⁵⁷ Under the converted entity-MF business framework, there is no need to mitigate risks.

²⁵³ Kunde, Supra note 146

²⁵⁴ Efrem, supra note 127

²⁵⁵ Addise, supra note 139

²⁵⁶ *ibid*

²⁵⁷ <https://corporatefinanceinstitute.com/resources-accounting-subsidary-definition>: accessed at 14/2/2023

Chapter Four

4. Entry problems arising from Microfinance Institution Conversion tool Customers of the Converted entities and ways of mitigating the risks

4.1. Major Problems/risks of Entry Regulations and its Mitigations

There are different kinds of problems/risks concerning to converting MFIs to banks regulations. Such problems/Risks arising from the entry market are associated with converted MFIs and the old customers, emanate from information irregularities,²⁵⁸ mission drift, infrastructure and geographical remoteness, inadequacy of capital guarantee, and legal/regulatory. Appropriately, regulatory/legal problems/risks are the potential loss resulting from changes in laws or rules during conversion.²⁵⁹ Thus, compliance problems are one of the losses arising from non-compliance with laws, rules, and regulations, prescribed practices, internal policies, procedures, and ethical standards. Certain situations of laws or rules governing certain bank products or activities may be ambiguous or untested for the old customers and stakeholders, and they might void the relations with the existing old section and cope with the new scenarios of the existing situation.²⁶⁰

There is also a risks/problems connected with ICT and digital banking knowledge to comply with banking business.²⁶¹ It is impossible to eliminate risks entirely; rather, it is better to minimize and manage them. Profit can be optimized without exposing the organization to unnecessary losses or institutional failure.²⁶² Thus, it could be examined whether prudential regulations, policies, and procedures proposed to mitigate risks comply with banking business.

²⁵⁸ Thankom Arun "Regulating for Development, The case of microfinance", in David Hulme and Thankom Arun (edn) *Microfinance, A reader*, Routledge, London(2009) p.192-194

²⁵⁹ MFI Edition Adaptation of the Global Corporate Governance Forum's Governing Banks Supplement July 2013, p-48

²⁶⁰ Supra note 257

²⁶¹ <https://Global-hitachi-solutions.com/blog/risk/management-in-banks>; accessed 11, January 2023

²⁶² Addressing Capital Adequacy for MFIs: A Risk Management Approach Estelle Berger, Director of Knowledge Management Opportunity International US January 2010, p-4

These risks expose the former MFIs clients to the possibility of terminating their contracts.²⁶³ Consequently, converted MFIs require contemporary solutions to mitigate risks.

4.1.1. Mission Drift and Information Irregularity;and Its Mitigations

Organizational goals vary from profitability to productivity, efficiency, and customer satisfaction. Wassie, S., Kusakari, H., and Sumimoto, M., in their study of Ethiopian MFIs, find that there is no evidence of conflict between the social and financial performance of the institutions of MFIs.²⁶⁴ Different questions arose and could be answered by firms, especially those who entered banks from MFIs. Is there a social and financial performance conflict in the entry requirements of converted MFIs to banks? How rationally effective is relicensing to achieve social and financial products simultaneously? The answers could be both in the context of the nature of the firms, and the companies' mission based on the status quo of the organizations.

The BoMs are playing key roles in ensuring the entry requirements for converting MFIs into banks by responding to social and financial objectives. A lack of balance between the two/if one mission fails at the entry requirement may create a mission drift. In cases where the board has too much social orientation, the organization falls into the trap of a mission drift against commercial interests. Sidama Bank has proposed a business plan motivating social missions.²⁶⁵ Similarly, boards that have a heavy commercial orientation may want faster attainment of sustainability, larger financial objectives in order to increase profitability, in which case the organization falls into the trap of changing social interests. TB proposed a business plan motivated by social objectives.²⁶⁶ SB has provided MF and banking services in parallel. Therefore, the MFIs converted to a banking business and were recognized and exposed to the market in the sense of the provision of MF and banking services. They also put in place the required resources for fully advanced and well organized operations.²⁶⁷

²⁶³ Supra note 258

²⁶⁴ Wassie, S., Kusakari, H. and Sumimoto, M. "Performance of MFI in Ethiopia: integrating financial and social metrics", *Social Sciences* (2019), Vol. 8 No. 4, p-117

²⁶⁵ Efrem, supra note 127

²⁶⁶ Ibid

²⁶⁷ Directive No/74/2020, Supra note 12, Art.4(6)

The perception of converted MFIs as banks has not been helpful to the poor as an MF. The idea of creating and forming banks emerges from the blueprint, in which the need for business growth and creating something new is that there is a risk of information irregularity and a lack of knowledge on the part of customers. This causes the perception of product interruptions; especially banking businesses established that for profit implies that MF doesn't continue with poor old MFI customers/clients.²⁶⁸ But, the NBE addresses this concern and requires that the pre-existing products should not be interrupted, as well as the pre-existing customers should not be dropped from the converted entity.

The NBE has supervised banks and the financial sectors of the country.²⁶⁹ Within the entry/ongoing conversion of MFI to a bank, a question has been raised about the ability of MFIs to perform financially well without compromising the current service as part of its banking product.²⁷⁰ The converted entities have produced a written commitment undertaking to continue the MF services to avoid mission drift. Hence, bank formation based on global, continental, national and regional regulatory systems.

Also, MFIs involved in partnerships with banks should make sure that the objectives of banks and MFIs are aligned to avoid the risk of the mission drifting under the control of NBE.²⁷¹ Therefore, the law balances the mission and entry requirements to achieve both objectives. However, whether the converted MFI to the bank is continuously delivering socially objective equal financial services will deserve further research with ongoing requirements. The finding through interview and document analysis shows that there was a proper and equal balance of legal procedures here.

Mission drift is a significant issue for MFIs as a result, and BoM seeks to maintain control over the company to maintain harmony between social and financial objectives. Information inconsistencies, however, are having an effect on older MFI consumers. This demonstrates that MFIs owned by regional governments turned into federal government banks without the knowledge of their customers.

4.1.2. Regulatory/Legal problems/risks and its mitigations

Legal and regulatory requirements for businesses that do not take into account the nature of pre-converted entities may result in risks/problems that must be managed while conducting

²⁶⁸ Mulalem, supra note 180

²⁶⁹ Efrem, supra note 127

²⁷⁰ Directive No/74/2020, Supra note 12, Art.4(8)

²⁷¹ Cozarenco, A. MFIs and Banks in Europe: The story to Date(2015), No.15-027

business. One thing to keep in mind is that the entire legal process involved in company transactions is a must. Certain legal and regulatory requirements that conflict with banking operations may have an impact on the converted entity, the customers and stakeholders of the former MFIs.

First, starting from the objectives of converting MFIs to banks, the entity has proposed to balance financial and social objectives. As provided under Section 4.1.1, no customer should be dropped and no product should be interrupted. The Microfinance business law provided that, except for distributions to shareholders, any MFI that makes profit from its business and fully ploughs it back shall be exempt from profit tax.²⁷² This could be done where revenue is collected annually to capacitate and encourage the business. So that in cases where the MFIs converted to banks, the regulator does not consider the privileges of tax a profit exemption. The law is silent about the profit from its business, and fully ploughs back shall exempt profit tax as per Art.23 of Procl/No/626/2009. This demonstrates that the converted MFIs, which constitutes both MF and banking line business, face regulatory problems/risks. Risks/problems may not only emanate from commercial industries' fears of bankruptcy, loss, or exhaustion.

To mitigate such problems/risks, the law should address such profit tax privileges. Also, if MF Products is established as a separate subsidiary entity, the net earnings from a non-profit, charitable, tax-exempt subsidiary can be transferred to the parent as a contribution. Since the object of microfinance may be considered a charitable function, local assessing officers of the Income Tax Department often exempt the income from MF business activities. However, converted MFIs need to apply to the income tax authorities to get this exemption. Thus, proclamation prevails over directives through application and interpretation. The situation in these sectors, in one way or another, paved the way to revise, or adopt new notions.

Second, the Oromia Regional State regulates that exempt court fee when and where the RG MFI is a plaintiff.²⁷³ On the other hand, in Amhara Regional State, there was no such regulation of court fee exemption.²⁷⁴ The problem related to OSCI post conversion is that the converted entity relicensed as a SB has been forced to pay court fees. Though the bank's regulations didn't consider the RG rules during conversion, The RG has its own set of laws and regulations that the NBE is not considered to be complying with. Thus, there is a compliance risk arising in

²⁷² Procl/No/626/2009, Supra note 11, Art.23

²⁷³ Dereje, supra note 165

²⁷⁴ Mulalem, supra note 180

situations of this type, and the laws or rules governing OSCI products or activities of the company/clients may be distressing and confusing. The NBE has to search for challenges to come up with a conversion.

Thus, RGs have different rules and guidelines to apply their respective rules differently. Such conditions become a problem for RGs while applying national law.

Third, concerning the taxing power, the pre-converted entity has been paid to the Regional Government tax authority. However, after conversion, the practice brings a change in the taxation system from RG to FG tax authority.²⁷⁵ Interview respondents from the two RGs and MFIs addressed the matter. Accordingly, Addise argues that taxation power should follow ownership of the company that has to be paid to the RG tax authority.²⁷⁶ Dereje added that RG enterprise tax has to be paid to the RG tax authority under the principle of fiscal federalism.²⁷⁷ On the other hand, respondent, Mulalem argues that RG is considered as one of the Shareholder entity registered and licensed by FG and that the competent authority is a FG tax authority.²⁷⁸ The taxing authority is not privilege the bank from tax exemption. Thus, this is a regulatory problem/risk to the old MFI customers, i.e., it affects the RG tax authority/stakeholders. However, a dispute will be inevitable between FG and RG on taxation power. The conclusive remarks both from the interview and document analysis indicated that mitigation is under question.

However, in order to reduce such risks/problems, the law, namely constitutional law, must be properly implemented. Second, the RG owned MFI is culturally and morally tied to the RG and is better introduced as a state bank by addressing MF and banking activities similarly to accommodating the two. Thus, both the RG, or privately owned MFIs, and those managed by the FG could be trusted by their respective clients.

4.1.3. Problems of Capital Inadequacy and Its Risk Mitigations

As provided under Section 3.6.4 above, capital adequacy is guaranteed to carry out banking transactions without loss. The merger and acquisition transaction has secured more capital or addressed a solution to MCRs to convert the MFIs. The unsatisfied required capital even after the transaction of merger and acquisition may cause risks for the converting entity, employees,

²⁷⁵Addise, supra note 139

²⁷⁶Ibid

²⁷⁷Dereje, supra note 165

²⁷⁸Mulalem, supra note 180

customers, and various stakeholders.²⁷⁹ RG based converted MFIs to banks, i.e., TB and SB have a huge amount of adequate capital to enter the market compared to private/small MFIs. Capital inadequacy makes banks/MFIs CEOs and employees in Ethiopia anticipate job losses.²⁸⁰

By ensuring that new entrants have the required regulatory tools to provide sustainable financial intermediation, capital adequacy helps reduce risks. Therefore, risk reduction includes deposit insurance, access reserves, and payment guarantees for specific kinds of financial transactions between banks and clients.²⁸¹ Preventive regulatory actions also aim to control the risk to reduce the probability of failure by issuing various requirements related to market entry.²⁸² As a result, the converted organizations that wanted to become banks met the capital adequacy requirements. Inflation, market losses, and the country's national debt are factors that put the converted institution at risk. Increases in the Growth National Program (GNP) and Growth Development Program (GDP) should be given in order to lower these risks.

4.1.4. Problems of ICT and Digital banking; and its risk mitigations

The acquisition of technology for the core banking system is essential to developing MFI's business plan. The banking industry is an intensive user to increase the economies of bank products, development of new products and services, such as payment processing, cash management, and bank office operations.²⁸³ The core banking and financial system of a country is mandated to abide by the rules and regulations of the country.

Huge reductions in the cost of computer processing power, as well as significant decreases in the cost of storing and sharing data, have allowed banks and other financial services firms to more easily utilize the information they gather on their customers.²⁸⁴ Many of these developments have benefited consumers in their data-mining abilities, allowing them to better understand customer profiles, increase the range of services offered to customers, evaluate creditworthiness more accurately, and price risk accordingly.²⁸⁵ There was a big difference between rural areas and urban centers for customers. But they differ in the contexts and situations in which the system operates. However, the rural customers of MFI during conversion

²⁷⁹ Addise, supra note 139

²⁸⁰ *ibid*

²⁸¹ Rodrigo and Claudio, Supra note 74

²⁸² *ibid*

²⁸³ Carol Ann Northcott: - Competition in Banking: A Review of the Literature (2004), p-25

²⁸⁴ <https://www.minneapolisfed.org/article-2004/banking-regulation-the-focus-return-to-the-consumer>, accessed, on 19/02/2023

²⁸⁵ *ibid*

become the bank's main customer base were unaccustomed to ICT. Therefore, accessing the digital services is a challenge because they have never used it before.²⁸⁶ This is a risk and negative impact on consumers and financial institutions with a range of negative outcomes.²⁸⁷ Customers are therefore at danger since they lack financial literacy, are poorly educated, and have a limited grasp of financial products. Technology-related data breaches and misuse result in a risk relationship. Customer is reluctant to adopt new technology, particularly among conventional, unsophisticated consumers. Additionally, the converted MFI workers are likely to have poorer information processing skills and have significantly less education than their counterparts in formal banking sectors. The reduction of client risks enhances customer satisfaction and financial inclusion.²⁸⁸ The regulator should provide financial education and awareness to employees and consumers before operation or at the entry stage.²⁸⁹ The advancement of using computers, broadband, web pages, and digitalized financial works could be assessed and motivated by the converted entity works.

4.1.5. Problems of Geographical and Infrastructural Remoteness

One of the objectives of the conversion of the MFI to the bank is to increase outreach, that is, for the institution to reach lower income people. The challenge includes new banking infrastructure, monitoring systems, and communication.²⁹⁰ This approach means that the requirements of a fully-pledged branch for the conversion of MFIs to banks are so expensive for the institutions to establish in each village, unlike banks in Addis Ababa and regional capital cities in short time. There were big gaps between Addis Ababa and the rural areas found in the RGs. Customers in rural areas are expected to travel long distances and pay high transport costs in an attempt to contact the converted MFI at the bank.²⁹¹ The inadequate rural branch of the banking sector has prevented direct service delivery to rural and low income clients and has increased risk perceptions towards the customers.²⁹² Also, there is a challenge in receiving information on the performance of branches and sub-branches. There are different problems, physically, socially, and culturally, in dealing with converted entities in general. Therefore, to

²⁸⁶ Kunde, Supra note 146

²⁸⁷ *ibid*

²⁸⁸ Mulalem, Supra note 180

²⁸⁹ Frewot, supra note 150

²⁹⁰ Dereje, Supra note 165

²⁹¹ *ibid*

²⁹² Supra note 37, p.4

solve the situation, it has to do with more than the mere weakness of the banks; it also has to do with the role of the government to improve infrastructure by opening or pushing bank branches into remote areas and small towns in the region. To achieve universal access, banks will need to adapt their high-volume transactional environment and build a more flexible, accessible marketing network of points at which people can conveniently pay into or cash out of their transactional accounts.²⁹³ Auditing, registering accounts, and auditing work by hand and through electronic devices were not the same even in one city. The rural areas lacked internet access, electrical power, and manpower for construction projects.

²⁹³CGAP, Overview, available at <http://www.cgap.org/p/site/c/template.rc/1.11.1029/1.26.1525/>, accessed on 21/02/2023

Chapter Five

5. Conclusion and Recommendations

5.1. Conclusion

The National Bank of Ethiopia is empowered to convert microfinance institutions into banks in conformity with the legislation governing banking operations and the administrative requirements of the Banking Licensing Directives. Therefore, microfinance institutions adhere to the same regulations as formal banks before applying for a license. To convert microfinance institutions into banks, they must observe the same legal requirements as well as to conducting banking businesses. A change of the Memorandum of Association pre-supposes to allow microfinance institutions to become banks.

The amended Memorandum of Association must be addressed by shareholders in their signed minutes, along with an attendance sheet attesting to their support for the proposal to relicense microfinance institutions as banks while maintaining equal access to banking and microfinance products without losing the pre-converted customers. The microfinance business line functions in parallel with the banking business line to establish a client's trust and balance missions. As part of the registration procedure, which also involves the final licensing stages and name, license, and documents verification, letter issue, microfinance firms are relicensed to banks. Regional Governments can register and certify converted microfinance institutions, while Federal Governments can carry out creation, licensing, and regulations to reflect the Federalist spirit.

Converting microfinance institutions to banks improves governance, regulatory compliance, and financial restructuring to engage in international banking operations. Also, it requires the development of core banking system technology, recognition of government interest, the transformation of products, access to public deposits, improved customer profitability, and promotion of competition.

However, conversion activity is not easy due to a lack of experience, so the regulator has to check the required capital, whether it is directed and managed by persons of fit and proper criteria; business plan and organizational structure; ownership diversification; and the restrictions to be relicensed. Banks licensed by the National Bank of Ethiopia can engage in the

microfinance business. However, the microfinance industry requires re-licensing to operate in the banking industry.

Although the National Bank prepared Directive No/SBB/74/2020 in light of Procl/No/626/2009, Art. 21. It took eleven years to establish the standards for re-licensing MFIs. Additionally, the National Bank also provided minimum capital requirements under Directive No/78/2021 as entry conditions for MFI relicensing to banks. For private/small microfinance banks to achieve the minimum capital requirements, the law requires merger and acquisition transactions. The majority of Regional Governments-owned microfinance organizations have fulfilled the entry-level legal requirements for a banking license. The newly converted MFIs to banks committed to providing microfinance products as a unit within the bank rather than as a separate subsidiary or license.

Even though the National Bank of Ethiopia-formulated entry and regulatory requirements relating to institutional form and legal personality, business strategy, and organizational structure, as well as management and ownership qualities of converting microfinance institutions to banks, they conform with banking laws. Institutionally, the converted microfinance organizations into banks rigorously adhere to the share company rules and can be referred to as "publicly owned banks." By relicensing microfinance institutions to banks, Directive No/74/2020 addressed both the financial and social aims of mitigating mission drift. However, due to substantial operating expenses associated with the establishment and upgrading of existing branches, the conversion is not likely to be profitable in the first year.

Therefore, the study addresses the following findings from legal analysis and interviews: The important findings are as follows:

First, Directive No/SBB/74/2020 does not adequately address the inclusive procedural rule that supports both microfinance and banking business services in conversion activities. The converted entity uses the bank as an improper business name that is not accommodates both banking and microfinance entities to address the community's incorrect view of information irregularities. There is no collaboration between the regulator and the regulated entities, nor is there a distinct management body championed by which conversion is facilitated. There was also a shareholder's meeting delay to report the mission, vision, core values, and goal of the organization as supported by the memorandum of association. The minutes of the shareholder's meeting are not signed, indicating a lack of transparency. There is also an incomplete evidence

report regarding capital adequacy, asset quality, managerial competence, earnings, and the liquidity ratings composite. These tasks take time and put the conversion process to the test. The phrase Article of Association, as defined by Directive No/74/2020 and the previous commercial code, is not recognized by the New Commercial Code. The converted entity divided the business into microfinance and banking line services, which continue to serve consumers in the low and high classes, respectively, like former microfinance institutions and banking businesses.

Second, because of the high fixed costs, labor-intensive nature of the operations, limited availability of information and communication technology and digital banking networks, lack of infrastructure and premise requirements, and security threats, the conversion of microfinance institutions to banks and sub-branches is frequently seen as a barrier to market entry.

Third, the ability of private or small microfinance institutions to transform into banks was not taken into account when the National Bank of Ethiopia set the minimum capital requirement by Directive No/78/2021. The necessity for capital sufficiency (minimum capital requirements) and the task they undertook probably meant that the Regional Government microfinance institutions moved more quickly. It is considered that the law prevents private/small microfinance institutions from entering the market and hinders their ability to compete. Ethiopia introduced one-size-fits-all minimum capital requirements for all microfinance institutions' conversion, which is not suitable for private Microfinance institutions to enter the market.

Fourth, there is an argument that under Directive No/74/2020, 70% of shares represented by Regional Governments violate business principles, which might impact judgments made against the voiceless, and allocating the remaining 30% of shares lacks transparency. The distribution of the residual share is not governed by any strict regulations. The merger of politics and business generally has the potential to bias expert judgment in favor of strong political motivations over sound economic ones. The Regional Government creates the company and indirectly manages the distribution of residual shares with the motive of political decision; the converted entity is termed a public-owned bank.

Last but not least, there is a chance that risks would harm the newly converted organization, the stakeholders, and the customers of the former microfinance institution. The converted MFIs may be affected by liability stemming from the old microfinance business, loss of court costs and profit tax exemption due to microfinance firms combining with banks in the name of

banking, and unfamiliar workers with digital banking services. Risks associated with former consumers of micro-financing institutions include asymmetric information, inaccurate community opinions of microfinance enterprises they believed had been shut down, access to a bank, and technological illiteracy barriers. The Regional Government is a stakeholder in this project, and one of the major risks or problems is the loss of revenue or tax earned from the converted entity before conversion.

5.2 Recommendations

Based on the study's findings and conclusions, the researcher forwarded the following recommendations:

- It is recommended that the National Bank design a workable administrative system for converting microfinance institutions that includes a distinct competent manager who aids the process as well as clear, appropriate, accessible, and enforceable policies that accommodate microfinance and banking business procedural requirements. In doing so, officials from the regulator and the regulated organization should work together to alleviate the current challenges of the transfer of microfinance operations to banks.
- The National Bank of Ethiopia is urged to remove the "Article of Association" from Article 4(2) of Directive No/SBB/74/2020 to comply with the New Commercial Code, as well as to enhance the period of validity for licenses under banking legislation and re-licensing under the new legislation within a single legal framework.
- The National Bank of Ethiopia is better to introduce a tiered regulation for small/private microfinance institutions based on their nature and risk-bearing capacity, rather than providing one-size-fits-all.
- The National Bank of Ethiopia is asked to reconsider the huge amount assigned to 70% of shares for the Regional Government and set strict conditions for the transfer of the remaining shares so that political interference is prevented. The rules are the same for all the converted companies.
- The National Bank should concentrate its attention on developing awareness of the use of converted entities to all microfinance institutions and societies to promote a national financial literacy plan.

- The National Bank of Ethiopia is better off improving and applying the standards of an effective conversion risk mitigation process rather than simply treating symptoms to encounter the existing problem.
- The National Bank would be better served by redefining the term "converted entity" to encompass the banking and microfinance businesses, creating it as a Regional Government bank, or continuing the microfinance as an autonomous subsidiary.

Bibliography

1. Laws

- DRE, MFB Procl/No/626/2009, Federal Negarit Gazette 15th Year No.33, May 2009,
- FDRE Banking Business Proclamation No/592/2008, Federal Negarit Gazette No/57, 25th August 25, 2008,
- Proclamation No/40/1996, Federal Negarit Gazette 2nd Year No. 30 Addis Ababa, July 5, 1996)
- Banking Business (Amendment) Procl/No/1159/2019
- Commercial Code of Ethiopia, Procl/No/1243/2021
- NBE Establishment (Amendment) Procl/No/591/2008
- Microfinance Business (Amendment) Procl/No/1164/2019
- Banking Business Requirements for Relicensing a MFI as a Bank, Directive No/SSB/74/202
- Requirements for Licensing and Renewal of Microfinance Business Directives No/MFI/23/2013
- Banking Business MCRs for Banks (Amendment) Directive No/SSB/78/2021
- Banking Business MCRs for banks Directive No/SSB/50/2011

2. Books, journals, and online materials

- African Development Bank: Microfinance Policy and Strategy for the Bank Group, Operations Policies and Review Department (Popr), May 2006
- John Mageo Mokoro: mokoro2001@yahoo.com, Richard Bitange Nyaoga, Peterson Obara Magutu, Odipo Martine Khoya & Cliff Ouko Onsongo((2010)
- Mahdot Solomon; Distinction between the Regulation of Commercial Banks and MFI under the Laws of Ethiopia(2016)
- Wolday Amha, Corporate Governance of the Deposit Taking Microfinance Institutions in Ethiopia (2008),
- Financial Market Development, Policy, and Regulation: International Experience and Ethiopia's Need for Further Reform Solomon Abay (2011)
- Yigrem Kassa, Regulation and Supervision of MFB in Ethiopia: Achievements, Challenges, and Prospects, Paper presented at the International Conference on Microfinance Regulation held on (2010)

- <https://www.capitalethiopia.com/2021/05/31/the-transition-to-sinqe-bank>, accessed on February 16, 2023
- <https://www.capitalethiopia.com/2021/05/31/the-transition-to-sinqe-bank>, accessed on February 16, 2023
- <https://www.wallstreetmojo.com/organizational-structure/> , accessed on February 16, 2023
- MFIs - National Bank (nbe.gov.et), 22/2/2023.

3. Official Reports and Newspapers

- NBE 2021/2022 first quarter report, NBE quarterly bulletin,
- NBE 20022/2023 Second Quarter Report, NBE Quarterly Bulletin,
- WB Group & IMF, "Financial Sector Assessment; A Handbook" (2010), WB Publications. 197

4. Interviews

- Interview with Mr. Bekele Tola, former Directorate of Legal Director of Siinqee Bank, May 2020, Finfinnee,
- Interview with Mr. Addise Gemechu, New Directorate of Legal Director of Siinqee Bank, 16th February, 2020, Finfinnee,
- Interview with Kurunde Tesgera, NBE, Principal Micro-finance Executive supervisor, 12th May, 2022, Finfinnee,
- Interview with Sintayehu Dasita, NBE, principal bank executive supervisor, May 20, 2022, Finfinnee,
- Interview with Frewot Kiros, NBE, bank examiner, May 20, 2022, Finfinnee
- Interview with Mr. Ermias Barak, Chief Acting Legal Expert of NBE, May 18, 2022, and February 8, 2023, Finfinnee,
- Interview with Dereje Bayera, Legal Expert of Siinqee Bank, May 20, 2022, and February 16, 2023, Finfinnee,
- Interview with Mulalem Zawudie, TB, Head Legal and Loan Recovery Director, February 17, 2023, Finfinnee
- Interview with Mr. Merga Waqoya, NBE, MFIs Directorate, February 14, 2023, Finfinnee,

Appendix

I. Interview Questions

Interview guide questions for both the MF and bank principal Executive supervisors of NBE, legal experts of NBE, legal experts of Siinqee Bank and Tseday Bank, and other experts have direct information about the subject.

I, Abdissa Dashura, a Masters student at AAU, kindly request..... that you prepare or inscribe your answer to the following interview questions. This interview guide is prepared for the purpose of gathering information for my Master's thesis entitled "**Conversion of MFIs to Banks in Ethiopia: Exploring the Entry Challenges and Solutions**" that I am pursuing in the AAU College of Law and Governance, Business Law Master's program. I am grateful for your kind cooperation and for investing your precious time to respond to my interview questions. The following are interview questions:

1. Is converting MFIs into banks transacting only in the name of banking and following banking business procedures reasonable? How do you comply with entry requirements?
2. Is the Minimum Capital Requirement required in Directive No/SBB/78/2021 suitable for the small or private, compared with the Regional Government MFI to be relicensed as a bank? If your answer is no, what requirements could be needed to make small or private MFIs convenient for conversion?
3. Banks prohibit influential shareholders or restrict undue dominance by limiting the amounts of shares in other banks. How could the converted entities comply with limiting shares or ownership among the shareholders under the new set-up of banking business? What is your legal ground that the Regional Government is allowed to hold up to 70% of the converted MFI as the bank's share? How the remaining share is transparently distributed?
4. The converted MFIs to banks required good management and ownership quality that could meet the standards of proper and fit standards, as well as professional employees to comply with banking requirements to be relicensed MFIs as banks. Is the existing MFI's board of directors, CEOs (management), and employees proper and fit or meet the requirements to hire in the banking business?

5. The newly converted MFIs are required to continue their MF product. How is the MF product continued under the bank? As a separate subsidiary or as a unit within the converted bank? What are the challenges of continuing the MF business under the converted bank?
6. What are the challenges or risks that the converted entity and old MFI customers have faced during the entry requirements? What are the solutions?