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HAWASSA UNIVERSITY

COLLEGE OF LAW AND GOVERNANCE

SCHOOL OF LAW

LLM COMMERCIAL LAW PROGRAM

**REGULATORY FRAMEWORK FOR FOREIGN BANK ENTRY IN
ETHIOPIA: CHALLENGES AND PROSPECTS**

LLM THESIS

MIRCHAWORK HABTAMU (ID NO: GPCLR/0006/2014)

HAWASSA UNIVERSTIY, HAWASSA, ETHIOPIA

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MIRCHAWORK HABTAMU (ID NO: GPCLR/0006/2014)

ADVISOR: YIDNEKACHEW AYELE (PhD)

**LLM THESIS SUBMITTED TO SCHOOL OF LAW, COLLEGE OF
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***IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE
DEGREE OF LLM IN COMMERCIAL LAW***

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ADVISOR'S APPROVAL SHEET

This is to certify that the thesis entitled “*Regulatory Framework for Foreign Bank Entry in Ethiopia: Challenges and Prospects*” submitted in partial fulfillment of the requirements for the degree of Master of LLM, the Graduate School of Hawassa University has been carried out by Mirchawork Habtamu (ID NO: GPCLR/0006/2014), under my supervision. Therefore, I recommend that the student has fulfilled the requirements and hence hereby can submit the thesis to the department.

Name of advisor

Signature

Date

EXAMINER'S APPROVAL SHEET

SCHOOL OF GRADUATE STUDIES

HAWASSA UNIVERSITY

We, the undersigned, members of the Board of Examiners of the final open defense by Mirchawork Habtamu have read and evaluated her thesis entitled “*Regulatory Framework for Foreign Bank Entry in Ethiopia: Challenges and Prospects*” and examined the candidate. This is, therefore, to certify that the thesis has been accepted in partial fulfillment of the requirements for the degree.

Name of Major Advisor	Signature	Date
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Name of Internal Examiner-I	Signature	Date
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Name of Internal Examiner-II	Signature	Date
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Name of External examiner	Signature	Date
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SGS Approval	Signature	Date
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DECLARATION

I, Mirchawork Habtamu, have carried out a thesis on “*Regulatory Framework for Foreign Bank Entry in Ethiopia: Challenges and Prospects*” independently in partial fulfillment of the requirement of the Master of LLM with the guidance and support of my research advisor, Yidnekachew Ayele (PhD). I also declare that this thesis is my original work and that all sources of materials used for the work have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree.

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_____	_____	_____
Name of the Designate	Signature	Date

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ACRONYMS

BOD = Board of Directors

BSD = Banking Supervision Department

CAR = Capital Adequacy Ratio

CBE = Commercial Bank of Ethiopia

CB = Central Bank

DBE = Development Bank of Ethiopia

IMF = International Monetary Fund

LTD = Loan-to-deposit

NBE = National Bank of Ethiopia

SARB = South African Reserve Bank

SMEs = Small Scale Industries

SAPs = Structural Adjustment Programs

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ABSTRACT

Ethiopia's planned framework for foreign bank entry aims to attract foreign investment and expertise to its financial sector. While fostering competition and economic growth, the framework faces challenges in balancing the interests of domestic banks and ensuring fair competition. This study examines the regulatory framework for foreign bank entry in Ethiopia and explores the challenges and prospects associated with it. The study's main objective is to analyze the challenges and prospects associated with the new regulatory framework currently under development. To achieve this, the study assesses the legal ramifications of allowing foreign banks to operate within Ethiopia; investigate the potential difficulties and opportunities that the new regulations might present and evaluate the Ethiopian National Bank's capacity to effectively manage and oversee the implementation of the new framework. The research adopts a qualitative research approach by relying on doctrinal legal research methods in addition to non-doctrinal methods, including interviews. This study underlines the Ethiopian government's decision to open the banking sector to foreign banks presents both opportunities and challenges. Its findings show legal gaps that have been identified including inadequate supervision of prudential requirements, lack of specific regulations for foreign branch banking, limited control by host authorities, lack of formal agreements with host countries, lack of clarity and consistency in regulations regarding foreign ownership in banks, lack of specific regulations for joint ventures, inadequate legal framework for mergers and acquisitions, and limited coordination between regulatory bodies. To address these gaps, the study raised recommendations which include enhancing regulatory oversight, developing specific regulations and guidelines, strengthening the regulatory framework, establishing formal agreements with host countries, providing clarity and consistency in regulations, establishing clear guidelines and regulations, developing a comprehensive legal and regulatory framework, and establishing a working relationship between regulatory bodies.

CHAPTER ONE

1 INTRODUCTION

1.1 Background of the Study

Foreign bank participation in countries in economic transition, like Ethiopia, has been a topic of debate, with potential benefits and drawbacks. Before the global financial crisis of 2008, many believed that foreign banks were more efficient than local banks and could boost local competitiveness, economic growth, and improve borrowers' financial and economic performance.¹ Some of the potential benefits of foreign bank participation include efficiency gains. Foreign banks can bring new technologies, products, and management techniques, leading to increased efficiency in the host country's financial system.²

In addition, the entry of foreign banks can stimulate competition in the local banking market, leading to lower operating costs and smaller margins between interest rates on loans and deposits.³ Finally they help stable funding and lending patterns: Foreign banks may have greater access to resources from abroad, resulting in more stable funding and lending patterns

¹ RE Litan and others, *Open Doors: Foreign Participation in Financial Systems in Developing Countries* (Brookings Institution Press 2001) <<https://books.google.com.et/books?id=Pi23AAAAIAAJ>>; Robert J Cull and María Soledad Martínez Pería, *Foreign Bank Participation in Developing Countries: What Do We Know about the Drivers and Consequences of This Phenomenon?* (World Bank, Development Research Group, Finance and Private Sector Development Team 2010) <<https://books.google.com.et/books?id=Rw3IxxEACAAJ>>.

² Juan Cárdenas, Juan Graf and Pascual O'Dogherty, 'Foreign Banks Entry in Emerging Market Economies: A Host Country Perspective' <https://www.researchgate.net/publication/253138199_Foreign_banks_entry_in_emerging_market_economies_a_host_country_perspective/citation/download>; Allen N Berger, 'International Comparisons of Banking Efficiency' (2007) 16 *Financial Markets, Institutions & Instruments* 119 <<https://doi.org/10.1111/j.1468-0416.2007.00121.x>> accessed 1 December 2023.

³ Cárdenas, Graf and O'Dogherty (n 2); Litan and others (n 1).

than domestic banks.⁴ However, there are also concerns that foreign banks may negatively impact domestic banks and the local economy.⁵

Some of these concerns include competitive pressure which states that foreign banks may target well-established and wealthy enterprises, potentially forcing domestic banks out of the market.⁶ Another concern is spillover effects which means that the entry of foreign banks can expose host countries to events happening in other countries where their foreign banks operate, which may have negative consequences.⁷ Finally, reduced access to finance is a concern too. Some case studies suggest that foreign banks may limit access to finance for local borrowers, especially in countries with underdeveloped contractual and institutional environments.⁸

Empirical evidence on the impact of foreign bank participation is mixed. While some studies suggest that foreign banks can exert competitive pressure and enhance access to finance, others show that foreign banks can destabilize the local banking sector and limit access to finance for local borrowers.⁹ In general, the impact of foreign bank participation in countries in economic transition, like Ethiopia, depends on various factors, including the country's specific circumstances and the overall economic environment.

To accelerate the state's economic success, the current Ethiopian administration has begun many adjustments to improve the efficiency and competitiveness of the banking sector.¹⁰ One

⁴ Cárdenas, Graf and O'Dogherty (n 2).

⁵ Cull and Pería (n 1); Litan and others (n 1).

⁶ Litan and others (n 1).

⁷ Cárdenas, Graf and O'Dogherty (n 2).

⁸ Cull and Pería (n 1).

⁹ *ibid.*

¹⁰ Asayehegn Desta and Admassu Bezabeh, 'Banking Sector Reform in Ethiopia' (2014) 3 *International Journal of Business and Commerce* 25.

of the adjustments is opening the Banking sector to foreign investors. Foreign Bank's entry to Ethiopia, large and anticipated by some and feared by others was legalized in 2022¹¹ The NBE stated the prerequisite for international banks to be allowed to operate in Ethiopia. In Ethiopia's banking sector, foreign investors have four modalities to participate, each presenting distinct risks and challenges. Establishing a new bank or acquiring an existing one requires careful compliance with local regulations and adaptation to the Ethiopian banking environment, alongside managing cultural and competitive differences. Buying shares in banks involves navigating corporate governance complexities and ensuring alignment with local partners for effective management. Opening a foreign bank branch demands adherence to operational regulations, capital requirements, and coordination challenges with headquarters. Meanwhile, establishing a representative office offers market insight but lacks direct investment impact. Addressing these risks is crucial for safeguarding national interests, fostering sustainable growth, and maintaining a stable financial system.¹² Others claim that the sector's opening to foreign banks will start with a small number of carefully chosen banks and that foreign banks will need to open a subsidiary in Ethiopia and purchase shares from local banks to provide services in rural areas, housing, agriculture, and infrastructure development.¹³

¹¹ Addis Zeybe, 'National Bank Sets Conditions for the Entrance of Foreign Banks in Ethiopia' <<https://addiszeybe.com/featured/national-bank-sets-conditions-for-the-entrance-of-foreign-banks-in-ethiopia>> accessed 1 December 2022.

¹² The Council of Ministers, Opening the Ethiopian Banking Sector to Foreign Investment: A Policy Document 2014; Addis Zeybe, 'National Bank Sets Conditions for the Entrance of Foreign Banks in Ethiopia'.

¹³ Addis Zeybe (n 11).

1.2 Statement of Problem

Since the mid-1980s, many African countries have implemented financial sector reforms aimed at restructuring and privatizing state-controlled banks as part of the IMF and World Bank structural adjustment policies (SAP), but were accompanied by auxiliary policies that eased entry and exit restrictions, interest and capital controls, as well as the overhaul of supervisory and regulatory frameworks in the banking sector.¹⁴ These policies have led to the emergence of more efficient private deposit taking institutions that are directly channeling financial resources to more productive sectors, facilitating risk sharing and supporting private sector development.¹⁵

While the overall economic benefits of SAP continue to be debated among experts, the consensus is that at least in the financial sector, such policies have led to positive outcomes.¹⁶ However, challenges remain, such as reducing structural impediments to lending, promoting competition, and minimizing distortions from subsidized lending while maintaining an effective supervisory regime.¹⁷

The Ethiopian government's recent decision to open the banking sector to foreign investors marks a significant shift in the country's economic policy. The Council of Ministers endorsed

¹⁴ Peter Gakunu, 'Reforming the Financial System in Sub-Saharan Africa: the (long) Way Ahead' (2007) 28–29 *Finance & Bien Commun* 139 <<https://www.cairn.info/revue-finance-et-bien-commun-2007-3-page-139.htm>>.

¹⁵ Jean-Pierre Briffaut and others, 'I. Overview', *Financial Sector Development in Sub-Saharan African Countries* (International Monetary Fund 1998) <<https://www.elibrary.imf.org/view/book/9781557757586/9781557757586.xml>>; Gakunu (n 14); Catherine A Pattillo and others, *Sub-Saharan Africa: Financial Sector Challenges* (International Monetary Fund 2006) <<https://www.elibrary.imf.org/view/book/9781589065659/9781589065659.xml>>.

¹⁶ Gakunu (n 14); T Beck and others, *Financing Africa: Through the Crisis and Beyond* (World Bank Publications 2011) <<https://books.google.com.et/books?id=5FYuJRbZjVsC>>.

¹⁷ Briffaut and others (n 15); Gakunu (n 14).

a policy document that allows for the entry of foreign banks through various models, including the acquisition of stakes in existing banks, subsidiary formation, the opening of branches, and the opening of representative offices. This move is part of the government's broader efforts to liberalize the economy and attract foreign investment.¹⁸

While the entry of foreign banks is expected to bring several benefits, such as increased competition and improved financial services, the decision has also raised some concerns.¹⁹ For example, the policy document does not mention joint ventures as an entry model, contrary to earlier reports in some media.²⁰ Some observers have suggested that the policy gives too much in terms of entry options referring to the risk of branch entry, and that the government should have restricted the modes of entry given the country's low rate of financial inclusion and the potential risks associated with the entry of foreign banks.²¹ Permitting foreign bank presence through branch opening doesn't seem to be a wise policy from regulatory and competitive points of view. Establishing a presence through branching will be the easiest for foreign banks but, it will also be the most difficult to regulate for the National Bank of Ethiopia. Key prudential requirements such as solvency cannot be supervised at the branch level. Other

¹⁸ Ecofin Agency, 'Ethiopia Will Grant 3 to 5 Licenses to Foreign Banks (Central Bank)' (*Ecofin Agency*, 4 May 2023) <<https://www.ecofinagency.com/finance/0405-44491-ethiopia-will-grant-3-to-5-licenses-to-foreign-banks-central-bank>>; David Kageenu, 'Ethiopian Financial Sector Structure And The Liberalization Committee' (*Fie-Consult*, 24 August 2023) <<https://fieconsult.com/ethiopian-financial-sector-structure-and-the-liberalization-committee/>>; Matt Smith and Saqib Tariq, 'Foreign Banks Eye Ethiopia as Government Reforms Gather Pace' (*S&P Global Market Intelligence*, 13 December 2018) <<https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/foreign-banks-eye-ethiopia-as-government-reforms-gather-pace-48767392>>; Fekadu Petros, 'Modalities for Foreign Bank Entry into Ethiopia A Need for Caution in Policymaking' (2022) 11 *Ethiopian Business Review* <<https://ethiopianbusinessreview.net/modalities-for-foreign-bank-entry-into-ethiopia-a-need-for-caution-in-policymaking/#:~:text=The%20policy%20document%20as%20well,and%20opening%20of%20representative%20offices.>>.

¹⁹ Petros (n 18).

²⁰ Ecofin Agency (n 18).

²¹ *ibid*; Smith and Tariq (n 18); Petros (n 18).

requirements, such as capital adequacy, can also be problematic to monitor at the branch level. Thus, generally, home authorities are the ones that can exercise regulatory authority over foreign branches of their domestic banking institutions. In contrast, host country central banks have the lead regulatory responsibility for foreign subsidiaries they host.²²

The entry of foreign banks through financial liberalization may improve bank supervision through regulatory spillover. However, the government will need to carefully manage the liberalization process to ensure financial stability and maintain the interests of the majority of Ethiopians. The National Bank of Ethiopia, as the regulator of the banking sector, will play a crucial role in overseeing the entry of foreign banks and ensuring that they comply with the country's banking regulations.²³

Therefore, based on the above problems discussed, the study analyzed the regulatory framework for foreign bank entry in Ethiopia focusing on its challenges and prospects.

²² Petros (n 18).

²³ Kozo Kiyota, Barbara Pietsch and Robert Stern, 'The Case for Financial Sector Liberalization in Ethiopia' <https://www.researchgate.net/publication/30856220_The_Case_for_Financial_Sector_Liberalization_in_Ethiopia/citation/download>; Fetene Bogale, 'Foreign Bank Entry and Issues Efficiency, Stability and Economic Growth: Implication for Ethiopia from Sub-Sahara African Countries Panel Data.' (PhD Thesis, Adama Science and Technology University 2017) <https://eea-et.org/sites/default/files/forms/Foreign_Bank_Entry.pdf>.

Based on the premises discussed in the problem, the study analyzed to seek answers to the following questions.

1. What are the legal framework for governing foreign bank entry in Ethiopia?
2. What are the legal consequences of permitting the presence of foreign banks in Ethiopia?
3. What are the opportunities and possible challenges of governing systems will encounter?
4. Are the existing regulatory capabilities of the Ethiopian National Bank aligning with or meet regulation demands of the changes?

1.3 The Study's Objective

1.3.1 General Objective

The general objective of the study is to analyze foreign bank entry in Ethiopian banking sector particularly examining the challenges and prospects of the regulatory legal regime.

1.3.2 The Study's Specific Objectives

The study's specific objectives are:

1. To identify the legal framework governing foreign bank entry in Ethiopia.
2. To assess the legal consequences of permitting foreign banks in Ethiopia.
3. To investigate the difficulties and potentialities of regulatory legal systems.
4. To explore whether the regulatory capacities of the Ethiopian National Bank will align with forthcoming regulations and alterations.

1.4 Methodology

The research adopts a qualitative research approach. This approach is chosen in response to the nature of the research questions of the study which focused on describing and characterizing the nature of Foreign Banks' entry to Ethiopia and the prospects and challenges of the regulatory Legal Regime of Ethiopia in light of the existing international Banking investment and this would involve argumentations, reasoning, and critical analysis of the issue. The study employs descriptive and analytical methodologies. In addition, it uses qualitative method of data gathering.

The research on foreign bank entry into the Ethiopian banking industry aimed to examine the challenges and opportunities presented by the regulatory legal environment. To achieve this objective, a combination of doctrinal and non-doctrinal research methods was employed. This approach involved the utilization of both primary and secondary materials, ensuring a comprehensive analysis of the subject matter.

Doctrinal research refers to the study of existing laws, regulations, and policies through legal texts and documents. In the context of this research, doctrinal methodology involved an in-depth analysis of relevant legislation, including banking laws, foreign investment laws, and regulations governing the entry of foreign banks into Ethiopia. By scrutinizing these legal frameworks, researchers were able to identify potential obstacles or facilitators for foreign banks seeking to enter the Ethiopian market.

Non-doctrinal research, on the other hand, encompasses a broader range of methods that do not solely rely on legal texts. It includes empirical studies, interviews, surveys, case studies,

and comparative analyses. In this particular research, non-doctrinal methodology was employed to gather data beyond legal sources, mainly interviews. Thus, interviews with key stakeholders such as government officials, and local industry experts were conducted to gain insights into their experiences and perspectives on the regulatory environment.

In collecting data, the researcher in this study utilized a semi-structured type of interview to gain an in-depth understanding of the status of the challenges and prospects of foreign bank entry in Ethiopia. This approach was chosen to allow for flexibility and exploration of various aspects related to foreign bank entry. The focal persons selected for the interviews were experts who possessed a strong knowledge base in investment banking law, including individuals from the National Bank of Ethiopia (NBE) and from Domestic banks like Awash Bank legal Department office, Abyssinia Bank legal department office and other experts in Ethiopia.

To determine the number of interviewees, the researcher employed purposive sampling technique. In this study, the researcher conducted 5 interviews based on the purposive selection.

Data analysis technique considered ensuring a comprehensive analysis of the subject matter to explain the banking reform, challenges and issues that anticipate implications in future by relying on the legal concepts and literature. Primary data played a crucial role in this research as they provided firsthand information directly related to the topic under investigation. Secondary data was also utilized in this study to complement the primary sources. These materials included academic articles, books, scholarly journals, reports from international organizations such as the World Bank or International Monetary Fund (IMF), and reputable other sources.

1.4.1. Scope of the Study

1.4.2. Legal Scope

The legal framework governing the banking sector in Ethiopia is primarily established under the National Bank of Ethiopia (NBE) Charter and the Commercial Code of Ethiopia. The NBE Charter provides the legal basis for the regulation and supervision of banks in Ethiopia, while the Commercial Code provides general principles for the conduct of business activities, including banking.

1.4.3 Geographical Scope

This study focused on the regulatory legal regime for foreign bank entry into the Ethiopian banking sector. Specifically, it examined the legal and regulatory challenges faced by foreign banks seeking to enter the Ethiopian market, as well as the potential prospects for foreign bank entry in the sector.

1.4.4 Methodological Scope

This study employed a combination both doctrinal and non-doctrinal approaches to analyze the challenges and prospects of foreign bank entry into the Ethiopian banking sector. Data was collected through referring the legal documents and interviews with key stakeholders in the sector, including representatives from the NBE Three experts, from Domestic banks like Awash Bank legal Department office one expert, Abyssinia Bank legal department office one expert. In this study, interview was conducted with 5 experts, Additionally, relevant literature

and documents, such as the NBE Charter and the Commercial Code, was reviewed to provide context and background information.

1.5 Limitation of the Study

The assessment of investment banking and the legal regimes under the Ethiopian Commercial Law depends on factors, conditions, and determinants, including legal, economic, and institutional factors. One of the biggest limitations encountered in this study is a scarcity of available empirical evidence in the area concerning Ethiopian law.

1.6 The Study's Significance

The study has significant legal, academic, and policy contributions. One of the key contributions of this study is its potential to assist the law-making body in formulating regulatory and supervisory standards for Ethiopia's National Bank. By conducting a comprehensive analysis of the current regulatory framework, identifying gaps and weaknesses, and proposing appropriate measures, this study can provide valuable guidance to policymakers. The findings and recommendations can be used as a foundation for drafting new laws or amending existing ones to ensure a robust and effective regulatory environment for the National Bank.

Furthermore, this study can play a crucial role in enhancing the Ethiopian financial regulatory systems as a whole. By examining the specific case of the National Bank, it can shed light on broader issues and challenges faced by the financial sector in Ethiopia. The insights gained from this study can be extrapolated to other financial institutions and regulatory bodies, thereby contributing to the overall improvement of the financial regulatory landscape in the country.

This holistic approach can lead to a more stable, transparent, and efficient financial system that fosters economic growth and protects stakeholders' interests.

Moreover, this study will serve as a valuable resource for researchers interested in exploring related topics or conducting further studies. Researchers can build upon the findings of this study to delve deeper into specific aspects of financial regulation or explore alternative approaches to address emerging challenges. By serving as a reference point, this study can facilitate knowledge sharing and collaboration among researchers working towards advancing financial regulation in Ethiopia.

1.7 The Study's Organization

The study is divided into four chapters. Chapter 1 provides a foundation for the research, outlining the objectives, research questions, and methodology used. It serves as a roadmap for the subsequent chapters, establishing the groundwork for the analysis. Chapter 2 explores the conceptual and theoretical literature to contextualize the phenomenon of foreign bank entry within the Ethiopian banking sector. Chapter 3 examines the regulatory framework governing foreign banks in Ethiopia, primarily established by the National Bank of Ethiopia (NBE). It critically evaluates the effectiveness of these regulations in fostering a stable and competitive banking environment and assesses NBE's regulatory capacity to uphold international standards and best practices. Chapter 4 synthesizes the findings to draw meaningful conclusions regarding the challenges and prospects of the regulatory legal regime for foreign banks in Ethiopia. It offers actionable recommendations to enhance the regulatory framework and foster a more conducive environment for foreign bank entry and operation in Ethiopia.

CHAPTER TWO

2 CONCEPTUAL AND THEORETICAL BACKGROUND OF FOREIGN BANK ENTRY

2.1 Conceptual Review

2.1.1 *Definition of regulation*

Regulation is the administrative public supervision of private behavior through the implementation of rules created with the public interest in mind. Therefore, the process consists of an organization that does not directly engage in the activity placing deliberate limitations on the activities that a subject chooses to engage in. When the term is used in reference to the financial system, it is called financial regulation. It describes a procedure whereby financial institutions are overseen by an organization that is overseen by the government's endeavors to achieve growth targets through financial policies and other legal measures. Regulations must be carefully considered and implemented in order to prevent disastrous outcomes from coming from insufficient or ineffective regulatory measures.²⁴

Another term for regulations is a process whereby financial institutions are overseen by an organization under government direction in an effort to accomplish macroeconomic objectives through monetary policy and other appropriate legal measures.²⁵

²⁴ Kevin Greenidge and Nicole Browne, 'The Impact of Regulatory Measures on Commercial Banks Profitability in Barbados.'

²⁵ D Vittas, *Financial Regulation: Changing the Rules of the Game* (World Bank 1992) <<https://books.google.com.et/books?id=qyIPfg8o7JQC>>.

2.1.2 Types of Financial Regulations

Financial regulations can be categorized based on their aims and functions. Regulations can be classified as structural, prudential and monetary.²⁶ Structural laws set boundaries for commercial banks, limiting the activities in which they can engage and prohibiting others. For instance, granting commercial banks a license and forbidding them from carrying out other business operations.²⁷ Prudential regulation is a subset of laws that places a strong emphasis on managing systematic risk, mainly through balance sheet restrictions like allowable bank concentration ratios and enough capital. For instance, NBE limited the amount of a single borrower to 25% of the bank's paid-up capital and reserve.²⁸ The process of establishing monetary directives with an emphasis on interest rates, credit control, and reserve requirements in order to achieve the intended macroeconomic result is known as monetary regulation. It affects the lending and deposit-taking operations of commercial banks. For instance, each loan disbursed includes a 27 percent NBE bill purchase obligation.²⁹

2.1.3 Banking Regulation: Rational

Banking is typically regarded as a topic of public interest, despite the fact that banks are run for profit and that bankers have broad discretion in many aspects of their everyday operations. Numerous facets of banking were covered by banking rules and regulations, such as who might establish banks, what kinds of goods could be sold, and how banks could grow.³⁰ The following

²⁶ Marion Vernese Williams, *Liberalizing a Regulated Banking System: The Caribbean Case* (Avebury 1996) <<https://books.google.com.et/books?id=9dqNQgAACAAJ>>.

²⁷ NBE, NBE Directive: legal reserve requirement 1995.

²⁸ NBE, NBE Directive: Amendment on single borrower limit 2002.

²⁹ NBE, Amendment on NBE Bill purchase 2013.

³⁰ Lazaros E Panourgias, *Banking Regulation and World Trade Law: GATS, EU and Prudential Institution Building* (Bloomsbury Academic 2006) <<https://books.google.com.et/books?id=wAK5AAAAIAAJ>>; Kenneth

sections focus on several of the more commonly accepted goals of bank regulation. Also, because of the potential for conflict among regulatory goals, special attention is given to what banking regulation should not do.³¹ The banking system has special features which justify special regulation.³² Special rules for the regulation of banking are justified by the significance of banks for the conduct of monetary policy, the financing of the economy, the conduct of payments and credit allocation, as well as concerns about depositor protection, an excessive concentration of power, and negative externalities to the rest of the economy.³³

2.1.3.1 Protection of Depositors

The safeguarding of deposits is the fundamental justification for banking regulation. As more people started using banks for financial transactions and as more people and businesses started storing a sizable amount of their money in banks, there was a growing need for this kind of regulation. Depositors at banks could find it harder to safeguard their interests than patrons of other kinds of companies.³⁴ Although it is theoretically possible for depositors to form broad opinions on the state of banks, doing so would still be challenging, expensive, and occasionally prone to error. These statistics explain a large portion of the public push for banking regulation to safeguard depositors, especially when combined with the history of depositor losses prior to federal deposit insurance.³⁵

Spong, *Banking Regulation: Its Purposes, Implementation, and Effects* (5th edn, Federal Reserve Bank of Kansas City 2000).

³¹ Spong (n 30); Panourgias (n 30).

³² Howell E Jackson, *The Regulation of Financial Holding Companies* (John M Olin Center for Law, Economics, and Business, Harvard Law School 1997) <<https://books.google.com.et/books?id=7vKVGwAACAAJ>>.

³³ *ibid.*

³⁴ Spong (n 30); Panourgias (n 30).

³⁵ Spong (n 30).

2.1.3.2 *Monetary policy*

The commercial banks supply the mechanism for transmission of monetary policy decisions to the rest of the economy.³⁶ Because they make sure that adjustments to interest rates or open market operations are accurately reflected in their balance sheets, commercial banks are essential in communicating monetary policy decisions to the wider economy. This transmission mechanism is necessary for monetary policy to be implemented effectively. Numerous studies have looked at how interest rate fluctuations affect bank profitability and the availability of lending.³⁷ The results imply that credit availability and loan sizes may be impacted by interest rate spreads and bank attributes like liquidity ratios. Furthermore, the transmission of monetary policy may also be impacted by the degree of financial growth and the market dominance of banks.³⁸

2.1.3.3 *Monetary and Financial Stability*

Apart from just being concerned about individual depositors, banking regulation must also seek to provide a stable frame work for making payments.³⁹ With the vast volume of transactions conducted every day by individuals and businesses, a safe and accept able means

³⁶ Corrigan E Gerald, *Statements and Speeches of E. Gerald Corrigan* (Federal Reserve Bank of St Louis 1980) <<https://books.google.com.et/books?id=UnCqswEACAAJ>>.

³⁷ Ekta Kasana, K Chauhan and Bibhu Sahoo, 'Policy Interest Rate and Bank Profitability-Scheduled Commercial Banks in India' (2023) 27 *Finance: Theory and Practice* 138; Thanh Phuc Nguyen, Thi Thu Hong Dinh and Ngoc Tho Tran, 'Financial Development and Monetary Policy Transmission in a Multiple-Tool Regime: The Case of Vietnamese Commercial Banks' (2022) 9 *Cogent Business & Management* 2135218 <<https://doi.org/10.1080/23311975.2022.2135218>>; Mohammad Farajnezhad, 'Examine the Credit Channel of the Monetary Policy Transmission Mechanism in an Emerging Market Economy: The Case of South Africa' (2022) 2 *Journal of Money and Business* 149 <<https://doi.org/10.1108/JMB-02-2022-0006>> accessed 15 December 2023.

³⁸ YIFEI WANG and others, 'Bank Market Power and Monetary Policy Transmission: Evidence from a Structural Estimation' (2022) 77 *The Journal of Finance* 2093 <<https://doi.org/10.1111/jofi.13159>>.

³⁹ Spong (n 30).

of payment is critical to the health of our economy.⁴⁰ As a matter of fact, it is difficult to see how a complex economic system could continue to run smoothly and prevent major disruptions if the numerous daily transactions were not able to be carried out with a high level of certainty and safety.⁴¹ The goal of bank supervision should be to keep fluctuations in the economy and problems at specific banks from interfering with the flow of economic transactions and undermining public confidence in the banking system.⁴²

2.1.3.4 Economy financing

Banks play a crucial role in the economy by acting as intermediaries between depositors and borrowers, facilitating the flow of funds for financing needs.⁴³ They attract savings from depositors and then direct those funds into loans to fund various economic activities, which ultimately leads to economic growth. The mobilization of savings through banks stimulates the investment multiplier, resulting in increased investment and overall economic impact.⁴⁴ Banks also make money by lending money to people and collecting interest on those loans. But banks also have to deal with issues like borrowers' prompt loan repayment, which can be resolved by using predictive models to determine how likely it is that borrowers would repay their debts.⁴⁵

⁴⁰ *ibid.*

⁴¹ *ibid.*

⁴² *ibid.*

⁴³ DR Fischel and others, *The Regulation of Banks and Bank Holding Companies* (Law and Economics Program, University of Toronto 1986) <<https://books.google.com.et/books?id=cEiRtgAACAAJ>>; Sajawal Piracha and others, 'New Insights and Different Economic Factors in Banking Sectors and Current Challenges' (2022) 8 *Scholars Bulletin* 75 <https://saudijournals.com/media/articles/SB_82_75-78.pdf> accessed 15 December 2023.

⁴⁴ Aman Soni and KC Prabu Shankar, 'Bank Loan Default Prediction Using Ensemble Machine Learning Algorithm', *2022 Second International Conference on Interdisciplinary Cyber Physical Systems (ICPS)* (2022).

⁴⁵ *ibid.*

2.1.3.5 *Efficient and Competitive Financial System*

Customers who use a sound banking system also benefit from affordable, first-rate services. Establishing a regulatory framework that fosters efficiency and competition while guaranteeing a suitable standard of banking services throughout the economy is one of the objectives of bank regulation. Numerous regulatory implications arise from the creation of a banking system that is both competitive and efficient. Competition and efficiency are influenced by the number of banks operating in a market, the ability of other banks to enter and compete, and the ability of banks to grow to a size that allows them to adequately service their clients.⁴⁶

2.1.3.6 *Undue concentration of power*

Anti-competitive practices and concentration of power in a few banks can lead to excess profits, distortionary credit policies, and undue influence on the political system.⁴⁷ Governments are concerned about these issues because they can have negative effects on the economy and society as a whole.⁴⁸ In the US, the increase in bank market power has amplified

⁴⁶ Spong (n 30).

⁴⁷ SN Brissimis and MD Delis, *Bank-Level Estimates of Market Power* (SSRN 2010) <<https://books.google.com.et/books?id=6oDszgEACAAJ>>; Elsa Massoc, 'Banks, Power, and Political Institutions: The Divergent Priorities of European States towards "Too-Big-to-Fail" Banks: The Cases of Competition in Retail Banking and the Banking Structural Reform' (2020) 22 *Business and Politics* 135 <<https://www.cambridge.org/core/journals/business-and-politics/article/abs/banks-power-and-political-institutions-the-divergent-priorities-of-european-states-towards-toobigtofail-banks-the-cases-of-competition-in-retail-banking-and-the-banking-structural-reform/8B030C0A9169935B0199C24428C2DE3F#>>; Andrei Vernikov, *State-Controlled 'National Champions' of the Russian Banking Market: Concentration, Competitiveness and Efficiency* (2013) <https://www.researchgate.net/publication/256048986_State-Controlled_'National_Champions'_of_the_Russian_Banking_Market_Concentration_Competitiveness_and_Efficiency/citation/download>; AT Villa, *Credit Misallocation and Macro Dynamics with Oligopolistic Financial Intermediaries* (Federal Reserve Bank of Chicago 2022) <<https://books.google.com.et/books?id=HIBuzwEACAAJ>>.

⁴⁸ Jackson (n 32).

the impact of macroeconomic shocks and worsened recessions.⁴⁹ In Europe, the politics of banking have been shaped by the interaction between global incentives to promote "too big to fail" (TBTF) banks and domestic opposition to this promotion.⁵⁰ In Russia, the growing concentration of state-controlled "national champions" in the banking industry has led to high market concentration, reduced competitiveness, and higher profitability for core public banks.⁵¹ In general, larger and state-owned banks tend to exert more market power than smaller and privately-owned banks.

2.1.3.7 Consumer protection

Protecting consumers' interests in all aspects of their banking interactions is another goal of banking regulation. The former regulatory goals protect customers in several ways, chief among them being the preservation of their deposits and the encouragement of competitive banking services.⁵² Consumers are safeguarded in their banking operations in a variety of other ways, though. The goals of consumer protection often align with the values of sound banking. In actuality, bankers providing competitive services should benefit most from informed consumers and credit and deposit disclosures. Likewise, any banker hoping to maximize earnings must treat borrowers equally and without discrimination.⁵³

⁴⁹ Villa (n 47).

⁵⁰ Massoc (n 47).

⁵¹ PD Culpepper and T Tesche, *Death in Veneto? European Banking Union and the Structural Power of Large Banks* (SSRN 2019) <<https://books.google.com.et/books?id=bBgAzwEACAAJ>>.

⁵² Spong (n 30).

⁵³ *ibid.*

2.1.3.8 Negative externalities

Bank failures can disrupt monetary policy, hinder other businesses' financial operations, and have an adverse psychological impact on economic agents, all of which can have an outsized negative impact on the rest of the economy. Failures in commercial banking can be attributed to the intermediation process itself.⁵⁴ Banks are vulnerable to liquidity issues because of the maturity mismatch between their long-term assets and short-term liabilities on their balance sheets. The subsequent failure of other banks and systemic risk are what exacerbate the detrimental impact on the economy.⁵⁵ This negative effect (social cost) that exceeds the cost of the bank failure itself (private cost) is not internalized by the bank and will have to be addressed by regulation.⁵⁶

2.1. Theoretical Review on Bank Regulatory Regime

2.1.1. Regulations on Bank Activities and Banking-commerce Links

There are five main theoretical reasons for restricting the degree to which banks can engage in securities, insurance, and real estate activities, or own non-financial firms. Indeed, it is such regulations that help define what observers mean by the term “bank”.⁵⁷ For starters, conflicts of interest can occur when banks engage in operations such as securities underwriting, insurance underwriting, and real estate investing. Banks, for example, may seek to "dump"

⁵⁴ David T Llewellyn, *The Economic Rationale for Financial Regulation* (Financial Services Authority 1999) <<https://books.google.com.et/books?id=wtK8XwAACAAJ>>.

⁵⁵ *ibid.*

⁵⁶ *ibid.*

⁵⁷ Sofoniyas Mekonnen, ‘Regulation and Supervision of National Bank of Ethiopia and Its Impact on the Activities of Ethiopian Private Banking Industry’ (PhD Thesis, Addis Ababa University 2012).

stocks on uninformed investors or transfer risk to them in order to aid corporations with outstanding debts.⁵⁸

Secondly, banks will have more opportunities to increase risk if they are permitted to participate in a wider range of activities, to the extent that adverse selection encourages risky behavior on their part. Third, extensive financial activities and the blending of banking and business can lead to the creation of incredibly large and intricate companies that are very challenging to keep an eye on. In fact, Michel Camdessus, the previous chairman of the International Monetary Fund,⁵⁹ stated that we are seeing "... the creation of novel financial instruments, and the structuring of banks into financial conglomerates, whose extent is frequently difficult to understand and whose activities may be unfathomable for outside observers - even bank supervisors - to oversee."⁶⁰

Fourth, big institutions could grow to be "too big to discipline" due to their economic and political clout. Finally, by suppressing competition, massive financial conglomerates may lower the efficiency of the financial system. These arguments contend that the government can improve bank performance and stability while reducing market flaws through regulatory actions.⁶¹

Nonetheless, there exist alternate theoretical justifications for permitting banks to partake in a diverse array of activities. First, banks can benefit from economies of scale and scope in

⁵⁸ Kose John, Teresa A John and Anthony Saunders, 'Universal Banking and Firm Risk-Taking' (1994) 18 *Journal of Banking & Finance* 307 <<https://EconPapers.repec.org/RePEc:eee:jbfina:v:18:y:1994:i:2:p:307-323>>.

⁵⁹ Michael Thomas Fiebig, 'Prudential Regulation and Supervision for Agricultural Finance' (2001) <<https://api.semanticscholar.org/CorpusID:168089447>>.

⁶⁰ *ibid.*

⁶¹ *ibid.*

acquiring and processing firm information, managing different kinds of risks for clients, marketing and distributing financial services, upholding contracts, and cultivating client reputation capital when there are less regulatory restrictions on their operations.⁶² Second, fewer regulatory restrictions may raise a bank's brand value, which would encourage more prudent bank operations. Third, growing activities could diversify sources of revenue, making banks more stable.⁶³ Lastly, a study's regulatory approach suggests that governments refrain from limiting bank operations to mitigate market failures. Regulatory constraints, on the other hand, obstruct bank performance and stability since they reinforce government authority and increase the role of corruption by allowing exceptions to the norm.⁶⁴

2.1.2. Regulations on Domestic and Foreign Bank Entry

Different viewpoints on the importance of and effects of restrictions on entry into the banking industry are presented by economic theory. Because banks are so important to the economy, their widespread failure would be extremely damaging. By sufficiently vetting applicants for bank entrance, governments can promote bank stability. Additionally, certain research highlights the inherent monopolistic nature of banks. In particular, banks that possess monopolistic power are more likely to be motivated to make the necessary investments to get over informational barriers and allow credit to flow to more worthy businesses.⁶⁵ Additionally, monopolistic banks could have a high franchise value, which promotes prudent risk-taking.

⁶² Stijn Claessens and Daniela Klingebiel, 'Competition and Scope of Activities in Financial Services' (2001) 16 World Bank Research Observer 19 <<https://elibrary.worldbank.org/doi/abs/10.1093/wbro/16.1.19>> accessed 1 December 2023.

⁶³ *ibid.*

⁶⁴ Andrei Shleifer and Robert W Vishny, 'Corruption' (1993) 108 *The quarterly journal of economics* 599.

⁶⁵ Mitchell A Peterson and Raghuram G Rajan, 'The Benefits of Lending Relationships: Evidence from Small Business Data' (1994) 49 *The Journal of Finance* 3 <<https://onlinelibrary.wiley.com/doi/abs/10.1111/j.1540-6261.1994.tb04418.x>>.

Because of this, the government might provide a "helping hand" in lowering unstable competition.⁶⁶

The Shleifer and Vishny regulatory mechanism regulate admission in a completely different way. Although there might be legitimate economic justifications for access limits, this point of view highlights how these limitations encourage corruption and impede economic efficiency.⁶⁷ Entry limitations are used by politicians and authorities to reward sympathetic people, obtain campaign support, and collect bribes.⁶⁸ Furthermore, an open, competitive banking industry may yield fewer strong institutions that overly influence policymakers in ways that harm bank performance and stability.

2.1.3. Regulations on Capital Adequacy

Traditional methods to bank regulation elaborate the positive features of capital adequacy requirements.⁶⁹ Capital, or net worth, serves as a buffer against losses and hence failure. Furthermore, with limited liability, the proclivity for bank owners to shift toward higher risk activities decreases with the amount of capital at risk relative to assets.⁷⁰ Official capital

⁶⁶ M Peterson and R Rajan, 'Benefits of Lending Relationships: Evidence from Small Business Data' (1994) 49 *Journal of Finance* 37.

⁶⁷ Shleifer and Vishny (n 64).

⁶⁸ Rafael La Porta, Florencio Lopez-De-Silanes and Andrei Shleifer, 'Government Ownership of Banks' (2002) 57 *Journal of Finance* 265 <<https://EconPapers.repec.org/RePEc:bla:jfinan:v:57:y:2002:i:1:p:265-301>>.

⁶⁹ Mathias Dewatripont and Jean Tirole, 'The Prudential Regulation of Banks' (ULB -- Universite Libre de Bruxelles 1994) <<https://EconPapers.repec.org/RePEc:ulb:ulbeco:2013/9539>>.

⁷⁰ Naomi R Lamoreaux, *Insider Lending: Banks, Personal Connections, and Economic Development in Industrial New England* (National Bureau of Economic Research, Inc 1994) <<https://EconPapers.repec.org/RePEc:nbr:nberbk:lamo94-1>>.

adequacy laws, in conjunction with deposit insurance (implicit or explicit), play a critical role in matching the interests of bank owners with depositors and other creditors.⁷¹

On the other hand, experts disagree about whether capital requirements actually reduce the incentives to take risks. In addition, regulators and supervisors find it extremely challenging, if not impossible, to set capital requirements that are similar to those that knowledgeable, undistorted private market participants seek. Alexander and Baptista claim that real capital requirements could encourage risk-taking.⁷² In a more cautious evaluation Thakor illustrates how risk-based capital requirements raise credit rationing, which has a detrimental impact on economic development.⁷³ Moreover, higher capital requirements could encourage debtors to move to capital markets, which would hinder capital allocation, according to Thakor and Wilson. Therefore, the theory's predictions regarding whether capital requirements improve or worsen bank performance and stability are erratic.⁷⁴

2.1.4. Powerful Supervision

Certain theoretical frameworks emphasize the benefits of having strong government regulators and supervisors. This is basically the line of thinking. Firstly, banks are expensive and hard to keep an eye on. Private agents may try to free-ride since they lack the capacity or motivation to

⁷¹ Frederick T Furlong and Michael C Keeley, 'Capital Regulation and Bank Risk-Taking: A Note' (1989) 13 *Journal of Banking & Finance* 883 <<https://EconPapers.repec.org/RePEc:eee:jbfina:v:13:y:1989:i:6:p:883-891>>.

⁷² GJ Alexander and AM Baptista, *A Var-Constrained Mean-Variance Model: Implications for Portfolio Selection and the Basle Capital Accord* (SSRN 2001) <<https://books.google.com.et/books?id=gWTQzgEACAAJ>>.

⁷³ Anjan Thakor, 'The Design of Financial Systems: An Overview' (1996) 20 *Journal of Banking & Finance* 917 <<https://EconPapers.repec.org/RePEc:eee:jbfina:v:20:y:1996:i:5:p:917-948>>.

⁷⁴ Anjan Thakor and Patricia Furlong Wilson, 'Capital Requirements, Loan Renegotiation and the Borrower's Choice of Financing Source' (1995) 19 *Journal of Banking & Finance* 693 <<https://EconPapers.repec.org/RePEc:eee:jbfina:v:19:y:1995:i:3-4:p:693-711>>.

oversee banks.⁷⁵ Banks will thus receive insufficient oversight, which will lead to subpar performance and stability. Official authorities can help to mitigate this market failure. Second, some argue that because of knowledge asymmetries, bank runs are contagious and costly for society.⁷⁶ According to the "helping-hand" perspective, government surveillance in such a situation can serve a socially useful purpose. Third, because many countries decide to put in place deposit insurance plans, this circumstance: (1) encourages banks to take on excessive risk; and (2) lessens the incentive for depositors to supervise banks.⁷⁷ Therefore, stringent government supervision will help to keep banks from taking on too much risk, enhancing bank stability and performance.⁷⁸

Powerful government regulators and supervisors, on the other hand, may have a detrimental impact. Governments with strong oversight agencies may utilize this authority to benefit favored citizens, solicit campaign donations, and extort bribes.⁷⁹ According to this viewpoint, powerful regulators/supervisors will be more concerned with garnering political support and achieving their own restricted aims than with overcoming market failures.⁸⁰ According to this 'grabbing-hand' viewpoint, strong supervision and regulation will be associated with corruption and will not promote bank performance or stability.⁸¹ Policymakers and international

⁷⁵ Ross Levine, 'Foreign Banks, Financial Development, and Economic Growth' (1996) 35 *Journal of Economic Literature*

<https://www.researchgate.net/publication/239064963_Foreign_Banks_Financial_Development_and_Economic_Growth/citation/download?_tp=eyJjb250ZXh0Ijp7ImZpcnN0UGFnZSI6InB1YmxpY2F0aW9uIn19>.

⁷⁶ *ibid.*

⁷⁷ Gerard Caprio, James R Barth and Ross Levine, *Bank Regulation and Supervision: What Works Best?* (World Bank Publications 2001) <<https://books.google.com.et/books?id=1bXnMBDGvEIC>>.

⁷⁸ *ibid.*

⁷⁹ *ibid.*

⁸⁰ *ibid.*

⁸¹ *ibid.*

institutions discuss and provide suggestions on a wide range of bank regulation and supervisory methods in practice. Countries assign substantially diverse priority to bank supervision in terms of supervisory resources and authority.⁸²

2.1.5. Regulations on Easing Private Sector Monitoring of Banks

Private bank surveillance is supported by numerous supervisory authorities. For instance, supervisory bodies have the authority to mandate that banks get certified audits and/or ratings from global rating agencies. If information is false or misleading, bank directors may be held legally responsible in a number of nations. Certain regulatory agencies mandate that banks provide accurate, comprehensive, and integrated data regarding all bank operations and risk-management protocols.⁸³

Moreover, some countries rightfully implement a "no deposit insurance" policy in order to promote private bank surveillance. Some economists have expressed worries about official bank supervision and called for a greater reliance on the private sector over time. For example, the "grabbing-hand" interpretation of government regulations states that banks will put pressure on legislators, who can then unduly sway regulators and supervisors. Moreover, supervisors may face conflicting incentives when it comes to strict adherence to regulations because they are often underpaid in some nations, which makes it easy for them to move into banking.⁸⁴ Furthermore, because supervisors do not have their own money invested in banks when it comes to monitoring and punishing banks, they have different motivations than private

⁸² *ibid.*

⁸³ Mekonnen (n 57).

⁸⁴ Shleifer and Vishny (n 64).

debtors.⁸⁵ Others, however, caution putting too much faith in private-sector oversight, particularly in nations with underdeveloped financial markets, accounting standards, and legal systems.⁸⁶ Countries with weak institutional systems will gain more from government supervisors and regulators controlling excessive risk-taking behavior of banks and establishing more trust in depositors than from private-sector monitoring.⁸⁷

2.1.6. Government Ownership of Banks

Economists have different views about the effect of banks owned by the government on financial and economic development.⁸⁸ The socialist viewpoint contends that government ownership of banks helps the mobilization of savings and the allocation of those funds to long-term beneficial initiatives for an economy.⁸⁹ According to this point of view, governments have sufficient information and incentives to assure socially good investments.⁹⁰ Government ownership of banks therefore helps nations capitalize on externalities, overcome flaws in the private capital market, and make investments in strategic areas. Lewis specifically advocates government ownership of banks to promote financial and economic growth, especially in underdeveloped countries.⁹¹

On the other hand, Shleifer and Vishny contend that insufficient government incentives prevent them from making investments that benefit society. Ownership by the government has a

⁸⁵ *ibid.*

⁸⁶ *ibid.*

⁸⁷ *ibid.*

⁸⁸ Porta, De-Silanes and Shleifer (n 68).

⁸⁹ WA Lewis, *The Principles of Economic Planning* (Routledge 2003) <<https://books.google.com.et/books?id=kCkqJjcGDk0C>>.

⁹⁰ *ibid.*

⁹¹ *ibid.*

tendency to politicize the allocation of resources, loosen fiscal restrictions, and create other barriers to economic efficiency. Therefore, government ownership of banks facilitates the financing of politically desirable but not always economically beneficial projects.⁹²

2.1.1. Historical Background of Foreign Bank Regulation in Ethiopia

Emperor Menelik II established the first Bank of Abyssinia on February 15, 1906, marking the commencement of banking in Ethiopia. It was a private bank, and its stock was traded in Addis Ababa, New York, Paris, London, and Vienna.⁹³ The Franco-Ethiopian Railway, which reached Addis Ababa in 1917, was one of the earliest projects supported by the bank. Emperor Haile Selassie overhauled the banking system in 1931.⁹⁴ The Bank of Abyssinia was liquidated, and the newly founded Bank of Ethiopia, a 100% government-owned bank, took over the defunct bank's administration, employees, and buildings. The Bank of Ethiopia supplied the country with central and commercial banking services.⁹⁵ The Italian invasion in 1935 ended one of the early African banking efforts. Italian banks were engaged in Ethiopia during the Italian occupation.⁹⁶

The State Bank of Ethiopia became the Central Bank on April 15, 1943, and remained in operation until 1963. Proclamation 206 of 1963 created the National Bank of Ethiopia, which

⁹² Shleifer and Vishny (n 64).

⁹³ Arnaldo Mauri, 'The Short Life of the Bank of Ethiopia' [2010] Acta Universitatis Danubius. Oeconomica 104 <<https://EconPapers.repec.org/RePEc:dug:actaec:y:2010:i:4:p:104-116>>.

⁹⁴ *ibid.*

⁹⁵ *ibid.*

⁹⁶ *ibid.*

commenced operations in January 1964. Earle O. Latham, the first Vice President of the Federal Reserve Bank of Boston, was a US Department of State envoy who assisted in the formation of the new organization.⁹⁷

This proclamation significantly expanded the responsibilities and powers of the National Bank of Ethiopia, providing it with extensive administrative autonomy and legal identity. The NBE was tasked with various critical functions that are essential for the stability and regulation of the country's financial system.⁹⁸ One of the primary tasks assigned to the NBE is to regulate the supply, availability, and cost of money and credit within Ethiopia. This involves managing the amount of money circulating in the economy, controlling inflation, and ensuring that there is an adequate supply of credit to facilitate economic activities while maintaining stability. The NBE was also mandated to manage and administer Ethiopia's international reserves. This responsibility includes overseeing foreign currency reserves, such as foreign exchange holdings, to ensure stability in international transactions and safeguard against external economic shocks.⁹⁹

The National Bank of Ethiopia (NBE) is responsible for licensing and supervising banks, regulating interest rates, issuing paper money and coins, acting as an agent for the government, and controlling foreign exchange rates. It ensures compliance with regulations, manages

⁹⁷ National Bank of Ethiopia, 'ABOUT US' <<https://nbe.gov.et/about-national-bank-of-ethiopia/>> accessed 7 January 2023.

⁹⁸ *ibid.*

⁹⁹ *ibid.*

currency circulation, and maintains public confidence in the monetary system. The NBE also acts as an agent in executing government monetary policies and facilitating transactions.¹⁰⁰

However, monetary and banking proclamation No. 99 of 1976 went into effect in September 1976 to shape the bank's position in accordance with the country's socialist economic theory. As a result, the bank was authorized to actively engage in national planning, especially financial planning, in collaboration with the relevant state organs. The bank's regulatory jurisdiction was also expanded to encompass other financial organizations like as insurance companies, credit cooperatives, and investment banks. Furthermore, the proclamation established the new 'Ethiopian birr' in lieu of the previous Ethiopian Dollar, which had ceased to be legal currency.¹⁰¹

The bank's relationship with the government was altered by the declaration. It first increased the legal limitations on outstanding government domestic borrowing to 25% of the government's real ordinary revenue for the previous three budget years, up from 15% under Proclamation 206/1963. This proclamation remained in effect until a new proclamation was issued in 1994 to reform the bank in accordance with market-based economic policy in order to maintain monetary stability, a strong financial system, and other credit and exchange circumstances favorable to the country's balanced growth. As a result, proclamation 83/1994 entrusted the bank with the following authorities and duties:¹⁰² regulate the supply and

¹⁰⁰ *ibid.*

¹⁰¹ *ibid.*

¹⁰² *ibid.*

availability of money and credit and applicable interest and other changes; set limits on gold and foreign exchange assets which banks and other financial institutions authorized to deal in foreign exchange and hold in deposits; set limits on the net foreign exchange position and on the terms and amount of external indebtedness of banks and other financial institutions; and make short and long-term refinancing facilities available to banks and other financial institutions.

Finally, the proclamation increased the bank's paid-up capital from Birr 30.0 million to Birr 50.0 million. The Ethiopian National Bank is one of the initial 17 regulatory organizations to make explicit national commitments to financial inclusion as part of the Alliance for Financial Inclusion's (AFI) Maya Declaration.¹⁰³

2.1.1.1. Commercial Bank of Ethiopia

The Commercial Bank of Ethiopia (CBE) is Ethiopia's largest commercial bank. It had around 86.5 billion Birr in assets as of June 2011 and owned roughly 63.5 percent of deposits and approximately 38 percent of all bank loans in the nation. The bank employs over 8,000 people who work in its headquarters and over 500 branches located in major cities and provincial communities.

The Ethiopian government divided the State Bank of Ethiopia (founded in 1942) into three banks in 1963: the National Bank of Ethiopia, the Central Bank, and the Commercial Bank of

¹⁰³ GSM Association, 'GPF 2011 Ends Successfully with the Signing of the Maya Declaration on Financial Inclusion' (GSM, 2011) <<https://www.gsma.com/mobilefordevelopment/programme/mobile-money/gpf-2011-ends-successfully-with-the-signing-of-the-maya-declaration-on-financial-inclusion/>>.

Ethiopia (CBE).¹⁰⁴ In 1958, the State Bank of Ethiopia established a branch in Sudan that the Sudanese government nationalized in 1970.¹⁰⁵ In 1980, the government combined Addis Bank into the Commercial Bank of Ethiopia, making CBE the country's sole commercial bank.¹⁰⁶ Addis Bank was formed by the government's merger of the recently nationalized Addis Ababa Bank with the Ethiopian operations of Banco di Roma and Banco di Napoli. Addis Ababa Bank was an associate that National and Grindlays Bank created in 1963 and held 40% of. Addis Ababa Bank had 26 branches before it was nationalized.¹⁰⁷ When Eritrea gained independence in 1991, CBE's branches in Eritrea were nationalized. These branches served as the foundation for what became the Commercial Bank of Eritrea in 1994. CBE was also restructured and re-established by the Ethiopian government in 1994.¹⁰⁸

2.2. Banking Reform in Ethiopia

Banks are financial intermediaries with a vital role in the financial sector and in spurring economic growth.¹⁰⁹ The banking industry steers the flow of resources within the economy

¹⁰⁴ AF Brimmer, 'Banking and Finance in the Sudan' (1960) 28 South African Journal of Economics 23 <<https://doi.org/10.1111/j.1813-6982.1960.tb01848.x>>.

¹⁰⁵ Arnaldo Mauri, 'The Re-Establishment of the Ethiopia's Monetary and Banking Systems' (Department of Economics, Management and Quantitative Methods at Università degli Studi di Milano 2008) Departmental Working Papers <<https://EconPapers.repec.org/RePEc:mil:wpdepa:2008-11>>.

¹⁰⁶ *ibid.*

¹⁰⁷ *ibid.*

¹⁰⁸ *ibid.*

¹⁰⁹ Andreas Busch, *Banking Regulation and Globalization* (Oxford University Press 2008) <<https://EconPapers.repec.org/RePEc:oxp:obooks:9780199218813>>; JR Barth, G Caprio and R Levine, *Rethinking Bank Regulation: Till Angels Govern* (Cambridge University Press 2008) <<https://books.google.com.et/books?id=gezaH4B0R0YC>>.

and it contributes to economic development.¹¹⁰ Banks are mediums where money is deposited and from where loans are provided - which are crucial fuels for economic development.¹¹¹ Banking system, however, can also be a source of financial crisis.¹¹² It is due to the versatility of banks and their sensitive role that governments gravitate towards regulating them strictly and hold them to conservative standards.¹¹³

Durability of a particular economy can be inferred from the strength and performance of its financial industry.¹¹⁴ Because, services provided by banks are life bloods of the economy. Banks are repositories of savings; they provide loans to individuals and businesses and they sustain liquidity, operate payment system as well as serve as information channel between lenders and borrowers.¹¹⁵

In 1994, Ethiopia began the process of reforming its banking sector with the goal of improving the country's financial system and promoting economic growth. However, despite efforts to make changes, progress has been slow.¹¹⁶ One reason for this slow progress is the

¹¹⁰ Gebrehiwot Ageba and Derk Beinen, *Ethiopia's Accession to the WTO and the Financial Services Sector* (2008).

¹¹¹ Van Wyk K. and others, *Understanding South African Financial Markets* (6th edn, Van Schaik 2019).

¹¹² Ageba and Beinen (n 110).

¹¹³ Maria Eleni K Agoraki, Manthos D Delis and Panagiotis K Staikouras, 'The Effect of Board Size and Composition on Bank Efficiency' (2010) 2 *International Journal of Banking, Accounting and Finance* 357 <<http://www.inderscience.com/link.php?id=37155>> accessed 16 January 2023.

¹¹⁴ Gerard Caprio, Luc Laeven and Ross Levine, 'Governance and Bank Valuation' (National Bureau of Economic Research, Inc 2003) <<https://EconPapers.repec.org/RePEc:nbr:nberwo:10158>>.

¹¹⁵ Agoraki, Delis and Staikouras (n 113).

¹¹⁶ Desta and Bezabeh (n 10).

implementation of repressive policies by the government. These policies have likely hindered the growth and development of the banking sector, making it difficult for the industry to adapt and modernize.¹¹⁷ The Ethiopian banking system is indeed dominated by large public banks and has been relatively underdeveloped compared to other sub-Saharan African countries. The state-owned Commercial Bank of Ethiopia (CBE) holds a significant share of the market, with more than 60% of total bank deposits, loans, and foreign exchange.¹¹⁸ Additionally, the Development Bank of Ethiopia (DBE) is another government-owned bank that provides loans to investors operating in priority sectors. The sector has 29 players, all of which are locally owned, indicating a lack of foreign competition.¹¹⁹

The Ethiopian banking sector has historically been dominated by large public banks and has faced challenges related to competition, efficiency, and economic growth. However, recent developments indicate a shift in the government's stance towards opening up the sector to foreign investors.¹²⁰ The National Bank of Ethiopia (NBE) is finalizing amendments to the Banking Business Proclamation to allow foreign banks to enter the country, with plans to issue licenses to at least five foreign banks within the next five years.¹²¹ The move to allow foreign

¹¹⁷ *ibid.*

¹¹⁸ Nicola Limodio and Francesco Strobbe, 'The Development Impact of Financial Regulation: Evidence from Ethiopia and Antebellum USA' (Society for Economic Dynamics 2015) <<https://EconPapers.repec.org/RePEc:red:sed015:355>>.

¹¹⁹ *ibid.*

¹²⁰ Hailemariam Nega Gebeyehu, 'CONCENTRATION AND COMPETITION IN ETHIOPIAN BANKING INDUSTRY (A PANEL DATA ANALYSIS)' (KDI School of Public Policy and Management 2018) <<https://archives.kdischool.ac.kr/bitstream/11125/32287/1/Concentration>>.

¹²¹ *ibid.*

bank entry is part of broader economic reforms aimed at driving foreign investment inflows and economic growth.¹²² While concerns have been raised about the potential risks associated with foreign bank entry, such as the possibility of a banking crisis, the government's commitment to increasing competition in the sector reflects a shift towards liberalizing the banking industry and attracting foreign investment.¹²³

Research has shown that the Ethiopian banking industry has been highly concentrated, with competition being higher among private banks, although it is still dominated by the state-owned Commercial Bank of Ethiopia (CBE).¹²⁴ Additionally, studies have highlighted the low level of financial inclusion in Ethiopia, with only about one-third of Ethiopians holding bank accounts, indicating the potential for growth and development in the banking sector.¹²⁵ Efforts to open up the banking sector to foreign investors are expected to bring about competitive pressures that stimulate efficiency, foster competitiveness, and promote stability of the financial system.¹²⁶ However, it is crucial for the National Bank of Ethiopia to regulate foreign banks effectively to minimize potential risks and ensure the stability of the banking sector.¹²⁷

¹²² *ibid.*

¹²³ Ashenafi Endale, 'Bill Sees Major Amendment for Foreign Banks Entry' (*The Reporter*, 2022) <<https://www.thereporterethiopia.com/27015/>>.

¹²⁴ Senay Lemma, 'Let the Foreign Banks Come, But Regulate Them' (*Addis Fortune*, 2022) <<https://addisfortune.news/let-the-foreign-banks-come-but-regulate-them/>>.

¹²⁵ *ibid.*

¹²⁶ *ibid.*

¹²⁷ *ibid.*; Endale (n 123).

Though an open banking sector can potentially be a source of financial crisis, it also has an affirmative contribution towards economic development - if well regulated.

2.2 Banking Reform in Ethiopia

Banks are financial intermediaries with a vital role in the financial sector and in spurring economic growth.¹²⁸ The banking industry steers the flow of resources within the economy and it contributes to economic development.¹²⁹ Banks are mediums where money is deposited and from where loans are provided - which are crucial fuels for economic development.¹³⁰ Banking system, however, can also be a source of financial crisis.¹³¹ It is due to the versatility of banks and their sensitive role that governments gravitate towards regulating them strictly and hold them to conservative standards.¹³²

Durability of a particular economy can be inferred from the strength and performance of its financial industry.¹³³ Because, services provided by banks are life bloods of the economy. Banks are repositories of savings; they provide loans to individuals and businesses and they sustain liquidity, operate payment system as well as serve as information channel between lenders and borrowers.¹³⁴

In 1994, Ethiopia began the process of reforming its banking sector with the goal of improving the country's financial system and promoting economic growth. However, despite efforts to

¹²⁸ Busch (n 109); Barth, Caprio and Levine (n 109).

¹²⁹ Ageba and Beinen (n 110).

¹³⁰ Van Wyk K. and others (n 111).

¹³¹ Ageba and Beinen (n 110).

¹³² Agoraki, Delis and Staikouras (n 113).

¹³³ Caprio, Laeven and Levine (n 114).

¹³⁴ Agoraki, Delis and Staikouras (n 113).

make changes, progress has been slow.¹³⁵ One reason for this slow progress is the implementation of repressive policies by the government. These policies have likely hindered the growth and development of the banking sector, making it difficult for the industry to adapt and modernize.¹³⁶ In fact, big public banks control the majority of the Ethiopian banking industry, which is undeveloped in comparison to other sub-Saharan African nations. With over 60% of all bank deposits, loans, and foreign money, the state-owned Commercial Bank of Ethiopia (CBE) commands a large portion of the market.¹³⁷ Additionally, the Development Bank of Ethiopia (DBE) is another government-owned bank that provides loans to investors operating in priority sectors. The sector has 29 players, all of which are locally owned, indicating a lack of foreign competition.¹³⁸

Large public banks have long dominated Ethiopia's banking industry, which has struggled with issues of efficiency, competition, and economic expansion. Recent events, however, suggest that the government's position on welcoming foreign investment into the industry has changed.¹³⁹ The National Bank of Ethiopia (NBE) is finalizing amendments to the Banking Business Proclamation to allow foreign banks to enter the country, with plans to issue licenses to at least five foreign banks within the next five years.¹⁴⁰ The move to allow foreign bank entry is part of broader economic reforms aimed at driving foreign investment inflows and economic growth.¹⁴¹ While concerns have been raised about the potential risks associated with

¹³⁵ Desta and Bezabeh (n 10).

¹³⁶ *ibid.*

¹³⁷ Limodio and Strobbe (n 118).

¹³⁸ *ibid.*

¹³⁹ Gebeyehu (n 120).

¹⁴⁰ *ibid.*

¹⁴¹ *ibid.*

foreign bank entry, such as the possibility of a banking crisis, the government's commitment to increasing competition in the sector reflects a shift towards liberalizing the banking industry and attracting foreign investment.¹⁴²

Research has shown that the Ethiopian banking industry has been highly concentrated, with competition being higher among private banks, although it is still dominated by the state-owned Commercial Bank of Ethiopia (CBE).¹⁴³ Additionally, studies have highlighted the low level of financial inclusion in Ethiopia, with only about one-third of Ethiopians holding bank accounts, indicating the potential for growth and development in the banking sector.¹⁴⁴ Efforts to open up the banking sector to foreign investors are expected to bring about competitive pressures that stimulate efficiency, foster competitiveness, and promote stability of the financial system.¹⁴⁵ However, it is crucial for the National Bank of Ethiopia to regulate foreign banks effectively to minimize potential risks and ensure the stability of the banking sector.¹⁴⁶ Though an open banking sector can potentially be a source of financial crisis, it also has an affirmative contribution towards economic development - if well regulated.

2.1. The Banking System of Ethiopia

Investment in the banking sector in Ethiopia has historically been exclusively reserved for Ethiopian nationals, as stated in Article 2(1)(a) of the Investment Regulation No. 270/2012. This regulation restricted foreigners from opening banks, branch offices, or subsidiaries of

¹⁴² Endale (n 123).

¹⁴³ Lemma (n 124).

¹⁴⁴ *ibid.*

¹⁴⁵ *ibid.*

¹⁴⁶ *ibid.*; Endale (n 123).

banks in Ethiopia, as well as acquiring shares of Ethiopian banks.¹⁴⁷ The Ethiopian government implemented this policy to protect the banking sector from foreign competition and to maintain its control over the financial system.¹⁴⁸

The National Bank of Ethiopia (NBE) is indeed the regulator and supervisor of commercial banks, as per Article 5(7) of Proclamation No. 592/2008. The NBE plays a crucial role in regulating and supervising the operations of banks, insurance companies, and other financial institutions in Ethiopia. The bank has been entrusted with various responsibilities to ensure the stability and soundness of the financial system, as well as to foster monetary stability and balanced economic growth.¹⁴⁹ The regulatory and supervisory functions of the National Bank of Ethiopia (NBE) in relation to domestic banks can be deemed commendable, as the existing framework of domestic banks is relatively straightforward.¹⁵⁰ The landscape of the Ethiopian banking industry is primarily characterized by the prevalence of sizable public banks, wherein the Commercial Bank of Ethiopia (CBE) boasts a significant majority share of over 60% in terms of bank deposits, loans, and foreign currency reserves.¹⁵¹

The GOE approved the development of private banks and insurance businesses in 1994, although foreign ownership is still prohibited in these industries. The National Bank of

¹⁴⁷ 'Regulation No. 270/2012: Investment Incentives and Investment Areas Reserved for Domestic Investors' *Federal Negarit Gazeta* (Addis Ababa, 29 November 2012) <<http://www.ethiopianembassy.org.in/investment/Investment%20Regulations%20No.%20270%20of%202012%20of%20Ethiopia%20word%20doc.pdf>>.

¹⁴⁸ *ibid.*

¹⁴⁹ FDRE House of Peoples Representatives, The Banking Business Proclamation No. 592/2008 2008 [592] 41.

¹⁵⁰ U.S. Department of Commerce, 'Ethiopia - Banking Systems' (*Privacy Shield Framework*, 2019) <<https://www.privacyshield.gov/ps/article?id=Ethiopia-Banking-Systems>>.

¹⁵¹ Alemayehu Geda, 'The Structure and Performance of Ethiopia's Financial Sector in the Pre- and Post-Reform Period with a Special Focus on Banking' (World Institute for Development Economic Research (UNU-WIDER) 2006) <<https://EconPapers.repec.org/RePEc:unu:wpaper:rp2006-112>>.

Ethiopia (NBE), which acts as the country's central bank, a state-owned development bank, a government-owned commercial bank, and more than twenty privately held banks currently make up Ethiopia's banking industry.¹⁵² NBE intended to raise the minimum capital required for banks to function to 2 billion Birr (\$90 million) under the Growth and Transformation Plan II (GTP II), and all commercial banks were directed to raise their capital to that level by 2020.¹⁵³ Although foreign banks are not allowed to offer financial services in Ethiopia, Prime Minister Abiy Ahmed's administration is pursuing significant economic changes, thus in the medium term, the industry may open up.¹⁵⁴ As of right now, Ethiopia has permitted a select group of international banks to set up liaison offices in Addis Ababa in order to help businesses in other countries get loans. Ethiopia has seen the opening of liaison offices by banks from China, Germany, Kenya, Turkey, and South Africa.¹⁵⁵

As far as assets, deposits, bank branches, and the whole banking workforce are concerned, the market is dominated by the state-owned Commercial Bank of Ethiopia (CBE). The Development Bank of Ethiopia (DBE), another government-owned bank, offers loans to investors in high-priority industries. DBE provides short-, medium-, and long-term loans for feasible development initiatives, such as those in the fields of agriculture and industry.¹⁵⁶ In addition, DBE offers its customers various banking services like checking and savings accounts. For many years, the DBE has struggled with a portfolio that contains a sizable portion of non-performing loans (NPLs), ineffective capital allocation, and corruption. Because of this,

¹⁵² U.S. Department of Commerce (n 150).

¹⁵³ *ibid.*

¹⁵⁴ *ibid.*

¹⁵⁵ *ibid.*

¹⁵⁶ *ibid.*

it has been a primary focus of PM Abiy's reform drive and is presently going through a significant restructuring process.¹⁵⁷

2.2. The NBE and Banking Regulation

Article 51(7) of the Federal Democratic Republic of Ethiopia (FDRE) Constitution grants the federal government the responsibility of managing the National Bank of Ethiopia (NBE) and controlling the flow of foreign exchange and money. This provision establishes the government's authority in regulating and overseeing the monetary and foreign exchange systems in the country.¹⁵⁸ Accordingly, the federal government issued a proclamation to establish the NBE as a central bank.¹⁵⁹ The National Bank of Ethiopia (NBE) possesses a rich history and plays a vital role in the financial system of the country. Its establishment dates back to 1963, under Order No. 30, which was subsequently ratified by Proclamation No. 591 of 2008. This proclamation confirmed the legal standing of the NBE and paved the way for its functioning. The autonomy of the NBE was further enhanced through Proclamation No. 592 of 2008, which elucidated its regulatory and supervisory mandate as outlined in articles 5(7) and 3(4).¹⁶⁰ These articles outline the specific duties and powers of the NBE, encompassing activities such as the issuance of banking licenses and the oversight of banks. Ultimately, the NBE is accountable to the Prime Minister of Ethiopia, ensuring a level of supervision and responsibility in its operations. This organizational structure enables the NBE to operate

¹⁵⁷ *ibid.*

¹⁵⁸ Federal Democratic Republic of Ethiopia, *The Constitution of Ethiopia* (Federal Negarit Gazeta 1995) <<https://ethiopianembassy.be/wp-content/uploads/Constitution-of-the-FDRE.pdf>>.

¹⁵⁹ FDRE House of Peoples Representatives, PROCLAMATION NO. 591/2008: A PROCLAMATION TO AMEND THE NATIONAL BANK OF ETHIOPIA ESTABLISHMENT 2008 [591] 20.

¹⁶⁰ FDRE House of Peoples Representatives, The Banking Business Proclamation No. 592/2008 (n 149).

independently while remaining answerable to the highest echelons of government.¹⁶¹ Proclamation No. 591 of 2008 in Ethiopia outlines the mandate of the National Bank of Ethiopia (NBE) and sets out its objectives. Article 4 and Article 5(7) of the proclamation highlight key aspects of the NBE's mandate, which include achieving monetary stability, maintaining a robust financial system, ensuring exchange rate and price stability, and promoting a sound financial system.¹⁶²

The National Bank of Ethiopia (NBE) is indeed empowered by Proclamation No 591 of 2008 to stipulate the eligibility requirements for bank directors and managers, reject the appointment of nominees who do not meet the set standards, direct banks to make financial statements available to the public, monitor transactions that could trigger conflicts of interest, regulate shareholders' rights, and oversee banks' risk management systems.¹⁶³ The NBE also ensures banks' compliance with regulations through on-site and off-site supervision mechanisms and has the authority to impose sanctions in cases of non-compliance.¹⁶⁴ The NBE's broad powers and duties are essential for fostering a stable and well-functioning financial environment in Ethiopia. The NBE's role in regulating and supervising the banking sector is crucial for maintaining monetary stability, ensuring a sound financial system, and promoting the balanced growth of the country's economy. The NBE's oversight and regulatory functions contribute to

¹⁶¹ *ibid.*

¹⁶² FDRE House of Peoples Representatives, PROCLAMATION NO. 591/2008: A PROCLAMATION TO AMEND THE NATIONAL BANK OF ETHIOPIA ESTABLISHMENT (n 159).

¹⁶³ Endale (n 123).

¹⁶⁴ *ibid.*

the integrity and stability of the financial sector, which is vital for the overall economic well-being of the country.¹⁶⁵

The regulatory framework of the National Bank of Ethiopia (NBE) indeed provides comprehensive guidelines for the disclosure of information. As per Article 10 (2) and (5) of the Proclamation, the NBE has the authority to require commercial banks to submit detailed information. This can include data on shareholders' names and voting rights, as well as personal details of potential chief executive officers and bank directors such as age, marital status, employment history, and education level. This level of transparency allows the NBE to maintain a high standard of governance within the banking sector. It ensures that individuals in positions of power within these institutions are suitably qualified and that shareholders exercise their voting rights responsibly. Furthermore, the NBE is obligated to ensure that every bank has appointed competent auditors. As per Article 26 (1) and Article 27 of the Banking Business Proclamation, these auditors are tasked with analyzing the policies adopted by the government. This ensures that the banks are operating in compliance with these policies and that any potential issues are identified and addressed promptly.¹⁶⁶

Indeed, as per Article 22 of the Proclamation, the National Bank of Ethiopia (NBE) has the authority to gather any information it deems necessary from banks and other financial institutions. This can include a wide range of data, from financial statements and transaction records to internal policies and procedures.¹⁶⁷ However, the NBE is not obligated to disclose

¹⁶⁵ *ibid.*

¹⁶⁶ FDRE House of Peoples Representatives, The Banking Business Proclamation No. 592/2008 (n 149).

¹⁶⁷ FDRE House of Peoples Representatives, PROCLAMATION NO. 591/2008: A PROCLAMATION TO AMEND THE NATIONAL BANK OF ETHIOPIA ESTABLISHMENT (n 159).

this information publicly. This is a common practice among financial regulators worldwide, as it helps to protect the confidentiality of sensitive financial information and the privacy of individuals and institutions.¹⁶⁸ There are, however, a few exceptional circumstances where the NBE may be required to disclose certain information. These exceptions are typically defined by law and could include situations where disclosure is necessary for legal proceedings or to protect the public interest.¹⁶⁹

As per Article 27 of the Proclamation, the National Bank of Ethiopia (NBE) does indeed have the power to issue directives for the implementation of the National Bank of Ethiopia Establishment Proclamation No 591 of 2008 and any regulations issued pursuant to the establishment. This power is crucial for the NBE to effectively carry out its role as the country's central bank and financial regulator. The directives issued by the NBE provide detailed guidelines on how the provisions of the Proclamation and related regulations should be implemented by banks and other financial institutions.¹⁷⁰ These directives can cover a wide range of topics, from prudential standards and reporting requirements to consumer protection measures and anti-money laundering controls. By issuing these directives, the NBE can ensure that the financial sector operates in a manner that is consistent with the country's monetary policy objectives and financial stability goals. It also allows the NBE to respond swiftly to changes in the financial environment by updating its directives as needed.¹⁷¹

¹⁶⁸ *ibid.*

¹⁶⁹ *ibid.*

¹⁷⁰ *ibid.*

¹⁷¹ *ibid.*

2.3. Financial Transparency

A corporate regulatory regime is a set of rules and standards that govern the conduct and operations of corporations.¹⁷² Improving the culture of openness and prompt information sharing on pertinent matters impacting the rights and interests of different stakeholders—including creditors, employees, consumers, regulators, and the general public—is one of the primary goals of such a system. In the corporate sector, accountability, trust, and efficiency are contingent upon transparency and disclosure.¹⁷³

Ownership and governance, financial status and performance, and any other pertinent issues that could have a substantial impact on a company's operations, reputation, or sustainability—such as environmental, social, and governance (ESG) factors, risks, opportunities, challenges, innovations, and accomplishments—are some of the major issues that call for transparency and disclosure.¹⁷⁴

Enforcing strict and careful transparency and disclosure criteria is essential for the National Bank of Ethiopia (NBE) to build a strong regulatory framework in the banking sector. As to Article 28 of the proclamation 592/2008, all commercial banks are required to provide the NBE with a properly endorsed balance sheet no later than one month after the end of the fiscal year. Maintaining monetary stability, ensuring a safe financial system, and promoting the

¹⁷² OECD, *Principles of Corporate Governance* (revised version, OECD 2004).

¹⁷³ *ibid.*

¹⁷⁴ *ibid.*

equitable growth of the country's economy all depend on the NBE's critical role in monitoring and supervising the banking industry.¹⁷⁵

The regulatory structure of the NBE has been carefully designed to foster a dynamic environment of openness and timely disclosure of relevant information, including as a company's ownership, governance, financial standing, and performance. This unmatched commitment to openness and disclosure is vital to fostering a stable and effective financial environment in Ethiopia and maintaining the highest standards of integrity and stability in the financial industry.¹⁷⁶

Article 28 of the Banking Business Proclamation No. 592 of 2008 outlines particular disclosure obligations that banks in Ethiopia may not be complying with in practice. As a result, the banks' failure to display their financial statements at their place of business and to publish them in widely read periodicals raises the possibility that they are not abiding by the legal requirements outlined in the proclamation. Concerns regarding accountability and openness in the banking industry are raised by this difference between the actual practice and the legal obligation.¹⁷⁷ There are several ramifications for failing to comply with disclosure responsibilities. It might restrict access to crucial financial data about banks for all parties involved, including the public and investors. This lack of openness can impair the ability to make well-informed decisions, restrict market efficiency, and reduce public confidence in the banking industry.¹⁷⁸

¹⁷⁵ FDRE House of Peoples Representatives, The Banking Business Proclamation No. 592/2008 (n 149).

¹⁷⁶ *ibid.*

¹⁷⁷ Asnakech Getnet Ayele, 'Revisiting the Ethiopian Bank Corporate Governance System: A Glimpse of the Operation of Private Banks' (2013) 1 Law, Social Justice & Global Development Journal (LGD) <https://warwick.ac.uk/fac/soc/law/elj/lgd/2013_1/asnakech/>.

¹⁷⁸ *ibid.*

Monitoring adherence to pertinent rules on the nomination and duties of the board of directors under Articles 14–16 of the proclamation and the directive is one of the National Bank of Ethiopia's (NBE) primary regulatory mandates. Ensuring a stable financial system, preserving monetary stability, and encouraging balanced economic growth all depend on the NBE's oversight and regulation of the banking industry.¹⁷⁹ The regulatory framework of the NBE is intended to enhance the transparency and disclosure culture while guaranteeing adherence to pertinent regulations regarding the designation and duties of the board of directors. Maintaining the integrity and stability of the financial sector in Ethiopia as well as promoting a stable and well-functioning financial environment depend on this transparency and disclosure framework.¹⁸⁰

The most prestigious National Bank of Ethiopia (NBE) appoints directors to banks, but only after they meet the standards. These prerequisites include having a minimum of a first-degree degree, having enough banking management experience, and displaying flawless character attributes like honesty, integrity, and diligence.¹⁸¹ The proclamation and the directive's Articles 14–16 make these requirements clear. Since the banking industry is essential to preserving monetary stability, a strong financial system, and the balanced expansion of the country's economy, the NBE's role in regulating and supervising it is of the utmost significance.¹⁸²

¹⁷⁹ National Bank of Ethiopia, Licensing and Supervision of Banking Business: Amendment for New Bank Licensing and Approval of Directors and CEO 2006 [Directive No. SBB/39/2006].

¹⁸⁰ *ibid*; FDRE House of Peoples Representatives, The Banking Business Proclamation No. 592/2008 (n 149).

¹⁸¹ National Bank of Ethiopia Licensing and Supervision of Banking Business: Amendment for New Bank Licensing and Approval of Directors and CEO (n 179).

¹⁸² FDRE House of Peoples Representatives, The Banking Business Proclamation No. 592/2008 (n 149).

The appointment of a bank's chief executive officer (CEO) is approved by the National Bank of Ethiopia (NBE). The CEO must be qualified and able to demonstrate a command of the risks and management procedures necessary to operate the bank as well as the technical requirements of the banking industry. Additionally, the CEO needs to meet the requirements for appropriateness and fit as outlined in Articles 14–16 of the proclamation and the directive.¹⁸³ The NBE's role in regulating and supervising the banking sector is crucial for maintaining monetary stability, ensuring a sound financial system, and promoting the balanced growth of the country's economy.¹⁸⁴

2.4. Controlling Risk

Due to the unique role and characteristics of banks in the financial system, both depositors and shareholders require legal safeguards.¹⁸⁵ Indeed, the health of the banking industry is crucial to the stability of the entire financial system and the general economy. Banks play a central role in the economy by facilitating transactions, providing loans for businesses and individuals, and serving as intermediaries for capital flows. Therefore, any instability in the banking sector can have far-reaching effects on the broader economy. To mitigate these risks, governments often take measures to ensure the prudence and stability of the banking industry.¹⁸⁶

¹⁸³ National Bank of Ethiopia Licensing and Supervision of Banking Business: Amendment for New Bank Licensing and Approval of Directors and CEO (n 179).

¹⁸⁴ FDRE House of Peoples Representatives, The Banking Business Proclamation No. 592/2008 (n 149).

¹⁸⁵ Thankom Arun and John Turner, 'Corporate Governance of Banks in Developing Economies: Concepts and Issues' (University of Manchester, Institute for Development Policy and Management (IDPM) 2003) <<https://EconPapers.repec.org/RePEc:ags:idpmde:30551>>.

¹⁸⁶ Hanna Westman, 'The Role of Ownership Structure and Regulatory Environment in Bank Corporate Governance' [2010] SSRN Electronic Journal.

Deposit insurance is one such policy that, in the event that a bank fails, protects depositors' money up to a specific amount. This can lessen the likelihood of bank runs, in which depositors rush to take their money out of the bank out of fear that it will fail. Bank bailouts are an additional tactic, in which the government gives financially troubled banks financial help to save them from collapsing. Bailouts, albeit divisive, can contribute to maintaining financial stability during difficult times. But they also bring up the issue of moral hazard, since they might incite banks to act carelessly if they anticipate being bailed out in the event of failure.¹⁸⁷

The stability and integrity of the financial system depend heavily on the National Bank of Ethiopia's (NBE) oversight of commercial banks. The NBE is able to guarantee that every bank has strong risk management guidelines and procedures in place. This entails evaluating the effectiveness of risk assessment protocols, risk mitigation techniques, and internal controls in banks. In banking, risk management entails locating, assessing, and managing risks that might have an effect on a bank's profits or capital. These risks can take many different forms, from market and credit risk to liquidity and operational risk.¹⁸⁸

The NBE can make sure banks are taking the required precautions to prevent and manage risks by keeping an eye on these factors. This entails making sure banks have enough capital to cover losses, have enough liquidity to fulfill their commitments, and adhere to responsible lending guidelines to reduce credit risk. Furthermore, if a bank's risk management procedures are deemed to be deficient or if it is exposed to excessive risk, the NBE may step in to initiate

¹⁸⁷ *ibid.*

¹⁸⁸ NBE, 'Risk Management Guideline' <<https://nbebank.com/wp-content/uploads/2019/04/Rm-Guideline-revised-1.pdf>>.

corrective action as needed. By actively monitoring banks, bank failures that could destabilize the financial system and negatively impact the economy are prevented.¹⁸⁹

In fact, the National Bank of Ethiopia (NBE) is essential to the banking industry's risk management. In accordance with Proclamation No. 592 of 2008, Articles 18 and 20, the NBE is in charge of figuring out how much capital and reserves commercial banks must maintain as a minimum. These regulations are established in accordance with each bank's risk profile, guaranteeing that banks with higher risk profiles uphold larger capital buffers.¹⁹⁰

Furthermore, banks must keep a specific reserve account in accordance with Banking Business Proclamation No. 592 of 2008, Article 21(7). This account acts as a guarantee against losses that may result from directors' or employees' dishonest or careless behavior. The NBE's role in risk management is further strengthened by this clause, which guarantees banks have a financial buffer to withstand such losses.¹⁹¹ The NBE's dedication to upholding the integrity and stability of the banking industry is demonstrated by these regulations. The NBE assists in reducing the risks associated with banking operations and safeguarding the interests of depositors and other stakeholders by establishing capital and reserve requirements as well as requiring the upkeep of a specific reserve account. The resilience and overall well-being of the banking industry depend heavily on this proactive approach to risk management.

As argued in Bonn it is commonly agreed that, in the absence of market failures, free and competitive markets produce strong incentives to satisfy customer wants effectively and to

¹⁸⁹ *ibid.*

¹⁹⁰ FDRE House of Peoples Representatives, The Banking Business Proclamation No. 592/2008 (n 149).

¹⁹¹ *ibid.*

adapt to changing expectations and technologies over time.¹⁹² With very few exceptions, there is no economic rationale for regulation in the absence of a market failure. The primary reason for banking regulation is to address concerns about the safety and stability of financial institutions, the financial sector as a whole, or the payments system.¹⁹³ The following description and evaluation must obviously reflect the perspectives of competition authorities. With the exception of one bank regulator, no bank regulator has examined this study, which does not necessarily reflect the viewpoints and opinions of bank regulators.¹⁹⁴

2.4.1. The risk of bank runs

All banks operate with a fractional liquidity reserve. The vast bulk of a bank's obligations are relatively liquid deposits that may be redeemed on demand. Instead, the vast bulk of their assets are significantly more illiquid loans.¹⁹⁵ This circumstance creates the issue that if all depositors requested their money returned at the same time, any bank (even if totally healthy) would have major difficulties honoring its obligations to its depositors.¹⁹⁶ A single bank may receive refinancing on the financial market, but the situation will be serious if there is insufficient liquidity on the market or if the issue affects a large section of the banking sector. It is widely documented in the literature that when depositors begin to fear their bank's insolvency, their

¹⁹² Darryl Biggar and Alberto Heimler, 'An Increasing Role for Competition in the Regulation of Banks' [2005] Antitrust Enforcement in Regulated sectors–Subgroup 1, ICN (International Competition Network) <https://scholar.google.com/scholar?hl=en&as_sdt=0,5&cluster=8613701515555410338#d=gs_cit&t=1701522566092&u=%2Fscholar%3Fq%3Dinfo%3AopHsG-QDincJ%3Ascholar.google.com%2F%26output%3Dcite%26scirp%3D0%26scf%3D1%26hl%3Den>.

¹⁹³ *ibid.*

¹⁹⁴ *ibid.*

¹⁹⁵ *ibid.*

¹⁹⁶ *ibid.*

first and most usual reaction is to withdraw their deposits, causing major issues for the banks. This type of action is commonly referred to as a bank run.¹⁹⁷

2.4.2. The risk of excessive risk taking (moral hazard) in banking

Banks frequently make loans that are funded by deposits. This provides a substantial incentive for banks to make rash loans and take on too much risk.¹⁹⁸ In actuality, it is well acknowledged in the literature that, while the risk of failure of the funded initiative is carried mostly by bank depositors, profits accrue predominantly to the bank in the case of success. The Asian financial crisis of 1997, which is detailed further below, is a prime example of this abnormal behavior.¹⁹⁹

However, in general, this motivation is somewhat offset by the prospect that the market, both via depositors and through rival banks, might monitor the risks accepted by the bank's management.²⁰⁰ The primary goal of regulation is to avoid the severely unfavorable economic repercussions of widespread bank collapses. There are two major lines of reasoning for banking regulation. The first is concerned with the systemic risks posed by bank failures, while the second is concerned with the requirement for security and stability in the payments system.²⁰¹

¹⁹⁷ *ibid.*

¹⁹⁸ Víctor Livio Enmanuel Cedeño Brea, *The Legal Structure of Commercial Banks and Financial Regulation: Does Organizational Form Matter for the Design of Bank Regulation?* (Erasmus University 2017) <<https://books.google.com.et/books?id=Q9qfswEACAAJ>>.

¹⁹⁹ *ibid.*

²⁰⁰ Biggar and Heimler (n 192).

²⁰¹ *ibid.*

2.4.3. *Systemic dangers of a bank failure*

The main argument for bank regulation focuses on the possibility of systemic or system-wide consequences of a bank failure i.e., the possibility that the failure of one institution could lead to the failure of others. This assertion is summarized by Feldstein as discussed below.²⁰² The banking system as a whole is a public utility that benefits the nation in addition to the profits earned by bank owners. Systemic hazards to the financial sector are threats to the entire country.²⁰³ Although the management and owners of individual institutions are naturally keen to defend the solvency of their own institutions, they fail to appropriately account for the negative implications of systemic collapse on the nation.²⁰⁴ Banks left to their own devices will take on more risk than is ideal from a systemic standpoint. That is the fundamental argument for government control of banking activity and the imposition of capital requirements.²⁰⁵

There are two processes through which the failure of one bank might lead to the failure of other banks or non-bank enterprises.²⁰⁶ The failure of one bank causing a drop in the value of its assets sufficient to cause the failure of another bank ("consequent failure"), and (b) the failure of one bank causing the failure of another fully solvent bank via some contagion failure.²⁰⁷

²⁰² Martin Feldstein, *The Risk of Economic Crisis* (University of Chicago Press 2009) <<https://books.google.com.et/books?id=ubWtBgAAQBAJ>>.

²⁰³ Mekonnen (n 57).

²⁰⁴ *ibid.*

²⁰⁵ *ibid.*

²⁰⁶ Caprio, Barth and Levine (n 77).

²⁰⁷ *ibid.*

2.4.4. Supervisory policies and profitability

It is critical for regulatory agencies to maintain control over the standardized practices of these institutions.²⁰⁸ Government regulation and supervision of banks promotes their safety and soundness in order to protect the payments system from bank runs, which contract bank lending and threaten macroeconomic stability. Deposit insurance is routinely used to protect the payment system.²⁰⁹ If the insurance is legitimate, it lessens depositors' motivation to run banks when they are concerned about the institutions' viability. As a result, it decreases banks' liquidity risk and, to the extent that it is underpriced, provides banks with an incentive to take on extra risk in exchange for a higher projected return.²¹⁰

²⁰⁸ *ibid.*

²⁰⁹ *ibid.*

²¹⁰ *ibid.*

CHAPTER THREE

3 THE REGULATORY LEGAL REGIME OF FOREIGN BANK ENTRY IN ETHIOPIA

3.1 Introduction

Banks is a crucial component of the financial services industry, which also includes thrift associations, insurance businesses, securities firms, mutual fund companies, and commercial and investment banking. Any organization that provides financial services functions essentially as a middleman between savers, investors, and borrowers, bridging the gap between surplus and deficit economic units (such as governments, businesses, and people).²¹¹ Depending on the system, an institution's engagement in banking could be defined by its activities, by having a charter, or by having deposit insurance. It's crucial to remember, though, that regulatory restrictions placed on banks—rather than underlying variations in the nature of their intermediation—are what really make banking unique.²¹²

There is a lot of disagreement in the literature about how regulations affect the operations of foreign banks. Because of the difficulty in characterizing regulatory differences in terms of how they affect regulated firms' businesses and the availability of data on cross-border regulatory disparities, it is challenging to measure objectively.²¹³ A range of indicators are

²¹¹ Taeho Kim, *International Money and Banking* (Routledge 1993) <<https://books.google.com.et/books?id=GU4UAQAAMAAJ>>.

²¹² *ibid*; Michael P Malloy and William Anthony Lovett, *Banking and Financial Institutions Law in a Nutshell* (West Academic Publishing 2019) <<https://books.google.com.et/books?id=R4J1xgEACAAJ>>.

²¹³ Joel F Houston, Chen Lin and Yue Ma, 'Regulatory Arbitrage and International Bank Flows' (2012) 67 *The Journal of Finance* 1845.

available in the literature that can be used to investigate this issue using both qualitative and quantitative approaches.

A technique to appraise the current regulations pertaining to overseas branches and subsidiaries is to rate the limitations placed on foreign banks functioning in a specific nation using a qualitative grading system.²¹⁴ Because different kinds of qualitative rankings were used, different results have been obtained when this approach has been used. As a result, it is impossible to say with certainty that regulations have a big influence on multinational banks' choice of foreign location.²¹⁵

More sophisticated techniques use statistical techniques (such principal component analysis) to identify the main regulatory differences between domestic and international banks. Then, using these differences, a composite index on bank protectionism is created.²¹⁶ Various national variances in bank regulations are taken into consideration by this index. But the empirical data only shows a little influence in understanding the choice of international banking markets.²¹⁷

For a considerable duration, foreign investors have been the only ones allowed access to Ethiopia's financial system. It is noteworthy, however, that foreign banks have been given authorization to open representative offices that are open to people of Ethiopian descent.

²¹⁴ Lawrence G Goldberg and Denise Johnson, 'The Determinants of US Banking Activity Abroad' (1990) 9 *Journal of International Money and Finance* 123.

²¹⁵ Sichong Chen and others, 'Bank Competition, Foreign Bank Entry, and Risk-Taking Behavior: Cross Country Evidence' (2019) 12 *Journal of Risk and Financial Management*; Haiyan Yin, 'Foreign Bank Entry and Bank Competition: Cross-Country Heterogeneity' (2021) 48 *Global Finance Journal* 100558 <<https://www.sciencedirect.com/science/article/pii/S1044028320301198>>.

²¹⁶ Chen and others (n 215); Silvia B Sagari, *The Financial Services Industry: An International Perspective* (New York University, Graduate School of Business Administration 1986).

²¹⁷ Sagari (n 216).

Furthermore, foreign investors have been barred from the capital goods finance subsector for a considerable amount of time.²¹⁸

The banking industry has grown tremendously in terms of total assets, deposits, loans, bonds, and branch counts since it opened to domestic private investors. Because of this, as of December 31, 2022, the sector had total assets of Birr 2.4 trillion, total deposits of Birr 1.48 trillion, loans of Birr 896.69 billion, bonds of Birr 522.10 billion, and capital of Birr 167.06 billion.²¹⁹

In ten years, the number of branches rose from 841 to 8,38. In addition, three banks that converted from minor financial organizations to banks and seven new banks were recently approved and entered the banking industry. Because of this, there are now 28 banks overall, up from 18 for a long time.²²⁰

Although the banking sector in Ethiopia has expanded dramatically, it still faces obstacles such limited loan availability, outdated services, limited accessibility, and a small financial infrastructure that cannot keep up with customer demand. These are stark illustrations of the shortcomings in the industry. The primary cause of these issues in the sector—a lack of innovation and competition—is made worse by the absence of new services.

The primary causes of these difficulties are the industry's lack of advancement and the lack of competition. This is because international banks are prohibited from operating in this market,

²¹⁸ The Council of Ministers, Opening the Ethiopian Banking Sector to Foreign Investment: A Policy Document (n 12).

²¹⁹ U.S. Department of Commerce (n 150).

²²⁰ The Council of Ministers, Opening the Ethiopian Banking Sector to Foreign Investment: A Policy Document (n 12).

and tiny deposits are the result of both the tremendous need for money in our economy and the absence of capital markets for safe long-term lending. It is entirely dependent on the funding source. Thus, by providing loans to a select group of wealthy individuals and huge corporations, the banking industry has placed the financial system at grave risk rather than providing new loans to new borrowers and small and micro businesses.

Furthermore, because the credit system is predicated on guarantees, the requirements for loans for operating, startup, and investment purposes are inflated, and obtaining loans without collateral is challenging. Thus, loans from the banking industry are only available to a select group of very large clients. It is under each person's control. It is necessary to upgrade and switch from a credit system that is exclusively dependent on collateral to one that is based on repayment capacity. Only by increasing financing and competitiveness in our economy can this be possible. It is vital to involve foreign investors in the banking sector through policy changes in order to address these and other concerns.

3.2 The Current Legal Framework for the Banking Sector in Ethiopia

Foreign bank entry in Ethiopia is governed by various legal frameworks and regulations. The National Bank of Ethiopia (NBE) Regulations establish guidelines for foreign banks, including capital requirements and licensing procedures.²²¹ The Investment Proclamation outlines procedures for obtaining investment permits and mechanisms for dispute resolution.²²² The

²²¹ Misrak Abate and Ratinder Kaur, 'BANKING SECTOR IN ETHIOPIA: ORIGIN AND PRESENT STATE' (2023) 9 EPH - International Journal of Business & Management Science 1.

²²² Senbeta Tesfaye Boresa, 'Regulatory Regime Governing Deposit Insurance under the Ethiopian Law: A Comparative Review in Light of International Core Principles' Perspectives' (2023) 14 Beijing Law Review 253.

Banking Business Proclamation regulates the establishment and operation of banks, including criteria for obtaining a banking license and capital adequacy standards.²²³ The Commercial Code governs commercial activities, including banking operations.²²⁴ Foreign exchange regulations dictate procedures for foreign currency transactions and compliance with exchange rate policies.²²⁵ Anti-Money Laundering (AML) and Counter-Terrorist Financing (CTF) laws require foreign banks to implement internal controls and reporting procedures . Understanding and complying with these legal frameworks are crucial for foreign banks entering and operating in Ethiopia. Failure to comply can result in penalties or license revocation.

3.2.1 Foreign bank entry: is it beneficial or harmful

The economy and the functioning of the financial markets may be impacted by the admission of foreign banks into Ethiopia's banking industry in both positive and negative ways. Positively, foreign banks can contribute to reducing shortages of foreign exchange, bringing in capital and experience, and increasing the competitiveness of the banking sector.²²⁶ The entry of foreign banks into the Ethiopian market will introduce cutting-edge financial technologies, goods, and services that will boost the local banking industry's competitiveness

²²³ Yemegnu Mesele Dejene, 'The Room for Imposing Performance Requirements on Foreign Investors under the Ethiopian Legal Regime' (2022) 16 Mizan Law Review 391 <<https://www.ajol.info/index.php/mlr/article/view/240409>> accessed 25 March 2024.

²²⁴ Gemechu Yeda and Getu Tigre, 'DO PRIVATE BANKS AFFECT ETHIOPIA'S ECONOMIC GROWTH?' (2022) 32 Jurnal Ekonomi dan Bisnis Airlangga 103.

²²⁵ Bereket Alemayehu Hagos, 'Major Features of Ethiopia's New Investment Law: An Appraisal of Their Policy Implications' 135 <<https://www.un-ilibrary.org/content/journals/2076099x/29/1/5>>.

²²⁶ Matiws Ensermu, 'Prospects and Challenges of Foreign Banking Entry to Ethiopian Financial Market' (2018) 9.

and improve the effectiveness of financial services, which will benefit both companies and customers.²²⁷

But there are also worries about the possible drawbacks, like the threat of dominance by foreign banks, the requirement for a robust domestic supervisory body, and the influence on the environment that makes domestic banks competitive.²²⁸ The Ethiopian government has put in place measures such limiting the amount of foreign bank staff, limiting the number of banks that can open, and assessing their effects in order to reduce these risks. Therefore, it is important to carefully consider the possible benefits and dangers of allowing foreign entrance into Ethiopia's banking industry and to make sure that the necessary laws are in place to maximize those benefits and avoid any potential damages.²²⁹

Indeed, the entry of foreign banks into the Ethiopian banking sector can bring significant benefits, such as alleviating foreign currency shortages and introducing advanced technologies. Additionally, increased competition can lead to improved efficiency and better financial services for businesses and consumers. However, it is crucial to carefully evaluate the potential risks and challenges associated with foreign bank entry. Concerns about foreign bank domination and the need for strong domestic regulation and supervision are valid. Implementing appropriate regulations and ensuring a level playing field for both foreign and domestic banks can help mitigate these risks. Limiting the number of foreign banks and evaluating their impact is a prudent approach to ensure a controlled and gradual entry into the market. Monitoring the effects of foreign entry on the local banking sector, employment, and overall financial stability is essential in making informed decisions and adjusting policies as needed.²³⁰

²²⁷ *ibid.*

²²⁸ Samuel Getachew, 'Ethiopia's Call for Foreign Investment in Its Banking Sector Comes with Strings' (*Semafor Africa*, 7 December 2023) <<https://www.semafor.com/article/12/07/2023/ethiopia-foreign-investment-banking>>.

²²⁹ *ibid.*

²³⁰ Mirchawork Habtamu, Interview with Ato Dulla Merera, Director of Legal Department at Abyssinia Bank Main Branch, 'Regulatory Framework for Foreign Bank Entry in Ethiopia: Challenges and Prospects' (June 2023); Mirchawork Habtamu, Interview with Ato Sintayehu Desalegn, Director of Preserve Policy and Financial Analysis, 'Regulatory Framework for Foreign Bank Entry in Ethiopia: Challenges and Prospects' (June 2023); Mirchawork Habtamu, Interview with Ato Takele Arega, Director of Legal Service at Awash International Bank Main Branch, 'Regulatory Framework for Foreign Bank Entry in Ethiopia: Challenges and Prospects' (June 2023).

3.2.2 *Adoption of other nations' legal and regulatory systems about FBE*

The entry of foreign banks into Ethiopia is expected to increase investment, enhance technological capabilities, and improve service delivery in the finance sector.²³¹ The National Bank of Ethiopia is preparing to grant licenses to at least five foreign banks to enter the country in the next five years.²³² This move is part of a broader strategy by the Ethiopian government to open up the economy to foreign investment.²³³ According to Ato Muluken Mihretu,²³⁴

Ethiopia has adopted the experience of developed nations regarding the legal and regulatory systems for the entry of foreign banks. This process involved organizing committees, such as Steering and Technical Committees, and selecting experts from relevant departments, including the Department of Legal Matters, Bank Supervision, and Payment & Settlement System Departments. The committees considered the experiences of other nations that are more experienced and similar in social, economic, and political status. The analysis included desk reviews of the legal framework of other countries, challenges faced, and empirical evidence of foreign bank entry implementation practices, challenges, and prospects.

The experience analysis involved desk reviews of the legal framework of other countries, challenges they faced, and empirical evidence of foreign bank entry implementation practices, challenges, and prospects. The adopted experiences of other countries, such as Indonesia and the Philippines, served as major references. Several concepts were taken from different countries, but their ideas were not large enough to represent a country. Additionally, two foreign bank-related experts from the National Bank of Ethiopia conducted research on the issue of foreign bank entry in Ethiopia and presented their findings to the macro-economic committee. The committee discussed their findings and the agenda at hand. The crafting of the policy started after all these procedures.²³⁵

The ratified policy document of foreign bank entry states that the Ethiopian government plans to liberalize the banking sector to boost economic growth and development by increasing finance and foreign exchange availability through foreign investors. The sector will offer modern banking services and strengthen international connections to meet growing demand.

²³¹ ENA, 'Opening up of Foreign Banks in Ethiopia Will Enhance Investment, Technologies: Economists' (*Ethiopian News Agency*, 23 August 2023) <https://www.ena.et/web/eng/w/eng_3239189>.

²³² *ibid.*

²³³ *ibid.*

²³⁴ Mirchawork Habtamu, Interview with Ato Muluken Mihretu, Senior Legal Expert at NBE, 'Regulatory Framework for Foreign Bank Entry in Ethiopia: Challenges and Prospects' (June 2023).

²³⁵ *ibid.*

The government plans to grant up to five banking licenses, with foreign investors acquiring 30% of local banks and the remaining 60% under local ownership.²³⁶

Indeed, Ethiopia has been actively adopting different country experiences and international financial standards to enhance its legal and regulatory framework for foreign banks. One prominent example is the Basel Principles, which provide guidelines for banking regulation and supervision globally. By aligning with these principles, Ethiopia aims to enhance its financial system's resilience, attract foreign investment, and ensure effective supervision of foreign banks operating in the country. However, it is important to note that achieving full adaptation to international standards is an ongoing process. While Ethiopia is making progress, complete implementation may take time due to various factors, including the need for legislative changes, capacity-building efforts, and coordination among relevant stakeholders. The adaptation process involves carefully assessing the specific requirements of the Basel Principles and tailoring them to fit Ethiopia's unique economic and regulatory environment. This approach ensures that the standards are effectively implemented, taking into consideration the country's specific needs and priorities. Ethiopia recognizes the importance of aligning its financial system with international standards to foster financial stability, attract foreign investment, and promote the competitiveness of its banking sector. The ongoing efforts reflect the commitment to implementing sound regulatory practices and fostering a conducive environment for foreign banks' entry. As the Director of Preserve Policy and Financial Analysis at NBE, I can assure you that Ethiopia is dedicated to the continuous improvement of its legal and regulatory systems, learning from the experiences of developed nations, and collaborating with international organizations to achieve its objectives.²³⁷

Over the past decade, a dozen foreign banks have set up representative offices in Ethiopia and are exploring the possibilities in the Ethiopian market.²³⁸ The representative offices can now be officially recognized by the National Bank of Ethiopia (NBE) and operate as commercial representative offices.²³⁹ Other entry modalities also include subsidiary, branch, and acquiring up to 30 percent of local banks.²⁴⁰

The licensing is expected to start within a year after the NBE amends the Banking Business Proclamation and enacts new regulation.²⁴¹ The entry of foreign banks into Ethiopia will bring

²³⁶ The Council of Ministers, Opening the Ethiopian Banking Sector to Foreign Investment: A Policy Document (n 12).

²³⁷ Habtamu, Interview with Ato Sintayehu Desalegn, Director of Preserve Policy and Financial Analysis (n 230).

²³⁸ Ashenafi Endale, 'A Peek at Foreign Banks' Appetite in Ethiopia' (*The Reporter*, 26 November 2022) <https://www.thereporterethiopia.com/28121/#google_vignette>.

²³⁹ *ibid.*

²⁴⁰ *ibid.*

²⁴¹ *ibid.*

much-needed capital, technology, and competition, ultimately improving the efficiency of the Ethiopian financial system.²⁴²

The entry of foreign banks into Ethiopia is expected to increase investment, enhance technological capabilities, and improve service delivery. The National Bank of Ethiopia is preparing to grant licenses to at least five foreign banks to enter the country, as part of a broader move to open up the Ethiopian banking sector. This move is seen as a positive development that will bring much-needed capital, technology, and competition, ultimately improving the efficiency of the Ethiopian financial system.²⁴³ Furthermore, over the past decade, a dozen foreign banks have set up representative offices in Ethiopia, and the country is planning to issue up to five banking licenses to foreign investors. The potential effects of opening the Ethiopian banking sector to foreign banks are theorized to include the reduction of the cost of credit, improvement of domestic banks' economic potential, and benefits to the country based on experiences from neighboring countries like Kenya and Egypt.²⁴⁴

However, local banks need to improve their financial and technological capabilities to compete with their foreign counterparts.²⁴⁵ The government should ensure that foreign banks are subject to the same regulations as local ones and implement strict monitoring and supervision to protect the Ethiopian financial sector from domination by foreign banks.²⁴⁶

The Ethiopian government has adopted the experience of model countries in the legal and regulatory systems for the entry of foreign banks. This process involved analyzing the legal framework of other countries, the challenges they faced, and the empirical evidence of foreign bank entry implementation practices, challenges, and prospects. The country's unique status was taken into consideration, and experts who went abroad to countries like Dubai returned with necessary information regarding foreign bank entry and other ideas included in the reform draft. The amended proclamation will include other mega-reform ideals, such as mergers and acquisitions, improving interest-free banking, and introducing new products.

The entry of foreign banks into Ethiopia is expected to bring much-needed capital, technology, and competition, ultimately improving the efficiency of the Ethiopian financial system. However, it is important to ensure that foreign banks are subject to the same regulations as local ones and that strict monitoring and supervision are in place to protect the Ethiopian financial sector from domination by foreign banks. The government's plan to issue up to five banking licenses to foreign investors in the next five years is part of a broader strategy to open up the Ethiopian banking sector to foreign investment.

²⁴² ENA (n 231).

²⁴³ Mirchawork Habtamu, Interview with Ato Efreem Baraki, Senior Legal Expert II and Acting Chief Legal Expert at NBE, 'Regulatory Framework for Foreign Bank Entry in Ethiopia: Challenges and Prospects' (June 2023).

²⁴⁴ *ibid.*

²⁴⁵ ENA (n 231).

²⁴⁶ *ibid.*

This move is seen as a positive development that will bring investment, technological capabilities, and competition, ultimately improving the efficiency of the Ethiopian financial system.

3.2.3 Capacity of NBE to regulate FBs

Allowing foreign banks to enter a country can indeed improve the capacity of the National Bank of Ethiopia (NBE) to regulate the banking system. The entry of international banks can lead to a more competitive banking market, which in turn necessitates the enhancement of NBE's regulatory capacity. The literature on foreign banking suggests that the entry of foreign banks can make national banking markets more competitive, forcing domestic banks to improve their efficiency and quality of service.²⁴⁷ The experience of various countries has shown that increased foreign bank activity can lead to policy changes that enhance the regulatory and competitive conditions in the domestic banking sector.

The proverb "ህልም ተፈርቶ ሳይተኛ አይታደርም!" emphasizes that avoiding reform based on fear and pre-judgment of capacity is not productive. In the context of allowing foreign banks to enter a country's banking system, this proverb implies that the NBE should not refrain from embracing reforms and opening up to foreign banks based solely on concerns about its regulatory capacity. The entry of foreign banks can indeed enhance the regulatory capacity of the NBE. By allowing foreign banks to enter the banking system, the NBE opens the doors to international banking standards and practices. This exposure to global best practices can act as a catalyst for the NBE to improve its regulatory regime and enhance its capacity to effectively supervise and regulate the banking sector. The presence of international banks introduces competition, which in turn calls for the NBE to strengthen its regulatory capacity to ensure a level playing field and maintain financial stability.²⁴⁸

The entry of foreign banks into a hosting country's banking market can bring about increased competition, which often leads to improvements in the efficiency and quality of services

²⁴⁷ George Clarke and others, 'Foreign Bank Entry: Experience, Implications for Developing Economies, and Agenda for Further Research' (2003) 18 *The World Bank Research Observer* 25 <<http://www.jstor.org/stable/3986423>> accessed 12 December 2023.

²⁴⁸ Habtamu, Interview with Ato Dulla Merera, Director of Legal Department at Abyssinia Bank Main Branch (n 230); Habtamu, Interview with Ato Efreem Baraki, Senior Legal Expert II and Acting Chief Legal Expert at NBE (n 243); Habtamu, Interview with Ato Muluken Mihretu, Senior Legal Expert at NBE (n 234).

provided by domestic banks.²⁴⁹ Competition pushes domestic banks to enhance their operational efficiency, optimize their internal processes, reduce costs, and improve productivity. This drive for efficiency can result in streamlined operations, better resource allocation, and the adoption of more efficient technologies and systems. As a result, domestic banks can operate more effectively, reduce operational inefficiencies, and provide faster and more reliable services to their customers.²⁵⁰

Foreign banks often introduce new products, services, and innovative banking practices to the market, which can spur domestic banks to innovate and develop their own unique offerings.²⁵¹ To differentiate themselves from foreign competitors, domestic banks may introduce new banking products, upgrade their digital platforms, and explore value-added services to meet the evolving needs and preferences of customers. The competition fosters a culture of innovation, benefitting customers with a wider range of choices and improved services.²⁵²

Increased competition raises the bar for customer service and experience. Domestic banks strive to provide better customer service to retain existing customers and attract new ones. They may invest in training their staff to deliver superior customer service, implement customer feedback mechanisms, and enhance their digital channels for more convenient and

²⁴⁹ Mekonnen Hurisa, 'Potential Effects of Opening the Ethiopian Banking Sector to Foreign Banks' (PhD Thesis, Addis Ababa University 2017) <http://etd.aau.edu.et/bitstream/handle/123456789/4046/Mekonnen_Hurisa.pdf?sequence=1&isAllowed=y>; Harry Clynch, 'Hopes for Increased Competition in Ethiopia's Banking System' (*African Business*, 19 June 2023) <<https://african.business/2023/06/finance-services/hopes-for-increased-competition-in-ethiopia-banking-system>>.

²⁵⁰ Clynch (n 249).

²⁵¹ Ensermu (n 226).

²⁵² Clynch (n 249); Mekonnen Hurisa (n 249).

personalized banking experiences. Competition motivates domestic banks to prioritize customer satisfaction, resulting in improved services and stronger customer relationships.²⁵³

In a competitive market, banks are compelled to offer competitive pricing to attract customers. Domestic banks may revise their pricing strategies to remain competitive with foreign banks, which can lead to reduced fees, lower interest rates, and more favorable terms for customers. Moreover, the pressure to reduce costs and operate efficiently drives domestic banks to negotiate better deals with suppliers and service providers. These cost savings can be passed on to customers, making banking services more affordable and accessible.²⁵⁴

Competition can also spur efforts to enhance financial inclusion. Domestic banks may focus on expanding their outreach to underserved populations and developing tailored products and services to cater to specific customer segments. This can include offering basic banking services to previously unbanked individuals, facilitating access to credit for small businesses, or developing innovative solutions to address the needs of low-income customers. Competition encourages domestic banks to innovate and extend their services to previously underserved markets, promoting financial inclusion and fostering economic growth.²⁵⁵

Competition in the banking market, spurred by the entry of foreign banks, compels domestic banks to enhance their operational efficiency, risk management practices, and customer service. This increased competition acts as a driving force for domestic banks to invest in technology, systems, and staff training, which, in turn, necessitates the NBE to adapt and strengthen its regulatory capacity to monitor and regulate a more dynamic and competitive banking environment.²⁵⁶

²⁵³ Clynch (n 249); Mekonnen Hurisa (n 249).

²⁵⁴ Clynch (n 249); Mekonnen Hurisa (n 249).

²⁵⁵ Claessens and Klingebiel (n 62); Clarke and others (n 247).

²⁵⁶ Habtamu, Interview with Ato Efreem Baraki, Senior Legal Expert II and Acting Chief Legal Expert at NBE (n 243).

Regulatory changes: The presence of foreign banks can prompt policy changes that enhance the regulatory and competitive conditions in the domestic banking sector.²⁵⁷

Transfer of international expertise: Foreign banks can bring international expertise, technological knowledge, and quality banking services to domestic banks, contributing to their profit efficiency.²⁵⁸

Foreign banks, with their diverse experiences and expertise, can transfer knowledge to the NBE and domestic banks. This knowledge transfer can help the NBE align its regulatory framework with international norms, upgrade its supervisory practices, and enhance its understanding of emerging risks and challenges in the banking industry. The NBE can learn from the risk management practices, corporate governance standards, and regulatory compliance frameworks employed by foreign banks, thereby improving its own capacity in these areas.²⁵⁹ Furthermore, the entry of foreign banks often brings advanced technological solutions and innovations to the domestic market. The NBE can leverage this opportunity to upgrade its regulatory framework and address the challenges and risks associated with technological advancements. By encouraging the adoption of new technologies while safeguarding financial stability, the NBE can enhance its regulatory capacity to effectively oversee the operations of both foreign and domestic banks.²⁶⁰

Impact on domestic banks: The entry of foreign banks can force domestic banks to adapt and improve their operations to remain competitive in the market.²⁶¹ The policy's steps for short and long-term preparation regarding the reform, including enhancing the capacity of the National Bank of Ethiopia (NBE), are crucial for the country's banking system. The entry of international banks can lead to a more competitive banking market, necessitating the enhancement of NBE's regulatory capacity. This is supported by the literature on foreign banking, which suggests that the entry of foreign banks can make national banking markets

²⁵⁷ Claessens and Klingebiel (n 62); Yin (n 215).

²⁵⁸ Eric Osei-Assibey, William Bekoe and Michael Armah, 'Does Foreign Banks Entry Influence Domestic Banks' Efficiency? Evidence from Ghana' (2022) 27 African Journal of Management Research 56 <<https://www.ajol.info/index.php/ajmr/article/view/220142>> accessed 12 December 2023.

²⁵⁹ Habtamu, Interview with Ato Muluken Mihretu, Senior Legal Expert at NBE (n 234).

²⁶⁰ Habtamu, Interview with Ato Dulla Merera, Director of Legal Department at Abyssinia Bank Main Branch (n 230).

²⁶¹ Claessens and Klingebiel (n 62); Clarke and others (n 247).

more competitive, forcing domestic banks to improve their efficiency and quality of service.²⁶² Additionally, the experience of various countries has shown that increased foreign bank activity can lead to policy changes that enhance the regulatory and competitive conditions in the domestic banking sector.²⁶³

The reform's restructuring, including the amendment of the NBE's responsibilities, and the adaptation of international accords such as Basel III to Ethiopia's current situation, are important steps in preparing for the entry of foreign banks. The memorandum of understanding with host countries to gain their experience and share the job of regulating the banks will also be beneficial in this process. These measures reflect a proactive approach to reform and regulatory enhancement, which is essential for the successful integration of foreign banks into the Ethiopian banking system.²⁶⁴

The Basel III reforms, which guide the banking system, have been implemented to improve the banking sector's ability to absorb shocks arising from financial and economic stress, reduce the risk of spillover from the financial sector to the real sector, and minimize the negative impact on the economy.²⁶⁵ By adapting Basel III to Ethiopia's current situation, Ethiopia can benefit from the international experience and best practices in banking regulation, further strengthening its capacity to cope with changes and manage risks in the banking system.

The policy recognizes the need for both short-term and long-term preparations to facilitate the reform process. In the short term, a key focus is on enhancing the capacity of the NBE. The NBE has initiated a study to understand and formulate the necessary reforms and improvements required to effectively cope with the upcoming changes. This study will help identify areas where the NBE needs to strengthen its capabilities, procedures, and regulations. Additionally, the policy recognizes the significance of the Basel framework, an international accord that provides guidelines for the regulation of banks. Ethiopia is adapting the Basel framework to its current situation and utilizing it as a guide for its banking system. This adaptation involves aligning the principles and standards of the Basel framework with Ethiopia's specific context, taking into account the unique characteristics of its financial system, banking sector, and

²⁶² María C Cañamero, 'Final Basel III Reforms: How Can Banks Prepare for the "Basel IV"' [2019] Mody's Analytics <<https://www.moodyanalytics.com/articles/2018/final-basel-reforms-how-can-banks-prepare>>.

²⁶³ Blair Keefe and Andrew Pfleiderer, 'Basel III: What It Means for the Global Banking System' (2012) 27 *Banking & Finance Law Review* 407 <<https://search.proquest.com/openview/31dab2268d44e836bd37ee2ed818facf/1?pq-origsite=gscholar&cbl=44976>>.

²⁶⁴ Habtamu, Interview with Ato Efreem Baraki, Senior Legal Expert II and Acting Chief Legal Expert at NBE (n 243); Habtamu, Interview with Ato Muluken Mihretu, Senior Legal Expert at NBE (n 234).

²⁶⁵ Keefe and Pfleiderer (n 263).

economic landscape. By incorporating the Basel framework, the NBE aims to enhance its regulatory capacity, promote financial stability, and ensure compliance with internationally recognized banking standards.²⁶⁶

3.2.4 The regulatory framework of the banking system and NBE's staff professionalism

The National Bank of Ethiopia (NBE) is working towards improving its capacity to regulate international banks by restructuring its setup. This includes considering the professionalism of NBE staff and the potential employment of foreign employees by foreign banks. NBE has detailed requirements for approving the hiring of foreign employees, including the need to demonstrate that the positions cannot be filled by the local market. There will be sector-wise regulation and a limited number of foreign employees allowed to be hired by foreign banks.²⁶⁷

With respect to the current regulatory framework of the banking system and the professionalism of National Bank of Ethiopia staff in bank regulation, it is clear that NBE is actively pursuing improvements in its capacity to regulate multinational banks. However, it is important to note that this does not imply starting from scratch. Rather, the focus lies on restructuring the institution to better align with the demands of the international banking sector.²⁶⁸

The focus is on addressing underlying structural and relational asymmetries between financial sector participants that make it challenging for National Development Banks (NDBs) to accomplish their mission. In Côte d'Ivoire, for example, the main NDB prioritizes financial intermediation over providing credit to productive sectors due to the push for commercialization by International Financial Institutions.²⁶⁹ The relationship between corporate governance and organizational performance in commercial banks has been studied,

²⁶⁶ Habtamu, Interview with Ato Muluken Mihretu, Senior Legal Expert at NBE (n 234).

²⁶⁷ Thabo Msimango, 'Investigating the Economic Impact of the Financial Services Sector's Support for the Country's Uninsured Population' (2023) 13 International Journal of Scientific and Research Publications 6 <<https://www.ijsrp.org/research-paper-0523.php?rp=P13712880>>.

²⁶⁸ Habtamu, Interview with Ato Sintayehu Desalegn, Director of Preserve Policy and Financial Analysis (n 230).

²⁶⁹ Georges Quist, 'A Financial Straitjacket? Côte d'Ivoire's National Development Banks' (2022) 46 Cambridge Journal of Economics 1087 <<https://EconPapers.repec.org/RePEc:oup:cambje:v:46:y:2022:i:5:p:1087-1108.>>.

revealing a significant relationship between board ability and reputation and measures of organizational performance.²⁷⁰ The impact of board effectiveness on corporate cash holdings and financial performance in banks across the MENA region has also been examined, with findings showing associations with board independence, gender diversity, and size, but no significant relationship with financial performance.²⁷¹

When discussing staff professionalism, it is crucial to consider the arrangements that foreign banks will make upon their arrival, particularly with regards to the potential employment of foreign individuals. While foreign banks do have the ability to hire foreign employees, it is essential for them to justify that the specific position cannot be filled by local talent. NBE has stringent and comprehensive requirements in this regard, ensuring that the process is thorough and transparent. Furthermore, there will be regulation specific to each sector, and foreign banks will only be permitted to hire a limited number of foreign employees in accordance with these regulations. This is a necessary step to maintain order and balance within the banking industry.²⁷²

Moreover, the Code of Conduct for Financial Institutions in Saudi Arabia, which can be considered a relevant reference, also emphasizes professional behavior, honesty, objectivity, and integrity in carrying out job duties.²⁷³ The NBE's focus on professionalism and compliance with regulations, as well as its efforts to ensure the integrity of its staff, indicates its commitment to creating a regulatory framework and a professional workforce capable of effectively regulating multinational banks. This approach aligns with international standards and best practices in the banking sector.

²⁷⁰ Akhigbemidu Julie Jite, A Nwuche Christine and Akhigbe Omoankhanlen Joseph, 'Corporate Governance and Organisational Performance in Nigerian Banking Industry' (2022) 4 South Asian Res J Bus Manag 52.

²⁷¹ Hussien Mohsen and others, 'Board Effectiveness, Corporate Cash Holdings, and Financial Performance Across MENA Region', *Contemporary Research in Accounting and Finance: Case Studies from the MENA Region* (Springer 2022).

²⁷² Habtamu, Interview with Ato Efreem Baraki, Senior Legal Expert II and Acting Chief Legal Expert at NBE (n 243); Habtamu, Interview with Ato Muluken Mihretu, Senior Legal Expert at NBE (n 234).

²⁷³ 'Code of Conduct and Work Ethics in Financial Institution' <https://www.sama.gov.sa/en-US/Laws/BankingRules/Code_of_Conduct_and_Work_Ethics_in_Financial_Institutions-EN.pdf>.

3.2.5 *Foreign bank entry modalities*

An incredibly noteworthy development is the admission of international banks into the banking systems of the transition economies. It is clear that, in the majority of transition economies, foreign-owned banks accounted for more than half of all banks in 2000 and more than two thirds of all bank assets.²⁷⁴

Foreign banks play a significant role in facilitating international trade by reducing financial frictions for firms and increasing the availability of external finance.²⁷⁵ The presence of foreign banks from the importing country is associated with higher exports, especially in sectors more dependent on external finance, in emerging markets with weaker institutions.²⁷⁶ Market-level foreign capital presence leads to higher returns on assets for commercial banks in Thailand, while bank-level foreign ownership share results in lower default risk but higher operating expenses.²⁷⁷ The footprint of foreign banks has a larger impact on exports than the presence of these banks and the level of financial development in sub-regions, and banks from neighboring countries can decrease exports.²⁷⁸

²⁷⁴ Ilko Naaborg and others, 'How Important Are Foreign Banks in the Financial Development of European Transition Countries?' (2003) 3 *Journal of Emerging Markets Finance*.

²⁷⁵ Wanxue Lu and Fumiharu Mieno, 'Impact of Foreign Entry into the Banking Sector: The Case of Thailand in 1999–2014' (2020) 64 *Pacific-Basin Finance Journal* 101424 <<https://www.sciencedirect.com/science/article/pii/S0927538X20300998>>; Stijn Claessens and Neeltje van Horen, 'Foreign Banks and Trade' (2021) 45 *Journal of Financial Intermediation* 100856 <<https://www.sciencedirect.com/science/article/pii/S1042957320300103>>.

²⁷⁶ Stijn Claessens, Omar Hassib and Neeltje Horen, 'The Role of Foreign Banks in Trade' [2017] SSRN Electronic Journal.

²⁷⁷ Francesca de Nicola and Shawn W Tan, *Foreign Banks and Trade: Bridging the Information Gap?* (The World Bank 2017) <<https://doi.org/10.1596/1813-9450-7967>> accessed 23 December 2023.

²⁷⁸ *ibid.*

Foreign banks typically expand their operations in a foreign market by first establishing representative offices, then opening branches, and eventually establishing subsidiaries.²⁷⁹ The primary objective of this expansion is not to build retail franchises, but rather to facilitate trade and investment movements. Even if international banks' profitability is declining in China, many of them are still growing there through acquisitions or organic development since foreign lenders might benefit from even a small portion of China's banking industry.²⁸⁰

However, because to their more erratic asset growth, increased sensitivity to conditions in their home countries, and laxer host government oversight, foreign bank branches represent a bigger danger to host nations than subsidiaries do.²⁸¹ A strategic strategy, solid relationships with local players, and in-depth knowledge of local legislation are necessary for success in international branch banking. Foreign banks can enter the market primarily through: -

3.2.5.1 Representative offices

Although representative offices of foreign financial institutions are normally not allowed to conduct any banking operations, they can still provide prospects for contracts pertaining to the overseas market with the parent bank and its clients. The majority of these offices are found in significant American cities with a strong financial and global commerce sector. When evaluating the state of foreign banks' activities in the United States and their capacity to sustain those operations, the Federal Reserve is a crucial player. Because they are more sensitive to

²⁷⁹ Iñaki Aldasoro, John Caparusso and Yingyuan Chen, 'Global Banks' Local Presence: A New Lens' <https://www.bis.org/publ/qtrpdf/r_qt2203d.htm>.

²⁸⁰ Jiayue Huang, 'Why Do Foreign Banks Expand in China despite Weakening Profitability?' (*S&P Global Market Intelligence*, 2021) <<https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/why-do-foreign-banks-expand-in-china-despite-weakening-profitability-64778421>>.

²⁸¹ Aldasoro, Caparusso and Chen (n 279).

conditions in their home countries, have more variable asset growth, and have less control over their operations than subsidiaries, foreign bank branches provide greater risks to the host nation. Notwithstanding the dangers, foreign banks contribute to the deep and liquid markets that sustain lending and American companies, making them a vital source of cash for the country. International banking jobs are available in the US at large financial firms like JPMorgan Chase.²⁸²

At its thirteenth regular session, which convened on August 4, 2022, the Council of Ministers decided to approve a policy statement that would allow foreign investors to participate in the banking industry. The National Bank of Ethiopia (NBE) disseminated the policy and a draft modification to the banking business proclamation subsequent to this decision. The policy statement and the draft legislation permit foreign banks to enter Ethiopia through four different models: purchasing shares in already-existing banks, forming subsidiaries, building branches, and opening representative offices.²⁸³

Even if setting up a representative office doesn't equal entering the market, several international banks have been allowed to do so for a long time. Above all, representative offices are limited to promotional activities and are not permitted to provide client services. Contrary to prior reports in various media, the joint venture is not mentioned as an entrance model. This is not to say that there is something lacking in the suggested models. Conversely, one would

²⁸² Yaron Z Reich, 'U.S. Federal Income Taxation of U.S. Branches of Foreign Banks: Selected Issues and Perspectives' (2022) 2 Florida Tax Review <<https://journals.upress.ufl.edu/ft/article/view/472>> accessed 25 December 2023; Viktoriia Yevtushenko, Dmytro V Mangushev and Anton Bilovskiy, 'BANKING SERVICES FOR FOREIGN ECONOMIC ACTIVITIES OF INDUSTRIAL ENTERPRISES' [2023] Market Infrastructure <<https://api.semanticscholar.org/CorpusID:257711076>>.

²⁸³ Petros (n 18).

be inclined to conclude that the policy offers an excessive number of entrance alternatives. With Ethiopia being the second most populous country in the continent with one of the lowest rates of financial inclusion, there was no doubt that Ethiopia's banking market would attract interest even if the country restricts the modes of entry.²⁸⁴

3.2.5.2 Foreign branches

A foreign branch represents a greater level of commitment than a representative office and is an overseas office of a bank that is incorporated in another nation. Because foreign bank branches in the US are more sensitive to conditions in their home countries, have more variable asset growth, and have less control over their operations than subsidiaries, they provide larger risks to the host nation than subsidiaries do.²⁸⁵ Nevertheless, in spite of these dangers, foreign banks remain a vital source of funding for American companies, supporting the development of deep and liquid markets that facilitate lending.²⁸⁶ Rather than opening retail locations, the primary goal of international banks' local presence expansion in the United States is to facilitate trade and investment flows.²⁸⁷

Foreign banks will find it simpler to develop a presence through branches, according to Fekadu Petros. Nonetheless, controlling this presence will be the National Bank of Ethiopia's biggest challenge (NBE). Important prudential standards like solvency cannot be effectively

²⁸⁴ *ibid.*

²⁸⁵ Julia C Morse, 'A Primer on International Financial Standards on Illicit Financing', *The Bankers' Blacklist: Unofficial Market Enforcement and the Global Fight against Illicit Financing* (Cornell University Press 2022) <<https://books.google.com.et/books?id=W-siEAAAQBAJ>>.

²⁸⁶ Jeremy C Kress, 'Domesticating Foreign Finance' [2020] SSRN Electronic Journal <<https://www.ssrn.com/abstract=3705314>> accessed 25 December 2023.

²⁸⁷ Sudipta Basu, Mahsa S Kaviani and Hosein Maleki, 'Bank Entry Barriers and Firms' Risk Taking' <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3002895>.

supervised at the branch level. At this stage, keeping an eye on regulations like capital adequacy can also be challenging. Therefore, home authorities have the primary regulatory jurisdiction over overseas branches of domestic banking firms. On the other hand, the central banks of the host nation are primarily in charge of overseeing the foreign subsidiaries they are hosting.

Prudently speaking, branches could put the Ethiopian financial industry at danger of external shocks readily seeping into our internal financial systems. The NBE is unable to prevent these dangers because it is not equipped to adequately regulate the particular branch in question. Branches can be dangerous for the industry and domestic customers in cases when the home country's authorities are unable or unwilling to step in.²⁸⁸

Despite the fact that branches can endanger the stability of domestic finances, NBE legal experts Ato Muluken Mihretu and Ato Efreem Baraki said that the organization is currently seeking a way to lessen these dangers. Signing a memory of declaration is one way to guarantee a unified regulatory framework. Furthermore, there are strict guidelines for opening a branch, especially if accepting deposits from overseas is involved. A foreign bank that wants to create a deposit-taking branch must send a minimum capital equivalence that is decided by the National Bank instruction, under the draft proclamation to change the banking business proclamation. A foreign bank's minimum capital requirements for forming a new subsidiary may also be specified in a National Bank order.

To further bolster its regulatory capacity, the NBE plans to establish Memoranda of Understanding (MoUs) with host countries. These MoUs will serve as important frameworks for collaboration and knowledge-sharing. By gaining insights and experiences from other

²⁸⁸ Petros (n 18).

countries, the NBE can enhance its understanding of best practices in regulating banks. Sharing the responsibilities of regulating banks through these MoUs can also provide valuable support and expertise to the NBE in implementing effective oversight measures. Furthermore, the reform process involves restructuring not only Proclamation 592/2008, but also Proclamation 591/2008, which established the NBE. By amending both proclamations, the NBE's responsibilities and functions will be adjusted to align with the anticipated changes resulting from the reform process. This restructuring will ensure that the NBE is equipped with the necessary authority and mechanisms to effectively regulate and supervise the banking sector in light of the reforms.²⁸⁹

Fekadu Petros is adamant that there is a compelling business rationale opposing branching. Unquestionably, international branches can improve access to credit for individuals and companies, lower intermediation costs, and allow for a more effective distribution of savings that are mobilized on a continental or worldwide scale. Comparably, the opening of international bank branches in Ethiopia suggests—at the very least in theory—the unfettered transfer of deposits raised in Ethiopia to other nations where the bank conducts business. However, the draft law forbids cross-border loans outright. What benefits does the nation therefore expect from overseas branches?²⁹⁰

For international banks, opening branches can be a more advantageous option than purchasing stock in already-existing banks or forming subsidiaries since it is less complicated and demands less initial capital. Nevertheless, because branches can compete for larger clients with a smaller amount of money and investment than local banks, this might lead to unhealthy rivalry. Additionally, branches can reduce Ethiopian regulators' regulatory intervention, which could benefit international banks even more. Additionally, branching may not be the most daring move because international banks may choose to pursue their primary Ethiopian clients and steal them from local banks rather than promoting financial inclusiveness.²⁹¹

²⁸⁹ Habtamu, Interview with Ato Muluken Mihretu, Senior Legal Expert at NBE (n 234).

²⁹⁰ Petros (n 18).

²⁹¹ *ibid.*

Foreign bank branches may therefore pose a risk to domestic banks. Since important prudential criteria, such solvency, cannot be monitored at the branch level and because it can be challenging to monitor other requirements, like capital adequacy, at the branch level, the National Bank of Ethiopia (NBE) may find it challenging to regulate foreign bank branches. Foreign branches of domestic banking organizations are often subject to regulatory power exercised by home authorities. Conversely, the primary regulatory authority over foreign companies that they host rests with the central banks of the host nation.²⁹²

From the perspective of accepting countries, the legal vacuum that emerging economies experience as a result of foreign banks opening branches has multiple ramifications. Restrictions on foreign bank branches have been implemented by nearly 30% of emerging nations, depriving many economies of potentially advantageous access to global financing. Foreign banks use a range of institutional forms, such as joint ventures, subsidiaries, and branches, when they enter emerging markets. In nations where their operations are restricted and where regulations make it challenging for new banks to open, foreign banks are less likely to operate as branches.²⁹³

The financial systems and economy of the host nations may profit from the presence of foreign bank branches in the form of enhanced competition and efficiency advantages from new goods, services, and technologies. Foreign bank branches can, however, also provide dangers because they are more erratic lenders than subsidiaries and react more strongly to domestic

²⁹² Jonathan Fiechter and others, 'Chapter 11: Subsidiaries or Branches: Does One Size Fit All?' (International Monetary Fund 2012) <<https://www.elibrary.imf.org/view/book/9781616352295/ch11.xml>>.

²⁹³ Eugenio Cerutti, Giovanni Dell'Ariccia and Maria Soledad Martínez Pería, 'How Banks Go Abroad: Branches or Subsidiaries?' (2007) 31 *Journal of Banking & Finance* 1669 <<https://www.sciencedirect.com/science/article/pii/S0378426606003190>>.

circumstances. This could have an impact on the stability of the financial system in the host nation.²⁹⁴ Thus, the legal void created by international banks opening branches in emerging nations may have an effect on the availability of credit, the stability of the financial system, and the degree of competition in the banking industry.

3.2.5.3 *Bank subsidiaries*

Foreign companies that are majority-owned by a parent company located in a different nation are known as subsidiaries. By operating under the rules and regulations of the host nation, they enable the parent firm to evade requirements that are not in its best interests and are enforced by the parent nation. Generally speaking, subsidiary banks participate in the retail banking space and provide a constrained range of retail banking services. Basic financial services like checking and savings accounts are marketed to the general public through local branches under the umbrella of retail banking. A substantial portion of the business of the top five biggest commercial banks in the United States by assets is retail banking services.²⁹⁵

The Ethiopian government has allowed up to 100% ownership of subsidiary banks to open subsidiaries in the country. The rationale behind this policy is that foreign banks can provide banking skills, specialized services, and technology, as well as an opportunity to attract foreign investment and exports from developed countries and economies. Additionally, accessory banks are established in accordance with Ethiopian law, providing an opportunity to build good company management from the beginning.²⁹⁶

²⁹⁴ Asli Demirgüç-Kunt, Harry Huizinga and Stijn Claessens, *How Does Foreign Entry Affect the Domestic Banking Market?* (The World Bank 1999) <<http://elibrary.worldbank.org/doi/book/10.1596/1813-9450-1918>> accessed 25 December 2023.

²⁹⁵ Hai Lam, 'Analyzing the Measures of Credit Risk on Financial Corporation and It's Impact on Profitability' (2023) 3 *International Journal of Research in Vocational Studies (IJRVOCAS)* 64; F Marsintauli and others, 'Does the Market React to Intellectual Capital, Capital Structure, Geopolitical Risk, and Cryptocurrency Impact?', *2023 8th International Conference on Business and Industrial Research (ICBIR)* (2023).

²⁹⁶ Habtamu, Interview with Ato Efreem Baraki, Senior Legal Expert II and Acting Chief Legal Expert at NBE (n 243); Habtamu, Interview with Ato Muluken Mihretu, Senior Legal Expert at NBE (n 234).

The establishment of subsidiary banks has been examined in relation to Ethiopia's new Commercial Code as part of international bank entrance models. The code acknowledges the establishment of holding companies and permits them to directly invest in trade activities or possess shares in subsidiaries. Wholly-owned subsidiaries (WOS) and majority-owned subsidiaries (MOS) are the two categories of subsidiaries (MOS). With the exception of a few nominal shareholders needed to achieve minimum membership requirements, the parent owns nearly all of the shares in a WOS. In a MOS, the parent owns more than half of the shares, but to clearly establish a parent-subsidiary connection, the parent's holding typically exceeds two-thirds of the voting shares.²⁹⁷

However, the policy also limits investment in a stock that is in operation or in a new indigenous bank. Non-banked foreign nationals are allowed to invest up to 5%, foreign banks up to 30%, and the total foreign investment rate up to 40%. The purpose of this policy is to ensure that the current leadership roles of indigenous banks continue and to prevent foreign investors from completely taking over the country's banking sector. This policy also aims to protect the country's economy from exposure to foreign markets and potential financial and economic crises.²⁹⁸

It is highlighted that current restrictions addressing foreign ownership in banks are inconsistent. On the one hand, totally or majority-owned subsidiary banks are permitted, but foreign ownership of current banks is limited to a maximum of 30 percent. The policy's justification is unclear. A one-member corporation is recognized as an entity under the draft legislation, most likely for wholly-owned subsidiaries. But it would be smarter to mandate that a share company take the form of a legal entity instead, as this would mean implementing the

²⁹⁷ *Commercial Code of the Federal Democratic Republic of Ethiopia: Proclamation No. 1243/2021*. (1st edn, Federal Negarit Gazette Extra Ordinary Issue 2021) <https://lawethiopiacomment.files.wordpress.com/2021/11/new-commercial-code-no-1243_2021_english.pdf>.

²⁹⁸ Habtamu, Interview with Ato Efreem Baraki, Senior Legal Expert II and Acting Chief Legal Expert at NBE (n 243); Habtamu, Interview with Ato Muluken Mihretu, Senior Legal Expert at NBE (n 234).

toughest corporate governance system possible, in line with the high requirements of the financial sector regulatory framework.²⁹⁹

The National Bank of Ethiopia faces particular difficulties as it moves from regulating widely held businesses with distributed ownership to regulating wholly owned subsidiaries (WOS) and majority-owned subsidiaries (MOS) (NBE). In an effort to deter management meddling, NBE previously dealt with boards and management of businesses with ownership percentages less than 5%. As a result of NBE's orders, which permitted tight monitoring of owners holding more than 2 percent and designated them as "influential shareholders," a management structure was established in which NBE had a major effect.³⁰⁰ A board of directors is recommended in the draft proclamation as a means of resolving issues with corporate governance in WOS and MOS. In particular, it suggests a supervisory board and an executive board as the two tiers of the board structure. It's crucial to remember, though, that a board of directors, no matter how independent or competent, may find it difficult to rein in a dishonest owner who owns 100% of the company.³⁰¹

On the other hand, mandating a share company as the legal form of organization can offer a more robust corporate governance framework for more wholesome operations. It creates a framework that encourages responsibility, openness, and improved governance procedures by

²⁹⁹ *Commercial Code of the Federal Democratic Republic of Ethiopia: Proclamation No. 1243/2021.* (n 297); Petros (n 18).

³⁰⁰ Petros (n 18).

³⁰¹ *ibid.*

requiring a share company form. Shareholders in a share corporation have clearly defined rights and obligations, which helps to reduce the dangers related to concentrated ownership.³⁰²

Establishing a share company structure has a number of advantages. It guarantees a distinct division of ownership and management, enabling the use of decision-making authority for the benefit of the business and its stakeholders. The rights of shareholders, including the ability to vote and receive dividends, are well-defined. Furthermore, a larger class of investors, particularly institutional investors who favor open governance procedures, may be drawn to the share company structure. This can therefore improve market confidence, make it easier to obtain financing, and possibly create growth prospects for WOS and MOS.³⁰³

From a financial stability point of view and regulatory simplicity establishing subsidiary banks is preferred by GOA according to NBE legal experts. Establishing subsidiary banks involves creating a separate legal entity that is owned by the foreign bank but operates under the regulatory framework of the host country. This option offers several benefits:³⁰⁴

- Financial Stability: Subsidiary banks contribute to financial stability by operating as independent entities with their own capital and risk management. They are subject to local regulations and supervision, which helps ensure compliance with prudential norms and safeguards against systemic risks.
- Regulatory Simplicity: Regulatory oversight is typically clearer and more straightforward for subsidiary banks. Host country regulators have direct control over capital requirements, risk management practices, and compliance with local regulations. This allows for better alignment with the host country's financial stability objectives.
- Local Presence: Subsidiary banks often have a physical presence in the host country, which can foster deeper relationships with local businesses and consumers. This can contribute to greater financial inclusion and support economic development.

3.2.5.4 Joint venture and affiliate relationships

Another strategy for expanding internationally is to form joint ventures or connected ties. This typically entails the foreign banks managing the local banks to varied degrees and acquiring

³⁰² *ibid.*

³⁰³ *ibid.*

³⁰⁴ Habtamu, Interview with Ato Efreem Baraki, Senior Legal Expert II and Acting Chief Legal Expert at NBE (n 243); Habtamu, Interview with Ato Muluken Mihretu, Senior Legal Expert at NBE (n 234).

minority holdings in local entries. But joint ventures and related connections can also provide some obstacles, like managing the joint venture and conflicts of interest or disagreements over strategic direction.³⁰⁵

The policy of the Ethiopian government and the proclamation amending the regulations pertaining to the entry of foreign banks into the nation do not specifically address the joint venture (JV) model, which is a business arrangement wherein two or more parties agree to pool their resources in order to accomplish a specific task. In the banking sector, joint ventures (JVs) usually entail the establishment of a firm by several banks, frequently as a calculated move into untapped markets. JVs in transnational banking are defined by the Basel Concordat (BIS 1983) as a workable plan for a consortium of foreign banks to establish JVs in Ethiopia.³⁰⁶

It's unclear, though, if a few international banks can create joint ventures without going over the 30 percent ownership threshold. In order to prevent additional rivalry for local businesses, the strategy also advises that joint ventures (JVs) in the banking sector would be more advantageous if they included Ethiopian institutions. Notable are the paucity of regulatory guidance on joint ventures (JVs) and the lack of experience in analyzing JVs in Ethiopia's financial sector. Thus, even if joint ventures (JVs) have potential, more regulatory guidance and experience in assessing JVs in Ethiopia's financial industry are required.³⁰⁷

³⁰⁵ International Monetary Fund, 'CHAPTER VI THE ROLE OF FOREIGN BANKS IN EMERGING MARKETS', *International Capital Markets: Developments, Prospects, and Key Policy Issues* (INTERNATIONAL MONETARY FUND 2000) <https://books.google.com.et/books?id=XmP2zY_7DacC>.

³⁰⁶ Petros (n 18); Habtamu, Interview with Ato Muluken Mihretu, Senior Legal Expert at NBE (n 234).

³⁰⁷ Petros (n 18).

3.2.5.5 The process of mergers and acquisitions (M&As)

In Ethiopia, the process of mergers and acquisitions (M&As) between domestic and foreign banks brings up a number of significant issues. The Ethiopian government has permitted foreign banks to purchase up to a thirty percent stake in domestic banks; the total amount of foreign ownership in a single bank, comprising foreign banks and non-bank foreigners, is limited to forty percent.³⁰⁸ However, the attractiveness of a 30% stake for foreign banks is influenced by various factors.

First, for successful restructuring and increases in cost efficiency, foreign ownership shares in other industries must be comparatively bigger (over 50%). However, given the distribution of ownership in banks and the strict regulation and administration of the National Bank of Ethiopia (NBE), a thirty percent stake in the banking industry is seen substantial enough to exert control.³⁰⁹

The process of M&As also raises questions about the regulatory guidance on whether foreign banks will be required to be issued new shares or will bid for existing shares from the shareholders.³¹⁰ Additionally, there is a need for transparency in the acquisition of existing shares, as the sale of a 30% stake comes with a de-facto control right due to the dispersion of ownership in banks. Therefore, there should be fair and transparent mechanisms for the

³⁰⁸ *ibid.*

³⁰⁹ Allen Berger and others, 'The Dynamics of Market Entry: The Effects of Mergers and Acquisitions on Entry in the Banking Industry' (2004) 77 *The Journal of Business* 797; Petros (n 18).

³¹⁰ Berger (n 2).

acquisition of such stakes to ensure that all shareholders have an equal opportunity to participate.³¹¹ According to NBE legal experts:³¹²

Establishing a working relationship between the National Bank of Ethiopia (NBE) and the Ministry of Trade and Regional Integration (MoTRI), body would be beneficial to smoothen future mergers and acquisitions (M&A) in the banking sector. The MOTRI body plays a crucial role in evaluating M&A transactions from a competition and consumer protection perspective. Their expertise lies in assessing the potential impact of mergers and acquisitions on market competition, ensuring fair business practices, and safeguarding consumer interests. While the MOTRI body may have experience in evaluating M&A transactions in various industries, their specific experience in the financial sector, especially in banking, could be limited. We believe that the new legislation to amend the banking business will address such concerns when ratified.³¹³

Given that M&A transactions in the banking sector have unique characteristics and potential implications for competition and consumer protection, it is important for the NBE to collaborate with the MOTRI body. Establishing a working relationship would allow for knowledge sharing, capacity building, and coordination between the two entities. By working together, the NBE and the MOTRI body can develop a deeper understanding of the specific considerations and challenges associated with M&A in the banking sector. This collaboration can help ensure that future M&A transactions are evaluated effectively, taking into account both financial stability concerns and competition and consumer protection aspects. Furthermore, cooperation between the NBE and the MOTRI body can lead to the development of comprehensive guidelines and frameworks specifically tailored to M&A transactions in the banking sector. These guidelines can provide clarity and transparency for market participants, streamline the approval process, and enhance the overall regulatory environment for M&A in the banking sector.³¹⁴

Furthermore, the role of the Ministry of Trade and Regional Integration (MoTRI), in evaluating M&As in the financial sector is important. However, there is a lack of experience in evaluating M&As in the financial sector, and it is essential for the NBE to establish working relationships with this entity to facilitate future M&As in the banking sector.³¹⁵

The legal and regulatory framework for the merger of banks in Ethiopia has been a subject of study and analysis. While there are laws and regulations in place, there are also discussions about the adequacy of the existing framework and the need for further guidance and experience in evaluating mergers and acquisitions (M&As) in the financial sector. Proclamation No. 1263/2021 dictates that the Ministry of Trade and Industry, Trade Competition and Consumer Protection Authority, and Ethiopian Commodity Exchange Authority, which currently hold

³¹¹ Petros (n 18).

³¹² Habtamu, Interview with Ato Efreem Baraki, Senior Legal Expert II and Acting Chief Legal Expert at NBE (n 243); Habtamu, Interview with Ato Muluken Mihretu, Senior Legal Expert at NBE (n 234).

³¹³ Habtamu, Interview with Ato Efreem Baraki, Senior Legal Expert II and Acting Chief Legal Expert at NBE (n 243); Habtamu, Interview with Ato Muluken Mihretu, Senior Legal Expert at NBE (n 234).

³¹⁴ Habtamu, Interview with Ato Efreem Baraki, Senior Legal Expert II and Acting Chief Legal Expert at NBE (n 243); Habtamu, Interview with Ato Muluken Mihretu, Senior Legal Expert at NBE (n 234).

³¹⁵ Petros (n 18).

powers and responsibilities related to trade according to existing laws, will now be transferred to the newly established Ministry of Trade and Regional Integration as outlined in the Proclamation. However, there is a need for further regulatory guidance and experience in evaluating M&As in the financial sector with regard to foreign bank entry. Additionally, the National Bank of Ethiopia (NBE) should work to establish the necessary regulatory guidance and relationships with relevant entities to facilitate M&As in the banking sector. Therefore, while there is an existing legal and regulatory framework, there are ongoing discussions about its adequacy and the need for further guidance and experience in evaluating M&As in the financial sector.³¹⁶

3.2.6 The challenges of regulatory bodies in terms of regulation

Given that Ethiopia's banking industry has been virtually totally closed to outsiders for decades, the decision to allow international banks to operate in the country's financial market represents a significant policy change. It is anticipated that this shift would present both chances and difficulties. Increased rivalry from foreign banks could have an impact on local banks' market share, shareholders, depositors, and other stakeholders.³¹⁷

The opening of Ethiopia's financial market to foreign banks can indeed bring about various challenges and complexities, including those related to international banking engagement, domestic bank competition, digital banking systems, cybercrime, account closures, and bilateral investment treaties (BITs).

The entry of foreign banks into Ethiopia's financial market can create intense competition for domestic banks. Local banks may face challenges in terms of maintaining their market share, profitability, and competitiveness. This competition can impact shareholders, depositors, and other stakeholders associated with domestic banks. Domestic banks may need to adapt by improving their services, operational efficiency, and customer experience to remain competitive.³¹⁸

³¹⁶ Habtamu, Interview with Ato Efreem Baraki, Senior Legal Expert II and Acting Chief Legal Expert at NBE (n 243); Habtamu, Interview with Ato Muluken Mihretu, Senior Legal Expert at NBE (n 234).

³¹⁷ International Trade Administration, 'ETHIOPIA BANKING SECTOR OPPORTUNITIES' (2022) <<https://www.trade.gov/market-intelligence/ethiopia-banking-sector-opportunities>>; Abreham Ketema, 'The Entry of Foreign Banks Might Crumble the Local Banks and Domestic Economy' [2022] *Capital* <<https://www.capitalethiopia.com/2022/11/27/the-entry-of-foreign-banks-might-crumble-the-local-banks-and-domestic-economy/?amp=1>>.

³¹⁸ Habtamu, Interview with Ato Dulla Merera, Director of Legal Department at Abyssinia Bank Main Branch (n 230); Habtamu, Interview with Ato Takele Arega, Director of Legal Service at Awash International Bank Main Branch (n 230).

Additionally, the introduction of advanced digital and core banking systems by foreign banks may pose challenges for local banks in terms of coping with such advancements and addressing potential cyber-related security threats.³¹⁹

The introduction of foreign banks often brings advanced digital and core banking systems. Domestic banks may face challenges in adapting to and integrating these systems into their existing infrastructure. Upgrading technology, enhancing IT capabilities, and training employees to leverage the new systems will be essential for domestic banks to keep up with advancements and remain competitive. As the financial market opens to foreign banks and digital systems become more prevalent, the risk of cyber-related crimes increases. Foreign banks, as well as domestic banks, need to strengthen their cybersecurity measures to protect against data breaches, hacking attempts, and other cyber threats. Collaborative efforts between banks, regulatory authorities, and other relevant organizations are necessary to establish robust cybersecurity frameworks and share best practices to mitigate cyber risks.³²⁰

Furthermore, the relationship between Ethiopia and host countries, as well as the potential impact of Bilateral Investment Treaties (BITs) on banking and investment regulations, are aspects that need to be carefully considered and managed.³²¹

The engagement of foreign banks in Ethiopia may pose challenges in terms of building relationships with the host countries of these banks. Differences in regulations, cultural practices, and business environments can create complexities that need to be managed. Effective communication, collaboration, and understanding between Ethiopia and the host countries will be crucial to address potential challenges arising from these differences. Bilateral Investment Treaties (BITs) can introduce complexities in the relationship between the banking system and investment regulations. Foreign banks may choose to register in countries where Ethiopia has signed BITs and operate in Ethiopia through those entities. This can complicate the regulatory landscape and require alignment between banking regulations and investment regulations. Close coordination and harmonization between regulatory bodies are necessary to ensure consistency and clarity in the regulatory framework.³²²

The potential challenges associated with the entry of foreign banks into Ethiopia's banking sector highlight the need for the country to carefully assess and address the various

³¹⁹ International Trade Administration (n 317).

³²⁰ Habtamu, Interview with Ato Efreem Baraki, Senior Legal Expert II and Acting Chief Legal Expert at NBE (n 243); Habtamu, Interview with Ato Muluken Mihretu, Senior Legal Expert at NBE (n 234).

³²¹ Getachew (n 228).

³²² Habtamu, Interview with Ato Efreem Baraki, Senior Legal Expert II and Acting Chief Legal Expert at NBE (n 243); Habtamu, Interview with Ato Muluken Mihretu, Senior Legal Expert at NBE (n 234).

implications of this policy change. This may involve enhancing the regulatory framework, improving the capacity of the regulator, and ensuring that local banks are able to compete and adapt to the new dynamics of the market.³²³ Moreover, it will be important for Ethiopia to consider the broader economic and political implications of this move, particularly in terms of safeguarding the stability and resilience of the domestic banking sector while also leveraging the potential benefits that foreign investment can bring.³²⁴

If foreign banks decide to close their bank accounts in Ethiopia due to various reasons, it can create challenges and potential chaos. This situation may disrupt financial transactions and impact the stability of the banking system. Effective coordination between regulatory authorities, banks, and relevant stakeholders is crucial to manage such situations and minimize their adverse effects on the financial market. To address these challenges, it is important for Ethiopia's regulatory authorities, domestic banks, and relevant stakeholders to develop robust policies, regulations, and frameworks that promote transparency, stability, and competitiveness in the financial market. Collaboration, capacity building, and continuous monitoring and adaptation are key to effectively managing the potential complexities associated with opening the financial market to foreign banks.³²⁵

The policy also identified risks associated with foreign bank entry³²⁶;

- Exposure to foreign crisis: Financial and economic crises created by other countries can cause a national economy and make the economy vulnerable. When large cross-border banks go bankrupt, they can cause this crisis to spread to their peripherals and branches in other countries.
- Reserves: An excess of foreign ownership reserves in the banking sector may cause the country's economy to suffer due to financial and economic hardship in another country

³²³ Mussie Delelegn Arega, 'Does Ethiopia Need Foreign Banks or Domestic Banks of a Different Genre?' *The Reporter* (Addis Ababa, 1 October 2022) <<https://www.thereporterethiopia.com/26765/>>; International Trade Administration (n 317).

³²⁴ Getachew (n 228); Ketema (n 317).

³²⁵ Habtamu, Interview with Ato Efram Baraki, Senior Legal Expert II and Acting Chief Legal Expert at NBE (n 243); Habtamu, Interview with Ato Muluken Mihretu, Senior Legal Expert at NBE (n 234).

³²⁶ The Council of Ministers, *Opening the Ethiopian Banking Sector to Foreign Investment: A Policy Document* (n 12).

or zone and/or expose the country to unwanted political or hand-wringing colonialism. In addition, it may cause the competitive capacity of foreign banks to be significantly greater than that of indigenous banks and, as a result, cause indigenous banks to be rolled over by foreign investors.

- Withdrawal during a financial crisis can be experienced differently during the country's economic crisis, exposing the economy to further crises, leaving foreign banks, and especially if this phenomenon is implemented in conjunction with the exemption of capital flows by foreign banking.
- Regulatory challenges include complex and cross-border financial transactions and services carried out by international banks that may be beyond the national bank's ability to oversee. However, by putting in place and implementing adequate policy protections, national interests can be further enhanced and threats can be minimized.

3.3 Legal Gaps with regard to Foreign Banks Entry

Acting as a financial middleman between savers, investors, and borrowers, banking plays a vital role in the financial services industry. The regulatory limitations placed on banks, rather than underlying distinctions in their intermediation, are what make banking distinct. There is a lot of disagreement in the literature about how regulations affect the operations of foreign banks.

Due to customer demand, Ethiopia's banking industry still faces challenges with minimal accessibility, traditional services, restricted loan availability, and insufficient financial infrastructure. These difficulties are mostly caused by the industry's lack of advancement and

its lack of competition. It is necessary to make improvements to the banking industry's collateral-only credit system and shift it to a repayment-based credit system. This can only be accomplished by increasing the level of economic financing and competition.

3.3.1 Potential legal gaps

The financial and technological capacities of local banks are still insufficient to compete with those of their international counterparts. To prevent foreign banks from dominating Ethiopia's financial system, the government should introduce stringent oversight and supervision measures and guarantee that international banks are bound by the same laws as domestic ones.

Because of their unstable asset growth, sensitivity to conditions in their home countries, and lax host government oversight, foreign bank branches provide greater risks to their host nations. A strategic strategy, solid relationships with local players, and in-depth knowledge of local legislation are necessary for success in international branch banking. The National Bank of Ethiopia (NBE) encounters difficulties in overseeing overseas branches since crucial prudential standards including capital adequacy and solvency are not adequately monitored. The NBE is currently seeking ways to reduce these risks, including putting Memoranda of Understanding (MoUs) in place with host nations and signing a memory of declaration.

For international banks, opening branches might be advantageous because it needs less capital up front than setting up subsidiaries or purchasing stock in already-existing banks. Nevertheless, branches might minimize Ethiopian regulators' regulatory action and foster unhealthy rivalry, which benefits foreign banks. Since about 30% of developing nations have

imposed limitations on foreign bank branches, many economies are deprived of the chance to obtain credit from around the world.

Foreign banks can expand internationally through joint ventures and affiliate arrangements, which frequently involve varied degrees of involvement and minority ownership in local banks. Conflicts of interest, divergent opinions regarding the joint venture's strategic direction, and management challenges can make these relationships tough. It is not clear from Ethiopian government policy what the joint venture (JV) concept entails—namely, combining resources for a given objective. In the banking sector, joint ventures (JVs) usually entail the establishment of a firm by several banks, frequently as a calculated move into untapped markets.

In Ethiopia, the process of mergers and acquisitions (M&As) between domestic and foreign banks brings up a number of significant issues. The Ethiopian government has permitted foreign banks to purchase up to a maximum of thirty percent of local banks; the total amount of foreign ownership in a single bank is limited to forty percent. However, elements like the distribution of bank ownership and the strict monitoring and oversight of the National Bank of Ethiopia affect how appealing a thirty percent holding is to foreign banks (NBE).

To facilitate future mergers and acquisitions in the banking industry, the Ministry of Trade and Regional Integration body and the National Bank of Ethiopia (NBE) should establish a cooperative connection. Through information exchange, capacity building, and coordination between the two organizations, this collaboration would enable the creation of comprehensive frameworks and norms specifically designed for M&A transactions in the banking industry. There has been research and analysis done on Ethiopia's legislative and regulatory framework

for bank mergers, and there are still debates on how adequate it is and whether more experience and direction are needed when assessing mergers and acquisitions in the financial industry.

3.3.2 Anticipated legal gaps

The National Bank of Ethiopia's (NBE) ability to regulate is still restricted, and it is not yet beginning to take concrete steps toward reform. A more competitive banking market brought about by FBE will necessitate increased regulatory capacity from the NBE. According to research on international banking, the arrival of foreign banks may increase competition in local banking markets, pushing domestic banks to raise the caliber of their operations and services. The policy emphasizes both short- and long-term planning, with a particular emphasis on strengthening the National Bank of Ethiopia's capabilities (NBE). The NBE is studying the Basel framework to identify areas for improvement and align its principles with Ethiopia's unique financial system, banking sector, and economic landscape which can be evaluated as minimum effort considering what it is signed on.

In order to more effectively oversee foreign banks, the National Bank of Ethiopia (NBE) is reorganizing its financial infrastructure. Enhancing the professionalism of NBE employees and resolving relational and structural imbalances amongst financial sector players are the main priorities. When recruiting international banks, the NBE has strict guidelines that include proving that local talent cannot fill the posts. Sector-specific regulations and a cap on the number of foreign workers that foreign banks are permitted to hire are also being contemplated. It may also be slick for international banks to claim that there isn't enough labor in the local market to hire foreign workers once the door was opened for them. The foreign banks can put up a lot of convincing arguments or viewpoints to support their foreign hiring.

Foreign companies that operate under the laws and regulations of their host nation and are majority-owned by a parent business located elsewhere are known as subsidiaries. Usually, they provide local branches with retail banking services, including checking and savings accounts, to the general population. The government of Ethiopia has made it possible for international banks to establish subsidiaries with up to 100% ownership. This gives these banks access to technology, specialized services, and banking expertise, as well as the chance to draw in exports and foreign investment from industrialized nations.

The new Commercial Code of the Ethiopian government acknowledges the establishment of holding corporations and permits them to own stock in subsidiaries or make direct investments in commercial endeavors. Wholly-owned subsidiaries (WOS) and majority-owned subsidiaries (MOS) are the two categories of subsidiaries (MOS). It is highlighted that current restrictions addressing foreign ownership in banks are inconsistent. On the one hand, totally or majority-owned subsidiary banks are permitted, but foreign ownership of current banks is limited to a maximum of 30 percent. The policy's justification is unclear. A one-member corporation is recognized as an entity under the draft legislation, most likely for wholly-owned subsidiaries. Another problem will arise from this contradiction.

The National Bank of Ethiopia has particular difficulties as it moves from regulating widely held businesses with distributed ownership to regulating wholly-owned and majority-owned subsidiaries (NBE). By encouraging accountability, transparency, and improved governance practices, the use of a share company form can offer a stronger corporate governance sub-structure for more robust operations.

CHAPTER FOUR

4 CONCLUSION AND RECOMMENDATIONS of THE STUDY

4.1 Conclusions of the Study

The Ethiopian government is planning to open up its banking sector to foreign banks as part of its strategy to attract foreign investment and boost economic growth. The current challenges faced by the Ethiopian banking sector include limited accessibility, traditional services, low access to credit, and limited financial infrastructure. The entry of foreign banks is expected to address these challenges by introducing competition, modern banking services, and strengthening international connections.

The potential effects of opening the banking sector to foreign banks include reducing the cost of credit, improving domestic banks' economic potential, and benefiting from the experiences of neighboring countries. However, local banks need to enhance their financial and technological capabilities to compete with foreign counterparts. To protect the Ethiopian financial sector from domination by foreign banks, it is crucial for the government to ensure that foreign banks are subject to the same regulations as local banks and implement strict monitoring and supervision.

The literatures indicate that there might be the threat of dominance by foreign banks, the requirement for a robust domestic supervisory body, and the influence on the environment that

makes domestic banks competitive.³²⁷ The Ethiopian government has put in place measures such as limiting the amount of foreign bank staff, limiting the number of banks that can open, and assessing their effects in order to reduce these risks. Therefore, it is important to carefully consider the possible benefits and dangers of allowing foreign entrance into Ethiopia's banking industry and to make sure that the necessary laws are in place to maximize those benefits and avoid any potential damages.³²⁸

The National Bank of Ethiopia (NBE) plays a crucial role in enhancing its regulatory capacity to accommodate foreign banks. The entry of foreign banks can lead to a more competitive banking market, forcing domestic banks to improve efficiency and quality of service. The presence of international banks can introduce competition, which necessitates the NBE to strengthen its regulatory capacity to ensure a level playing field and maintain financial stability. Competition can also foster innovation, customer satisfaction, and financial inclusion.

Allowing foreign banks into Ethiopia could push the National Bank of Ethiopia (NBE) to improve its regulation of banks. This is because foreign banks would make the banking market more competitive, forcing Ethiopian banks to be more efficient and provide better service. This is similar to what research on foreign banking has found in other countries.³²⁹

Foreign banks can bring international expertise, technological knowledge, and quality banking services to domestic banks, contributing to their profit efficiency. The NBE can learn from the risk management practices, corporate governance standards, and regulatory compliance

³²⁷ Getachew (n 228).

³²⁸ *ibid.*

³²⁹ Clarke and others (n 247).

frameworks employed by foreign banks, improving its own capacity in these areas. The NBE faces challenges in regulating foreign bank branches due to the lack of effective supervision of key prudential requirements. Mitigating these risks requires the establishment of Memoranda of Understanding (MoUs) with host countries and finding solutions to enhance supervision.

The establishment of subsidiary banks allows foreign banks to provide specialized services, technology, and attract foreign investment. Implementing a share company structure can promote transparency, accountability, and better governance practices. Joint ventures and mergers and acquisitions between foreign and local banks are additional avenues for foreign expansion, but they present unique challenges that need to be carefully managed.

Opening Ethiopia's financial market to foreign banks brings opportunities and challenges. It may increase competition, potentially affecting local banks' market share. Cybersecurity measures need to be strengthened to protect against data breaches and cyber threats. Enhancing the regulatory framework, improving regulators' capacity, and ensuring local banks can compete and adapt are crucial for successful implementation.

4.2 Finding of the Study

The decision to open Ethiopia's banking sector to foreign banks is a significant policy shift that holds both opportunities and challenges. While it can bring benefits such as increased competition, improved services, and access to international expertise, it also poses risks to local banks and requires careful management. To ensure a successful transition, the Ethiopian government needs to focus on enhancing the regulatory framework, strengthening cybersecurity measures, and improving the capacity of regulators. It is important to strike a

balance between attracting foreign investment and safeguarding the interests of domestic banks and stakeholders. Based on the analysis, eight legal gaps are identified that need to be addressed in order to effectively regulate foreign banks in Ethiopia.

Firstly, the study identified a significant gap in regulating foreign banks in Ethiopia which is inadequate supervision of prudential requirements by the National Bank of Ethiopia (NBE). This gap challenges the effective monitoring of crucial prudential aspects, such as solvency and capital adequacy, particularly for foreign bank branches. Strengthening regulatory oversight is crucial to ensure compliance with these requirements and mitigate risks associated with volatile asset growth and responsiveness to home country conditions.

Secondly, the absence of specific regulations governing foreign branch banking in Ethiopia was highlighted by the study. This absence hampers the ability to address the unique risks and challenges posed by foreign bank branches. Establishing comprehensive regulations and guidelines covering areas such as risk management, corporate governance, and reporting requirements is imperative to ensure alignment with local regulations and uphold the best interests of the host country.

Thirdly, host authorities, including the NBE, face limitations in exerting adequate control over foreign bank branches, leading to weaker supervision and oversight. This deficiency could result in regulatory gaps and heightened risks for the host country's financial system. Enhancing the regulatory framework and empowering the NBE with greater authority over foreign branches is essential to address this issue effectively.

Furthermore, despite efforts by the NBE to mitigate risks associated with foreign bank branches through agreements such as memoranda of declaration and Memoranda of Understanding (MoUs) with foreign countries where the banks are coming, the absence of formal agreements and cooperation frameworks poses a challenge. Formalizing agreements between the NBE and host countries is crucial to facilitate effective supervision and coordination in managing the risks posed by foreign branches.

The study also revealed inconsistency in existing regulations concerning foreign ownership in banks, with unclear rationale behind regulations limiting foreign ownership in existing banks to a maximum of 30%. Addressing this gap requires clarification of foreign ownership regulations to ensure coherence and transparency in the banking sector.

Additionally, the government's policy does not explicitly address the joint venture (JV) model in the banking sector, as found in the study. Establishing clear guidelines and regulations to govern joint ventures, including provisions for conflict resolution and strategic direction, is necessary to provide clarity and facilitate the effective operation of such ventures.

Moreover, the study found that the process of mergers and acquisitions (M&As) between foreign and local banks lacks a comprehensive legal and regulatory framework. Establishing guidelines and frameworks tailored to M&A transactions in the banking sector is essential to facilitate smooth and transparent M&A processes, including addressing issues such as ownership limits, supervision, and oversight.

Lastly, the study identified limited coordination between regulatory bodies, particularly between the NBE and the Ministry of Trade and Regional Integration, posing a challenge in

regulating M&As in the banking sector. Establishing a working relationship and legal framework between these entities is crucial to ensure comprehensive guidelines and frameworks, enabling effective oversight and evaluation of M&A transactions.

Addressing these legal gaps would provide clarity, consistency, and a strong regulatory framework for foreign banks operating in Ethiopia. It would help create a level playing field, protect the interests of domestic banks, and ensure the stability and competitiveness of the banking sector.

4.3 Recommendations

Based on the identified legal gaps in regulating foreign banks in Ethiopia, the following recommendations are made:

First, the National Bank of Ethiopia (NBE) should enhance its regulatory oversight to ensure compliance with key prudential requirements, such as solvency and capital adequacy, for foreign bank branches. This can be achieved through regular on-site inspections, off-site surveillance, and the establishment of clear reporting mechanisms.

Then, specific regulations tailored to foreign branch banking are essential. The NBE needs to develop and implement guidelines covering areas such as risk management, corporate governance, and reporting requirements. These regulations should ensure alignment with local laws and safeguard the interests of the host country.

Next, strengthening the control exerted by host authorities, particularly the NBE, is crucial. This can be achieved through the development of clear protocols for information sharing, joint

inspections, and collaboration with home country regulators. Such measures ensure effective supervision and oversight of foreign branch operations.

Following that, establishing formal agreements with host countries is paramount. The NBE should prioritize the establishment of cooperative frameworks to manage risks associated with foreign branches. This includes signing memoranda of declaration and establishing Memoranda of Understanding (MoUs) to formalize regulatory relationships.

Then, the NBE must provide clarity and consistency in regulations regarding foreign ownership in banks. Addressing existing inconsistencies between wholly- or majority-owned subsidiary banks and restrictions on foreign ownership in existing banks is essential.

After that, clear guidelines and regulations should be established for joint ventures in the banking sector. This involves outlining provisions for conflict resolution and strategic direction to provide a framework for the establishment and operation of joint ventures involving foreign banks.

Next, a comprehensive legal and regulatory framework for mergers and acquisitions (M&As) in the banking sector is needed. This framework should address ownership limits, supervision, oversight, and establish clear approval processes for M&A transactions.

Finally, coordination between regulatory bodies, such as the NBE and the Ministry of Trade and Regional Integration, is vital. Establishing a working relationship and legal framework between these entities can lead to comprehensive guidelines and frameworks, ensuring effective oversight and evaluation of M&A transactions in the banking sector.

These recommendations are essential for addressing the identified legal gaps and ensuring the effective regulation of foreign banks in Ethiopia. By focusing on these areas, the Ethiopian government can work towards a successful transition that balances the benefits of foreign investment with the safeguarding of the interests of domestic banks and stakeholders.

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INTERVIEWS.

- ❖ Interviews with Ato Muluken Mihretu, Senior Legal Expert at National Bank of Ethiopia. On 13 April 2023
- ❖ Interviews with Ato Efrem Baraki, Senior Legal Expert II and Acting Chief Legal Expert at National bank of Ethiopia on 16 may 2023
- ❖ Interviews with Ato Sintayehu Desalegn, Director of Preserve Policy and Financial Analysis, at National Bank of Ethiopia on 17 may 2023
- ❖ Interviews with Ato Dulla Merera, Director of Legal Department at Abyssinia Bank Main Branch on 27 June 2023
- ❖ Interviews with Ato Takele Arega, Director of Legal Service at Awash International Bank Main Branch, on 22 June 20023

ANNEXES



HAWASSA UNIVERSITY SCHOOL OF LAW

DEPARTMENT OF COMMERCIAL LAW

Dear interview participant

The purpose of this interview is to gather valuable insights that will aid in the evaluation of "Foreign Bank Entry in Ethiopian Banking Sector: Analysis of the Challenges and Prospects of the Regulatory Legal Regime" exclusively. This research endeavor is being pursued as a partial requirement for the fulfillment of my Master's Degree in Commercial Law. I am conducting this interview in order to acquire a portion of the necessary data for my LLM. Throughout the course of the interview, I will attentively listen to your answers and transcribe them using both written notes and a voice recorder. These transcriptions will be utilized to derive certain conclusions in a collective manner, devoid of any mention of your personal identity. Hence, your name or any form of identification will not be included in any of the research's outcomes. I would also like to emphasize that your participation in this interview is entirely voluntary, and you retain the option to withdraw at any point during or after the interview.

Best regard, Mirchawork Habtamu

Annex 1

I. Interview guides prepared for the selected National Bank supervisors and Experts

Personal details of respondent

Name of the respondent (if he or she consented) _____

Position of the respondent _____

Organization of the respondent _____

Type of Study: Master Thesis in law (LL.M Thesis)

Title: Regulatory Framework for Foreign Entry in Ethiopia: Challenges and Prospects

Objective of this study. To gather valuable insights that will aid in the evaluation of "Foreign Bank Entry in Ethiopian Banking Sector: Analysis of the Challenges and Prospects of the Regulatory Legal Regime" exclusively. so you are kindly requested to respond to the interviews as your information will be helpful for effective accomplishment of the study and as it will be kept confidential and analyzed anonymously unless for the discloser of your identity and personal views.

Thank you in advance for your co-operation

1 .DO foreign Bank entry into the Ethiopian banking sector as a transforming economy beneficial or harmful from the global view of financial markets operation in the Ethiopian Economy?

2. Have you ever adopted developed nation experience regarding legal and Regulatory systems about Foreign Banks' entry to Ethiopia?

3. Does foreign banks' entry improve bank supervision through regulatory spillover? And do you think if foreign banks enter the country, will the NBE be able to regulate and supervise foreign banks effectively?

4. What will be the challenges of regulatory bodies while permitting foreign bank entry in terms of regulation?

5. Is the current Regulatory framework of the Banking System and NBE staff professionalism in Bank Regulation fit to Regulate Multinational Banks?

6. What modalities gap is observed among draft regulations and policies for foreign banks' entry into Ethiopia that needs caution from policymakers?

7. What do you think of the entry mode of a foreign bank in Ethiopia with branching?

For example, Branching is less common as a form of entry in countries with highly risky macroeconomic environments, where parent banks seem to prefer the shield of "hard" limited liability. This might be the reason why most African countries do not allow branches of foreign banks. According to data from the World Bank Banking Regulation and Supervision Database (2012) and the Regulatory Framework Database (AfDB 2010), only 10 out of 48 countries practically allow foreign bank presence through branching. What is more, entry through branching is most common in the countries with some of the most developed financial sectors, such as South Africa, Mauritius, and Seychelles. So, do you think that permitting foreign bank presence through branch opening be a wise policy from a Regulatory point of view?

8. Does Ethiopia have an Adequate Legal and Regulatory Framework for the Merger of Banks? Hence merger and acquisition of banks are one mode of the foreign bank of entry. Concerning M&A, the role of Minister trade and regional integration body is, however, marked lack of experience in evaluating M&A in the financial sector. So, do you think that NBE needs to create the necessary working relationships with this entity to smoothen future M&A in the banking sector.?

9. From a financial stability point of view and regulatory simplicity, which entry options do you think are better for Ethiopia?

Annex-II

I. Interview guides prepared for Awash Bank supervisors and Experts

Personal details of respondent

Name of the respondent (if he or she consented) _____

Organization of the respondent _____

Type of Study: Master Thesis in law (LL.M Thesis)

Title: Regulatory Framework for Foreign Entry in Ethiopia: Challenges and Prospects

Objective of this study. To gather valuable insights that will aid in the evaluation of "Foreign Bank Entry in Ethiopian Banking Sector: Analysis of the Challenges and Prospects of the Regulatory Legal Regime" exclusively. so you are kindly requested to respond to the interviews as your information will be helpful for effective accomplishment of the study and as it will be kept confidential and analyzed anonymously unless for the discloser of your identity and personal views.

Thank you in advance for your co-operation

Guiding questions for Abyssinia Bank legal Experts

1. DO foreign Bank entry into the Ethiopian banking sector as a transforming economy beneficial or harmful from the global view of financial markets operation in the Ethiopian Economy?
2. Does foreign banks' entry improve bank supervision through regulatory spillover? And do you think if foreign banks enter the country, will the NBE able to regulate and supervise foreign banks effectively?
3. What will be the challenges of regulatory bodies while permitting foreign bank entry in terms of regulation?
4. Is the current Regulatory framework of the Banking System and NBE staff professionalism in Bank Regulation fit to Regulate Multinational Banks?
5. Does Ethiopia have an Adequate Legal and Regulatory Framework for the Merger of Banks? Hence merger and acquisition of banks are one mode of the foreign bank of entry. Concerning M&A, the role of Minister trade and regional integration body is, however, marked lack of experience in evaluating M&A in the financial sector. So, do you think that NBE needs to create the necessary working relationships with this entity to smoothen future M&A in the banking sector.?

Annex-III

I. Interview guides prepared for Abyssinia Bank legal Experts

Personal details of respondent

Name of the respondent (if he or she consented) _____

Organization of the respondent _____

Type of Study: Master Thesis in law (LL.M Thesis)

Title: Regulatory Framework for Foreign Entry in Ethiopia: Challenges and Prospects

Objective of this study. To gather valuable insights that will aid in the evaluation of "Foreign Bank Entry in Ethiopian Banking Sector: Analysis of the Challenges and Prospects of the Regulatory Legal Regime" exclusively. so you are kindly requested to respond to the interviews as your information will be helpful for effective accomplishment of the study and as it will be kept confidential and analyzed anonymously unless for the discloser of your identity and personal views.

Thank you in advance for your co-operation

Guiding questions for Abyssinia Bank legal Experts

1. DO foreign Bank entry into the Ethiopian banking sector as a transforming economy beneficial or harmful from the global view of financial markets operation in the Ethiopian Economy?
2. Does foreign banks' entry improve bank supervision through regulatory spillover? And do you think if foreign banks enter the country, will the NBE able to regulate and supervise foreign banks effectively?
3. What will be the challenges of regulatory bodies while permitting foreign bank entry in terms of regulation?
4. Is the current Regulatory framework of the Banking System and NBE staff professionalism in Bank Regulation fit to Regulate Multinational Banks?
5. Does Ethiopia have an Adequate Legal and Regulatory Framework for the Merger of Banks? Hence merger and acquisition of banks are one mode of the foreign bank of entry. Concerning M&A, the role of Minister trade and regional integration body is, however, marked lack of experience in evaluating M&A in the financial sector. So, do you think that NBE needs to create the necessary working relationships with this entity to smoothen future M&A in the banking sector.?