Addis Ababa University
School Of Graduate Studies

ASSESSMENT OF THE FINANCIAL AND OPERATING PERFORMANCE AND CHALLENGES OF MFIs IN ADDIS ABABA

By:

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ACRONYMS

AEMFI	Association of Ethiopian Micro – Finance Institutions
CBE	Commercial Bank of Ethiopia
CGAP	Consultative Group to Assist the Poorest
IFAD	International Fund for Agricultural Development
MFIs	Micro – Finance Institutions
NBE	National Bank of Ethiopia
NGO	Non – Governmental Organization
PAR	Portfolio at Risk
ROA	Return on Assets
ROE	Return on Equity
ROSCAs	Rural Organization of Savings and Credit Associations
SDI	Subsidy Dependence Index
SFPI	Specialized Financial and Promotional Institution
SAPs	Structural Adjustment Programs
UNDP	United Nation Development Program

CHAPTER I

1. INTRODUCTION

1.1 Background of the Study

Financial resource like any other economic resources is believed to be the critical input in any country's development endeavor. This resource is considered to be one of the most critical factors impeding the socio-economic development of countries like Ethiopia. In addition, the vast majority of Ethiopians are still deprived of the capacity to participate in the wealth creation of the nation due to the extreme shortage of the resource as well as the obstacles in the legal framework of access to it.

Improving access to financial services is an important development tool, because it helps in creating employment opportunities for the unemployed and increases their income and consumption, which would in the final analysis reduce poverty. Access to financial services to the poor also facilitates economic growth by easing liquidity constraints in production, by providing capital to start-up new enterprises or adopt new technologies, and by helping producers to assume production risk. Moreover, the transformation from subsistence to a more commercially driven economy requires capital formation and increased demand for working capital.

In Ethiopia, the potential demand for financial services, particularly micro-credit is huge. However, the existing supply of financial services to the poor is very limited. As a strategic tool in alleviating the problem, though provision of micro-finance services by government and non-government organizations were started in the past years, much emphasis was not given until the recent years.

The paradigm shift in reaching and mobilizing the poor is attaining greater attention both at the national and international level. By virtue of these facts, besides strengthening the effort of both parties, the recent phenomenon is the establishment of formal micro-financing institutions operating in the county.

Before 1980s the source of finance for the majority of poor both in rural and urban and small scale enterprises owners in Ethiopia were mainly limited only to informal and semi-formal source of finance. During 1980s following the drought of 1984/85 some NGOs introduced the idea of saving and credit among poor people as a strategy for rehabilitation and development.

Institutionalization of Microfinance is evolved after the Ethiopian government issued the proclamation No.40/1996. Because, NGOs, government agencies, and cooperatives and others perform micro credit delivery and savings mobilization in the country, in a scattered and inconsistent way, the government took the initiative to establish the regulatory framework in order to facilitate the sound development of the microfinance industry. This resulted in institutionalization of 26 MFIs which are currently operating in the economy.

As per the information from the Association of Ethiopian Micro – finance Institution (AEMFI), as of September 2006, the total capital of the Micro Finance Industry was birr 767,078,028 where as total liability was birr 1,348,695,544. The figure shows a remarkable growth as compared with what is was at the beginning of their operation in 1997 G.C by 12 MFIs with their total capital and total liabilities amounted to birr 40,832,000 and 184,667,000, respectively.

1.2 Statement of the Problem

Following their establishment, the Microfinance institutions have two – fold objectives of (1) mobilizing the vast majority of the able poor capable of participating in the economic activity with little support from the institutions and, (2) as formalized financial institutions, are expected to make profit for their continued existence. To achieve both objectives the institutions ought to work towards institutional sustainability. This is possible only if the institutions are acting strategically and if there is compatibility between the short-range operational activities and the core strategy. That is, the simple increment of the number of the institutions and their capital alone or their better financial performance towards their narrow organizational objective may not speak about the success in achievement of the set national objectives. Rather the operation should be measured by indicators like the rate of increase in the coverage of needy population, the retaining rate of existing beneficiaries, diversification and expansion of funding sources, the quality of the service, financial performance, etc.

Currently, it is believed that MFIs in Ethiopia are characterized by low savings, high default rates, poor loan management and very low saving mobilization, etc. Furthermore, throughout their operations little effort is made to change, modify, and create new products in the industry.

In this regard, though one can haphazardly suggest something about the issues, the researcher believes that there is no complete knowledge of the full picture in a more comprehensive manner. That is, there is no study conducted indicative of the strengths and weaknesses as well as the challenges of the operations so as to suggest improvements in the future.

1.3 Justification of the Study

The rationale of the study is aimed at shading some light as a contribution to address the problem. Furthermore, the findings of this research will be disseminated to officials in MFIs, and NBE so that corrective actions and revision of strategic policy will be made. In more clear terms:

- The results from this finding help to better link the MFIs with the beneficiary.
- The findings from this research work will be expected to identify the very causes of the problem.
- The findings from this research work will be expected to tackle the problems that are prevalent in the current operations of MFI in the country and help promote the country's socio-economic development.

1.4 Objective of the Study

The study focused on the assessment and evaluation of the core operations, evaluation of the communities' opinion towards the services of the institutions, challenges of the institutions etc… so as to make the necessary recommendations. Thus, the specific objectives are:-

- To measure the rate of increase in the coverage of the beneficiaries (outreach).
- To assess whether existing clients are well retained.
- To evaluate the fund diversification/expansion mechanisms.
- To compare the trend in loan disbursement and collection.
- To compare the enterprises financial performance (growth).
- To see the existing relationship prevailed between the above factors.
- To identify the challenges which are prevalent in the operation of MFIs, etc.

1.5 Significance of the Study

As discussed precisely in the background and problem statements sections, the success of micro-financing operations has a paramount importance in the development endeavor of the country.

The institutional sustainability in line with the two basic objectives is to improve the living standard of the poor and promote the mass mobilization in the nation's wealth creation as well as initiate other capable Ethiopians to participate in playing their role in the different sectors of the economy.

Equally important, the micro financing effort is currently backed by foreign donor countries and international agencies. So the effective coverage rate and service provision is expected to generate more assistance in the short-run while sustainable financial resource must be secured internally in the long-run. Besides, the government and pertinent offices have their own responsibilities.

In line with the above facts, it is hoped that the results of this study will:-

- Provide relevant information to decision makers (investors, donors, creditors, clients, or government) about how well the institutions are performing.
- Tells the management of the institutions the strengths and weaknesses of the current operating systems, and identifies the challenges of the MF industry, and
- Suggest possible recommendations to improve or revise the existing financial and operational performances of the institutions.

Furthermore, the result of the study is hoped to serve as a base for further research that enable the sustained operation.

1.6 Scope of the Study

This project is confined only to the assessment of the operational and financial performance and challenges of some selected MFIs operating in Addis Ababa for 2005 and 2006 fiscal periods. Nonetheless, it would have been much better and exhaustive for the study had there been a chance of accommodating all MFIs found in Addis Ababa. However, to make the study manageable and to evaluate the problem in detail, the researcher is forced to delimit the study to incorporate only three of the MFIs found in Addis Ababa.

1.7 Limitation of the Study

As any research requires sufficient time, up-to-date information, reference materials, finance, and the like, the student researcher also encountered some of these challenges in carrying out this project. Especially, while looking for information from the MFIs, the officials of some of the institutions were not willing to provide with the necessary information. A case in point in this regard, was the officials in Addis Credit and Savings Institution. Since the officials were not willing to cooperate, the researcher was forced to look for other similar institutions. This took a lot of the researcher's time, effort, and cost.

1.8 Methodology

In any research undertaking, the methodology/research design to be followed is determined by the nature of the problem statement or more specifically by the research objectives. Here in this case study, the methodology followed is largely of exploratory as well as descriptive approach. This is because one major importance of the exploratory research is it helped the investigator to gain background information on the study's subject. Moreover, the descriptive approach has been employed with regard to elements of the core operations (both financial and non-financial) and the financial ratios. This is to mean that both qualitative and quantitative data have been used.

1.8.1 Sample Population

There are 26 microfinance institutions countrywide. Among them 11 microfinance institutions are found in Addis Ababa. With the supposition that the cluster of microfinance institutions are found here in Addis, this study focused its survey on this locality/area/. From the eleven microfinance institutions, three of them are selected with purposive sampling method. Thereby, some of the institutions' officials and clients under them have been considered as subjects of the study. Accordingly, a total number of 36 officials /12 from each/ who are currently working as General Managers, Branch Managers, Assistant Branch Managers and Loan /Credit/ Officers have been selected as respondents of the study. Moreover, a total number of 300 respondents (clients) /100 from each/ have been selected with the accessibility technique from the active and inactive clients of the microfinance institutions under consideration.

1.8.2 Data Gathering Techniques

The study has employed both primary and secondary data collection techniques. Review of annual reports, financial statements, and other relevant documents of the MFIs and documents of the regulatory bodies and other pertinent offices have been used as the sources for the secondary data collection.

Both structured and unstructured questionnaires have been developed as instruments of primary data collection tools so as to get the necessary information from the top officials of some of the selected institutions and the active and non-active beneficiaries' /clients/.

1.8.3 Data Analysis Techniques

The objective of the analysis is for drawing important conclusions that reflects the researcher's interest of inquiry stated right at the beginning of the study. Based on the general concepts, the statement of the purpose of the institutions' existence, and their real practices; strengths and gaps can be identified and analyzed using qualitative and quantitative analysis. That is, ratio analysis, comparative analysis of financial statements over time (trend analysis), descriptive presentations on responses of beneficiaries are included as part of quantitative analysis. Under qualitative analysis assessment of the institutions operation will be analyzed based on the officials' response and the secondary data collected from the documents.

1.9 Organization of the Study

This research project consists of four chapters. The first chapter presented background of the study, statement of the problem, justification of the study, objectives of the study, significance of the study, scope of the study, limitation of the study, and the research design and methods of procedure.

Discussion in chapter two focuses on literature review of important concepts that are relevant to the study. The third part of the study deals with the collection of data, the analysis of these data on the problem in the sample, and generalized the causes of the problem. In this section, the real practices of the enterprise as well as the profile of the financial statements were also collected, analyzed, and evaluated in line with the industry standards.

Finally, the last chapter attempt to generalize and recommend possible solutions to the problems.

CHAPTER II

2. REVIEW OF RELATED LITERATURE

2.1. Microfinance – An Overview

The emergence of the global micro finance has a history of about three decades, yet has gone through stages of historical development. The micro finance industry is said to be in revolution: the service that was initiated in small scale and small village of South East Asia “Chintanga”, Bangladesh now turned to be international agenda and an issue addressing one of the main problems i.e. poverty in developing countries of the world.

As commonly understood, the term micro finance refers to the activities of financial and social intermediation services directed to low income population group. The financial intermediation refers to loans, savings, insurance, transfer services and other financial products targeted at low income population group. The social-intermediation, however, refers to group formation, development of self confidence, training in financial skills, and arrangement capabilities among the poor section of the society. This idea is supported by (Robinson, 2001) that microfinance industry strives to provide services that help the low –income poor reduce financial risk, improve their management skills, increase their productivity and therefore their income, collect higher returns on investments, provide financial and emotional security, and improve the overall quality of life for their families.

2.1.1. What is a Microfinance Institution (MFI)?

Quite simply, a microfinance institution is an organization that offers financial services to low income populations. Almost all of these offer Microcredit and only take back small amounts of savings from their own borrowers, not from the general public. Within the microfinance industry, the term microfinance institution has come to refer to a wide range of organizations dedicated to providing these services: NGOs, credit unions, cooperatives, private commercial banks and non-bank financial institutions (some that have transformed from NGOs into regulated institutions) and parts of state-owned banks, for example.

The image most of us have when we refer to MFIs is of a “financial NGO”, an NGO that is fully and virtually exclusively dedicated to offering financial services; in most cases Microcredit NGOs are not allowed to capture savings deposits from the general public. These groups of a few hundred NGOs have led the development of

Microcredit, and subsequently microfinance, the world over (CGPA, 2003). Most of these constitute a group that is commonly referred to as "best practice" organizations, ones that employ the newest lending techniques to generate efficient outreach that permit them to reach down far into poor sectors of the economy on a sustainable basis.

A great many NGOs that offer Microcredit, perhaps even a majority, do many other non-financial development activities and would bristle at the suggestion that they are essentially financial institutions. Yet, from an industry perspective, since they are engaged in supplying financial services to the poor, we call them MFIs. The same sort of situation exists with a small number of commercial banks that offer microfinance services. For our purposes, we refer to them as MFIs, even though only a small portion of their assets may actually be tied up in financial services for the poor (CGPA, 2003). In both cases, when people in the industry refer to MFIs, they are referring only to that part of the institution that offers microfina nce.

There are other institutions, however, that consider themselves to be in the business of microfinance and that will certainly play a role in a reshaped and deepened financial sector. These are community-based financial intermediaries. Some are membership based such as credit unions and cooperative housing societies. Others are owned and managed by local entrepreneurs or municipalities. These institutions tend to have a broader client base than the financial NGOs and already consider themselves to be part of the formal financial sector. It varies from country to country, but many poor people do have some access to these types of institutions, although they tend not to reach down market as far as the financial NGOs.

2.1.2. The Development of Microfinance Institutions

Creating a financial system capable of lending to micro-enterprises and low-income households is an integral part of the World Bank’s strategy for developing the indigenous private sector and alleviating poverty. Micro-enterprises typically foster little productive employment growth, but they do alleviate the severe unemployment that threatens the survival of the poor in Africa. Micro-enterprises often need access to very small loans to survive and grow as demand fluctuates. They rely heavily on the informal system of relatives, suppliers' credit, savings and credit associations, and moneylenders for their financial needs. The performance of international best-practice institutions shows that the self-employed repay their loans at high rates and are willing to pay high rates of interest in order to obtain access to financing. The key challenge in micro-enterprise development is to strengthen the capacity of the financial system—both informal and formal—to lend sustainably to micro-enterprises (Pitamber, 2003).

Microfinance institutions consist of agents and organizations that engage in relatively small financial transactions using specialized, character-based methodologies to serve low-income households, micro-enterprises, small farmers, and others who lack access to the banking system. They may be informal, semi-formal (that is, legally registered but not under central bank regulation), or formal financial intermediaries. The Bank's strategy emphasizes incorporating these activities into countries' financial development strategies to expand the scope and raise the efficiency of financial intermediation. The intention is to ensure that access to financial services by poor households, micro-entrepreneurs, women, and farm households improves sustainably over time, rather than on a one-time project basis (Pitamber, 2003).

2.2. Micro-finance and Poverty Alleviation

Most poor people manage to mobilize resources to develop their enterprises and their dwellings slowly over time. Financial services could enable the poor to leverage their initiative, accelerating the process of building incomes, assets and economic security. However, conventional finance institutions seldom lend down-market to serve the needs of low-income families and women-headed households. They are very often denied access to credit for any purpose, making the discussion of the level of interest rate and other terms of finance irrelevant. Therefore the fundamental problem is not so much of unaffordable terms of loan as the lack of access to credit itself (Kim 1995).

The lack of access to credit for the poor is attributable to practical difficulties arising from the discrepancy between the mode of operation followed by financial institutions and the economic characteristics and financing needs of low-income households. For example, commercial lending institutions require that borrowers have a stable source of income out of which principal and interest can be paid back according to the agreed terms. However, the income of many self employed households is not stable, regardless of its size. A large number of small loans are needed to serve the poor, but lenders prefer dealing with large loans in small numbers to minimize administration costs. They also look for collateral with a clear title - which many low-income households do not have. In addition bankers tend to consider low income households a bad risk imposing exceedingly high information monitoring costs on operation.

Over the last ten years, however, successful experiences in providing finance to small entrepreneur and producers demonstrate that poor people, when given access to responsive and timely financial services at market rates, repay their loans and use the proceeds to increase their income and assets. This is not surprising since the only realistic alternative for them is to borrow from informal market at an interest much higher than market rates. Community banks, NGOs and grassroots savings and credit groups around the world have shown that these micro-enterprise loans can be profitable for borrowers and for the lenders, making microfinance one of the most effective poverty reducing strategies.

To the extent that microfinance institutions become financially viable, self sustaining, and integral to the communities in which they operate, they have the potential to attract more resources and expand services to clients. Despite the success of microfinance institutions, only about 2% of world's roughly 500 million small entrepreneurs are estimated to have access to financial services (Barry et al. 1996). Although there is demand for credit by poor and women at market interest rates, the volume of financial transaction of microfinance institution must reach a certain level before their financial operation becomes self sustaining. In other words, although microfinance offers a promising institutional structure to provide access to credit to the poor, the scale problem needs to be resolved so that it can reach the vast majority of potential customers who demand access to credit at market rates. The question then is how micro-enterprise lending geared to providing short term capital to small businesses in the informal sector can be sustained as an integral part of the financial sector and how their financial services can be further expanded using the principles, standards and modalities that have proven to be effective.

To be successful, financial intermediaries that provide services and generate domestic resources must have the capacity to meet high performance standards. They must achieve excellent repayments and provide access to clients. And they must build toward operating and financial self-sufficiency and expanding client reach. In order to do so, microfinance institutions need to find ways to cut down on their administrative costs and also to broaden their resource base. Cost reductions can be achieved through simplified and decentralized loan application, approval and collection processes, for instance, through group loans which give borrowers responsibilities for much of the loan application process, allow the loan officers to handle many more clients and hence reduce costs (Otero et al. 1994).

Microfinance institutions can broaden their resource base by mobilizing savings, accessing capital markets, loan funds and effective institutional development support.

Savings facilities make large scale lending operations possible. On the other hand, studies also show that the poor operating in the informal sector do save, although not in financial assets, and hence value access to client-friendly savings service at least as much access to credit. Savings mobilization also makes financial institutions accountable to local shareholders. Therefore, adequate savings facilities both serve the demand for financial services by the customers and fulfill an important requirement of financial sustainability to the lenders. Microfinance institutions can either provide savings services directly through deposit taking or make arrangements with other financial institutions to provide savings facilities to tap small savings in a flexible manner (Barry 1995).

Convenience of location, positive real rate of return, liquidity, and security of savings are essential ingredients of successful savings mobilization (Christen et al. 1994).

Once microfinance institutions are engaged in deposit taking in order to mobilize household savings, they become financial intermediaries. Consequently, prudential financial regulations become necessary to ensure the solvency and financial soundness of the institution and to protect the depositors. However, excessive regulations that do not consider the nature of microfinance institution and their operation can hamper their viability. In view of small loan size, microfinance institutions should be subjected to a minimum capital requirement which is lower than that applicable to commercial banks. On the other hand, a more stringent capital adequacy rate (the ratio between capital and risk assets) should be maintained because microfinance institutions provide uncollateralized loans (Otero et al. 1994).

Governments have a complicated role when it comes to microfinance. Until recently, governments generally felt that it was their responsibility to generate development finance', including credit programs for the disadvantaged. Many years of insightful critique of rural credit programs revealed that governments do a very bad job of lending to the poor. Short term political gain is just too tempting for politically controlled lending organizations; they disburse too quickly (and thoughtlessly) and they collect too sporadically (unwillingness to be tough on defaulters). In urban areas, governments never really got into the act, and subsidized micro-enterprise credit is still relatively rare when compared to its rural counterpart.

According to (Pitamber, 2003), Governments should provide an enabling legal and regulatory framework which encourages the development of a range of institutions and allows them to operate as recognized financial intermediaries subject to simple supervisory and reporting requirements. Usury laws should be repelled or relaxed and microfinance institutions should be given freedom of setting interest rates and fees in order to cover operating and finance costs from interest revenues within a reasonable amount of time. Government could also facilitate the process of transition to a sustainable level of operation by providing support to the lending institutions in their early stage of development through credit enhancement mechanisms or subsidies.

One way of expanding the successful operation of microfinance institutions in the informal sector is through strengthened linkages with their formal sector counterparts. A mutually beneficial partnership should be based on comparative strengths of each sector. Informal sector microfinance institutions have comparative advantage in terms of small transaction costs achieved through adaptability and flexibility of operations (Ghate et al. 1992). They are better equipped to deal with credit assessment of the urban poor and hence to absorb the transaction costs associated with loan processing. On the other hand, formal sector institutions have access to broader resource-base and high leverage through deposit mobilization (Christen et al. 1994).

Therefore, formal sector finance institutions could form a joint venture with informal sector institutions in which the former provide funds in the form of equity and the later extends savings and loan facilities to the urban poor. Another form of partnership can involve the formal sector institutions refinancing loans made by the informal sector lenders. Under these settings, the informal sector institutions are able to tap additional resources as well as having an incentive to exercise greater financial discipline in their management.

Microfinance institutions could also serve as intermediaries between borrowers and the formal financial sector and on-lend funds backed by a public sector guarantee (Phelps 1995). Business-like NGOs can offer commercial banks ways of funding micro-entrepreneurs at low cost and risk, for example, through leveraged bank-NGO-client credit lines. Under this arrangement, banks make one bulk loan to NGOs and the NGOs packages it into large number of small loans at market rates and recover them (Women's World Banking 1994). There are many on-going researches on this line but context specific research is needed to identify the most appropriate model.

2.3. Micro Finance Institutions Can Help Small Business

Experience shows that microfinance can help the poor to increase income, build viable businesses, and reduce their vulnerability to external shocks. It can also be a powerful instrument for self-empowerment by enabling the poor, especially women, to become economic agents of change.

Poverty is multi-dimensional. By providing access to financial services, microfinance plays an important role in the fight against the many aspects of poverty. For instance, income generation from a business helps not only the business activity expand but also contributes to household income and its attendant benefits on food security, children's education, etc. Moreover, for women, who, in many contexts, are secluded from public space, transacting with formal institutions can also build confidence and empowerment.

Recent research has revealed the extent to which individuals around the poverty line are vulnerable to shocks such as illness of a wage earner, weather, theft, or other such events. These shocks produce a huge claim on the limited financial resources of the family unit, and, absent effective financial services, can drive a family so much deeper into poverty that it can take years to recover.

Giving the poor and low income earners access to financial institutions is the only way to transform the economy. This has not been possible because commercial banks are far out of reach for them. Concerning this, Mr. Moses Banda, the Chief Manager of Credit and micro finance operations at K-rep Bank, says that there are more than 1.3 million people in the country who own small scale business but who have no access to banks.

Micro Finance Institutions differ from commercial banks in their social objectives. Banda says they aim at serving the low income earners and the poor people who do not have access to mainstream banks. For example, “In Kenya 80 per cent of adults do not have access to financial institutions. The Micro Finance Institutions have a different application of banking principals (Banda, May 2007).

They lend small loans and have small saving transactions. They do not ask for large deposits nor do they require conventional collateral to secure a loan. Unlike mainstream banks, they take banking to the entrepreneurs." For instance K-rep bank has a marketing outlet in the form of bank branches. These serve people in the estates and the rural areas. They are located where people in the low income groups of 20 to 30 people and divide up to subgroups of six. They meet regularly, recruit new entrants, apply foe loans and guarantee each other (Nusselder, 2003).

Many people who go to their offices, he says, do not borrow money to start new business but sustain or expand already existing ones. They also give large scale loans to credit unions or saccos, which constitutes 21 per cent of their clientele. 52 per cent is taken up by small scale loans and savings while conventional loans take another 12 per cent (Banda, May 2007).

"Micro Finance Institutions are able to lend small loans ranging from Sh 1,000 to Sh 40,000. Repayments can be within a day, a week, a month or even six months with minimum interest. He said that this makes it accessible to a lot of people. Most vendors and hawkers are K-rep clients". Says Banda,

"Most of these clients used to borrow small amounts but they have now gone into large scale businesses and take big loans. If all the rest take these steps, we can see Kenya's economy transform. There is no economy in the world that has grown without micro enterprises." (Banda, 2007).

On the support they receive from the government. Banda says that they refused any type of special treatment.

"We wanted to fit legitimately in the financial sector so as to be commercially viable in poverty eradication." Because of this, micro finance institutions have made a great impact in the business world.

Micro finance institutions have been lobbying the government to allow them to take money from the public as savings and loan money to them. They too can be regulated through the banking act by the Micro Finance Institutions bill.

This will give small entrepreneurs an alternative to other informal means of borrowing and saving.

2.4. Can Microfinance be Profitable?

It is true that in order to provide efficient financial services MFIs should operate at a profit. Now days, most MFIs offer loans to the poor and SMEs from funds obtained from foreign donor organizations. However, this trend should not be continued, and MFIs should mobilize funds from the public or else they should be owned by private owners. Therefore, for their continued existence and viability these institutions should be free from any impositions by the government and be profitable.
Data from the Micro-Banking Bulletin reports that 63 of the world's top MFIs had an average rate of return, after adjusting for inflation and after taking out subsidies programs might have received, of about 2.5% of total assets. This compares favorably with returns in the commercial banking sector and gives credence to the hope of many that microfinance can be sufficiently attractive to mainstream into the retail banking sector. Many feel that once microfinance becomes mainstreamed, massive growth in the numbers of clients can be achieved (CGAP, 2003).

Others worry that an excessive concern about profit in microfinance will lead MFIs up-market, to serve better off clients who can absorb larger loan amounts. This is the “crowding out” effect. This may happen; after all, there are a great number of very poor, poor, and vulnerable non-poor who are not reached by the banking sector. It is interesting to note that while the programs that reach out to the poorest clients perform less well as a group than those who reach out to a somewhat better-off client segment, their performance is improving rapidly and at the same pace as the programs serving a broad-based client group did some years ago. More and more MFI managers have come to understand that sustainability is a precursor to reaching exponentially greater numbers of clients. Given this, managers of leading MFIs are seeking ways to dramatically increase operational efficiency (Robinson, 2001). In short, we have every reason to expect that programs that reach out to the very poorest micro-clients can be sustainable once they have matured, and if they commit to that path. The evidence supports this position.

2.5. Key Principles of Microfinance

When Microfinance institutions were emerged before 30 years ago, they have the overriding concerns of eradicating poverty and helping the poor by providing them different financial services. Thus, unlike the mainstream banks, they have the social objectives of helping the poor who do not have any means to access any form of loans. Here under are the basic principles of MFIs. These principles were developed and endorsed by CGAP[1] and its 31 member donors, and further endorsed by the Group of Eight leaders at the G8 Summit on 10 June 2004.

1. **Poor people need a variety of financial services, not just loans**. Like everyone else, the poor need a range of financial services that are convenient, flexible, and affordable. Depending on circumstances, they want not only loans, but also savings, insurance, and cash transfer services.

2. **Microfinance is a powerful tool to fight poverty**. When poor people have access to financial services, they can earn more, build their assets, and cushion themselves against external shocks. Poor households use microfinance to move from everyday survival to planning for the future: they invest in better nutrition, housing, health, and education.

3. **Microfinance means building financial systems that serve the poor**. In most developing countries, poor people are the majority of the population, yet they are the least likely to be served by banks. Microfinance is often seen as a marginal sector—a "development" activity that donors, governments, or social investors might care about, but not as part of the country's mainstream financial system. However, microfinance will reach the maximum number of poor clients only when it is integrated into the financial sector.

4. **Microfinance can pay for itself, and must do so if it is to reach very large numbers of poor people**. Most poor people cannot get good financial services that meet their needs because there are not enough strong institutions that provide such services. Strong institutions need to charge enough to cover their costs.

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[1]*CGAP is a consortium of 31 public and private development agencies working together to expand access to financial services for the poor, referred to as microfinance.*

Cost recovery is not an end in itself. Rather, it is the only way to reach scale and impact beyond the limited levels that donors can fund. A financially sustainable institution can continue and expand its services over the long term. Achieving sustainability means lowering transaction costs, offering services that are more useful to the clients, and finding new ways to reach more of the unbanked poor.

5. **Microfinance is about building permanent local financial institutions**. Finance for the poor requires sound domestic financial institutions that provide services on a permanent basis. These institutions need to attract domestic savings, recycle those savings into loans, and provide other services. As local institutions and capital markets mature, there will be less dependence on funding from donors and governments, including government development banks.

6. **Microcredit is not always the answer. Microcredit is not the best tool for everyone or every situation**. Destitute and hungry people with no income or means of repayment need other kinds of support before they can make good use of loans. In many cases, other tools will alleviate poverty better—for instance, small grants, employment and training programs, or infrastructure improvements. Where possible, such services should be coupled with building savings.

7. **Interest rate ceilings hurt poor people by making it harder for them to get credit.** It costs much more to make many small loans than a few large loans. Unless micro-lenders can charge interest rates that are well above average bank loan rates, they cannot cover their costs. Their growth will be limited by the scarce and uncertain supply soft money from donors or governments. When governments regulate interest rates, they usually set them at levels so low that Microcredit cannot cover its costs, so such regulation should be avoided. At the same time, a micro-lender should not use high interest rates to make borrowers cover the cost of its own inefficiency.

8. **The role of government is to enable financial services, not to provide them directly**. National governments should set policies that stimulate financial services for poor people at the same time as protecting deposits. Governments need to maintain macroeconomic stability, avoid interest rate caps, and refrain from distorting markets with subsidized, high-default loan programs that cannot be sustained. They should also clamp down on corruption and improve the environment for micro-businesses, including access to markets and infrastructure. In special cases where other funds are unavailable, government funding may be warranted for sound and independent microfinance institutions.

9. **Donor funds should complement private capital, not compete with it**. Donors provide grants, loans, and equity for microfinance. Such support should be temporary. It should be used to build the capacity of microfinance providers; to develop supporting infrastructure like rating agencies, credit bureaus, and audit capacity; and to support experimentation. In some cases, serving sparse or difficult-to-reach populations can require longer-term donor support. Donors should try to integrate microfinance with the rest of the financial system. They should use experts with a track record of success when designing and implementing projects. They should set clear performance targets that must be met before funding is continued. Every

project should have a realistic plan for reaching a point where the donor's support is no longer needed.

10. **The key bottleneck is the shortage of strong institutions and managers**. Microfinance is a specialized field that combines banking with social goals. Skills and systems need to be built at all levels: managers and information systems of microfinance institutions, central banks that regulate microfinance, other government agencies, and donors. Public and private investments in microfinance should focus on building this capacity, not just moving money.

11. **Microfinance works best when it measures—and discloses—its performance**. Accurate, standardized performance information is imperative, both financial information (e.g., interest rates, loan repayment, and cost recovery) and social information (e.g., number of clients reached and their poverty level). Donors, investors, banking supervisors, and customers need this information to judge their cost, risk, and return.

2.6. Women and Microfinance

Since the establishment of the Grameen Bank as a micro-credit delivery model, many programmes have rushed to replicate the relative success and in doing so, a lot of attention has been given to female micro-credit borrowers. Women were specifically targeted because they make up the majority of the poorest of the poor in the rural areas and are responsible for the social and economic welfare of the family. During the 1990s micro-credit was seen as successful amongst female clients because of high payment rates and savings capacities. Furthermore, at the same time many Non-Governmental Organizations (NGOs) and donor's were dictated by gender policies which specifically called for increased micro-credit outreach to women, and these micro-credit programmes did not limit their desired impact to portray reduction only, but extended it to achieve women's empowerment (Khandker, 1998: Kabeer, 1998).

Generally most microfinance programmes, and specifically those aimed at women, aim to reduce poverty for women and also empower them by enabling them to have their own income and capital. However, there is very little empirical evidence that microfinance will directly empower women (Zaman, 1999). Empowerment, as a concept, is highly contextual and changes from one environment to another, whereas microfinance delivery process is applied in almost the same way in most countries.

In order to achieve women's empowerment, there must be a change in gender relations. Although definitions and understanding of empowerment vary, the broader guiding milestones are generally agreed to be: Increased access to and control over resources, and specifically income, greater participation in decision making in the household and over her body, improved negotiation capacity and greater mobility (Pitamber, 2003).

According to (Mayoux, 2000), there are three underlying paradigms in the debate on micro-finance and gender and empowerment. The financial self-sustainability paradigm emphasizes the need to provide self-sustainability financial services to the rural people, especially micro-entrepreneurs. This is usually seen in the different manifestations of the village bank model and the Rural Organization of Savings and Credit Associations (ROSCAs). The assumption here is that women's access to these services will lead to economic empowerment thereby automatically enabling her to have decision making powers, increased mobility, etc. because it is assumed that power is derived from income. However, this is understandably a weak link between microfinance and women's empowerment because evidence from India and Bangladesh shows that women still tend to give up their credit and any resulting income to the male, either voluntarily or forcibly (Hunt and Kasyanathan, 2001; Mayoux 1998: Mosley and Hulme, 1998).

The second paradigm explained by Mayoux (2000) is called the poverty alleviation paradigm which is manifested in increasing outreach and access to the poor, providing small loans for consumption and production, savings facilities, group formation and training in some of the related aspects. In this paradigm women are targeted mainly as the poorest of the poor segments of the population and also the one's who are directly responsible for family well-being. The assumption here is that by increasing women's access to credit, and thereby increasing their income, a positive impact on household income will occur. This will further contribute to better family well-being and improved status and position of the female in the home, thus empowering her further to negotiate other forms of change in gender roles and relations.

There are a number of issues within the women's empowerment framework which affect the assumed outcome under this paradigm. Firstly, the size of the loans does not enable the women to make any long lasting income change for the household; at most the women's income will complement other sources of income, such as from the children or the husband. In the African context, this analysis sheds new light because in a household where both male and female are present, and where a negotiation of gender roles is necessary for empowerment, the micro-loan does not result in a high female income, in most cases the husband's income is still the major contributor to household expenses. Secondly, the increased access to credit in the same geographical area could contribute to market saturations of products provided by women. This is mainly because poor women generally tend to operate in the same kinds of businesses, such as food vending, petty trading etc. and also operate from the same local markets. This process reduces the resulting income for each women and increases competition in an already limited market. Thirdly, some evidence (Kabeer, 1998) suggests that in such circumstances a woman's successful business may have a negative impact on the girl-child who may be required to leave school to help the mother expand the business. Thus, the microfinance link to gender empowerment under the poverty alleviation paradigm cannot be assumed to occur naturally or automatically.

Mayoux's (2000) third paradigm for the microfinance and gender debate is called the feminist empowerment paradigm, which underlies many of the gender policies of NGOs and donor agencies. Micro-credit, under this paradigm, is seen as an entry point to negotiation and change in other broader issues of gender equality and women's rights. This paradigm is geared more towards addressing the social and/or political empowerment issues because its implications touch more upon the strategic needs of women. To a certain extent they also touch upon the economic-class stratification of women who may benefit under this paradigm and bring about the perceived change in gender relations and women's empowerment.

While it is not possible either to identify or to design a micro-credit programme neatly into anyone of the above paradigms, it is worth noting at this time, that most MFIs and other donor-driven micro-credit programmes fall within the first two paradigms mentioned above. Moreover, despite the lack of clear and convincing evidence of micro-credit's ability or inability to sustainably reduce poverty, more and more funds are still being put into similar micro-credit programmes. Despite the popularity of micro-credit as a poverty reduction mechanism, there is very little evidence indicating a real positive net effect on poverty reduction (Mosley and Hulme, 1998; Wright and Dondo, 2001). Measurements and indicators of client members, repayment rates, increase in total loan amounts and portfolio, and sometimes savings rates are misleading and may not automatically result in increased income for the household or the client.

2.7. Arguments Against the Micro-financial Sector

Perhaps the most prevalent critique of microfinance in today's international system is that it does not have the ability to reach "the poorest of the poor." Regardless of the arguments about what microfinance *should* do, it seems clear that this critique is generally true. The United Nations Consultative Group to Assist the Poor (CGAP) stated that "most microfinance clients today fall in a band around the poverty line and the extremely poor are rarely reached by microfinance" (CGPA, 2003). In addition, there is a lack of a consensus as to whether reaching the poorest should be the goal of microfinance institutions. First, it is much more expensive to reach the poorest, both for the institutions and the clients themselves. If an individual access credit, but does not have the financial capability to service that debt, access to loan services and interest rates become an additional burden. The poorest also request small individual loans with flexible repayment schedules, services that are very expensive for a microfinance institution to provide. Second, while the poorest do have a demand for financial services, perhaps their demand for necessary social services is more important. It is often the case that the poorest lack access to food, shelter, and sanitation – all needs that cannot be fulfilled permanently with short term loans. It is more likely that microfinance services will benefit these people once their basic needs are taken care of by either a government service, or international relief and development organizations.

As women often fall into the category of the poorest, it has been argued that microfinance may not be beneficial to them. In most of the developing countries, however, women are often the ones who are working to provide for the rest of the family. The working poor, who often fall into the category of the poorest, have great potential to benefit from microfinance services. For example, access to credit for a woman struggling to provide for her family by running a small enterprise may enjoy great benefits through an opportunity to enhance her business. Simple access to financial services, however, cannot guarantee empowerment or poverty alleviation, especially for women in an economy dominated by male policies (Women and Finance, 1995).

In addition, there are also many conflicting opinions about the ability of microfinance as a development tool to reach poor women in most of developing countries. Many are uncertain about its ability to create and foster an environment of truly sustainable and holistic development. Some of the loudest voices in this debate come from women's groups and organizations that do not see a clearly causal relationship between financial stability and women's empowerment. Their arguments centers around three primary issues: the relationship between structural adjustment programmes and the onset of microfinance, the physical limitations and/or past failures of micro-financial programmes and the inability of microfinance to create a culture of holistic empowerment (Women and World Banking, 2001).

These programmes “intensify the trade-off between women’s producer and non-producer roles, or, in stronger terms, that the ‘crises of social disinvestment’ (under adjustment) is financed from a ‘social fund’ provided by the superhuman efforts of poor women” (Baden 1997, 38). Thus, in order to achieve the goals of growth and economic efficiency intended for these programmes, women’s burdens are increased and their labor is exploited. Therefore, women seeking credit from microfinance institutions are not creating businesses out of a personal desire to become entrepreneurs; they are forced to work so that they and their families can survive in the vicious economic cycle that has been created by Structural Adjustment Programmes (SAPs).

Feminist critics of microfinance also argue that poverty alleviation models have overemphasized the importance of private funding and support. There has been a shift from development as the responsibility of nation-states to development as the responsibility of the global community, including international markets, financial institutions, and private corporations and organizations (Poster & Salime, 2002). The microfinance industry is an example of how development has transferred in to a business that prefers private lenders over government sponsored funds. It is consistent with the leading model (driven by structural readjustment) that encourages decentralization, self-employment, and individual entrepreneurship (McMichael, 2000). However, critics of this type of model argue that this type of ne0-liberal economic agenda relies on the strengths of individual woman to help themselves, rather than focusing on structural changes in the economy (Kabeer, 1999). Thus, it is up to each woman to fight for her own individual rights and to better the livelihood of her family. With this individual focus, critics believe that it is unlikely that microfinance will have the ability to empower women to improve their status in the home, the community, and in the national economy.

2.8. How to Measure the Performance of Microfinance Programs

The achievements of MFIs are examined through the lenses of standard industry performance metrics over a series of variables: Outreach (breadth and depth), financial structure, financial performance, efficiency and productivity, and portfolio quality (Lafourcade, et.al, April 2005, p. 6).

The performance of Microfinance institution is also best evaluated in light of the institution's context and stage of development. Note where the MFI's key strategic moves may have adverse short-term financial consequences but positive long-term effects. MFIs' achievement can be evaluated in terms of social performance and financial performance.

2.8.1. Social Performance of MFIs

2.8.1.1. Depth and Breadth of Outreach

Efforts to extend Microfinance services to the people who are underserved by financial institutions are classified as outreach. Outreach can be measured in terms of breadth – number of clients served and volume of services (i. e. total savings on deposit and total outstanding portfolio) – or depth – the socio economic level of clients that MFIs reach (Lafourcade, et.al, April 2005, p. 6). In general indicators of outreach include:

- The value and number of loans and savings accounts;
- Types of financial services offered;
- Number of branches established;
- Percentage of target population served;
- Annual growth rate of assets;
- Participation of women.

All thriving microfinance institutions did well in at least 2 of these areas (CGAP, 2003). Furthermore, the social performance of MFIs can be measured in terms of changes in the social and economic lives of clients and their households.

2.8.2. Financial Performance of MFIs

MFIs earn financial revenue from loans and other financial services in the form of interest fees, penalties, and commissions. Financial revenue also includes income from other financial assets, such as investment income. An MFI's financial activities also generate various expenses, from general operating expenses and the cost of borrowing for provisioning to the potential loss from defaulted loans. Profitable institutions earn a positive net income (i. e. operating income exceeds total expenses).

- Average portfolio outstanding
- Liquidity ratio
- Delinquency and loan ageing reports
- Ratio of losses to average portfolio outstanding

2.8.2.1. Profitability and Self-Sustainability

A credit programme or institution is self-sustaining when income exceeds expenditures (including the opportunity costs of equity). When an institution providing credit receives a subsidy, it may be profitable but unable to sustain that profitability (CGAP, 2003).

Subsidies to credit institutions can take several forms:

- below-market interest rates;
- losses absorbed by the state instead of the institution;
- reimbursements of operating costs;
- exemptions from reserve requirements or forced investments.

2.8.2.2. Financial Structure

MFIs finance their activities with funds from various sources, both debt (deposits from clients and borrowings from banks and other financial institutions) and equity. Measures of financial structure describe these various fund sources and compare them with assets purchased with those funds (Lafourcade, et.al, April 2005, p. 6).

2.8.2.3. Efficiency and Productivity

Efficient institutions minimize costs of delivering services. The efficiency of a MFI can be calculated in various ways; it may be measured by costs per borrower and costs per saver as indicators of efficiency.

Productivity often is measured in terms of borrower per staff member. Productivity is a combination of outreach and efficiency. Productive MFIs maximize services with minimal resources, including staff and funds. In general the specific indicators of the efficiency and productivity of MFIs are (Lafourcade, et.al, April 2005, p. 6):

- Total costs per average loan
- Revenues per average loan
- Clients per loan officer/staff person
- Staff expense as a percentage of average assets
- Net interest margin
- Unit cost ratio
- Cost per currency unit lent

Whether annual volume of clients is increasing and whether costs are decreasing per loan.

2.8.2.4. Portfolio Quality

The loan portfolio is an MFI's most important asset. Portfolio quality reflects the risk of loan delinquency and determines future revenues and an institution's ability to increase outreach and serve existing clients (CGAP, 2003). Thus, it is important for the MFI to effectively measure, monitor, and manage portfolio risk to maintain its viability.

2.8.3. The Subsidy Dependence Index (SDI)

The SDI is a financial tool developed to measure the reliance of an institution on subsidies. The index measures how much the average lending interest rate would have to be increased to compensate for complete and immediate subsidy elimination. The lower the SDI, the more sustainable the institution (Yaron, 1994).
The SDI measure does not mean that adjusting interest rates is feasible in all cases. Successful rural finance institutions vary greatly in their dependence on subsidies. Measuring the performance of credit programs is not accomplished by the uniform application of narrow criteria. A flexible approach yields the best results, but evaluation criteria must address these core areas of performance (Yaron, 1994).

Source: Yaron, Jacob. 1994. Successful Rural Finance Institutions. Finance and Development, vol. 31, no. 1, p. 33.

2.9. Ethiopian Microfinance Policy and Development Framework

Ethiopia is the second most populous nation in sub-Saharan Africa with approximately 63 million people and almost 44% of the population being in the age of 15 years and below. Ethiopia ranks 158 out of 162 countries in the Human Development Index (UNDP, 2001a). Its per capita income of $110 is roughly one-quarter the average for sub-Saharan Africa. Poverty in Ethiopia is more persistent in the rural areas and especially amongst the agricultural households. The average size of poor rural households tends to be larger and approximately 20% of rural households are female headed. Thus, women-headed households are more vulnerable as they traditionally have less access to land and other productive resources. Most rural households depend on agriculture as their primary source of income but lack essential social infrastructure, such as roads, education and primary health care facilities, safe drinking water supplies and fuel. Furthermore, increase in other development challenges such as the HIV/AIDS, persistent malaria in the low lands, and other communicable diseases is expected further to increase poverty levels in Ethiopia.

The origin of MFIs in Ethiopia is largely rooted in their NGO past with a clearly defined mission of rural poverty eradication. A government decree in 1996 established the licensing and supervision of MFIs as a 'share companies' in accordance with the Commercial Code of Ethiopia. With a network of about 500 sub-branches and branches, the MFIs have expanded to many of the regions where the incidence of poverty is highest. As of January 2001, MFIs in Ethiopia had made loans to and mobilized savings from about 500,000 clients nationally. Some MFIs have also started to offer other services such as pension remittances and money transfer services (IFAD, 2001: Nagash et.al. 2002).

The provision of financial services to the poor has been going on for several years by projects designed by government ministries and departments and non-governments. The majority of MFIs are in reality owned either by NGOs or Regional

Governments (Haftu, 2004). Individual owners except in very few cases have merely posed as owners at the request of either an NGO or Regional Governments. Such ownership arrangements are mainly motivated by the social cause of the objective of respective MFIs. The only truly individually owned MFI is the recently established Aggar Micro-financing S.C. It is owned by about 400 individual investors who expect profit from their share contributions. One can confidently say that the ownership structure of Ethiopian MFIs is very loose. In other words the so-called owner has no real control over the shares (AEMFI, 2004).

The following table indicates the ownership structure of some selected MFIs.

Table 2.1: ***Ownership Structure of Selected MFIs in Ethiopia.***

MFI	Paid-Up Capital in Million Birr	NGO	Private Organizations	Regional Governments	Associations	Individuals
Addis Credit & Savings Institution	1.1	-	-	9.8%	1.7%	0.03%
Africa Village & Savings Institution	0.2	-	-	-	-	-
Dedebit Credit & Savings	1.0	50%	-	25%	25%	-
Eshet MFI	0.225	20%	-	-	-	80%
Gasha MFI	0.2	30%	-	-	-	70%
Omo MFI	0.5	-	9.5%	80%	10%	0.5%
PEACE	0.2	16%	-	-	-	84%
SEYA MFI	0.235	-	-	-	-	100%
Sidama MFI	0.2	12.5%	12.5%	-	75%	-
Wisdom MFI	0.2	-	-	-	-	100%

Source-*Microfinance Development Review Volume iii No.2, 2004 (AEMFI)*

2.9.1 Institutional and Operational Arrangements of Micro–finance Institutions

A large number of MFIs have set-up networks in many African countries taking advantage of increased pressure on governments to deregulate the economy and the financial sector, encourage competition in all sectors, and create the conducive environment for increased production. Thus, microfinance delivery has become an attractive business over the last decade in Africa. Some of these MFIs are local based, while others are either regional or even international. Most of the MFIs are specialized in the delivery of small loans to a wide range of clients, and especially the “poorest of the poor”. MFIs encompass different kinds of organizations, such as limited companies, para-statals, in addition to those legally registered as MFIs (Magill, 1994). Experience shows that some MFIs may also channel delivery and recovery of funds through other existing banks with which they may have an operations agreement. Thus, such MFIs, may not directly be involved in loan disbursements, repayment collection, or business monitoring, etc. (Pitamber, 2003).

MFIs operate in a niche market because 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 (Pitamber, 2003).

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 micro-loans. In Ethiopia, studies suggests that, other than agricultural credit, repayments are required to start immediately, starting the week after the loan has been disbursed, and repayments are in weekly installments (Pitamber, 2003).

CHAPTER III

ANALYSIS AND INTERPRETATION OF DATA

The analysis is based on the information obtained from 273 MFIs clients, 31 MFIs officials, from three micro finance institutions found in Addis Ababa, viz Aggar, Specialized Financial Promotional Institutions (SFPI), and Harbu Micro Finance Institutions (Table 1). The analysis also incorporated information obtained through an interview with the officials in the Association of Ethiopia Micro – Finance Institutions (AEMFI).

The respondents involved in this study included clients, branch manages, assistant branch managers, and loan officers drawn from each of the three MFIs indicated above. Besides, to learn more about the sector the financial and operations reports of the institutions have been intensely referred.

Finally, out of the 300 questionnaires distributed to clients, 273 (or 91%) were collected. And, out of the 36 questionnaires distributed to the officials 31 (or 86.11%) were collected.

Table 3.1: *Characteristics of the Respondents by Sex and Study Center*

Name of MFIs	Clients N = 273			MFIs officials N= 31		
	Male	**Female**	**Total**	**Male**	**Female**	**Total**
Agar	42(41.05%)	53(55.79%)	95(96.84%)	7(58.33%)	5(41.67%)	10(100%)
SFPI	29(28.13%)	67(69.79%)	96(97.92%)	8(80%)	2(20%)	10(100%)
Harbu	36(43.90%)	46(56.09%)	82(100%)	6(66.67%)	3(33.33%)	9(100%)
Total	**107**	**166**	**273**	**21**	**10**	**31**

As can be seen in Table 3.1 most of the clients included in the study 166 (61.81%) were females while 107 (39.19%) were males.

The sampled MF officials were also drawn from the three MFIs listed on Table 1. Accordingly, most of them 21 (67.74%) were males and the rest 10 (32.26%) were females.

Table 3.2: *Characteristics of the Respondents in terms of Age and Educational Qualification*

	Aggar	SFPI	Harbu	Total	%
Age					
25-30	2	5	4	11	35.48%
30-35	4	3	2	9	29.03%
35-40	3	1	2	6	19.35%
40-45	2	1	0	3	9.68%
Above 45 years	1	0	1	2	6.45%
Total	**12**	**10**	**9**	**31**	**100%**
Educational Qualification					
Certificate	4	3	2	9	29.03%
Diploma	5	5	6	16	51.61%
First Degree	3	2	1	6	19.35%
Second Degree	0	0	0	0	0.00%
Other	0	0	0	0	0.00%

Considering the age of the officials in the selected MFIs, it was found that 11 (35.48 %) were in the age category of 25 – 30 years, 9(29.03%) were between 30 – 35 years and 6 (19.35%) were between 35 – 40 years, and another 3 (9.68%) were in the age group of 40 – 45 years, still another 2(6.45%) of the officials were above 45 years old.

Regarding the educational qualification of the officials in the sampled MFIs, about 9 (29.03%) were certificate holders, 16 (51.61%) were diploma graduates and only 6(19.35%) were first degree holders.

Position wise the officials in the selected MFIs were also drawn. Accordingly, 9(29.03%) were branch managers, the majority 13 (41.94%) were assistant branch managers and another 6(19.35%) were loan officers; and the rest 3(9.68%) were head of the institutions.

Considering the responsibility of the MFIs clients included in the study, the majority 144 (52.75%) were head of the household. And 66 (24.78%), and 63(23.08%) were son/daughter and spouse, respectively.

A large member 138 (50.55%) of the clients have 3 – 5 family members. The rest 72 (26.37%), 42 (15.38%), and 21(7.69%) have family members of 6 – 8, 2, and above 8, respectively. Thus, this can be evident that most MF clients support above 3 family members.

It is also found out that a great majority 168 (61.58%) of the sampled MFIs clients earned an average monthly income of less than Br. 500. The rest 105 (38.42%) of the clients in the sampled MFIs earned an average monthly income of above Br. 500.

MFI Clients Profile

A large number 192 (70.33%) of the clients in the sample MFIs were engaged in private small business sector. Whereas some 63 (23.08%) were government employees. Only 18 (6.59%) were daily laborers.

The client profile of the MFIs obtained from their operations reports also categorized into small enterprise operators, poor farmers and low salaried employees. Micro and Small Business still holds the highest percentage share.

Table 3.3: *Clients relationship with MFIs*

Item	Aggar	SFPI	Harbu	Total	Percent
1. How long have you been client in the MFIs?					
A. Above 1 years	42	24	42	108	39.56
B. 2 years	45	50	40	135	49.45
C. 2 - 5 years	9	21	0	30	10.99
D. Before 5 years	-	-	-	-	-
2. How many rounds you become beneficiary with the loan?					
A. More than 5 rounds	0	12	0	12	4.40%
B. Four rounds	6	21	18	45	16.48%
C. Three rounds	36	30	30	96	35.16%
D. Two rounds	42	18	20	80	29.30%
E. Only one round	12	14	14	40	14.65%
Total	**96**	**95**	**82**	**273**	**100%**

As shown in Table 4 above the majority 134 (49.08%) of the clients in the sampled MFIs have attachment with the MFIs for about 2 years. Another 31 (11.36%) of the clients have more than 2 years of business relation with the respective MFIs. The rest 108 (39.56%) of the clients, on the other hand, became clients of MFIs just a year ago.

96 (35.16%) of the clients in the sampled MFIs so far took loans and became beneficiaries for three rounds. Another 80 (29.30%) became beneficiaries for a couple of rounds. Some 45 (16.48%) of them took loans for four rounds. The rest 40 (14.65%) and 12 (4.4%) of the clients took loans from the institutions once and more than five rounds, respectively. Thus, from this one can conclude that most of the clients have established business relationship with the respective MFIs before two years and became beneficiaries of loan for more than two rounds.

Small Business Training

Regarding small business training most of the clients 228(83.52%) and all 31(100%) of the MF officials responded that MFIs provide training on small business to clients. The rest 23(8.42%) and 22(8.06%) of the clients responded *"No"* and *"Do not know"*, respectively. Thus, from the above findings one can infer that MFIs offer small business training to their clients. In this regard the operations report obtained from SFPI revealed that during 2006 it had planned to offer small business training to a total of 638 urban clients who are involved in Micro and Small Business activities. Whereas, at the end of the reporting period (2006), it offered training to a total of 1008 clients. This has made the percentage of clients who have got training to 157.99% against the plan.

Table 3.4*: Clients and Officials response on the participation of women in the MFIs.*

	Aggar		**SFPI**		**Harbu**		**Total**		**Percent**	
1. How do you rate the participation of women in the MFIs?	Clients	Officials	Clients	Officials	Clients	Officials	Clients	Official	Clients	Officials
A. Very High	48	7	36	5	40	4	124	16	45.42	51.61
B. High	12	3	28	4	27	2	67	9	24.54	29.03
C. Fair (Average)	18	2	22	1	9	3	49	6	16.13	19.35
D. Low	6	-	10	-	-	-	16	-	5.86	0.00
D. Very low	-	-	-	-	6	-	17	-	6.23	-
F. No response								1		3.22
2. How do you rate the achievement of MFIs poverty reduction goal?										
A. Very High	6	-	-	-	8	-	14	-	5.13	-
B. High	8	2	5	3	7	2	20	7	7.33	22.58
C. Average	72	4	60	3	41	7	173	10	63.37	32.26
D. Low	10	5	30	4	22	2	62	11	22.71	35.48
E. Very Low	-	1	-	-	-	1	-	2	-	6.45

F. No Response	-	-	-	-	4	1	4	1	1.47	3.22
3. Do you know some one who showed improve ments in his/her life or bus iness understandings just because of the service sh e/he obtained from the MFIs?										
A. I know many	36		18		24		78		28.57	
B. I know very few	52		66		55		173		63.37	
C. Do not know anyone	7		12		3		22		8.06	

MF clients and officials were also asked to rate the participation of women in the MFIs. Hence, 124(45.42%) of the clients and 16(51.61%) of the officials rated women participation as *"very high*". Another 67(24.54%) of the clients and 9(29.03%) of the officials rated women participation as *"high*". While some 49(17.95%) of the clients and 6(19.35%) of the officials rated women participation as *"Average*". The rest 16(5.86%) and 17(6.25%) of the clients rated women participation as *"Low" and "Very Low*", respectively. And 1(3.22%) of the officials failed to respond to the item.

However, the operations reports obtained from the sampled MFIs revealed that women clients constituted from 37% (for Harbu MFI) to 56% (for SFPI) of the total clients. Thus, though most clients and officials rated women clients' participation as "high" and "very high", the reports obtained from the institutions disclosed that the participation of women should be rated as "average". All in all, the responses from the three MFIs have shown more or less similar results.

MF clients and officials were also asked to rate the achievement of MFIs poverty reduction goal. Accordingly, the majority 173(63.37%) of the clients and 10(32.26%) of the officials rated as "*Average*". Some 62(22.71%) of the clients and 11(35.48%) of the officials rated the sector's poverty reduction goal as "*low"*. Only 7(22.58%) of the officials rated the poverty reduction goal of MFIs as *"very low*".

On the other hand, 14(5.13%) of the clients rated it as *"very high*", and some 20(7.33%) of the clients and 7(22.58%) of officials rated as "*high*". Therefore, from the above description one can conclude that currently the MFIs poverty reduction goal is rated somewhere between average and low.

Clients of MFIs were also asked whether or not they know someone who showed improvements in his/her life or business because of the services of the MFIs. Accordingly, the majority 173(63.37%) of them replied that they know very few individuals who made a change in their life or business activities. Another 78(28.57%) of the clients responded that they know many people who made a change in their life and business activities due to the services of the MFIs. The rest 22(8.06%) of the clients do not know anyone who made a change in life or business because of the services of the MFIs. Thus, from the responses summarized above it seem that only very few individuals made a change in life and business activities as a result of the services of the MFIs.

Table 3.5: *Adequacy of Loan Size and Repayment Period*

	Aggar	SFPI	Harbu	Total	Percent
1. How do you evaluate the loan size?					
A. Average	20	30	25	65	23.81
B. High	0	0	0	0	0.00%
C. Low	18	29	27	74	27.11
D. Very low	54	36	36	126	46.15
E. Do not know	3	1	4	8	2.93
2. Does the loan size shows:					
A. Increasing trend	83	72	70	225	82.42
B. Decreasing trend	0	0	0	0	-
C. No change	0	0	0	0	-
D. Do not know	12	24	12	48	17.58
3. How do you rate the loan repayment rate?					
A. Sufficient	53	59	32	125	45.79
B. Very Short	42	36	47	144	52.75
C. Very Long	0	0	0	0	0.00

D. Do not know	0	1	3	4	1.47

MF clients were asked to express their ideas about the adequacy of the loan size. Accordingly, the majority 126(46.15%) of the clients responded the loan size is “very low”. 74(27.11%) of them believe that the loan size is “low”. Another 65(23.81%) rated the loan size as “average”. Some 8(2.93%) of the clients failed to respond to the item. Thus, from this one can infer that the loan size that MFIs extend to clients is very low.

A question was also forwarded to MF clients to express their views whether or not the loan size is increasing. Thus, a great majority 225(82.42%) of the MF clients replied that the loan size shows increasing trend. While 48(17.58%) of the clients failed to respond to the item. Hence, it is evident that for those clients who make successful repayment of loan, the next loan size will be increased.

Regarding the loan repayment period, 144(52.75%) of the clients responded that the loan repayment period is “Very short”. The other 125(45.79%) rated the loan repayment period as “sufficient”. Some 4(1.47%) of the clients failed to respond to the item.

Mechanisms Used to Select Borrowers.

Officials in the sample MFIs were asked how the client obtains the legitimacy necessary to enable him/her to borrow. Accordingly all 31 (100%) of the officials responded that the client must present a document certifying his/her degree of poverty and must present a government employee with above a certain monthly salary as a bail.

Products/Services of MFIs

The types of financial products/services that the current MFIs offered according to the officials in the selected MFIs are micro credit (loan) and savings (*both compulsory and voluntary)*. As per the response obtained from these officials when client borrow money from the institutions s/he will be forced to keep in the compulsory savings account 10% of the loan and take only 90% of the loan fund.

Concerning the loan policy of the MFIs, the clients in the sampled MFIs were asked. Hence, 156 (57.14%) responded that the current loan size and the repayment period needs to be improved (increased). Another 66 (24.18 %) replied that the loan interest rate is too high and thus it needs to be reduced. 51 (18.68%) of the clients in the sampled MFIs believed that the current loan size as well as the loan repayment period do not have as such big problems except some procedural minor problems. Thus, they believe that MFIs should not make major changes in their loan policy.

Generally, it is indicated in the responses of the clients that the current loan size of the sample MFIs is too small with short repayment period. Also clients asserted that the interest rate charged by the institutions is very high (as high as 13% excluding penalty charge).

Regarding the compulsory savings clients in the sampled MFIs were asked. Accordingly, the majority 135 (49.45%) stressed on the importance of compulsory savings as it protects the institutions from being bankrupted. Another 84 (30.77 %) of the clients replied that although compulsory savings benefits both the clients and the institutions, its rate, which is 10% of the loan amount is too large and, therefore, it needs to be reduced. The other 54 (19.78%) strongly believed that compulsory savings should be avoided.

Table 3.6: *Views on the Challenges of the Current Operations of MFIs*

Response	MF clients N = 273	MF officials N=31
Clients marketing problems (i.e., not having sufficient working place for customers, very	36 (13.19%)	18 (58.06%)

low market for their products, etc)		
Too small loan size	89 (32.60%)	12 (38.71%)
Unfair treatment by NBE (unfair competition among MFIs)	-	15 (48.39%)
High interest rate on loan	122 (44.69%)	-
Shortage of skilled manpower in the fields	39 (14.29%)	9(29.03%)
Inadequate training to clients	15 (5.49 %)	-
Lack of clear procedures	35 (12.82%)	-
Takes very long time to process loan	23 (8.42%)	-
Lack of knowledge and experience on the part of the society	9 (3.30%)	13(41.94)
Unperformed loan	-	5(16.13%)
Shortage of loan able funds	-	7 (22.58%)
No response	0. (0.00%)	5 (13.89%)

36 (13.19%) of MF clients and 18 (58.06%) of the MF officials disclosed that the major challenges of the current operations of MFIs in Addis Ababa is clients marketing problems. They contend that most clients do not have sufficient working place and there is no or low demand for their products/services. 89 (32.60%) of the clients in the sample MFIs and 12 (38.71%) of the officials in the selected MFIs believed that very small loan size of the MFIs is a major challenge in the current operations of MFIs. Whereas 15 (48.39%), 5 (16.13%) and 7 (22.58%) of the officials in the sample MFIs disclosed that the major challenges in the current operations of MFIs are unfair competition among MFIs, the increase in the unperformed loans, and shortage of loanable funds, respectively.

On the other hand, the majority 122 (44.69%) of the clients in the selected MFIs strongly believed that the major challenge is the high interest rates charged on loans by the MFIs. They contend that due to a high interest rate charged on loans many clients forced to quite relationship with their respective MFIs.

Another group of clients 39 (14.29%) and 9(29.03%) mentioned that shortage of skilled manpower in the filed is to be considered as major problem in the operation of MFIs. The rest 23 (8.42%), 9 (3.30%), 15 (5.49%), and 35 (12.82%) of the clients were replied that long loan processing time, lack of knowledge and experience on the part of the society, inadequate training to clients, and lack of clear procedures are the major constraints (challenges) in the current operation of MFIs in the capital.

Thus, the responses obtained from the clients and officials of MFIs in A.A clearly indicated that client marketing problems, small loan size, the high interest rate, shortage of skilled manpower in the field and the increasing trend in the unperformed loans are the major challenges facing the current operations of MFIs in Addis Ababa.

Generally speaking, the research outcomes disclosed that there seems to be many challenges in the current operation of microfinance sector in Addis Ababa, which needs to be resolved for the institutions to perform better.

Limited outreach, particularly women: currently the number of average women clients is about 35 %(at industry level). However it is encouraging to witness that all MFIs still give high priority to recruiting women clients. The problem may be related to the overall situation of women in the external environment.

Table 3.7: *Measures to be taken to Improve MFI operation*

Response	**MF clients N = 273**	**MF officials N=31**
MFIs in coordination with the government and other institutions should solve the marketing problems of the clients	37 (13.55%)	18(58.06%)
NBE should lift the loan limit that MFIs can extend	-	11 (35.48%)
MFIs should extend other financial services like micro insurance, local money transfer, CPO, managing pension funds, etc.	7 (2.56 %)	12(38.71%)
Cooperation of MFIs with other financial institution	-	5 (16.13%)
MFIs should increase the loan size and extend further the loan repayment period	112 (41.03%)	-
Continuous training and follow up of clients must be made	44 (16.12 %)	14 (45.16%)
Reduction of MF loan interest rate	163 (59.71)	-

MFI must use new technologies competent personnel to facilitate the service offered to the clients	53 (19.41)	-
NBE should devise ways for mainstream banks to extend large loans to MFIs so that MFIs loan shortage can be resolved.	-	11 (35.48%)
The government (NBE) should treat all MFIs Uniformly	-	4 (12.90%)
No response	-	1 (3.23%)

Regarding the measures to be taken to improve MF operations, 37 (13.55%) of the clients and 18 (58.06%) of the officials said that MFIs in coordination with the government and other institutions should solve the marketing problems of the clients.

Whereas, the majority 11 (35.48%) of the officials in the selected MFIs suggested that NBE should lift the loan limit that MFIs can extend to their clients.

On the other hand, the majority 163 (59.71%) of the clients asserted that reduction of MF loan interest rate should be made to reduce the drop out rates and to attract more clients and improve the services of the sector.

Some 112 (41.03%) of the clients contended that MFIs should increase the loan size and the loan repayment period to improve their services. And, 7 (2.56%) of the clients and 12(38.71%) of the MF officials said that to provide efficient services MFIs should extend other financial services like micro insurance, local money transfer, and CPO, etc, to diversify their revenue sources.

44 (16.12 %) of the clients and 14 (45.16%) of the officials suggested that for MFIs to provide efficient and effective services continuous training and follow up of clients should be conducted.

A significant number 53 (19.41%) of the clients, on the other hand, suggested that to improve the services that MFIs provide, they must use new technologies and recruit competent personnel.

On the other hand, 5(16.13%) of the officials in the sampled MFIs contended that cooperation of MFIs with other financial institutions should be made to improve the sectors performance. Another 11(35.48%) of the officials said that for MFIs to increase their performance, NBE should devise ways for mainstream banks to extend large loans to MFIs as a mechanism for solving loanable fund problems of the MF sector. Still another 4(12.90%) of the MF officials forwarded that it is important that the government (NBE) should treat all MFIs uniformly to improve the service and performances of the MF sector. Some officials indicated that some government affiliated regional MFIs are favored by NBE. They strengthen this idea that recently one of the regional governments owned MFI secured birr 300 million huge loan from CBE with the permission of NBE. Other MFIs requested CBE to do the same via their association (AEMFI) but CBE refused.

Table 3.8: *Mechanisms used to increase savings & reduce savings withdrawals*

Response	Micro Finance Officials				
	Aggar	SFPI	Harbu	Total	Percent
Increase the loan size given to the client	5	4	3	11	35.45%
Pays higher interest on savings relative to main stream banks	5	3	2	9	29.03%
Assist/educate clients on the importance of savings	2	3	4	9	29.03%
No response	0	2	3	2	6.45%

Regarding the mechanisms used to increase savings in the respective MFIs, the responses obtained from the officials in the sampled MFIs disclosed that 11 (35.48%) of the respondents believed that increasing the loan size given to the clients might help the MFIs to increase savings and reduce withdrawals. 9(29.03%) of the officials contended that to increase voluntary savings it is important to pay attractive interest on savings. Still another 9(29.03%) of the respondents believed that in order to increase voluntary savings it is important to assist and educate clients on the importance of savings. The other 2(6.45%) respondents failed to respond to the item. Thus, from the responses obtained for MFIs in order increase voluntary savings and reduce withdrawals, it is important that they: (1) should increase the loan size, (2) pay higher interest rates, and (3)educate clients.

Savings and Credit Operations

Mobilization of savings is one of the focus areas of MFIs for several reasons (1) to help clients accumulate own capital by way of saving, (2) the mobilized saving from client is to be used to finance a good part of the program at relatively lower price than borrowed fund. Thus, the increase in saving amount is an advantage both to the clients and the MF institutions.

Table 3.9: *Savings, Withdrawals and Net Savings*

MFIs	Items	Actual				Projected		
		2004	2005	2006	Growth Rate 2006	Projected 2006	Achieved percentage 2006	
AGGAR	Gross savings	N.A.	1,594,504	1,922,940	24.10%	2,391,756	80.40%	
	Withdrawals	N.A.	-	-	-	-	-	-
	Net savings	N.A.	-	-	-	-	-	-
SFPI	Gross savings	5,818,759	6,342,849	7,294,276	15%	7,928,561	92%	
	Withdrawal	1,710,966	1,827,732	2,028,783	11%	-	-	
	Net savings	4,107,595	4,515,117	5,265,493	16.62%	-	-	
HARBU	Gross savings	N.A.		2,170,488	-	1,453,800	149.30%	
	Withdrawals	N.A.	-	649,730	-	-	-	
	Net savings	N.A.	423,987	1,481,974	249.5%	-	249.53%	

As can be seen in Table 3.9 above, in all of the three sampled MFIs savings shows increasing pattern. For Aggar MF, for example, the institution planned to reach gross savings of birr 2,391,756. However, it achieved birr 1,922,940 or 80.40% of the plan. Compared to the previous year's achievement, gross savings of Aggar increased by 24.1%.

For SFPI, it is more or less similar to Aggar. In 2006 gross savings increased from birr 6,342,849 to birr 7,294, 276, which means it reflected a growth rate of 15%. During 2006 SFPI planned to achieve birr 7,928,561in gross savings but actually achieved birr 7,294,276 (or 92%) of its target.

In contrast to the other two MFIs mentioned above, Harbu MF registered a remarkable achievement in net savings in 2006. Compared to the 2005 gross savings of birr 423,986.85, in 2006, it reached birr 1,481,973.47, which means that the firm registered a remarkable 249.53% increment in net savings. With regard to gross savings, in 2006 Harbu planned to achieve a gross savings amounts of birr 1,453,800, but actually achieved 149.3% or birr 2,170,488.

All in all, the MFIs included in the sample seem efficient in mobilizing savings.

Table 3.10: *Outreach Summary*

	AGGAR			**SFPI**			**HARBU**		
	2005	**2006**	**%change**	**2005**	**2006**	**%change**	**2005**	**2006**	**%change**
Total number of active clients	1590	1906	20%	14,117	18,033	27.74%	1071	3396	217.09%
Total number of loan clients	1339	1679	25.4%	N.A.	N.A.	N.A.	1071	3396	217.09%
Total number of savings clients	1590	1906	20%	14,117	18,033	27.74	1071	3396	217.09%
Value of client savings	1,594,504	1,922,940	21%	6,342,849	7,294,276	15%	423,987	1,481,974	258.68%
Percentage of women clients	**42%**	**51%**	**19.12%**	**51%**	**55%**	**59%**	**19.13%**	**37%**	**165%**

N.A. *Not Available*

As it can be seen from the table above the total number of active clients in the selected MFIs has been increasing. For example, Aggar MFI's total number of active clients in 2005 was 1590 in 2006 this number rose to 1906 which shows a 20% growth.

Whereas, SFPI's total number of active clients in 2005 was 14,117 but in 2006 the number has reached 18,033. It has shown a 27.74% growth compared to the 2005.

Client outreach in Harbu MF also reflected an increasing trend. Even though Harbu MF was established 2 years ago in mid 2004 and begins formal operation in January 2005, it has registered a 217% growth in client outreach.

From the information obtained from the sample MFIs, the proportions of women clients also shown increasing pattern. For instance, in Aggar MFI out of the total 1906 clients 51% or 972 were women. This number is quite larger compared to the 668 women clients in 2005. Similar patterns have been registered for the other MFIs. The reports obtained from SFPI and Harbu MFIs disclosed that the share of women clients in rural areas was very low, for example, in SFPI in 2006 women participation in rural areas was 29.52% while it was higher than 60% in urban areas. It seems that the cultural barrier that hinders women to come to the forefront is one of the challenges faced in rural areas.

Thus, it is true that considering the client outreach activities the MFIs included in the sample are performing well and are efficient.

Table 3.11: *Number of Dropouts and Dropout Rates*

Client mobilization	AGGAR			SFPI			HARBU		
	2005	**2006**	**%change**	**2005**	**2006**	**% change**	**2005**	**2006**	**%change**
Number of clients	1805	2266	25.54%	17,642	22,149	24.41%	1288	3850	198.91%
Dropouts	215	360	67.44%	3525	4116	16.77%	217	454	109.22%
Drop Rate	11.91%	15.89%	3.98%	19.18%	18.58%	-0.6%	16.85%	11.79%	-5.06%
Number of Active clients	1590	1906	20%	14,117	18,033	27.74	1071	3396	217.09%

Client Mobilization

Client mobilization activities was undertaken is 2006 in each of the sampled MFIs (Table 3.11) to increase the number of clients and at the same time to fill in the gap created by dropouts. Hence, a total of 676 new clients joined Aggar MFI after passing the evaluation criteria. This includes replacement for client dropouts (11.91%) from the balance of active clients at the end of the previous year (2005). Whereas in the case of SFPI, in 2005 a total of 3,297 clients took the orientation program and joined SFPI after completing the preliminary criteria. In 2006 a total of 8032 new clients were registered in all of its four branches and took the orientation programs and joined SFPI after passing the evaluation criteria. This includes replacement of client drop out (19.18%) from the balance of active clients at the end of the previous year.

Harbu MFI also undertakes client mobilization activities in 2006. As a result, 2779 new clients have been registered and became client of the firm. In general, from the above analysis one can infer that even though the institutions engaged every year in client mobilization activities, there seems a high drop out rates in all of the three MFIs in the sample. It seems that the major causes for the higher savings withdrawals and client dropouts are: (1) the small loan size, and (2) the short repayment period.

Table 3.12: *Clients and Products*

Clients and products	AGGAR				SFPI				HARBOU			
	Actual 2005	Actual 2006	Project 2006	Actual %	Actual 2005	Actual 2006	Project 2006	Actual %	Actual 2005	Actual 2006	Proj. 2006	
Total number of loan s disbursed	1339	1679	2800	60	N/A	N/A	N/A	-	1537	3516	N/A	-
Number of loans outstanding	1590	1906	2414	79	N/A	N/A	N/A	-	1071	3396	N/A	-
Total gross loans portfolio	4,597, 743	5,610, 501	13,158, 767	43	N/A	N/A	N/A	-	1,221, 896	4,422,370	N/A	-
Number of voluntary savings clients	-	-	-	-	N/A	N/A	N/A	-	258	1,143	N/A	-
Total balance of volu ntary savings a/c	97,936	89,185	190,000	46.94	N/A	N/A	N/A	-	330,663	1,030,393	N/A	-

Client Retention

During 2006 Aggar MFI planned to retain about 75% of the active clients. However, it achieved only 57.67% of its clients. It was not achieved its plan mainly because of the following two reasons (1) the low loan size, and (2) due to the short repayment period. Though the total number of loans disbursed in 2006 increased to 1679 compared to 1339 of the 2005, the company failed to achieve its target of 2800. In terms of total gross loan portfolio, Aggar achieved only 43% of what it has planned (Table 3.12).

With regard to voluntary savings, Aggar planned to increase voluntary savings to reach Br. 190,000 in 2006, however, it achieved only 46.94% of what it has projected to attain. This low level of voluntary savings amount seems the result of higher savings withdrawals and low client retention activities.

Even compared to the voluntary savings that was achieved in 2005, it is less by 8.32%.

During 2006 Harbu MF disbursed a total number of 3516 loans. Compared to 2005 the firm registered a 128.76% growth rate. In terms of the total value of loans in 2006, it disbursed birr 4, 422,370 which enabled the firm to achieve a 261.93% growth compared to the previous year. With regard to the number of voluntary savings clients, in 2006 the firm reported total number of voluntary saving clients of 1143 which again registered a remarkable achievement.

In 2006, the total balance of voluntary savings account for Harbu MFI increased from birr 330,663 to birr 1,030,393. Thus, the firm achieved a 211.61% increment compared to that of the 2005 fiscal year.

During 2006 SFPI planned to retain about 80% of the active clients. However, it achieved only 32.09%. This was not possible because of the high drop out rate in the year. The causes of the high drop out rate in 2006 can be attributed to the low loan size and short repayment period. Though the average loan size has increased to birr 1800 in 2006 compared to birr 1509 in 2005, the company failed to reach its target amount of birr 2000. Compared to the average loan size of the industry (birr 1047), still it is large enough.

Table 3.13: *Credit Operations*

	AGGAR				SFPI				HARBOU			
	2005	2006	Project 2006	Act %	Act. 2005	Act 2006	Proj 2006	Act. %	Act 2005	Act 2006	Proj 2006	Act %
Total loans disbursed	4,597,743	5,610,501	13,158,767	43%	16,576,000	20,073,185	26,540,902	68.7	1,221,896	4,422,370	3,468,525	127.5
Loan collection	2,049,166	1,698,376	5,284,405	32.14	12,493,846	12,926,599	19,714,197	63.37	442,720	2,248,136	3,234,263	69.51
Outstanding loan	2,548,577	3,912,125	7,874,362	50%	13,946,297	21,092,882	20,478,527	103	849,178	3,023,410	N/A	N/A

N/A: *Not Available*

Loan Disbursement

In year 2006 Aggar MF planned to disburse birr. 13, 158, 767 for a total of 2800 clients with the assumption that each will have an average loan of birr 4700.00. However, the actual number of clients who took loan within the budget year were only 1679 while the total amount of loan disbursed was birr 5,610, 501 leaving the average loan size to be birr 3,341.57, which is less than the plan. Hence, the target achievement for the disbursement is only 43%. This under achievement in loan disbursement could be attributed to the lower client mobilization and due to the clients' loss as a result of political instability in the country.

Considering the SFPI case, in 2006 it planned to disburse a total of birr 26,540,902 to 13,270 clients. Whereas the actual amount of loan disbursed was birr 20,073,185 which enabled the firm to achieve only 75.63% of its plan. The reason for the lower achievement of disbursed loan seems that clients who were not active in terms of clearing their arrears were terminated from the program to the extent of using their savings to offset the outstanding loans and this made the repeat loans lower than what was expected.

On the other hand, during 2006 Harbu MFI planned to disburse a total loan of birr 3,468,525 but actually disbursed birr 4,422,370, which enabled the firm to achieve 127.5% of its plan. It seems that the higher loan disbursement rate is due to the good outreach program by the firm.

Loan collection

During 2006 Aggar MF planned to achieve a collection of birr 5, 284, 405. But the actual collection during the same year was birr 1, 698, 376. Hence, the institution achieved only 32.14% of what it had planned to achieve. It seems that this lower level achievement in collection is mainly due to the low level disbursement and poor follow up of clients during the same year.

With regard to collection, SFPI in 2006 planned to collect birr 19,714,197 from part of the 2006 and 97% of the previous years outstanding loans. The actual collection for the same period shows only birr 12,926,599. Thus, it was achieved only by 65.57% against the plan. The low collection is mainly the result of the lower value disbursement and lower average loan size.

During 2006 Harbu MFI targeted to collect birr 3,234,263. However, the firm actually collected birr 2,248,136, which is 69.51% of the target. This lower level collection, according to the report is due to the fact that most of the loans were disbursed in the third and fourth quarter of the year.

Outstanding Loan

In 2006 Aggar MFI was planned that outstanding loan at the end of the year would reach a total of birr 7,874, 362. However, the actual outstanding loan for the year was birr 3,912,125. Therefore, it achieved only half of what it planned. The lower achievement can be attributed mainly to the year's lower level loan disbursement.

On the other hand, during the same year (2006), SFPI was expecting that the year end outstanding loan would reach birr 20,478,527. However, the total outstanding loan at December 31, 2006 reached birr 21,092,882. It is slightly higher than the planned amount by 3%. The reason for the higher outstanding loans was that most credit officers of the institutions were instructed to primarily enhance payments that were in arrears in the third quarter of the year. The bulk of the disbursement was undertaken in the last quarter that in effect would lower the volume of collection and at the same time push up the level of the outstanding loan.

On the other hand, at the end of 2006 Harbu MFI reported birr 3,023,410 outstanding loan. Compared to the last year (2005), it exceeds by 256%. This high outstanding loan is due to the low level of collection made during the year.

Portfolio at Risk (Quality)

The occurrence of arrears has its own implications on the level of risks. Therefore, it is essential to assess the risks associated with the contamination of the part of the outstanding loans due to the arrears. All the outstanding loans with 30 and more days with arrears are considered in the assessment of the portfolio at risks according to the industry norms and standards. In line with this, Aggar MFI reported a total of birr 808, 439 as the value of outstanding balance of loans in arrears at the end of 2006. This figure is larger than the same figure for 2005 by 37.6%.

Even though the rate of portfolio at risk for the year 2006, which is, 20.67%, is less than the previous year, it is quite larger than the target (8%). The higher portfolio at risk reported for Aggar MFI at the end of 2006 is indicative of the less follow-up activities made to the clients.

In 2006 SFPI reported a total of birr 1, 961, 638 as arrears. The rate of arrears for 2006 is 9.3%, which is a bit more than the target set by the institutions (8%). In the reported value of arrears included were: (1) unpaid loan due to death, (2) bankruptcy of clients and (3) sickness and disappearance of clients.

For Harbu MFI the actual arrears reported at the end of 2006 was birr 110,989.60. Compared to the total outstanding loan balance for the same year, it is 3.67%. This is slightly larger than the plan (3%).

Regarding the loan loss ratio, Aggar MFI reported 6.89% and 13.11% loan loss ratios in 2005 and 2006 fiscal years, respectively. Compared to the industry standard (norm) of 2%, the reported loan loss ratios in both years are very large. The reason for the higher loan loss ratio once again is the result of the inadequate client follow-up activities.

During 2005, SFPI reported only 0.24% as loan loss ratio (bad debt expense). This is well within the industry norm of 2%. However, in 2006, the reports obtained from SFPI indicated that the loan loss ratio is increased to 3.30%, which is slightly larger than the industry standard.

On the other hand, Harbu MFI reported a loan loss ratio of 0.81% in 2006. This ratio is well within the industry standard of 2%.

Generally, with regard to loan loss ratio, especially Aggar and partly SFPI reported higher loan loss ratios.

Table 3.14: *Performance Ratios Analysis*

		AGGAR			SFPI			HARBU		
		2005	2006	%Increase	2005	2006	%Increase	2005	2006	%Increase
Profitability & sustainability										
1	Return on Assets	-6.66%	-7.11%	18.15%	0.59%	3.01%	2.42%	0.28	-2.58	_
2	Return on Equity	-9.04%	-13.05%	18.15%	1.14%	5.68%	4.54%	0.97	-3.40	_
3	Operational self-sufficiency	59.14 %	64.8%	9.5%	N/A	104.4 %	_	_	_	_
4	Financial sustainability	46%	50.7%	10%	N/A	80.7%	_	_	_	_
Efficiency and productivity										
5	Operating Cost Ratio	39.90%	25.27%	-14.63%	13.08 %	13.5%	-0.42	19.62	22.99	-3.37
6	Cost per Active client	430.74	428.26	-2.97%	Br. 159	Br 146	-8.19	Br 125.37	Br 201.09	60.03
7	Borrowers per credit officers	191.29	210	9.95%	505	515	1.98%	134	283	111.2
8	Average outstanding loan size	3434	3342	-2.68%	1509	1800	19.28	N/A	N/A	-
Asset/Liability Management										
9	Debt to Equity Ratio	33.74 %	45.22%	11.48%	44.86 %	48.41 %	3.55%	36.43	66.66	30.23
10	Liquidity Ratio	2.19:1	0.93:1	-	-	-	-	0.5:1	0.73:1	
11	current Ratio	3.6:1	2.43:1	-	2.14:1	1.99:1	-	2.61:1	3.26:1	
Portfolio Quality										
12	Portfolio -At-Risk PAR Ratio > 30 days	23.05 %	20.7%	-2.38%	8%	9.3%	1.3%	-	3.67%	3.67
13	Write-offs-Ratio	6.89%	13.11%	6.22%	0.24%	3.3%	3.06%	0	0.81	0.81

N.A *Not Available*

Financial Statements Analysis

The starting point for sound financial management is the timely and accurate production of financial reports, which requires timely and accurate financial records. Frequently, MFIs must produce financial statements based on a format required by lenders, donors, and regulators (NBE), or network organizations (AEMFIs).

Such statements may satisfy reporting requirements of one or more of those groups. Furthermore, to make financial statements to be useful, managers and investors need to analyze and interpret the statements. Careful analysis of financial statements can help decision makers evaluate an organizations past performance and predicts its future performance. Such evaluation help managers, investors, and others make intelligent and informed financial decisions.

Therefore, in line with this the financial statements of the sampled MFIs are analyzed to show how well they are performing.

Profitability Ratio

Return on Assets Ratio

Balance sheet percentages are usually based on the total assets (as 100%). This analysis was based on the statement of financial position and the profit and loss reports of the selected MFIs. For Aggar MFI, the total assets and the net worth at the end of 2006 decreased compared to the previous years, whereas the firm's total liabilities during the years showed increasing pattern. The decrease in assets and net worth are attributed to the higher operating losses suffered by the firm and thus, the Return on Assets and the Return on Equity declined for the years 2005 and 2006 with the ratios of -6.66% and -7.11% for the return on Assets, respectively(Table 3.14). The negative ROA ratios are as a result of the net loss suffered by the firm in 2005 and 2006.

The return on assets (ROA) for SFPI for 2005 and 2006 fiscal periods were 0.60% and 3.01%, respectively. The return on assets reported in 2005 was very low compared to the industry standard of 2% for growing MFIs. This low return on asset ratio is mainly due to the low level operating income reported by the firm. However, in 2006 the return on assets ratio increased to 3.01% together with the increase in net income. Thus, this tells us that the firm accomplished better compared to the previous year.

On the other hand, in 2005, in its first full year operation, Harbu MF reported a return on assets ratio of 0.28% which is a good achievement for the newly established firm. However, in 2006 the firm incurred a total loss of birr 45,528.33. As a result, it reported a negative return on assets of -2.58%. According to the officials the higher loss reported in 2006 were due to the higher bad debt expense maintained by the firm and the additional expense incurred in connection with branch expansion.

Return on Equity (ROE)

For Aggar MF the return on equity (ROE) measured based on its financial statements for the years 2005 and 2006. The results revealed -9.04% and -13.05% in 2005 and 2006, respectively.

The results for both years show a negative ratio because of the increasing pattern of operating losses over the years.

The ratio for both years is far below what is expected from a firm such as this. As many commercial financial institutions target a RoE ratio of about 15% to 25%, the results obtained for Aggar MFI is very far below the standard.

When we look at the results of SFPI again in Table 3.14, the RoE reported in 2005 and 2006 were 1.14% and 5.68%, respectively. As many commercial financial institutions target a RoE of about 15% to 25%, the results obtained for SFPI is also very low. But compared to the 2005 ratio (which is 1.14%), in 2006 the institution performed better.

For Harbu MFI the results of RoE for 2005 and 2006 reflected a 0.97% and -3.40%, respectively. For a MFI that began formal operation in 2005, the result reported during the same year is encouraging. However, during 2006 the firm reported a negative RoE. The negative return on equity in 2006 as explained earlier was due to the higher operating expenses related to loan loss and branch expansion.

Total loan portfolio per loan (credit) officer.

To see whether the sampled MFIs are financially viable or not, an assessment was made that compares the amount of loan portfolios per loan officer.

For Aggar, results of the 2006 annual report indicated Birr 489, 015.63 compared to the previous (2005) year Birr 364, 082.43; thus, it exceeds by Br. 124, 933.20 (or 34.31%). Thus, from this one can infer that in year 2006, Aggar has done better in this particular case.

On the other hand, when we look at the case of SFPI, the results for 2006 revealed Birr 602,653.79. Compared to the 2005 birr 498,082, it exceeds by Birr 104,571.79 or 20.99%. Therefore, compared to the set target by the firm in 2006 it is exceeds by Birr 49,180 (or 8.89%).

All in all, from the above discussion one can conclude that the institutions are performing well in this particular case.

Efficiency and Productivity

Operating expense/cost Ratio

An attempt was also made to evaluate the operating cost ratio of the selected MFIs by comparing their respective operating costs with the average value of loans outstanding. The results obtained are presented for each of the MFIs as follows:

For Aggar MFIs the results showed 39.90% and 25.27% for 2005 and 2006 fiscal years respectively. This ratio measures the cost per unit of money lent. Thus, for Aggar this cost for 2005 is 39.90% per unit of money lent which is much more than the 25% target set by the institution. However, in 2006 the ratio decreased to 25.27%. Therefore, one can deduce from this that compared to the previous year (2005), in 2006 Aggar MFI was efficient in meeting its target.

The results obtained for SFPI from the annual reports showed more or less similar results. The cost per unit of money lent for SFPI for the years 2005 and 2006 reported 13.08% and 13.5%, respectively. Hence, one can infer from this that the ratios for each year are lower compared to the set standard by the institution (24%). Thus, the institution seems efficient.

We also obtain similar results if we go through the reports of Harbu MFI. In that, the firm reported an operating cost ratio of 19.62% in 2005 and 22.99% in 2006. Hence, it seems a bit inefficient and unproductive compared to the 2005. But compared to the standard set by the firm (which is 25%), it is still efficient.

All in all, from the results presented in the above paragraphs, one can easily infer that the financial efficiency ratios of the institutions are favorable since a declining ratio is positive.

Productivity Ratio

Number of Active Borrowers Per Credit Officers.

Regarding the productivity ratio, the total number of active borrowers for each of the selected MFIs was compared with the total number of loan officers for 2006 fiscal period.

Accordingly, for Aggar MF the results obtained from its annual operations report indicated (1679/8), or 210. Hence, compared to the 2005 report (1339/7 or 191), the number increased significantly, evidencing the firm's productivity.

The reports obtained for SFPI also indicated similar results. In 2005, the results as per the analysis indicated quite an impressive achievement (14,117/28), 505.

For 2006, the results showed (18,033/35), or 515, which is more or less similar to that of the 2005. Compared to Aggar, SFPI was more productive for it reported more than double what was reported by Aggar in both 2005 and 2006.

A ratio of active borrowers per credit officer for Harbu MFI for 2005 was 134. The 2006 result as per the analysis indicated 283, which is larger by 149 or 111.19%. Hence, one can see that the number increases significantly.

Liquidity Ratios and Liquidity Risk

An attempt was also made to assess the sampled MFIs current and liquidity ratios for 2005 and 2006 fiscal periods.

Hence, the results for current ratio for Aggar MFI indicated 3.6:1 and 2.43:1 for 2005 and 2006 fiscal periods, respectively. Thus, it seems reasonably adequate for each of the two years as the industry norm is between 1:1 and 5:1. From this one can infer that the institution is able to meet its maturing (current) obligation when it falls due without borrowing cash.

With regard to liquidity ratio, Aggar seems a bit uncomfortable in 2006 since a ratio of 2.19:1 and 0.93:1 reported, respectively for 2005 and 2006 fiscal years. The industry norm dictates companies in the industry to maintain a liquidity ratio of greater than 1 (one).

However, for SFPI the analysis revealed a current ratio of 2.14:1 and 2:1, for 2005 and 2006 fiscal years, respectively.

Therefore, it is evident that one can infer from this that the institution is at a better position and be able to meet its entire current obligation without being engaged itself in borrowing.

Finally, Harbu MFI also reported a current ratio of 2.61:1 and 3.26:1 in 2005 and 2006 fiscal years, respectively. With regard to liquidity ratio the firm reported

0.5:1 and 0.73:1 which is a bit lower than what the industry standard dictates for similar firms.

Growth Rate

The study also assesses the growth rate of the sampled MFIs as part of performance indicators. To analyze the case, such growth rate indicators like growth in portfolio, growth in borrowers and growth in equity were tested. Accordingly, the results for each of the aforementioned MFIs are presented in the paragraphs below.

Growth in total portfolio for Aggar MF in 2006 shows a 22.03% increment compared to the 2005 fiscal year. Regarding growth in borrowers, the analysis revealed that borrowers increased 25.39% (from 1339 in 2005 to 1679 in 2006) compared to the previous year.

With respect to the growth in equity, the reports for 2006 show -18.17% compared to that of the 2005. Thus, from the information presented in the report one can easily understand that the decrease in equity is partly from the consecutive losses reported over the years. And the other cause for the negative growth in equity seems the unchanging shareholders equity reported over the two years period.

The growth in portfolio for SFPI showed a 40.07% and 51.24% for the years 2005 and 2006, respectively. Regarding the growth in borrowers, the reports revealed that borrowers increased by 21.48% in 2005, and by 27.74 % in 2006. Also, the growth in equity for SFPI indicated an 18.5% and 30.44% increment in 2005 and 2006, respectively. Thus, based on the above findings, one can easily infer that the institution accomplished (registered) a remarkable achievement.

However, on the other hand, Harbu's operations reports for the same period reflected a somewhat different figure. The result for growth in portfolio reported a 296.44% growth in 2006 compared to that of the 2005. Regarding the growth in borrowers, the analysis disclosed that borrowers increased by 217.09% in 2006 fiscal year compared to that of the 2005.

Regarding the growth in equity for Harbu the same report revealed that there was a 301.46% growth in 2006 compared to that of the previous year.

All in all, the growth rate for the sampled MFIs reported positive results except the negative growth in equity for Aggar MFIs which is partly attributed to the huge loss reported over a number of years by the firm.

Leverage and capital Adequacy

Financial strength

This study also attempted to measure the sampled MFIs financial strength by comparing the total liabilities with the firms' total assets for the same years. Hence, the results for Aggar MFI revealed 33.74% and 45.22% for 2005 and 2006, respectively. Therefore, one can judge from this that the firm was financing almost two-third of its assets from equity and one-third from liabilities in 2005. But in 2006 little improvement has been made. However, this increase was as a result of the increase in liabilities and the decrease in total assets in 2006.

On the contrary, the results reported for SFPI were 44.86% and 48.4% during 2005 and 2006, respectively. Thus, one can conclude from this that the ratios reported for the firms are somewhat lower than that is required for less maturing MFIs, and therefore, good. In this particular case the industry practice dictates for less mature and growing MFIs the ratio would range 70% to 80%.

The financial strength of Harbu MFI is also tested for 2005 and 2006 fiscal years. Accordingly, in 2005 the firm reported a ratio of 57.3% while in 2006 it is reduced to 42.34%, implying that the firm is financially strong and viable.

CHAPTER IV

SUMMARY, CONCLUSION AND RECOMMENDATIONS

This part of the study presents summary, conclusions and recommendations.

4.1. SUMMARY

As it has been indicated earlier in the previous chapters, the main objective of this study is to make an assessment of the challenges and the operating and financial performance of microfinance institutions in Addis Ababa.

On the basis of data obtained from the respondents through questionnaires and interview as well as the operations and financial reports of the respective MFIs, interpretation an analysis of data were made.

Here in this section the major findings are presented below:

1. Clients included in the sample are more of females (16.81%) than males (39.19%)
2. The MFIs officials included in the study are more of males (67.74%) than females (32.26%)
3. It is indicated in the study that the officials in the MFIs were studied in terms of their positions. Accordingly, the majority 13 (41.94%) were assistant branch managers, 9 (29.03%) were branch managers, 6 (19.35%) were loan officers and the rest 3 (9.68%) were head of the institutions.
4. The MFIs clients included in the sample were also studied in terms of their family size. Hence, most of the clients have more than 3 family members.
5. It is also found but that the majority of the clients included in the study earned an average monthly income of less than Birr 500.

6. It is also learned that the majority of the clients in the selected MFIs are engaged in private small business sector. Of which the great majority of them 102 (53.12%) are engaged in Micro and Small Business activities.
7. A little more than half 165(60.44%) of the MFI clients confirmed that they have more than 2 years of business relationship with the MFIs, and a large number 233(83.35%) of these clients asserted that they became beneficiaries with the MFI loans for more than two rounds.
8. The majority 228 (83.52%) of the MFI clients and all 31(100%) of the MF officials conformed that small business training is undertaken by the MFIs.
9. Women participation in the MFIs was rated as "very high" and "high" as conformed by the majority 124(45.42%) of the clients and 16(51.61%) of the officials, and 67(24.54%) of the clients and 9(29.03%) of the officials, respectively.

   However, the operations reports obtained from the MFIs revealed that women clients constituted from 37% (for Harbu MFI) to 55 %(for SFPI) of the total clients. Thus, though most clients and officials rated women's participation as "high" & "very high", the reports obtained from institutions themselves revealed that the participation of women clients should be rated somewhat as "average". The average figure for the industry is 35%.
10. A large number 235(86.08%) of the clients and 21(67.74%) of the MFI officials rated the MFIs poverty reduction goal as below "Average". Moreover, slightly more than half 173 (63.37%) of the clients asserted that they know only very few individuals who made a change in their life or business undertakings due to the services they obtained from the MFIs.
11. As confirmed by the majority 120(46.15%) and another 74 (27.11%) of the clients the loan size given to the clients is "very low" and "low", respectively. Also, regarding the loan repayment period, slightly more than half 144(52.75%) of the MFIs clients responded that the loan repayment period is "sufficient".

12. The types of services/products offered by the MFIs are: - micro credit (loan) and savings (both compulsory and voluntary) and training on small business challenges of MFIs.

13. Regarding the challenges of MFIs, the responses obtained from the MF officials and clients revealed that small loan size and short repayment period higher interest rate changed by the MFIs, clients marketing problems, and shortage of skilled work force in the field are some of the major challenges facing the current operations of MFIs in Addis.

14. **Saving Mobilization:**

    All the three MFIs included in the study undertake saving mobilization activities in years 2005 & 2006. Accordingly, the reports obtained from Aggar MFI revealed that in 2006 savings (total) reached birr 1, 922, 940 from birr 1, 594, 504 in 2005, that is it is increased by 21%.

    However, compared to the set target, it achieved only 80.40% of the plan.

    For SFPI, it is more or less similar. In 2006, it planned to achieve birr 7, 928, 561 in gross savings but actually achieved 92% of its target with a gross savings of birr 7, 294, 276.

    Harbu MFI also registered a remarkable achievement in gross savings during 2006 by achieving a 249. 53% increment.

    Overall, the MFIs included in the study seem efficient in mobilizing savings.

15. **Client Mobilization:**

    All of the three MFIs also undertook client mobilization activities. Hence, Aggar MFI in 2006 registered 679 new clients. SFPI also registered some 8032 new clients in 2006, of course; this includes replacement of client drop out (19.18%) from the balance of active clients at the end of 2005. Harbu MFI also undertakes client mobilization activities by recruiting 373 new clients.

16. **Clients Retention**

During 2006, Aggar MFI planned to retain about 95% of its active clients. However, it achieved only 86.64% of the plan. The main reason for not achieving the target is associated with the higher drop out rate. Two reasons can be sited for not meeting the plan (1) the low loan size, and (2) due to the short loan repayment period.

During 2006, SFPI planned to retain 80% of its active clients. But, this was not achieved due to the high drop out rate in the same year.

17. **Loan Disbursement**

Regarding loan disbursement, in 2006 Aggar MFI planned to disburse birr 13,158, 767 to 2800 clients with average loan size of birr 4700.

However, the actual number of clients who took loan with in the budget year was only 1679 while the total amount of loan disbursed was birr 5, 610, 50 leaving the average loan size to be birr 3, 341.57. Hence, the target achievement for the disbursement is only 43%.

SFPI in 2006 planned to disburse a total of birr 26, 540, 902. But the actual amount of loan disbursed was birr 20, 073, 185 which the firm achieved only 75.63% of the plan. The reason for the lower achievement of the plan seems the lower client mobilization and clients' loss because of political instability in the country.

On the contrary, during 2006 Harbu MF planned to disburse birr 3, 468, 525, but actually disbursed birr 4, 422, 370, which makes firm achieved 127.50% of its plan. It seems that the higher loan disbursement is due to the good outreach & savings mobilization activities of the firm.

18. **Loan Collection:**

During 2006, the MFIs engaged themselves in loan collection activities. Accordingly, Aggar actually collected birr 1, 698, 376, which is only 32.14% of its plan. The lower level collection is due to the lower level disbursement and loan size. Whereas SFPI in 2006 planned to collect birr 19, 714, 197, but it achieved only 65.57% of its plan.

The low collection rate is mainly the result of the lower value disbursement and loan size.

During the same year (2006), Harbu MF targeted to collect birr 3, 234, 263. However, the firm actually collected birr 2, 248, 136, which is 69.51% of the target. This lower level collection, according to the report is because most of the loans were disbursed in the third and fourth quarter of the year.

19. **Outstanding loan.**

Due to the lower level loan disbursement in 2006, Aggar reported birr 3, 912, 125 actual at outstanding loan. Thus, it achieved only 50% of its plan because of the low loan disbursement in the same year. On the other hand, during the same year (2006) SFPI achieved 3% more than its target.

Compared to the 2005 outstanding loans, it the end of 2006, Harbu MF reported a 256% increment. This increment is the value of outstanding loan is due to the lower of collection in the same year.

20. **Profitability Ratio**

The institutions return on assets (ROA) and return on equity (ROE) ratios have also been tested. Accordingly, for Aggar MF the results obtained shows unfavorable (negative) results with the ROA ratios of -6.66% and -7.11% in 2005 and 2006 fiscal periods and with the ROE ratios of -9.04% in 2005 and -13.05% in 2006. The unfavorable ratios are the results of the huge net loss reported by the firm during the years. SFPI's ROA ratios for 2005 and 2006 fiscal periods are 0.60% and 3.01% respectively. It also reported ROE ratios of 1.14% and 5.68% in 2005 and 2006 fiscal years, respectively.

The ROA ratios for Harbu MFI were 0.28% in 2005 and -2.58% in 2006. While the ROE ratios for the same years were 0.97% and -3.40% respectively.

21. **Efficiency and Productivity**

An attempt was also made to evaluate the operating cost ratios of the selected MFIs by comparing their respective operating costs with the average value of loans outstanding. Hence, the results revealed that the institutions are efficient in this regard since a declining ratio is positive.

Regarding the productivity ratio the total number of active borrowers for each of the selected MFIs was compared with the total number of loan officers. Thus, for Aggar MF the results for 2006 indicated 210, this number was 191 in 2005.

For SFPI during 2005, the results as per the analysis indicated (14.117/28), 505. This number increased to 515 (18, 033/35) in 2006.

A ratio of active borrowers per credit officer for Harbu MFI in 2005 was 134 whereas the 2006 result as per the analysis indicated 283, which reflected a 111.19% increment.

22. **Portfolio Quality Ratios**

The study also examines the portfolio at risk of the firms by comparing the outstanding balance of all loans with 30 days (PAR > 30) past due payments with the value of current portfolio outstanding. Hence, for Aggar the results revealed 23.05% and 20.67% in 2005 and 2006 fiscal periods, respectively. Compared to the set target (which is 9%) the actual achievement indicated the firms' ineffectiveness.

During 2006 SFPI reported a total of birr 1, 961, 638 as arrears. The rate of arrears is 9.3%, which is higher than the set target by 3.3%.

Harbu MFI also reported a portfolio at risk ratio of 3.67% during 2006.

4.2 CONCLUSION

Lack of access to financial services—the absence of convenient savings instruments and credit mechanisms—is a major constraint limiting the accumulation of assets by the poor and the development of indigenous enterprises. Even in a free market environment, gaps in financial services to micro-enterprises, SMEs, and low-income households (both urban and rural) are likely to persist for several reasons.

First, formal financial institutions perceive high risks associated with lending to micro-enterprises, SMEs, and rural households and high transaction costs associated with the lack of reliable information on their clients. Adding to banks' limited capacity to lend to SMEs are the difficulty of enforcing contracts (the result of an inadequate legal framework and inefficient court system) and the lack of appropriate instruments for managing risk. Also, supervisory and capital adequacy requirements often penalize banks for lending to enterprises that lack traditional collateral.

Second, alternative intermediaries, including nongovernmental organizations and indigenous savings and credit groups, can often address these constraints through specialized techniques but frequently suffer from lack of sustainability because of their welfare orientation, small scale, low absorptive capacity, and lack of exposure to international best practices of micro and **SME** finance. The Bank's strategy has not given adequate attention to informal savings and lending mechanisms which are based on common bonds and knowledge about the borrower. Yet these mechanisms have proven their ability to manage risk, enforce lending contracts, and reduce the transaction costs of delivering credit. Hence they should be incorporated in strategies to deepen and broaden financial intermediation.

International best practice shows that lending to micro-enterprises and SMEs is feasible if financial institutions implement practices that allow them to widen their scale and outreach, lower their costs and risks, and provide suitable products. A critical element is a regulatory framework that is conducive to the evolution of new ways of doing business, including interest rates sufficient to cover costs and innovations in risk management.

It is with all these requirements in mind that the microfinance institutions in Ethiopia established in 1996 to cover the gap created and to supply small loans to the able poor and to SMEs. Since their establishments, these small financial institutions expanded their operations throughout the country and supported millions of poor citizens and small business operators that otherwise do not have any access to the financial services of mainstream banks.

Currently there are around 26 MFIs in Ethiopia, out of which eleven are operating in the capital, Addis Ababa. From among the eleven MFIs found in Addis Ababa, three of them are selected for the sake of this research paper. The purpose of this study, as it has been indicated earlier, is to assess the challenges and performances of these institutions.

Thus, from the various reports obtained and mainly from the information secured through questionnaire and interview, the performances of these institutions partly revealed an encouraging results. After all, MFIs have two-fold goals of reaching the poor and becoming sustainable. Thus, in view of this the following conclusions can be drawn.

1. The financial and operations reports of the selected MFIs were referred intensely. Accordingly, the researcher found out that these reports were prepared in line with the accepted accounting standards.
2. It seems that females' participation in the services of MFIs is somewhat average, especially in the rural areas the participation of women is low compared to urban areas. It is learned from the officials of MFIs that the reason for the low participation of women in rural areas is the cultural barriers that hinders women to come to the forefront.

3. The inadequate and insufficient participation of female clients themselves in the design of the programs affects the levels of poverty reduction; the inability of certain commonly used indicators of success/failure of micro-credit in measuring the non-quantifiable impact of the programs on the clients.
4. The type and quality of products/services offered to clients in one way or the other affects the firm's ability to satisfy its clients. In this regard, the small loan size and short repayment period of the MFIs along with the high interest charge discourage clients. As a result of this, there is high client drop out and low client retention rates.
5. Mobilization of saving is one of the focus areas of MFIs for several reasons: (1) to help clients accumulate own capital by way of saving, (2) the mobilized saving from clients is to be used to finance a good part of the program at relatively lower price than borrowed fund. It is indicated in the study that in all of the MFIs, client savings shows continuous increment over the two years period. Hence, this can be considered as the strengths of the institutions.
6. It is fact that the only source of revenue for MFIs is the revenue from loans. For the institutions to earn sufficient income it has to disburse loans in sufficient amounts. However, (except for Harbu) the MFIs included in the study seem inefficient in meeting their target.
7. For any MFIs in order to function smoothly, it has to collect in sufficient amounts and on time the disbursed loans from the clients. Unless otherwise MFIs collect their claims with great care and follow-up, their operations will be jeopardized. However, it is indicated in the study that almost all of the MFIs in the sample achieved far below their plan. Thus, this is a good indication of the institutions inefficiency and poor follow-up activities.
8. Growth indicators like growth in portfolio, growth in borrowers, shows increasing pattern for each of the three MFI in the sample.

9. The institutions ROA and ROE show unfavorable results. Especially for Aggar MF the result for ROA and ROE for both 2005 and 2006 reflected a negative ratio. The ROA and the ROE for SFPI though minimum shows an increasing pattern. On the other hand, the ROA and ROE for Harbu shows a declining pattern. Thus, the declining profitability ratios are the results of a huge net loss realized by the respective firms.
10. The efficiency of the firms in terms of operating cost ratios shows declining ratios. Thus, indicating the firms' efficiency.
11. With regard to arrears the firms reported relatively higher portfolio at risk ratios compare to their plans. This is due to the inadequate follow-up activities of the credit officers on the clients.

4.3 RECOMMENDATIONS

With all these important considerations in mind, the following is a list of recommendations for a successful microfinance program (operations).

Expand the scope of Client Training program

It is indicated in the findings that MFIs provide/offer small business training to the clients. However, the training is confined to only business training. Thus, MFIs should expand their scope of training to include accounting, bookkeeping and cost calculation, budgeting, and leadership/decision-making, etc.

Enhance Women Participation

The data obtained from the operations report of the MFIs show that women's participation in the services of MFIs can be rated as "average". Since supporting female means supporting the entire family, the MFIs should better focus on female clients. Women's are specifically targeted because they make up the majority of the poorest of the poor and are responsible for the social and economic welfare of the family.

Working towards Poverty Reduction

It is solid fact that MFIs have the dual goals of reaching the able poor to reduce poverty, and remain sustainable (profitable). However, it is indicated in the study that the MFIs contributions in the fight against poverty is very minimal. Therefore, much is expected from MFIs to fight for poverty just by expanding the services to include as many poor as possible. The government (NBE) is also expected to cooperate with MFIs to strengthen the capabilities of micro credit for poverty reduction.

Low loan size & short repayment period

It is asserted by the majority MF clients that the loan size given to the clients are too small with a short repayment period. It seems that small loan size and short repayment period along with the small returns from the use of the loan and the fact that the returns themselves are still not always the major contributor to the family income makes the MF Programmes inefficient. Thus, it is recommended that MFIs should further increase the loan size and extend the credit period.

Expand services

It is disclosed in the study that the type of services or products offered by MFIs are: loan (credit) and savings. However, MFIs should expand the scope of their services and extend services like micro insurance, social benefits, etc.

Challenges of MFIs

The results of the study shows that client marketing problems, high interest rate charged by the MFIs, shortage of loanable funds for MFIs are some of the problems facing the current operations of MFIs. Therefore, it is recommended that the MFIs together with other concerned bodies should solve the marketing problems of the clients and reduce the interest charged on loans.

In addition, the NBE should device ways to solve the shortage of loanable funds by allowing them to borrow in bulk from mainstream banks and lend in small loans to the able poor. Furthermore, to solve the problem of funds, the institutions should undertake aggressive fund raising activities either through issuing shares or aggressive move for soliciting donations.

Clients Retentions

The data obtained from the reports of the MFIs revealed that there is a high dropout rate in all of the MFIs in the sample. The causes of this high dropouts are: (1) the low loan size, (2) short repayment period, and (3) due to the higher interest change on loan. Therefore, to achieve better retention of clients, MFIs should increase the loan size and extend the loan repayment period and reduce the interest rate changed on the loans.

Loan Disbursement

With regard to loan disbursement it is indicated in the study that in 2006 Aggar and SFPI, achieved only 43% and 75.63% of target respectively. The reasons for the low achievement are (1) due to the high dropout rate, and (2) low client outreach. Thus, it is recommended that these institutions should do their level best to minimize the dropout rates and increase outreach there by to enhance loan disbursement.

Loan Collection

It is observed that all the three MFIs in the sample failed to meet their target in terms of loan collection during 2006. The reasons for the lower achievement can be (1) the lower level disbursement and due to the fact that the bulk of the loans were disbursed in the 3rd and 4th quarter of the year. Therefore, it is recommended that the institutions should revise their collection strategy and implement appropriate incentive mechanism and follow up to enhance collection.

Measures must be taken to enhance the Profitability of Firms (Strengthening the Sustainability of the Firms)

It is indicated in the study that all of the three MFIs reported a very low ROA and ROE ratios.

The reason for this is due to the low net income (or net loss) realized during the periods. Thus, it is suggested that the institutions should do their best in order to cut some of the expenses and minimize the loan losses in order to be profitable.

Improve the portfolio Quality

The research study disclosed that Aggar and SFPI reported relatively higher arrears compared to the plan (target). The causes for these higher ratios seem the less follow-up of clients. Therefore, it is recommended that the institutions should conduct frequent follow-up activities on their clients.

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Annex 1. Outreach, Efficiency and Financial Performance of MFIs in Ethiopia, June 2006

		OUTREACH			EFFICIENCY	FINANCIAL PERFORMANCE	
NO	NAME	No. of Active Clients	Loan Outstanding	Client Savings	Operating Expense Ratio	Operational Self-Sufficiency	Operational Self-Sufficiency
1	ACSI	503,262	590,225,000	301,929,000	6.2%	200.0%	150%
2	ADCSI	59,700	123,932,000	40,239,000	4.1%	197.3%	106.6%
3	AGGAR	1,914	3,399,097	1,922,428			
4	ASSER	1,352	566,258	273,076			
5	AVFS	6,904	7,325,220	2,037,320	14.7%	76.8%	61.9%
6	BENSHANGUL	16,940	15,540,240	4,893,092			
7	BUSSA GONOFA	14,845	9,480,757	1,511,809	30.4%	76.5%	64.2%
8	DECSI	401,190	725,506,156	193,014,703	2.8%	197.3%	151.4%
9	DIRE	2,644	5,141,005	922,413			
10	DIGAFE	330	296,110	319,800			
11	ESHET	17,838	18,434,860	2,094,768	11.8%	148.05	117.2%
12	GASHA	9,133	13,616,98	6,156,446	14.6%	109.7%	91.4%
13	GHION	149	331,765	291,986			
14	HARBU		1,430,297	765,452			
15	LETTA						
16	MEKET	2,357	1,477,966	259,737			
17	MEKLIT	7,596	7,603,814	1,921,260	17.4%	85.3%	79.3%
18	METEMAMEN	5,425	1,573,500	13,400			
19	OCSSCO	181,403	220,571,724	73,097,217	7.5%	146.8%	110.1%
20	OMO	101,800	96,653,561	43,645,394	10.3%	111.6%	82.6%
21	PEACE	16,570	21,610,114	4,658,220	12.1%	103.1%	80.6%
22	SFPI	18,033	17,348,831	6,933,617	13.5%	104.45	80.7%
23	SHAAHEMENE	2,036	2,122,368	517,599			
24	SIDAMA	26,726	14,710,598	4,542,429	15.9%	74.8%	41.7%
25	WASASA	18,985	17,011,377	3,579,238	16.5%	99.2%	75.9%
26	WISDOM	39,615	43,064,539	11,115,667	19.5%	107.1%	90.9%
	TOTAL	**1,456,747**	**1,958,973,254**	**706,655,069**			
	AVERAGE	**60,698**	**78,358,930**	**28,266,203**	**13%**	**123%**	**92%**
	AFRICA AVERAGE				**35%**	**104%**	**90%**

NB. *Efficiency and Financial Performance Indicators was taken from 2005 Audit Report.*

ADDIS ABABA UNIVERSITY
FACULTY OF BUSINESS AND ECONOMICS
MBA PROGRAM

Questionnaire to be filled By Officials in Micro Finance Institutions in Ethiopia

Objective:

The objective of this interview is to secure the necessary and relevant first-hand information that may be useful to conduct a research project regarding the current performance, challenges, and prospects of Micro Finance Institutions in Ethiopia. Therefore, your response in this regard helps a lot to undertake the study smoothly. The student researcher thus appreciates in advance for your cooperation and for spending your valuable time in filling this interview.

Thank you!

Section I

1. Name of Micro Finance Institution:

____

2. Region/Sub City:

____

3. Educational Qualification: A. Diploma Holder B. First Degree holder
C. Masters degree holder D. Other, please specify

4. Age: A. 25 – 30 B. 30 – 35 C. 35 – 40 D. 40 – 45 E. above 45 years

5. Position in the institution: A. Branch manger B. Assistant branch Manger
C. Loan officer D. Other_______________

Section II

1. Are there any incentive mechanisms used by your institution that encourage early payment of loan by clients? If your answer is "yes" describe them:
   A. Increase the loan size for those who make timely repayments.
   B. Extending uncollateralized loans
   C. Extending the credit periods further in the next loan
   D. If any other incentives, please specify

   ____

   ____

2. How does the institution deals with cash flow constraints?
   A. By borrowing funds in large size from other mainstream banks.
   B. From donation
   C. Through issuing securities, like shares, bonds, etc.
   D. Other, specify

   ____

   ____

3. How does the client obtain the legitimacy necessary to enable him/her to borrow?
   A. The client must produce a certificate or presents a witness evidencing his/her degree of poverty.
   B. Before s/he starts to borrow s/he should have sufficient deposits in his/her savings account.
   C. The borrower must produce a document certifying his degree of poverty and must present a government employee with above a certain monthly salary as a bail.
   D. Other, please specify

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4. How do you evaluate the enterprise's self-financing from internal resources? That is, from deposits?
   A. The institution makes loan entirely from its internal source of financing

B. The institution makes loan from both internal and from other sources like donation and funds obtained from other financial institutions
C. Since the internal source of financing is weak it makes loans mostly from donation and other sources
D. If any other, please specify

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5. Does your institution promote voluntary withdrawable savings?

   A. Yes B. No

6. Does your company requires collateral and substitutes when loan is granted?

   A. Yes B. No

7. What are some of the mechanisms (if any) used by your institution to select borrowers?

   A. The institution selects those who can present collateral
   B. The institution selects those with a good records in loan repayment
   C. The mechanisms used by the institutions while selecting borrowers are not clear and objective.
   D. If any other, please specify

____

____

8. Does your institution ever has conducted training and orientation programmes to the employees?

   A. Yes B. No

9. Who do you think are your major clients?

   A. Informal small business owners
   B. Government employees
   C. Formal traders
   D. Employees in NGO
   E. Daily laborers

F. Other,specify____

____

10. How do you evaluate the participation of women in your institution?
    A. Women are highly participated in the Microcredit programme and they constitute the majority of our clients
    B. Women's participation in the Microcredit programme can be rated as fair and moderate.
    C. Women's participation in the Microcredit programme can be rated as low.
    D. If any other, please specify

    ____

    ____

11. Describe the type of financial products/services that your institution currently offered to clients.

    A. Micro credit　　B. Insurance

    C. Local money transfer　　D. Checking account services

    E. If any other, please specify

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12. How do you measure your institution's current operating and financial performance?

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13. In your opinion, what is important in performance measure?

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14. How do you evaluate the loan collection policy of your company?

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15. How do you evaluate the state of savings (savings mobilization strategy) of your company?

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16. What are the mechanisms that your company is used to increase savings and reduce savings withdrawals?

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17. What mechanisms are you planning to implement in order to increase the collectibles of outstanding loans?

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18. What do you suggest to increase the customer retention rate of your institution?

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19. Do you think you are succeeded in reaching the planned target of beneficiaries whether your answer is a “yes” or “no” please state your reason

    ____
    ____
    ____
    ____

20. What are the major challenges in the current operation of MFIs in Ethiopia?

    ____
    ____
    ____
    ____

21. What do you suggest to solve the challenges you mentioned above?

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22. In your opinion, what must be done to improve the overall operations of MFIs in Ethiopia?

    ____
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Annex 2

ADDIS ABABA UNIVERSITY
FACULTY OF BUSINESS AND ECONOMICS

MBA PROGRAM

Questionnaire to be Filled by Beneficiaries of the Services of MFIs

Objective:

The objective of this questionnaire is to secure the necessary and relevant first-hand information that may be useful to conduct a research project regarding the current performance, challenges, and prospects of Microfinance Institutions in Ethiopia. Therefore, your responses in this regard help a lot to undertake the study smoothly. The student researcher thus appreciates in advance for your cooperation and for spending your valuable time in filling this questionnaire.

Thank you!

SECTION I: General Characteristics of the respondent

1. Age: A. 18 – 25 B. 26 – 35 C. 36 – 45 D. Above 45
2. Sex: A. Male B. Female
3. Status in the family: A. Head of the household B. Spouse C. Husband
   C. Son/Daughter E. Other
4. Average monthly income: A. below Birr 150 B. Birr 150 – Birr 300
   C. Birr 300 – Birr 500 D. Birr 500 – Birr 700
   E. Above Birr 700

5. Number of family members:

   A. 2 B. 2 – 5 C. 5 – 8 D. Above 8

6. Beneficiaries responsibility in the family:

   A. Fully support the family B. Share family responsibility

   C. Specify, if any ______________________________

7. Education Level: A. 1 – 4 grades B. 4 – 8 grades C.8–12 grades

   D. Illiterate

8. Occupation (if any): A. Private small business owner B. Informal private job

   C. Government employee D. Private organization employee

   E. Daily laborer F. Other, specify_______________

9. For Question # 8 if your answer is "formal private small business owner", which area are you engaged in: A. Service providing firm B. Manufacturing firm

   C. Retail business D. Wholesale business

   E. Micro and small business F. Other, specify

   ____

<u>SECTION II: Questions Related to the Study</u>

10. For how long have you been client in this micro-credit institution?

    A. about 1 year B. about 2 years C. 2 – 5 years

    D. before 5 years

11. When the institution grants loan, does it provide consultancy or training services on how to use the money?

    A. It offers B. It never offers

12. Before you became client of the institution what types of services were you expecting?

    A. Loan service only B. Loans, training and consultancy services

    C. Training and consultancy services only.

    D. Other, please specify

    ____

____

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13. Currently, what is your relationship with the institution?

A. taking loan and open saving accounts B. Loan service only

C. Savings account only D. Discontinued saving

E. Drop out

F. Other, specify ____

14. For how many rounds you become beneficiary with the loan?

A. More than five rounds B. Four rounds C. Three rounds

D. Only two rounds E. Only one round

15. How do you evaluate the loan size?

A. Fair B. Too small C. too large

16. Does the loan size shows:

A. Increasing trend B. decreasing trend C. the same amount

17. How do you rate the loan repayment period?

A. It is quite sufficient B. It is too short C. It is too long

18. If you are a drop out, what is/are your reason(s)?

A. Because I am not satisfied with the services offered by the institution

B. Because I do not trust the institution

C. Due to other personal problems

D. Other, specify

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19. Do you know any person or friends who are also the client of the institution? If you know, what are their opinions about the institution's services?

A. They are satisfied with the services offered by the institution

B. They admit that there are problems in the current operation but strongly believe that through time the problems will be resolved

C. they want to quit due to the poor services

D. Other, specify

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20. What are some of the mechanisms used by the institution to select borrowers?

A. Select those with the necessary collateral

B. Select those who have good records in loan repayment

C. The mechanisms used by the institutions while selecting borrowers are not clear and objective.

D. Do not know

21. Does the institution ever have any incentive mechanisms for timely repayment? If "yes", what are they?

A. Increase the loan size　　B. Increasing the repayment period

C. Financial reward　　D. Other, specify

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22. How do you evaluate the participation of women in the services of the institution?

A. Very high　　B. High

C. Fair　　D. Very low

23. Do you know some one who showed improvement in his/her life or family's life just because of the service?

A. I know many　　B. I know very few

C. I do not know even a single successful person.

24. Does the institution provide training and consultancy services to the clients?

A. Yes　　B. No

25. If your answer is "yes" what type of training does it provide?

A. Training on how to prepare business plan

B. Training on how to keep records

C. Any other please specify,

____

26. What do you suggest concerning the loan policy of the institution?

    A. The current loan size and the repayment period needs to be improved

    B. No problem with the loan size, but the repayment periods should be improved

    C. No problem with the repayment period, but the loan size is too small therefore it needs to be improved.

    D. Every thing is ok, as a result no improvement be needed in the future.

27. In your opinion, what are the major challenges in the current operation of MFIs in Ethiopia?

28. What do you suggest the institution should do in the future so that it can provide efficient and improved services?

I Thank You!

Annex 2

ADDIS ABABA UNIVERSITY

FACULTY OF BUSINESS AND ECONOMICS

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C. Due to other personal problems

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