

The performance of Micro Finance Institutions in Ethiopia: A case of six microfinance institutions

Research Paper Submitted To Addis Ababa University In Partial Fulfillment Of The Requirement For The Degree In Msc. Program In Accounting And Finance

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STATEMENT OF DECLARATION

I, Alemayehu Yirsaw, declare that this study entitled “The performance of micro finance institutions in Ethiopia: A case of six microfinance institutions”, is my own work. I have carried out independently the research work with the guidance and support of the research advisor.

This study has not been submitted to any degree/diploma in this or any other institution. It is done in partial requirement of the M.Sc Degree in Accounting and Finance.

Alemayehu Yirsaw: _____

Date: _____

STATEMENT OF CERTIFICATION

This is to certify that Alemayehu Yirsaw has carried out his research work on the topic entitled “The performance of micro finance institutions in Ethiopia: A case of six microfinance institutions”

This work is original in nature and is suitable for submission for the award of M.Sc. in Accounting and Finance.

Ato Abebe Yitayew (Asst Professor): _____

Date: _____

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ACRONYMS

IDB	Inter-American Development bank
OCSSCO	Oromia Credit and saving share company
MFI	Microfinance Institutions
UNDP	United Nation Development Program
MDGs	Millennium Development Goals
NGOs	Non-Government Organizations
CGAP	Consultative Group to Assist the Poorest
USAID	United States Agency for International Development
PEACE	Poverty Eradication and Community Empowerment
ACSI	Amhara Credit and Saving Institute
DECSI	Dedebit credit and Saving Institute
AEMFI	Association of Ethiopian Micro Finance Institutions

ABSTRACT

Currently micro financing is one of the most powerful tools for combating poverty primarily by providing loan to the poor section of the society. The number of micro financing institutions serving the poor in Ethiopia has grown to over 27with in short period of time .The steady growth in the sector has created a competition for scarce funding among institutions. Hence, recent years have seen a growing push to measure performance of micro financing institutions in order to be able to compete and achieve their objectives. In light of this , the paper attempted to look at the performance of MFIs by taking six institutions as a case from Profitability and Sustainability; Asset and Liability management; and Efficiency and productivity perspectives

Data for the study was from secondary sources and various ratios and indicators were used to measure the performance of the MFIs .Five years data from 2002 to 2006 were used to see the trend in performance

The majority of MFIs passed both operational and financial self sufficiency and fewer still requires support to survive and sustain in the industry. Most MFIs are strong performers on return on asset .in connection with liquidity, most MFIs lack strong position to effect immediate obligations. large MFIs are more efficient and productive than small and medium ones. But small MFIs seem to reach the poorest section of the society. Finally ,the trend in performance of microfinance institutions during those years of operation was encouraging.

CHAPTER ONE

INTRODUCTION

1.1. Background of the Study

One of the most stylized facts of developing economies is that formal financial institutions leave the poorest population tightly constrained in their access to financial services. It is also widely recognized that economic progress relies largely on access to financial services such as savings, insurance, and credit. Where formal financial institutions fail the large majority of the poor population, there is evidence to support the proposition that microfinance institutions & credit unions can fill some of the gap (Barham, Boucher and Carter, 1996).

Micro-Finance Institutions (MFIs) are often defined in terms of the following characteristics: targeting the poor (especially the poor women); promoting small businesses; building capacity of the poor; extending small loans with out collaterals; combining credit with savings; and charging commercial interest rates. MFIs are often innovative and flexible in their design and implementation (Dejene, 1998)

Micro finance is the chance the poor never had. It provides credits and savings services to the self-employed to enable them to start-up or expand small income generating activities (www.lifeinafrica.com/microfinace/). The typical micro finance clients are low-income persons that do not have access to formal financial institutions. Micro-Finance clients are typically employed, often house hold based entrepreneurs. In rural areas, they are usually small farmers and others who are engaged in small income generating activities such as food

processing and petty trade. In urban areas, microfinance activities are more diverse and include shopkeepers, service providers, artisans, street vendors, etc. Micro-Finance clients are poor and vulnerable non poor who have a relatively stable source of income (www.mixmarket.org/en/who_are_microfinance_.asp).

The formal financial institutions have played little role in financing development efforts in the rural area because they are clustered in urban conglomerations, concentrate on funding large enterprise, inaccessible to the rural poor especially in terms of distance. In addition to this, the rural poor can not fulfill banking requirements to obtain banks loan/credit. Besides, banking requirements for collateral/material guarantee and intrinsic banking procedure which in most cases is very difficult for the poor to deal with, the volume loan demanded by small farmers/poor is not appealing to the bank. Usually, small farmers or poor require small loan size that is known as micro-loan or micro credit and micro-finance services. Thus, processing of small or micro-loan is not financially feasible and it is difficult to manage. So as a result the formal financial institutions such as banks are reluctant to finance the demand of small farmers or lend small loan. On the other hand, Credit from informal sources is in adequate and more over the interest charged on such loan is exorbitantly exploitive or costly nature of informal financial sources of finance led to the establishment of specialized financial institutions-MFIs with the purpose of extending micro credit to the rural and urban poor, with the following objective

- To extend the banking facilities to the poor men and women
- To eliminate the exploitation of money lenders

- To create opportunities for self-employment and vast unutilized human resources
- To reverse the age old cycle of “low savings, low investment and low-income” in to expanding system of “low-income, micro-credit, investment, more income, more investment, more income and more savings...” (OCSSCo. 2002).

The UN millennium project identifies micro credit as one of the development strategies that should be implemented and supported to attain the ambition of reducing world poverty by half. The very importance of micro finance, as a useful tool against poverty and food insecurity, has come from the United Nations with the designation of 2005 as the international year of micro credit. (UNDP 2005)

In Ethiopia, the poverty reduction strategy is becoming the operational framework to translate the global MDGs targets in to national action (UNDP 2005). Micro finance service intervention in Ethiopia have also be considered as one of the policy instrument of the government and non government organizations (NGOs) to enable rural and urban poor increase out put and productivity, induce technology adoption, improve input and productivity, induce technology adoption, improve input supply, increase income, reduce poverty and attain food security. The sustainability of micro finance institutions that reach a large number of rural and urban poor who are not served by the conventional financial institutions, such as the commercial banks, has been a prime component of the new development strategy of Ethiopia (Wolday 2000)

This paper tried to assess the financial and operational performance of MFIs. MFIs must struggle to have good financial and operational performance so that they can play a major

role in the poverty reduction. MFIs have two challenges one of which is to become a viable institution that built a firm foundation for efficient operation. Only an institution operating efficiently (operationally and financially) can be instrument in sustainable poverty alleviation efforts (Healey, 1998 as cited in HaileSelassie, 2004). The paper tried to address whether MFIs are financially and operationally efficient using the key financial and operational performances indicators as agreed upon by the Inter-American Development Bank (IDB), the Consultative Group to Assist the Poorest (CGAP), the United States Agency for International Development (USAID) and Micro Rate for transparency in micro finance and to measure the risk and performances of MFIs.

Microfinance institutions, regardless of their social mission, are financial intermediaries. therefore, it is important to assess the viability and soundness of MFIs. To evaluate the performance of micro finance institutions SEEP Network and CGAP (most widely used) evaluate financial and operational performance in terms of:

- Sustainability and Profitability
- Asset and Liability Management
- Portfolio Quality
- Efficiency and Productivity

The financial performance indicators are usually ratios extracted from the financial reports (Balance Sheet, Income Statement and Portfolio Report).but due to lack of information on portfolio report performance against portfolio quality were not made.

1. Sustainability and Profitability

Tend to summarize performance in all areas of the company and its sustainability .Most widely indicators of Sustainability and Profitability includes: Adjusted return on equity, Adjusted return on assets , Operational self-sufficiency & Financial self-sufficiency

2. Assets/Liability Management

This includes the following performances indicators: *portfolio to assets, adjusted cost of funds ratio, adjusted debt to equity, and liquidity ratio*

3. Portfolio Quality

The most widely used measure of portfolio quality in the microfinance industry includes: *Portfolio at Risk , Write-off ratio, & Risk coverage ratio*

4. Efficiency/Productivity

Efficiency and productivity indicators are performance measures that show how well the institution is streamlining its operations. Productivity indicators reflect the amount of output per unit of input. These indicators reflect how efficiently an MFI is using its resources, particularly its assets and its Personnel. The Most common efficiency and productivity indicators includes: *Personnel productivity, Average Outstanding Loan Size, Operating expense ratio & Cost per borrower*

1.2. Statement of the Problem

The establishment of sustainable MFI that reach a large number of rural and urban poor who are not served by the conventional financial institutions, such as the commercial banks, has been a prime component of the new development Strategy of Ethiopia (Wolday 2000)

The Ethiopian microfinance sector is one of the fastest growing in the world today. As per the end of year 2005 the then 26 operational MFIs serviced 1277939 borrowing clients with an aggregated portfolio of 1622 billion birr. In terms of outreach these figures represent a nearly 300% increase from end of year 2001 (Ethiopian micro finance institutions performance report, June 2007). The objective of almost all of the micro financed institutions in Ethiopia is poverty alleviation. To achieve these objective micro finance institutions should be financially viable and sustainable. Despite the increasing reliance on micro finance to reduce poverty in Ethiopia there has been surprisingly little work under taken to evaluate their performance. There is also a fear among interested parties in the industry that MFIs could not stay in the market to serve the poor with out the immense support of government, donors and others.

Thus, the purpose of this project is to analyze the performance MFIs. So far, most research tried to assess the impact of microfinance on poverty, women empowerment, income generation, agricultural productivity, etc. But the paper tried to assess whether the MFIs are financially and operationally sound or not. The paper tried to answer questions like:

- ❖ Do MFIs have good financial and operational performance?
- ❖ What are the indicators of the financial and operational performances?
- ❖ What are the determinants of best financial performances?

This research project believed to be significant in improving the operation of MFIs by clearly indicating the performances of the institutions. The performance indicators showed where the position of each MFI so that it will help them to improve their performances. This is to say that the aim of this assessment is to assist microfinance practitioners in measuring the financial and operational performances of MFIs and consequently to give some insights into how a MFIs' financial and operational performances could be improved.

1.3. Objective of the Study

The general objective of the study is to assess the financial and operational performance of micro finance institutions. The specific objectives of the study are:

- To assess the financial and operational performance of micro finance institutions
- To see the sustainability MFIs
- To compare the performance of MFIs in the industry
- To assess the trend of performance of microfinance institutions

1.4. Testable Research Hypothesis

The paper has a set of propositions tested. The propositions of interest were the following:

Hypothesis 1:

Ho: MFIs operating in Ethiopia don't have good financial and operational performances

Ha: MFIs operating in Ethiopia have good financial and operational performances

1.5. Research Design and Methodology

1.5.1 Target Population

Currently there are more than 27 microfinance institutions in Ethiopia, who are serving the Ethiopian people neglected by conventional financial institutions such as commercial banks. Of the 27 MFIs 6 microfinance institutions were selected to participate in the study and the paper was organized as a case study that assessed the financial and Operational performance of Micro Finance Institutions in Ethiopia. The selected microfinance institutions were:

- ❖ Buusa Gonofaa micro finance s.c.
- ❖ Wasasa microfinance Institution
- ❖ Gasha microfinance Institution
- ❖ Poverty eradication and community empowerment (Peace)
- ❖ Amhara credit and saving institution (ACSI) &
- ❖ Dedebit credit and saving institution (DECSI.)

The micro finance institutions were selected based on different criterion: for one thing the size of the institutions (small, medium and large), and geographical distributions (to include at least major regions of Amhara, Tigray, Oromia and Addis Ababa) and the other criterion is

their affiliations (some of them are government affiliated, while others are NGO affiliated and privately owned). This criterion is included in order not to misstate the finding due to the different degree of support received from the government, donors and others.

The Institutions selected as a case is categorized in to three clusters following the method introduced by the micro bank bulletin and applied by microfinance information exchange (the MIX market). The criterion for being a member of the cluster is the scale of operation (gross loan portfolio). The first group is made up of small (Buusa Gonofaa micro finance s.c. and Wasasa microfinance Institution) microfinance institutions with gross loan portfolio less than or equal to 8 million birr ; the second group is made up of medium ones(Gasha microfinance Institution Poverty eradication and community empowerment (Peace)) with gross loan portfolio between 8 million &30 million birr and the third group is made up of large microfinance institutions with gross loan portfolio greater than 30 million birr (ACSI and DECSI).

1.5.2Types of Data Collected

This study is mainly based on secondary data from the annual financial reports of the institutions such as income statement, and the balance sheet of Selected MFIs, data form books, journals, news papers, magazines, reports of various governmental and non governmental organizations such as AEMFI (Association of Ethiopian Micro Finance Institutions) and national bank of Ethiopia and the mix market web sites were used. When clarification was required finance heads of each institution were communicated through telephone. To increase the reliability of data audited annual reports were used.

1.5.3 Data Analysis Method

To provide a better indication of the true performance of MFIs and facilitate comparisons among MFIs, adjustments on the financial institutions were made. The financial results were adjusted to ensure comparability across institutions, taking in to account the effect of inflation, and subsidy levels (inflation and cost of fund adjustments were made)*. All data were computed and analyzed after these adjustments have been made. To facilitate the computation of ratios and indicators all information on the financial statements of each institution were converted in to a common format developed by the SEEP network and alternative credit technologies (ACT). The data were analyzed using different statistical tools like mean, & ratio analysis to address the scientific evidence in financial and operational performances of MFIs. TO reveal performance of MFIs very well, five years data from 2002 to2006 were used to see the trend in performance.

1.6 Limitation of the Study

This study focuses on the financial performance of microfinance institutions in Ethiopia by taking six microfinance institutions as a case. In addition the study based entirely on secondary sources and lack of primary data due to time and information constraint can have a limitation on the findings of the study. Except the above mentioned limitations, the study is believed to represent the true financial performance of the institutions.

*

Inflation rate used (12.3%)were obtained from National bank of Ethiopia data base whereas average commercial lending rate(7%)were from the united nations statistics division –common database

CHAPTER TWO

LITERATURE REVIEW

2.1 theoretical reviews

2.1.1 Evolution of Microfinance

Traditional banking sector cannot reach millions of poor for whom small loans could make huge differences. There are several reasons for this. Most of the poor are rural, and they are much dispersed. They have low education levels, if at all. As a result, administrative cost of supplying loans to the poor population is extremely high. Another issue that makes it difficult to serve these customers through traditional banking is that the poor does not have any assets to use as collateral. As a result, the poor had access to loans only through local money-lenders at exorbitantly high interest rates.

Micro-credit financing starts with the assumption that the poor is willing to pay high interest rates to have access to finance. In general, the system uses the social trust as the collateral. Although there are different micro-credit financing models, the borrowers in the pioneering models are usually members of small groups. Loans are given to individuals, but an entire group is responsible for the repayment. Hence, the borrower who does not fulfill his commitment to repay back will lose his/her social capital. Micro-credit institutions report that their repayment rates are above the commercial repayment rates, sometimes as high as 97%. Today, there are millions of poor people around the world who turn to be entrepreneurs through the micro-credit sector.

Micro credit and microfinance are relatively new terms in the field of development, first coming to prominence in the 1970s, according to Robinson (2001) and Otero (1999). Prior to then, from the 1950s through to the 1970s, the provision of financial services by donors or governments was mainly in the form of subsidised rural credit programmes. These often resulted in high loan defaults, high loss and an inability to reach poor rural households (Robinson, 2001). Robinson states that the 1980s represented a turning point in the history of microfinance in that MFIs such as Grameen Bank and BRI2 began to show that they could provide small loans and savings services profitably on a large scale. They received no continuing subsidies, were commercially funded and fully sustainable, and could attain wide outreach to clients (Robinson, 2001). It was also at this time that the term “micro credit” came to prominence in development (MIX3, 2005). The difference between micro credit and the subsidised rural credit programmes of the 1950s and 1960s was that micro credit insisted on repayment, on charging interest rates that covered the cost of credit delivery and by focusing on clients who were dependent on the informal sector for credit (ibid.). It was now clear for the first time that micro credit could provide large-scale outreach profitably. The 1990s “saw accelerated growth in the number of microfinance institutions created and an increased emphasis on reaching scale” (Robinson, 2001, p.54). Dichter (1999, p.12) refers to the 1990s as “the microfinance decade”. Microfinance had now turned into an industry according to Robinson (2001). Along with the growth in micro credit institutions, attention changed from just the provision of credit to the poor (micro credit), to the provision of other financial services such as savings and pensions. (microfinance) when it became clear that the poor had a demand for these other services (MIX, 2005).

2.1.2 Evolution of the MFIs Industry in Ethiopia

Initially, micro credit started as a government and non-government organizations motivated scheme. Following the 1984/85 severe drought and famine, many NGOs started to provide micro credit along with their relief activities although this was on a limited scale and not in a sustained manner (IFAD 2001). The Government also sporadically provided loans largely for the purchase of oxen through its Rural Finance Department of the Ministry of Agriculture and Cooperatives. But these loans were not based on proper needs assessment and no mechanism was in place to monitor their effectiveness. In many cases, these loans were not to be repaid and might have fostered a culture of not repaying loans. (Getachew Teaka Yishak Mengesha 2005).

During the command economic system (1974-91), the Development Bank of Ethiopia (DBE) and the Commercial Bank of Ethiopia (CBE) were also involved in extending loans to cooperatives largely in response to the government's pressure. A massive default by the cooperatives following the demise of the command economy along with its extensive control systems, however, forced the CBE to continue to provide loans for the purchase of fertilizers and improved seeds on the basis of regional government guarantees. The DBE has also been providing loans to micro and small-scale operators in some selected towns. This scheme was, however, based on donor funds designed in the form of revolving fund, and essentially based on a limited scale in terms of the number of clients covered. Funds were simply given from the DBE to clients identified and screened by the Trade and Industry Bureaux of regional Governments, which led to a low loan recovery rate (DBE 1999). In line with this, the early formal microfinance activity is the DBE (Development Bank of Ethiopia)

Place, Pilot Credit Scheme, initiated in 1990 under the Market Towns Development Project [1] , implemented in 1994. While many NGOs Programmers that emphasizes both credit and savings began in early 1990s. For example, the REST Credit Scheme of Tigray (RCST) (own Dedebit Credit and Savings Institution, DECSI) was launched in 1993; Sidama Saving and Credit scheme (now Sidama Microfinance Institution) was established in 1994; Oromia Credit and Saving Scheme

(Now Oromia Credit and Saving S.C.) Started in 1996 (Gerehiwot Ageba). The formulization of the Micro finance institutions, micro credit used to be provided in a fragmented and unplanned manner even during the early 1990s. The micro credit scheme was donor driven rather than an outcome stemming from a clear policy direction and development strategy. Their outreach and impact also remained Limited (IFAD 2001). Another feature of these credit schemes is hat all was trying to address the credit delivery service alone. The provision of savings facilities, which is essential for a sustained credit service delivery, was completely ignored. The failure of the formal banks to provide banking facilities, on the one hand, led the unsustainability of the NGO's credit scheme on the other hand, led the government to issue out a legal framework for the establishment and operation of micro finance institutions. Currently there are 27 microfinance institutions in Ethiopia, licensed and registered by NBE, following the issuance of proclamation No. 40/1994. ?

2.1.3 What Is Microfinance?

Microfinance has been defined as: - the means by which poor people convert small sums of money into large lump sums (Rutherford 1999). Microfinance services may be seen in terms of four main mechanisms:

Loans: which allow a lump sum to be enjoyed now in exchange for a series of savings to be made in the future in the form of repayment instalments.

Savings: which allow a lump sum to be enjoyed in future in exchange for a series of savings made now.

Insurance: which allows a lump sum to be received at some unspecified future time if needed in exchange for a series of savings made both now and in the future. Insurance also involves income pooling in order to spread risk between individuals on the assumption that not all those who contribute will necessarily receive the equivalent of their contribution.

Pensions: which allow a lump sum to be enjoyed as a specified and generally distant date in future in exchange for a series of savings made now.

In the literature the terms micro credit and microfinance are often used interchangeably, but it is important to highlight the difference between them because both terms are often confused. Sinha (1998) states "micro credit refers to small loans whereas microfinance is appropriate where NGOs and MFIs supplement the loans with other financial services (savings, insurance, etc). Therefore micro credit is a component of microfinance in that it involves providing credit to the poor, but microfinance also involves additional non-credit financial services such as savings, insurance, pensions and payment services (Okio credit, 2005).

2.1.4 Models of microfinance interventions

Despite the lack of data on the sector, it is clear that a wide variety of implementation methods are employed by different MFIs. The Grameen Bank (2000) has identified fourteen different microfinance models of which I will focus on three: Rotating savings and credit Association (ROSCAs), the Grameen Bank and the Village Banking modes, as these are the three microfinance models that are common in the industry.

A. Rotating Savings and Credit Associations

These are formed when a group of people come together to make regular cyclical contributions to a common fund, which is then given as a lump sum to one member of the group in each cycle (Grameen Bank, 2000). This model is a very common form of savings and credit. He states that the members of the group are usually neighbours and friends, and the group provides an opportunity for social interaction and are very popular with women. (Eoin Wrenn, 2005)

B. The Grameen Solidarity Group Model

This model is based on group peer pressure where by loans are made to individuals in groups for four to seven. Group members collectively guarantee loan repayment, and access to subsequent loans is dependent on successful repayment by all group members. This model has contributed to broader social benefits because of the mutual trust arrangement at the heart of the group guarantee system. The group itself often becomes the building block to a broader social network (Eoin Wrenn, 2005)

C. Village Banking Model

Village banks are community-managed credit and savings associations established by NGOs to provide access to financial services, build community self-help groups and help members accumulate savings. They usually have 25 to 50 members who are low-income individuals seeking to improve their lives through self-employment activities.

These members run the bank, elect their own officers, establish their own by-laws, distribute loans to individuals and collect payments and services (Grameen Bank, 2000a). The loans are backed by moral collateral; the promise that the group stands behind each loan. The sponsoring MFI lends loan capital to the village bank, who in turn lend to the members. All members sign a loan agreement with the village bank to offer a collective guarantee. Members are usually requested to save twenty percent of the loan amount per cycle. Members' savings are tied to loan amounts and are used to the loan amount and are used to finance new loans or collective income generating activities and so they stay within

2.1.5 Performance measurement in microfinance

Microfinance institutions, regardless of their social mission, are financial intermediaries. therefore, it is important to assess the viability and soundness of MFIs. To evaluate the performance of micro finance institutions SEEP Network and CGAP (most widely used) evaluate financial and operational performance in terms of:

- Sustainability and Profitability
- Asset and Liability Management
- Portfolio Quality

- Efficiency and Productivity

The financial performance indicators are usually ratios extracted from the financial reports (Balance Sheet, Income Statement and Portfolio Report).but due to lack of information on portfolio report performance against portfolio quality were not made.

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This includes the following performances indicators: *portfolio to assets, adjusted cost of funds ratio, adjusted debt to equity, and liquidity ratio*

3. Portfolio Quality

The most widely used measure of portfolio quality in the microfinance industry includes: *Portfolio at Risk ,, Write-off ratio, & Risk cove-rage ratio*

4. Efficiency/Productivity

Efficiency and productivity indicators are performance measures that show how well the institution is streamlining its operations. Productivity indicators reflect the amount of output per unit of input. These indicators reflect how efficiently an MFI is using its resources, particularly its assets and its Personnel. The Most common efficiency and productivity

indicators includes: *Personnel productivity, Average Outstanding Loan Size, Operating expense ratio & Cost per borrower*

2.2 Empirical literature review

The micro finance institutions participation in several developing economies is escalating from time to time. Various studies on different countries on the performance of the MFIs confirm this (Adongo and Stork 2005, Zeller and Meyer 2002, Meyer 2002, Robert cull et al. 2007). For example, in Bangladesh a microfinance institution called Grameen Bank at the end of 2000 reported 2.4 million members, where 95 percent of them are women, with \$225 million outstanding loan. In addition, Thailand also has reported impressive outreach⁵ through agricultural lending by the Bank for Agriculture and Agricultural Cooperative (Meyer 2002). In general, a lot number of microfinance institutions have registered impressive outreach in several developing economies including India, Cambodia, and others (Meyer 2002).

A survey by Robert cull and others on the performance of leading MFIs in 49 countries finds interesting results. It founds over half of surveyed MFIs are profitable after making adjustment of subsidies. It also identified no evidence of trade off between being profitable and reaching the poor.

For the Ethiopian case, there are few studies undertaken in relation to MFIs. But, the objectives addressed in these previous studies are different, insuring the value added of this study.

Lakew (1998) examines POCSSBO's⁶ micro financing program contribution to poverty

reduction. He found that after the credit program employment opportunity for the beneficiaries have been created. He also noted that the credit program of POCSSBO had positive effect on income and saving of the clients. In addition, He stated that medical, education and nutrition access of the clients had been improved.

Similarly, Aklilu (2002) reviews the importance of micro finance institutions in developing economies based on countries' experiences. In the review she suggested for promotion of the existing well developed institution 'iddir" to facilitate growth of formal MFIs.

Borchgrevink and et. al (2005), studies marginalized groups, credit and empowerment for the case of Dedebit Credit and Saving Institution (DECSI) of Tigray. The study finds that female household heads are extremely marginalized groups; and also, young households', rural landless households and urban house-renting households are the other marginalized groups. Trough two-phase assessment, the study found that the DECSI's program has had a positive impact on the livelihood of and as well enhanced the social and political position of many clients. Concerning the constraints for economic development, the study noted poor rainfall, small farm size, and shortage of labor during peak agricultural seasons as the main constraints. Similarly, the main constraints in non-farm business

6 POCSSBO stands for Project Office for Creation of Small Scale Business Opportunities and the office was established in 1995.ventures are low return and lack of demand. However, credit is not the main constraining factor for expanding economic activity, exceptthat in urban areas. The study further noted, DECSI's heavy involvement in credit delivery in the region has more or less satisfied to most of the people with some exceptions in the urban areas.

CHAPTER THREE

EMPIRICAL ANALYSIS

Introduction

The Ethiopian microfinance sector is one of the fastest growing in the world today. As per the end of year 2005 the then 26 operational MFIs serviced 1277939 borrowing clients with an aggregated portfolio of 1622 billion birr. In terms of outreach these figures represent a nearly 300% increase from end of year 2001 (Ethiopian micro finance institutions performance report, June 2007). The objective of almost all of the micro finance institutions in Ethiopia is poverty alleviation. To achieve this objective micro finance institutions should be financially viable and sustainable.

The findings stated below are extracted and analyzed from the financial statements of each microfinance institutions under considerations. In order to increase the reliability of data audited reports were used. In this section the paper presents findings of the study on Sustainability and Profitability; Asset and Liability Management; and Efficiency and Productivity of microfinance institutions. Due to inaccessibility of portfolio analysis report of the institutes, portfolio quality ratios were not considered in the study.

Performance of microfinance institutions in the year 2006

3.1 Sustainability and Profitability of microfinance institutions

Profitability and sustainability ratios reflect the microfinance institutions' ability to continue operating and grow in the future. Regardless of their nonprofit or for profit status; donors and investors alike look to fund sustainable institutions. Sustainability and profitability of microfinance institutions were measured and analyzed using operational and financial self sufficiency; adjusted return on assets ; and adjusted return on equity ratios as follows:

3.1.1 Operational self sufficiency and financial self sufficiency

Operational self sufficiency indicates whether revenues from operations are sufficient to cover all operating expenses. It reflects the MFI's ability to continue its operations if it receives no further subsidies. The break even point of an MFI's operation is 100 percent. Where as, financial self sufficiency measures not only MFI's ability to cover its operating costs but also its ability to maintain the value of its equity relative to inflation and to operate and expand without subsidies.

Table3.1: small MFIs

MFIs	<i>Indicators</i>	
	Operational self sufficiency	Financial self sufficiency
Buussa	78%	66%
wasasa	121%	96%
Average	99.5%	81%

Source: researcher's own computation from financial statements

The above table showed that average operational self sufficiency for small MFI is 99.5% where as average financial self sufficiency still below the threshold level (81%). from this it can be concluded that small MFIs were not in a position to generate sufficient revenue to cover operating costs and at the same time their ability to operate and expand without subsidies is difficult for these institutions.

Table3.2: medium MFIs

MFIs	<i>Indicators</i>	
	Operational self sufficiency	Financial self sufficiency
Gasha	93%	92%
Peace	205%	159%
Average	149%	125.5%

Source: researcher's own computation from financial statements

As per the above table the average Operational self sufficiency and financial self sufficiency for medium MFIs is 149% and 125% respectively.

Table 3.3: large MFIs

MFIs	<i>Indicators</i>	
	Operational self sufficiency	Financial self sufficiency
ACSI	223%	146%
Dedebit	189%	113%
average	206%	129.5%

Source: researcher's own computation from financial statements

From the above table it can be observed that large microfinance institutions scored 206 % in operational and 129.5% in financial self sufficiency .In general it can be concluded that large MFIs did well in terms of operational and financial self sufficiency because in both ratios they achieved beyond the threshold level (100%)

3.1.2 Adjusted return on assets

Adjusted Return on assets indicates how well an MFI is managing its assets to optimize its profitability. Return on assets should be positive. It provides an indication of the ability of an MFI to expand profitably with unsubsidized funding. According to SEEP Network Guideline on measuring performance of microfinance institutions, a positive correlation exists between adjusted return on asset ratios and portfolio to assets. The ratio is higher for institutions that maintain a large percentage of the assets in the gross portfolio.

Table3.4: small MFIs

MFIs	<i>Indicators</i>
	adjusted return on assets
Buussa	-8%
wasasa	0.6%
Average	-3.7%

Source: researcher's own computation from financial statements

Table3.5: medium MFIs

MFIs	<i>Indicators</i>
	adjusted return on assets
Gasha	-1.4%
Peace	7.5%
Average	3.05

Source: researcher's own computation from financial statement

Table3.6: large MFIs

MFIs	<i>Indicators</i>
	adjusted return on assets
ACSI	4.6%
Dedebit	1%
average	2.8%

Source: researcher's own computation from financial statements

During the year under consideration (2006), 66.6 %(4 out of 6 MFIs) registered a positive return on assets where as the remaining 2 MFIs were not good in managing their assets to optimize profit.

3.1.3 Adjusted return on equity

Table3.7: small MFIs

MFIs	<i>Indicators</i>
	adjusted return on equity
Buussa	-11%
Wasasa	-1.3%
Average	-6.2%

Source: researcher's own computation from financial statements

In the year under consideration, small microfinance institutions reported a negative return on equity. This shows that the institution's ability to generate income from their core financial service activity was not good.

Table3. 8: medium MFIs

MFIs	<i>Indicators</i>
	adjusted return on equity
Gasha	-25.6%
Peace	27.5%
Average	0.95%

Source: researcher's own computation from financial statements

Medium microfinance institutions reported a positive return on equity even though still below 1 % (0.95%). The deviation in adjusted return on equity between Gasha and Peace is huge.

Table 3.9: large MFIs

MFIs	<i>Indicators</i>
	adjusted return on equity
ACSI	14.8%
Dedebit	5.54%
average	10.17%

Source: researcher's own computation from financial statements

Based on the summary of the above tables 3 out of 6 MFIs secured a positive return on equity and were good in using retained earnings and donor money to become sustainable. But the remaining 3 MFIs had a negative return.

Table 3.10 sustainability and profitability ratio of the average Ethiopian MFIs

<i>Microfinance institutions</i>	<i>Indicators.</i>			
	Adjusted return on equity	Adjusted return on assets	Operational self sufficiency	Financial self-sufficiency
<i>Buussa</i>	-11 %	-8 %	78 %	66 %
<i>Wasasa</i>	-1.3 %	0.6 %	121 %	96 %
<i>Gasha</i>	-25.6 %	-1.4 %	93 %	92 %
<i>Peace</i>	27.5 %	7.5 %	205 %	159 %
<i>ACSI</i>	14.8 %	4.6 %	223 %	146 %
<i>DECSI</i>	5.54 %	1 %	189 %	113 %
<i>Ethiopia average</i>	1.65 %	0.71 %	151.5%	112 %

Source: researcher's own computation from financial statements

From the above table summary it can be concluded that microfinance institutions in Ethiopia were doing well in the year 2006 from profitability and sustainability point of view. They have achieved a positive return both on equity and on assets and passed the break even point in operational and financial self sufficiency

3.2 Asset and Liability management of microfinance institutions

The basis of financial intermediation is the ability to manage assets (the use of funds) and liabilities (the source of funds).it is required at different level:

A) Interest rate management -the MFI make sure that the use of funds generates more revenues than the cost of funds.

B) Asset management-funds should be used to create assets that produce the most revenue.

C) Leverage – the MFIs seeks to borrow funds to increase assets and there by increase revenue and net profit. MFI should also manage the cost and use of borrowing.

D) Liquidity management –the MFI must make sure that it has sufficient funds available to meet any short term obligations.

E) Foreign currency management-this occurs when an MFI lends, invests, or borrows in foreign currency.

In general the asset and liability management of an MFI can be measured using ratios such as portfolio to assets; adjusted cost of fund; adjusted debt to equity; and liquidity ratios.

3.2.1 Portfolio to assets ratio

This ratio shows how well an MFI allocates its assets to its primary business (making loans and providing other financial services to micro entrepreneurs)

Table 3.11:smallMFIs

<i>MFI</i> s	<i>Indicators</i>
	Portfolio to assets
Buussa	66.6%
Wasasa	70.8%
Average	68.7%

Source: researcher's own computation from financial statements

As per the above table, small microfinance institutions on average allocated 68.7% of their assets to provide loan services to micro entrepreneurs.

Table3.12:medium MFIs

<i>MFI</i> s	<i>Indicators</i>
	Portfolio to assets
Gasha	72.1%
Peace	92.5%
Average	82.3%

Source: researcher's own computation from financial statements

The table above showed that medium microfinance institutions devoted more than three-fourth of their assets in making loans to their clients.

Table3.13: large MFIs

<i>MFIs</i>	<i>Indicators</i>
	Portfolio to assets
ACSI	80.5%
Dedebit	69.1%
Average	74.8%

Source: researcher's own computation from financial statements

Most microfinance institutions used more than 68% of the assets to their primary activity (making loans to micro entrepreneurs). Relatively peace microfinance institution devoted the highest portion (92.5%) of its asset in making loan to the poor section of the society.

3.2.2 Adjusted cost of funds ratio

This ratio gives a blended interest rate for all the MFI's average funding liabilities, deposits, and borrowings.

Table3.14smallMFIs

<i>MFIs</i>	<i>Indicators</i>
	Adjusted cost of fund ratio
Buussa	4.2%
Wasasa	3.95%
Average	4.07%

Source: researcher's own computation from financial statements

According to the summary in the above table, small MFIs on average incurred 4.07% cost in financing their operation, which is below the commercial banks' lending rate (8%)

Table3.15:medium MFIs

<i>MFIs</i>	<i>Indicators</i>
	Adjusted cost of fund ratio
Gasha	4.7%
Peace	6.96%
Average	5.83%

Source: researcher's own computation from financial statements

The above table showed that medium MFIs incurred Br.5.83 cost to finance each Br.100 in liability.

Table3.16:largeMFIs

<i>MFIs</i>	<i>Indicators</i>
	Adjusted cost of fund ratio
ACSI	3.54%
Dedebit	3.96%
Average	3.75%

Source: researcher's own computation from financial statements

Microfinance institutions finance their activities with funds from debt and equity. When operation is financed through debt, it resulted in incurrance of cost (Cost of financing).

Institutions should strive to get a loan that bears small interest rate. A low cost of funds results from an MFI gaining access to deposits and /or borrowings at a reasonable cost because depositors and lenders considered it credit worthy. In this respect large MFIs were successful in obtaining funds at a least average interest rate (3.57%).

3.2.3-adjusted debt to equity and liquidity ratios

Adjusted debt to equity ratio indicates how well the MFI is able to leverage its equity to increase assets through borrowing. It also indicates the safety cushion the institution has to absorb losses before creditors are at risk. Where as liquidity ratio shows the sufficiency of cash to meet the most immediate payment

Table 3.17 smallMFIs

<i>MFIs</i>	<i>Indicators</i>	
	Adjusted debt to equity ratio	Liquidity ratio
Buussa	43.6%	116.7%
Wasasa	138%	51%
Average	90.8%	83.85%

Source: researcher's own computation from financial statements

As per the above table small microfinance institutions reported on average 83.85% in terms of liquidity and 90.8% is their average adjusted debt to equity ratio.

Table3.18:medium MFIs

<i>MFIs</i>	<i>indicators</i>	
	Adjusted debt to equity ratio	Liquidity ratio
Gasha	1084%	58.9%
Peace	176%	19.9%
Average	630%	39.4%

Source: researcher's own computation from financial statements

On average medium microfinance institutions reported a 630% in adjusted debt to equity ratio and 39.4% in liquidity to meet immediate payment .

Table 3.19:large MFIs

<i>MFIs</i>	<i>indicators</i>	
	Adjusted debt to equity ratio	Liquidity ratio
ACSI	234%	13.3%
Dedebit	501%	66.9%
Average	367.5%	40.1%

Source: researcher's own computation from financial statements

Medium MFIs had the highest average debt in proportion to their equity (630%) and small MFIs the least (90.8%) where as large microfinance institutions had 367.5% debt to equity ratio. From this it can be concluded that medium and large performed well in obtaining funds as compared to their small counter parts.

For MFIs, maintaining sufficient cash is important not only to pay bills, salaries or creditors but also uphold its promise to provide repeat loans to clients, which is a major incentive to repay loans .similarly, any financial institution that fails to repay client deposits on time is likely to lose client confidence and access to future funding. In this regard small microfinance institutions have the highest liquidity ratio (83.85%) followed by medium and large MFIs having 39.4% and 40.1% respectively.

Table3.20 Asset and liability management of MFIs in Ethiopia

<i>Microfinance institution</i>	<i>indicators</i>			
	Portfolio to assets	Adjusted cost of funds ratio	Adjusted debt to equity	Liquidity ratio
<i>Buussa</i>	66.6 %	4.2 %	43.6 %	116.7%
<i>Wasasa</i>	70.8 %	3.9 %	138 %	51 %
<i>Gasha</i>	72.1 %	4.7 %	1084 %	58.9 %
<i>Peace</i>	92.5 %	6.9 %	176 %	19.9 %
<i>ACSI</i>	80.5 %	3.5%	234 %	13.3 %
<i>Dedebit</i>	69.1 %	3.9 %	501 %	66.9 %
<i>Ethiopia average</i>	75.2%	4.5 %	362.7 %	54.4 %

Source: researcher's own computation from financial statements

From the summary of asset and liability management of MFIs in Ethiopia , microfinance institutions assigned more than 75% of their assets in making loan and the average cost of financing is 4.5%,which is below the lending rate of commercial banks. And the debt of the institutions is more than three times their equities. But their liquidity is almost 50%.

3.3 Efficiency and productivity of MFIs

Efficiency and productivity indicators reflect how well an MFI uses its resource, particularly its assets and personnel .This particular study employed personnel productivity; average outstanding loan size; operating expense ratio and cost per borrower as Efficiency and productivity indicators

3.3.1 Operating expense ratio

This ratio shows administrative and personnel expense to the MFI's yield on the gross loan portfolio .It is the ratio of operating expense to average gross loan portfolio. The lower the ratio, the more efficient the MFI is.

Table 3.21smallMFIs

<i>MFIs</i>	<i>Indicators</i>
	Operating expense ratio
Buussa	17%
Wasasa	13.7%
Average	15.35%

Source: researcher's own computation from financial statements

From the above table it can be observed that small microfinance institutions incurred Br.15.35 for administration and personnel in order to provide a Br.100 loan to their customers.

Table3.22:medium MFIs

<i>MFIs</i>	<i>Indicators</i>
	Operating expense ratio
Gasha	13.8%
Peace	8%
Average	10.9%

Source: researcher's own computation from financial statements

The above table showed that the average operating expense incurred by medium microfinance institutions to provide a Br.1 loan to their customers amounted 10.9 cents.

Table 3.23:largeMFIs

<i>MFIs</i>	<i>Indicators</i>
	Operating expense ratio
ACSI	5%
Dedebit	2.59%
Average	3.79%

Source: researcher's own computation from financial statements

As per the above tables large MFIs have the lowest operating expense ratio(3.79%) and small MFIs the highest operating expense ratio(15.35%) where as medium MFI have an average operating expense ratio of 10.9%. from this it can be concluded that ,as the size of MFIs increases the operating expense ratio decreases. This might be due to economics of scale and/or learning effect (experience) can enhance of MFI efficiency.

3.3.2 Cost per borrower

It indicates an institution how much it currently spends in personnel and administrative expenses to serve a single borrower it informs the MFI how much it must earn from each borrower to be profitable.

Table3. 24 smallMFIs

<i>MFIs</i>	<i>Indicators</i>
	Cost per borrower
Buussa	170
Wasasa	77.90
Average	123.95

Source: researcher's own computation from financial statements

As per the above table on average small microfinance institutions incurred Br.123.95 to serve a single borrower

Table3.25: medium MFIs

<i>MFIs</i>	<i>Indicators</i>
	Cost per borrower
Gasha	165
Peace	89.33
Average	127.16

Source: researcher's own computation from financial statements

On average small microfinance institutions spent Br.127.16 to serve a single borrower.

Table3. 26: large MFIs

<i>MFIs</i>	<i>Indicators</i>
	Cost per borrower
ACSI	52.24
Dedebit	45.35
Average	48.79

Source: researcher's own computation from financial statements

On average large microfinance institutions incurred Br.48.79 per borrower where as small and medium MFIs Br.123.95 and 127.16 respectively. Large MFIs spends the least (efficient) in personnel and administrative expenses to serve a single borrower.

3.3.3 Average outstanding loan size

The average outstanding loan size is one proxy for an MFI to measure its ability to reach poorer clients

Table 3.27 smallMFIs

<i>MFIs</i>	<i>Indicators</i>
	average outstanding loan size
Buussa	1002
Wasasa	812
Average	907

Source: researcher's own computation from financial statements

According to the computation in the above table, on average small microfinance institutions lend Br.907 to a single borrower.

Table3.28 :medium MFIs

<i>MFIs</i>	<i>Indicators</i>
	average outstanding loan size
Gasha	1094
Peace	1405
Average	1249.5

Source: researcher's own computation from financial statements

The above table showed that the average loan size given to a single borrower by medium microfinance institutions was Br.1249.5.

Table3.29:largeMFIs

<i>MFIs</i>	<i>Indicators</i>
	Average outstanding loan size
ACSI	1264
Dedebit	1832
Average	1548

Source: researcher's own computation from financial statements

The average outstanding loan size provided by small MFIs during the year 2006 was Br.907; and B r.1249.5 and 1548 by medium and large ones respectively. Although several factors other than the income level of the client contribute to smaller outstanding loan sizes, a correlation exists between average outstanding loan size and the average income of the area served. Based on this, small MFIs seems to reach poorer clients since the average loan size is the smallest.

3.3.4 Personnel productivity

This indicator measures the overall productivity of the staff and examines the ability of the MFI'S personnel to manage all its clients, including borrowers, voluntary savers, and other clients. As MFIs offer more products to meet their clients diverse financial need ,active clients per staff member is more relevant than borrowers per loan officers

Table 3.30: small MFIs

<i>MFIs</i>	<i>Indicators</i>
	Personnel productivity
Buusaa	299
Wasasa	388
Average	344

Source: researcher's own computation from financial statements

As per the above table on average each member of staff in small microfinance institutions served 344 clients in order to meet their diversified financial need.

Table3.31: medium MFIs

<i>MFIs</i>	<i>Indicators</i>
	Personnel productivity
Gasha	134
Peace	480
Average	307

Source: researcher's own computation from financial statements

The table above showed that a single staff member in medium microfinance institutions on average served 307 clients.

Table 3.32: large MFIs

<i>MFIs</i>	<i>Indicators</i>
	Personnel productivity
ACSI	368
Dedebit	400
Average	384

Source: researcher's own computation from financial statements

As per the above table each staff member of large MFIs on average served 384 clients during the year 2006. relatively large MFIs served the highest client perstaff member (384) and medium MFIs served the least per staff member (307).

Table3.33 Efficiency and productivity of MFIs in Ethiopia

<i>Micro finance institutions</i>	<i>Indicators</i>			
	Personnel productivity	Average outstanding loan size	Operating expense ratio	Cost per borrower
<i>Buussa</i>	299	1002	17 %	170
<i>Wasasa</i>	388	812	13.7 %	77.9
<i>Gasha</i>	134	1094	13.8 %	165
<i>Peace</i>	480	1405	8 %	89.33
<i>ACSI</i>	368	1264	5 %	52.24
<i>Dedebit</i>	400	1832	2.6 %	45.35
<i>Ethiopia</i>	345	1234.8	10 %	99.9
<i>Average</i>				

Source: researcher's own computation from financial statements

The above summary table showed that on average a single staff member served 345 clients and Br.1234.8 the average loan size for the institutions .it requires an administrative and personnel cost of 10 cents to provide a Br.1 loan. But it costs Br.99.9 to serve a single borrower.

Trend analysis on performance of microfinance institutions

Trend analysis is the examination of a company's financial statements and indicators over time to determine how action affects results. Since financial statements for a single period do not reveal much about the institutions trend analysis covering five years period from 2002 to 2006 were used to show their performance.

I sustainability and profitability

Table 3.34. Trend in sustainability and profitability of small MFIs

<i>Indicators(average)</i>	<i>years of operation</i>				
	2006	2005	2004	2003	2002
<i>Adjusted return on assets</i>	-39.7%	-6.05%	-0.03%	-3.33%	2.81%
<i>Adjusted return on equity</i>	-12.3%	-9.75%	1.3%	-4.1%	3.8%
<i>operational self sufficiency</i>	99.5%	90.8%	127.3%	123.75%	135.3%
<i>financial self sufficiency</i>	81.16%	72.65%	105.5%	89.35%	126.9%

Source: researcher's own computation from financial statements

As per the above table the performance of small MFIs in terms of adjusted return on assets and on equity the trend shows a steady decline in performance .these institutions were better in earlier years of operation than later years. Similarly, they were good in operational and financial self sufficiency in before 2004 and were not in a position to lift the ratio towards and beyond the threshold level (100%)

Table3.35 Trend in sustainability and profitability of medium MFIs

Indicators(average)	years of operation				
	2006	2005	2004	2003	2002
Adjusted return on assets	3.02%	-1.41%	-6.55%	-5.6%	-3.85%
Adjusted return on equity	0.95%	-7.6%	-27.1%	-27.63%	-14.97%
operational self sufficiency	149.3%	111.5%	128.1%	81.35%	72.15%
financial self sufficiency	125.6%	94%	117.55%	61.3%	72.15%

Source: researcher's own computation from financial statements

From The above table it can be observed that the performance of medium MFIs in terms of adjusted return on assets and on equity, the trend shows increase in performance .these institutions were better in recent years of operation than later years. Similarly, they were good in operational and financial self sufficiency in recent years and were in a position to pass the threshold level.

Table3.36 Trend in sustainability and profitability of large MFIs

Indicators(average)	years of operation				
	2006	2005	2004	2003	2002
Adjusted return on assets	2.78%	2.29%	5.93%	0.11%	4.11%
Adjusted return on equity	10.17%	16.25%	-1.82%	6.22%	11.7%
operational self sufficiency	206%	199.49%	218.9%	201.3%	179.75%
financial self sufficiency	260%	132.4%	195.7%	102.1%	180.35%

Source: researcher's own computation from financial statements

The trend in performance showed that large MFIs were successful from sustainability and profitability point of view, even though the rate fluctuates year after year. In all years operation these institutions were operationally and financially self sufficient .and secured a positive return both on equity and assets except in the year 2004 in which the institutions reported a negative return on equity.

Table3.37 Trend in sustainability and profitability of all MFIs

<i>Indicators(average)</i>	<i>types of MFIs</i>	<i>years of operation</i>				
		2006	2005	2004	2003	2002
<i>Adjusted return on assets</i>	small	-39.7%	-6.05%	-0.03%	-3.33%	2.81%
	medium	3.02%	-1.41%	-6.55%	-5.6%	-3.85%
	large	2.78%	2.29%	5.93%	0.11%	4.11%
<i>Adjusted return on equity</i>	small	-12.3%	-9.75%	1.3%	-4.1%	3.8%
	medium	0.95%	-7.6%	-27.1%	-27.63%	-14.97%
	large	10.17%	16.25%	-1.82%	6.22%	11.7%
<i>operational self sufficiency</i>	small	99.5%	90.8%	127.3%	123.75%	135.3%
	medium	149.3%	111.5%	128.1%	81.35%	72.15%
	large	206%	199.49%	218.9%	201.3%	179.75%
<i>financial self sufficiency</i>	small	81.16%	72.65%	105.5%	89.35%	126.9%
	medium	125.6%	94%	117.55%	61.3%	72.15%
	large	260%	132.4%	195.7%	102.1%	180.35%

Source: researcher's own computation from financial statements

All in all, the trend in performance in medium and large microfinance institutions were promising, from profitability and sustainability point of view. But there is a decline in performance from the side of small MFIs.

II asset and liability management

Table 3.38 Trend in asset and liability management of small MFIs

<i>Indicators(average)</i>	<i>years of operation</i>				
	2006	2005	2004	2003	2002
<i>Portfolio to assets</i>	68.7%	64.29%	68.5%	60.05%	75.7%
<i>Adjusted cost of funds ratio</i>	4.07%	6.05%	6.05%	6.77%	6.86%
<i>Adjusted debt to equity</i>	90.8%	38.95%	61.22%	31.09%	25.59%
<i>Liquidity ratio</i>	83.85%	136.35%	277.59%	178.13%	111.52%

As per the above table portfolio to asset ratio for small MFIs were almost stable (between 60.05% and 75.5%). the adjusted cost of funding shows a continuous decrease from 6.86% in the year 2002 to 4.07% in the year 2006. the trend in debt to equity showed an increase except in the year 2005 which shows a decline. surprisingly, liquidity ratio dropped in the year 2006 to 83.85 % but for the remaining years above 100%.

Table 3.39 Trend in asset and liability management of medium MFIs

Indicators(average)	years of operation				
	2006	2005	2004	2003	2002
Portfolio to assets	82.3%	81.14%	58.5%	29.77%	30.6%
Adjusted cost of funds ratio	5.83%	11.35%	7.85%	1.52%	1.76%
Adjusted debt to equity	630%	570.72%	414.42%	157.93%	99.5%
Liquidity ratio	39.4%	49.6%	129.3%	269.3%	235.4%

Source: researcher's own computation from financial statements

For medium MFIs the trend in portfolio to asset showed a subsequent increase from 30.6% in the year 2002 to 82.3% in the year 2006. In terms of adjusted cost of funds, the institutions were good in 2002 (1.76%) and 2003 (1.52%) but the rate was high in 2005 (11.35%) but in the year 2006 dropped in to 5.83%. These MFIs debt as compared to equity increased progressively in subsequent years (from 99.5% to 630%)

Table 3.40 Trend in asset and liability management of large MFIs

Indicators(average)	years of operation				
	2006	2005	2004	2003	2002
Portfolio to assets	74.8%	73.26%	71.65%	65.35%	52.8%
Adjusted cost of funds ratio	3.75%	6.59%	3.24%	2.37%	2.84%
Adjusted debt to equity	367%	273.53%	196.93%	120.61%	225.99%
Liquidity ratio	80.2%	46.28%	44.52%	52.6%	62.8%

Source: researcher's own computation from financial statements

For large MFIs on average there is a steady progress in portfolio to asset ratio from 52.8 %(in 2002) to 74.8 %(in 2006) .but the cost of fund was high in the year 2005(6.59%)and almost between 2.37% and 3.75%in the remaining years. the proportion of debt to equity in all years remain above 100% but there was no consistency in liquidity ratio

Table 3.41 Trend in asset and liability management of all MFIs

<i>Indicators(average)</i>	<i>types of MFIs</i>	<i>years of operation</i>				
		2006	2005	2004	2003	2002
<i>Portfolio to assets</i>	small	68.7%	64.29%	68.5%	60.05%	75.7%
	medium	82.3%	81.14%	58.5%	29.77%	30.6%
	large	74.8%	73.26%	71.65%	65.35%	52.8%
<i>Adjusted cost of funds ratio</i>	small	4.07%	8.05%	6.05%	6.77%	6.86%
	medium	5.83%	11.35%	7.85%	1.52%	1.76%
	large	3.75%	6.59%	3.24%	2.37%	2.84%
<i>Adjusted debt to equity</i>	small	90.8%	38.95%	61.22%	31.09%	25.59%
	medium	630%	570.72%	414.42%	157.93%	99.5%
	large	367%	273.53%	196.93%	120.61%	225.99%
<i>Liquidity ratio</i>	small	83.85%	136.35%	277.59%	178.13%	111.52%
	medium	39.4%	49.6%	129.3%	269.3%	235.4%
	large	80.2%	46.28%	44.52%	52.6%	62.8%

Source: researcher's own computation from financial statements

In general, the trend showed an increase in portfolio to assets ratio over years for medium and large MFIs. And cost of fund was high in the year 2005 in all institutions and below the lending rate of commercial banks. In the five years of operation, there was a steady growth in the proportion of debt to equity. Liquidity was not a major problem for small MFIs but medium and large MFIs should work on it.

III efficiency and productivity

Table 3.42 Trend in efficiency and productivity of small MFIs

<i>Indicators(average)</i>	<i>years of operation</i>				
	2006	2005	2004	2003	2002
<i>Personnel productivity</i>	344	275	263	310	382
<i>Average outstanding loan size</i>	907	762	780	768	990
<i>Operating expense ratio</i>	15.4%	22.9%	29.3%	28.42%	26.2%
<i>Cost per borrower</i>	124	135.7	111.8	115.3	108.4

Source: researcher's own computation from financial statements

As per the above table there was no consistency in all parameters for small MFIs. It varies from year to year. But small MFIs loan size was not greater than Br.990.and the cost per borrower was between Br.108.4 and 135.7 in those years. In terms of operating expense ratio, the institutions were efficient in the last two years.

Table 3.43 Trend in efficiency and productivity of medium MFIs

<i>Indicators(average)</i>	<i>years of operation</i>				
	2006	2005	2004	2003	2002
<i>Personnel productivity</i>	307	301	213	179	158
<i>Average outstanding loan size</i>	1250	1250	831	644.5	597
<i>Operating expense ratio</i>	10.9%	17.3%	21.4%	34.5%	36.1%
<i>Cost per borrower</i>	127.2	117.9	127	151.6	183

Source: researcher's own computation from financial statements

From the above table it can be observed that personnel productivity has increased over the years from 158 in the year 2002 to 307 in the year 2006. average loan size per borrower showed a continuous increase in those years of operations from Br.597 (in 2002) to Br.1250 (in 2006) the institutions became more efficient as time passes. There was also a decrease in cost of serving a single borrower over periods.

Table 3.45 Trend in efficiency and productivity of large MFIs

Indicators(average)	Years of operation				
	2006	2005	2004	2003	2002
Personnel productivity	384	413	435	440	NA
Average outstanding loan size	1547.8	1284	993	756	494
Operating expense ratio	3.79%	4.5%	5.1%	7.1%	8.5%
Cost per borrower	48.8	44.3	39.1	44.1	41.5

Source: researcher's own computation from financial statements

The personnel productivity index in the above table showed that there was a decrease in number of clients by a single staff member. But loan size per borrower has increased from Br.494 (in 2002) to Br.1547.8 (in 2006). operating expense ratio showed a subsequent decrease over time from 8.5% in 2002 to 3.79% in 2006. and the cost to serve a single borrower remained between Br.39.1 and Br.48.8.

Table 3.46 Trend in efficiency and productivity of all MFIs

<i>Indicators(average)</i>	<i>types of MFIs</i>	<i>years of operation</i>				
		2006	2005	2004	2003	2002
<i>Personnel productivity</i>	small	344	275	263	310	382
	medium	307	301	213	179	158
	large	384	413	435	440	NA
<i>Average outstanding loan size</i>	small	907	762	780	768	990
	medium	1249.6	1250	831	644.5	597
	large	1547.8	1284	993	756	494
<i>Operating expense ratio</i>	small	15.4%	22.9%	29.3%	28.42%	26.2%
	medium	10.9%	17.3%	21.4%	34.5%	36.1%
	large	3.79%	4.5%	5.1%	7.1%	8.5%
<i>Cost per borrower</i>	small	124	135.7	111.8	115.3	108.4
	medium	127.2	117.9	127	151.6	183
	large	48.8	44.3	39.1	44.1	41.5

Source: researcher's own computation from financial statements

In general, there was an increase in personnel productivity for medium MFIs. The average outstanding loan size showed a steady progress for medium and large MFIs but the loan size for small MFIs remained low. Operating expense ratio decreased over time for small and medium MFIs but the cost remained low for large MFIs. Large MFIs registered the lowest cost to serve a single borrower.

CHAPTER FOUR

CONCLUSION AND RECOMMENDATION

4.1. Conclusion

Based on the analysis made in Chapter Three the following conclusions are made on the performance of microfinance institutions.

Microfinance institutions, regardless of their social mission, are financial intermediaries. therefore, it should be financially viable and sound to achieve its mission.

From profitability and sustainability point of view, Most of the microfinance institutions were doing well in terms of Operational self sufficiency and financial self sufficiency. As the size of MFIs decreases in terms of gross loan portfolio, Operational self sufficiency and Financial self sufficiency decreases as well. Half of the MFIs were not good in using retained earnings and donor money to become sustainable but most of them were brilliant in managing their assets to optimize profit. In general, during the year 2006 MFIs were doing well.

From asset and liability management angle, most microfinance institutions used the highest portion of the assets to their primary activity (making loans to micro entrepreneurs). A low cost of funds results from an MFI gaining access to deposits and /or borrowings at a reasonable cost. In this respect all MFIs were successful in obtaining funds at an average interest rate below commercial banks lending rate(7%). medium and large MFIs performed

well in obtaining funds as compared to their small counter parts. In the year under investigation, medium and large MFIs had below 50% liquidity ratio represented by current asset over current liability.

From efficiency and productivity point of view, large MFIs have the lowest operating expense ratio (more efficient) and small MFIs the highest operating expense ratio represented by operating expense over average gross loan portfolio. As the size of MFIs increases the operating expense ratio decreases as well. Still Large MFIs spends the least (efficient) in personnel and administrative expenses to serve a single borrower. Small MFIs seem to reach poorer clients since the average loan size is the smallest. In general large microfinance institutions were more efficient and productive but Small MFIs seem to reach poorer clients.

The trend in performance in medium and large microfinance institutions were promising, from profitability and sustainability point of view. But there is a decline in performance from the side of small MFIs.

In general, the trend showed an increase in portfolio to assets ratio over years for medium and large MFIs. And cost of fund was high in the year 2005 in all institutions but below the lending rate of commercial banks. In the five years of operation, there was a steady growth in the proportion of debt to equity. Liquidity was not a major problem for small MFIs but medium and large MFIs should work on it.

The trend in efficiency and productivity showed There was an increase in personnel productivity for medium MFIs. The average outstanding loan size showed a steady progress for medium and large MFIs but the loan size for small MFIs remained low. Operating expense ratio decreased over time for small and medium MFIs but the cost remained low for large MFIs. Large MFIs registered the lowest cost to serve a single borrower.

4.2 Recommendations

Based on the findings of the study the following recommendations are made by the researcher:

Even though the MFIs were doing well in terms of profitability and sustainability, small MFIs should exert maximum effort to pass the minimum threshold level in connection with operational and financial self sufficiency to cover their costs, grow and sustain by their own.

Since return on equity for half of the institution is negative, these institutions should work on it and move towards positive return on equity because this is the means to assure their survival in the market by their own, with out the immense support of government and donors.

MFIs should devise a means to obtain funds from diversified sources in order to minimize the risks associated with obtaining funds from few sources. Specially, small firms should

work in obtaining additional funds in order to expand their operations since they are not good in this regard.

To pay bills, salaries or creditors; to provide repeat loans to clients, which is a major incentive to repay loans; to repay client deposits on time microfinance institutions should maintain at least more than 50% liquidity ratio. Any financial institution that fails to repay client deposits on time is likely to lose client confidence and access to future funding. Hence, Medium and large MFIs should upgrade their liquidity level to win and get trust of customers to the desired level possibly by increasing their current assets.

Medium and small MFIs should decrease their operating expenses in order to become more efficient through experience sharing with the most efficient counterparts and benchmarking themselves against best performers in the industry. Medium and large MFIs should reappraise them selves to ascertain whether they are reaching the poorer section of the society or not and act accordingly.

Small MFIs should on profitability and sustainability since the trend was not good in those periods by decreasing their operating expenses .in addition medium and small MFI should devised a mechanism to obtain funds at lowst cost like that of large MFIs.

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