SCHOOL OF GRADUATE STUDIES

BY TSION GETACHEW

FACTORS AFFECTING THE TRANSFORMATION OF MICROFINANCE INSTITUTIONS INTO COMMERCIAL BANKS IN ETHIOPIA; IN THE CASE OF TSEDEY BANK

A THESIS SUBMITTED TO THE SCHOOL OF GRADUATE STUDIES IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE MSC IN ACCOUNTING AND FINANCE

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DECLARATION

I, Tsion Getachew, hereby declare that the work being presented in this thesis entitled: **Factors Affecting the Transformation of MFIs into Commercial Banks in Ethiopia; in the Case of TSEDEY BANK** is my original work, prepared under the guidance of St. Mary's University. All sources of material used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree.

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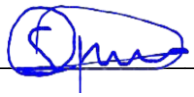
ENDORSEMENT

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



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ST. MARY'S UNIVERSITY

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List of Acronyms and Abbreviations

ACSI- Amhara Credit and Savings Institution

ETB – Ethiopian Birr

AEMFI -Association of Ethiopian Microfinance Institutions

MFI – Microfinance institutions

NBE – National Bank Of Ethiopia

SPSS – statistical package for the social sciences

Abstract

This study aimed to investigate factors affecting the transformation of microfinance institutions into commercial banks; in the case of tsedey bank taking large MFIs in Ethiopia. The study was conducted using an explanatory research design to attain this study. The study employs a mixed-methods approach, combining qualitative and quantitative data collection methods to gather and estimate primary and secondary data sources. Semi-structured interviews with MFI directors and interpreters will give in-depth insights into the motives behind the transformation. For the study, a comprehensive analysis of financial data from among the 46 registered MFIs that were presently members of AEMFI selected AMHARA CREADIT AND SAVING MFIs transforming would conducted to assess the economic implications of the shift. The identified factors influencing the transformation process would categorized into internal and external factors By assaying these factors, the study aims to give a holistic understanding of the challenges and opportunities associated with the transformation. The findings of this research would contribute to the existing literature on microfinance and banking transformations, particularly in the environment of developing economies. Likewise, the study's recommendations may help policymakers, regulatory bodies, and industry practitioners formulate strategies that facilitate a smooth and successful transition for MFIs into commercial banks, ensuring sustainable financial inclusion and economic development in Ethiopia.

Keywords: *Transformation, Microfinance institution, human resource, inflation rate, exchange rate, market demand, and competition.*

Chapter one

Introduction

1.1 Background of the study

Microfinance is the most visible anti-poverty intervention of the last 25 years. It has successfully delivered financial services to the poor, reaching over 150 million clients (mostly women), often in countries where little else works. (Armendáriz, The economics of microfinance., 2010) MFIs offer a range of financial services, including microcredit (small loans), savings accounts, insurance, and payment services. These services are tailored to meet the needs of clients who are typically excluded from formal banking due to their low income, lack of collateral, or limited credit history. Microfinance institutions play a crucial role in providing financial services to the unbanked population, especially in developing countries like Ethiopia. Over the years, there has been a significant push toward transforming microfinance institutions into formal banking entities to enhance financial inclusion, promote economic growth, and improve the overall financial landscape in the country. The financial landscape in Ethiopia is undergoing significant transformations, with microfinance institutions (MFIs) emerging as key players in the provision of financial services to underserved populations. In recent times, a notable trend has emerged, pointing towards the transformation of these MFIs into full-fledged commercial banks. This shift raises critical questions about the factors influencing such transformations and the broader implications for the Ethiopian financial sector.

One of those MFIs into full-fledged commercial banks is TSEDEY BANK.TSEDEY Bank, previously known as Amhara Credit and Savings Institution (ACSI), has officially begun operations September 24, 2022. In doing so, the bank has upgraded its status from a microfinance institution (MFI) to being the first newly launched Ethiopian bank in 2015 E.C (2022-23 G.C fiscal year). A total of 148 branches were simultaneously opened in Addis Ababa and the Amhara region during the day.

The history of the bank dates back to 1996 according to Gashaw Workneh, the Chief Corporate Property Manager of the Bank. Initially established as a “Rural Credit Service” with only ETB3 million to its name, the institution was elevated to an MFI– Amhara Credit & Savings Institute (ACSI)– a year later in 10 zones of the Amhara region. In its 20 years of operation, it managed to become Africa’s top and the world’s 6th-best credit and savings institute.

TSEDEY Bank, upon its inauguration, registered one of the highest capital recorded among new banks, with net capital and signed-up capital reaching ETB11.3 and ETB7.75 billion, respectively. As per the article by Ethiopians Today, Tsedey has a total asset of more than ETB40 billion, ETB24 billion of total savings, and has disbursed an aggregate of ETB28.8 billion in loans.

However, the establishment of Tsedey Bank comes at a time of vigorous competition. The number of local banks increased from 18 to 30, adding one bank every month, on average. These include Goh Betoch, Amhara, Ahadu, and Tsehay Banks, in that particular order. The number is just so because an additional 13 banks in the pipeline failed, as they could not meet even the ETB500 million minimum paid-up capital, which was raised to ETB5 billion a few months back.

The upsurge followed the NBE's new banking proclamation, which permitted the establishment of interest-free banks and the transformation of MFIs into banks. Furthermore, it is worth noting that the Ethiopian government recently deregulated the banking sector, allowing foreign investors to enter the market.

Understanding this nature and trend of the sector, Tsedey hopes to arm itself with up-to-date and sophisticated technology. the bank installed an ETB270 million data center in Bahir Dar, a northern region in Ethiopia. The information center, being one of high capacity, complexity, and longevity, had required the staff to undergo the required training to ensure the hub is run smoothly and efficiently. The firm considered the move a necessity rather than one made out of luxury. At the launching event, Tsedey Bank's CEO, Mekonnen Yelewemwessen duly noted, "Besides capital, valuable and meaningful technology is imperative to survive and thrive in the banking industry."

Ethiopia, a country marked by diverse economic activities and a growing population, has witnessed a surge in the importance of microfinance institutions in fostering financial inclusion. These institutions, originally established to address the financial needs of the unbanked and under-banked, are now at a juncture where they consider evolving into commercial banks.(tsedeybank -sc.com)

The financial landscape in Ethiopia has been undergoing significant transformations, with the evolution of microfinance institutions (MFIs) playing a crucial role in the broader economic development strategy. Microfinance has traditionally been a key driver of financial inclusion, targeting underserved and economically vulnerable populations. However, there has been a noticeable trend of MFIs transitioning into commercial banks in Ethiopia in recent years.

This shift is influenced by various factors stemming from both internal and external sources. Internally, MFIs may seek to expand their service offerings, increase their outreach, and enhance their financial sustainability by transforming into commercial banks. The potential benefits of this transformation include increased access to capital, improved operational efficiency, and the ability to engage in a broader range of financial activities.

Externally, regulatory changes, market dynamics, and economic conditions play a pivotal role in shaping the decision of MFIs to transform into commercial banks. The Ethiopian government's policies, regulatory frameworks, and the overall economic environment contribute to the opportunities and challenges faced by financial institutions undergoing this transformation.

Given the dynamic nature of these factors, it becomes imperative to explore and understand the various elements influencing the transformation of MFIs into commercial banks in Ethiopia. This study aims to provide a comprehensive analysis of these factors to contribute valuable insights to policymakers, regulatory bodies, and industry practitioners.

As the financial sector in Ethiopia strives for greater inclusivity and stability, examining the motivations, challenges, and outcomes of the transformation of MFIs into commercial banks becomes essential. This research will shed light on the implications for financial inclusion, economic development, and the overall sustainability of the financial sector in Ethiopia.

1.2 Statement of the Problem:

Several factors drive the decision of MFIs to transform into formal banking institutions. One of the primary reasons is the need to access additional funding sources to support their growing operations. By becoming regulated banks, MFIs can attract deposits from the public, access capital markets, and forge partnerships with other financial institutions (Smith, 2020; Johnson & Brown, 2018; Davis, 2019)."

Furthermore, the transformation allows MFIs to offer a broader range of financial products and services, including insurance, investment products, and remittances. This expansion of services enables them to cater to the diverse needs of their clients and compete more effectively in the financial market.

The transformation of MFIs into formal banks presents both opportunities and challenges. On the one hand, becoming a regulated bank enhances the credibility and reputation of an institution, attracting a larger customer base and fostering trust among depositors. It also enables MFIs to leverage technology and data analytics to improve operational efficiency and risk management.

However, the transition process is not without its challenges. Hishigsuren (2006) discovered from the research that transforming MFIs experience challenges before, during, and after the transformation. the study generated knowledge on challenges faced by MFIs that had successfully transformed. The transformation of Amhara credit and saving microfinance institutions (MFIs) into Tsedey banks in Ethiopia is influenced by several factors. Still, in the previous research paper, some significant factors are not explicitly mentioned but could potentially influence the transformation of MFIs into commercial banks. These are market demand and competition, economic conditions, and well-trained human resources. This study hence seeks to fill the existing gap in the literature by researching large MFIs that have head offices in Addis Ababa, Ethiopia. Toward these goals, the study sought to investigate the factors impacting the transformation of MFIs into commercial banks in the case of Tsedey Bank.

1.3 Research question

Here are some relevant study questions for the title "Factors Impacting Transformation of Microfinance Institutions into Commercial Banks in Ethiopia":

1. What competitive strategies and market demand for financial services beyond microfinance affect the transformation process of MFIs into commercial banks in Ethiopia?
2. How do inflation rates influence the success of MFIs transitioning into commercial banks?
3. How do currency fluctuations influence the success of MFIs transitioning into commercial banks?
4. What is the factor of human resources on MFI's transformation into a commercial bank in Ethiopia?

1.4 Objectives of the study

1.4.1 General objectives

The study's general objective was to analyze the factors impacting the transformation of Microfinance institutions into commercial banks in Ethiopia.

1.4.2 Specific objective

Here are specific areas that the study could address:

1. To evaluate competitive strategies and market demand for financial services beyond microfinance on the transformation process of Microfinance Institutions (MFIs) into commercial banks in Ethiopia.
2. To assess how inflation rates influence the success of Microfinance Institutions (MFIs) transitioning into commercial banks in Ethiopia
3. To assess how currency fluctuations influence the success of Microfinance Institutions (MFIs) transitioning into commercial banks in Ethiopia.
4. To find out the factor of human resources on MFIs' transformation into commercial banks in Ethiopia.

1.5 The hypothesis of the study

In this study, They are formulated to be tested through data collection and analysis to determine if there is enough evidence to support the proposed relationship. the hypotheses are structured to investigate the impact of various factors on the transformation of Microfinance Institutions (MFIs) into commercial banks in Ethiopia. As a result, one dependent variable against four independent variables was constructed which influenced the transformation of an MFI into a commercial bank. the dependent variable is the transformation of MFIs into commercial banks, whereas market demand and competition, inflation rates, currency fluctuation, and human resources are the key predictors.

Based on the specific objective I provided earlier, here is the hypothesis for my study.

1. H1: Competitive strategies and increased market demand for financial services beyond microfinance positively affect the transformation process of MFIs into commercial banks in Ethiopia.
2. H1: Higher inflation rates negatively influence the success of MFIs transitioning into commercial banks in Ethiopia.
3. H1: Greater currency fluctuations negatively influence the success of MFIs transitioning into commercial banks in Ethiopia.
4. H1: Effective human resource management positively influences the transformation of MFIs into commercial banks in Ethiopia.

1.6 Significance of the study

The study's significance lies in its potential to drive positive change, promote inclusive growth, and enhance the resilience and competitiveness of the financial sector in Ethiopia and beyond. This research holds significance for various stakeholders, including policymakers, regulators, microfinance institutions, and investors, who contribute to economic development and the broader community. The findings are anticipated to inform strategic decisions, and policy formulations, and contribute valuable insights to the ongoing discourse on transforming microfinance institutions into commercial banks in Ethiopia.

1.7 Scope of the study

The study will specifically examine the Ethiopian context, considering the country's unique economic, political, market demand, and competition, that influences the transformation process. The study used an explanatory research design and a mixed research approach technique to investigate the critical factors influencing the transformation of microfinance institutions into commercial banks in EthiopiaThe sample size for this study was determined by their high total capital, efficient management system, productivity, and service reach. The decision for microfinance institutions to transform into commercial banks is a consequential one, with implications for the institutions themselves, the financial sector, and the broader economy. As Ethiopia strives for sustainable economic development, it becomes imperative to scrutinize the factors influencing this transformation to ensure that it aligns with the nation's goals and contributes to financial sector stability.

1.8 Limitation of the Study

The main objective of the study was to examine the factors that affect the transformation of MFIs. The transformation of MFI indicators selected for the study was limited to internal and external factors. The research will be carried out in the top 4 big MFIs, which were chosen among the 46 registered MFIs that were currently members of AEMFI and provided microfinance services in the areas of credit distribution, savings, money transfer, and pension payment but based on my specific objective among selected four MFIs only one MFIs to fulfill the objective is TSEDEY bank. The study might have been conducted with a limited number of MFIs and commercial banks and the findings are based on a specific period. Economic and technological changes over time could influence the transformation process differently.

1.9 Organization of the Paper

The paper was organized into five chapters in which the details of the study were stated. Chapter one deals with the introduction part in which the background of the study, statement of the problem, objective of the study, the significance of the study, limitation of the study, and scope of the study were discussed. Chapter Two introduced the review of literature in which both theoretical as well as empirical studies related to the paper were reviewed. Chapter three deals with the issue of research methodology in which research design, research approach, sample design, sampling technique, sources of data and collection methods, and data analysis and

presentation methods were described. Chapter four discusses data analysis and discussion in which the data that was collected from various sources with different data collection techniques was analyzed and discussed. Finally, chapter five deals with the research summary, conclusion, and suggestions in which the summary, the conclusion reached, and recommendations suggested were discussed.

2 Chapter two

Literature review

2.1 Overview of Microfinance Institutions in Ethiopia

Since the 1970s, many non-governmental organizations (NGOs), such as World Vision, Save the Children, Christian Children's Fund, and Care, have directly provided credit services to their organizational and project beneficiaries. Even though these loans' size, terms, and conditions differ, the majority charge very low interest rates. Loans are usually in default, with a significant proportion overdue, meaning some MFIs report a poor credit portfolio. After a series of consultations between 1992 and 1995 involving concerned government bodies and NGOs, it was agreed to establish a specialized institution – governed by a board of trustees – that would handle the financial interventions of NGOs. The Ethiopian government issued its first microfinance legislation in 1996 (proclamation 40/1996) to provide microfinance services to the poor by deposit-taking MFIs. The main objectives of these institutions are to deliver loans, micro saving, micro insurance, money transfers, and leasing to the large excluded population in the country cost-effectively and sustainably. At the end of the day, the intervention of MFIs in the country should contribute to a positive and measurable impact on the well-being of millions of households. Before the specialized institution could be established, proclamation 40/1996 prohibited other forms of organizations to provide similar financial services to the newly regulated MFIs. Proclamation 40/1996 allowed for the establishment of deposit-taking MFIs and supported the development of the microfinance sector for the subsequent decade. The microfinance sector has, as such, experienced a notable change from humanitarian-oriented organizations (e.g. NGOs) to specialized MFIs targeting financial sustainability and outreach.

Ethiopia, a country in the Horn of Africa, has a significant population that lacks access to formal financial services. MFIs have emerged as key players in bridging this gap by providing financial products such as microloans, savings accounts, and insurance to low-income individuals and small businesses. These services are vital for promoting financial inclusion, poverty reduction, and economic development in the country. Currently, there are 45 MFIs in Ethiopia, excluding the four that transitioned into full-fledged banks – Sinqee, Shebelle, Sidama, and Tsedey. Omo MFI will be the fifth MFI to graduate into a bank. According to the National Bank of Ethiopia

(NBE), the number of microfinance institutions (MFIs) that have successfully transformed into banks stands at 37 as of the third quarter of the 2021/22 fiscal year. This decline in the number of MFIs occurred following the transition of three MFIs Oromia Credit and Savings Institution, Amhara Credit and Savings Institution, and Somali Microfinance Institution into banks. These former MFIs, now operating as Siinqee, Tsedey, and Shabelle banks, had significant contributions in the sector, of microfinance that has been fully converted into commercial banks, I have chosen for this study Amhara Credit And Saving Institution is known as TSEDEY Bank.

2.2 The Impact of Economic Factors on MFI Transformation

Microfinance institutions (MFIs) are crucial in providing financial services to low-income individuals and underserved communities, often in developing economies. As these institutions grow and evolve, many consider transitioning into commercial banks to expand their services and reach a wider customer base. However, this transition is heavily influenced by various economic factors, among which inflation and exchange rates are particularly significant. These factors can significantly impact the operations, sustainability, and outreach of MFIs, ultimately shaping their ability to fulfill their social mission. This paper explores the impact of inflation and exchange rates on the transformation of MFIs, considering the various perspectives and implications associated with these economic factors.

2.2.1 Inflation and MFI Transformation

It is generally accepted that highly volatile inflation is potentially harmful to the general economy. However, given this consensus, it is quite surprising that many countries, especially those in Africa and Latin America, have experienced high and volatile inflation. Nevertheless, most developed countries have maintained low and stable inflation rates.

In 1974, a popular revolution toppled the imperial regime and brought the Derg to power. Derg's economics was characterized by a socialist ideology that subjugated market forces and systematically socialized production and distribution. Moreover, a strong dependence on agriculture, subject to the vagaries of nature, led to an irregular growth rate (Alemayehu, 2003a). Furthermore, it was also marked by intense conflict, which aggravated the dismal economic performance of the Derg regime. The monetary authorities directly regulated the financial variables in Ethiopia during the command era. Since the Derg regime, Ethiopia’s inflation rate has been low due to the government’s control over prices and provision of fixed-price goods.

Another factor that has helped lower inflation rates is the lower and fixed exchange rate. From 2006 to 2015, Ethiopia had an average inflation rate of 18.69 percent.

Following the downfall of the Derg regime and the rise of the Ethiopian People's Revolutionary Democratic Front to power in Ethiopia, the focus shifted from direct command over monetary variables to market-based policy instruments, as the government left economic policy to the private sector (Chewaka, Citation2014). This in turn gave rise to price fluctuations in the economy. During war and drought, general prices rose dramatically. In the Imperial era, the military regime, and the first decade following Derg's death, the consumer price index increased by an average of 3.5, 8.8, and 5.3 percent per year, respectively.

Following the change in the government's monetary and fiscal policy and the government's activism in the economy, inflation began to threaten the economy in the post-2002/03 period (Tafere, Citation2008). Until 2003, Ethiopia had an inflation rate in the single digits, except in years of supply shocks and war. As an example, between 1971 and 2003, inflation averaged 7.5%. During this time, the highest inflation rate of 45% occurred in 1991, the first year the Ethiopian People's Revolutionary Democratic Front came to power after the end of the civil war. Nonetheless, between 2004 and 2014, inflation rates increased rapidly and the average inflation rate in this period reached 17.7% with the highest rate of 39.5% registered in 2008. Accordingly, the highest inflation episodes occurred in 1984/85 and 2003 as a result of drought, and in 1991/92 as a result of war (Loening et al., Citation2009).

Compared to a year earlier, headline inflation increased to 19.9 percent in 2019/20 (NBE, Citation2019). As a result of their study, Getachew and Meaza (Citation2018) have determined the optimal level of inflation in Ethiopia that affects economic growth most positively. In this study, thresholds were applied. For Ethiopia, a rate of inflation of about 9%-10% is optimal. Economic growth may not be possible if inflation is higher or lower than the threshold level. Recently, double-digit inflation has become worrisome for policymakers and society alike, even though Ethiopia has experienced a low inflation rate and good economic performance. In March 2022, Ethiopia's annual inflation rate increased to 34.7%, up from 33.6% the previous month. A temporary price cap for food items and a three-month ban on rent increases by landlords were recently implemented to control inflationary pressures, but the reading was the highest since December last year. Both food prices (43.4% vs 41.8% in

February) and non-food items (23.5% vs 22.9%) were up. Consumer prices inched up 4% every month, the most significant jump in six months (CSA, Citation2022).

Inflation rates are one of the primary economic factors that significantly impact the feasibility and success of MFIs transitioning into commercial banks. inflation can erode the value of a country's currency, leading to higher costs of goods and services. Inflation, defined as the sustained increase in the general price level of goods and services in an economy, substantially impacts MFI transformation. High inflation rates can affect clients' purchasing power, reducing savings, increasing loan defaults, and heightened financial vulnerability. Banks need loan classification systems to monitor and manage the credit risk inherent in their loan portfolio (Adhikary, Bishnu Kumar,2003). In some countries, banking supervisors have introduced standardized requirements for classifying loans into specified categories based on the loans' credit quality. These classifications in turn are also used to quantify provisioning requirements. The NBE " Directive No SBB/69/2018 asset classification and provisioning 5th replacement" laid down the framework for the loan classification system for all banks operating in the Ethiopian banking industry. The directive is applied to all banks irrespective of their ownership and purpose of establishment (i.e. development and commercial banks as well as government and private banks). The NBE's guideline utilized a 5-grade (pass, special mention, substandard, doubtful, and loss) loan classification framework to classify loan accounts.

Pass; loan or advances in this category are fully protected by the current financial and playing capacity of the borrower and are not subject to criticism, special mention; loan or advance with pre-established repayment programs past due 30days-90day, n substandard; 90days-180 days, doubtful; 180days -360 days, loss; after one year.

In addition, it highly relied on delinquencies (measured as the number of days or months of loan repayment that are past due) as the main benchmark to classify loans. Thus, loans with pre-established repayment programs are classified as non-performing loans when principal and/or interest is unpaid for 90 days or more. In addition, loans without repayment terms when the account remains outstanding, exceeds its limit, interest due uncollectible, and inactive for 90 consecutive days or more. In response to inflation, MFIs may face challenges in maintaining the real value of loan portfolios and deposits, which can erode their financial viability. Inflation can have several effects on the transformation of Microfinance Institutions (MFIs) into commercial

banks in Ethiopia, particularly concerning their operations and customer base. Inflationary pressures often lead to higher interest rates. As MFIs transition into commercial banks, they may face increased costs of borrowing from the central bank or other financial institutions. This can result in higher interest rates on loans offered to customers. Consequently, borrowers may be less inclined to take out loans due to the higher cost of borrowing, potentially affecting the customer base of the newly transformed commercial bank. Inflation can impact the behavior of savers and depositors. High inflation erodes the purchasing power of money over time. Customers may be less motivated to keep their savings in traditional deposit accounts if the interest rates offered by the bank do not keep pace with inflation.NBE " banking risk management guidelines" have implemented stringent measures to curb the growth of lending by commercial banks and address persistently high inflation. As of August 11, 2023, the yearly credit expansion by banks is restricted to 14% This can lead to a shift in customer preferences, affecting the composition of the bank's deposit base. Inflation can affect borrowers' ability to repay loans. If inflation outpaces income growth, borrowers may face challenges in servicing their debts, leading to potential defaults or delays in loan repayments. This can impact the asset quality of the commercial bank, influencing its risk management practices and overall financial health. Inflation can also affect the operational costs of commercial banks. Higher inflation may lead to increased costs of goods and services, including salaries, rent, utilities, and technology expenses. Commercial banks may need to adjust their fee structures or pricing strategies to account for these higher costs, which can impact customer relationships and retention.

Furthermore, inflation can influence the cost of funds for MFIs, affecting their ability to raise capital and manage liquidity effectively. Inflation, as a sustained increase in the general price level of goods and services, can have far-reaching implications for MFIs. One of the primary concerns is the erosion of the purchasing power of both the institution and its clients. As inflation diminishes the value of money, it becomes more challenging for MFIs to maintain operational sustainability and provide affordable financial services to their target clientele. Moreover, inflation can lead to higher borrowing costs for MFIs, affecting their ability to access capital and expand their outreach. inflation can influence the decision-making process for MFIs considering transformation into commercial banks. However, high or unpredictable inflation rates can undermine the stability and effectiveness of MFIs, necessitating strategic adaptation and risk management. Nawaz et al. (Citation2017) determined that the money supply, government

expenditure, government revenues, and foreign direct investment positively impact inflation within Pakistan.

2.2.2 Exchange Rate Dynamics and MFI Transformation

The exchange rate, which represents the value of one currency in terms of another, is another critical economic factor that impacts MFI transformation, particularly in countries with significant exposure to foreign currency fluctuations. As cited by Fentahun (2011) from Pilbeam (1998), the exchange rate can be expressed in two ways. These are domestic currency per unit of foreign currency and foreign currency units in terms of domestic currency. Fluctuations in exchange rates can affect the financial performance of MFIs that have foreign currency-denominated borrowings or investments.

Foreign Currency Reserves: Commercial banks typically need to hold reserves in foreign currencies as part of regulatory requirements or to facilitate international transactions. Exchange rate fluctuations can impact these reserves' valuation, affecting the institution's capital adequacy. A depreciation of the local currency can reduce the value of foreign currency reserves in terms of the local currency, potentially impacting the bank's ability to meet capital adequacy ratios. Exchange rate movements can affect the operational cost that is import cost MFIs transforming into commercial banks may need to upgrade their technology and infrastructure, often sourcing equipment and services from abroad. A weaker local currency increases the cost of these imports, impacting the bank’s operational budget and potentially slowing down the transformation process. Additionally, exchange rate volatility can influence the ability of MFIs to attract foreign funding as MFIs transition to commercial banks, they may seek funding from international sources. Exchange rate volatility can impact the cost of these funds. For example, if an MFI borrows in US dollars but operates in a country where the local currency depreciates against the dollar, repaying the debt becomes more expensive in local currency terms, affecting the institution’s profitability and financial stability and if MFIs provide loans in foreign currencies, exchange rate changes can affect borrowers' ability to repay.

For instance, if borrowers' income is in local currency and the local currency depreciates, their debt burden in local currency terms increases, raising the risk of defaults and impacting the MFI's loan portfolio quality. For MFIs serving clients engaged in cross-border trade or remittances, repayment capacity and operational stability. Exchange rate fluctuations can

significantly impact the transformation of MFIs, particularly in economies with a high reliance on foreign currency. A depreciating domestic currency can increase the cost of servicing foreign currency-denominated debt for MFIs, potentially straining their financial position. This, in turn, may affect the availability and affordability of financial services for clients, especially in regions heavily exposed to exchange rate risk. Additionally, in economies with a significant inflow of remittances, exchange rate dynamics can influence the disposable income of MFI clients, thereby affecting their repayment capacity and overall financial behavior.

2.3 The impact of market demand and competition on MFI transformation

Market demand and competition play a crucial role in transforming Microfinance Institutions (MFIs) as they navigate the evolving financial landscape. Understanding market demand dynamics and competition dynamics is essential for MFIs to serve their clients and achieve sustainable growth effectively.

In the context of MFI transformation, understanding market demand involves conducting comprehensive market research to identify the financial needs and preferences of the target client base. This process encompasses analyzing demographic trends, income levels, and the demand for various financial products and services. By gaining insights into the specific requirements of their clients, MFIs can tailor their offerings to address the demand for accessible and suitable financial solutions effectively. An in-depth understanding of market demand enables MFIs to develop innovative financial products and services aligned with their client's evolving needs. This may involve offering tailored loan products, savings accounts, insurance, and other relevant financial instruments that cater to the diverse requirements of different customer segments. By continuously innovating and adapting their product portfolio, MFIs can enhance their competitiveness and relevance in the market while fostering financial inclusion. Tseday Bank is sure to face strong competition from the already existing private banks in the country in addition to foreign banks poised to enter, and potentially dominate, the banking industry. Mr. Gashaw remarked that the bank will continue providing quality service and strengthen its international competitiveness by introducing new systems. By prioritizing market demand, MFIs can adopt a customer-centric approach, ensuring that their operations are aligned with the preferences and requirements of their clients. This may involve enhancing the accessibility of financial services through digital channels, simplifying the application and approval processes, and providing

financial literacy programs to empower clients. Understanding market demand allows MFIs to build stronger relationships with their clients and foster trust, thereby driving customer retention and loyalty.

Rapid advancements in technology have significantly transformed the way financial services are delivered and accessed. The rise of digital banking, mobile payments, robo-advisors, and blockchain technology has reshaped consumer expectations and preferences, leading to a shift in the demand for convenient, accessible, and secure financial services.

Microfinance institutions (MFIs) play a crucial role in providing financial services to unbanked and underserved populations, particularly in developing countries. Over the years, the landscape of MFIs has evolved significantly, driven by various factors such as market demand and competition. This paper aims to explore the impact of market demand and competition on the transformation of MFIs

Market demand refers to the desire for a particular financial product or service within a specific market segment. In the context of MFIs, market demand encompasses the need for accessible and affordable financial services such as microloans, savings accounts, insurance, and remittances among low-income individuals, small business owners, and rural communities. Market demand plays a crucial role in shaping the transformation of Microfinance Institutions (MFIs) around the world. As the financial landscape evolves and customer needs change, MFIs must adapt to these shifts in demand to remain relevant and sustainable. The intersection of market demand and MFI transformation has far-reaching implications for financial inclusion, economic development, and poverty alleviation. The impact of market demand on Microfinance Institution (MFI) transformation refers to the influence that the changing needs and preferences of clients have on the evolution and adaptation of MFIs. Microfinance institutions are specialized financial institutions that provide financial services, such as loans, savings, and insurance, to low-income individuals and communities, often excluded from traditional banking services. The transformation of MFIs is influenced by various factors, including market demand, which plays a crucial role in shaping the products, services, and operations of these institutions.

One of the primary ways in which market demand influences MFI transformation is through the diversification of financial products and services. The evolving market demand has led MFIs to

diversify their product offerings beyond traditional microcredit. For example, MFIs have started to provide savings and insurance products to cater to the broader financial needs of their clients. This transformation is driven by the recognition that the demand for financial services extends beyond just credit and that offering a broader range of products can create more value for clients and the institution itself.

The landscape of financial services in Ethiopia has been undergoing significant changes in response to shifting market demands. While microfinance institutions (MFIs) have traditionally focused on providing financial services to low-income individuals and small businesses, the evolving market demand for a broader range of financial products and services has prompted MFIs to consider transformation into commercial banks. This transformation process is not only influenced by internal factors within the MFIs but also by external market forces and regulatory frameworks.

Moreover, the changing market demand is also linked to the aspirations of Ethiopian consumers and businesses for more convenient and innovative financial solutions. With advancements in technology and digital banking, there is a growing expectation for seamless and efficient banking experiences, such as online and mobile banking, e-commerce payment solutions, and access to a broader network of ATMs and branches. Several MFIs have embraced digital transformation to enhance their outreach and efficiency. Electronic commerce (e-commerce) has become an important technological advancement for businesses in changing business practices (Brodie et al., 2007; Gonza´lez et al., 2008; Lichtenstein and Williamson, 2006).In particular, information-oriented industries such as banking services are expected to experience the highest growth in e-commerce (Ibrahim et al. 2006; Hughes, 2002). By leveraging mobile banking, online platforms, and digital payment solutions, these institutions have expanded their reach to remote areas, reduced operational costs, and improved customer experience. The evolution of electronic banking started with the use of automatic teller machines (ATM) and has passed through telephone banking, direct bill payment, electronic fund transfer, and revolutionary online banking (Alter, 2002). These evolving consumer preferences have compelled MFIs to reconsider their business models and explore the potential benefits of transitioning into full-fledged commercial banks.

In addition to market demand, the regulatory environment in Ethiopia plays a crucial role in shaping the transformation process of MFIs into commercial banks. The National Bank of Ethiopia, as the regulatory authority overseeing the financial sector, has been instrumental in formulating policies and guidelines that govern the operations of MFIs and commercial banks. The regulatory framework not only sets the criteria for the conversion of MFIs into banks but also establishes the prudential standards, capital requirements, and corporate governance regulations that MFIs must adhere to to operate as commercial banks.

Moreover, market demand drives innovation within MFIs, prompting them to adopt new technologies and delivery channels to enhance accessibility and efficiency. The rising market demand for convenient and accessible financial services has spurred MFIs to embrace technological innovation. Mobile banking, digital payments, and online loan applications are becoming increasingly popular among clients, prompting MFIs to invest in digital infrastructure to meet these evolving needs. This transformation not only enhances the efficiency of MFIs but also improves the overall customer experience.

In addition, market demand influences the governance and sustainability of MFIs. With a growing emphasis on responsible and ethical finance, there is a heightened demand for transparency, accountability, and social performance from financial institutions. In response, MFIs are compelled to adopt best practices in governance, risk management, and social impact measurement to build trust and credibility among their stakeholders. As market demand continues to evolve, MFIs are facing the challenge of managing risks associated with diversification and technological integration. While meeting market demand is essential for growth, MFIs must carefully assess and mitigate the potential risks that come with expansion and innovation. For instance, offering new products may expose MFIs to unfamiliar risks, and technological integration requires robust cybersecurity measures to protect client data.

While responding to market demand is crucial for the sustainability of MFIs, this transformation also raises important considerations regarding their social mission. MFIs have traditionally aimed to alleviate poverty and promote financial inclusion. However, as they adapt to market demand, there is a risk of deviating from their social objectives in pursuit of financial sustainability. Striking a balance between meeting market demand and upholding their social mission is a critical challenge for MFIs.

The impact of market demand on ACSI MFI transformation is multifaceted, influencing product diversification, and technological innovation. While these changes are essential for meeting evolving client needs and ensuring the financial sustainability of MFIs, institutions must navigate this transformation while staying true to their social mission.

2.4 The impact of Human resource on MFI Transformation

Human resource The issue of human resources is a familiar problem for the sector turnover is high, particularly in rural areas where living conditions may be unattractive to staff and in urban areas where the private sector offers more attractive remuneration and alternative benefits such as shareholdings. In Ethiopia, there is the additional challenge of the stringent personnel requirements for senior staff of the MFIs. The chief executive officer must have a minimum of a first degree in social sciences plus three years of senior management experience in a financial institution. All board members must have graduated from high school. These requirements are often detailed as prohibitive as the lack of skilled personnel in the sector has impaired fulfillment of this requirement. The set of skills required of staff will change as MFIs transform into business banks. Whether the organization chooses to hire additional bankers, re-train its existing staff, or apply a combination of the two, MFIs need to be aware of the significant amount of time and money required (Campion and White, 1999). Transformation is a hard manner requiring sturdy leadership. A transforming MFI must identify a change champion early enough in the technique (Ledger Wood & White, 2006; Awan, 2010). Similarly, aid from all quarters is crucial. All board participants, management, and teams of workers should be worried about the manner and informed of all the most important modifications (Ledger Wood & White, 2006). Group of workers' attitudes should be managed to make certain they're tremendous or at the least, not an obstacle to the transformation process. Conversation channels and remarks systems need to be clear and 27 applicable all through the procedure.

Reports in Pakistan with a desirable body of workers and control involvement in remodeling NRSP aid this view (Awan, 2010). The researchers Ledger Wooden & White (2006); and BOU (2010) supported that this view transformation brings modifications in operations and the way things are completed, brings in new products and techniques, reporting requirements and frequencies among different adjustments. These consequences are in competencies and know-how gaps that must be addressed via the transforming organization. Personnel retraining to

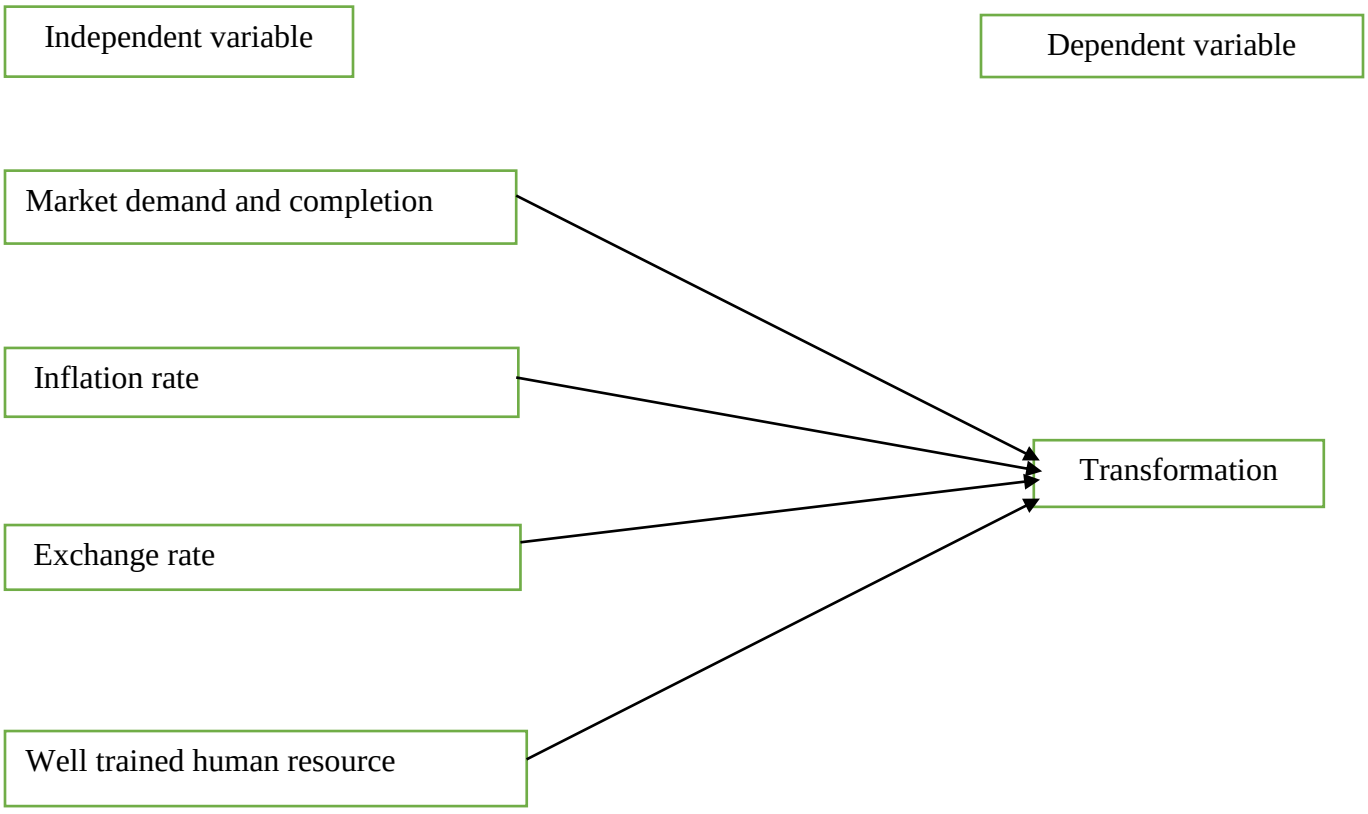
improve competencies and information is consequently essential (Awan, 2010). In instances, those modifications create opportunities for a modern-day cadre of team workers with certain records like treasury management. The primary task is where a new set of senior controls for the transformed MFI (Lauer, 2008) is required. This creates fear among the senior management and board who can also foresee their exit

. The reaction is that the transformation procedure is put on preserve. Many kinds of research have depicted that Ethiopian microfinance institutions are confronted with several troubles and challenges, which include low outreach, fund shortage, restricted product diversification, limited research and innovation, and susceptible inner control machines and MIS (Woldey A, 2000). So it is suspected this might be taking their time to transform due to the fact their management fears pushing themselves out of a task. according to ACSI Institutional Profile, Current Status, and Future Strategy, The credit is normally distributed to those in the "productive" age group yet education and skill achievement are very low. The majority of activities financed by ACSI credit concentrate on traditional business areas like agriculture, petty trade, etc, with very little diversification. Business Development Services (BDS) are highly underdeveloped in the region as a whole, and those that are available (The agricultural package program, the Adult Skill Training Centers, REMSEDA, ADA skill training centers, etc) provide very limited skill training, in few vocational fields, and are concentrated in the urban areas or in already "surplus producing" rural areas. Their diversification and expansion to the food-insecure areas should be an urgent task, as this would determine the effectiveness of the program

2.5 Conceptual framework

The conceptual framework for investigating the factors impacting the transformation of microfinance institutions (MFIs) into commercial banks can be structured to capture the key elements and relationships that drive this transformation. This framework includes market demand and competition, inflation rate, exchange rate, and well-trained human resources, among other factors. A conceptual framework is the diagrammatic presentation of variables and it illustrates the relationship between the independent and the dependent variables (Chandran, 2004; Oso & Onen, 2009). It is a schematic representation of a research problem that includes a network of concepts, that is, factors or variables, and shows the flow and direction of their relationships.

The conceptual framework for this study presents the variables that were identified from the available relevant literature as factors impacting the transformation of MFIs into commercial banks in the case of Tsedey Bank. The factors that were identified from the available relevant literature were grouped into four, which became the independent variables for the study. They are market demand and completion, inflation rate, exchange rate, and human resource. The four variables are presented diagrammatically that impact the transformation of MFI into a commercial bank summarized in Figure



3 CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents a description of the research methodology that would be used in this study and presents in detail the procedure that was used to answer the research questions by discussing the research design, the research philosophy, the research strategy, the research method, the target population, the sample and sampling techniques, research instruments, data collection, and data analysis. When deemed necessary and appropriate, the presentation and discussion in each section were supported by a justification based on the expert opinion of the philosopher.

3.2 Research design

refers to the general plan that integrates the distinctive mechanisms of the study logically, ensuring that the studies effectively address the research problem (De Vaus, 2011). Different researcher Mathoko (2007) additionally argued that a research design is a procedural plan adopted by the researcher to answer research questions in an objectively, precisely, valid, and economic way; therefore, research designs the arrangement of conditions for data collection and analysis of in a way that seeks to combine relevance with the purpose of the research. It constitutes the blueprint for the collection, measurement, and analysis of data and guides the researcher to know what to do throughout the research process Saunders, Lewis & Thornhill (2009) argued that research questions like what, how, and why answers using an explanatory research design method. Therefore in this study, the researcher applied a mixed research design method in which the researcher first performs quantitative research analysis and then builds on the results to explain them in more detail with qualitative research, since the initial quantitative data results with the qualitative data were further explained trying to understand the transformation phase and the factors that make up impacting the process, trying to explain the topic under study and trying to answer the question of what, how, and why. Transformation implies change and therefore a process. Studying factors impacting this process requires a little exploration, which can serve the purpose of this study.

3.3 Research Philosoph

The study followed ontological and epistemological methodology for the choice of research strategy, formulation of the problem, data collection, processing, and analysis. Dietz (2010) stated that ontological philosophy is a reflection of the nature of reality, which is explored through the researcher's answers to problems such as what is the nature of the world, including social phenomena. The researcher describes how the researcher ontologically reports facts within a field of knowledge. Therefore based on ontology the study follows the constructivism (interpretivism) paradigm which employs inductive logic and qualitative research methods. The epistemological philosophy of concerned with all aspects of the validity, scope, nature, information, sources, and methods of acquiring knowledge, possibilities of transferring, and limitations of knowledge in the field of study. According to Crotty (2003), he pointed out Epistemology is "a way of understanding and explaining how we know what we know."

Another researcher Maynard (1994) also explained that Epistemology „is concerned with providing a philosophical basis for deciding what kinds of knowledge are possible and how we can ensure that they are both adequate and legitimate." Consequently primarily based on epistemology this study follows the post-positivism paradigm which employs deductive logic and quantitative research method that there is "no single way to learning but many different ways of understanding due to the fact there are numerous realities (Saunders, et al. 2012; Collis, et al. 2014 and Wilson, 2010)". The constructivist paradigm of this study was embraced by the interviews performed to gather information from the respondents in answering qualitative questions. The questionnaire (quantitative tools) embraced the post-positivism perspective utilizing searching for answers to concept-driven questions. Therefore, Knowledge of multiple realities is obtained by integrating multiple research methods. The mixed method approach enhanced a more detailed understanding of the research questions and results leading to a balanced conclusion on the factors impacting the transformation of MFIs on the research problem.

3.4 Research Approach

Research approaches point out the methods of data collection, data analysis, interpretation, communicating findings, validation and the questions to be responded to, the chosen approach of

inquiry equally determines the study techniques. In keeping with Leedy and Ormrod (2013) a research approach may be regarded as a blueprint, a grasp plan that specifies the methods. Therefore, every study requires a research design that is carefully tailored to the exact needs of the problem under investigation (Creswell, 2009). As mentioned in Kothari (2004) and Creswell (2003) research approach can be classified into three approaches and a researcher can use one tactic in conducting a given research. Those are quantitative, qualitative, and mixed research approaches. In this paper, the researcher used a mixed research approach to better understand a research problem by combining both numeric values from quantitative research through questionnaires, and those which are not covered by the questionnaires are gathered through qualitative research which are interviews to neutralize limitations of applying any of a single approach. According to Creswell (2009), this approach enables to offset of the weaknesses inherent within one method with the strengths of the other method. Besides, as an extra benefit, the approach is not limited to one method, or the researcher is not committed to only one method which means that the investigator is flexible. Considering the research problem and objective along with the philosophy of the different research approaches, a mixed research approach was found to be appropriate for this study. That is to get the benefits of a mixed methods approach and to mitigate the bias in adopting only either quantitative or qualitative approaches.

3.5 Research method

The main aim of this study was to investigate the factors affecting the transformation of MFI into a commercial bank in the case of tsedey bank and the researcher wanted to generalize the findings to a population therefore this study adopted a mixed methods approach. The combined method approach specializes in gathering, analyzing, and mixing both quantitative and qualitative data. The use of every quantitative and qualitative technique in combination gives more information on study issues than both approaches achieve on my own. Mixed method research includes both gathering and analyzing quantitative and qualitative data either sequentially or simultaneously.

3.6 Target population, sampling techniques, and sample size

In line with Ngechi (2004), a population is stated to be a well-described set of human, offerings, elements, activities, agencies of things, or households that can be investigated. Even as the target population is the overall collection of elements approximately the researcher desires to make a few inferences. Therefore the target population for this study is during the third quarter of

2022/23, the number of Micro Finance Institutions (MFIs) in Ethiopia reached 46. registered microfinance institutions that are currently members of AEMFI which have been providing microfinance activities within the areas of credit delivery, saving, money transfer, and pension payment services in Ethiopia (AEMFI, 2020). From the target population, the large MFIs were selected based on their total capital adequacy, profitability, management efficiency, productivity, and outreach performance, which are named ACSI Wisdom (vision fund), and Wassassa. In such an effort, due to the newness and technicality of the study topic the researcher used a non-random sampling technique that uses judgmental /purposive/expert sampling. The reason for selecting this purposive sampling technique is to select participants that were best to assist the researcher in understanding the problem and the research question (Creswell, 2003). So from different MFIs in Ethiopia, the researcher can decide on one of them. According to Cresswell (2003) also added that purposive sampling techniques are employed when identifying and selecting individuals or groups of individuals that are especially knowledgeable about or experienced with a phenomenon of interest. From Tsedey Bank, 40 respondents were purposively selected including a principal district operation officer, a marketing and business development manager, a risk management and compliance manager, digital service manager, credit manager, human resource manager, a saving and credit management manager.

3.7 Sources, Methods, and Tools of Data Collection

Data collection is the process of acquiring subjects and gathering information needed for a study; methods of collection vary depending on the study design (Kothari, 2004). The dependent variable was identified as the pace of change measured by the progression through the stages of transformation to become a commercial bank. Independent variables are market demand and competition, inflation rate, exchange rate, and human resources. In this study, Primary data were collected through a standardized questionnaire that was administered semi-structured questionnaire by the researcher to CEOs or operations managers who are conveniently key roles in MFIs readiness for transformation. This type of questionnaire has both closed and open-ended questions. Closed questions have to be predetermined answers and usually collect quantitative data while open-ended questions give the respondents freedom to express their views and usually collect qualitative data. The use of questionnaires ensures collection of data from respondents within a short time and respondents are free to express their views and give relevant information because they are assured of their anonymity (Mugenda and Mugenda, 2003). The aim is to

collect qualitative data that would explain events, behaviors, and positions taken by MFIs regarding the transformation. Welman, Kruger & Mitchell (2005) argued that semi-structured interviews help the researcher to probe for clarity. At times, the interviews would tend to be unstructured to allow for more explanations and to get information on general views and opinions on the transformation process. This data was used to supplement and explain the results of quantitative analysis on data capture through the 40 questionnaires.

3.8 Data analysis and presentation

Data analysis is the backbone of any study. Daniel (2012) argued that data analysis transforms data to extract useful information and facilitate conclusions. Other researchers Cooper & Schindler (2003) also supported that the whole process which starts immediately after data collection and ends at the point of interpretation and processing data is data analysis. The data analysis technique became based on a combined approach using one after the other analyzing each type of data; evaluating outcomes through procedures and a side-by-side evaluation in a discussion, reworking the quantitative information set into qualitative, or displaying both sorts of facts together. The quantitative data analyzed by descriptive statistics and qualitative data will be analyzed through analytical and critical thinking, text analysis, interpretation, categorization, and comparison of the interview and primary research findings. The coded data were entered into the Statistical Package for Social Sciences (SPSS) for analysis. Data analysis and presentation were based on the variables identified in the literature review. The independent variables are market demand and competition, exchange rate, inflation rate, and political instability. The data were analyzed through relevant statistical tools which both SPSS and Microsoft Excel employ. The findings were communicated through tables, frequency, percentages, notes, hypothesis tests, confidence intervals, and correlation and regression analysis. In this study, multiple linear regression models were applied to investigate the factors affecting the transformation of MFIs into commercial banks in the case of tsedey bank. According to Unver and Gamgam (1999), multiple regression analysis is an attempt to account for the variation of variables in the dependent variable synchronically. The study used a regression model to analyze the factors that affect the transformation of MFIs into commercial banks in Ethiopia in the case of tsedey bank. The model was used to estimate the relationship between the indicated factors and the transformation process.

The multiple regression model of this study was formulated as follows:-

Y= transformation of MFIs = $f(MD\&C, IR, ER, HR)$

Transformation of MFIs= MD&C +IR + ER + HR

Where

MD&C= market demand and competition

IR= Inflation rate

ER= Exchange rate

HR= human resource

$Y= \beta_0 + \beta_1 (MD\&C) + \beta_2 (IR) + \beta_3 (ER) + \beta_4 (HR) + \varepsilon$

$= \beta_0 + \beta_1(x_1) + \beta_2(x_2) + \beta_3(x_3) + \beta_4(x_4) + \varepsilon$

Where

Y = transformation of MFIs

X_1 = market demand and competition

X_2 = inflation rate

X_3 = exchange rate

X_4 = human resource

ε = error term or disturbance of the model

β_0 = constant of the model

$\beta_1, \beta_2, \beta_3, \beta_4$ is the coefficient of predictor variables.

3.9 Definition and measurements of variables

3.9.1 Dependent variable

Transformation in the MFIs generally refers to the institutional process whereby microfinance institutions create or convert into a broad group of shareholders, expanding product offerings, changing human resource requirements, and becoming commercial banks to carry out banking business which was measured either transforming or not yet transformed.

3.9.2 Independent variable

- Market Demand and Competition; Market demand on MFI transformation refers to the influence of consumer needs and preferences for financial services on the evolution of microfinance institutions into commercial banks. As the demand for diverse and sophisticated financial services grows among underserved and low-income populations, MFIs are motivated to transform to offer a broader range of products, such as savings accounts, loans, insurance, and digital banking services. competition on MFI transformation refers to the impact of competitive pressures from other financial institutions, including traditional banks, fintech companies, and other non-bank financial entities, on the decision and process of MFIs evolving into commercial banks.
- Inflation; The inflation rate significantly impacts the transformation of MFIs into commercial banks. High inflation increases operational costs, complicates loan repayment, affects asset quality, and influences customer behavior.
- Exchange rate; Exchange rate fluctuations significantly impact the transformation of MFIs into commercial banks. Volatile exchange rates can affect funding stability, operational costs, loan portfolio quality, and customer demand for financial services.
- Human resource; The success of this transformation hinges on developing the necessary skills, fostering a supportive organizational culture, attracting and retaining talent, ensuring regulatory compliance, optimizing operations, and maintaining employee well-being.

4 CHAPTER FOUR

4.1 DATA PRESENTATION, ANALYSIS AND INTERPRETATION

Following the research objectives, this chapter introduced data analysis, presentation, interpretations, and discussions. The overall goal of this research was to examine the factors that affect MFIs becoming commercial banks. Closed and open-ended questions were utilized to collect data in this study, and the researcher employed Likert scale questionnaires to ensure that data from a large number of respondents was collected quickly. The collected data was analyzed using descriptive and inferential statistics using a statistical package for social scientists (SPSS).

4.2 General information about the respondents

This section contains information about the respondents, including their level of education, employment status, and MFI experience.

4.2.1 Respondent's educational background

Table 4.1: Respondent‟s education background

edu. background					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Degree	17	42.5	42.5	42.5
	Master	23	57.5	57.5	100.0
	Total	40	100.0	100.0	

According to the table above, the majority of respondents (57.5%) have a master's degree, while (42.5%) have a university bachelor's degree. According to the survey, the majority of the respondents have a master's degree, implying that they have greater capabilities and can synthesize, analyze, and interpret questionnaires.

4.2.2 Respondent's current working position

The current working position of respondents is summarized below:-

Table 4.2: Respondent‟s working position

current position					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	digital service manager	8	20.0	20.0	20.0
	principal district operation officer	2	5.0	5.0	25.0
	senior debt recovery	3	7.5	7.5	32.5
	customer experience senior officer	3	7.5	7.5	40.0
	customer service and experience	2	5.0	5.0	45.0
	marketing and business development manager	4	10.0	10.0	55.0
	risk management and compliance	7	17.5	17.5	72.5
	microfinance supervision team	2	5.0	5.0	77.5
	saving and credit management managers	2	5.0	5.0	82.5
	coporate credit analisis and apprisal manager	1	2.5	2.5	85.0
	loan workout and portfolio	4	10.0	10.0	95.0
	accountant	2	5.0	5.0	100.0
	Total	40	100.0	100.0	

4.2.3 Year of experience in tsedey bank

Work experience					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1-5	20	50.0	50.0	50.0
	6-10	16	40.0	40.0	90.0
	>10	4	10.0	10.0	100.0
	Total	40	100.0	100.0	

Table 4.3: Respondents experience with tesedey bank

As shown in Table 4.3, half of the respondents have relatively recent work experience (1-5 years). This could imply a younger, possibly more adaptable workforce open to new processes and systems required for the transformation. , (40%) has moderate experience (6-10 years), which might combine a balance of stability and flexibility, contributing positively to the transition. The rest (10%) with over 10 years of experience can provide deep institutional knowledge and continuity, which is critical during transformative processes. As a result, employees with 1-5 years of experience might require extensive training and development to align their skills with the requirements of a commercial bank. Those with 6-10 years of experience might serve as mentors or trainers, leveraging their expertise while also needing some updates on new banking practices. Senior employees with over 10 years of experience might need specific training to shift their mindset from MFI practices to commercial banking operations.

4.3 Descriptive statistics

After the records have been searched based on the study objectives, descriptive statistics are provided. In this section of the study, the mean and standard deviation were used. According to Aggresti (2009), mean(x) is the average value derived by summing the values of each case of the study variables and dividing by the total number of cases, with the mean being used to measure the data's central tendency. The standard deviation is a value that indicates the degree of variability of data. It suggests how close the facts are to the mean. According to Aggresti &

Franklin (2009), a mean of 1.00-2.49 was considered very weak, 2.50-3.49 was considered weak, 3.50-4.49 was considered strong, and 4.50-5.00 was considered very strong, whereas a standard deviation of greater than 0.5 was considered homogeneity and a standard deviation less than 0.5 was considered heterogeneity of data.

4.4 Factors affecting the transformation of MFIs into banks; in the case of tsedey bank

In chapter two, various challenges to microfinance institutions' eventual shift to banking operations were discussed. These challenges motivated the experts to explore the variables that influence the transition process, either slowing it down or prohibiting some MFIs from becoming banks. Evidence collected had a strong score in the majority of the factors while in others it was not very clear and would require further research to confirm or disprove them. The factors are addressed in more detail below.

4.4.1 market demand and competition on MFI transformation

One of the study's objectives was to determine how market demand and competition influence microfinance institutions' transformation strategy to banking. The respondents were asked to rate how much they agreed with the following assertions about market demand and competition influence. Based on the findings of the survey, the majority of respondents agreed that market demand and competition a significant factors in MFIs' transformation into banking.

Market Demand and Competition on MFI Transformation					
	N	Minimum	Maximum	Mean	Std. Deviation
financial sustainability	40	1.00	5.00	3.5500	1.19722
Undeserved population	40	1.00	5.00	3.7750	1.44093
Access to credit SMs	40	1.00	5.00	3.8750	1.26466
Abilty of socialmission	40	1.00	5.00	4.0000	1.26085
Stability financial sector	40	1.00	5.00	4.0500	.93233
impact of technology	40	2.00	5.00	4.2000	.88289

Market demand and competition	40	3.00	5.00	4.2250	.76753
stakeholder collaboration	40	2.00	5.00	4.4250	.81296
Valid N (listwise)	40				

Table 4.4 Market Demand and Competition on MFI transformation

In Table 4.4, respondents agreed that a strong perception of financial sustainability influences the transformation of MFIs, as shown by an average mean of 3.55 and standard deviations of 1.19. In response to the underserved population, which has an average mean of 3.77 and a standard deviation of 1.44 generally believe that transforming MFIs will expand financial services to underserved populations. In response to access to credit SMs which has an average mean of 3.87 and a standard deviation of 1.26 respondant think the transformation will significantly enhance access to credit for SMEs.,in response to in the ability of MFIs to maintain social mission which has an average mean 4.00 and standard deviation 1.26, In response to the stability of financial sector respondents believe the transformation will positively impact the overall stability of the financial sector., which has a mean of 4.05 and standard deviation 0.93 , In response to the impact of technology, which has a mean of 4.20 and a standard deviation of 0.88 there is high optimism about the role of technology in facilitating MFI transformation., market demand and competition, which has an average mean of 4.22and standard deviation 0.76 respondents view market demand and competition as significant factors driving MFI transformation., stakeholder collaboration which has an average mean of 4.42and standard deviation 0.81 the majority respondents believe stakeholder collaboration is crucial for successful MFI transformation. As a result the respondents generally have a strong perception of the positive impacts of various factors on the transformation of MFIs into commercial banks. The responses are relatively homogeneous, with some moderate to high variability in certain factors, indicating consistency in the views of the respondents.

4.4.2 Economic factor on MFI transformation

Economic factors significantly influence the transformation process of MFIs into commercial banks. A stable economic environment, favorable regulatory policies, access to capital, and investment in human resources and technology are crucial for a successful transition.

Understanding and strategically managing these economic factors can enhance the viability and growth prospects of MFIs aiming to become commercial banks.

Economic factor on MFI transformaton			
	N	Mean	Std. Deviation
Exchange rate affect	40	3.3250	1.02250
inflation rate affect	40	3.7500	1.08012
Level of risk	40	3.8500	.89299
Regulatory requirements	40	4.1500	.66216
Valid N (listwise)	40		

Table 4.5 Economic factors on MFI transformation

The analysis indicates that regulatory requirements and the level of risk are perceived as the most significant economic factors impacting the transformation of MFIs into commercial banks. Inflation rate and exchange rate effects are also important but to a lesser extent. Political instability is considered the least impactful but has the most variability in responses, indicating diverse opinions among respondents.

These insights can help prioritize regulatory and risk management strategies in the transformation process while also addressing the concerns related to inflation and exchange rates. Efforts to stabilize political conditions may also be beneficial, given the wide range of perceptions on its impact.

4.4.3 human resource on MFI transformation

The drive for transformation is the human component of an organization. According to Awan (2010), NRSP in Pakistan was able to transform faster because staff were involved, trained, and informed of everything that was happening, and their concerns were addressed. When employees are aware of what is happening and that the transforming institution accommodates their concerns, they are willing to support the process. When the employees do not participate in

institutional change, there is much resistance due to fear of the unknown, and the transformation boat is rocked from within (Nkungi, 2010).

human resources on MFI transformation

	N	Mean	Std. Deviation
Adequately prepared	40	3.1250	1.26466
Human resource motivation	40	4.0750	.85896
Valid N (listwise)	40		

Table 4.6 human resources on MFI transformation

Regarding the findings of Table 4.6, the influence of human resources the majority of respondents strongly agreed that MFIs transform into the banking business. This means that the respondents are mostly in agreement with the statements, an indication that human resources increases the probability of success and improves the satisfaction level of the MFI transformation process as mentioned by the statements. An average mean of 3.12 and a standard deviation of 1.26 were reported for adequately prepared in terms of human resource and organizational capacity for the transition into a commercial bank. management and staff competency (skills, knowledge, and attitude), implying that transformation is a difficult process that requires a capable leader as well as strong senior management, and it needs additional specialized staff to manage banking functions and engage expert advice on the process or training their teams on transformation as well as institutional preparedness facilitated transformation and that institutions had also hired consultants to help them with the process; MFIs require skilled leaders and strong management teams to facilitate their operational processes and compete in the new and current banking sectors. In response to human resource motivation and capability contribute to MFIs' transformation strategy into commercial banking an average mean of 4.07 and standard

deviation of 0.85 if an MFI becoming a banking industry was identified as a motivator. It was associated with an improved public image of stability and discipline pushing MFIs to achieve their transformation process.

According to NBE directive No.SBB/70/2019 the requirements for persons with significant influence in a banking business are board of directors, chief executive officer, and senior executive officer shall fulfill at a minimum of knowledge, experience, and age. The board of directors shall hold a minimum of first degree or equivalent that has a core competency of banking, finance, accounting, investment management, economics, and business administration and work experience and age shall be at least 30 years old. Besides this the chief executive officer holds a minimum of first degree and has a minimum of 12 years‟ of experience in banking and at least 5 years as a senior executive officer. The senior executive officer also holds a minimum of first degree and has a minimum of 10 years‟ experience in banking, of which, at a minimum 4 years shall be experience as a department manager or equivalent. back to the research paper, from the total employees in tsedey bank, that means out of 13396, 1285 managers, 3808 professionals, and 8303 supportive staff.

Korynski (2007) stated that MFIs are considered before transformation, relationships among staff members are defined and expectations are more or less understood. Organizational change disturbs the established dynamic, causing employees to be fearful and uncertain about the future. When change is first proposed some people will deny that it is required, or try to reduce the scope of change, deflect or delay the change, or ignore it. However, if the change process is well-managed, these reactions can be addressed and strategies developed to prevent them from blocking the process. If the change is not well-managed, such resistance can either considerably delay or even overtly sabotage the transformation.

4.5 Overall factors impacting MFIs transformation into a commercial bank

Descriptive Statistics	N	Mean	Std. Deviation
exchngerateaffect	40	3.8250	.87376

human resource motivation	40	3.8250	1.19588
marketdemand	40	4.0250	1.04973
inflation rate affect	40	4.2250	.76753
Valid N (listwise)	40		

Table 4.7 over all factor on transformation

as shown in Table 4.7 the result indicated that the majority of the respondents strongly agreed with the market demand and competition, human resource, inflation rate, and exchange rate on the transformation of MFIs to commercial banks. The respondents strongly agreed that the inflation rate, and market demand, have a significant impact on the transformation of MFIs into commercial

banks, with average mean values of 4.22, 4.02, and standard deviations of 0.76, and 1.04, respectively. Furthermore, the respondents agreed that human resource motivation and exchange rate, which have a mean of 3.82, 3.82, and a standard deviation of 1.19,0.87 have a moderate impact on MFI transformation.

4.6 Inferential statistics Inferential statistics

were used through correlation analysis, which was used to determine the nature of the existing relationship between the dependent variable and the independent variables with statistical significance. The factors influencing MFIs' transformation into commercial banks were also investigated using a multivariate regression model. The transformation of MFIs into commercial banks in Ethiopia was the dependent variable, which was examined using correlation, regression, R square, and ANOVA.

4.6.1 Correlation between independent and dependent variables

The linear relationship between the explanatory and response variables was checked using Karl Pearson's coefficient of correlation. The Pearson correlation coefficient is an excellent tool for determining the statistical relationship between independent (explanatory) and dependent (response) variables. Saunders (2003) suggested that $r = 1$ implies that a perfect linear correlation, $0.9 < r < 1$ indicates positive strong correlation, $0.7 < r < 0.9$ positive high correlation, $0.5 < r < 0.7$ positive moderate correlation, $0 < r < 0.5$ weak correlation, $r = 0$ no relationships and $-1 < r =< 0$ negative correlation.

4.6.2 Correlations between market Demand and competition and transformation to Commercial Bank

Table 4.8: Correlation between market demand and competition and transformation to commercial bank

Correlations			
		Market demand	Transformation into a commercial bank
market demand	Pearson Correlation	1	.566**
	Sig. (2-tailed)		<.001
	N	40	40
transformationtocomba nk	Pearson Correlation	.566**	1
	Sig. (2-tailed)	<.001	
	N	40	40

Results in Table 4.8 indicated that the relationship between market demand and competition and transformation of MFIs to commercial banks in Ethiopia where the respondents N 40 and the significance level is 0.01, the results indicate that market demand and competition had a positive moderate correlation to transformation (r = 0.566 p = 0.001) which was less than the significant level of the 0.05. When the p-value is less than a significant level of 0.05, it can be concluded that variables are correlated, the null hypothesis is rejected and the alternative hypothesis is accepted (Saunders, 2003). This indicates that as market demand increases, the likelihood or degree of transformation into a commercial bank also tends to increase, and this relationship is statistically significant.

4.6.3 Correlation between inflation rate and transformation to commercial bank

Table 4.9: Correlation between inflation rate and transformation to commercial bank

Correlations			
		inflation rate affect	Transformation into a commercial bank
inflation rate affect	Pearson Correlation	1	.627**
	Sig. (2-tailed)		<.001
	N	40	40
transformationtocomba nk	Pearson Correlation	.627**	1
	Sig. (2-tailed)	<.001	
	N	40	40

**. Correlation is significant at the 0.01 level (2-tailed).

The relationship between the inflation rate and transformation to commercial banks in Ethiopia is shown in Table 4.9, with 40 respondents and a significant level of 0.01. the output shows that the explanatory variable (inflation) has a strong positive correlation to (predictor variable) transformation with r = 0.627 and a p-value is 0.001 which is less than 0.05, indicating that the variables are correlated and there is significant evidence to reject the null and accept the alternative hypothesis.

4.6.4 Correlation between exchange rate and transformation to commercial

Table 4. 10: Correlation between exchange rate and transformation to commercial bank

Correlations		
	exchngerateaffect	transformation tocombank

exchngerateaffect	Pearson Correlation	1	.454**
	Sig. (2-tailed)		.003
	N	40	40
transformationtocomba nk	Pearson Correlation	.454**	1
	Sig. (2-tailed)	.003	
	N	40	40

**. Correlation is significant at the 0.01 level (2-tailed).

From Table 4.10 above the relation between exchange rate and transformation into commercial banks in Ethiopia, where the respondent N is 40 and the significant level is 0.01, the results indicate that human resources have a positive moderate correlation to transformation into commercial banks equal to r = 0.454 and the p-value is 0.003 which is less than 0.05. When the p-value is less than the significant level, it is concluded that predictor variables and outcome variables are correlated and there is a piece of evidence to reject the null hypothesis and accept the alternative hypothesis.

4.6.5 Correlation between human resource and transformation to commercial bank

Correlations

		Human resource motivation	Transformation into a commercial bank
human resource	Pearson Correlation	1	.663**
	Sig. (2-tailed)		<.001
	N	40	40
Transformation into a commercial bank	Pearson Correlation	.663**	1
	Sig. (2-tailed)	<.001	
	N	40	40

**. Correlation is significant at the 0.01 level (2-tailed).

Table 4.11 Correlation between human resorce and transformation to commercial bank

From Table 4.11 above the Pearson correlation coefficient between human resources and the transformation into a commercial bank is 0.663. This value indicates a strong positive correlation, suggesting that higher levels of human resource motivation are associated with a higher likelihood of successful transformation into a commercial bank. The p-value associated with this correlation is less than 0.001, indicating that the correlation is statistically significant at the 0.01 level. This means there is a less than 1% probability that the observed correlation occurred by chance, providing strong evidence that the relationship between human resources and the transformation into a commercial bank is real and not due to random variation.

4.7 Multiple Regression Analysis

Multiple regression analysis is one of the most commonly used multivariate regression procedures and is used to build models for predicting scores on one variable, the dependent variable from scores on some other variables, the independent variables (Terre Blanche, etal, 2006). The researcher tried to predict the model in terms of transformation to commercial banks (dependent variable) from independent variables such as market demand and competition, inflation rate, exchange rate, and human resources. Based on the data, a multiple regression model is applied to empirically investigate the impact to which market demand and competition, inflation rate, exchange rate, and human resource can predict the criterion variables transformation to the commercial bank by the MFIs and the relationship between the indicated factor affects and the transformation process.

4.7.1 Test of linear assumption

The linear analysis determines whether or not there is a linear relationship between the independent and dependent variables. The Pearson product-moment was used to evaluate the linearity assumption in the study, as indicated in Table 4.14 below.

Table 4.12: Test of linear assumptions

Correlations						
		Market demand	Inflation rate affect	Exchange rate affect	Human resource	Transformation to commercial bank
market demand	Pearson Correlation	1	.438**	.368*	.637**	.566**
	Sig. (2-tailed)		.005	.019	<.001	<.001
	N	40	40	40	40	40
inflation rate affect	Pearson Correlation	.438**	1	.290	.603**	.627**
	Sig. (2-tailed)	.005		.070	<.001	<.001
	N	40	40	40	40	40
exchngerate affect	Pearson Correlation	.368*	.290	1	.313*	.454**
	Sig. (2-tailed)	.019	.070		.049	.003
	N	40	40	40	40	40
human resource	Pearson Correlation	.637**	.603**	.313*	1	.663**
	Sig. (2-tailed)	<.001	<.001	.049		<.001
	N	40	40	40	40	40
Transformation into a commercial bank	Pearson Correlation	.566**	.627**	.454**	.663**	1
	Sig. (2-tailed)	<.001	<.001	.003	<.001	
	N	40	40	40	40	40

4.7.2 Test of homoscedasticity

Homoscedasticity assumes that the dependent variable shows an equivalent level of variance across the range of predictor variables; homoscedasticity is one of the assumptions required for multivariate analysis. The study used Durbin-Watson statistics to test the assumption of homoscedasticity. The Durbin-Watson statistics tests for autocorrelation value ranges from 0 to 4 as a rule of thumb, the value should be between 1.5 and 2.5 to indicate independence of observation (Garson, G. David, 2010). As indicated in Table 4.16, the Durbin-Watson statistic value of 1.172, which is between 1 to 1.5 is inconclusive, indicating that there is no autocorrelation and that the model is appropriate.

Table 4.13 Test of Homoscedast

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.764[a]	.584	.536	.61695	1.172

a. Predictors: (Constant), human resource, exchange rate, inflation rate, market demand

b. Dependent Variable: transformation into commercial bank

4.7.3 Test of normality Assumption

One of the assumptions for multivariate analysis is normality. This study used Skewness and kurtosis to test the normality of data. Skewness is used to describe how symmetrical data distribution is; on the other hand, kurtosis is used to describe how flat or peaked the data distribution is. According to Hair et al. (2010), Skewness and kurtosis should be between ±1.96. shows all variables with corresponding Skewness and kurtosis values. Most of the variables were between ±1.96 showing that the data is normal.

Statistics						
		Market demand	Inflation rate	Exchange rate	Human resource	Transformation into a commercial bank
N	Valid	40	40	40	40	40
	Missing	0	0	0	0	0
Skewness		-1.032	-.416	-.856	-.781	-.872
Std. Error of Skewness		.374	.374	.374	.374	.374
Kurtosis		-.012	-1.161	.382	-.261	.309
Std. Error of Kurtosis		.733	.733	.733	.733	.733

Table 4.13 Test of Homoscedast

4.8 Overall regression analysis model summary results

Table 4. 14 Model Summary of overall regression analysis results

Model Summary										
				Std. Error of the Estimate	Change Statistics					
Model	R	R Square	Adjusted R Square		R Square Change	F Change	df1	df2	Sig. F Change	Durbin-Watson
1	.607[a]	.368	.296	.36790	.368	5.103	4	35	.002	1.823

a. Predictors: (Constant), market demand & competition, inflation rate, exchange rate, human resource

b. Dependent Variable: transformation to commercial bank

This statistic indicates the average distance that the observed values fall from the regression line. In this case, the value .36790 suggests that on average, the actual transformation to commercial bank values deviates from the predicted values by about 0.36790 units. A lower value would indicate a better fit of the model to the data.

R Square, also known as the coefficient of determination, indicates the proportion of the variance in the dependent variable that is predictable from the independent variables. An R Square value of .368 means that approximately 36.8% of the variance in the transformation to a commercial bank can be explained by the combined effects of market demand & competition, inflation rate, exchange rate, and human resource.

Table 4.15: ANOVA of model summary

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2.763	4	.691	5.103	.002[b]
	Residual	4.737	35	.135		
	Total	7.500	39			

a. Dependent Variable: transformation into a commercial bank

b. Predictors: (Constant), market demand & competition, inflation rate, exchange rate, human resource

The ANOVA results indicate that the model is statistically significant, with the independent variables collectively contributing to the prediction of the transformation into a commercial bank. However, while the model explains a significant portion of the variance, there is still a substantial amount of unexplained variance, suggesting that other factors may also play a role in the transformation process. Further investigation and potential inclusion of additional predictors could improve the model's explanatory power.

Table 4. 16 Model Summary of overall regression analysis results

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	1.356	1.020		1.329	.193		
	Market demand	.701	.179	.701	3.924	<.001	.566	1.766
	Inflation rate	.184	.147	.210	1.252	.219	.640	1.563
	Exchange rate	.415	.166	.449	2.498	.017	.558	1.793
	Human resource	-.396	.159	-.419	-2.491	.018	.639	1.566

a. Dependent Variable: transformation into commercial bank

Y= 1.356+ 0.701x1+ 0.184x2+ 0.415x3-0.396x4

From the above regression equation, it was revealed that the regression weight of the independent variables was significant with market demand and competition P < 0.001, inflation rate P = 0.219, exchange rate p = 0.017, and human resource P = 0.018 are statistically significant at a 5% significance level. The regression model suggests that market demand, exchange rate, and human resources significantly influence the transformation of microfinance institutions into commercial banks. Market demand has a strong positive impact on the dependent variable. The standardized coefficient indicates that a one standard deviation increase in market demand results in a 0.701 standard deviation increase in the dependent variable. This relationship is statistically significant (p<.001), suggesting a very strong and reliable effect. The VIF of 1.766 indicates low multicollinearity. Market demand and exchange rate positively impact the transformation, while human resources negatively impact it.

The inflation rate has a positive effect on the dependent variable, but this effect is not statistically significant (p=.219). The VIF of 1.563 indicates low multicollinearity. The inflation rate does not significantly influence the transformation in this model. The exchange rate has a positive and significant effect on the dependent variable (p=.017). A one standard deviation increase in exchange rate results in a 0.449 standard deviation increase in the dependent variable. The VIF of 1.793 suggests low multicollinearity. Human resources has a negative and significant effect on the dependent variable (p=.018p = .018p=.018). A one standard deviation increase in human resource results in a 0.419 standard deviation decrease in the dependent variable. The VIF of 1.566 indicates low multicollinearity. These insights can help focus efforts on enhancing market demand and managing exchange rates while addressing human resource issues to facilitate the transformation process.

4.8.1 Result for hypothesis testing

The potential influence factors (independent variables) on the transformation to commercial banks (dependent variable) of MFIs are explained with the four formulated hypotheses for each linkage; these theoretical hypotheses are empirically tested. Independent variables or factors with significant values less than 0.05 would accept the alternative hypothesis or reject the null hypothesis. The result is provided as shown below based on the above regression result.

Table 4.17 hypothesis test

hypothesis	results	Effect of test
1. Market demand &Competitive strategies employed by Microfinance Institutions (MFIs) have no significant effect on their ability to navigate increasing competition in the banking sector during the transformation process into commercial banks in Ethiopia. Alternative	<.001	accept

2. Economic factors such as inflation rate fluctuations do not significantly influence the feasibility and success of Microfinance Institutions (MFIs) transitioning into commercial banks in Ethiopia.	.219	reject
3. Economic factors such as currency fluctuations do not significantly influence the feasibility and success of Microfinance Institutions (MFIs) transitioning into commercial banks in Ethiopia.	.017	accept
4. Human resources have no a positive and significant impact on the transformation of MFI into a commercial bank in Ethiopia	.018	accept

5 CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 SUMMARY

The survey gathered data from respondents with diverse educational backgrounds, primarily holding master's degrees. They held various positions in digital services, operations, risk management, marketing, and finance. The work experience of the respondents ranged from 1-5 years, 6-10 years, and over 10 years.

To analyze the data, mean and standard deviation were used to measure central tendency and data variability. Factors such as market demand, economic stability, and human resources were assessed for their impact on MFI transformation.

The study revealed a strong positive correlation between market demand and competition, indicating that market demand plays a significant role in MFI transformation. Economic factors, such as regulatory requirements and risk management, were also seen as crucial in the transformation process. Additionally, the study found a significant positive correlation between the availability of human resources and the success of transformation.

Inferential statistics were used to examine relationships between different variables. Correlation analysis showed positive correlations between market demand, inflation rate, exchange rate, human resources, and MFI transformation.

Overall, the findings suggest that market demand, economic stability, and human resources are key factors influencing the transformation of MFIs. By understanding and addressing these factors, MFIs can enhance their transformation efforts and achieve greater success.

5.2 CONCLUSION

The study on the transformation of microfinance institutions (MFIs) into formal banks in Ethiopia has identified crucial factors that were previously overlooked in research. By employing a mixed-methods approach and analyzing both qualitative and quantitative data, this study sheds light on the motives, challenges, and opportunities associated with this transformation. The findings not only contribute to the existing literature on microfinance and banking transformations but also offer actionable recommendations for policymakers and industry practitioners.

The transformation of microfinance institutions into commercial banks is a complex process that is influenced by various factors. Some of the key factors that can affect this transformation include regulatory environment, financial sustainability, governance structure, and market demand. based on the research findings, it is recommended that microfinance institutions carefully assess these factors before embarking on the transformation process. They should also develop a clear strategy and roadmap for the transformation, taking into account the unique characteristics and needs of their institution.

Additionally, microfinance institutions need to seek support and guidance from relevant stakeholders, including regulators, investors, and industry experts. Collaboration and partnerships with other financial institutions can also help facilitate a smooth transition to a commercial bank.

Overall successful transformation from a microfinance institution to a commercial bank requires careful planning, strong leadership, and a deep understanding of the market dynamics. By addressing the key factors identified in the research, microfinance institutions can increase their chances of successfully making this transition and expanding their reach to serve a broader customer base. These insights are pivotal for facilitating a smooth transition of MFIs into commercial banks, ensuring sustainable financial inclusion, and fostering economic development in Ethiopia.

5.3 RECOMMENDATION

Based on the findings of this research, it is recommended that policymakers, regulatory bodies, and industry practitioners focus on several key areas to facilitate a smooth and successful transition of MFIs into commercial banks in Ethiopia. Regulatory Environment: Conduct a thorough analysis of the regulatory framework governing the transition from a microfinance institution to a commercial bank. Ensure compliance with all regulatory requirements and engage with regulators to seek clarification and guidance on the process.

Firstly, there should be a concerted effort to strengthen human resource capabilities within MFIs, particularly in areas such as banking operations, risk management, and financial analysis, to align with the requirements of formal banking.

Strategic Planning: Develop a comprehensive strategy and roadmap for the transformation process, outlining key milestones, timelines, and resource requirements. Engage stakeholders, including employees, customers, investors, and partners, in the planning process to ensure buy-in and support for the transformation.

Capacity Building: Invest in training and capacity-building initiatives to equip staff with the necessary skills and knowledge to operate as a commercial bank. Provide ongoing support and mentorship to help employees adapt to the new business model and deliver high-quality services to customers.

Secondly, strategies should be devised to mitigate the impact of inflation rate fluctuations, possibly through effective interest rate management and hedging mechanisms. Thirdly, proactive measures should be taken to manage exchange rate risks, including diversification of funding sources and currency hedging strategies.

Additionally, policies should be formulated to address market demand dynamics and enhance competition in the banking sector while ensuring consumer protection and financial inclusion. : Conduct market research to identify the demand for commercial banking services in the target market. Tailor products and services to meet the needs of potential customers and differentiate the institution from competitors. Develop a marketing strategy to promote the new banking offerings and attract clients

Collaboration and Partnerships: Explore opportunities for collaboration and partnerships with other financial institutions, technology providers, and industry experts to leverage their expertise and resources during the transformation process. Build strong relationships with key stakeholders to enhance the institution's credibility and reputation in the market.

By addressing these factors and implementing the recommended strategies, microfinance institutions can successfully navigate the transformation process and position themselves for growth and sustainability as commercial banks. Overall comprehensive approach addressing these factors will contribute to sustainable financial inclusion and economic development in Ethiopia.

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Factors affecting the Transformation of Microfinance Institutions into commercial banking in the case of Tsedey Bank

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Questionnaire

INSTRUCTIONS

1. **No need to write your name**
2. **Multiple choice questions indicate your answers with a tick mark (√) in the appropriate block. For blank spaces please write the correct information**

I. **GENERAL INFORMATION**

1. Organization: _____
2. Age: _____
3. Gender: Male ☐ Female ☐
4. Educational background: Diploma ☐ Degree ☐ Master ☐ PhD ☐
5. Current position in your organization
   - Credit Manager ☐
   - Digital service manager ☐
   - Principal District Operation Officer Manager ☐
   - Risk management and compliance ☐
   - Marketing and business development manager ☐
   - Saving and credit management manager ☐
   - Senior debit recovery ☐
   - Microfinance supervision team ☐
   - Human resource development manager ☐
6. Work experience related to Microfinance institutions

   1-5 years ☐ 5-10 years ☐ above 10 years ☐

II. **Transformation of MFIs to commercial banking:**

Kindly rate the extent to which you agree with the following statements on the transformation of MFIs into commercial banking in the case of **Tsedey Bank**

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

	Statement	**1**	**2**	**3**	**4**	**5**
1	Market demand and competition influence MFI's transformation strategy to a commercial bank.					
2	The inflation rate affects MFI's transformation strategy into a commercial bank.					
3	The exchange rate affects MFI's transformation strategy into a commercial bank.					
4	Political instability plays an important role in the transformation of MFIs into commercial banks.					
5	I believe the transformation of MFIs into commercial banking is primarily driven by the need for financial sustainability.					
6	Regulatory requirements significantly influence the decision of MFIs to transform into commercial banking.					
7	Human resources motivation and capability contribute to MFI transformation strategy to commercial banking.					
8	I am confident that the transformation of MFIs into commercial banking will lead to an expansion of financial services to underserved populations.					
9	The level of risk associated with the transformation of MFIs into commercial banking is manageable.					
10	I am optimistic about the potential impact of technology in facilitating the transformation of MFIs into commercial banking.					
11	Stakeholder collaboration (regulators, investors, donors, etc.) is important in supporting the successful transformation of MFIs into commercial banking.					
12	I am confident in the ability of MFIs to maintain their social mission while transitioning into commercial banking.					

13	MFIs are adequately prepared in terms of human resources and organizational capacity for the transition into commercial banking.					
14	The transformation of MFIs into commercial banking will have a positive impact on the overall stability of the financial sector.					
15	I believe the transformation of MFIs into commercial banking will enhance access to credit for small and medium enterprises (SMEs).					

III. Open-ended questions

If any additional points that would not yet included in the above questionnaires', please specify them below.

1. Specify issues related to market demand and competition.

_____

_____

_____

2. Issues related to the inflation rate.

_____

_____

_____

3. Issues related to the exchange rate.

_____

_____

_____

4. Issues related to human resource

_____

_____

IV. **Interview question**

1. Why is MFI's transformation into a commercial bank difficult in Ethiopia?

2. What are the factors that encourage the transformation of MFIs into commercial banks?

3. Does the inflation rate affect the transformation of MFIs into commercial banks? How?

5. Does the exchange rate affect the transformation of MFIs into commercial banks?

6. How do market demand and competition on the transformation of MFIs into commercial banks?

7. Is political instability a major challenge for transformation?