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Financial Sustainability and Outreach of
Microfinance Institutions in Ethiopia: Case
of Oromia Credit and Saving Share Company

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Abstract

In microfinance industry, sustainability is one of the crucial issues attracted the attention of many researchers. This is because it is widely believed that without being sustainable, microfinance institutions can not achieve their objective of reducing poverty. However, some microfinance institutions give little attention to sustainability. They depend on subsidy from government and donor organizations. They also concentrate on providing credit services and ignore saving services which result in lack of reliable source of loan funds. These problems were the major motivations for undertaking this research. This paper attempts to study sustainability of microfinance institutions in Ethiopia taking Oromia Credit and Saving Share Company as case study. For this study both primary and secondary data were used. The data gathered were analyzed by using ratios and percentages. The results indicate that the institution, like other microfinance institutions (MFIs) partly depend on subsidies for the loans it provides. With regard to financial sustainability, it is in good condition. The outreach is increasing in terms of number of clients. The overall efficiency of the institution is improving. However, its performance is weak on areas such as saving mobilization, women participation, and loan officer productivity.

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ACRONYM

GDP- Gross Domestic Product

MFIs- Microfinance Institutions

MSE- Micro and Small Enterprise

NBE- National Bank of Ethiopia

OCSSCO- Oromia Credit and Saving Share Company

ONRS- Oromia National Regional State

ODA- Oromia Development Association

OSHO- Oromo Self-Help Organization

ONRG- Oromia National Regional Government

REST- Relief Society of Ethiopia

UN- United Nations

CHAPTER ONE

1. 1 Introduction

Poverty in Ethiopia is deep-rooted and multifaceted. Ethiopia is one of the poorest countries in the world. The per capita income of the country is only USD 177.4 at end of 2005/06 (NBE 2007). Unemployment and inflation are also other pressing problems of the country. Reducing poverty requires addressing the multiple poverty dimensions and using different poverty reduction tools. Microfinance is one of such tools adopted in the past few decades and found to be appropriate. “Poverty has always been a concern of microfinance” (Hatch and Frederick, 1998: ix). “The use of microfinance as a major strategy for poverty reduction in developing countries ... is increasingly being perceived as an effective tool for rural poverty reduction among the development community (Yeboah, 2007: 2). “Charity is not the appropriate answer for the eradication of poverty, since it only lessens the immediate problem” (Pisco et al, : 6). So, microfinances are an instrument of inclusion, because they offer financial tools to the economically active poor people, who are excluded or have difficulty in accessing the classic bank system (Robinson, 2001).

Access to financial services improves the lives of poor households in many ways. The poor get better nutrition, education, medical services, housing and others.

Study after study confirms that poor families with access to financial services eat better, keep their children in school longer, receive better medical care, and live in safer housing than those who do not have such access, other factors being equal. Access to financial services hands poor people the tools to solve their own problems and to chart their own paths out of poverty (CGAP, 2004: V).

Microfinance meets these objectives through provision of credit, saving and other services such as insurance and training. It is hoped that the poor use credit facilities to start new businesses; expand their business activities; and smoothen their consumption. By so doing, they increase

their earning and savings. Access to saving services enables them to save some portion of their earnings for future use and at the same time earn interest on the saving. Gradually, the poor will be able to improve their nutrition; send their children to school; and improve their medical care and housing. Therefore, microfinance development is one of the crucial issues to be considered as poverty reduction tool and then to bring economic growth and even development. “The development of financial services in rural areas is important to promote rural development and thus economic growth” (Economic Institute of Columbia, 2006: 2).

In Ethiopia there are many microfinance institutions established in the past few decades to deliver services to the poor so as to contribute their part in the poverty alleviation effort. Based on commercial code of the country and proclamation No. 40/1996, OCSSCO was established by five shareholders as a share company. These shareholders include Oromia National Regional State (ONRS), Oromia Development Association (ODA), Oromo Self Help Organization (OSHO), Dinsho PLC and one natural person. OCSSCO had commenced its formal operational activities with head office in Addis Ababa and four branch offices namely Kuyyu, Shashemene, Hetosa and Sinana Dinsho in 1997.

Currently, OCSSCO has been attempting to increase the number of shareholders and amount of shares. Accordingly, the current shareholders of the Company are Oromia National Regional Government (ONRG), Oromia Development Association (ODA), Oromo Self Help Organization (OSHO), Arsi and Finfinnee Forest Enterprises, Sabata and Bushoftu municipalities and one natural person.

The main objective of OCSSCO is poverty alleviation through provision of financial services; that is: credit, saving, micro insurance and advisory services to the poor. The company provides these services to the poor mainly residing in rural areas and engaged in agricultural activities and

those living in urban centers and engaged in small enterprises. It also provides these services to those who are unemployed so that they will be able to create jobs and improve their earnings. In the long-run, the company has the objective of improving the households' asset base to bring sustainable earning and then development.

At the end of year 2006/07, OCSSCO has reached 180 branch offices and 64 satellite offices which are generally 244 service outlets. To realize the objectives of expanding its services and to be closer to the target group in the region, OCSSCO has opened 84 new branch offices and 64 satellite offices during the fiscal year 2006/07.

OCSSCO has raised the interest rate on group based loan by 1 percent from the former interest rate of 11.5 percent to 12.5 percent on the group based loan disbursed from January 1, 2008 onwards on flat base.

The other charges which group based loan borrowers should pay are service charge of 3% of the gross loan and membership fee of Birr 10.00 for new clients per client up front payment which is one time charge unless the clients drop and rejoin the scheme.

OCSSCO has been charging an interest rate of 10% on MSE loan on flat bases on all MSE loans. On top of the interest rate, the Company has been charging 2% of the gross MSE loan up front as application fee.

1.2 Statement of the Problem

The main objective of microfinance programs is to combat poverty by reaching large numbers of poor people with financial services. The provision of these services should be in a sustainable way so that the poor will continuously have access and get out of poverty. As long as poverty is there, either microfinance services should be provided continuously or other tools of poverty reduction should be devised if microfinance fail to address poverty.

It is argued that in many instances, microfinance institutions can not be sustainable without the funding of donors and grants from governments. Therefore, as Befekadu (2007) argues answering whether MFIs can be sustainable without the funding of donors is significant. Thus, it is desirable to investigate the MFIs ability of delivering financial services without the support of donor organizations is crucial. Donors are also encouraging MFIs to achieve self-sufficiency in a short period of time and in many cases sustainable institutions are argued to have impact on poverty.

Depending on cheap funds has the danger of creating inefficiency and problem of discipline. If the funds are easily accessible, the pressure for the institutions will be reduced and the borrowers become reluctant to repay. This will result in inefficiency in performance which in turn affects the institutions' continued performance and provision of services.

The easy availability of donor grants often reduces the pressure for MFIs to operate in a cost effective manner, and actually damages their prospects for survival and growth over the longer term, just as subsidised rates of interest are often observed to reduce the probability that borrowers will repay their loans (The Foundation for Development Cooperation, 1998: 6).

Therefore, subsidy dependence affects MFIs not only by limiting the access of funds if their supply is stopped but also their efficiency.

The argument being that, however, many MFIs focus on the provision of credit services only. Saving mobilization, particularly voluntary saving mobilization has been ignored by many institutions. In order to provide credit to the poor, they use compulsory savings as collateral. This means, saving mobilization is not meant to be used as source of funds to provide credits but as condition the borrowers should fulfill to obtain loan. Borrowers do not know the benefits of saving except that they can obtain loan if they have saving which will be used as collateral.

The institutions' lack of reliable domestic funds will hamper their objective of reducing poverty as the institutions can not be sustainable if they do not get sufficient funds consistently. Thus, microfinance institutions should be able to have reliable source of funds on which they depend for their operation which actually many argue can be obtained by mobilizing savings from the poor themselves.

On the other hand, some argue that subsidy has important role to play at beginning stage of the institution so that the institution will have base on which to build its own. Zaman (2004) "... subsidies can be justified to support "infant" microfinance institutions, as long as there is a viable route to institutional sustainability."

In addition to this, the poor need not only credit but also saving services so that they will be able to save their surplus for future needs. "To ensure that microfinance functions as a poverty-reducing tool, it should go beyond mere provision of credit" (Yeboah, 2007: 8). "Good practice in microfinance is based on the ability to provide appropriate financial services to individuals and households that are otherwise excluded from the financial system" (Hatch and Frederick, 1998: 1). There is strong argument that savings also protect against seasonality of income for depositors and serve as collateral for the institutions. According to Webster & McGrath (1996) it has also been proved that the poor need saving services as much or more than credit services.

In general, subsidy dependence and lack of mobilizing sufficient funds from saving have negative effect on sustainability of microfinance institutions.

1.3 Objective of the Study

1.3.1 General Objective

The objective of this paper was to investigate the sustainability and outreach of Oromia Credit and Saving Share Company (OCSSCO) and suggest possible solutions

1.3.2 Specific Objectives

The specific objectives were to:

- study the financial sustainability of the institution
- assess the portfolio quality of the institution
- study the productivity/efficiency of the institution's asset

1.4 Significance of the Study

Microfinance is used as one of the tools to alleviate poverty by making financial services accessible to the poor section of the society. The findings of this study is hoped to be useful in the effort the company makes towards reducing poverty by pointing to its problem or limitations in reaching the poor people of the region in a sustainable and efficient way. This research will also serve the company to be aware of its weaknesses (if any) and take corrective actions, and at the same time can capitalize over its strengths (if any).

The findings of this study can also be used by other researchers who want to make further investigations on the area.

1.5 The Scope of the Study

The scope of this study was limited to sustainability of Oromia Credit and Saving Share Company. For focus group discussions, only four branches were taken.

1.6 Limitation of the Study

Some of the factors taken into consideration to measure sustainability could not be compared with the industry because the amount of subsidy that is received by different institutions differs.

1.7 Organization of the Study

This paper has five chapters. The first chapter is the research plan or the proposal. The second chapter deals with the review of the related literature. It reviewed the works that were done on

the area by other researchers or writers. In the third chapter, research methodology was described. In the fourth chapter, the analysis and interpretation of the data were presented. Finally, the fifth chapter includes the conclusions and recommendations of the study.

CHAPTER TWO

REVIEW OF RELATED LITERATURE

2.1 What is Microfinance?

Microfinance has several definitions. Marcus et al, (1999) defined microfinance as small-scale credit and finance services for the poor. United Nations (UN) defines microfinance as the provision of small-scale financial services such as savings, credit and other basic financial services to poor and low-income people. According to Robinson also the major services of microfinance is providing credit and saving.

Microfinance refers to small-scale financial services primarily credit and savings provided to people who farm or fish or herd; who operate small enterprises or microenterprises where goods are produced, recycled, repaired, or sold; who provide services; who work for wages or commissions; who gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and groups at the local levels of developing countries, both rural and urban (Robinson, 2001).

The definition tells us that microfinance is the provision of small-scale financial services for different uses. The services of these institutions are saving and credit. The institutions focus on developing countries because the majority of the people of these countries are poor and need financial services provided by MFIs.

Poor people need financial services to run their businesses, build assets, stabilize consumption and protect themselves from being exposed to risks. The poor need not only saving and credit services but also other services such as insurance, training and advisory services from the institutions. This because, they should get training on how to use the money they borrowed from the institutions; how to save and use their savings; and they also should protect their businesses.

Therefore, microfinance institutions can not be effective by providing only credit and saving services but they have to support their clients by providing these supplementary services so that the poor can utilize their savings and credit productively and in turn get out of poverty. The institutions also can achieve their objective only if the services they provide to the poor have impact on the poor and if they can repay the loan they have taken.

2.2 Why Microfinance?

As the definition given above indicates, the objective of microfinance institutions is to give the poor access to financial services from formal financial institutions. The poor did not have access to financial services because they have no collateral especially to obtain credit from formal financial institutions. As a result they were marginalized and kept in poverty. They should pay usury interest for informal money lenders to get credit.

To tackle these problems, microfinance institutions have emerged. These institutions aimed at reaching the poor in rural and urban areas with no access to financial services because of lack of collateral. In addition to lack of collateral, the poor are also scattered in the rural areas where there are no infrastructures and as a result the formal financial institutions can not reach.

In short, we need microfinance because commercial banks tend to be concentrated in urban areas and they tend to serve clients who are relatively better off. The poor in rural areas are unable to access any financial services, allowing microfinance to play a leading role (Economic Institute of Cambodia, 2006: 2).

Therefore, microfinance play important role in addressing the poor in rural areas and those who do not have access to financial services because of lack of collateral. These institutions reach the areas which can not be reached by commercial banks and other formal financial institutions.

Microfinance is believed to have potential to reduce poverty. According to UN development paper (2007) it does so through enhancing income, smoothing of consumptions and preparing the poor for shocks or addressing the vulnerability in the aftermath of shocks.

According to Hulme and Mosley (1996), advocates of microfinance as poverty reduction tool argue that the poor are trapped in a vicious circle where low income causes low saving; constraining investment and then reinforce low income.

The low income of poor people makes their saving also low. If saving is low, investment will then be low and results again in low income. Thus, it is vital to improve the income level of these poor people by providing them credit. If they are able to use the credit for productive purposes, they can increase their earning thereby improving their savings and their consumption. Therefore, credit is very essential for the poor so that they can have working capital. Some people consider credit as something more than money. Yunus (1997) for example argue that credit is more than business. Just like food, credit is a human right. "If we are looking for one single action which will enable the poor to overcome their poverty, I would go for credit" (Yunus, 1994).

In fact, the poor need not only credit but also saving services so that they be able to save their earnings. According to Deepa Narayan et al (2000) "many poor people view credit as a strategy for improving their livelihoods, but say they will require much better access to savings and credit services and more favorable terms than are currently available."

Many studies of the impact of microfinance show that microfinance can contribute to the poverty reduction efforts but it is not the only tool to reduce poverty. Centre for development puts it as:

The demonstrated role of microfinance in reducing vulnerability for clients and their households points to a role for continued donor investments in microfinance programs. Impact studies across programs, contexts and client groups find that microfinance services contribute to building assets, diversifying income sources, and strengthening coping mechanisms for clients at different poverty levels. The impact of microcredit on these indicators of reduced vulnerability cuts across all client groups. While microfinance is not a magic bullet that can eliminate poverty, it can contribute to this process and play an important role in improving the lives and livelihoods of the poor (Center for Development, 2003).

In addressing poverty, microfinance institutions should also be sustainable in that they should be able to provide services to the poor continuously. This means, in addition to their concern to poverty reduction, they should also worry about their long-term ability of providing such services to their clients so that their goal of poverty reduction will be realized.

In short, provision of microfinance services mainly, saving and credit are important tools to reduce poverty. To be effective, the provision of these services should be supplemented by other services such as training, advisory and insurance provision.

2.3 The Two Approaches in Microfinance

The two basic approaches in microfinance are the institutionalist approach or the financial system approach and the welfarist or poverty lending approach. “Both approaches share the goal of making financial services available to poor people throughout the world.” (Robinson, 2001: 7). The main focus of financial system approach is ensuring financial sustainability of microfinance institutions. The institutionalists try to attract private investment to the industry to increase the outreach and meet the demand of financial services. They also argue that interest rates should be raised and costs should be lowered to achieve sustainability.

The poverty lending approach on the other hand attempts to reduce poverty through provision of microfinance services to the poor regardless of the source of funds. Their focus is on the impact of providing these services rather than attaining sustainability. As Robinson (2001) puts it “except for mandatory savings required as a condition for receiving a loan, savings is not normally a significant part of the poverty lending approach to microfinance.”

Robinson (2001) argues that commercial microfinance is not appropriate for extremely poor people. Instead she says they need food, shelter, medicines, skill training and employment for which government and donor subsidies and charitable contributions are appropriate.

This argument questions the appropriateness of microfinance for the poor. That means, the poor may not be able to use the loan for productive activities rather, they use the loan for consumption purposes. That is why the poor need humanitarian supports than microfinance services.

Understanding the two approaches and their area of emphasis will help us to study the performance of microfinance institutions.

2.4 Microfinance in Ethiopia

In other parts of the world, the establishment of microfinance institutions has the age of decades.

In Ethiopia, microfinance institutions started in 1990s.

The introduction of microfinance in Ethiopia is a recent phenomenon. The first microfinance service in Ethiopia was introduced as an experiment in 1994, when the Relief Society of Tigray (REST) attempted to rehabilitate drought and war affected people through rural credit scheme. It was inspired by other countries’ experiences and adapted to the conditions of the Tigray region. In the second half of 1990s, as a result of its success, the microfinance service was gradually replicated in other regions (Mulat 2000).

Renee Chao Beroff et al (2000) cited in Mubarek (2006) indicated that economically active poor people in Ethiopia who can potentially access financial services are about 5.2 million. That means, there still remains high demand for credit and saving services unmet. According to Chao Beroff (2000) cited in Wolday (2002) there is very limited supply of financial services to the poor.

In Ethiopia, saving and credit activities have been taking place for a long time in an informal way. People keep their 'surplus' with their relatives, friends, and at home. They save in cash and in kind. They also borrow from relatives, friends, and others when fall short of money and other materials for their family's survival. They make payment at harvest time.

Mubarek (2006) indicated this in "although the establishment of formal microfinance institutions is a recent phenomenon in Ethiopia, saving and credit services have been provided to the rural people in various forms through government, bilateral institutions, NGOs and community based and traditional organizations."

The microfinance institutions established in line with applicable laws and regulations are allowed to conduct almost all traditional banking activities. Receiving deposit and extension of microcredit facilities, among others, are two major activities allowed by microfinancing proclamations.

According to Wolday (2002) the microfinance institutions in Ethiopia have been delivering uniform loan and saving products to all clients.

2.5 What is Sustainability?

There is much semantic confusion surrounding the word "sustainable." In general terms, sustainability implies institutional permanence - it captures the idea that an institution is and will continue to be a "going concern"(Woller, 1997). This indicates that sustainability is about providing services for the clients (in microfinance context) in the future continuously.

Self-sustainability refers to the long-term ability to meet goals. For financial institutions and for firms, this requires private profitability: a return on equity, net of subsidy that exceeds the private opportunity cost of resources (Schreiner and Leon, 2001).

Sustainability is defined as repeating performance in the future. Such permanency requires a flexible organization and a structure of incentives to maintain performance in spite of changes in the environment (Von Pischke, 1991).

Khandker et al., (1995) define sustainability as “the ability of a program to continuously carry out activities and services in pursuit of its objectives.” Some scholars take sustainability as full cost recovery or profit making. Cost recovery helps the institutions to last long and provide services to clients without depending on government and donor subsidies.

Sustainability of an MFI is measured in terms of generating enough revenue (excluding subsidies) to cover the cost of all aspects of productions and loan funds (Yohannes, 2006).

To continuously give financial services, MFIs need to be profitable. Otherwise, they tend to depend on subsidies from donor organizations and government grants. This, however, can not sustain for long as donors give funds for limited time. Funds from donors do not last forever.

That is why it is argued that MFIs should also give attention to their profitability in addition to their core objective of poverty reduction which is measured by impact.

More recent developments in the provision of rural financial services (both savings and credit) have demonstrated that proper institutional design and adherence to appropriate policies pay off handsomely and has the potential to generate substantial achievements in terms of both sustainability and greater institutional outreach Yaron et al (1998).

Sustainability is important for the reasons mentioned by Pollinger et al. According to them:

Self-sufficiency is seen as an appropriate mechanism for achieving the long-term viability of the microfinance sector. First, available resources and subsidies are too small to provide microfinance to all who might benefit from it. Second, a focus on self-sufficiency can lead to decreased costs through increased efficiency. Third, leverage is more easily attained by organizations that generate the means to repay debt. Finally, reliance on subsidies might alter a firm's incentive structure in ways that could increase the likelihood of a negative event (Pollinger et al, 2007: 32).

The demand for microfinance services is huge. In order to meet this demand the institutions need funds continuously. The funds are obtained either from donations and grants or from the institutions own revenue from operations and savings mobilized from the depositors. Since donor funds are too small, MFIs are expected to mobilize savings as well as reduce costs of operations. Cost reduction is possible through increased efficiency in their operations.

Sustainability is one of the central problems in modern microfinance, not least because many microfinance institutions are located in countries that are susceptible to huge swings in economic climate (Hollis and Sweetman, 2004).

Economic development of developing countries is not stable. There are ups and downs. As a result, government may not be always in a position to subsidize MFIs. Therefore, the institutions should be self-sufficient so that they can cope with the fluctuations in the economy.

“Attaining some measure of financial sustainability is doubtless an important long term goal” (Woolcock, 1999). Although they can depend on donations and grants for the first few years of their establishment, they should target sustainability in the long run.

For (Cuevas. 1996), building sustainable financial services systems for poor men and women is of critical interest from three perspectives: Financial sector development, i.e., integrating people into formal financial sector who did not get the access because of different reasons like low income, gender, remote location and etc, enterprise formation and growth, which means start up and operations of micro and small enterprises, and poverty reduction by providing credit and enabling them to engage in productive activities.

A sustainable institution... may be understood as one which can operate with no financial support from a donor institution, or it may operate within a given level of support to offset costs associated with outreach activities (Hollis and Sweetman, 2004). However, others argue that local capital is limited and therefore external funds are required. Grieco (1998) “for many low income communities and regions, the available local capital is too restricted to meet their needs and the resort to external sources is a necessary one.”

Conning (1999) has fear of emphasis on financial self-sufficiency “focusing on financial self-sufficiency will divert MFIs’ attention and resources away from their core objective of poverty alleviation and away from their core poor market.” This fear is based on several factors. The poor tend to be concentrated in harder-to-reach rural areas characterized by weak and fragmented markets for goods and services, dispersed populations, limited non-farm activities, and underdeveloped infrastructures.

These factors imply both relatively high costs per dollar lent and relatively greater risk. Other factors implying relatively high administrative costs are the difficulties inherent in identifying and reaching poor persons and the heavy delegation and monitoring costs resulting from the lack of physical collateral (Conning 1999).

The lack of physical collateral in turn implies higher credit risk. In short, delivering financial services to the poor is comparatively costly and difficult, and is fraught with risk, none of which bodes well for long-term financial self-sufficiency. Hence the belief (or fear) that financial self-sufficiency and depth of outreach are inherently dichotomous. (Woller and Schreiner, 1997)

Sustainability, which shows their ability of the MFIs to cover their total expenses from their own financial service operations, has not been a major objective of MFIs in Ethiopia at the initial stage (Wolday, 2006). According to him in 2004, 12 out of 15 MFIs were operationally sustainable, while 5 out of 15 were financially sustainable.

2.5 Factors Affecting Sustainability

There are several factors that affect the sustainability of MFIs. Among these factors, the efficiency of the institution, that is, reduced costs of operation; asset performance, which means the income generating capacity of the institutions' assets, portfolio quality which is the measure of the institutions' ability of collecting the loans it provide; and level of subsidy dependence are the major ones.

In order to achieve sustainability, MFIs should strive to operate at reduced cost. This will increase the efficiency of the institution as more outputs are produced at the same cost or the same outputs are produced at lower cost.

The income generating capacity of the assets of the institutions is another determining factor to achieve sustainability.

Portfolio quality means the amount or percentage of portfolio at risk and the percentage written-off as bad debt. The better the repayment of the loans provided to the borrowers, the better the performance of the institutions and the likely of the institutions' sustainability.

Whether MFIs highly depend on subsidies or not is also another major factor for their sustainability. Those institutions which receive large proportion of their fund from donor institutions and government in the form of grants and subsidies for their operation can not be sustainable if donors stop provision of the funds.

The scarcity of these subsidies and the fact that donor and government support is often volatile and transitory make it difficult for MFIs to sustain their expansion with this funding base. In addition, subsidized funds lack clear ownership and can therefore distort incentive structures and undermine sustainability (Hanning and Wisniwski 1999).

Other factors such as saving mobilization, interest rate, and borrower turnover are also significant. To achieve sustainability, reliable source of funds is needed. The interest rate charged on the loans provided should be sufficient enough to cover the cost of operation. Borrowers' turnover should be kept to minimum.

... savings are key to microfinance institutions' success in attaining full financial self-sufficiency because they provide a sustainable, local source of loan funds and because using savings deposits as loan funds (as opposed to grants from donors) imposes greater responsibility and therefore greater discipline on lending institutions (Thirlwall 1999).

According to Robinson (2001), many institutions using poverty lending approach provide microcredit to poor borrowers at low cost. But these institutions are typically not sustainable, primarily because their interest rates on loans are too low for full cost recovery. In addition they do not meet the demand among the poor for voluntary savings services.

A high level of repayment performance is a prerequisite for financial sustainability, but it is not a sufficient condition of financial health as high administrative costs or high borrower turnover could be the counterpart of high repayment rates (Godquin 2004: 1924).

This means that high rate of repayment is one of the important conditions for sustainability of microfinance institutions but it can not alone make the institutions sustainable unless other factors such as administrative costs kept to minimum and the high turnover of borrowers is reduced. If the non-repayment is high the value of the loan portfolio will be eroded and income is reduced. This in turn, affects sustainability.

As Robinson (2001) puts it, there was assumption that “the poor cannot afford and will not be able to repay credit at commercial rates.” Zeller and Meyer (2002) argue that while the poorest are generally considered less credit-worthy, the real cost to MFIs is in obtaining information about individual’s credit-worthiness, no matter how big or small the loan.

There are also other factors that directly or indirectly affect the sustainability of MFIs. There are instances where barriers created by remoteness, poor infrastructure, a stagnant economy, illiteracy or social factors like caste and gender render self-sustainability unattainable in a reasonable time frame (Cuevas 1996).

For example, remoteness affects sustainability because the cost of reaching remote areas is high. The same reason can be given for poor infrastructure. If the economy is stagnant, the borrowers can not have sufficient income to repay their debt. If the borrowers are illiterate, they do not

know how to use the loans for productive activities. As a result, they consume them or they spend on areas which are not profitable. Therefore, the poor will not be able to repay their loan.

In sum, full financial sustainability is reached when administrative, loan loss, inflation, and financial costs are covered entirely by revenues (Thirlwall, 1999). MFIs must have high enough interest rates to cover financial and administrative costs, pay adequate interest rates to encourage voluntary savings, use efficient methods and techniques in processing loans and collecting repayments and others, and have their accounts audited externally. Studies show that it is possible to be financially self-sufficient, if institutions are able to charge a high interest rate” (Mubarek, 2006).

To achieve sustainability, microfinance institutions, be they NGOs, government agencies, or commercial banks, need to ensure that the costs of providing the service are kept low and are covered by income earned through interest and fees on loans (Havers, 1996).

When poor households are not very sensitive to price changes, prices can be raised without fear of losing the core customer base and suffering from mission drift. When that is so, microfinance institutions can offer credit at a sufficiently high interest rate to cover their operating costs and at the same time not merely skim the cream by appealing only to the most eligible borrowers (Montgomery et al, 2005). They argue that the key to the expansion of microfinance globally depends on the success of microfinance as a commercial phenomenon, free from subsidy.

As the MFI strives for sustainability it will come up with better products and demand-oriented approaches and increase its efficiency with cost reducing information systems, new lending technologies, and other such measures (Zeller and Meyer, 2002).

The role of government and donor agencies in microfinance at the very initial stage is to support the institutions to put their foundations. Then after, the institutions themselves should strive for their sustainability.

2.6 Outreach of Microfinance Institutions

“The term outreach is typically used to refer to the effort by MFOs (microfinance organizations) to extend loans and financial services to an ever-wider audience (breadth of outreach) and especially toward the poorest of the poor (depth of outreach)” (Conning, 1999: 52).

According to Yaron (1994), outreach is a hybrid measure that assesses the extent to which the MFI has succeeded in reaching its target clients and the degree to which it has satisfied the clients demand for financial services.

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 socioeconomic level of clients that MFIs reach (Lafourcade et al, 2005: 4).

Outreach is thus described in terms of depth (level of poverty) and breadth (number of clients served). The institutionalists focus on the later where as the former is focused by welfarists.

To meet the demand for financial services of the poor there should be sustainable microfinance institutions. As Robinson (2001) puts it, “microfinance demand can be met on a global scale only through the provision of financial services by self-sufficient institutions.” Even successful institutions following the poverty lending approach in aggregate, can meet only a small portion of the demand for microfinance. In contrast, formal sector commercial microfinance has proven itself able to make financial services both credit and savings, available to low income clients on a large scale, and to do so profitably.

2.6.1 Size of the Loan

According to Yaron (1997) the intention of giving smaller loan could be that, the financial assistance is given to the real poor and needy people. With low loan size, a limited financial resource can go further and helps more people where as large loans would considerably limit the number of loan beneficiaries. In addition to this, if average loan is high, it would attract the better off people and therefore, the poorest may be excluded from getting the access.

Repayment can be mentioned as a factor that affects the availability of loan. This is due to the fact that if the institutions can not collect the loans they provided already, they may face shortage of funds to give additional loans unless the institutions obtain regular source of subsidy and grants from donors and government. Godquin (2004) for example puts his argument as “high repayments are indeed largely associated with benefits both for the MFI and the borrower. They enable the MFI to cut the interest rate it charges to the borrowers, thus reducing the financial cost of credit and allowing more borrowers to have access to it.” On the other hand, Levitsky (1998) cited in Mubarek (2006) argues that the strongest incentive to repay a loan is the anticipation that this will lead to being granted another larger loan.

2.7 Saving in Microfinance Institutions

As stated earlier, saving is one of the major services of microfinance institutions. It is not only provision of loan that reduce poverty. It should be supported by saving. The poor should have opportunity to save the small earnings. From the side of the institutions, they should have funds to be provided to the borrowers. Saving therefore, is one source of local fund that should be used to provide loan. “Savings form one of the cheapest and dependable sources of funds for the MFIs” (Wolday & Narayana, 2007).

Possibly the greatest challenge in microenterprise finance is to expand the provision of savings services to the poor. Access to credit by the poor has been emphasized, but research has established that the poor can also benefit from access to secure and liquid savings with adequate returns (CGAP, 1995)

In this argument, microfinance institutions have difficulty in mobilizing savings and their primary focus is on making credit accessible to the poor. However, the poor can benefit from both saving and credit services.

Thus, mobilization of savings has paramount importance both for microfinance institutions and for the clients of these institutions.

According to (Tiwari and Fahad) “adequate savings facilities both serve the demand for financial services by the customers and fulfill an important requirement of financial sustainability to the lenders.”

Savings are important for microenterprises and provide them with a major source of investment funds. The large demand for deposit services among the poor is confirmed by empirical evidence (Microfinance Development Strategy).

“Savings will contribute to evening out income streams that are subject to seasonal variations, a phenomenon that particularly affects farm households whose cash-flow depends on a few crops” (Hannig & Wisniwski, 1999). Saving services allow savers to store excess liquidity for future use and to obtain returns on their investments (Robinson, 2001).

As a means of accumulation of wealth, they (savings) help to achieve the household’s long-term goals that may include social and religious obligations, or facilitate future investment and consumption (Hannig & Wisniwski, 1999). Saving is wealth accumulation that will be used in

the future. The problem of poor people is consuming whatever they get and lack of saving. Saving is also used for investment which will increase earning.

Abdulatif (2003) “Available studies have revealed that microcredit programs have positive impact on household savings (Khandker and Chowdhury, 1995; Proshika, 1995).

According to Hannig & Wisniwski (1999) savings make borrowers more reliable, can be used as collateral, help to determine borrowers’ paying capacity, play important role in expansion and deepening of outreach. Borrowers will repay their loans because of their savings. That is, saving can serve as collateral and as source of funds to repay loans.

According to Webster and Peter (1996) the quality of savings services becomes difficult to measure in cases where deposit is mandatory, either as a membership requirement or a precondition for receiving a loan. This tells us that there should be voluntary saving to say that clients are aware of the benefits of saving other than as a precondition for receiving loan.

2.7.1 Factors Affecting Savings

The savings of households are dependent upon different factors. (Christen et al. 1994) cited in (Tiwari and Fahad) argues that convenience of location, positive real rate of return, liquidity and security of savings are essential ones for successful savings mobilization. Admassu (2006) also supports this argument “access to the financial institution provides an opportunity to save.” This means that proximity to where the financial institution operates can play role in encouraging people to save. According to Jone and Morduck (1999) quoted in Mubarek (2006) poor households would deposit their surplus in MFIs provided, that they get attractive interest rate, convenience/location (priority and accessibility), security (the safety of the saving option), and ease of withdrawal.

According to Von Pischke (1983); Vogel and Burkett (1986) and Robinson, (1994a, 1994b) the demand for deposit facilities largely depends on the confidence in the deposit-taking institution's ability to safeguard deposits and provide immediate access to savings when requested. There is empirical evidence that depositors respond positively to increased rates of return, considering, as mentioned above, both interest income and transaction costs. However, there are indications that the poor will save even when obtaining a negative rate of return, underlining their emphasis on other factors such as safety and easy access.

Others argue that seasonality of cash flow is also important determining factor for saving. That means savings increase during harvest periods. Clients in the cash crop producing areas can save in a large volume during harvest time when the crop is converted in to cash. This implies that there is a seasonal variation in the saving of such areas. Therefore, MFIs need to be aware of such variations and make use of it (Admassu, 2006).

A stable and growing economy also helps households to have potential for savings. According to Moll (1998), to effectively mobilize savings, people must have sufficient income, secure and dependable opportunities to save and incentive to save.

(Padmanabhan, 1988; Moll, 1998; Chao-Beroff, 2000; Woller, 2000; CGAP, 2003; Gonzalez-vega, 2004, Nagarajan and Meyer, 2005) argues that “public confidence is the most determinant factor for any business transaction in general, and greatly influences saving mobilization efforts on financial institutions in particular”

Road and other infrastructures are important determinants for saving mobilization. According to (Getaneh, 2005) “... distance is one of the most important determinants of transaction costs.” He

argues that transaction costs are higher in rural areas because of deficiencies in transportation and communication infrastructures which in turn reduce the demand for microfinance services.

Opportunity cost is one of the major factors affecting savings decision. The clients of MFIs choose to save sometimes if the opportunity cost of saving the money in the institutions is better than that of others and of investing the money in other areas.

“Based on empirical findings, it is suggested that increased availability of credit will enable the rural households to undertake larger productive activities which will increase their income and savings” (Abdullatif 2003). According to him microcredit influences saving in that credit is associated with compulsory saving; credit can be used for productive activities which increases saving; and the indirect effect is that since the borrowers’ income will rise due to the fact that if the loan is invested in productive activities the income will be voluntarily saved and as a result get incentives for doing so.

According to Hanning and Wisniwski (1999) savings facilities have particular gender implications. Research on women in finance highlights that savings are probably the most important financial service that can be offered to women (Rhyne and Holt, 1994). On the one hand, experience indicates that female clients of financial institutions show more thriftiness and are often more disciplined than men are in making regular savings.

Women participation in microfinance programs is emphasized by many researchers by studying the impact of microfinance services in poverty reduction. According to some studies women are more productive and the impact is more positive in use of these services.

According to Khandker (1998); World Bank (1998), based on the impacts of three credit programs in Bangladesh such as Grameen Bank, Bangladesh Rural Advancement Committee and Bangladesh Rural Development Board found that impacts of microfinance services given to women were much greater than that of men. In all three programs a 10 percent increase in women's borrowing increases household spending per capita by 0.4 percent; women's borrowing increased household consumption twice greater than men's borrowing. In addition to this, women's borrowing also found improved children's welfare and their education (Yohannes, 2006: 39).

This means, microfinance services have better impact on women than on men. This shows that women participation plays important role in achieving the objective of the institutions. Not only does access to credit give the woman the opportunity to make a larger contribution to the family business, but she can also deploy it to assist the husband's business and act as the family's banker - all of which increase her prestige and influence within the household" (UNDP, 1999).

Therefore, women participation can play major role in the sustainability of microfinance institutions as well as achieving the poverty alleviation objective.

CHAPTER THREE

METHODOLOGY

3. Research Methodology

In this chapter, the methods used to analyze the data obtained from primary and secondary sources are presented. The research design selected was a case study. In this study, both primary and secondary data were used.

The primary data were collected using questionnaires which were distributed to the management and staff of the head office and operations department. In addition to this, discussions were made with the officers and beneficiaries of the institution. Focus group discussions were held with the beneficiaries in different areas. Through this technique the researcher tried to see the services provided to the users and the prospect of the institution from the beneficiaries' point of view. The purpose of the focus group discussion was also to know the concerns and interests of the borrowers.

Secondary data were mainly obtained from the financial statements (profit and loss statement and balance sheet) and business plan of the institution.

For this study, the secondary data obtained from financial statements and business plan of the institution were analyzed by using different ratio calculations and they were expressed in terms of ratio and percentage. In addition, the primary data obtained from the questionnaires distributed to the officers and staff of the institution were analyzed by using percentages and presented in the forms of graphs and tables.

For analysis of the secondary data, the methods and formula used are obtained from CGAP, (2003), Natilson et al (2001), Woller (1999) and MicroCAMEL. In these methods, ratios and percentages were used as the indicators of sustainability and outreach. The ratios include:

Financial sustainability ratios, Operating Efficiency/Productivity ratios, Portfolio Quality, and Outreach variables.

For MFIs to be sustainable, they should be efficient in operation, that is, they should try to reduce their cost of operation. Saving mobilization also contributes to sustainability because saving can be used as loan fund. Portfolio quality is another factor that should be taken seriously in an attempt to achieve sustainability. This is because of the fact that loans provided to borrowers should be collected so that MFIs continue in operation. Therefore, in studying sustainability these factors should be considered.

I. Financial Sustainability Indicators

It makes no difference whether the MFI is nonprofit or for-profit; all reputable MFIs are striving for sustainability, and investors and donors look for those institutions with sustainability potential (Natilson, et al 2001: 26). The common profitability/sustainability ratios include: Return on performing assets ratios, financial cost ratios, loan loss provision ratio, operating cost ratio, operating grants ratio, operating self-sufficiency ratio, and financial self-sufficiency ratio.

1. *Return on performing assets*: indicates financial productivity of credit services and investment activities.

$$\text{Return on performing assets} = \frac{\text{Financial Income}}{\text{Average Performing Assets}}$$

Trend: an increasing trend is positive.

2. *Financial cost ratio*: shows cost of funds; affected by mix of soft loans, hard loans and net worth.

$$\text{Financial cost ratio} = \frac{\text{Financial Costs}}{\text{Average Performing Assets}}$$

Trend: decreasing ratio is positive

3. *Loan loss provision ratio*: indicates provisioning requirements on loan portfolio of the current period.

$$\text{Loan loss provision ratio} = \frac{\text{Loan Loss Provision}}{\text{Average Performing Assets}}$$

Trend: decreasing ratio is positive

4. *Operating cost ratio*: is a key indicator of efficiency of lending operations.

$$\text{Operating cost ratio} = \frac{\text{Operating Costs}}{\text{Average Performing Assets}}$$

Trend: decreasing ratio is positive.

5. *Operating grants ratio*: shows dependency of institution on outside funding for operations.

$$\text{Operating grants ratio} = \frac{\text{Operating Grants}}{\text{Average Performing Assets}}$$

Trend: decreasing ratio is positive.

6. *Operating Self-Sufficiency ratio*: shows ability of institution to cover costs of operations through internally generated income. This is simply operating revenue as a percentage of operating and financial expenses. If the ratio is greater than 100 percent, it means that the MFI is covering all of its costs through its own operations and is not relying on contributions to survive.

$$\text{Operating self-sufficiency} = \frac{\text{Financial Income}}{\text{Total Expenses}}$$

Trend: an increasing ratio is positive

7. *Financial Self-Sufficiency ratio*: shows whether revenue earned is sufficient to cover all operating, financial and loan expenses as well as to maintain the value of equity. This is similar to operational sustainability; however, the ratio also includes inflation and subsidy adjustments.

$$\text{Financial self-sufficiency} = \frac{\text{Adjusted Operating Revenue}}{\text{Financial Expense} + \text{Loan Loss Provision Expense} + \text{Adjusted Operating Expense}}$$

Trend: increasing trend is positive.

II. Operating Efficiency/Productivity Ratios

In this section, the ratios included are: Loan officer productivity, personnel productivity, and cost per borrower ratio.

1. *Loan officer Productivity:* Measures the average caseload of each loan officer.

$$\text{Loan officer productivity} = \frac{\text{Number of Active Borrowers}}{\text{Number of Loan Officers}}$$

Trend: The higher the ratio, the more efficient the MFI.

2. *Personnel productivity:* Measures the overall productivity of the MFI's total human resources in managing clients who have an outstanding loan balance and are thereby contributing to the financial revenue of the MFI. This is a vital ratio for all financial institutions because staff is usually the largest operating expense.

$$\text{Personnel Productivity} = \frac{\text{Number of Active Borrowers}}{\text{Number of Personnel}}$$

Trend: the higher the ratio, the more efficient the MFI.

3. *Cost per borrower:* Provides a meaningful measure of efficiency for an MFI, allowing them it to determine the average cost of maintaining an active borrower or client (or how much it costs to serve a client). As the MFI grows, its cost per unit of money lent should fall.

$$\text{Cost Per Borrower} = \frac{\text{Operating Expense}}{\text{Number of Active Borrowers}}$$

III. Portfolio Quality

Portfolio quality indicators include portfolio at risk ratio and write-off ratio. These ratios are considered important for the sustainability of financial institutions in general and microfinance institutions in particular because collections of loans provided determine the operations of the institutions in the long-term as loans collections are the principal source of revenue. Thus, MFIs need to measure the quality of their loan portfolio.

Because an MFI does not receive its revenue at the time of “sale” (loan disbursement), but receives the revenue over time, the MFI must continue to worry about quality long after the “sale” of the loan is complete. High quality means low delinquency. Because MFIs have very different policies regarding how they report and manage delinquency, it is important to be sure to use the same definitions when comparing ratios between institutions (Natilson, 2001 et al: 29).

1. *Portfolio At Risk Ratio*: Portfolio at risk is the outstanding principal amount of all loans that have one or more installments of principal past due by a certain number of days.

$$\text{Portfolio at risk ratio} = \frac{\text{Portfolio at risk (>30 days)}}{\text{Gross Loan Portfolio}}$$

2. *Write off ratio*: Represents the percentage of the MFI’s loans that have been removed from the balance of the gross loan portfolio because they are unlikely to be repaid. A high ratio may indicate a problem in the MFI’s collection efforts.

$$\text{Write-off ratio} = \frac{\text{Value of Loans Written-off}}{\text{Average Gross Loan Portfolio}}$$

IV. Outreach Variables

“Outreach is sometimes defined as the total number of clients reached, and sometimes it becomes more specific to include what segment of clients is served.”

Growth and outreach are important targets to monitor not only as “social” objectives, but also as a financial indicator: new clients are the basis for revenue and asset growth.

$$\text{Percentage growth} = \frac{\text{Final amount} - \text{Initial amount}}{\text{Initial Amount.}} \times 100$$

1. *Number of Borrowers:* is a good indicator of future revenues. As the number of experienced clients increases, the loan portfolio and revenues will increase.
2. *Loan portfolio growth:* is the engine of revenue growth. An MFI may experience seasonal fluctuation of its loan portfolio such that it may shrink from one quarter to the next. However, an MFI should exhibit long-term growth of its loan portfolio.
3. *Average disbursed loan size:* measures the average loan size that is disbursed to clients.

$$\text{Average Disbursed Loan Size} = \frac{\text{Value of Loans Disbursed}}{\text{Total Number of Loans Disbursed}}$$

4. *Average outstanding loan size:* measures the average outstanding loan balance by client, which may be significantly less than the average disbursed loan size.

$$\text{Average Outstanding Loan Size} = \frac{\text{Gross Loan Portfolio}}{\text{Number of Loans Outstanding}}$$

Evaluates how well the MFI is penetrating the market of very-low income clients by comparing the average outstanding loan size with gross domestic product per capita.

5. *Women participation:* women participation was also taken as one indicator of outreach as it shows to what extent the services of the institution reached one of the most poverty affected section of the society.

CHAPTER FOUR

DATA PRESENTATION AND DISCUSSIONS

In this chapter the results of the study are presented and analyzed. The data obtained from primary and secondary sources were discussed and interpreted. The primary data obtained from the beneficiaries through focus group discussion and from the questionnaires distributed to the officers of OCSSCO were presented and analyzed along with the secondary data obtained from the financial statements and business plan of the institution by using ratios and percentages.

The discussions were made under four major categories: financial sustainability ratios, efficiency/productivity ratios, portfolio quality and outreach variables. Under each major category, there are other subsections which were used as indicators of sustainability and outreach.

Financial sustainability and outreach are argued to be complimentary to each other because microfinance institutions enjoy economies of scale as their outreach increase. This is because the fixed costs are distributed over the additional clients reached. But some argue that the two are inversely related because institutions pay additional cost to get the information to determine trustworthy clients when they try to reach additional clients.

The ratios are presented and discussed as follows:

I. Financial Sustainability Ratios

The financial sustainability ratios considered include: return on performing assets, financial cost ratio, loan loss provision ratio, operating cost ratio, operating grants ratio, operating self-sufficiency, and financial self-sufficiency.

The financial sustainability ratios for OCSSCO for the years 2003 to 2006 were indicated in the following table.

Table 4.1 Financial sustainability ratios

Indicators \ Year	2003	2004	2005	2006
Return on performing assets	12.3%	13.5%	12.3%	13.6%
Financial cost ratio	5.1%	2.1%	2.6%	2.2%
Loan loss provision ratio	3.12%	0	0.28%	0.21%
Operating cost ratio	7.8%	6.9%	5.8%	5.3%
Operating grants ratio	18.43%	17.07%	15.87%	12.21%
Operating self-sufficiency	95%	149%	146%	181%
Financial self-sufficiency	90%	83%	99%	99%

Source: from the researcher's calculation and OCSSCO's record

The first indicator of financial sustainability ratios indicated in the above table is return on performing assets. The return on performing assets for the four years under investigation indicate that the percentage were almost the same. Thus, it can be said that the assets of the institution were not performing well. In principle, the return on performing assets is positive if it shows increasing trend. But this ratio shows neither increase nor decrease. Their performances have been the same.

The other indicator of financial sustainability is the financial cost ratio of the institution which was 5.1 percent in the year 2003. This ratio is the biggest of the four years ratio under investigation indicating that the cost of service provision was very high as compared to the other three years. The ratio showed improvement in the year 2004 by decreasing to 2.1 percent. But it increased again to 2.6 percent in 2005 and 2.2 percent in 2006. This implies that the financial

costs to the average performing assets were relatively reduced. This means the efficiency of the institution has been improving.

As indicated in table 4.1 in the year 2003 the loan loss provision ratio was 3.12 percent. There was no provision made in 2004. This is (according to accountant of the institution) due to the fact that there was no loan loss in the previous year. As a result, allowance for loan loss was not made for 2004. In the years 2005 and 2006 loan loss provisions were 0.28 percent and 0.21 percent respectively. The data indicate that the ratios were declining and this is positive because it implies that the institution's ability in collecting the loans it provides has been improving.

The other financial sustainability indicator is operating cost ratio. The operating cost ratio to the average performing assets as indicated in the table continually declined from 7.8 percent in the year 2003 to 5.3 percent in 2006. This ratio is considered as key indicator of efficiency of MFIs. This is because if operating costs are reduced or cost of providing financial services is reduced profitability increases thereby contributing to the sustainability of the institution. Therefore, decreasing ratio here is another indicator of efficiency of the institution which contributes to the sustainability of the institution.

Donations and grants ratio indicates how much the institution depends on outside funding for its operations. In this case, the figures in the above table show that OCSSCO's dependence on donations and grants from government and other funding organizations declined continuously for the consecutive years. This signals that the institution is gradually becoming dependent on its own sources rather than outside funding. The industry average is 31 percent in the country in the year 2007. OCSSCO's dependency ratio is below the industry average. This is also another major indicator of sustainability as outside sources are not always reliable and volatile; or the funding organizations may stop giving donations.

The operating self-sufficiency of the institution as indicated in table 4.1 above increased from 95 percent in the year 2003 to 181 percent in the year 2006. This is a rapid improvement. Operating self-sufficiency indicates how much the institution can cover all its cost of operations with its operating revenues or internally generated revenues.

Financial self-sufficiency indicates how much an MFI can cover all its costs from the revenue it earns considering adjustments. The data obtained from the institution’s business plan indicate that the institution is almost covering its costs from the revenues it generates internally. Financial self-sufficiency in the year 2003 was 90 percent but in 2004 the institution could cover only 83 percent of its costs, that is, financial sustainability of the institution decreased in this year. In 2005 and 2006 the percentage increased to 99 percent which indicate that the institution close to become financially self-sufficient.

II. Efficiency and Productivity Ratios

In this category the ratios included are: Loan officer productivity, Personnel productivity, and Cost per borrower ratio. These ratios are other major factors that contribute to sustainability of MFIs.

Efficiency and productivity ratios of OCSSCO are indicated in the table below:

Table 4.2 Efficiency and productivity ratios

Indicators \ Year	2003	2004	2005	2006
Loan officer productivity		1: 1,178	1: 1018	1: 1050
Personnel productivity	1: 135	1: 168	1: 196	1:241
Cost per borrower ratio	92.17	79.30	65.89	61.83

Source: researcher’s calculation

The loan officer productivity ratio indicates the number of loan officers required to produce a given level of outputs, which are borrowers. This ratio is positively related to self-sufficiency. The data indicate that the efficiency of loan officer has been declining from the year 2004 through 2006 continuously. In 2004, the ratio was 1: 1,178, which means the load of one loan officer was 1,178 borrowers. In the year 2005, the number of borrowers that one loan officer served reduced to 1,018 showing that the loan officer productivity declined. During this year (2005), one loan officer served only 1,018 borrowers which is less by 160 borrowers. In 2006, the productivity further declined; the ratio became 1: 1050.

The staff ratio is also positively related to self-sufficiency. The efficiency or the productivity of the personnel/staff productivity increased in each successive year. In the year 2003, 1 staff served 135 active borrowers where as in the year 2004 the number of borrowers served by one staff increased by 33 borrowers, that is, 1 staff served 168 borrowers. The number increased to 241 in the year 2006 indicating that the productivity of the staff further increased. This implies that the overall human resources of the institution are more productive than the loan officer.

Loan officer productivity of the institution has been declining. This is the result of increase in number of loan officers without proportionate increase in clients. This negatively affects the sustainability of the institution.

On the other hand the overall staff productivity or efficiency has improved from one year to the other and this reduces the cost of providing services and contributes to the sustainability of the institution.

Both ratios (loan officer and personnel) have direct cost implication and efficiency of MFIs. In this case OCSSCO's loan officer productivity or efficiency was decreasing but the efficiency of the personnel or staff was increasing during the years studied.

As it is indicated in the above table the cost per borrower ratio of the institution was declining from the year 2003 through 2006. In the year 2003 the cost of maintaining one borrower was 92 birr but in 2006 this cost was reduced to birr 62. This implies that the institution was becoming more efficient. The cost per borrower ratio is inversely related to self-sufficiency. The higher ratio means, more money and other costs are required to produce a given level of output. In this regard, the institution has shown improvement since the ratios have been decreasing during the years studied.

III. Outreach Variables

Outreach variables include percentage increase in number of borrowers, percentage increase in loan portfolio, women participation, average disbursed loan size, average outstanding loan size, and total saving as a percentage of gross loan portfolio. Percentage increase in number of borrowers, percentage increase in loan portfolio, women participation, and total savings as a percentage of gross loan portfolio indicate breadth of outreach whereas average disbursed loan size and average outstanding loan size are taken as indicators of depth of outreach. Women participation can also be taken as indicator of depth of outreach.

Depth and breadth of outreach are inversely related to each other. Wider outreach offsets depth of outreach.

The average disbursed loan size as depicted in the table below increased from the year 2002 through 2007. In 2002, the average disbursed loan size was birr 998, which increased to birr 1,004 in 2003. In years 2004 the amount in birr increased to 1,056 and in 2005 the amount remained the same but in 2006 the average loan disbursed increased to birr 1,277. This implies that the average value of loans disbursed means the amount of the loan borrowers received

increase in each consecutive year signaling increased availability of loan funds as compared to number of borrowers.

Table 4.3 average loan size

Year	2002	2003	2004	2005	2006
Average loan disbursed in birr	998	1,004	1,056	1,055	1,277

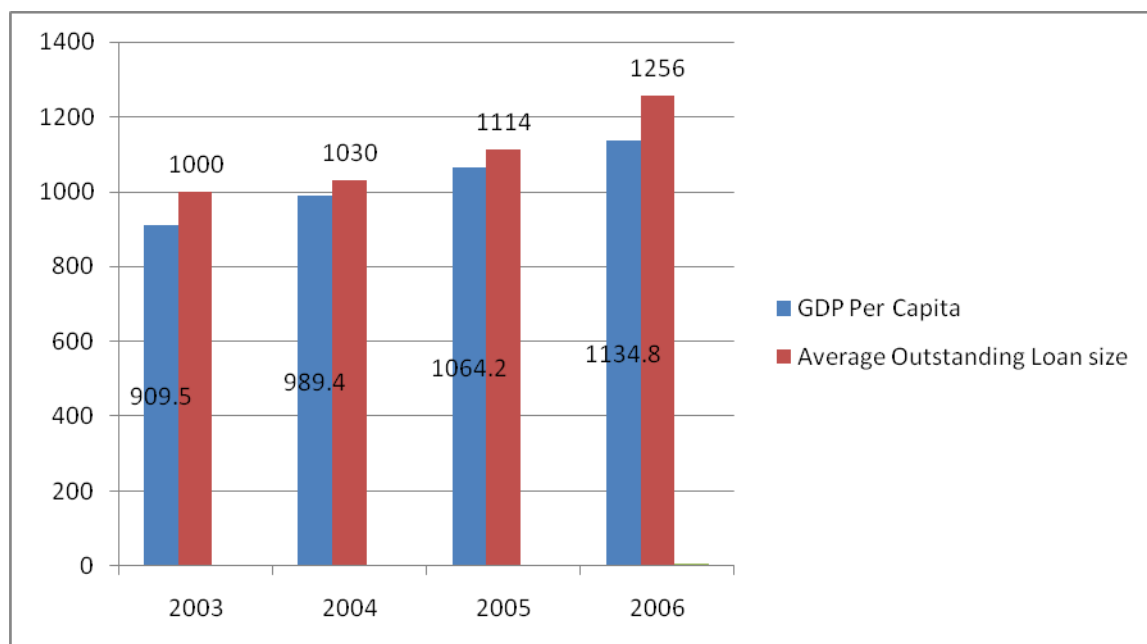
Source: researcher's calculation from the record of OCSSCO

The average outstanding loan size is a measure of the average outstanding loan balance by client or borrower. This shows how well the institution targeted the very low income clients or it is indicator of the depth of outreach. It is assumed that if the loan size is smaller the clients reached are poorer, which indicates the deeper outreach. To measure this, the average outstanding loan size is compared to GDP per capita. Here, GDP per capita is taken as a proxy for level of poverty. However, when GDP per capita is compared with the average outstanding loan size, the mean effect should be taken into consideration. This means, the GDP per capita can be affected by few rich people that pull the average up or many poor people who pull the average down. Therefore, this is not a good measure of depth of outreach but still it can be taken as one indicator.

As the data presented in the graph below indicates in the year 2003, the GDP per capita was birr 909.5 where as the average outstanding loan size in the same year was 1000. This implies that the institution did not reach the very poor clients as GDP per capita was less than the average outstanding loan size. In the year 2004 GDP per capita was birr 989.4 and the average outstanding loan size increased to birr 1030 which was greater than GDP per capita again. The same thing can be said for the years 2005 and 2006 as in both years GDP Per Capita were less than the average outstanding loan size. Based on this data it can be said that the outreach of the

institution is not deeper. The relationship of the GDP per capita income and the average outstanding loan size is indicated by the following graph.

Graph 4.1 Relationship of average outstanding loan with GDP per capita



Source: researcher's own calculation from the record of OCSSCO and data obtained from the Quarterly Report of National Bank of Ethiopia

On the other hand, the beneficiaries said that the amount of loan was too small and was not sufficient for their activities. This shows that they were willing to take additional loan but the amount provided by the institution was below what they needed. The beneficiaries said, “let alone now when everything is too expensive, we used to add from our own on the amount we borrowed from the institutions to purchase ox.” As they told the researcher, some of them were on the verge of quitting taking loan and some said they had already stopped and were withdrawing their savings. When they were asked why they quit, they responded that the bank could not provide them the amount they requested and the amount the bank provided them was not sufficient to run their business.

In general, these practical problems are contrary to the view that providing smaller loan enables MFIs to reach more number of poor people. The argument that providing larger loan size appeals to the better-off and is not in line with the objective of serving the poorest of the poor is also against the demand of the clients for larger size of loan.

The larger the loan size, the more profitability for the lender but less depth of outreach for the borrower.” Because, cost of reaching few borrowers with larger loan size is smaller than reaching many borrowers with smaller loan size. However, the depth of outreach becomes less because smaller loan size is hypothesized as positively related to depth of outreach.

In general, smaller loan size represents poorer borrowers as better off people are not normally attracted to smaller sizes.

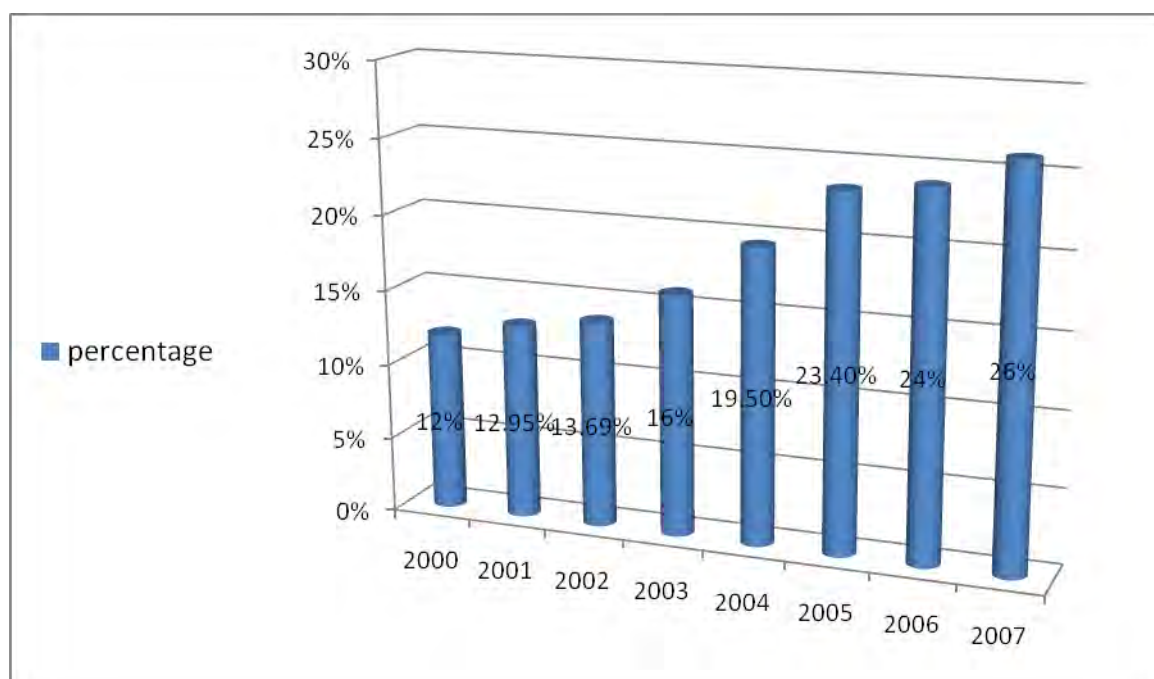
Women participation

Women are considered relatively poorer than men. Women constitute more than half of the Ethiopia’s total population. Therefore, reaching the poor women plays an important role in the overall performance and achievement of the objective of reducing poverty. Women participation is considered crucial for lending services to have impact on the livelihood of the beneficiaries. As literatures indicate, the borrowings by women have more impact than that of their male counterparts. As a result, women participation is taken as one measure of success of microfinance institutions.

As the graph below indicates, the proportion of women borrowers was insignificant, especially in the first five years. It is below 20 percent. In the other years too, the percentage is far from being satisfactory. According to Lafourcade et al (2005) in 2003, “women represented 61 percent of borrowers among the reporting MFIs in Africa”. According to the report by Lafourcade, the figure is higher in other parts of the world. For example it was 86 percent in South Asia, 80

percent in Middle East and North Africa. Therefore, the number of women borrowers in OCSSCO as compared to the other parts of the world is too small. At the industry level in Ethiopia, women credit access share is 38.4 percent as at June 2007. OCSSCO's performance is even below the industry average.

Graph 4.2 Percentage increase in women borrowers



Source: OCSSCO's record

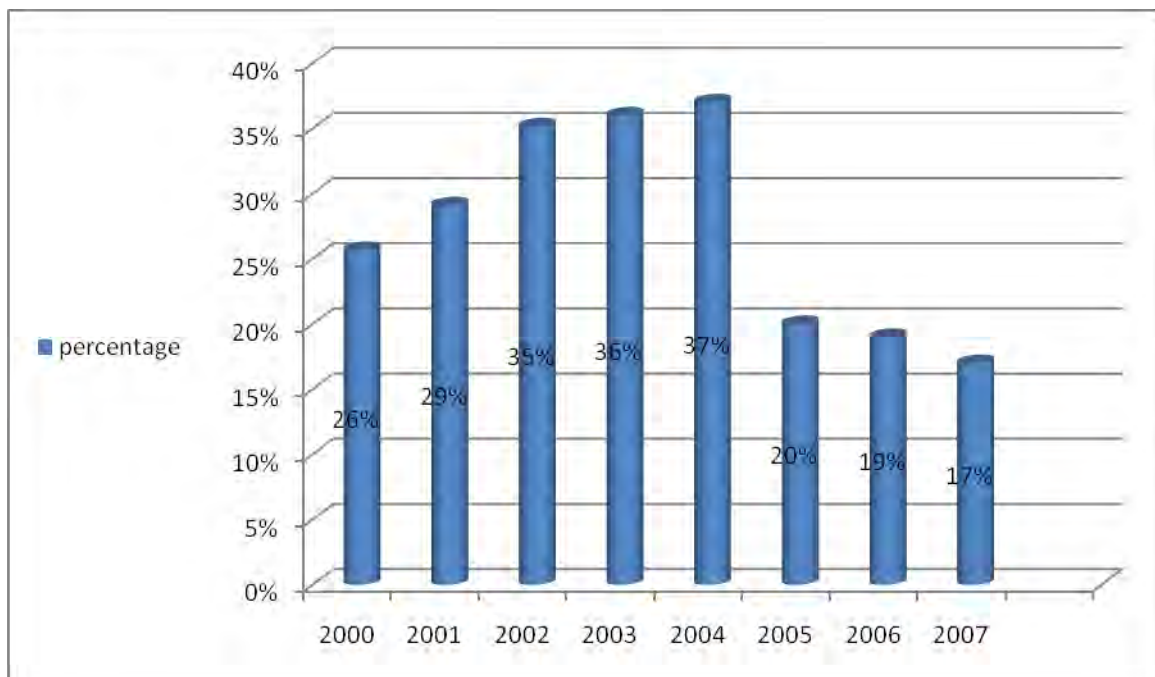
In reality, the major beneficiaries of microfinance services should have been women. However, this data shows that the reverse is true. The increase in each year is by small percentage. This implies that women do have difficulty in obtaining loan to improve their earning and this can hinder the ability of the institution to achieve the stated objective of poverty reduction as it requires active participation of women. This can also show that the institution is not reaching the poorer section of the society as women are considered poorer than men.

Its performance in reaching the poorer society means it faces difficulty in achieving poverty reducing objective. This in turn affects its sustainability because without achieving its objective it can not survive or its existence become meaningless.

Total saving as a percentage of gross loan portfolio

Saving is one of the two basic services microfinance institutions provide. If microfinance institutions do not give saving services, the institutions are considered incomplete in their service provision. The percentage of savings to gross loan portfolio of OCSSCO is shown in the following graph.

Graph 4.3 Percentage of savings to gross loan portfolio



Source: researcher's calculation from OCSSCO's record

As depicted on the graph above, the maximum percentage of savings to gross loan portfolio is 37 percent and the minimum is 17 percent. The average percentage for the last 8 years is 27 percent. This indicates that the institution finances on average only 27 percent of its loan to clients from

savings of the clients whereas the remaining is financed by soft loans and other cheap funds. Therefore, one can argue that the institution did not give due attention to the saving services. As a result, the institution does not have reliable domestic source of fund, which is savings mobilized from its clients and this can have negative impact on the sustainability of the institution. In fact, saving is not the only factor that determines the sustainability of the institution; however, it can be taken as one important factor.

In addition to this, it is argued that the poor need not only credit facilities, but also they need saving services to save their surplus for emergencies, social and religious obligations and other future use.

Sometimes saving is said as “forgotten half of MFIs services” as institutions mainly focus on providing credit services. They believe that if the poor were given loan it can improve their earnings. Moreover, the assumption that the poor can not and do not save made many MFIs to emphasize credit and ignore savings. However, the poor need savings as much as they need credit. The two (credit and saving) support one another. If the poor have access to credit, they will have earnings and as a result get something to save. At the same time if they have saving, they can get more credit as savings serve as collateral since the poor do not have physical collateral like plant assets.

Saving is also used as collateral for microfinance institutions for the amount they lend since the poor do not have collateral. Thus, the importance of saving is not only for the clients (depositors) but also for the receiving institution.

The other thing concerning saving is comparison of voluntary saving with compulsory saving. The percentage of voluntary saving as compared to total saving or compulsory saving is small.

The table below indicates that in 2002/03 voluntary saving is only 28.68 percent of total saving. Compulsory saving constitutes more than 70 percent. In the year 2003/04, the percentage of voluntary saving even decreased to 21.69 percent. In the following years, eventhough the proportion of voluntary saving to total saving increased, the increases are not significant. This implies that the institution did not give due attention to mobilizing voluntary saving. The compulsory saving is used as collateral for giving loans. Thus, it can easily understand from this fact that the focus of the institution is on credit delivery and saving is considered as secondary.

Table 4.4 percentage of voluntary saving to total saving

Year	Compulsory Saving	Voluntary Saving	Total Saving	% age of voluntary saving to total saving
2002/03	8,185,864	3,292,017	11,477,881	28.68
2003/04	11,024,494	3,053,240	14,077,734	21.69
2004/05	18,403,556	10,121,036	28,524,592	34.48
2005/06	28,947,451	16,960,136	45,907,587	36.94
2006/07	46,484,068	23,951,480	70,435,548	34

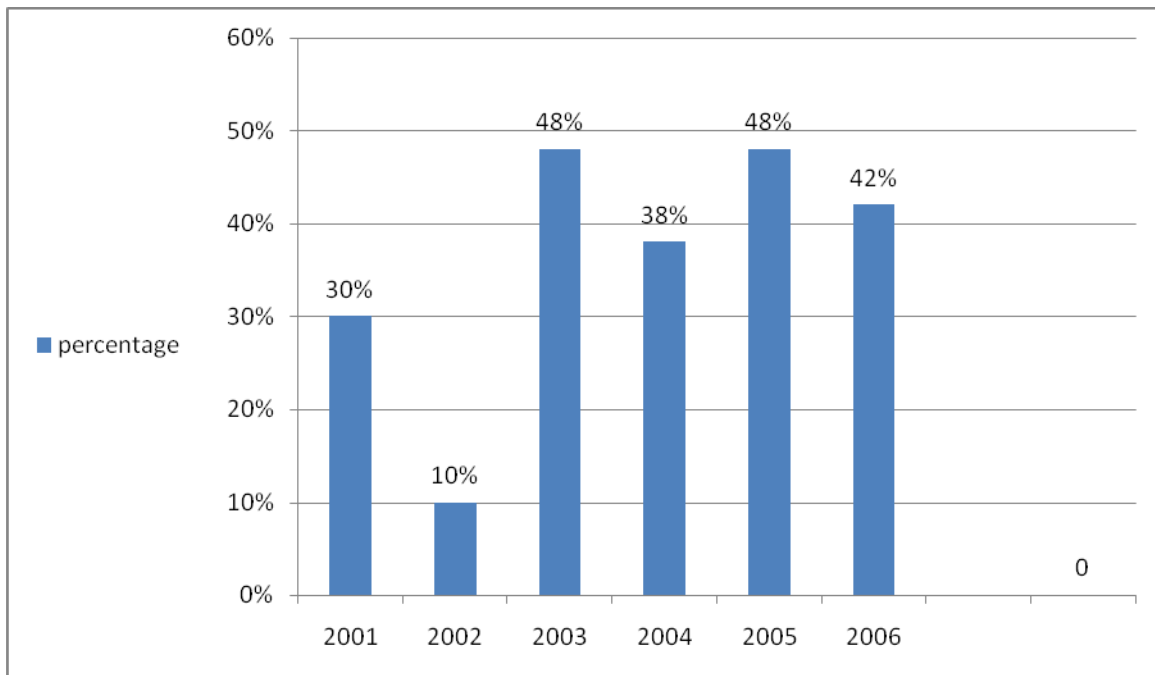
Source: OCSSCO business plan and researcher's computation

Percentage increase in number of borrowers

This is a measure of breadth of outreach or the number of clients reached by the institution. The percentage increase in number of borrowers as depicted in the graph below from 2001 to 2006 has shown significant improvement except in 2002 when the growth in number of borrowers is

only by 10 percent. This implies that the outreach was showing good progress in terms of the number of borrowers or breadth of outreach, that is, the coverage is growing. The relationship between the number of borrowers reached with the depth of outreach is inverse. Thus, the number of outreach affects the depth of outreach.

Graph 4.4 Percentage increase in number of borrowers

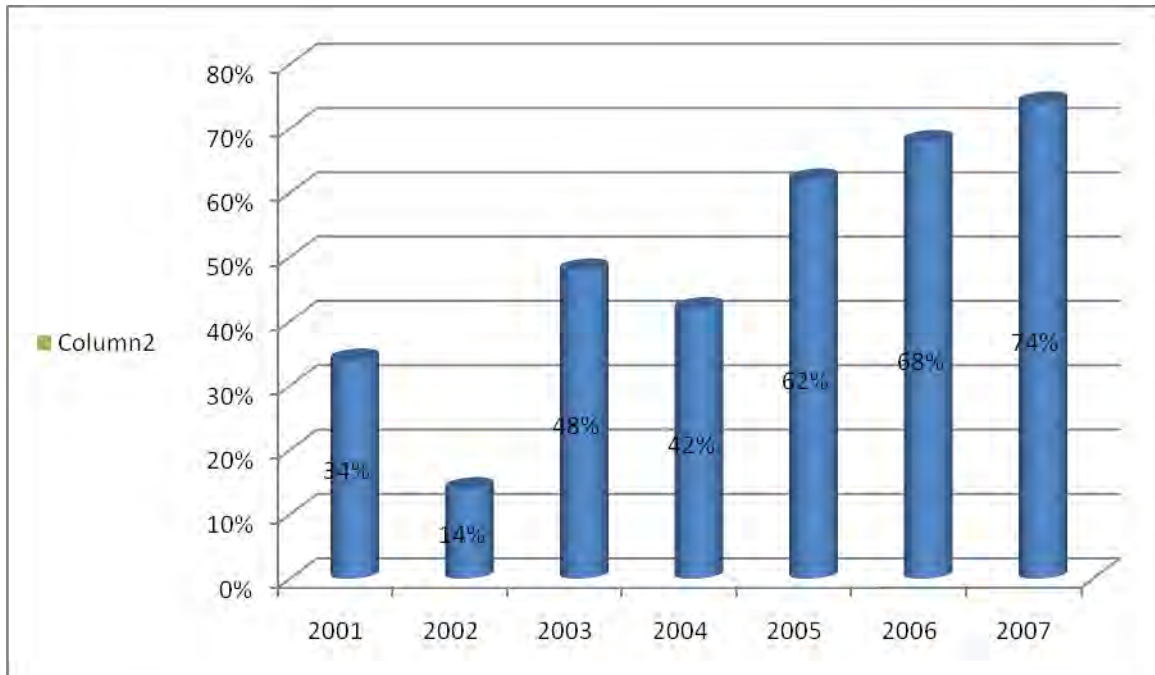


Source: researcher's calculation from the record of OCSSCO.

Percentage Increase in Loan Portfolio

The loan portfolio was constantly increasing from the year 2004 to 2007 as indicated in the following graph. But before that, there were some fluctuations. In general, it can be said that in recent years the loan portfolio was increasing smoothly. This shows that the amount of the loan funds that the institution provides to the borrowers and the outreach is increasing.

Graph 4.5 Percentage increase in loan portfolio



Source: researcher's calculation from record of OCSSCO

4. Portfolio Quality

Table 4.5 Percentage of Portfolio at risk

Year	2002	2003	2004	2005	2006	2007
Percentage of Portfolio at risk	6.12	7.90	5.01	3.92	2.64	1.64 (GB) 5.6 (MSE)

Source: From the record of OCSSCO

GB: Group Based MSE: Micro Enterprise

The percentages of portfolio at risk were constantly declining except for the year 2003. Since then, the ratio shows a decrease which means the institution's collection of the loan which has been given is increasing.

During the years taken under consideration, there was no write-off made. This means the institution was able to collect all of the loans made even though some of the loan amounts were collected after the due date. This is a result of group liability where all the group members

become liable for any defaulter. This in fact is a good practice for the institution. However, some of the clients who are forced to pay for defaulters may be discouraged and drop out from the institution's services.

Other indicators

Capital Composition

Capital Composition, as of December 31, 2007

Oromia National Regional State-----= Birr	50,050,000.00
Oromia Development Association-----=Birr	4,000,000.00
Arsi Forest Enterprise-----=Birr	4,000,000.00
Oromo Self Help Organization-----=Birr	5,000,000.00
Finfinnee Forest Enterprise-----=Birr	1,000,000.00
Sabata town municipality -----=Birr	449,000.00
Bushoftu town municipality -----=Birr	500,000.00
Aadde Adanech Habebe-----=Birr	1,000.00
Donated/Grant fund -----=Birr	27,288,932.00
Retained Earnings-----=Birr	<u>65,687,623.00</u>
Total-----= Birr	<u>157,976,555.00</u>

The data above indicate that the overall shareholder is government except one individual whose share is insignificant. The other portion of the capital is donated/grant fund. This implies that the institution is not willing to sell shares to private investors. Therefore, one can easily observe from the data that the institution is highly dependent on government and donors for its operation. The institutions' contribution is less than half of the total capital. This can affect the institution's sustainability since donors' fund is unstable and conditional.

Discussions of the Data Obtained by Questionnaire

The responses obtained from questionnaires distributed to OCSSCO's head office and operations department were presented and discussed as follows:

Factors affecting sustainability

To know the focus areas of the officers of the institution and give comments or suggestions some opinion questions were asked regarding the factors that affect sustainability of microfinance institutions. The responses given by the officers were indicated in the table below. From these factors known to have considerable effect on sustainability of MFIs, the data indicate that emphasis is primarily given to repayment. This fact actually has the support of repayment performance of the institution which is close to 99 percent. Following repayment rate, saving mobilization, administrative cost and stagnant economy are the other factors considered as highly affecting sustainability of MFIs. However, contrary to this data, the institution has not given due attention to saving mobilization as indicated by percentage of to gross loan portfolio. Administrative cost as shown by cost per borrower and other cost indicators is also decreasing and on this aspect the institution is doing well.

According to the majority of the respondents, subsidy moderately affects sustainability which is contrary to the widespread belief that subsidy does have high effect on sustainability. Only 23 percent of the respondents supported the argument. About 69 percent said subsidy only moderately affects sustainability of MFIs. This is the unexpected response. It is not in line with the common understanding about the effect of subsidy on the sustainability of microfinance institutions. Subsidy is considered to be the basic factor that affects sustainability. Many of the researchers on this area argue that MFIs should not depend on subsidy except at the initial stage.

Table 4.6 Factors affecting sustainability

Factors	Highly affects		Moderately affects		Does not affect		Others		Total	
	No. of resp.	%	No. of resp.	%	No. of resp.	%	No. of resp.	%	No.	%
Interest rate	5	38.5	6	46.2	1	7.7	1	7.7	13	100
Saving	10	76.9	2	15.4	1	7.7	-	-	13	100
Repayment rate	12	92.3	-	-	1	7.7	-	-	13	100
Adm. Cost	10	76.9	3	23.1	-	-	-	-	13	100
Borrower turnover	8	61.5	4	30.8	1	7.7	-	-	13	100
Poor infrastructure	6	46.2	6	46.2	1	7.7	-	-	13	100
Stagnant economy	10	76.9	3	23.1	-	-	-	-	13	100
Subsidy	3	23.1	9	69.2	1	7.7	-	-	13	100

Among these factors saving mobilization, repayment rate, borrower turnover, and administrative cost are those factors that can be controlled by MFIs to some extent. For example, it is possible to increase the amount of savings made by the clients by encouraging the clients to save through the use of different incentive mechanisms such as paying better interest rate, giving prizes, giving trainings and others. Borrower turnover can also be reduced by giving training on how to

use the loan for productive activities and other techniques. Administrative costs can also be reduced by improving the efficiency of the staff and others. The only thing that is beyond the control of the institution is the stagnant economy which is combination of different factors.

Among the factors considered highly affecting sustainability, OCSSCO performed well on repayment rate. The administrative cost of the institution has been decreasing constantly as indicated by cost per borrower ratio. But the institution has weakness on saving mobilization particularly voluntary saving.

Table 4.7 Factors that affect saving mobilization

Effect Factors	Highly affects		Moderately affects		No effect		Others		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Location of branches	9	69.2	2	15.4	2	15.4	-	-	13	100
Interest rate	5	38.5	5	38.5	1	7.7	2	15.4	13	100
Safety	11	84.6	2	15.4	-	-	-	-	13	100
Ease of withdrawal	10	76.9	1	7.7	2	15.4	-	-	13	100
Economic growth	5	38.5	5	38.5	2	15.4	1	7.7	13	100
Opportunity cost	2	15.4	7	53.8	2	15.4	2	15.4	13	100
Seasonality of income	9	69.2	4	30.8	-	-	-	-	13	100

According to the responses indicated in the table above location of branches, safety or security of the deposits, ease of withdrawal and seasonality of income are the factors that highly affect saving mobilization. Opportunity cost is the factor that has moderate effect on saving mobilization according to the majority of respondents. The data imply that clients need proximity

of branches; security of their funds; simplicity of withdrawal of their savings whenever they need them; and depositing during the season they have surplus. However, these factors need to be investigated from the point of the clients.

Table 4.8 Opinion of respondents on interest rate charged on loan

Interest rate	High		Medium		Low		Total	
	No. of resp.	%	No. of resp.	%	No.of resp.	%	No.of resp.	%
	-	-	3	23.1	10	76.9	13	100

According to the opinion of respondents, the interest rate the institution charges on the loan it provides is low. 76.9 percent of the respondents said the interest rate is low and the remaining percent said it is medium. Actually, revision of the interest rate was made and from 1 January 2008, the rate was increased by 1 percent and now the institution charges 12.5 percent. This rate is low as compared to the interest rate charged by some microfinance institutions and other informal lenders. The informal lenders actually charge 100 percent or more. But in comparison to the interest rates that are charged by commercial banks and development banks, the interest rate charged on loans seem high. However, the transaction costs of microfinance institutions are higher than that of commercial and development banks.

The respondents were asked whether the institution has plan to change the interest rate. All the respondents, that is, 100 percent said that the institution has plan to change the interest rate. All of them said that OCSSCO will increase interest rate.

The respondents were also asked the reason of increasing the interest rate. About 77 percent of the respondents said the reason for increasing the interest rate is because OCSSCO charges lower interest rate relative to other MFIs. About 33 percent said that the reason for increasing interest rate is to avoid subsidy.

From this one can understand that subsidy is not something to worry about for the majority of the respondents. But the reason that MFIs are advised to charge sufficient interest rate is to cover their cost of operations and by gradually reducing their dependence on subsidies and grants and finally become self-sufficient.

OCSSCO's plan to finance the supply of loan in the future according to the respondents' response was indicated in the table below:

Table 4.9 OCSSCO's plan of source of financing loan supply

Means of financing	Yes		No		Others		Total	
	No.	%	No.	%	No.	%	No.	%
By mobilizing saving	13	100	-	-	-	-	13	100
Through Subsidy	9	69.2	4	30.8	-	-	13	100
By selling more shares to investors	6	46.2	6	46.2	1	7.7	13	100
By borrowing from other sources	13	100	-	-	-	-	13	100

According to the data 100 percent of the respondents agree on saving mobilization and borrowing in order to finance the supply of loans. Majority of the respondents (about 69 percent) believe in use of subsidy to finance the loan supply and only 46 percent of them believe in the importance of selling more shares to investors as a means of financing the loan supply. This fact

implies that the institution's dependence on subsidy as one means of financing its operation continues.

The respondents were also asked their opinion whether the institution has given due attention to saving mobilization. Accordingly, 38.5 of the respondents said that due attention was not given to saving mobilization. 53.8 percent said that due attention is given to saving mobilization. The remaining did not respond.

The method of screening risky client was the other question presented to the respondents. All the respondents said that the institution screen out risky clients by means of group lending. This makes the clients liable for all members of the group for any default.

Others said the institution uses regular saving to screen out risky clients. The clients should have compulsory saving to get loan. Assessing the viability of borrower's proposed business is the other technique to screen risky clients. This means that if the proposed business is not potentially feasible, the institution does not give loan. The borrowers themselves screen out risky borrower because they know better each other.

Results of Discussions Made with the Beneficiaries

To know the beneficiaries concerns, expectations and interests focus group discussions were held with the beneficiaries. For this purpose points regarding loan size, interest rate the institution charges on loan, time of loan provision and repayment, clients' awareness about saving, lending methodology, and whether the clients had benefited from the institution's services were raised.

The first point of discussion was about the size of loan they receive from the institution. As discussed earlier in relation to average outstanding loan size, the beneficiaries said that the

amount of loan they receive is not sufficient for their businesses. Majority of the borrowers want larger size of loan.

The other area of discussion was about the interest rate the institution charges on the loan it gives to the borrowers. The borrowers said that the interest rate is low when they compare to the amount they pay if they take loan from the informal money lenders. The beneficiaries said that before they incorporated in OCSSCO's program, they had been paying interest rate of about 100 percent of the amount they used to receive measured by grain or money. Thus, the majority of the beneficiaries with whom the discussions were made were happy with the rate of interest.

With regard to time of receiving loan and repaying it, the borrowers said that the timing has no problem. They said that they receive loans during the time they need it. Almost all of them said that they take the money to purchase oxen and plough their land. After the agricultural activities are over, they fatten the oxen; sell them; and repay the loan. Although the term of loan is one year, the principle is PAYE (Pay as You Earn). Therefore, the borrower can pay at any time during the year.

With regard to saving, many of the clients especially Holeta branch said that they do not know about voluntary saving. They know only that there is compulsory saving to get loan. This indicates that awareness creation in some branches is weak.

The lending methodology of the institution is group lending. This means, the borrowers are jointly liable for the amount they borrowed. If one of the borrowers defaulted, the rest of the group members are responsible to repay the amount of the default. In this case some borrowers were disappointed and even there were instances where the borrowers quit program participation. Many of the borrowers said that it is better if the institution can lend them individually than with

group. This group lending methodology can also play negative role in excluding the very poor because the borrowers form groups by selecting those whom they believe can repay the loan to avoid group liability. The poorer are considered risky and thus marginalized. On the other hand, the institution stick to this group lending because it serves as collateral since the borrowers do not have collateral.

The beneficiaries said that they had benefited from participating in the institution's program. They said that there are changes in their nutrition, health and other aspects. The borrowers said for example that they did not have oxen used in agriculture. Now they could buy oxen and rent land from others and benefited from the loan. They have no doubt about the importance of the loan services.

However, one problem observed by the researcher, in addition to the size of loan almost all of the borrowers from the rural areas were engaged in similar activity, which is purchase of ox. They do not have other alternatives. This indicates lack of training which MFIs are expected to provide in addition to financial services.

In general, the majority of the beneficiaries were happy with the services except that the amount of loan being insufficient for their activities.

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

To study the sustainability of Oromia Credit and Saving Share Company, the data collected from the records, the beneficiaries, and the officers were analyzed and discussed in the previous chapter. In this chapter, the findings of the study were concluded and the possible recommendations were forwarded.

Conclusion

This paper attempted to investigate the sustainability and outreach of Oromia Credit and Saving Share Company. For this purpose, primary and secondary data were gathered from the concerned persons and available documents. The data collected from these sources were analyzed and their implications were discussed.

From the study the following points can be observed.

I. Financial Sustainability

Regarding the financial sustainability of the institution, it is in the right direction. The institution is close to being sustainable financially. However, in kind donations were not indicated in the report of the institution. As a result, the calculations were made based on the available data and other ratios were taken directly from the institutions own computation. As a result, there was no evidence that whether subsidy and inflation adjustments were made. To measure sustainability of microfinance institutions, these adjustments are very important. Therefore, this should be taken in to consideration to say that the institution is financially sustainable or not.

II. Efficiency Indicators

Personnel/staff Efficiency and productivity ratios and cost per borrower ratio had been improving. However, loan officer productivity had been declining constantly.

III. Outreach Variables

i. Women Participation

The study also indicated that the proportion of women borrowers was too small and women participation was weak. The institution did not work hard to increase women's participation even though in microfinance, women are considered the main beneficiaries as microfinance is used as a tool for women empowerment; supports them to improve their earning and enable them to be independent of their husband.

ii. Saving Mobilization

Saving mobilization was not given due attention by the institution. The percentage of saving to gross loan portfolio has been declining in recent years. The proportion of voluntary savings to total saving is small. Big portion of the saving of the institution is from compulsory saving that is used as a condition for loan. This does have strong negative impact on the sustainability of the institution if these donors some day stop giving donations.

iii. Loan Provision

The percentage increase in number of borrowers/ breadth of outreach is increasing smoothly. If the institution uses all the available sources of loan funds, it can reach the majority of the poor in the region and meet the demand for loans. The loan portfolio is also increasing by significant percentage.

iv. Loan Size

The average outstanding loan size had been greater than the GDP per capita and that shows the institution was not reaching the very poor. But the discussions with the beneficiaries indicated that the loan size was small and was not sufficient for their activities. The amounts of loan that have been provided to the borrowers were not significant enough especially in the recent years as the cost of things the beneficiaries purchase are increasing.

IV. Portfolio Quality

The percentage of portfolio at risk is declining from year to year. This means that the institution's collection ability of loans it given to borrowers is improving. In addition to this, there was no write-off during the years studied. The likely reason for this one is that the borrowers form groups which serve as collateral, i.e., there is group liability where all the group members become liable or be responsible for any default by a member of the group.

V. Others

According to the opinion of the respondents, subsidy is considered by majority of the respondents as moderately affecting the sustainability of MFIs. The respondents said that subsidy continues to be one source of financing the loan the institution provides to the borrowers.

Recommendations

Based on the findings of the study, the following recommendations were forwarded:

I. Financial Sustainability

The institution is about to achieve financial sustainability according to the data obtained from the institution. However, it does not include in kind donations in its report. As a result, it is difficult to judge whether the institution is sustainable or not without knowing how significant the in kind donation and how much it affects its sustainability. The company should have the records of all its revenues and their sources in order to measure its performance and whether it can continue the provision of services if subsidy and other supports are gone. The institution should include all the revenues and expenses as well as all cash and in kind donations in its records and reports so that it will be able to examine its performance and know where it stands.

II. Efficiency

Efficiency is one of the basic determining factors for achieving sustainability. If MFIs always do not make effort to improve their efficiency, sustainability will be in question. OCSSCO's efficiency of the overall staff is improving. But loan officers' productivity is declining. Therefore, the institution is expected to devise ways of improving their productivity so as to contribute to the overall efficiency and sustainability of the institution.

III. Outreach

i. women participation

Women participation in microfinance services is considered as very crucial in attaining the objective of poverty reduction. The impact studies made by many researchers indicated that women are more productive than men in using the money they borrow from microfinance institutions. Microfinance is also considered by its proponents as a tool for women empowerment

and gender equality because it builds the capacity of women by improving their earnings and enabling them to be independent of men. However, the finding of this study indicated that women participation is not significant in the OCSSCO. Therefore, the institution should work on this aspect by encouraging women participation. It should do so through implementation of different strategies such as giving training for women on how to use the loan for productive services in a way that it will improve their earning and livelihood. The institution also should encourage women participation by providing incentives for those women who borrow from the institution. However, this does not mean that the institution should provide loan services to every woman without considering their repaying capacity. In general, women constitute more than half of the population of Ethiopia. In any attempt of poverty reduction, women play crucial role. In this case too, they should participate to achieve the intended objective and the institution should work aggressively on this area.

ii. Saving mobilization

Saving is one of the basic services provided by microfinance institutions. The poor also need saving services in addition to loan and other services. Microfinance institutions also use savings collected from the poor as collateral for the loan they make since the poor do not have sufficient collateral. The study found out that OCSSCO did not give due attention to saving mobilization. As a result the institution was partly dependent on grants and other funds. This can hinder the institution from achieving its objective of reducing poverty and providing services to the poor in a sustainable way. Therefore, OCSSCO should give due attention to saving mobilization as this will be for the benefit of the institution in obtaining reliable fund for its operations as well as it will also benefit the poor savers as they want to use the surplus they deposit for future use. In order to mobilize savings the institution should increase awareness of the clients by providing

them training on the benefits of savings. In addition to this, the institution should provide incentives for depositors to encourage saving.

iii. Loan Size

As the focus group discussions with the beneficiaries indicated, the amount of the loan was too small. This shows that they were willing to take additional loan but the amount provided by the institution was below what they needed. The beneficiaries said, “let alone now when everything is too expensive, we used to add from our pocket on the amount we borrowed from the institutions to purchase an ox.” According to the beneficiaries, the amount was very far from being sufficient. As they told the researcher, some of them were on the verge of quitting taking loan and some said they had already stopped taking loan and have withdrawn their saving. When they were asked why they quit, they responded that “the institution could not provide us the amount we requested and the amount it provided us is not sufficient to run our business.” Therefore, it would be better for us to quit and try other things. Based on the findings, two options can be put forward under different conditions:

1. If the institution has enough funds to give as a loan to borrowers, it will be better to give them sufficient amount so that the borrowers continue to take loan and benefit from the loan.
2. If the first option is not possible due to different reasons, the institution should give its clients training so that they will be able to think of other opportunities other than purchasing oxen. That means, the borrowers should be trained in order to be able to utilize the small amount provided them on areas such as petty trades, cultivating their land to produce vegetables, and others.

But if the current trend continues, many of the existing clients of the institution will dropout and this will have negative impact on the sustainability of the institution as well as achieving its objective of reducing poverty.

To achieve the objective of poverty reduction and bring changes in the lives of the beneficiaries, the loan amount should be significant enough. This is not to say that the loan did not bring change on the lives of the borrowers; it did. However, it is not wise to provide the borrowers the amount the institution used to provide them because the increase in the price of commodity makes this amount meaningless for the borrowers. Therefore, there should be flexibility in the lending procedure depending on situations.

Subsidy

Subsidy should not be considered as a source of fund because the trend in the microfinance industry is self-sufficiency. Subsidy is not a reliable source of fund as it depends on the ability and willingness of the donors. Generally, subsidy is conditional. Therefore, OCSSCO has to give attention to saving mobilization as it is a dependable source of fund for operation.

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Minutes of Discussions held with Clients of OCSSCO

Time: From April 3 – 25, 2008

Places:

Sebeta Branch office and field at center meeting

Holeta branch office

Bushoftu branch office

Participants:

The participants of this discussion include clients of:

- Sebeta Branch
- Holeta Branch, and
- Bushoftu Branch

Points of Discussion:

- Loan size
- Interest rate
- Time of loan disbursement
- Time of repayment
- Voluntary saving mobilization
- Lending methodology, and
- Generally, whether the clients were benefited from the services

Loan Size

The first point of discussion was about the size of loan they receive from the institution. As discussed earlier in relation to average outstanding loan size, the beneficiaries said that the amount of loan they receive is not sufficient for their businesses. Majority of the borrowers want larger size of loan.

Interest Rate

The other area of discussion was about the interest rate the institution charges on the loan it gives to the borrowers. The borrowers said that the interest rate is low when they compare to the amount they pay if they take loan from the informal money lenders. The beneficiaries said that

before they incorporated in OCSSCO's program, they had been paying interest rate of about 100 percent of the amount they used to receive measured by grain or money. Thus, the majority of the beneficiaries with whom the discussions were made were happy with the rate of interest.

Time of Loan Disbursement and Repayment

With regard to time of receiving loan and repaying it, the borrowers said that the timing has no problem. They said that they receive loans during the time they need it. Almost all of them said that they take the money to purchase oxen and plough their land. After the agricultural activities are over, they fatten the oxen; sell them; and repay the loan. Although the term of loan is one year, the principle is PAYE (Pay as You Earn). Therefore, the borrower can pay at any time during the year.

Saving Mobilization

With regard to saving, many of the clients especially Holeta branch said that they do not know about voluntary saving. They know only that there is compulsory saving to get loan. This indicates that awareness creation in some branches is weak.

Lending Methodology

The lending methodology of the institution is group lending. This means, the borrowers are jointly liable for the amount they borrowed. If one of the borrowers defaulted, the rest of the group members are responsible to repay the amount of the default. In this case some borrowers were disappointed and even there were instances where the borrowers quit program participation. Many of the borrowers said that it is better if the institution can lend them individually than with group. This group lending methodology can also play negative role in excluding the very poor

because the borrowers form groups by selecting those whom they believe can repay the loan to avoid group liability. The poorer are considered risky and thus marginalized. On the other hand, the institution stick to this group lending because it serves as collateral since the borrowers do not have collateral.

Question Regarding Benefits of the Institution to Clients

The beneficiaries said that they had benefited from participating in the institution's program. They said that there are changes in their nutrition, health and other aspects. The borrowers said for example that they did not have oxen used in agriculture. Now they could buy oxen and rent land from others and benefited from the loan. They have no doubt about the importance of the loan services.

However, one problem observed by the researcher, in addition to the size of loan almost all of the borrowers from the rural areas were engaged in similar activity, which is purchase of ox. They do not have other alternatives. This indicates lack of training which MFIs are expected to provide in addition to financial services.

In general, the majority of the beneficiaries were happy with the services except that the amount of loan being insufficient for their activities.