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Research Paper

Filling the breach: Microfinance

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ABSTRACT

The Ethiopian microfinance sector is characterized by its rapid growth, an aggressive drive to achieve scale, a broad geographic coverage, a dominance of government backed Microfinance Institutions (MFIs), an emphasis on rural households, the promotion of both credit and savings products, a strong focus on sustainability and by the fact that the sector is Ethiopian owned and driven. The main objective of the study is to assess the performance and challenges of micro finance institutions. Relevant data for the study were collected from different Microfinance Institutions currently operating in the country. The regional state governments and many local NGOs are shareholders in many of the MFIs. The three largest micro finance institutions account for 65% of the market share in terms of borrowing clients, and 74% by loan provision. These are Amhara (ACSI), Dedebit (DECSI) and Oromia (OCSSCO) Credit and Savings Institutions. Microfinance institutions are decisive way outs from the vicious circle of poverty particularly for the rural and urban poor in a country like Ethiopia where many people live barely below the absolute poverty line.

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Key words: Microfinance, credit, clients, NGOs, regional government.

INTRODUCTION

The development of microfinance institutions in Ethiopia is a recent phenomenon. The proclamation, which provides for the establishment of microfinance institutions, was issued in July 1996. Since then, various microfinance institutions have legally been registered and started delivering microfinance services (Wolday, 2000). In particular, the Licensing and Supervision of Microfinance Institution Proclamation of the government encouraged the spread of Microfinance Institutions (MFIs) in both rural and urban areas as it authorized them among other things, to legally accept deposits from the general public (hence diversify sources of funds), to draw and accept drafts, and to manage funds for the micro financing business (Getaneh, 2005).

MFIs operate in a niche market as they address the needs of those clients who are considered ‘high-risk’ by bigger banks. High-risk groups or individuals are characterized as those with very few assets, requiring very small loans, high degree of close follow-up, business appraisal and evaluation, as well as those engaged in activities whose income is fluctuating such as small-holder farmers or petty traders. Thus, the MFIs cater for a market with an operationally acceptable demand level and where clients can be protected from the unreasonable conditions of the informal money lenders. Such MFIs, however, charge high administrative costs and higher charges for risk coverage, which is in addition to the market interest rates, and taking advantage of the niche market for microloans (Sunita, 2003).

Although the Government of Ethiopia has allowed private ownership of financial institutions, the financial sector is still dominated by large public financial institutions. Also within the microfinance sector, the major Microfinance Institutions (MFIs) are owned by regional governments/endowment companies. The public financial sector (excluding MFIs) has problems of excess reserves and a relatively large share of non-performing loans (20%). In recent years, the state and regional governments have made a major push to increase financial services for agriculture, micro and small enterprises and low-income households (IFAD, 2009).

The Ethiopian microfinance sector is characterized by its rapid growth, an aggressive drive to achieve scale, a broad geographic coverage, a dominance of government backed MFIs, an emphasis on rural households, the promotion of both credit and savings products, a strong focus on sustainability and by the fact that the sector is Ethiopian owned and driven. The industry has a strong focus on loans to the very poor, as indicated by the relatively small loans when compared to neighboring countries. Sector outreach is impressive and the financial performance of the sector is considered good, although the operational margins and profitability are low. MFIs have also mobilized a significant amount of savings, thereby improving financial as well as operational sustainability (MFT, 2011).

The MFIs are motivated to extend the frontier of financial intermediation to those traditionally excluded from conventional financial markets, the poor. A natural question is, thus: how efficiently are they doing this? Previous studies on the efficiency of financial intermediaries consider MFIs and CBs as completely different sectors. The two industries are conventionally left separate in efficiency analysis of financial firms, even though MFIs are motivated merely to extend financial services to those who were not able to access the conventional banking services (Hundanol and Berhanu, 2012).

The Ethiopian government identified a number of priority areas of actions as part of the government's poverty reduction and development programs. One of the priority areas acknowledged is the provision of support to microfinance institutions. In this regard the government is working hard to solicit funds from international donors for supporting the microfinance sector, hence the IFAD and AFDB supported Rural Financial Intermediation Program (RUFIP) and the European Union supported Micro and Small enterprise Development program (Meklit et al., 2005).

Objective of the study

The main objective of the study is to assess the performance and challenges of micro finance institutions. The specific objectives of the study include:

- To observe the sustainability of micro finance institutions
- To evaluate the performance of micro finance institutions in the industry
- To review the trend of performance of microfinance institutions

Research hypothesis

In conducting assessment of the performance and challenges of micro finance institutions and to address the main objective of the study, this study has the following hypotheses: The study has put proposition tested which are as follows:

Ho: Microfinance in Ethiopia do not have good performance track record
H1: Microfinance in Ethiopia have good performance track record

MATERIALS AND METHODS

Method of data collection

This study is mainly based on secondary data from the annual financial reports of MFIs, data from books, journals, newspapers, magazines, and reports of various governmental and nongovernmental organizations such as AEMFI (Association of Ethiopian Micro Finance Institutions). To increase the reliability of data, audited annual reports were used. Besides, crucial information was obtained from apex authority controlling the performance of Microfinance Institutions that is, the National Bank of Ethiopia.

Method of data analysis

The method of analysis used in the study is descriptive statistics and linear regression methods. In this study descriptive analysis were chosen because of its simplicity and clarity to draw inferences. Averages, percentages, diagrams and tables of legal frame work of micro-finance institutions, licensing of micro-financing business, operational and financial requirements, structure of ownership of micro-finance institutions, the performance of microfinance institutions and challenges of the micro financing industry were analyzed. The major findings of the study are compared to the previously published studies.

RESULTS AND DISCUSSION

This section of the study presents the Legal frame work of micro-finance institutions, Licensing of micro-financing business, Operational and financial requirements, Structure of ownership of micro-finance institutions, The Performance of Microfinance Institutions and Challenges of the Micro Financing Industry. The major findings of the study are compared to the previously published studies.

Legal frame work of micro-finance institutions

In an attempt to enhance the development and soundness of the micro-financing business; Micro-Financing Business Proclamation No. 626 /2009 was ratified by the House of

People's Representative. According to the Proclamation No. 626 /2009, the main purpose of a micro-financing institution shall be to collect deposits and extend credit to rural and urban farmers and people engaged in other similar activities as well as micro and small scale rural and urban entrepreneurs, the maximum amount of which may be determined by the National Bank.

In line with the above mentioned proclamation, a micro-financing institution may engage in some or all of the following:

- Accepting both voluntary and compulsory savings as well as demand and time deposit.
- Extending credit to rural and urban farmers and people engaged in other similar activities as well as micro and small-scale rural and urban entrepreneurs.
- Drawing and accepting drafts payable within Ethiopia.
- Micro-insurance business as prescribed by directive to be issued by the National Bank.
- Purchasing income-generating financial instruments such as treasury bills and other short term instruments as the National Bank may determine as appropriate.
- Acquiring, maintaining and transferring any movable and immovable property including premises for carrying out its business.
- Supporting income generating projects of urban and rural micro and small scale operators.
- Rendering managerial, marketing, technical and administrative advice to customers and assisting them to obtain services in those fields.
- Managing funds for micro and small scale businesses.
- Providing local money transfer services.
- Providing financial leasing services to peasant farmers, micro and small-scale urban and rural entrepreneurs in accordance with the Capital Goods Leasing Business Proclamation No. 103/1998; and
- Engaging in other activities as specified by directives of the National Bank from time to time.

Licensing of micro-financing business

Micro-Financing Business Proclamation No. 626 /2009 states that it is prohibited to engage in micro-financing business without obtaining a license from the National Bank of Ethiopia; provided however, that banks licensed under the appropriate law may engage in micro-financing business without a separate micro-financing business license.

Operational and financial requirements

The proclamation No. 626 /2009 lays down that every micro-financing institution shall maintain a register, in such form as the National Bank may approve, which shall show the list of shareholders with voting rights. Any transfer of shares, which is recorded in the register, shall have legal effect. Moreover, it has been stipulated that without prejudice to the provisions of any other law, any person who is a director, chief executive officer, senior officer or is otherwise directly or indirectly concerned in the management of a micro-financing institution in Ethiopia, shall cease to exercise such function if:

- Declared bankrupt, whether in Ethiopia or elsewhere; or
- Convicted of an offence involving dishonesty or fraud, whether in Ethiopia or elsewhere.

On the other hand, The National Bank of Ethiopia may set the limits on the maximum credit to be extended by a micro-financing institution to any individual or group and provisioning for problem loans. Above all, the Micro-Financing Business Proclamation No. 626 /2009 puts forward that without the prior written approval of the National Bank, no micro-financing institution shall:

- Enter into an agreement for the amalgamation or disposal of its business.
- Transfer or otherwise dispose of the whole or any part of its property other than in the ordinary course of business.
- Effect reduction of its capital, other than as a result of losses.
- Amend its memorandum and articles of association or alter the name under which it is licensed.
- Operate outside the area for which it has been issued with a license.

Structure of ownership of micro-finance institutions

Formal commercial banking has been unable to provide access to poor rural and urban Ethiopians that comprise 45% of the overall 82 million populations. These people live below the national poverty line even more they live in absolute poverty not attaining the minimum calorie intake per day and of course are living witnesses of a structural and endemic poverty (AEMFI, 2012).

The ownership structure of Ethiopian Micro-Finance Institutions is the direct effect of regulatory provisions (Degefe, 2009). According to the Proclamation No. 40/1996 of the Business of Micro Financing Institutions, micro-financing institution should be owned fully by Ethiopian nationals and/or organizations wholly owned by Ethiopian Nationals and registered under the laws of, and having its head office in, Ethiopia. This legislation excluded international NGOs and other overseas agencies not to own and run microfinance institutions in Ethiopia.

Regional governments share in microfinance institutions

In support of the various regional development plans and to

Table 1. Ownership structure of microfinance institutions in Ethiopia.

Micro finance institutions	Regional Government (%)	Associations and NGOs (%)	Individuals
Amhara Credit & Savings Institution S	25	75	-
Dedebit Credit & Savings Institution S	25	75	-
Oromia Credit & Savings Institution S	25	70	5
Omo Microfinance Institution	80	19.5	0.5
Addis Credit and Savings Institution S	96.7	3.3	-
Dire Microfinance Institution S.C	97	2.5	0.5
Benishang Microfinance Institution S.C	40	60	-
Harar Microfinance Institution S.C	96.6	3.3	0.1

Source: National Bank of Ethiopia.

address the social and economic problems of regions, the regional state governments own some shares in Micro finance institutions. Table 1 indicates that many regional state governments are involved in the ownership of the micro finances.

As it is indicated in Table 1 Dire Microfinance Institution S.C, Addis Credit and Savings Institution S.C, Harar Microfinance Institution S.C and Omo Microfinance Institution are almost owned by the regional state governments. On the other hand, Amhara Credit & Savings Institution S.C, Dedebit Credit & Savings Institution S.C and Oromia Credit & Savings Institution S.C though their major share goes to the Associations and NGOs, the Regional Governments control quarter of the total ownership. Although individuals control a minimal proportion of the micro finance institutions, they remain actors in the composition of ownerships structure.

The *involvement of NGOs in microfinance business*

Proclamation No. 40/1996 of the Business of Micro Financing Institutions prohibits the involvement of international organizations in the micro-financing business. However, many local NGOs are shareholders in many of the MFIs. According to Wolday (2008), after the microfinance law of 1996, NGOs (which used to have micro-credit programs) established MFIs by being shareholders and gave nominal shares to individuals working in the mother NGO and affiliated institutions. The mother NGOs have been providing capital, expertise and technical support to these MFIs. Table 2 reveals MFIs and their mother NGOs.

The performance of microfinance institutions

Since the first Proclamation of 1996 that gave the legal background for the operation of the micro-financing business, the industry has witnessed a major boom .Today, there are 31 MFIs registered with the National Bank of Ethiopia serving clients. The Ethiopian microfinance market is dominated by a few large MFIs, all of which are linked to regional state government ownership. The three largest institutions account for 65% of the market share in terms of borrowing clients, and 74% by loan provision. These are Amhara (ACSI), Dedebit (DECSI) and Oromia (OCSSCO) Credit and Savings Institutions. Table 3 shows the number of clients and the amount of loan granted by the microfinance institutions currently in the country.

The result from descriptive statistics in Table 4 shows that mean amount of loans extended by 30 microfinance institutions in the country is 2.29E8, whereas the mean borrowing customers equal an amount of 8.24E4.

As it is depicted in Table 5 the R square value is 0.913 implying that 91.3% of the variations in the amount of loans extended by 30 microfinance institutions in the country are explained by the number of borrowing clients. On the other hand, the Pearson correlation indicates strong positive linear relationships between number of borrowing clients and amount of loans extended.

The total number of active borrowing clients of the microfinance institutions in Ethiopia reached over 2.4 million customers in 2011 as depicted in Table 3 whereas the total credit extended by all microfinance institutions amounted to Birr 6.9 billion. Of the total credit granted, the share of the three largest Microfinance institutions is Birr 5.1 billion. The market shares based on the number of borrowing clients are 28.1, 16.1 and 20.4% for Amhara Credit and Saving Inst (ACSI), Dedebit Credit and Savings Inst (DECSI) and Oromia Credit and Savings (OCSSCO), respectively (Figure 1).

On the other hand, it can be calculated from Table 3 that the market share in terms of the total loan provision for Amhara Credit and Saving Inst (ACSI) is 28.2%, for Dedebit Credit and Savings Inst (DECSI) and Oromia Credit and Savings (OCSSCO), the market shares are 26.9 and 18.6%, respectively. Figure 2 depicts the share of the total loan provision for the three largest MFIs in the country.

Challenges of the micro financing industry

The microfinance institutions functioning currently in the country exhibit a number of strengths in their operation. To

Table 2. MFIs and their mother NGOs.

Microfinance Institutions	Mother NGO	Remarks
AVFS	Africa Village	Initially supported by CARE
Bussa Gonofa	Hunde	
Digaf	Addis Hiwot Mahber	
Eshet	Ersha	
Gasha	Pro Pride	Pro Pride, established by Action Aid
Ghion	Christian Aid	
Harbu	Facilitator for change Ethiopia (FCE)	
Letta	American volunteers residing in the USA	
Meket	SOS Sahel	
Meklit	Progynist	
Metemamen	CRS	
PEACE	Agri Service Ethiopia	
SFPI	Initially established with the support of Radda Barna	Commercial Bank of Ethiopia and Dashen Bank are shareholders
Shashemena	ACCORD	
Sidama	Sidama Development Program	Initially established by Irish Aid
Wasasa	Oromia Development Association	
Wisdom	World vision	

Source: Wolday, 2008.

mention few; the service provision is centered on urban and rural poor particularly in alleviating the chronic problem of poverty; the number of clients served is growing from time to time making it accessible for the needy partners; regional distribution of the services is appreciable as microfinance institutions are operating in all regional states of the country. Though the strengths of the Micro Financing Industry outweigh its weaknesses, there are still big challenges facing the microfinance institutions. The first challenge is the inaccessibility for foreign capitals which may foster their loan portfolio. As a result, many MFIs are limited to certain category of services. Lack of clarity in ownership structures persist specially in some MFIs where private investors are not the real owners of the MFIs though they are shareholders. Therefore, this situation could be seen as a challenge due to inefficiencies in the management.

Lack of skilled personnel is the common problem in Ethiopian Microfinance institutions. This situation is more exacerbated by high turnover of experienced personnel either for the need of better jobs or hate to work in rural areas with minimal facilities provided as compared to urban areas which offer better living conditions.

There is also a problem of using modern core finance technologies for many of MFIs specially those microfinance institutions operating in remote rural areas having poor infrastructure development. As a result, there are problems of non standardized reporting and performance monitoring system. On the other hand, MFIs face challenges of obtaining loans in the existing finance market particularly from banks which hampers strive for addressing various needs of clients.

There is an illegal way of doing the micro financing business from the side of the government, NGOs and other agencies which continue to provide uncollectible loans by violating the proclamations ratified by the House of People's Representatives. Apart from this, there are deep concerns within the microfinance sector about the growing issue of inflation on the profitability of MFIs, and the ability to maintain low interest rates.

Other challenges most commonly cited are lack of knowledge about microfinance services, weak governance and management capacities for further developments, less attention and emphasis on the financial sustainability of MFIs, low interest rates in the microfinance industry affecting the financial health and viability of MFIs and limited outreach particularly for women.

CONCLUSIONS

Microfinance institutions are decisive way outs from the vicious circle of poverty particularly for the rural and urban poor segment of the society especially in a country like Ethiopia where many people live barely below the absolute poverty line. The micro financing industry of Ethiopia is escalating in the face of the growing deep concerns for inflation and low interest rate in the microfinance industry

Table 3. Performance trends of microfinance institutions in Ethiopia, 2011.

No.	Microfinance Institutions	No. of borrowing clients	Amount of loans provided (Birr)
1	Amhara Credit and Saving Inst (ACSI)	694,993	1,940,827,401
2	Dedebit Credit and Savings Inst (DECSI)	396,648	1,849,942,011
3	Oromia Credit and Savings (OCSSCO)	503,000	1,280,000,000
4	Addis Credit and Savings Inst (ADCSI)	156,148	566,826,000
5	Africa Village Financial Services (AVFS)	17,359	14,974,452
6	Aggar Microfinance	5,854	19,130,224
7	Benishangul Gumuz Microfinance	28,874	51,762,087
8	Buusaa Gonofaa Microfinance	48,908	76,548,872
9	Digaf Microfinance	1,270	1,334,920
10	Diredawa Microfinance	5,923	16,285,631
11	Dynamic Microfinance Inst	261	2,224,932
12	Eshet Microfinance	24,116	40,588,029
13	Gambela Microfinance	880	1,173,831
14	Gasha Microfinance	6,991	14,736,312
15	Ghion Microfinance	233	286,268
16	Harar Microfinance	2,706	7,101,769
17	Harbu Microfinance	17,984	23,808,751
18	Lefayeda Credit and Savings	303	623,441
19	Letta Microfinance	925	4,790,020
20	Meket Microfinance	2,959	2,329,562
21	Meklit Microfinance	14,224	23,029,053
22	Metemamen Microfinance	10,218	8,720,938
23	OMO Microfinance	327,888	585,102,740
24	PEACE Microfinance Inst	17,206	45,507,171
25	Shashimene eddir yelimat Agar (SEYAMFI)	4,144	10,959,365
26	Sidama Microfinance	47,810	28,334,552
27	Specialized Financial & Promotional Inst (SFPI)	33,342	50,807,161
28	Tesfa Microfinance	162	203,576
29	Wasasa Microfinance	53,981	113,970,892
30	Wisdom Microfinance	45,331	101,205,955
31	Somali Microfinance	-	-
Total		**2,470,641**	**6,883,135,916**

Source: National Bank of Ethiopia, 2011.

Table 4. Descriptive statistics

Items	Mean	Std. Deviation	N
Amount of loans extended	2.29E8	5.237E8	30
Number of borrowing clients	8.24E4	169,719.226	30

Table 5. Value of the coefficient of determination and coefficient of the model.

Value of the coefficient of determination			
R	R Square	Adjusted R Square	Pearson correlation
.955	0.913	0.909	0.955

Table 6: Coefficients of the model

Model	Unstandardized Coefficients		Standardized Coefficients
	B	Std. Error	Beta
(Constant)	-1.331E7	3.208E7	
Number of borrowing clients	2947.636	172.423	0.955

a. Dependent Variable: Amount of loans extended
NB. The equation of least squares regression line for predicting values of Y from values of X is: Y=2947.636X-1.331E7

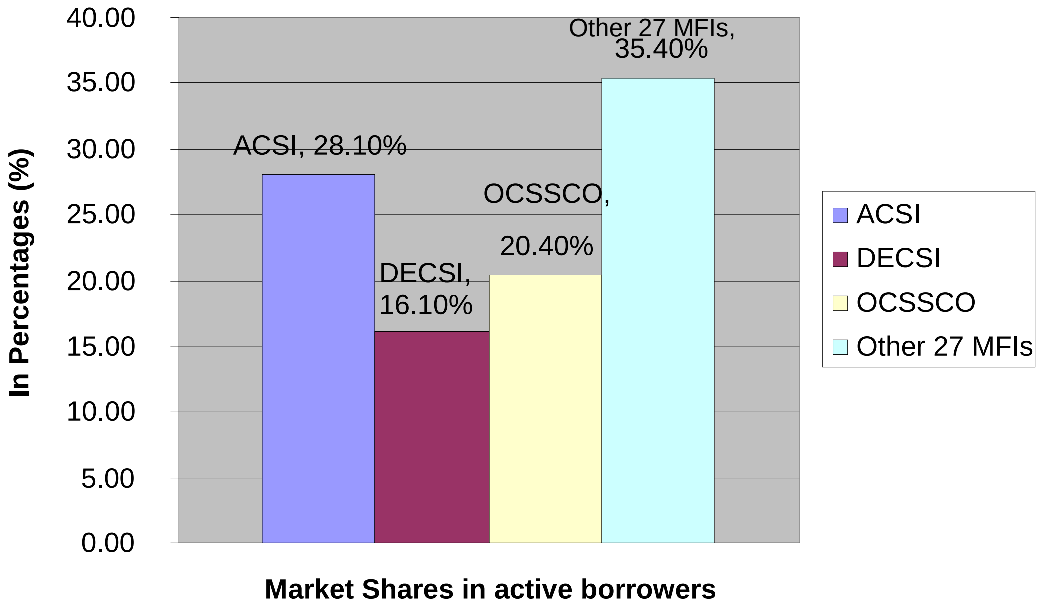

Figure 1. Share of borrowing clients of the three largest Ethiopian microfinance institutions.
Source: Authors' construction, 2012.

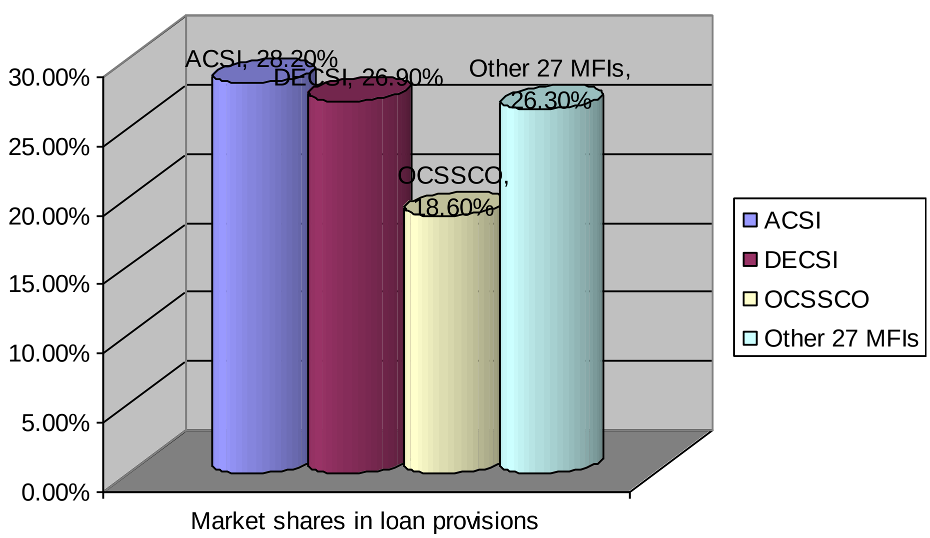

Figure 2. The share of credit provision by the three largest Ethiopian microfinance institutions.
Source: Authors' construction, 2012.

affecting the financial health and viability of MFIs. The National Bank of Ethiopia though supporting the industry it needs to smooth out the regulations and supervisions. For instance, the regulations requiring the microfinance institutions to operate in a tightened manner particularly their capital requirements. On the other hand, upgrading of the microfinance institutions' scale of operation such as graduating to the level of banking institution should be backed by a strong regulatory frame work from the National Bank of Ethiopia.

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