ADDIS ABABA UNIVERSITY

College of Law and Governance Studies

The Legal and Regulatory Framework on Merger of Banks in Ethiopia: the Reality on the Ground and the Prospects in the Future

By- Melaku Meseret

Advisor- Zekarias Keneaa(Associate Professor)

A Thesis Submitted to School of Graduate Studies of Addis Ababa University in Partial Fulfillment of the Requirements for Degree of LLM in Business Law.

January, 2019

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Declaration

I, Melaku Meseret, hereby declare that this thesis is my original work and that no part has been submitted before for a degree in any university and all source of materials used have been duly acknowledged.

Melaku Meseret Mengistu
Signature-
Date-

Members of Examining Committee

Advisor - Zakarias Keneaa(Associate Professor) Signature_____ Date_____

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Examiner- Fikadu Petros (Associate Professor) Signature_____ Date _____

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Abstract

Merger of banks may be happen due to voluntarily or involuntarily grounds. When banks merge by considering it as a strategy for business diversity and growth/synergy, it's based on voluntary ground. On the other hand; it's due to involuntary grounds when banks are compelled to merge due to external factors like capital and other regulatory requirements set by the regulator mainly for efficiency of the sector and the protection of depositors. Hence; merger in banking sector has got much attention in most jurisdictions currently.

At present; there are sufficient reasons that drive commercial banks in Ethiopia to be merged. And the process of bank merger; be it voluntary or involuntary , is complex and needs strict legal and strong regulatory supervision as it may adversely affect the financial growth and stability of the country's economy. Poorly conceived or badly executed bank mergers can present risks to the participating banks, to the banking system and to other economic sectors including that of depositors.

Therefore; having adequate laws and prudential supervisory procedures regarding bank mergers is timely and important.

This paper explores the adequacy of the legal and regulatory framework governing the merger of commercial banks in Ethiopia. The finding of the study indicated that there are some legal and regulatory loops on and accordingly the study recommends issuance and amendment of laws and directives.

Acronyms

Bank(s)	Both Government and Private Commercial Banks
Banking Business Proclamation	Banking Business Proclamation No. 592/ 2008
CBB	Construction and Business Bank
CBE	Commercial Bank of Ethiopia
NBE	National Bank of Ethiopia
OHADA	Organizations for the Harmonization of Business Law in Africa
UNCTAD	United Nations Conference on Trade and Development
U.S.A/ U.S /US /	United States of America
The Competition Authority	The Trade Competition and Consumers Protection Authority
The Competition Proclamation-	The Trade Competition and Consumers Protection Proc.No.813/2003
The Council of Ministers	The Federal Democratic Republic Of Ethiopia Council of Ministers
The Tax Authority	Ethiopian Revenues and Customs Authority

CHAPTER ONE: INTRODUCTION

1.1 Background

Merger usually happens when two or more firms agree to go forward as a single new company. In merger, the ownership of the companies are either transferred or combined.

Merger in banking sector has got much attention currently as it's emerged as one of the most popular strategies for business diversity and growth or synergy. At one point, merger among entities was mainly a US phenomenon but during the 1990's its volume in Europe started rivaling that of the U.S.A [1]. By 2000's merger had become commonly used corporate strategies for companies worldwide[2].

Coming to merger of banks in Ethiopia; the major merger activities in Ethiopian banking industry so far carried out is between state owned banks by the government decisions[3]. The recent merger activity in Ethiopia's banking industry happened in 2016 when CBE merged with the CBB[4].

At present; there are sufficient reasons that drive banks in Ethiopia to be merged. Primarily NBE is issuing various directives with the objective of creating a sound and more secured banking system that ensure safety of depositors. Among these directives, the minimum paid up capital requirement was raised from 75 million birr to 500 million birr for both new entrant and the existing banks as per Directive No. SBB/50/2011.The objective of this directive is to ensure the competitiveness of small banks and to guarantee the safety of depositors. This was a challenging directive for some private banks to attain[5]. With rapidly changing business environment and stiff competition, NBE is expected to issue more challenging directives to guarantee stability of banking environment and the competitiveness of all banks in the market. Through a circular dispatched on September 26, 2015; NBE

[1]The Basics of merger, available at <http://www.investopedia.com/university/mergers/mergers2.ap> ,(accessed on April 1, 2018)

[2] Ibid.

[3]National Bank of Ethiopia , History of Banking in Ethiopia, available at https://nbe.gov.et/aboutus/index.htmlSearch,(accessed on April 1, 2018)

[4]Public Financial Enterprises Agency ,Action plan for the amalgamation of the CBB with the CBE(2015, Unpublished)

Commercial Bank of Ethiopia's Takeover of Construction and Business Bank S.C Council of Ministers Regulation, 2016, Reg. No. 384, Fed. Neg. Gaz., 22nd year, No. 55.

[5]National Bank of Ethiopia ,Private Banks Performance Report (2016, unpublished)

instructed all private banks to set a target of minimum paid up capital of at least 2 billion birr by June 2020. This shows NBE might have further intention to raise the minimum paid up capital in the future. This will be challenging for some private banks and therefore their options are either consolidation through merger or dissolution.

Secondly, the competition in the banking industry will be more stiff in the future with the arrival of foreign banks with advanced banking technology and skilled man power. The negotiation of the government of Ethiopia with the World Trade Organization (WTO) has been progressing. Opening up the financial sector is one of the pre-conditions to get membership at WTO. Domestic banks are expected to be well prepared for such scenario.

Similarly; Ethiopia has already ratified the African Continental Free Trade Association /AfCFTA/ agreement by its Council of Ministers in February 2018. The main objectives of African Continental Free Trade Association /Af CFTA/ is to push into full economic as well as political integration and member states are expected to remove barriers to trade including opening up of financial sector for investment.

Therefore, merger will be one option to safeguard the competitiveness and sustainability of the domestic banks under such circumstance.

Thirdly, banks shall develop strategy towards merger to attain solid capital base and efficiency in their operation.

As there are various reasons as mentioned above that oblige commercial banks in Ethiopia to engage in merger, having prudential supervisory procedures besides adequate laws regarding bank mergers is timely and important. Poorly conceived or badly executed bank mergers can present risks to the participating banks, to the banking system; bank depositors and to other economic sectors. And bank mergers above all will have long-lasting effects, for better or for worse, on the structure and performance of the banking industry; the stability and enhancement of competitiveness in the banking system that requires a realistic appraisal to be made of the likely competitive effects of a bank merger.

1.2 Literature Review

Merger of banks may be happen due to voluntarily or involuntarily grounds. When banks merge by considering it as a strategy for business diversity and growth/synergy, it's based on voluntary ground. On the other hand; it's due to involuntary grounds when banks are compelled to merge due to external factors like capital and other regulatory requirements set by the regulator mainly for efficiency of the sector and the protection of depositors.

The process of bank merger; be it voluntary or not, is complex and needs strict legal and strong regulatory supervision as it may adversely affect the financial growth and stability of the country's economy. On the other hand; an effective and conducive legal and regulatory framework for merger of banks will help to ensure such banks to grow and in turn derive benefit resulted from the efficiency of the banking sector. Thus; having adequate merger laws /guidelines and efficient regulatory organs related to merger of banks are needed.

The Commercial Code of Ethiopia clearly describes that companies can amalgamate either by taking over or establishing a new firm[6]. By doing this the law defines the modes of merger for banking institutions too. And the decision to merge must be taken by the banks concerned[7]; i.e.- such shall be decided through extra ordinary meeting of shareholders.

If banks agree to merge; the Commercial Code requires the terms of the amalgamation to be drawn up by a deed and such to be published in the official Commercial Gazette[8].The deed is expected to include the basic legal and financial matters related to the merger.

On the other hand; most importantly by virtue of article 3(3) (c) of the banking business proclamation; it's clearly stipulated that without prior written approval of the NBE, merger or takeover of a bank is prohibited. Moreover, banks entering into any arrangement or agreement for the sale, disposal by amalgamation or otherwise, of its businesses, or effect major changes in its line of business is prohibited unless it gets prior written approval of the NBE[9]. This strict supervision may be due to the sensitivity of the sector to the macro economy of the country and safety of depositors.

[6]Commercial code of the Empire of Ethiopia, 1960, article 549 .
[7]Id., article 550.
[8] Id., article 551 .
[9]Banking Business Proclamation,2008, Art. 3(3)(d), proc. No. 592,Fed. Neg. Gaz., 14th year, No. 57.

The sectarian guideline in related to bank mergers is usually issued by the central banks. The guideline; besides seeking the consent of the shareholders' , should at least expected to guide the overall process of merger and lays down those basic legal and financial issues which ought to be considered by the merged banks like:-values at which the assets, liabilities and the reserves of merged banks are proposed to be incorporated bank by independent valuator , whether proper due diligence is done to assure profitability, revaluation of shares, change proposed in related to directorship, transfer of employees, branding and issue of optional buy-back mechanism for those shareholders who refuse the merger.

From the regulatory perspective; the role of the central banks with respect to merger of banking sector is mainly focused on the synergies and benefits of the consolidation and financial stability of the country between the merged banks to the economy.

However; though in the past much debate has been done over whether the competition authorities should at all have the power to approve merger of banks, currently in most jurisdictions competition authorities have got such power[10].Concerning this one posits that:[11]

> *Bank mergers can have a long-lasting effect, for better or worse, on the structure and performance of a market; the preservation and enhancement of competitiveness in the banking system should be an important objective of any national policy in every market-based economy, hence a realistic appraisal is required of the likely competitive effects of a bank merger."*

Accordingly the Competition Authority is empowered to prohibit the act of merger if it decides that it causes or is likely to cause a significant restriction to competition or eliminates competition[12]. No merger agreement shall be implemented before the authority grants permission to it.

It seems that before permitting the merger of banks, the Competition Authority will carry out through assessment of the merger. It has to meticulously assess the cost and benefits of permitting the merger, the impact of the arrangement on the market or market actors. The focus of the assessment of the merger arrangement could not be from the perspectives like

[10]International Competition Network, An Increasing Role for Competition in the Regulation of Banks ; June 2005, p.2.
[11] John V. Austin, The Role of Supervisory Authorities in Connection with Bank Mergers(2004) p.1.
[12]Trade Competition and Consumer Protection Proclamation , 2013, Art.9, proc. No. 813, Fed. Neg. Gaz., 20th year, No. 28 .

safety of depositors and other sensitive legal and financial issues related to the very nature of the sector.

Merger regulation besides promoting competition needs to consider matters of public interest, and take account of domestic and international market competition, efficiency and consumer protection. Hence; the Competition Proclamation allows the Competition Authority to exceptionally approve a bank merger if its efficiencies outweigh its anticompetitive effects, so long as the merger cannot achieve its efficiencies without restraining competition. This allows the Competition Authority to balance the merger's costs and benefits, and is necessary to promote healthy competition.

Furthermore, the Competition Proclamation provides for exemptions and in this regard the Council of Ministers may exempt all mergers in a certain industry including banking sector from review, if that industry is deemed essential for facilitating Ethiopian economic development.

1.3 Statement of the Problem

Under Ethiopian law the legal and regulatory framework for the merger of banks seems to be inadequate and scanty at best. There are provisions here and there scattered in different laws of the country.

The existing company law in relating to merger defines the modes of amalgamation, puts legal requirements and procedures of amalgamation decision and tries to protect the interest of creditors[13]. If banks agree to merge; the commercial code requires the terms of the amalgamation to be drawn up by a deed and such to be published in the official Commercial Gazette[14]. However; the Commercial Code does not clearly mention what the deed of amalgamation needs to constitute mandatorily.

In line with the above , one of the most critical elements in merger process is the valuation of companies assets as the success of merger is closely related to determining the fair value of the merged companies[15].Determining the value of a company is one of the most complex and difficult subjects in financial management[16].In this regard the relevant provision of the

[13]Commercial code of the Empire of Ethiopia, Cited above at note 6, article 549and 550.
[14] Id., article 551 .
[15]Professor NurhanAydin,Mergers and Acquisitions: A Review of Valuation Methods,International Journal of Business and Social Science , Vol. 8, No. 5, May 2017 .
[16]Ibid.

commercial code seems not satisfactory as it does not specify the system and methods of valuation in case of merger.

Regarding regulatory framework concerned ; it's clearly stipulated that without prior written approval of the NBE, merger of a bank is prohibited[17]. This strict supervision may be due to the sensitivity of the sector in relation to the stability of macro economy of the country and safety of depositors. Accordingly the banking business proclamation empowers the Council of Ministers to issue regulation and the NBE to issue directive for effective implementation of the proclamation including that of merger of banks[18].But; the Council of Ministers and the NBE till now failed to issue regulation and directive as mandated concerning the process of merger of the banks. Thus from what perspectives or standards that NBE is going to approve or decline the bank merger request is a surprising matter that needs clear response.

The overall process of merger of banks does have lots of legal and financial matters that need to be properly regulated. NBE as a sectarian regulator through its guideline should evaluate the merger on the basis of the effect it would have ensuring the safety of the depositors; the effect of the merger in risk taking ability and the overall stability in the financial sector. Besides; how persons aggrieved may obtain judicial review of the decisions of the supervisor: NBE on the merger proposal should be made by the law.

On the other hand; mergers of banks like any other economic sectors can have anticompetitive effects resulted from abuse of market dominance and such to be analyzed carefully before permitting merger. In most jurisdictions including USA market dominance usually analyzed by identifying the relevant product and geographic markets; assessing the parties' market shares and the market concentration; identifying possible anticompetitive activities the merged entity might carry out; and taking account of possible precompetitive effects and efficiencies the transaction creates[19].

Similarly under the Ethiopian Competition Proclamation market dominance is analyzed by identifying the relevant product and geographic markets; assessing the parties' market shares; the ability of the merged institution to create barrier to entry in the same market and other

[17]Banking Business Proclamation , cited above at note 9, article 3(3) (c).
[18]Id.; article 59.
[19] Wendell B. Jr. Alcorn, Merger Analysis for Banks and Others--Marine Bancorporation and Connecticut National Bank, Houston Law Review, Vol.12, No. 3 ,1975, p.539.

appropriate factor[20]. And the Competition Proclamation also provides for numerical expressions for market dominance that is to be issued by the council of Ministers[21].

But; both the Council of Ministers by its regulation as stated or the Competition Authority by its directive is failed to state the numerical expressions that help to assess the existence of market dominance as desired and such may cause subjectivity in assessing the dominance test. Besides the Competition Proclamation provides for exemptions and in this regard the Council of Ministers may exempt all mergers in a certain industry including banking sector from review, if that industry is deemed essential for facilitating Ethiopian economic development[22].This gives the Council of Ministers a very wide discretionary power, and so it might erode the purpose of the Proclamation itself.

Finally; NBE; as a financial sector regulator, has proper expertise and capability to assess bank mergers from the perspective of banking safety and banking service efficiency matter. Whereas in the case of Competition Authority; it will carry out through assessment of the merger from competition perspective. Thus; the Competition Authority need to have framed coordination with NBE to forestall any problems that could arise from the investigation of competition cases in the regulated sectors including approval of merger proposal .Besides ;as banks do have issue of confidentiality in their very business, the competition Authority should similarly be duty bound by law to keep those information obtained while entertains the bank merger approval. However there seems no legally framed coordination and any law regarding the above mentioned issues.

This paper will assess the adequacy of the existed legal and regulatory framework in relation to merger of banks in Ethiopia. Besides; the paper will explore and show those crucial legal matters that need to be properly regulated for subsequent measures for concerned organs.

1.4 Research Questions

This study addresses the following research questions.

I. Do the existing Ethiopian laws address the major legal issues that can possibly arise in relation to merger of banks?

[20] Trade Competition and Consumer Protection Proclamation, cited above at note 12; article 6.
[21] Id.; article 6/5.
[22] Id.; article 4/2.

II. What are the gaps in the existing laws of the country to address matters relating to merger of banks?

III. How adequate are the existing regulatory and supervisory frameworks in Ethiopia to address matters relating to merger of banks?

1.5 Objectives of the Study

The study aims to provide a general idea on the legal and regulatory framework relating to merger of banks in Ethiopia and to discuss the possible practical problems that may arise in the process.

The following are specific objectives of the study:

- To assess the existing legal and regulatory framework relation to merger of banks in Ethiopia.
- To Identify those legal issues that need to be addressed in relating to merger of banks in Ethiopia and to formulate proposals that if adopted will make the legal and regulatory framework adequate and conducive.

1.6 Significance of the study

The knowledge generated by this study enables readers to grasp the necessary information with respect to the existing legal and regulatory frame work in relating to merger of banks in Ethiopia. Besides; the research further shows those legal and regulatory loop holes that must be regulated relating to merger of banks in Ethiopia.

1.7 Scope of the study

In its scope, the research is limited to the examination of the legal and regulatory frame work relating to merger of banks in Ethiopia besides identifying those legal issues that need to be regulated in relating to merger of banks.

1.8 Research Design and Methodology

- **Choice of Method**

For this research paper, different laws and literatures are going to be studied on the subject matter to give a fundamental introduction to the topic.

- **Data Collection**

Besides those primary data: various relevant laws, secondary data that are important to address the research questions will be collected from books, reports, literatures and internet. These primary and secondary data are used to examine the legal and regulatory frame work relating to merger of banks in Ethiopia theoretically and practically besides identifying those legal issues that need to be regulated in related to merger of banks.

Practical merger cases in relation to banks: i.e - Merger of Commercial Bank of Ethiopia and Construction and Business Bank is going to be examined according to their relevance to the specific subject on hand.

- **Interviews**

Interviews will be conducted in the NBE and the Trade Practice and Consumers Protection Authority to get direct information regarding the legal and regulatory framework relating to merger of banks in Ethiopia theoretically and practically. Besides an interview will be conducted with the Ethiopian Bankers Association to get information that possibly drive commercial banks in Ethiopia to merge.

- **Analysis Method**

Data collected through interviews, practical cases and secondary documents were analyzed with the legal and regulatory framework relating to merger of banks in Ethiopia theoretically and practically besides identifying those legal issues that need to be regulated.

1.9 Limitation of the Study

During the process of conducting this thesis, unavailability of adequate literatures and practical cases upon the issue and lack of willingness and cooperation from some potential interviewees are expected.

1.10 Organization of the Study

The thesis is organized as follows. Chapter two provides general overview of merger of banks from the legal and regulatory framework perspective. The third chapter is organized to give full information on the legal and regulatory framework on merger of banks in Ethiopia particularly focusing on the reality on the ground: The case of merger of CBE with CBB. Chapter four is devoted to discuss the prospects for the future on merger of banks in Ethiopia. Finally conclusion and recommendations on the findings are provided under the last chapter.

CHAPTER TWO: GENERAL OVERVIEW OF MERGER OF BANKS FROM THE LEGAL AND REGULATORY FRAMEWORK PERSPECTIVE

2.1 Definition of Merger

The Black's Law Dictionary defined the word ''merger'' as ''the fusion or absorption of one thing or right into another; generally spoken of a case where one of the subjects is of less dignity or importance than the other and the less important ceases to have an independent existence[23]''.

The UNCTAD model law defines ''merger'' as follows[24]:

> *''Merger'' refers to a situation where there is a legal operation between two or more enterprises where by firms legally unify ownership of assets formerly subject to separate control. Those situations include takeovers, concentrative joint ventures and other acquisitions of shares ....*

'Merger' under competition laws of many jurisdictions is used in a wider sense and includes amalgamation, acquisition[25], pooling of resources in joint ventures, acquisition of another enterprise's shares, voting rights, assets, or control over that enterprise[26].

Although merger under the commercial code is not defined directly; the code clearly describes that companies can amalgamate either by taking over or establishing a new firm[27].

But under Ethiopian Competition Proclamation ''merger '' is broadly used and shall be deemed to have been occurred[28]:

> *a /when two or more business organizations previously having independent existence amalgamate or when such business organizations*

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[23]Featuring Black's Law Dictionary Free Online Legal Dictionary (2nd Ed) available at https://thelawdictionary.org/merger(accessed on April 1, 2018)

[24] UNCTAD; Seventh United Nations Conference to Review All Aspects of the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices , Geneva, 6–10 July 2015; P.4.

[25] An acquisition describes the takeover of control of an existing, but formerly independent firm.

[26] Richard Whish, Competition Law, (Oxford University Press, 6th ed. (2009), P. 798 .

[27]Commercial Code of the Empire of Ethiopia, cited above at note 6, article 549 and 550.

[28]Trade Competition and Consumer Protection Proclamation, cited above at note 12, article 9.

pool the whole or part of their resources for the purpose of carrying on certain commercial activity;

b/ by directly or indirectly acquiring shares , securities or assets of business organizations or taking control of the management of the business organization of another person by a person or group of persons through purchase or any other means

On the other hand; a merger of banks refers to

''*the amalgamation or fusion of two separate banks into a single legal entity and the merging banks combine to form a new bank in which the assets and liabilities of the merging institutions pass to the Successor Bank, and the merging institution(s) are simultaneously and legally dissolved. Accordingly Shares for both institutions are surrendered and new shares are issued in their place. The new bank formed is a separate legal entity …….*[29]''

In short bank merger is an event when previously distinct banks are consolidated into one institution. Furthermore; broadly defined, the term bank merger includes any exchange or purchase of assets or stock among two or more banks to create a single unit[30].

2.2 Types of Bank Mergers

Mergers of banks; from the economic and competition point of view can be generally classified as horizontal, vertical or conglomerate depending on the prior positions of the merging parties[31].

[29] Reserve Bank of Malawi, Guidelines for Processing Applications for Bank Mergers and Acquisitions(2010) P.5.

[30]Bank Charter, Branching, Holding Company and Merger Laws: Competition Frustrated, Yale Law Journal , Vol.71 , No.52, 1962, p.522.

[31]Chunlai and Findlay C ; A Review of Cross-border Mergers and Acquisitions in APEC (2003)

The Trade Competition and Consumers Protection Authority, Merger Directive No. 1/2016, p. 3

2.2.1 Horizontal Mergers of Banks

Horizontal merger of banks are the most common types of mergers and it involves the joining together of two banks which are producing essentially the same products or services and which compete directly with each other[32]. Horizontal merger is generally initiated to take advantages of economies of scale by eliminating duplication of facilities and operations[33]. It allows efficiency gains by exploiting economies of scale[34].

However; horizontal mergers generally harm competition more than other types of merger, because they reduce the number of market players, and increase the market share of the merged entity. The merged entity may therefore achieve or strengthen a dominant position. [35]

2.2.2 Vertical Merger

Though such kind of merger is not common in banks; it involves the combination of firms having supplementary relationship in distribution of services or products with a particular business of a bank [36]. Vertical merger can be beneficial to both firms and consumers by facilitating long term investment, enhancing the quality of the product, and creating efficiencies by reducing transaction costs[37].

However, vertical mergers may also harm competition by foreclosing rivals. Foreclosure can consist of input foreclosure and customer foreclosure[38].

2.2.3 Conglomerate Merger

Conglomerate merger involves joining of two or more firms engaged in unrelated types of activities [39].The business of two firms are not related to each other neither horizontally (in the sense of producing the same or competing products) nor vertically (in the sense of standing towards each other in the relationship of buyer and supplier or potential buyer and supplier)[40].

[32] BPP Learning Media;Advanced Financial Management; Sixth Edition ; (2012) London, P.301 and ff.

[33] Ibid.

[34]Ibid.

[35] Ibid.

[36] Ibid.

[37] Ibid.

[38] Ibid.

[39] Ibid.

[40]Ibid.

2.3 The Rationale for Merger of Banks

Considerable research in the area of merger shows that the reasons for mergers are varied; therefore, studies typically do not find just one motive but several motives and reasons for mergers[41].

The reasons and motives for merger can be divided into two groups; the first set of motives includes firm level motives[42].On the other hand there are also the external factors such as; globalization, deregulation, technological progress and other external factors that significantly affected the structure of the banking sector, creating pressures for change in the banking industry[43].

In short; several reasons that drive banks to merge can be identified. The basic ones are as follows.

2.3.1 Economies of Scale

One of the most commonly stated motives for merger is the opportunity to exploit economies of scale and such are enjoyed due to increase in size, production and a simultaneous reduction of fixed costs[44].This by itself would enable the merged bank to acquire relevant technology, engage high quality personnel and absorb shock and makes the merged bank to offer better and value-added services while increasing its earning capacity[45].

2.3.2 Increased Market Power

As horizontal mergers, by definition, reduce the number of independent competitors in the market and increase the market share of the merging firm; this may increase the market power and profitability of the merged bank[46].

2.3.3. Efficiency Gains

[41]Ali Awdeh and Chawki EL-Moussawi, Analyzing the Motives and the Outcomes of Bank Mergers, Middle Eastern Finance and Economics ISSN: 1450-2889 Issue 15., 2011, available at https://www.researchgate.net/publication/257866017 (accessed on April 10, 2018)

[42] Ibid.

[43] Ibid.

[44] Arnold A. Heggestad and John D. Wolken, Mergers and Acquisitions in Commercial Banking: Economic and Financial Considerations , L.A. L. Rev. ,1985 , available at: http://digitalcommons.lmu.edu/llr/vol18/iss4/8 ; (accessed on April 8, 2018)

[45]Nishith Desai Associates,ING Bank Merges with Kotak Bank (Sep.2015) P.9.

[46]Arnold A. Heggestad and John D. Wolken, Cited above at note 44.

On a combined basis, as the firms achieve important economies of scale or scope; they need less resource to produce the same output as they are able to integrate production facilities or use more efficient methods[47]. Besides; efficiency gains from a merger in the banking sector can occur through a transfer of knowledge and managerial skills, which in turn aims to enhance the managerial efficiency of the merged banks.[48]Furthermore, consolidation increases the potential of banks to compete effectively at the national, regional and global levels[49].

2.3.4 Greater Diversification and Global Presence

One of other advantages of bank merger activity, particularly of cross-border operations is diversification[50].Through merger operations, customer and assets diversity can be increased by broadening the geographic reach, adding new customers for existing clients and by increasing the breadth of the products and services offered[51].

Banks have generally attempted to achieve diversification synergies through merger or acquisition rather than through de novo growth. [52]The reason for this stems from bank regulations in many states that create incentives to expand through acquisitions rather than through expansion of the existing firm (such as branching)[53].

Mergers will give banks the muscle size and scale up their operations and become globally competitive[54].

2.3.5 Revenue Enhancement

Bank mergers lead to increased revenue through its effect on firm size either through product or through geographic diversification[55]. Besides it provides opportunities for revenue enhancement from increased market power.

2.3.6 Value Maximization

Another advantage of bank merger is value maximization, which is based on the assumption that the value of the new bank will exceed the sum of the individual values of banks to be

[47]Ibid.
[48] Ibid.
[49] Ibid.
[50] Ibid
[51] Ibid.
[52] Ibid.
[53]Id.; P.1183.
[54]Ibid .
[55]Ibid.

merged. Merger and acquisition have the potential to create value in the banking sector through gains in the market power.

2.4 Merger of Banks from the Legal and Regulatory Framework Perspective: Experiences of Selected Jurisdictions

When we talk about the experiences of few jurisdictions, it is essential to note that the discussions would focus both on legal and regulatory frameworks thereof. The jurisdictions for discussions are selected mainly for the below stated reasons and believing that our bank merger legal regime may take developed experiences from such jurisdictions in the future.

Primarily, the longest data series about merger activity in different economic sectors including that of banking business exists in the U.S.A[56].

Particularly Since 1980, the structure of the U.S. banking industry has changed considerably with over10,000 mergers involving more than $7 trillion in acquired assets taking place[57].Furthermore, the number of banks has declined dramatically over this period, and the concentration of assets held by the largest institutions has increased[58]. There were 19,069 banks operating in the U.S. in 1980 and there were 7,011 in 2010, a decline of over 60 percent[59]. Such experience resulted in economic and regulatory changes and development as to asset concentration, competition, banking efficiency and profitability, shareholder value, and the availability and pricing of banking services[60] . In relation to this one writer posted that[61]:

> *Most observers of the U.S. financial regulatory system would agree that if it did not exist, no one would invent it. Most, however, would also admit that the system–despite all its faults–has served both the financial services industry and consumers well.*

[56]Federal Reserve Board, Consolidation and Merger Activity in the United States Banking Industry from 2000 through 2010, (Finance and Economics Discussion Series Divisions of Research & Statistics and Monetary Affairs)
P. 2.
[57] Ibid.
[58]Ibid.
[59]Ibid.
[60]Ibid.
[61] Rose Marie Kushmeider, The US Federal Financial Regulatory System: Restructuring Federal Bank Regulation, FDIC Bank Review, *Vol. 17, No. 4,2005*, P. 1.

That's why it's believed that merger laws in U.S.A particularly in the banking sector; have developed through time experience compared to other states and one can say Ethiopia can learn from the experience of U.S.A.

Secondly, Kenya has experienced a substantial increase in mergers and acquisition activities during the period 2013–2014[62]. The Deal Drivers Africa Report published by Merger market, ranked Kenya as Africa's fourth most sought-after country for mergers and acquisitions next to S.Africa, Nigeria and Ghana[63].

Particularly concerning banking sector consolidation concerned; in Kenya, more than 30 banks merged between 1989 and 2010[64]. This shows that Kenya is better experienced compares to other East African countries in merger of banking cases.

In addition, indigenous and multinational banks with their East African headquarters in Kenya have expanded regionally and fuel some merger activity in the larger east African community[65].

On the other hand; Ethiopian commercial banks may think to consolidate with neighboring Kenyan banks in the long run as business growth strategy. Thus having some information about the legal and regulatory frameworks on bank mergers will be advantageous too.

2.4.1 Statutory and Regulatory Regime on Merger of Banks in the U.S.A

2.4.1.1 Statutory Regulation on Merger of Banks in the U.S.A

The overall banking sector is subject to both the federal and state government regulation depending on its establishment structure in USA. [66]Accordingly most of the banking regulations including merger regulation fundamentally focused on the preservation of financial stability and customer protection[67].

[62]Gideon Roberton ,The Mergers & Acquisitions Review, (8th ed , Law Business Research Ltd, London, 2014, P.447.

[63]Ibid .

[64] Central Bank of Kenya, available athttps://www.centralbank.go.ke/commercial-banks/mergers-and-acquisitions/,(accessed on oct. 1,2018)

[65]Gideon Roberton , cited above at note 62, p.456.

[66] Archie K. Davis, Banking Regulation Today: A Banker's View, 31 Law &Contemp (1966) p.639-647.

[67]Ibid.

However; currently the issue of bank merger is regulated by banking regulations and made subject to competition regulations due to the fact that competition policy is perceived as subordinate to stability concerns[68].

2.4.1.1.1 The Sherman Antitrust Act[69]

The Sherman Antitrust Act is the oldest federal anti-monopoly and antitrust statute, passed in 1890 to promote and preserve competition[70].Sherman Act is not meant to protect businesses from competition, but to protect consumers from monopolies.

Section 1 of the Sherman Act prohibits contracts, combinations, and conspiracies in unreasonable restraint of trade. Section 2 defines the concept of monopolization as an effort or actual action from one person to combine or to conspire with one or more persons to have or take complete control over any part of the commerce or trade in the U.S.A of the act proscribes monopolization and attempts to monopolize[71]. Either section of the Act may be used as a basis to attack mergers[72]. For example, the consolidation of First National Bank and Security Trust Co. of Lexington was held to violate section1 of the Sherman Act in 1964[73].

2.4.1.1.2 Clayton Antitrust Act[74]

The U.S.A Congress passed the Clayton Antitrust Act to augment the Sherman Act in 1914, and to protect the public from mergers that reduce competition; most importantly; from mergers and acquisitions where the effect may substantially lessen competition.

Section 7 of the Clayton act provides that:

> *''No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital* **...** *or* **...** *of the assets of another corporation engaged also in commerce, where in any of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly''*

What is very important is that all mergers, regardless of size and line of commerce, are subject of review by virtue of this Act[75].

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[68] Ibid.
[69]The Sherman Antitrust Act of 1890. Available at http://www.atg.wa.gov/antitrustguide.aspx#.U054_fRdUgs
[70] Wendell B. Jr. Alcorn; Cited above at note 19.
[71]Ibid.
[72]Ibid
[73] Ibid.
[74] US, the Clayton Anitrust Act of 15 October 1914.

Following particularly Philadelphia National Bank case[76], bank mergers became subject to section 7 of the Clayton Act and the merger request is going to be denied if it substantially lessens competition, or tend to create a monopoly. Accordingly the legality of merger request is analyzed by examining the relevant line of commerce, the relevant geographic market, and competitive effects[77].

However, the Clayton Act does not expressly prohibit merger by one bank of the assets of another bank acquisition. It was thought that the act applied only to bank mergers accomplished by *stock* acquisition, while most bank mergers apparently were consummated by asset[78].To address this loop on; the1950 Celler-Kefauver Amendment to the Act is made and such brought asset acquisitions specifically within the purview of the statute[79].

2.4.1.1.3 Bank Merger Act[80]

The Bank Merger Act was made to regulate mergers of national banks and state banks which are members of the Federal Reserve System, and state banks which are not members but which are insured by the Federal Deposit Insurance Corporation[81].With the scope of the Bank Merger Act it becomes apparent that virtually all banks in the United States are subject to merger regulation[82]. It seeks the approval of the Federal Reserve, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation; based on the regulatory status of the institutions; for bank merger[83]. In so doing, the following six so-called banking factors that reflect public interest need to be considered[84]: (1) the financial history and condition of the banks involved, (2) the adequacy of their capital structure, (3) their future earnings prospects, (4) the general character of their management, (5) the

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[75]K.Logan, J.D, Angelo,US Merger Control , Simpson Thacher2003, p. 5.

[76] The United States Supreme Court case:*United States v. Philadelphia National Bank in* 1963, that held, among other things, that banks are subject to the antitrust laws in their merger activities and that banking is essentially a local business.

[77] Wendell B. Jr. Alcorn; Cited above at note 19.

[78] Lynn M. Kelley, The Bank Merger Act and the Antitrust Law: Hopeless Conflict, University of Cincinnati Law Review, Vol.32, 1963, p. 512 and ff.

[79] Ibid.

[80] US, The Bank Merger Act of 1960.

[81] Lynn M. Kelley; cited above at note 78.

[82]Ibid.

[83] Paul M. Horvitz; Bernard Shull, The Bank Merger Act of 1960: A Decade after, 5 J. Reprints Antitrust L. & Econ. (1973), P.59 and ff.

[84] Lynn M. Kelley; cited above at note78.

Edward G. Guy; The Applicability of the Federal Antitrust Laws to Bank Mergers(Federal Reserve Bank of Neyork Monthly review(1966).

convenience and needs of the community to be served, and (6) whether the corporate powers of the banks were consistent with the purposes of the Federal Deposit Insurance Act.

In addition, the responsible agency was required to take into consideration "the effect of the transaction on competition (including any tendency toward monopoly)" although the Bank Merger Act was silent as to the applicability of the antitrust laws[85].

2.4.1.1. 4 Bank Holding Company Act[86]

Section 1842(c) of the Bank Holding Company Act of 1956 obliged the bank regulatory organs before approval of any merger or consolidation request to give due attention to whether or not the effect of such merger or consolidation would be to expand the size or extent of the bank holding company system involved beyond limits consistent with adequate and sound banking, the public interest, and the preservation of competition in the field of banking[87].

2.4.1.1. 5Riegle-Neal Interstate Banking and Branching Efficiency Act[88]

This Act permitted state and federally chartered banks to engage in interstate mergers that were restricted by interstate restrictions provisions of the so called Douglas Amendment under the Bank Holding Company Act[89].

2.4.1.1. 6The Merger Guidelines

The bank merger review guidelines promulgated by the Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and Department of Justice sought to harmonize their review of bank mergers[90]. They are limited to horizontal mergers and assess the requested merger in line with defining relevant and adverse competitive effects, entry, efficiencies, and the possibility that one of the firms is failing[91].

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[85] Ibid.

[86]US , Bank Holding Company Act of 1956.

[87]Klebaner Benjamin J; Federal Control of Commercial Bank Mergers, Indiana Law Journal, Vol. 37, available at: http://www.repository.law.indiana.edu/ilj/vol37/iss3/1,(accessed on April 8, 2018)

[88]Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994.

Development of Bank Merger Law, Fordham Journal Of Corporate &Financial Law , Vol. XIII ,2008 , P.512

[89] Ibid.

[90] Department of Justice, Horizontal Merger Guidelines (2010) ('US Horizontal Merger Guidelines'), available at : https://www.ftc.gov/sites/default/files/attachments/mergerreview/,(accessed on April 1, 2018)

[91]Ibid.

On the other hand; under the guideline, the "unduly" test[92]is going to be applied to permit mergers in the public interest which might substantially lessen competition[93].

2.4.1.2. Regulatory Framework of Merger of Banks in the U.S.A

From the perspectives of applicable rules and approval organs; merger of banks is different from other businesses in the U.S.A.

A proposed bank merger must be filed for approval with the proper banking authority alongside with U.S Department of Justice[94]. Besides; bank mergers are made to be exempted from Hart-Scott-Rodino Act[95] of 1976 that put pre-merger notification requirements[96].

The followings are the major regulatory organs in relation to bank mergers approval in U.S.A.

2.4.1.2.1 Department of Justice

It is antitrust federal government authority that is in charge of overseeing bank mergers in line with antitrust aspects[97]. The Bank Merger Act and Bank Holding Company Act authorize the Department of Justice to review bank mergers in a process separate from the review performed by banking agencies.

Development of Bank Merger Law, cited above at note 88.

[92] According to the "unduly" test ; bank mergers would serve the national welfare despite the fact that competition might be substantially lessened:
(1) where the acquired bank's future prospects are unfavorable because of inadequate management or lack of provision for management succession;
(2) where the acquired bank has inadequate capital or unsound assets;
(3) where the acquired bank is an uneconomic unit or is too small to meet the needs of the community **by** providing loans of sufficient size or necessary banking facilities;
(4) where there is a reasonable probability of the ultimate failure of the bank to be acquired; or
(5) where several banks in a small community are compelled by an "overbanked" situation to resort to unsound competitive practices which may eventually have an adverse effect upon the condition of such bank

[93]Development of Bank Merger Law; Cited above at note 88.

[94]Gina M. Killian, Bank Mergers and the Department of Justice's Horizontal Merger Guidelines: A Critique and Proposal,Notre Dame Law Review,Volume 69 , Issue 4, March 2014, p.857.

[95] Under the Hart- Scott-Rodino Act; anytime two or more parties are planning an acquisition or a transaction of a certain size-the current threshold is about $60 million-they are required to notify the U.S Department of Justice and the Federal Trade Commission of their planned transaction, and then wait thirty days while the agencies take a preliminary look at the proposed transaction to see whether there may be a competitive antitrust problem under section 7.25 of the Act. If the agencies decide there is not, the parties can go ahead and close at the end of that thirty-day waiting period.

[96] Clayton Act , cited above at note 74, section 7A(c)(8)

[97]Gina M. Killian, cited above at note 94.

Standards established by section 7 of the Clayton Act besides the bank merger review guidelines[98] are applied by U.S Department of Justice to see the competitive effects of a merger before deciding whether to approve[99].

Procedurally; the proper banking authority sends a merger application to the Department of Justice to get approval from competition per se[100]. Banking authorities wait until the U.S Department of Justice provides a report with its findings regarding the competitive effects of a merger before deciding whether to approve[101].

2.4.1.2.2Federal Banking Authorities

Federal banking agencies that are in charge of overseeing bank mergers, and any related competition aspects to these transactions, are the Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation[102].

A. **The Federal Reserve** is the central bank of the U.S.A. It provides the nation with a safe, flexible, and stable monetary and financial system. The Federal Reserve comments on the merger application for state member banks and financial holding companies[103].
B. **The Office of the Comptroller of the Currency** is an independent bureau of the US Department of Treasury and it charters, regulates and supervises all national banks and federal savings associations, and federal branches and agencies of foreign banks[104] .It gives approval on the merger application for all national banks[105].
C. **The Federal Deposit Insurance Corporation** is an independent agency authorized to insure bank deposits, examine and supervise banks for safety and soundness and consumer protection, and resolving and managing receiverships. It gives approval on merger application on insured state banks which are not members of the Federal Reserve System.[106]

Under the Bank Merger Act the Federal Banking Authorities are prohibited from approving a transaction that would have an anti-competitive effect and must consider the merging banks' financial and managerial resources, future prospects and efficiency in combating money

[98]Department of Justice, cited above at note 90.
[99]Paul M. Horvitz, cited above at note 83, P.83 and the following.
[100] Ibid.
[101] Ibid.
[102] Lynn M. Kelley; Cited above at note 78, P. 506-510.
[103] Ibid.
[104] Ibid.
[105] Ibid.
[106]Ibid.

laundering, as well as the convenience and needs of the relevant community. The agencies are also expected to consider any stability and risk that the proposed merger may pose in the US banking or financial system[107].

Though the general task of the banking regulators is to ensure that the resulting bank would have sufficient capital and other resources to operate in a safe and sound manner, and that the merger would not substantially lessen competition; federal banking authorities may waive any concerns about adverse effects on competition, if they conclude that the transaction is in the public interest because factors unrelated to competition are more important[108].

In fact, the United States differs from most other countries because the bank regulators have explicit antitrust authority. In most other countries, only the competition authorities deal with antitrust concerns in banking[109].

2.4.1.2.3. State Anti-trust Authorities

The state attorney general in each of the fifty US states and territories is the chief legal advisor to the state government and the state's chief law enforcement officer. State Attorney Generals have the authority to challenge proposed bank mergers that are anticompetitive and have protected competition and local economies by enforcing state and federal competition laws[110].

2.4.2 Statutory and Regulatory Regime on Merger of Banks in Kenya

2.4.2.1 Major Laws Governing Merger of Banks in Kenya

2.4.2.1.1 Competition Act of 2010[111]

The key statute regulating mergers and acquisitions in Kenya is the Competition Act, which came into force in August 2011. In addition to regulating mergers and acquisitions, the Kenyan Competition Act also contains provisions regulating restrictive trade practices, unwarranted concentrations of economic power, abuse of dominance and consumer protection[112]. Furthermore; the act established the Competition Authority of Kenya which is

[107] Ibid.
[108] Ibid.
[109] Ibid.
[110] Ibid.
[111] Kenyan CompetitionAct of 2010.
[112] Competition Authority of Kenya ;Consolidated Guidelines on the Substantive Assessment of Mergers under the Competition Act; P.3 and ff .
All Guidelines are available on the Competition Authority Website at : www.cak.go.ke

in charge of approval of merger on condition enshrined in the Competition Act[113]. Besides; the Act sets procedures of approval of merger request and ways of loading grievances for decline of merger request[114].

2.4.2.1.2 Guidelines Issued by Competition Authority of Kenya

The Competition Authority of Kenya based on the powers given by the Competition Act issued guidelines to govern merger of banks request like that of Guideline on Balancing Public Interest, Guidelines on the Various types of Mergers ,Guideline for Market Definition and Guideline for Merger Thresholds[115]. Thus a proposed bank merger request must satisfy those conditions stipulated in the mentioned guidelines[116].

Particularly in relation to those conditions of merger approval taken by the Competition Authority of Kenya; the followings are stipulated in the Competition Guidelines:

> *while reviewing a merger transaction, the Competition Authority considers the relevant market to be affected by the transaction and therefore defines the relevant market to start, together with an assessment of the market shares, market concentration levels; followed by a full assessment of the competitive effects of the merger, including a consideration of the type of merger (horizontal, vertical or conglomerate merger), any market entry barriers, countervailing power, whether there are any failing undertaking issues for consideration, efficiencies; and finally, any issues of public interest concern[117].*

2.4.2.1.3 Companies Act[118]

The Companies Act regulates the formation, conduct and winding up of companies registered in Kenya[119] . The Companies Act does not specifically regulate mergers and acquisitions but it has an impact on the financing of acquisitions, as it prohibits a company from giving financial assistance to any person to acquire its shares[120].

[113]Ibid.
[114] Ibid.
[115] Ibid.
[116] Ibid.
[117] Ibid.
[118] Kenyan Companies Act No. 17 of 2015.
[119] Id; section 34 and 35 .
[120]Gideon Roberton , cited above at note 62, p.447.

2.4.2.1.4 The Capital Markets Act[121] and the Capital Markets (Takeovers and Merger) Regulation 2002

The Kenyan Capital Market Act regulates those public companies including banks that are listed on the Nairobi Security Exchange[122].Besides the Act empowered the Cabinet Secretary for Finance to enact regulation to oversee matters of capital market including merger or acquisition of shares/stocks of banks[123].Accordingly, the Capital market (Takeovers and Merger) Regulation 2002 was issued and the regulation set out provisions detailing with the steps and approvals required in order to effect the takeover or acquisition of a controlling interest in a listed company in Kenya[124].

2.4.2.1.5 The Banking Act[125]

Commercial banks in Kenya shall not amalgamate or transfer their assets and liabilities without prior approval the Cabinet Secretary for Finance[126].

2.4.2.1.6 Prudential Guidelines on Mergers, Amalgamations, Transfer of Assets & Liabilities [127]

The Central Bank of Kenya has given power to approve any bank merger and to this effect it has published prudential guideline to regulate and assist commercial banks undergone through merger[128]. Based on such guideline, banks under the merger process are expected to satisfy the conditions and procedures set in the guideline and are required to present approval letter from the Competition Authority of Kenya.

Regarding the mandatory documents that need to be presented by banks intending to merge; the guideline sets the following:

> *banks intending to merge must present: an extract of minutes of the General Meeting of the shareholders of each of institution involved in the merger and the term and conditions of relevant agreement, latest audited accounts of institutions involve in the merger, memorandum and articles of association of institutions involved in the merger, a copy of proposed*

[121]Kenyan Capital Market Act of 2017.
[122]Id; section 12.
[123]Ibid .
[124] Ibid.
[125]Government of Kenya, 'the banking Act' .
[126]Id, section 9.
[127]Central Bank of Kenya, PRUDENTIAL GUIDELINES FOR INSTITUTIONS LICENSED UNDER THE BANKING ACT ,2013.
[128]Id., P.310-321.

agreement for merger, financial projection for the first 3 years of operation, proposed details of method of valuation, proposed details of senior management ,proposed shareholders structure, proposed Board of Directors, proposed branch network, proposed staff rationalization, software to be adopted and legal due-diligence included current and anticipated litigation, anticipated tax implications of the merger, operational contingencies and marketing plan, business strategy to be adopted and ICT strategy and system software to be adopted[129].

The Central Bank of Kenya; before approving the merger request, must be sure that those criteria that are set by the guideline need to be fulfilled and the guideline put the following criteria in this regard:

the merger shall be in public interest and viable , the business the applicant proposes to conduct is that of an institution under the Banking Act, the corporate affiliation or new group structure does not expose the institution to undue risk or hinder effective supervision, the banks intend to merge has from the outset adequate financial, managerial and organizational resources to handle the acquisition/merger, persons proposed as a director or an officer in the new organization complies with ,'Fit and Proper' criteria in accordance with the Schedule of the Banking *Act, the resulting institution, or in the case of such transfer of assets and liabilities, the bank or person taking over such assets and liabilities, shall have the same rights and be subject to the same obligations as those applicable prior to the merger/amalgamation or transfer and the resulting institution shall be in compliance with the Banking Act, Central Bank of Kenya Act, and any statutory requirements*[130] .

[129] Ibid.
[130] Ibid.

2.4.2.1.7 Common Market for East and Southern Africa /COMESA/Competition Regulations

Kenya is a member of the Common Market for Eastern and Southern Africa (COMESA), which brought into effect the COMESA Competition Regulations via gazette notice issued in January 2013[131].

The COMMESA Competition Commission has made regulations for controlling of mergers of companies including banks situated in member states so long as such merging banks meet the merger threshold and other conditions set by the regulation[132]. The act aimed to promote competitiveness of the business organizations found in the community.

2.4.2.2 Regulatory Framework of Merger of Banks in Kenya

2.4.2.2.1 Competition Authority of Kenya

It's an organ responsible to execute Kenyan Competition Act including the primary approval of merger of banks request from competition perspective[133]. Though there is no regulation; the Competition Authority of Kenya entertains the merger request based on guidelines issued by it.

Competition Authority of Kenya subjects mergers to two main review assessments: a competition assessment and a public interest assessment.[134] Under the competition assessment the authority reviews the transaction to see whether it is likely to lead to a substantial lessening of competition which may be manifested through unilateral or coordinated effects.[135]Certain quantitative and legal and economic conceptual constructs will be undertaken to reach a decision as to whether a merger is likely to substantially prevent or lessen competition. [136]These may include, but are not limited to: market definition, market concentration, horizontal mergers and their possible unilateral and coordinated effects, non-horizontal mergers and their possible foreclosure and coordinated effect, barriers to entry, countervailing power, efficiencies and failing undertakings criteria.[137]

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[131] COMESA Competition Regulations 2004 , see at http://www.comesa.int/competition/wp-content/uploads/2014/06/12 Gazette vol. 17 ANNEX 12 –COMESA-competition Regulation , (accessed at October 2018)
[132] Id.; article 23-25.
[133]Competition Authority of Kenya, cited above at note 112.
[134] Ibid.
[135] Ibid.
[136] Ibid.
[137] Ibid.

Under the public interest assessment the authority uses a separate but complementary assessment to the competition assessment and such allows the Authority to ascertain whether otherwise anticompetitive or pro-competitive mergers will conflict with certain government policies, for example, employment stability and the protection and encouragement of the growth of small businesses.[138]

2.4.2.2.2 The Central Bank of Kenya

The Central Bank of Kenya has given power to approve bank merger and to this effect it has published prudential Guideline to regulate and assist commercial banks undergoing through merger[139].

Based on such Guideline, banks under the merger process are expected to satisfy the conditions and procedures set in the guideline to get approval[140].

2.4.2.2.3 Capital Market Authority

It's a body corporate established to regulate and approve any merger or takeover request made by those public companies including banks that are listed on the Nairobi Security Exchange[141].

2.4.1.2.4 East African Community Competition Authority

The Authority is established by East African Community Competition Act and has got supremacy and a power to review the decision of member states competition Authority decisions in related to merger approval based on its own regulation to this effect[142].

2.4.2.2.5 Common Market for East and Southern Africa States /COMESA/Competition Authority

The Authority aims to have uniform interpretation and application of competition laws in the community and mandated to figure out any competition matter disputes arising in the member states. Besides it also given power to monitor and investigate anti-competitive practices including that of merger of banks[143].

[138] Ibid.
[139] Central Bank of Kenya, cited above at note 127, p.310-320.
[140] Ibid .
[141] Kenyan Capital Market Act, section 5.
[142] East African Community Competition Act 2006 , section 44-46.
[143] COMESA Competition Regulations 2004,cited above at note 131.

CHAPTER THREE: THE LEGAL AND REGULATORY FRAMEWORK ON MERGER OF BANKS IN ETHIOPIA: THE REALITY ON THE GROUND-THE CASE OF MERGER OF COMMERCIAL BANK OF ETHIOPIA WITH CONSTRUCTION AND BUSINESS BANK S.C.

3.1 History of Merger of Banks in Ethiopia

3.1.1Brief Overview of History of Banks in Ethiopia

The history of banking started in Ethiopia in 1905 when the Bank of Abyssinia was established in Addis Ababa, during the reign of Emperor MenelekII[144]. This event marked the introduction of modern banking in the country[145]. In 1908 a new development bank called Societe Nationaled'Ethiope Pour le Development de l'Agriculture et du Commerce and two other foreign banks Banque de l'Indochine and the Compagnie de l'Afrique Orientale were also established in Ethiopia.[146]

In 1931 the then Ethiopian Imperial Government purchased the Abyssinian Bank and renamed it as '' the Bank of Ethiopia ''[147]. But Italian occupation in 1936 brought the liquidation of such Bank. During the five-years of Italian occupation (1936-41) banking activity expanded and Italian banks: Banco di Italy ; Banco di Roma ; Banco di Napoli ; Banco Nacionale ; Casa de Creito and Society Nacionale di Ethiopi established and were in operation[148]. Besides Italian Banks; Barclays Bank/a bank from Britain /was established and it remained in business in Ethiopia between 1941 and 1943[149].

In 1943; the Ethiopian government established the State Bank of Ethiopia and the bank was operating as both a commercial and a central bank until 1963 when it was remodeled into today's National Bank of Ethiopia (the Central Bank was re-established in 1976) and the Commercial Bank of Ethiopia[150].After this period many other banks were established; and just before the 1974 revolution banks like National Bank of Ethiopia, Commercial Bank of Ethiopia, Banco di Napoli , Imperial Saving and Home Ownership Public Association,

[144]DegefeBula ,The development of money, monetary institutions and monetary policy in Ethiopia, 1941-75 (1995) P. 234 -240.
[145]Ibid.
[146]Ibid.
[147]Ibid.
[148]Ibid.
[149]Ibid.
[150] National Bank of Ethiopia ,History of Banking in Ethiopia, cited above at note 3.

Addis Bank Share Co. Ethiopian Saving and Mortgage S.Co.; Ethiopian Investment Corporation S.C., Banco di Roma (Ethiopia) S.C and Agricultural and Industrial Dev. Bank were established and in operation.

In January 1975 all privately owned financial institutions including three private commercial banks, were nationalized and the nationalized banks were reorganized into one commercial bank; i.e. the Commercial Bank of Ethiopia and two specialized banks-the Agricultural and Industrial Bank (AIB), later renamed as the Development Bank of Ethiopia (DBE) and Housing and Savings Bank (HSB), later renamed as the Construction and Business Bank (CBB)[151].

The competitive banking situation that started to flourish during the 1960s and 1970s was nipped in the bud by the command system that reigned between 1974- 1991. Following the change of government in 1991, and the subsequent measures taken to liberalize and reorient the economy towards a system of economy based on commercial considerations, the financial market was deregulated[152]. Proclamation Number 84/94 was issued out to fit into effect the deregulation and liberalization of the financial sector, and a number of private banks were established following the promulgation of the Proclamation.

3.1.2 History of Bank Merger in Ethiopia

Coming to history of merger of banks in Ethiopia; the major merger activities in the Ethiopian banking industry so far carried out is between public owned banks by government decisions. As stated above; following the declaration of socialism in 1974, the Dergue nationalized all private banks that were operating in the banking industry. The three private banks namely, Addis Ababa bank, Banco di Roma and Banco di Napoli were merged by government decision in 1976 to form Addis Bank[153]. The other merger happened between the Saving & Mortgage Corporation and Imperial Saving & Home Ownership Public Association to form the Housing & Saving Bank (later renamed as Construction & Business Bank) by proclamation No.60, 1975.

The main objective of these mergers was to setup a strong bank by bringing together those banks that perform similar activities[154].After four years in operation, Addis Bank itself

[151] Ibid.
[152] Ibid.
[153] Ibid.
[154] Ibid.

merged with the Commercial Bank of Ethiopia by Proclamation in 1980 to form current Commercial Bank of Ethiopia which was the sole commercial bank in the country till the private banks were allowed to enter into the market in 1994[155].

The recent merger activity in Ethiopia's banking industry happened in 2016 when the CBE took over the CBB. The primary motive behind the decision was to avoid duplication of efforts and mandate redundancies [156] since both banks were owned by the government and serve the same objectives. Moreover, it was hoped that the merger of the two banks would boost depositors trust and the Banks' role in the economic development of the country[157].

3.2 Major Laws Relating to Merger of Banks in Ethiopia

3.2.1 The Commercial Code

The term 'Merger' or 'Acquisition' [158] is not directly used under the 1960 Commercial Code of Ethiopia. The Code uses the word "amalgamation"[159] and the term is not even defined. However; the Code clearly describes that companies can amalgamate either by taking over/Acquisition/ or establishing a new firm/Merger/[160]. By doing this the law defines the modes of merger for banking institutions too. And the decision to merge must be taken by the banks concerned[161]; i.e. amalgamation shall be decided by extra ordinary meetings of shareholders. Besides; the merger decision has to be approved by the special meetings of shareholders of different classes or meetings of debenture holders[162]. If banks agree to merge; the Commercial Code requires the terms of the amalgamation to be drawn up by a deed and such to be published in the official Commercial Gazette[163] .The purpose of such announcement is to give the chance to creditors of the banks involved to take actions to protect their interests.

However; the Commercial Code does not clearly mention what the deed of amalgamation needs to contain mandatorily. In this regard for instance regarding merger of companies

[155]Ibid.
[156] Public Financial Enterprises Agency , cited above at note 4.
[157]Ibid.
[158]'Acquisition 'may be defined as an act of acquiring the effective control by one firm over the assets or management of the other corporate without any combination between them.
[159]'Amalgamation' is a legal process by which two or more banks or firms join together to form a new entity or one or more banks are to be absorbed or blended with another.
[160]Commercial code of the Empire of Ethiopia, cited above at note 6, article 549.
[161]Id.; article 550.
[162]Ibid.
[163]Id, article 551.

concerned the OHADA[164]requires that the companies involved in a merger or a division operation shall prepare a draft merger report or division document[165] which shall be adopted by the Board of Directors.

Most importantly the report shall explain and justify the proposed merger project in detail from a legal and economic standpoint.

3.2.2 The Public Enterprise Proclamation[166]

This proclamation governs; among many others issues, merger of public enterprises[167]including that of government owned commercial banks.

Accordingly certain basic requirements must be satisfied to start up the process of amalgamation. Such requirements are targeted to safeguard the interests of creditors and to know current financial status of the enterprises. To this effect the consent of creditors or guarantors of the enterprises involved in the merge process is required, and besides parties to the merger process need to present audited financial report before consolidation[168]. And after completing the merger process; the rights and obligations of those parties involved in the merger process automatically will be transferred to the new entity[169].

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[164] OHADA, Uniform Act Relating to Commercial Companies and Economic Interest Groups (1997), Article 671 and the followings.

[165]The said document shall contain the following information:

1) the form, name and registered office of all the participating companies;

2) the reasons and terms of the merger ;

3) a description and an evaluation of the assets and liabilities to be transferred to the acquiring or new companies;

4) the terms of transfer of the shares or stocks and the date from which such shares or stocks give entitlement to profits, as well as any special conditions relating to such entitlement, and the date from which the operations of the acquired or split company shall be considered completed from the accounting standpoint by the companies receiving the contributions;

5) the dates on which the accounts of the companies concerned which were used to establish the terms of the operation were adopted;

6) the report on the exchange of company entitlements and, where necessary, the amount of the cash adjustment;

7) the projected amount of the merger or division bonus;

8) the rights other than shares, the rights granted to members having special rights, as well as special benefits, where necessary.

[166] Public Enterprises Proclamation, 1992, proc. No. 25, Fed. Neg. Gaz., 27th year, No. 19.

[167] As per article 1 of the Public Enterprise Proclamation they are defined as wholly state enterprise established pursuant to the public enterprise proclamation to carry on for gain manufacturing service rendering or other economic activities.

[168] Public Enterprises Proclamation, cited above at note 166 , article 36.

[169]Id.; article 37.

Procedurally; the Supervisory Authority that is established by the Proclamation to protect the ownership right of the government is mandated to propose, where necessary to the Council of Ministers for the amalgamation of those public enterprises including government commercial banks under its control[170]. The council of Ministers does have a final say on deciding the amalgamation[171].The Council of Ministers; based on the power given to it by the Proclamation decided through Regulation, the merger of CBE and CBB through takeover in 2016 upon the proposal submitted by Public Financial Enterprises Agency[172].

3.2.3 The Trade Competition and Consumer Protection Proclamation

The introduction of competition policy and competition law in Ethiopia can be traced back to the 1960s, with the enactment of the Commercial Code and Civil Code of 1960, which prohibited unfair commercial competition. Besides the Criminal Code of 2004and Trade Registration and Protection Proclamation of 2006 also have the objective of prohibiting unfair practices that affect trade within Ethiopia.

Following the introduction of free market economic policy in 1991 ; Ethiopia has enacted competition laws to protect her free market economy in 2003 and later revised it in 2010, but such laws, particularly in relation to merger regulation, were far from being inadequate. To correct the problems observed in applying the laws and to respond to demand of liberalization of the economy, the Ethiopian government reenacted the Trade Practice and Consumer Protection Proclamation in 2013.

The Competition Proclamation is applicable to any commercial activity or transactions in goods or services concluded and conducted within the country including that of merger transaction in banking services[173].The declared aim of the Competition Proclamation, in conformity with the free market economic policy of the country, is to maximize economic efficiency and social welfare by promoting competition and regulating anti-competitive and unfair trade practices including regulating mergers affecting competition[174].Accordingly, the Competition Proclamation; unlike the commercial code, defines merger and hence a merger is considered to take place when two or more organizations, previously having independent

[170] Id.; art. 11(11).
[171] Id.; art. 47(1)(d).
[172] Commercial Bank of Ethiopia's Takeover of Construction and Business Bank S.C Council of Ministers Regulation, cited above at note 4.

[173]Trade Competition and Consumer Protection Proclamation, cited above at note 12, article 4 .
[174]Id.; art.3 and 9.

existence, amalgamate or when such business organizations pool the whole or part of their resources for the purpose of carrying on a certain commercial activity.[175] A merger also takes place by directly or indirectly acquiring shares, securities or assets of a business organization or taking control of the management of the business of another person or group of persons through purchase or any other means. [176]Hence, under Ethiopian law the term merger now describes and includes the term and concepts of acquisition and consolidation in its definition.

Secondly, the Competition Proclamation established a Competition Authority and empowered the Authority to prohibit the act of merger if it decides that it causes or is likely to cause a significant restriction to competition or eliminates competition[177].No merger agreement shall be implemented before the Competition Authority grants permission for it[178]. Besides; the Competition Proclamation also established the Federal Trade Competition and Consumers Protection Appellate Tribunal to hear and decide on appeals against the decision of the Authority[179].

Thirdly; section two of Competition Proclamation regulates merger through certain mandatory legal requirements like that of Pre-merger notification and substantive merger assessments[180] so as to deny the merger request if the proposed merger transaction in any business sector causes or is likely to cause appreciable adverse effects on competition[181].

Many merger control regimes require mandatory pre-merger notification usually for mergers of a certain size[182]. Though the Competition Proclamation says nothing about the minimum merger threshold, according to the Directive issued by the Competition Authority, mandatory pre-merger notification is required for any kind of merger where the annual turnover, asset or registered capital of the undertakings in the merger process is above thirty million[183]. Accordingly no doubt that mandatory pre-merger notification is needed for any bank merger before it is implemented.

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[175] Id.; art.9(3)
[176] Ibid.
[177]Id.; art. 27 and 11.
[178]Id.; art. 33
[179]Id.; art.33
[180] Merger Assessment is an investigation carried out to determine whether or not a merger has or likely to have significant adverse effect with trade competition with a view to approve or prohibit or approve conditionally.
[181]Trade Competition and Consumer Protection Proclamation, cited above at note 10, art.10(1) and 6
[182] International Competition Network, cited above at note 10.
[183] Trade Practice and Consumers Protection Authority, Merger Directive No.1/2016 , art 11-15.

Having mandatory pre-merger notification from competition perspective helps to block harmful bank mergers before they are consummated and such requirement is effective to prevent harmful mergers, than to allow them and regulate their anticompetitive effects using unilateral conduct laws which prevent the abuse of dominance.

Merger and market dominance are positively correlated as merger usually leads to increase the market dominance of business persons. Having market dominance is not prohibited by law. What is prohibited is the abuse of market dominance[184] which causes or is likely to cause a significant restriction on competition, or eliminate competition[185].

Mergers of banks like merger in any other sectors can have anticompetitive effects resulting from abuse of market dominance and this needs to be analyzed carefully before permitting merger. In most jurisdictions including U.S.A, market dominance is usually analyzed by identifying the relevant product and geographic markets; assessing the parties' market shares and the market concentration; identifying possible anticompetitive activities the merged entity might carry out; and taking into account possible precompetitive effects and efficiencies the transaction creates[186].

Similarly, under the Ethiopian Competition Proclamation market dominance is analyzed by identifying the relevant product and geographic markets; assessing the parties' market shares; the ability of the merged institution to create barrier to entry in the same market and other appropriate factors [187]. And the Proclamation also provides for numerical expressions for market dominance that is to be issued by the Council of Ministers[188].

But; neither Competition Proclamation nor any other Regulation or Directive issued there under state the exact numerical expressions that help to assess objectively the existence of market dominance.

[184] Article 5(2) of the Trade Competition and Consumer Protection Proclamation provides the following abusive practices of dominant business persons: 1) denying access to a potential competitor to an essential facility controlled by the dominant business person; (2) making the supply of particular goods or services dependent on the acceptance of competitive or non-competitive goods or services or imposing restrictions on the distribution or manufacture of competing goods or services or making the supply dependent on the purchase of other goods or services having no connection with the goods or services sought by the customer; and (3) in connection with the supply of goods or services, imposing such restrictions as to where or to whom or in what conditions or quantities or at what prices the goods or services should be resold or exported.
[185] Trade Competition and Consumer Protection Proclamation, cited above at note 12; art.5.
[186] Wendell B. Jr. Alcorn; Cited above at note 19.
[187] Trade Competition and Consumer Protection Proclamation, cited above at note 12; art.6.
[188] Ibid.

On the other hand; merger regulation ;besides promoting competition ;needs to consider public interest, and take into account domestic and international market competition, efficiency and consumer protection. In this regard; the Competition Proclamation allows the Competition Authority to exceptionally approve a bank merger if its efficiencies outweigh its anticompetitive effects and so long as the merger cannot achieve its efficiencies without restraining competition. This allows the Authority to balance the merger's costs and benefits, and is necessity to promote healthy competition.

Furthermore, the Competition Proclamation provides for exemptions and in this regard the Council of Ministers may exempt all mergers in a certain industry including banking sector from review, if that industry is deemed essential for facilitating Ethiopian economic development[189].

3.2.4 Trade Practice and Consumers Protection Authority Merger Directive [190]

This internal Directive sets standards and provides for detail procedures as to how the competition authority handles the merger request in every economic sector including the request for merger coming from the banking business sector.

In order to enable the Competition Authority to assess the merger request properly; the Directive puts a minimum threshold for mandatory merger notification assessment to be above thirty million[191]. And most importantly, the Directive defines Market share[192] and Relevant Market[193], in addition to providing detailed standards of merger assessment from trade competition, public interest and market perspective[194].

The Directive also puts time framework for merger approval decision, sets procedures for appeal on merger decision made by the Competition Authority[195]Furthermore; such Directive provides standards as to the post-merger assessment and follow-up mechanisms[196].

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[189] Id.; article 4/2 .
[190] Trade Practice and Consumers Protection Authority, cited above at note 183.
[191] Id.; article 11-25

[192] Market Share is defined as an indication of the share that an organization operating in a relevant market or production area has in the market as measured using sales revenue, capacity and production volume. It's calculated by making the total sales or capital or assets volumes of business organization and divide by the total sales or capital or assets of all organizations operating in the market.

[193] Relevant Market is defined as a notion which refers to the market (product market and geographic market) in which a particular product or service is available and help to assess its effect on competition.

[194]Trade Practice and Consumers Protection Authority, cited above at note 183, article 5-25 .

[195]Ibid.

3.2.5 The Banking Business Proclamation

In Ethiopia; merger of a bank including any arrangement or agreement for the sale, disposal by amalgamation or otherwise, of its businesses, or effect major changes in its line of business is prohibited unless it gets prior written approval of NBE[197].

Besides; the Banking Business Proclamation empowers the Council of Ministers to issue Regulation and the NBE to issue Directive for effective implementation of the Proclamation including that of merger of banks[198].

But Council of Ministers and NBE till now failed to issue Regulation and Directive respectively as mandated concerning the process of merger of banks in Ethiopia[199].

3.2.6 Labor Proclamation No. 377/2003

Enterprises must frequently adjust and restructure to survive and grow in this globalized and increasingly competitive world[200]. Merger is one basic form of restructuring and it involves human costs. It affects not just the employers and workers of the enterprises in question, but also other stakeholders[201]. Lack of attention paid to the human dimension of merger may prevent success and may even lead to complete failure. Employee communications, retention of key employees and cultural integration are the most important activities in the human resource area for successful merger integration[202]. Thus; in line with what is stated above, adequate and effective employment law is needed.

From an employment law perspective, Labor Proclamation No.377/2006 provides for the automatic transfer of employment contracts and that mergers of undertakings shall not have the effect of modifying a contract of employment[203].The effect of this is that the new bank that comes out of the merger process is automatically substituted in the place of the merged banks in respect of all the relevant contracts of employment in existence as at the date of the merger.

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[196] Ibid.
[197] Banking Business Proclamation, cited above at note 9, art. 3(3) (d).
[198] Id; art. 59.
[199] Interview' 'Confidential'with Bank Supervision Dep't of NBE , October 5,2018.
[200] International Labor Office, MCC Working Paper on HR issues, activities and responsibilities in mergers and acquisitions, P.1-5.
[201] Ibid.
[202] Ibid.
[203] Labor Proclamation, 2003, Art. 15, proc. No. 377,Fed. Neg. Gaz., 10th year, No. 12

The Labor Proclamation also regulates the conditions of the reduction of employees resulting from direct and permanent cessation of the workers' activities in part or in whole and a decision to alter work methods or introduce new technology with a view to raise productivity following the merger process[204].Accordingly the bank created as a result of merger may lawfully terminate the employment contracts of the workers of the previous banks gone through the merger process with notice keeping the conditions, criteria and benefits of the workers set in the Proclamation.

Furthermore; in related to matters of collective agreement; the Labor Proclamation in its article 135 (2) provides as follows:

> *In the case of amalgamation of two or more undertakings, unless decided otherwise by the concerned parties:*
> *a/ where undertakings which have their own collective agreement are dissolved ,the collective agreement concluded by more workers before the dissolution shall be deemed as concluded by the others and shall be applicable.*
> *(b) Where only one of the undertakings has a collective agreement, it shall be applicable to the undertaking which results from the amalgamation,*
> *(c) Where the number of workers of all of the undertakings are equal and they have their own Collective agreements, the one more favorable in general, shall be applicable*

Finally if the merger of the banks resulted in more than one trade union , the trade union which is going to bargain the applicable collective agreement and consult with authorities, is the one which gets fifty plus one or more support by all employees of the merged bank[205].

3.2.7 Tax Laws

When assets used in a business are sold, exchanged, or otherwise transferred, gain is recognized on the transfer and income tax shall be payable on gains obtained from the transfer (sale or gift) of business asset[206].

[204] Id.;art.28/2

[205] Id.; art. 135.

[206] Federal Income tax Proclamation, 2016, Art. 35, proc. No. 979, Fed. Neg. Gaz., 22nd year, No. 104 .

However; transfers of business assets among companies which are parties to reorganization[207] are not treated as a disposal of the property[208].

Accordingly the transfer of the business assets of those banks involved in the merger process for the creation of the newly merged bank is not considered as asset disposal and is not subject to any sales tax and capital gains tax since such process is considered as reorganization so long as the Tax Authority ensures that the merger, acquisition, takeover, division, or spin-off does not having tax avoidance as a principal objective[209]. To this effect, banks involved in the merger process are expected to inform such fact to the Tax Authority before implementing the merger[210].

3.2.8 .**Common Market for East and Southern Africa /COMESA/Competition Regulations**

The COMESA Competition Regulations aimed to promote competitiveness of the business organizations found in the community[211].

Ethiopia has ratified the Common Market for East and Southern Africa /COMESA/ treaty based on Proclamation No. 90/1994[212] **.** And such brought into effect the applicability of COMESA Competition Regulations/Guidelines on bank mergers so long as such merging banks meet the merger threshold and other conditions set by the regulation besides such merger will have cross boarder effect[213].

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[207] Based on article of the above proclamation article 35 "reorganization" means: (a) a merger of two or more resident companies; (b) the acquisition or takeover of fifty percent (50%) or more of the voting shares and fifty percent (50%) or more of all other shares by value of a resident company solely in exchange for shares of a party to the reorganization;(c) the acquisition of fifty percent (50%) or more of the assets of a resident company by another resident company solely in exchange for voting participations with no preferential rights as to dividends of a party to the reorganization; (d) a division of a resident company into or more resident companies; or (e) a spin-off

[208] Federal Income tax Proclamation, cited above at note 206.

[209] Ibid .

[210] Federal Tax Administration Proclamation, 2016, Art. 10, proc. No. 983, Fed. Neg. Gaz., 22nd year, No. 103.

[211] COMESA Competition Regulations 2004 , cited above at note 131.

[212] See the internet at https://www.ethiopianbusinessreview.net , (accessed on April 1, 2018)

[213] COMESA Competition Regulations 2004 , cited above at note 131.

3.3 Regulatory Regime Relating to Merger of Banks in Ethiopia

3.3.1 The Council of Ministers and the Public Financial Institutions Supervisory Agency

The Supervisory Authority that is established by the Public Enterprise Proclamation No.25/92 to protect the ownership right of the government in the financial sectors: i.e. the Public Financial Institutions Supervisory Agency is mandated to propose, where necessary to the Council of Minister, for the amalgamation of those public enterprises including government commercial banks under its control[214] .The Council of Ministers does have a final say on deciding the amalgamation[215].

3.3.2 The National Bank of Ethiopia

Currently in most jurisdictions, bank mergers have attracted regulators' attention due to the potential risks or benefits to the participating banks, the banking sector and the economy at large.

Likewise; in Ethiopia, merger of a banks including any arrangement or agreement for the sale, disposal by amalgamation or otherwise, of their businesses, or effect major changes in the lines of businesses is prohibited unless it gets prior written approval of the NBE[216].

From regulatory perspective; the role of the NBE with respect to merger of banking sector mainly focuses on the synergies and benefits of the consolidation and financial stability of the country between the merged banks to the national economy. To this effect, the NBE ought to have a clear Directive/Guideline. But the NBE until now has not yet issued any directive/ guideline in relation to merger of banks though such mandate is given to it by the Banking Business Proclamation[217].

3.3.3 The Trade Practice and Consumers Protection Authority

The Competition Proclamation established the Competition Authority as an autonomous federal organ which is accountable to the Ministry of Trade and Industry[218].

The Competition Authority is in charge of implementing Ethiopia's Competition and Consumer Protection Law, and most importantly, it administers Ethiopia's merger regime. While overseeing the implementation of the Competition Proclamation, the Authority can

[214] Public Enterprises Proclamation, Cited above at note 166, art. 11/11.
[215] Id.; art.47/1/d.
[216] Banking Business Proclamation, cited above at note 9, art. 3(3) (d).
[217] Interview' 'Confidential' with Bank Supervision Dep't of NBE , cited above at note 199.
[218] Trade Competition and Consumer Protection Proclamation, cited above at note 12, art.27.

adjudicate cases, impose administrative and civil sanctions, and order wrongdoers to compensate victims[219].

The Competition Authority is empowered to prohibit the act of merger if it decides that it causes or is likely to cause a significant restriction to competition or eliminates competition in any economic sector. This is because in Ethiopia the administration of competition law in every sector is undertaken by such a single authority unlike some jurisdictions[220].Thus, no merger agreement in any economic sector shall be implemented before the Authority grants permission for it.

Besides; before permitting the merger of banks, the Competition Authority will carry out through assessment of the merger proposal. It has to meticulously assess the cost and benefits of permitting the merger, the impact of the arrangement on the market or market actors[221]. Accordingly, the Competition Authority will assess the proposed bank merger by identifying the relevant product and geographic markets; assessing the parties' market shares; the ability of the merged bank to create barrier to entry in the same market and from the perspective of those appropriate factors set under the Merger Directive[222].

Besides; the Competition Authority handles the bank merger request based on the standards and detailed procedures put under the merger Directive[223]. Furthermore; based on the standards made under the merger Directive the Competition Authority carries out post-merger assessment too.

However; there are a number of sector regulators in key sectors in Ethiopia. NBE is one of the sectorial regulators for financial services sectors like banks and it's believed that it has proper expertise and capability to assess bank mergers from the perspective of banking safety and banking service efficiency. But before permitting the merger of banks, the Competition Authority shall have to carry out thorough assessment of the merger from competition point

[219] Id.; art.30-39.

[220] For example in USA there are a number of federal sector regulators with statutory authority to regulate competition within a specific sectors like that of the Federal Communications Commission, the bank regulatory agencies, the National Surface Transportation Board and the Nuclear Regulatory Commission.

[221] Trade Competition and Consumer Protection Proclamation, cited above at note 12; art.6.

[222] Trade Competition and Consumer Protection Proclamation, cited above at note 12; art.6.

Trade Practice and Consumers Protection Authority, cited above at note 183, article 5-25.

[223] Trade Practice and Consumers Protection Authority, cited above at note 183, article 5-25 .

of view. Therefore; the Competition Authority need to have framed coordination with NBE to forestall any problems that could arise from the investigation of competition cases in the regulated sectors including approval of merger proposals in the future.

Besides; in practice till now, no bank merger assessment is made by the Merger Directorate of the Competition Authority as there has been no request presented[224].

3.3.4The Tax Authority

Banks that have undergone through a merger process are required to inform such to the Tax Authority as the law requires notification for any proposed change in their status[225]. Besides; they need to obtain the consent of the Tax Authority before implementing the merger so as to enjoy the capital gain tax exemption as stated in section 3.2.7above.

3.3.5 The Ministry of Trade

Banks are always established in the form of Share Companies in Ethiopia and such form of establishment is always deemed to be a commercial business organizations[226].

Banks as business organizations obtain their legal personality upon registration in the Commercial Registration[227]. Banks cannot obtain any kind of business license from the NBE without being registered in the Commercial Register at first[228]. Besides, the establishment of a new bank through merger needs to be publicized in a newspaper having national circulation[229].

When banks merge either a new brand bank is going to be established or one of the merging banks continues its existing status by acquiring the rest. To this effect, it's the Ministry of Trade that is mandated to register banks in the Commercial Register[230]. But the Ministry of trade must get approval letter from the Competition Authority before accepting the merger and effect commercial registration so as to award the merged bank legal personality.

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[224] An interview conducted with W/T Marta Habtamu , Merger Expert , The Trade Competition and Consumers Protection Authority, dated on October 19;2018.

[225]Federal Tax Administration Proclamation, cited above at note 210.

[226] Banking Business Proclamation, cited above at note 9, art. 4.

Commercial Code; Cited above at note 6, art. 10 .

[227] Commercial Registration and Business Licensing Proclamation, 2016, Art. 5- 7, proc. No. 980, Fed. Neg. Gaz., 22nd year, No. 101

[228] Ibid

[229] Ibid

[230]Id.; Art.4/2

3.3.6. **Common Market for East and Southern Africa States /COMESA/ Competition Authority**

The Authority aims to have uniform interpretation and application of competition laws in the community and mandated to figure out any competition matter disputes arising in the member states[231] . Besides; it also given power to monitor and investigate anti-competitive practices including that of merger of banks that would have cross boarder effect and meet the conditions put under the COMESA Competition Regulation /Guideline[232].

3.4 Merger of Banks in Ethiopia: the Reality on the Ground-The Case of Merger of Commercial Bank of Ethiopia with Construction and Business Bank

3.4.1 Background

3.4.1. 1 Commercial Bank of Ethiopia's Profile

CBE is a state -owned banking service provider institution re- established pursuant to Council of Ministers Regulation No .202/1992 .(Please see section 4.1 for detail history of CBE) . Since its establishment, CBE has been a prominent financial service provider in the country and played and continues to play a significant role in financing the development endeavors of the nation.

Currently, CBE covers almost all part of the country through its more than 1,230 branches[233]. With its more than 33,000 staff, the Bank provides quality service for its customers.[234]CBE provides major banking functions, including: accepting saving, demand and time deposits; providing short, medium and long term loans; buying and selling foreign currencies; buying and selling negotiable instruments and securities issued by the government, private organizations or any other person; and engaging in other banking activities customarily carried out by commercial banks[235].

Data compiled by the National Bank of Ethiopia as at June 30, 2016 shows that CBE; till 2016 , held , 66.1 percent of the total deposit mobilized by the banking sector, 52.6 percent of loans and advances disbursed by the banking industry, and 36.3 percent share of branch

[231] COMESA cited above at note 211.
[232] Ibid.
[233]Commercial Bank of Ethiopia's Profile ; available at : https://www.combanketh.et/AboutUs/CompanyProfile.aspx,(accessed on October 1; 2018)

[234] Ibid.
[235]Ibid .

network in the country[236]. It is the first Bank in Ethiopia to open overseas branches in South Sudan and Djibouti. Studies are in progress to open additional overseas branches in Sudan (Khartoum), South Africa, and United States of America[237].

CBE has a vision to become a world-class Commercial Bank by 2025[238]. To this effect the bank has set its own mission, values and strategy.

3.4.1. 2 Construction and Business Bank's Profile (Before the Merger)

CBB was a state-owned banking service provider institution re- established pursuant to Council of Ministers Regulation No 203/2002 (please see section 4.1 for detail history of CBB).

Except financing loans for Condominium houses; CBB had been engaged in similar banking services like that of CBE at a time immediately before taken over by CBE[239] .

Before the merger; the CBB had: total asset of 7, 338 million; total capital and reserve of 773.9 million, 118 branches and 2020 staff strength[240].

3.4.2. Causes of the Merger

The main reason for the government to pass a decision of merger is to eliminate duplication of efforts and mandate redundancies as both banks engaged in the same banking business activities[241].

3.4.3 Overview of the process of the Merger from the Perspective of Complying with the Existing Legal and Regulatory Requirement

3.4.3. 1 General Overview of the process of the Merger

Following the government's decision to amalgamate CBB with the CBE, a general plan was set ahead of the activities to be carried out before, during and after integration is made and a particular project Office with 10 Teams[242] and a Steering committee is established . [243]

[236] Ibid.
[237] Ibid.
[238] Ibid.
[239] Construction and Business Bank; Annual Report 2014/15.
[240] Ibid.
[241] Public Financial Enterprises Agency , Cited above at note 4.
[242] 1. Employee Assessment and Placement Team has assessed employee data and their competency and accordingly it has accomplished employee placement. In addition to this, the team has conducted cultural assessment on the ex-CBB and proposed recommendations;

The Steering Committee[244] was established to provide strategic guidance; make decisions and oversee the overall implementation of the merger[245]. The Project Office was mandated to coordinate and lead the overall merger process.[246]

The technical teams that were established under the Project Office were responsible for the assessment and consolidation of: employee assessment and placement, review of financial status of the CBB and consolidating with CBE, review of loans and advances and assessing the collateral position of CBB, review of trade service transaction, review of branch network, location, grade and structure, conducting continuous communication and awareness creation, review of the IT infrastructure, review of legal , regulatory and supervisory framework, assessing financial ,operational , management and system risks and creating CBE strategy awareness and addressing change management issues[247].

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2. Financial Assessment, Reclassification and Consolidation Team has accomplished the assessment of the entire ex-CBB's book extending from balance confirmation up to fixed asset reconciliation;
3. Credit Assessment, Reclassification and Consolidation Team similarly has reviewed and takes over lending and security files, and loans under loan recovery. In addition, the team has reviewed staff mortgage and personal loans and it has made the overall assessment on collateral values, disbursement and provision status of CBB loans and accordingly accomplished reclassification of loans and advances;
4. Trade Service Technical Team reviewed Trade contracts and L/C commitments, Reconciliation and Settlements, Open positions Reports, Outstanding Guarantees, Correspondent Banks Relationship Status and Terms and Tariffs;
5. Branch Network Grading, Structuring and Consolidating Team developed detail branch review criteria and effectively carried out the overall review, evaluation and branch grading of all CBB branches which gives rise to the decision that 102 branches and one outlet of the CBB to be incorporated in the branch network of CBE while nineteen (19) branches and three outlets of the CBB shall terminate operation;
6. IT Infrastructure review and rearrangement Team has assessed the IT Infrastructures and Related Licenses and Support Agreements of CBB and Provided Recommendation and Conducted Test Migrations and conducted CBB Branch Infrastructure Migration;
7. Legal, Regulatory and Supervisory Review Team has Prepared Draft Regulation Concerning CBE's Takeover Action of CBB, Prepared a Recommendation on the Legal Status of Commercial Nominees and Other Companies after CBB's Dissolution, and reviewed all contracts. The team has also reviewed and took over active Civil, Foreclosure and Criminal cases in which CBB is currently engaged;
8. Awareness Creation Team on CBE's Strategy has coordinated and supervised the provision of Orientation programs of strategy awareness and change management to all ex-CBB employees for two days in three phases.
9. Communication Technical Team has been continuously informing the employees of the two banks in every important milestones of the project via different media;
10. Risk Assessment Technical Team produced different reports that can point out risk exposures and provide tips on what caution should be taken. These reports are CBB Risk & Compliance Profile Review Report, Project Risk Assessment and Mitigation Proposal, Critical Information Security Risk Assessment & Comprehensive Information Security Risk Assessment Reports, Major Operational Risk Assessment & Residual Operational Risk Assessment Reports, Governance and HR Risk Assessment, Financial Risk Assessment, and Legal and Compliance Risk Assessment report

[243] Ibid

[244] The project is headed by a steering committee of six members; the project sponsor: Director of Public Financial Enterprises Agency , presidents of the two banks, board chair persons of the two banks and the project director

[245] Public Financial Enterprises Agency , Cited above at note 4

[246]Ibid

[247]Ibid.

Among the ten technical teams, it was the Legal Team which was responsible for general review of the legal, regulatory and supervising framework and alignment with CBE[248]. Besides; the team was expected to propose recommendation on various legal issues relating to the merger process[249]. To this effect the team has made its own Action Plan with specific activities and respective time frames.

3.4.3.2 Issue of Legal and Regulatory Compliance

The Supervisory Authority that was established by Public Enterprise Proclamation No.25/92 to protect the ownership right of the government in relation to financial sectors: i.e. the Public Financial Institutions Supervisory Agency is mandated to propose, where necessary to the Council of Ministers for the amalgamation of those public enterprises including government commercial banks under its control[250].The council of Ministers does have a final say on passing decision on the amalgamation[251]. It's based on such authority that the Council of Ministers decided the merger of Commercial Bank of Ethiopia and Construction and Business Bank S.C through takeover in 2016[252].

From competition regulation perspective; in Ethiopia, the implementation of competition law in every economic sector is undertaken by such a single Authority unlike some jurisdictions. Thus no merger agreement in any economic sector shall be implemented before the Authority grants permission to it[253]. However; the Proclamation provides for exemptions and in this regard the Council of Ministers may exempt all mergers in a certain industry including banking sector from review, if that industry is deemed essential for facilitating Ethiopian economic development[254]. Hence; the merger decision made by the Council of Ministers may not need the approval of the Competition Authority.

From the perspective of supervision of the banking business banking business sector ;in Ethiopia, merger of a banks including any arrangement or agreement for the sale, disposal by amalgamation or otherwise, of its businesses, or effect major changes in its line of business is

[248]Ibid.
[249]An interview conducted with Ato Simon Assefa, Director Merger of CBE and CBB project Office, dated on Sep.21;2018 .
[250] Public Enterprises Proclamation, Cited above at note 166, Art. 11/11.
[251]Id.; art.47/1/d.
[252] Commercial Bank of Ethiopia's Takeover of Construction and Business Bank Share company Council of Ministers Regulation, cited above at note 4.
[253]Trade Competition and Consumer Protection Proclamation, cited above at note 12; art.6.
[254]Id.; Art.4/2

prohibited unless it gets prior written approval of the NBE[255]. Such strict supervision may be due to the sensitivity of the sector in relation to the stability of macro economy of the country and safety of all depositors.

Accordingly while the Council of Ministers decided that CBB to merge with CBE; the NBE was communicated by the same letter of notification of such decision to that of Public Financial Institutions Supervisory Agency[256]. The purpose of communicating the NBE was not to get prior approval. It was rather for effective implementation of the merger decision[257]. This is just because the NBE itself is accountable to the Prime Minister's Office and there is no legal basis for it to challenge the decision[258].

On the other hand, though the Banking Business Proclamation empowers the Council of Ministers to issue Regulation and the National Bank of Ethiopia to issue Directive for effective implementation of the Banking Business Proclamation including that of merger of banks; both failed to issue Regulation and Directive respectively as mandated[259].

For instance, in this regard the legal team which was established for general review of the legal, regulatory and supervising framework and alignment with CBE did request the NBE to disclose any directive that needs to be complied with in relation to CBE's merger with CBB by a letter and no response was given by the NBE[260].

[255]Banking Business Proclamation, cited above at note 9 Art. 3(3) (d)
[256] Letter From FDRE Office of the Prime Minister to the Public Financial Institutions Supervisory Agency, Hidar 29, 2008 E.C(Unpublished)
[257] Ibid
[258] The National Bank of Ethiopia Establishment (as Amended), Proclamation, 2008, Art. 3/4, Proc. No. 591 ,Fed. Neg. Gaz., 14th year, No. 50
[259] Interview' 'Confidential' with Bank Supervision Dep't of NBE , cited above at note 183.

[260] The writer of this paper came to know such fact as I was served as a chairperson of the Legal Team of the CBE and CBB merger project .

CHAPTER FOUR: THE PROSPECTS FOR THE FUTURE ON MERGER OF BANKS

4.1 General Overview of the Commercial Banks of Ethiopia

Currently there are about sixteen domestic private commercial and two government banks[261]. Following a significant capital injection by CBE; the total capital of the banking industry reached78.0 billion (around USD 2.8 billion) by end of June 2017[262]. This capital amount is not as such big compared to even those commercial banks capital found in sub-Sahara African Countries. For example; by Comparison, the total capital of all commercial banks of Ethiopia is by far less compared to the 8th top African and 337th world bank :i.e- EcoBank Transnational bank of Togo whose capital is around 3.1 billion dollar in 2017 [263] .

It's a known fact that Capital is one of the major macroeconomic variables that compliment bank performance. Economic theories show that inadequate capital contributes to bank failures and retards economic growth. Accordingly capital serves as an important measure of "safety and soundness" for banks as it's a buffer or cushion for absorbing losses.

Though the banking system has improved a lot in terms of accessibility over the last five years in particular; it leaves much to be desired compared to other countries. Almost all banks that are operating in the Ethiopian banking industry use branches to deliver their services. These branches enable banks to have access to customers at the grass root. The total branch network reached 4,257 as at June 2017[264]. The branch to population ratio has improved during the last ten years to reach about 1:22,164 thousands in 2017[265]. But, 33% of the branches are located in Addis Ababa[266]. This shows the physical presence of most bank branches is around the capital city leaving rural people unserved.

Furthermore, securing a loan has become a privilege that requires sufficient collateral even though loan provision is one of the core activities of banks. Ethiopia; based on the 2018

[261]National Bank of Ethiopia, Annual Report 2016/17, p.52.
The banks are: 1.Abay Bank S.C., 2. Addis International Bank S.C, 3. Awash International Bank S.C, 4. Bank of Abyssinia, 5. Berhan International Bank S.C, 6 .Bunna International Bank S.C, 7. Commercial Bank of Ethiopia, 8. Cooperative Bank of OromiaS.C, 10. Dashen Bank S.C, 10 .Debub Global Bank S.C, 11 Development Bank of Ethiopia, 12. Enat Bank S.C, 13 Lion International Bank S.C, 14 Nib International Bank S.C, 15. Oromia International Bank S.C, 16 United Bank S.C, 17 .Wegagaen Bank S.C and; 18.Zemen Bank.
[262]Ibid.
[263] See the internet at : http://africa.cgtn.com/2018/07/10-standard-bank-tops-lists-of-best-banks-in-inafrica (accessed on October 1;2018)
[264] The National Bank of Ethiopia , cited above note 261.
[265]Ibid.
[266]Ibid.

Doing Business ranking on getting credit, ranked at 173 out of 190 countries[267] . Competition on the supply side of loans and advance is not an issue for commercial banks in Ethiopia. Banks do not worry much about accessing customers for loans and advances, bearing in mind the huge demand for loans and advances coupled with its short supply which created a vast financing gap. For this reason, banks instead give more priority to deposit even by linking it with prizes, as there is a big demand for finance.

The total deposit, disbursement, collection and loan outstanding of commercial banks in Ethiopia reached about birr130,666 million; birr 109,011.2 million, birr 97,169.1 million and birr 323,007.4 million , respectively as at June 30;2016/17[268].

Compared to private banks, CBE is the biggest and dominant bank as it has54% of total capital share whereas the rest of all private banks hold 35.6 % and Development Bank of Ethiopia took 9.7% of total capital share[269]. Besides, CBE alone has 30.8% and all private commercial banks hold 66.6%share in branch network[270]. Data compiled by the NBE as at June 30, 2016 shows that, CBE until the end of 2016 , commands 64.1 percent of the total deposit mobilized by the banking sector and 52.6 percent of loans and advances disbursed by the banking industry[271]. In short CBE has the biggest market share in terms of deposit, loan and branch expansion.

Supplying limited Banking products, low level of technology utilization, huge reliance on manual work, and concentration on urban areas are features of commercial banks in Ethiopia. Besides; the adoption of financial innovation and usage of technological advances are narrower in scope in the commercial banking system though some rudimentary developments in ATM, VISA card payment system and telephone banking services for balance enquiry, and broadband local money transfer-using internet are observed. In general, banks in Ethiopian are competing in terms of service quality and efficiency (including use of technological advances), branch network expansions, advertising and prices, put in the order of their significance[272].

To sum up, the banking industry in Ethiopia is shield from foreign competition and its underdevelopment can be manifested in the small proportion of deposit, limited offer of

[267]Edward Batte and WondifrawZerihun, Ethiopia:2018 African Economic Outlook, p.6
[268]National Bank of Ethiopia , cited above at note 261,p.50-60.
[269]Ibid.
[270]Ibid.
[271]Ibid.
[272] Interview' 'Confidential' with Ethiopian Bankers Association , October 15,2018

saving products, and limited offer of credit to the private sector. Commercial banks in Ethiopia do not have adequate resources for loans and operate extremely in conservative lending policies and require physical collaterals for virtually all loans which constrain inclusive growth. Key risks to financial stability and inclusive growth include: Unpredictable inflation; foreign exchange shortage exacerbated by unstable export performance; lack of skilled manpower in the banking industry; collateral based lending is constraining private sector lending and alternative financing mechanism is lacking ;ineffective ICT infrastructure due to very weak internet connectivity; regulatory burden and/or tightening of regulations[273] ; lack of standardized accounting practices though currently IFRS/International Financial Reporting Standards / is introduced , and very weak and less organized risk management practices.

4.2 Basic Factors that drive for Merger of Ethiopian Commercial Banks in the Near Future

At present; there are sufficient reasons that drive commercial banks in Ethiopia to consider merging. The followings are the major ones.

4.2.1NBE's Intention to Increase the Minimum Paid up Capital

NBE is issuing various directives with the objective of creating a sound and more secured banking system that ensures safety of depositors. Among the directives, the minimum paid up capital requirement was raised from 75 million birr to 500 million birr for both new entrants and the existing banks as per Directive No. SBB/50/2011. The objective of this directive is to ensure the competitiveness of the small banks and to guarantee the safety of the depositors[274]. This was a challenging amount for some new private banks to attain. In line with this; such directive also put sanctions for non-observance of the stated minimum paid up capital requirement: Merger is proposed as an exit strategy for banks. The regulatory body, NBE, has also started to go public on the need to consolidate the sector[275].

[273] For Instance; the National bank of Ethiopia has issued a directive "Establishment and operation of National Bank of Ethiopia Bills Market Directive No., MFA/NBE BILLS/001/2011 which requires all banks in Ethiopia to purchase NBE bills to the amount of 27% of the disbursement towards loans and advances. The bills have a maturity period of five years and bear interest at the rate of 3% per annum, payable on annual basis.

[274] Licensing and Supervision of Banking Business Minimum Capital Requirement, Directive No. SBB/50/2011 , National Bank of Ethiopia

[275] The Reporter, September 8, 2016, available at: https://archive.thereporterethiopia.com/content/mega-banking-future-ethiopian-banks (accessed on October 1;2018)

Academic literature suggests that merger of banks in various countries is driven either by market factors and firm level decisions or induced by policies. However; a number of central banks around the world also have taken the initiative to implement bank consolidation programs. For example; in Nigeria the Central bank forced the inefficient and small banks to merge by issuing a directive increasing the capital base and such led to a remarkable reduction in the number of banks from 89 to 24 in 2005; changed their mode of operations and their contributions to the nation's economic development[276] . Nigerian Banks are now key players in the global financial market with many of them falling within the top 20 banks in Africa and among Top 1000 banks in the world[277].

With rapidly changing business environment and stiff competition, the NBE expected to issue more challenging directives to guarantee stability of banking environment and the competitiveness of all banks in the market. Through a circular dispatched on September 26, 2015 the NBE instructed all private banks to set a target of minimum paid up capital of at least 2 billion birr by June 2020 [278]. This wish letter shows that the NBE might have further intention to raise the minimum paid up capital in the future[279]. This will be again challenging for some private banks and therefore their options would be either consolidation through merger or dissolution.

4.2.2 Ethiopia's Accession to the World Trade Organization/ WTO and the African Continental Free Trade Association /AfCFTA/

The negotiation of the Government of Ethiopia with the World Trade Organization (WTO) has been progressing. To this effect the Government has established a special committee under the Prime Minister office earlier and has planned to finalize the accession process by the end of this fiscal year[280].

Opening of the financial sector is one of the pre-conditions to get membership in the WTO[281]. In this regard of the 70 more countries, who have managed to join the World Trade Organization (WTO) since 1995, none of them have succeeded in acceding without opening

[276]Anthonia T. Odeleye, Pre-Consolidation and Post-Consolidation of Nigerian Banking Sector:A Dynamic Comparison, International Journal of Economics and Financial Issues , Vol. 4, No. 1, 2014, pp.27-34.
[277]Ibid.
[278] 'Interview' 'Confidential' with Bank Supervision Dep't of NBE , cited above at note 199.
[279]Ibid .
[280]FDRE President MulatuTeshome's, Adress to the Joint Session of House of Peoples' Representative and House of Federation, in Ethiopian Broadcast Corporation , October 8 ,2018
[281]The Reporter, September 6, 2016, available at: https://archiveenglish.thereporterethiopia.com/content/beyond-%E2%80%9Cmerger%E2%80%9D (accessed on october 1;2018)

up their financial sector for investment[282].So opening up of the banking sector for foreign investment will be a must.

On the other hand; Ethiopia has already ratified the African Continental Free Trade Association /AfCFTA/ agreement by its Council of Ministers in February 2018[283]. The main objectives of African Continental Free Trade Association /AfCFTA/ is to push into full economic as well as political integration and member states are expected to remove barriers to trade including opening up of financial sector for investment[284].

Accordingly, the competition in the banking industry will be more stiff in the future with the arrival of foreign banks with advanced banking technology and skilled man power. The domestic banks shall have to be well prepared for such scenario. In line with this, most importantly, increased capitalization and consolidation will be key to give a competitive edge for the domestic banking sector[285]. Therefore, merger will be one option to safeguard the competitiveness and sustainability of domestic banks in the forthcoming tough circumstance.

4.2.3. Synergy

As stated earlier the Ethiopian commercial banking sector has been known for supplying limited financial products, aggressive branch expansions, low level of technology utilization, huge reliance on manual work, and concentration on urban areas over the past decades. Commercial banks cannot continue doing business using traditional business models in this very competitive industry and need to upgrade their overall competitiveness[286].

Therefore; commercial banks shall develop strategy towards merger to attain solid capital base and efficiency in their operation[287]. There are various benefits that merger will bring to commercial banks in Ethiopia. First, merger will bring economies of scale for the merged banks. Clearly, the core idea behind exploring merger of banks is to enable creation of large sized banks of adequate capital base to enable disbursement of greater credit, especially for large developmental projects as well as for effective management of bad loans.

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[282] Ibid.

[283] See the internet at https://www.ethiopianbusinessreview.net , (accessed on April 1, 2018)
[284] Ibid.
[285] The Reporter, September 8, 2016, cited above at note 275.
[286] Interview' 'Confidential' with Ethiopian Bankers Association, cited above at note 272.
[287] Ibid.

Secondly, banks usually buy IT systems that will help them acquire up-to-date technology. Besides; the banks need to continuously improve their technologies to stay competitive. And this requires large investment which is not feasible and economical for small banks. Thus merger will provide the necessary resource to invest more in up-to-date technologies.

Thirdly, merger will help banks to reach new markets and boost their revenues. Some banks' branches are skewed in limited geography areas. Therefore, merger will help the merged banks to be spread across wider geographic areas. Besides, it will help banks to save money by closing duplicated branches in the same area and by bringing together similar departments at head office levels. Overall, merger activities will allow the banks to gain synergy, the magic force that allows for enhanced revenue and cost efficiency.

4.3 Does Ethiopia have Adequate Legal and Regulatory Framework on Merger of Banks?

Merger of banks may happen voluntarily or involuntarily. When banks merge by considering it as a strategy for business diversity and growth/synergy, it's voluntary. On the other hand; involuntary merger happens when banks are compelled to merge due to external factors like capital adequacy and other regulatory requirements set by the regulator mainly for efficiency of the sector and the protection of depositors.

The process of bank merger; be it voluntary or involuntary, is sensitive, complex and needs strict legal and strong regulatory supervision as it may adversely affect the financial growth and stability of the country's economy.

Hence; an effective and conducive legal and regulatory framework for merger of banks will help ensure banks grow through merger and address all the above stated concerns.

For Ethiopia; like other states, having prudential supervisory procedures besides adequate laws regarding bank mergers is timely and important. Poorly conceived or badly executed bank mergers may bring about risks to the participating banks, to the banking system and to other economic sectors.

From the perspective of the above mentioned; the legal and regulatory framework for the merger of banks in Ethiopia seems to be inadequate and scanty at best. There are provisions here and there scattered in different laws of the country. They are discussed with their shortcomings below.

The existing company law in related to merger defines totally the modes of amalgamation, put legal requirements and procedures of amalgamation decision and try to protect the interest of creditors[288]. If banks agree to merge; the Commercial Code requires the terms of the amalgamation to be drawn up by a deed and such to be published in the official Commercial Gazette[289] .However; the Commercial Code does not clearly mention what the Deed of Amalgamation needs to embody mandatorily. In this regard, for instance regarding merger of companies the OHADA[290] requires that the companies involved in a merger division operation shall prepare a draft merger report or division document[291] which shall be adopted by the board of directors. Most importantly, the report shall explain and justify the proposed merger project in detail from a legal and economic standpoint.

One of the most critical elements in merger process is the valuation of companies assets as the success of merger is closely related to determining the fair value of the merged companies[292]. Determining the value of a company is one of the most complex and difficult subjects in financial management. Corporate executives face many choices and complications as they try to assess a company's value[293]. In this regard the relevant provision of the Commercial Code are not adequate as they do not specify the system and methods of valuation in case of mergers[294]. But from international financial perspective; there are a variety of ways to value a company[295]: book value[296], breakup value[297], liquidation value[298], fundamental value[299], and market value[300].

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[288]Commercial Code of the Empire of Ethiopia, cited above at note 6, article 549.
[289]Ibid, Article 551 .
[290] OHADA, Uniform Act Relating to Commercial Companies and Economic Interest Groups (1997), Art.671 and the followings.
[291] The said document shall contain the following information:
1) the form, name and registered office of all the participating companies;
2) the reasons and terms of the merger ;
3) a description and an evaluation of the assets and liabilities to be transferred to the acquiring or new companies;
4) the terms of transfer of the shares or stocks and the date from which such shares or stocks give entitlement to profits, as well as any special conditions relating to such entitlement, and the date from which the operations of the acquired or split company shall be considered completed from the accounting standpoint by the companies receiving the contributions;
5) the dates on which the accounts of the companies concerned which were used to establish the terms of the operation were adopted;
6) the report on the exchange of company entitlements and, where necessary, the amount of the cash adjustment;
7) the projected amount of the merger or division bonus;
8) the rights other than shares, the rights granted to members having special rights, as well as special benefits, where necessary.
[292]Professor NurhanAydin ,cited above at note 15
[293] Ibid
[294] Commercial Code of the Empire of Ethiopia, cited above at note 6, article 315.
[295]Barbara S. Petitt and Kenneth R. Ferris, Valuation for Mergers and Acquisitions (2ND Edition), Pearson Education, Inc., USA, 2013, P.10-12.

Thus, as the merger deed is at least expected to cover the major aspects and consequences of consolidation, the law has to set the system and method of valuation of assts of merged companies and above all the merger deed shall require the presentment of those documents to the regulatory organs [301] so as to adequately regulate and harmonize the merger process.

Regarding regulatory framework; it's clearly stipulated by law that without prior written approval of the NBE, merger or takeover of a bank is prohibited[302]. Besides; Banking Business Proclamation empowers the Council of Ministers to issue Regulation and the NBE to issue Directive for effective implementation of the Proclamation including that of merger of banks[303].

However; the Council of Ministers and the NBE till now have failed to issue Regulation and Directive respectively as mandated concerning the process of merger of banks[304].

Thus, using what criteria the NBE is going to approve or disapprove the bank's mergers requests is questionable.

The Core Principles 4 and 5 for effective banking supervision issued by the Basel Committee on Banking Supervision [305](1997) state that supervisors must have the authority to review and reject any changes in bank ownership or to establish criteria for reviewing merger or major acquisitions or investments requests by a bank[306]. Basel Principles refer to the requirement that banking supervisors should have the authority to establish criteria for ensuring that

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[296]Book value refers to the accounting value of a company—that is, the value reported in the balance sheet equity, also referred to as the company's net worth, is equal to its total assets minus its total liabilities.

[297]**Break-up value** refers to the amount that could be realized if a company were split into saleable units that could be disposed of in a negotiated transaction.
[298]**Liquidation value** refers to the amount that could be realized if a company were liquidated in a distress sale.
[299]**Fundamental value** , also called **intrinsic value**, refers to the value based on the after-tax cash flows that the company is expected to generate in the future, discounted at an appropriate rate that reflects the riskiness of those cash flows.
[300]**Market value** refers to the value established in an orderly marketplace such as a securities market. For example, the market value of equity, also called the **market capitalization** , is equal to the share price multiplied by the number of shares outstanding.
[301] The above mentioned documents indicated at note 284.
[302]Banking Business Proclamation , cited above at note 9, article 3(3) (d).
[303]Id.; art. 59
[304] Ibid.
[305]The "Basel Committee" established in 1974, is a committee that represents central banks and financial supervisory authorities of the major industrialized countries (the G10 countries). The committee concerns itself with ensuring the effective supervision of banks on a global basis by setting and promoting international standards.
[306] Basle Committee on Banking Supervision, Core Principles for Effective Banking Supervision (September 1997)

corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision[307].

The NBE as a sectorial regulator should enact directives/guidelines to evaluate the merger in the banking sector on the basis of the effect it would have ensuring the safety of the depositors; the effect of the merger in risk taking ability and the overall stability in the financial sector. Other basic financial and legal issues like whether there is a sound rationale for the proposed merger or not , issue of systematic benefits and advantage to the residual entity , interest of the banking industry, values at which the assets, liabilities and the reserves of merged banks are proposed to be incorporated, whether proper due diligence is done to assure profitability, revaluation of shares, change proposed in related to directorship, transfer of employees, branding and issue optional buy-back mechanism for those shareholders who refuse the merger must be outlined by the NBE .

Besides; the NBE through its directives/ guidelines should be able to determine, in advance of the filing with the Supervisor of any proposal for a bank merger, the information future proponents will be required to submit; what opportunities will be available for participation by the public in the process; what criteria the prudential and antitrust authorities will bring to bear on the proposal; what time frames will govern supervisory action on the proposed merger[308]. In addition, notice to the public of the filing of a bank merger proposal should be provided in timely fashion; members of the public should be provided with the opportunity to inspect non- confidential portions of the filing, and to submit comments thereon for consideration by the Supervisor in passing upon the proposal; and the proponents should be given the opportunity to respond to any comments filed in this fashion[309].

Furthermore; how persons aggrieved may obtain judicial review of the decisions of the Supervisor: NBE on the merger proposal should be made by the law.

On the other hand; mergers of banks, like any other economic sector can have anticompetitive effects resulting in abuse of market dominance and this has to be analyzed carefully before permitting merger. In most jurisdictions, including USA ,market dominance usually is analyzed by identifying the relevant product and geographic markets; assessing the

[307] Ibid.
[308] Ibid.
[309] International Monetary Fund, Code of Good Practices on Transparency in Monetary and Financial Policies: Declaration of Principles (September 26, 1999).

parties' market shares and market concentration; identifying possible anticompetitive activities the merged entity might carry out; and taking account of possible precompetitive effects and efficiencies the transaction creates[310].

Similarly under the Ethiopian Trade Practice and Consumer Protection Proclamation market dominance is analyzed by identifying the relevant product and geographic markets; assessing the parties' market shares; the ability of the merged institution to create barrier to entry in the same market and from the perspective of those appropriate factors set under the merger directive. [311]

Besides; the Merger Directive enacted by the Competition Authority sets standards and provides for detail procedures as to how the competition authority handles the merger request in every economic sector including that of banking business sector merger request.In order to enable the Competition Authority to assess the merger request properly; the directive puts a minimum threshold for mandatory merger notification assessment to be above thirty million, defines market share and relevant market , sets detailed standards of merger assessment from trade competition, public interest and market perspective, puts time framework for merger approval decision, sets procedures for appeal on merger decision made by the authority. Furthermore; the stated Merger Directive also provides standards as to the post-merger assessment and follow-up mechanisms.

However; though the Competition Proclamation provides for numerical expressions for market dominance that is to be issued by the council of Ministers; no regulation is issued in this regard. Therefore the dominance test provided by the Competition Proclamation is exposed to subjectivity and gives wider discretion to the competition Authority. Thus, the Council of Ministers should determine by regulation a market share-based dominance threshold.

Furthermore, the Competition Proclamation provides for exemptions and in this regard the Council of Ministers may exempt all mergers in a certain industry including banking sector from review, if that industry is deemed essential for facilitating Ethiopian economic development. This gives the Council of Ministers a very wide discretionary power, and so it might erode the purpose of the Competition Proclamation itself. To maintain the

[310] Trade Competition and Consumer Protection Proclamation, cited above at note 12; art.6.
[311] Ibid.

Proclamation's purpose, the Government should issue regulation in advance to help the Council of Ministers exercise its broad discretion.

Finally, in Ethiopia, the administration of competition law in every sector is undertaken by a single Authority unlike other jurisdictions. Thus no merger agreement in any economic sector shall be implemented before the authority grants permission for it[312]. However; there are a number of sector regulators in key sectors in Ethiopia. As stated above the NBE as a sectorial regulator for financial services sectors like banks has proper expertise and capability to assess bank mergers from the perspective of banking safety and banking service efficiency. But it seems that before permitting the merger of banks, the authority shall carry out thorough assessment of the merger from competition point of view. It has to meticulously assess the cost and benefits of permitting the merger, the impact of the arrangement on the market or market actors. The focus of the assessment of the merger arrangement need not be from the perspectives of safety of depositors and other sensitive banking business issues related to the very nature of the sector .Therefore; the Competition Authority need to have framed coordination with NBE to forestall any problems that could arise from the investigation of competition cases in the approval of merger proposal. Besides; as banks do have issue of confidentiality in their very business, the Competition Authority should similarly be duty bound by law to keep those information obtained while entertains the bank merger approval. However there is no framed coordination and any law regarding the above mentioned issues.

[312]Ibid .

CHAPTER FIVE: MAJOR FINDINGS AND RECOMMENDATION

5.1 Conclusion

Bank merger is a situation where previously distinct banks are consolidated into one institution. Furthermore; it includes any exchange or purchase of assets or stock among two or more banks to create a single unit.

Merger in banking sectors has got much attention currently as it has emerged as one of the most popular strategies for business diversity and growth or synergy. At one point, merger among entities was mainly a US phenomenon but during the 1990‘s its volume in Europe started rivaling that of the USA. By 2000‘s mergers had become commonly used corporate strategies for companies worldwide.

Coming to merger of banks in Ethiopia; the major merger activities in Ethiopian banking industry so far was the one that was carried out between state owned banks by the government’s decision. Presently; there are sufficient reasons that drive banks in Ethiopia to be merged. The NBE has issued various directives with the objective of creating a sound and more secured banking system that ensure safety of depositors. Among these directives in the one that raised the minimum paid up capital requirement from 75 million Birr to 500 million Birr for both new entrants and the existing banks as per Directive No. SBB/50/2011.The objective of this directive is to ensure the competitiveness of the small banks and to guarantee the safety of depositors. The minimum set was a challenge for some private banks to attain. With rapidly changing business environment and stiff competition, the NBE is expected to issue more challenging directives to guarantee stability in the industry and the competitiveness of all banks in the market. Through a circular dispatched on September 26, 2015 the NBE instructed all private banks to set a target of minimum paid up capital of at least 2 billion Birr by June 2020. This may be taken as an indication that the NBE might have further intention to raise the minimum paid up capital in the future. This will be challenging for some private banks and therefore their options would be either to consolidate through merger or dissolve.

Secondly, the competition in the banking industry will be more stiff in the future with the arrival of foreign banks with advanced banking technology and skilled man power. The negotiation of the government of Ethiopia with the World Trade Organization (WTO) has been progressing. Opening of the financial sector is one of the pre-condition to get membership in the WTO. The domestic banks have to be well prepared for such scenario. Therefore, merger will be one option to safeguard the competitiveness and sustainability of domestic banks under such circumstance.

Thirdly; the Ethiopian commercial banking sector has been known for supplying limited financial products, expensive branch expansions, low level of technology utilization, huge reliance on manual work, and concentration on urban areas over the past decades. Commercial banks cannot continue doing business using traditional business models in this very competitive industry and need to upgrade their overall competitiveness. Therefore; commercial banks shall have to develop strategy towards merger to attain solid capital base and efficiency in their operations.

As mentioned above, there are various reasons that would oblige commercial banks in Ethiopia to engage in merger. Thus having prudential supervisory procedures besides having adequate laws regarding bank mergers is also timely and important.

Poorly conceived or badly executed bank mergers can present risks to the participating banks, to the banking system; bank depositors and to other economic sectors. And bank mergers above all will have long-lasting effects, for better or for worse, on the structure and performance of banks; the stability and enhancement of competitiveness in the banking system that requires a realistic appraisal to be made of the likely competitive effects of bank mergers.

From the points mentioned above; the legal and regulatory framework for the merger of banks in Ethiopia seems to be inadequate and scanty at best. There are different provisions here and there scattered in different laws of the country.

The existing company law in relation to merger defines totally the modes of amalgamation, put legal requirements and procedures of amalgamation decision and try to protect the interest of creditors. If banks agree to merge; the Commercial Code requires the terms of the amalgamation to be drawn up by a deed and such to be published in the official Commercial Gazette. However; the Commercial Code does not clearly mention what the Deed of Amalgamation needs to contain mandatorily. Most importantly the report shall explain and justify the proposed merger project in detail from a legal and economic standpoint.

One of the most critical elements in merger process is the valuation of companies assets as the success of merger is closely related to determining the fair value of the merged companies. Determining the value of a company is one of the most complex and difficult subjects in financial management. Corporate executives face many choices and complications as they try to assess a company's value. In this regard the relevant provisions of the Commercial Code are not satisfactory as they do not specify the system and methods of valuation in case of merger.

Regarding regulatory framework; it's clearly stipulated by law that without prior written approval of the NBE, merger or takeover of a bank is prohibited. Besides; the banking business proclamation empowers the Council of Ministers to issue Regulation and the NBE to issue Directives for effective implementation of the Banking Proclamation including that of merger of banks.

However; the Council of Ministers and the NBE till now have failed to issue regulation and directive respectively as mandated concerning the process of merger of banks. Thus using what criteria would the NBE be approving or disapproving bank merger requests is questionable.

Having prudential guidelines enables the NBE; as a sectarian regulator, at least to ensure that after a merger a bank has suitable shareholders; adequate financial strength; legal structure that is in line with the bank's operational structure, a management with sufficient expertise and integrity and above all the convenience and needs of the community to be served among many other financial and corporate governance matters.

The Core Principles 4 and 5 for effective banking Supervision issued by the Basel Committee on Banking Supervision (1997) state that supervisors must have the authority to review and

reject any changes in bank ownership or to establish criteria for reviewing merger or major acquisitions or investments by a bank.

The NBE as a sectarian regulator ,by enacting directive should influence and evaluate mergers in the banking sector on the basis of the effect it would have thereby ensuring the safety of the depositors; the effect of the merger in risk taking ability and the overall stability in the financial sector. Other basic financial and legal issues like whether there is a sound rationale for the proposed merger or not , issue of systematic benefits and advantage to the residual entity , interest of the banking industry, values at which the assets, liabilities and the reserves of merged banks are proposed to be incorporated, whether proper due diligence is done to assure profitability, revaluation of shares, change proposed in related to directorship, transfer of employees, branding and issue optional buy-back mechanism for those shareholders who refuse the merger must be outlined by the NBE .

Besides; NBE through its directives should be able to determine, in advance of the filing with the Supervisor of any proposal for a bank merger, as regards the information future proponents will be required to submit; what opportunities will be available for participation by the public in the process; what criteria the prudential and antitrust authorities will bring that would have being the proposal; what time frames will govern supervisory action on the proposed merger. In addition, notice to the public of the filing of a bank merger proposal should be provided on time fashion; members of the public should be provided with the opportunity to inspect non- confidential portions of the filing and to submit comments thereon for consideration by the Supervisor in passing upon the proposal; and the proponents should be given the opportunity to respond to any comments filed in this fashion.

Furthermore; how persons aggrieved may obtain judicial review of the decisions of the Supervisor: NBE on the merger proposal should be made by the law. The existence of the right to appeal is very essential as it is the means by which justice would be maintained.

On the other hand; mergers of banks like any other economic sectors can have anticompetitive effects resulting from abuse of market dominance and this needs to be analyzed carefully before permitting merger. In most jurisdictions including USA, market dominance is usually analyzed by identifying the relevant product and geographic markets; assessing the parties' market shares and the market concentration; identifying possible anticompetitive activities the merged entity might carry out; and taking account of possible precompetitive effects and efficiencies the transaction creates.

Similarly under the Ethiopian Trade Practice and Consumer Protection Proclamation market dominance is analyzed by identifying the relevant product and geographic markets; assessing the parties' market shares; the ability of the merged institution to create barrier to entry in the same market and from the perspective of those appropriate factors set under the merger directive.

Besides; the Merger Directive that is issued by the Competition Authority sets standards and provides for detail procedures as to how the competition authority handles the merger request in every economic sector including that of banking business sector merger request. In order to enable the Competition Authority to assess the merger request properly; the directive puts a minimum threshold for mandatory merger notification assessment to be above thirty million, defines market share and relevant market, sets detailed standards of merger assessment from trade competition, public interest and market perspective, puts time framework for merger approval decision, sets procedures for appeal on merger decision made by the authority. Furthermore; the directive also provides standards as to the post-merger assessment and follow-up mechanisms.

However; though the Competition Proclamation provides for numerical expressions for market dominance that is to be issued by the Council of Ministers; no regulation is issued in this regard. Therefore the dominance test provided by the Competition Proclamation is exposed to subjectivity and gives wider discretion to the Competition Authority.

Furthermore, the Proclamation provides for exemptions and in this regard the Council of Ministers may exempt all mergers in a certain industry including banking sector from review, if that industry is deemed essential for facilitating Ethiopian economic development. This gives the Council of Ministers a very wide discretionary power, and so it might erode the purpose of the Proclamation itself. To maintain the Proclamation's purpose, a regulation should be issued in advance to help the Council of Ministers exercise its broad discretion.

Finally, in Ethiopia the administration of competition law in every sector is undertaken by such a single Authority unlike some jurisdictions. Thus no merger agreement in any economic sector shall be implemented before the authority grants permission for it.

However; there are a number of sector regulators in key sectors in Ethiopia. As stated above the NBE is a sectorial regulator for financial services sectors such as banks and it has proper expertise and capability to assess bank mergers from the perspective of banking safety and

banking service efficiency matters. But it seems that before permitting the merger of banks, the Competition Authority will carry out through assessment of the merger from competition perspective. The focus of the assessment of the merger arrangement could not be from the perspectives like safety of depositors and other sensitive banking business issues related to the very nature of the sector. Therefore; the Competition Authority need to have framed coordination with that of the NBE to forestall any problems that could arise from the investigation of competition cases prior to the approval of merger proposal. However there is no framed coordination set by law or by any directive between the Competition Authority and the NBE in this regard.

Finally; as there are issues of confidentiality in the banking businesses, the Competition Authority should similarly be duty bound by law to keep those information obtained while entertaining bank merger approval. However; there is no law to this effect.

5.2 Recommendations

Based on the findings of this paper, the writer would like to recommend the following:

1. The law shall clearly specify what the Merger Deed mandatorily constitutes so as to adequately regulate and harmonize the bank merger process. Besides; the law has to set clearly the system and method of valuation of assts of the to be merged companies.
2. The NBE must issue a Merger Directive so as to guide and approve the merger request in the banking sector on the basis of the effect it would have ensuring the safety of the depositors; the effect of the merger in risk taking ability and the overall stability in the financial sector.
3. An appeal right against the decision of NBE to deny bank merger has to set by the law. A regulation that determines market share-based dominance threshold should be issued by the Council of Ministers.
4. The duty of keeping information relating to customers and banking business imposed on banks should be similarly imposed on the Competition Authority by law.
5. Finally; the law maker shall enact a comprehensive separate law and set a coordinated regulatory framework as to merger of banks so as to adequately regulate and harmonize the bank merger process.

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