



SCHOOL OF GRADUATE STUDIES

DEPARTMENT OF ACCOUNTING AND FINANCE

**ASSESSMENT OF THE FINANCIAL AND OPERATING
PERFORMANCE OF MFIs: VISION FUND MICROFINANCE
INSTITUTION S.C**

**A Thesis submitted in partial fulfillment of the requirement for the Degree in
Masters of Science Degree in Accounting and Finance**

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STATEMENT OF DECLARATION

I, Getachew Mekonnen, declare that this study entitled “Assessment of Financial and Operating Performance of Microfinance institutions: A Case Study of Vision Fund Microfinance Institution S.C” is my own work. I have carried out independently the research work with the guidance and support of the research advisor. This study has not been submitted to any degree/diploma in this or any other institution. It is done in partial requirement of the MSc Degree in Accounting and Finance.

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STATEMENT OF CERTIFICATION

This is to certify that the research work entitled “Assessment of Financial and Operating Performance of Microfinance institutions: A Case Study of Vision Fund Microfinance Institutions S.C” is a bona-fide work by Getachew Mekonnen who carried out the research under my guidance. Certified further, that to the best of my knowledge the work reported herein doesn’t form part of any other research paper report or dissertation on the bases of which a degree or award was conferred on an earlier occasion on this or any other candidate.

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Acronyms and Abbreviations

| | |
|---------|---|
| ACSI | Amhara Credit and Saving Institution |
| AEMFI | Association of Ethiopian Microfinance Institutions |
| AROA | Adjusted Return on Asset |
| ADP | Area Development program |
| CBE | Commercial Bank of Ethiopia |
| CGAP | Consultative Group to Assist the Poor |
| DBE | Development Bank of Ethiopia |
| DESI | Dedebit Credit and Saving Institutions |
| ETB | Ethiopia Birr |
| FSS | Financial self-sufficiency |
| GNI | Gross National Income |
| GTP | Growth and Transformation Plan |
| IFAD | International Fund for Agricultural Development |
| MFI | Micro Finance Institutions |
| MSC | Masters of Science |
| NBE | National bank of Ethiopia |
| OSS | Operational self-sufficiency |
| PAR | Portfolio at Risk |
| POCSSBO | The Project Office for the Creation of small Scale Business Opportunities |
| REST | Relief Society of Tigray |
| SDI | Subsidy Dependent Index |
| SNNPR | Southern Nations Nationality and People Region |
| UN | United Nations |
| WVE | World Vision Ethiopia |
| VFMFI | Vision Fund Microfinance Institution |

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ABSTRACT

The objective of this study is to examine the overall financial and operational performances of Vision Fund Microfinance Institution S.C. for the recent five years (2012-2016). The paper is used both primary and secondary data sources which were analyzed using qualitative and quantitative methods applying a descriptive analysis method. Semi-structured interview was with the key officials of the institution at the head office level. Besides, a review of documents –both financial and non-financial was also used for the investigation. The major findings of the study indicate that VFMMFI is increasing in terms of its breadth and depth of outreach. VFMMFI can carry on in the future since its profitability is promising. From the financial sustainability point of view, VFMMFI has been gone up the ladder of sustainability measures over those five consecutive years. The institution also manages its loan portfolio as shown by the ratio of portfolio at risk (PAR) which is greater than 30 days that declined throughout the years and the write-off ratio was getting closer to zero by the year 2016. Since the institution spends least costs in its operating and administrative expenses for serving and providing loan to a single client, the trend in this regard showed that VFMMFI is cost efficient.

Keywords: Micro Finance Institution, Financial & Operation Performance, Sustainability

CHAPTER ONE

INTRODUCTION

This introduction presents a context for this research paper and helps clarify to the reader(s) how the research aims and objectives make its part contributions to the assessment of financial and operating performance of Micro Finance Institutions (MFIs) in the case of Vision Fund Microfinance Institutions S.C (VFMFI). To do so, the discussion starts with a background and statement of the problem, and then it explains objective of the study, research questions, significance of the study and scope and limitations of the study.

1.1. Background and purpose of the study

The provision of financial resources to the poor is widely believed to increase their incomes and productivity. This strategy follows from the assumption that economically active poor people fail to access financial resources from the traditional financial institutions. MFIs are the suppliers of financial resources to the poor. About 90 percent of people in developing countries lack access to financial resources from formal institutions (Stephen, Costa and Shamiso September, 2013)

Microfinance services in Ethiopia have existed for some years. Yet, for a number of reasons, they have not been able to reach the majority of the low income Ethiopians. Without the prioritization of the factors that impede the growth of these microfinance services, solutions might have no significant impact on the growth in the sector if they are not correctly targeted.

Establishing an efficient and growing microfinance system is central to serving the low income segment of society effectively while also contributing to the economic growth.

Henceforth, the identification of the major problems affecting the growth of MFIs provides guidance on how microfinance service providers should prioritize their activities. Moreover, the ranking of such problems could assist regulators, supervisors and the government to focus on resolving issues of greater importance rather than those that would have a minor impact.

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

The main purpose of the survey is to gather reliable information about the Micro Finance Institutions in question, Visions Funds Microfinance Institution s.c,(VFMFI) with the aim of shedding light on its overall performances, the constraints that it faces, the existing opportunities and challenges to its operation and existence and thereby provide information that can be used to see the sustainability of the Institution.

Vision Fund Microfinance Institution S.C. (VFMFI) has been in operation since 1999 as a regulated and legally registered Microfinance service provider. Since then the Institution has been in business to cater services to its clients in the capital and three regional states namely Oromia, Amhara, and Southern Nations Nationalities and Peoples' Region (SNNPR) and Addis Ababa city Administration.

The MFI is gearing up with the strategic objective of becoming a large-scale sustainable, rural focused financial institution that makes significant impact on the lives of poor communities through provision of customer oriented credit and saving services. Currently (as of June 2016), VFMFI operates in 56 branch networks and 5 sub offices having loan portfolio and saving balance of ETB 504 million and ETB 228 million respectively. The number of active clients and total employees as of the stated date reached 102,656 and 579 in that order. VFMFI serves its clients through offering loan products including: Agriculture loan, Agribusiness loan, Business loan, Individual loan, and Family loan and Enterprise loan along with delivering different saving products.

The MFI's annual & strategic plan is formulated in such a way that it is aligned with Government's Growth and Transformation Plan II (GTPII)'s growth and expansion strategy. Branch network expansion, introduction of Mobile & Agent banking services, scaling up of saving mobilization and SME financing and human resource development are among key areas of focus that the government has already set targets for MFIs where Vision Fund was striving as its focus areas.

1.2. Statement of the Problem

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

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Whenever Microfinance Institutions are established, they have two-fold objectives. Primarily, they are formed for mobilizing the vast majority of the able poor capable of participating in the economic activity with little support from the institutions. Secondly, they are expected to make profit for their successful operations and reliable existence as formalized financial institutions. In fact, these two objectives are highly interlocked and inseparable. (Arga, 2007)

In order to achieve these key objectives, the institutions have to work towards institutional sustainability, which is possible only if the institutions are acting strategically and there is compatibility between the short-range operational activities and their core strategy (ies). This implies that the simple increment in the number of the institutions and their capital alone or their better financial performance towards their narrow organizational objective may not speak about the success in the achievement of the set national objectives. Henceforth, the operations of the Institutions have to be measured by indicators like the rate of increase in the coverage of needy population, the retaining rate of existing beneficiaries, diversification and

expansion of funding sources, the quality of their services, and financial performance among others.

Even though there are few researches that tried to address the issue discussed at broader level, thus far, **Morduch (2000)** indicates that less than 1% of MFI are sustainable and no more than 5% will ever be. Though this statement was issued with regard to NGOs and donor- funded MFIs, it has created awareness on the challenges facing the industry in general. In Ethiopia, most MFIs are either government subsidized or donor funded institutions, however; the financial support from either the government or donors will not continue indefinitely, so MFIs need to be self-sufficient both in terms of financing and operations. The Consultative Group to Assist the Poor (CGAP, 2004b), states that MFIs need to achieve financial sustainability in order to reach significant number of the poor. The group through its Donor Guideline about good practice in microfinance institutions states that MFIs should finance themselves after 7-10 years of operation (CGAP 2004b).

Duressa (2009) stated that majority of the MFIs in Ethiopia are not yet financially and operationally sustainable, especially he concluded that MFIs owned by government are better in their performance than MFIs funded by NGOs in terms of their financial and operational sustainability. In terms of outreach, NGO supported Ethiopian MFIs are limited to the project areas where they undertake their development activities.

The subject of this study, **Vision Fund Microfinance Institution S.C**, since its establishment in 1998, is still accepting funds from donor thus, the study aims to assess the financial and operating performance of the institution by looking at the five performance indicator measures used (Outreach(breadth and depth),Financial Sustainability, Portfolio Quality and Efficiency). Vision Fund Microfinance Institute S.C as an affiliate of World Vision Ethiopia targets beneficiaries located in WVE Area Development Programs (ADPs). Thus, its outreach is limited to areas where the organization (WVE) has active development programs.

Therefore, all the above discussed problems along with the gap in the literature need to conduct extensive research regarding MFIs that are administered by Non-Governmental

Setups in Ethiopia, especially pertinent to Vision Fund Microfinance Institution S.C. Consequently, VFMFI has reached the self-sufficiency or maturity level indicated by CGAP. Therefore, this study assesses the financial and operation sustainability of VFMFI as it has reached the time frame set by CGAP for self-sufficiency level. Henceforth, the researcher believes that there is no complete knowledge of the full picture in a comprehensive manner that indicates of the strengths and weaknesses as well as the challenges of the operations of such institutions so as to suggest improvements in the future. This, accordingly, has raised a need to undertake a study on the case institution.

1.3. Objective of the study

1.3.1. General Objective

The main purpose of this paper is to assess the financial and operational performances of Vision Funds micro finance Institution S.C for the study period.

1.3.2. Specific Objectives

The specific objectives of the study are to:

- evaluate the funds sources and funds diversification mechanisms.
- assess the performances of the Institution over the study period. 2012-2016
- evaluate the financial and operational sustainability of the MFI.
- Identify the challenges and opportunities facing the MFI.

1.4. Research Questions

The following research questions addressed to achieve the aforementioned specific objectives. These are:

1. What are the funds sources of Vision Funds microfinance Institutions S.c (VFMFI)? Has it diversified its sources?

2. What do the performances of the Institution look like both financial and operational over the study period 2012-2016?
3. Is VFMMFI financially and operationally sustainable?
4. What are the challenges and opportunities that VFMMFI encountering?

The keys to answers on these questions are a properly conceived research model, which complies with all the relevant academic and scientific requirements.

1.5. Scope of the Study

There are different Micro-Finance Institutions, public-owned as well as private, that are operating at national level. There are also such financial institutions that operate only in Addis Ababa. However, to make the study manageable and evaluate the problem in detail, the researcher is forced to delimit the study to focus only Vision Fund microfinance Institutions S.C. Therefore, the scope of the given study is confined only to the assessment of the operational and financial performances of the stated microfinance institution from 2012 to 2016 fiscal periods.

1.6. Significance of the study

As the research study revolves around one of the popular issues of current business scenario, the assessment of performance of a Micro Finance Institution- VFMMFI, it is likely that there are benefits to different parties which can be derived from this study.

Firstly, the study is a partial requirement for the fulfillment of the MSC Degree in Accounting and Finance. Secondly, it may provide some insights about the financial and operational performance evaluation of the institution under study. Thirdly, it may identify some strengths and limitations of the Institution and thus, recommends some possible solutions to it concerning their finances and operational performances as well as sustainability. Fourthly, it may provide useful information related to the sector for those individuals or groups who are interested in the organization. Finally, it may serve as a reference for further studies on the subject matter.

1.7. Limitations of the Study

Although there is much remains to be done, this research generates important findings in the field of Microfinance institutions. In other words, having acknowledged the limitations of data processing, it can nevertheless confirm that there are some limitations of this study. Although the present study has yielded some preliminary findings, its design is not without flaws. A number of requirements need to be noted regarding the present study.

This research was carefully prepared, but still aware of its limitations and shortcomings. First of all, the research was conducted using primary and secondary data analysis both quantitative and qualitative data analysis techniques. However, Primary data analysis using semi structured interview were difficult to find significant relationships from the data and lack of experience and skill in conducting a research on part of the researcher was also another limitation.

1.8. Structure of the Study

This paper was organized in the following structure. The first chapter is an introductory part which consists of the background of the study, statement of the problem, the objective(s) of the study, the research questions, the significance of the study, the scope and the limitations of the study. The second chapter provides the related summary of relevant literatures' review on the financial and operating performances of the Microfinance Institution. Chapter three covered the data sources and methodologies, and chapter four described about analysis of data and discussion based on the data gathered. Finally, the fifth chapter concludes the study and provides relevant recommendations based on the findings of the study.

CHAPTER TWO

REVIEW OF RELATED LITERATURES

2.1. Theoretical Reviews

2.1.1. Microfinance & Microfinance Institutions

Traditional banking sector cannot reach millions of poor for whom small loans could make huge differences. There are several reasons for this. Most of the poor are rural, and they are much dispersed. They have low education levels, if at all. As a result, administrative cost of supplying loans to the poor population is extremely high. Another issue that makes it difficult to serve these customers through traditional banking is that the poor does not have any assets to use as collateral. As a result, the poor had access to loans only through local money-lenders at exorbitantly high interest rates (Alemayhu, 2008)

Micro-credit financing starts with the assumption that the poor is willing to pay high interest rates to have access to finance. In general, the system uses the social trust as the collateral. Although there are different micro-credit financing models, the borrowers in the pioneering models are usually members of small groups. Loans are given to individuals, but an entire group is responsible for the repayment. Hence, the borrower who does not fulfill his commitment to repay back will lose his/her social capital. Micro-credit institutions report that their repayment rates are above the commercial repayment rates, sometimes as high as 97%. Today, there are millions of poor people around the world who turn to be entrepreneurs through the micro-credit sector. Robinson (2001) and Otero (1999)

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

productivity and therefore their income, collect higher returns on investments, provide financial and emotional security, and improve the overall quality of life for their families.

2.1.2. What is a Microfinance Institution (MFI)?

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

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

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

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

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

In other words, a microfinance institution is an organization that offers financial services to low income populations. Almost all of these offer Microcredit and only take back small amounts of savings from their own borrowers, not from the general public. Within the microfinance industry, the term microfinance institution has come to refer to a wide range of organizations dedicated to providing these services: NGOs, credit unions, cooperatives, private commercial banks and non-bank financial institutions (some that have transformed from NGOs into regulated institutions) and parts of state-owned banks, for example, the image most of us have when we refer to MFIs is of a “financial NGO”, an NGO that is fully and virtually exclusively dedicated to offering financial services; in most cases Microcredit NGOs are not allowed to capture savings deposits from the general public. These groups of a few hundred NGOs have led the development Microcredit, and subsequently microfinance,

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

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

2.1.3. Conceptual Framework

Microfinance is defined by some scholars and organizations are seemingly different from one another. The essence of the definitions is usually the same, but the variations are mostly a matter of emphasis. The first term ‘micro-credit’ was invented in the 1970s to show that the provision of loans to the poor to establish income-generating projects, while the term ‘microfinance’ has come to be used since the late 1990s to indicate the so-called second revolution in credit theory and policy that are customer-centered instead of product-centered (Elahi and Rahman 2006:477).

The terms ‘microcredit’ and ‘microfinance’ are often used interchangeably to show the range of financial services provided specifically to poor, low-income households and micro-enterprises (CGAP website 2010; Brau and Woller 2004:3), but they do not have exactly the same meaning. Mostly both terms are confused so it is necessary to highlight the difference between them. Microfinance principally encompasses micro-credit and also involves additional non-microcredit financial services such as micro-savings, micro-insurance, pensions and payment services for the poor (Okiocredit, 2005). Microcredit, which is part of microfinance, is the practice of delivering small, collateral-free loans to usually poor &

unsalaried borrowers or membership of cooperatives who or else cannot get access to credit (CGAP website 2010; Hossain 2002:79).

According to Legerwood (1999 p. 1) defines Microfinance as the provision of financial services particularly credit & saving to poor and low income people. Robinson (2001 p. 9) stated it as small scale financial services mainly credit and saving provided to people who farm or fish or herd who operate microenterprises where goods are produced, recycled, repaired or sold; who offer services; who work for salary and commission; who earn income from leasing small amount of land, draft animals, vehicles, or machinery tools; and other groups and individuals at the local level of developing countries both rural and urban area. Therefore, microfinance can be defines as the provision of a broad range of financial services such as loans, deposits , insurance, pension, credit card, money transfers and payment services to the low income households and poor people and their farm or non-farm microenterprises and small businesses, to those who are neglected by the formal banking sector, through variety microfinance institutions.

Microfinance Institutions (MFIs) are organizations which were primarily established with the aim of support finance those small scale microenterprises and local economic activities which were mainly excluded from traditional finance and mainstream banking practice. However, in Sub-Saharan Africa, until now microfinance is not widespread and extremely low income earners, including a lot of the poor, cannot access financial services (CGAP, 2009; Spencer & Wood, 2005) while poverty is formally extensive and sever (World Bank, 2009).

Microfinance institutions are taking into account as a major instrument for poverty eradication as a result of enhancing access to finance and financial services. According to Basu *et al.* (2004) noted that MFIs complement efficiently the conventional banking industry in providing financial services to the low income people. The realistic of developing finance originates from the ground that empowerment of the poor through making revenue creating capacity allows the poor to gate all development necessities to avoid complicated dimensions of poverty and trim down their vulnerability to unanticipated proceedings (Davis *et al.*, 2004) whereas, studies of Ahlin and Jiang (2008) propose that these advantages of microfinance

can only be recognized on condition that the poor continue to be clients of the institutions of microfinance.

Hence, it is proposed that microfinance institutions should take into consideration additional allow the average borrower to graduate from the constant reliance on them to improve long run development. This will create MFIs as the weapon to alleviate poverty.

Microfinance is not a solution for poverty alleviation, but one among many good instruments & strategies to eradicate poverty and reach the United Nation's Millennium Development Goals through improving access to finance and financial services. According to Stewart R, van Rooyen C, Dickson K, Majoro M, de Wet T(2010) stated that microcredit and micro savings enable the poor to invest their money in the future, rise their incomes then 'lift themselves out of poverty'.

2.1.4. The MFIs Industry in Ethiopia

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

The provision of financial services to the poor has been going on for several years by projects designed by government ministries and departments and non-governments. The majority of MFIs are in reality owned either by NGOs or Regional Governments (Haftu, 2004). Individual owners except in very few cases have merely posed as owners at the request of either an NGO or Regional Governments. Such ownership arrangements are mainly motivated by the social cause of the objective of respective MFIs. The only truly individually owned MFI is the recently established Aggar Micro-financing S.C. It is owned by about 400 individual investors who expect profit from their share contributions. One can confidently

say that the ownership structure of Ethiopian MFIs is very loose. In other words the so-called owner has no real control over the shares (AEMFI, 2004).

During the command economic system (1974-91), the Development Bank of Ethiopia (DBE) and the commercial Bank of Ethiopia (CBE) were also involved in extending loans to cooperatives largely in response to the government's pressure. A massive default by the cooperatives following the demise of the command economy along with its extensive control systems, however, forced the CBE has continued to provide loans for the purchase of fertilizers and improved seeds on the basis of regional government guarantees.

The DBE has also been providing loans to micro and small-scale operators in some selected towns. This scheme was, however, based on donors fund designed in the form of revolving fund, and essentially based on a limited scale in terms of the number of clients covered. Funds were simple been given from the DBE to clients identified and screened by the Trade and Industry Breaux of regional Government rally led to a low loan recovery rate (DBE 1999). In line with this, the early formal microfinance activity is the DBE (Development Bank of Ethiopia) Place, Pilot Credit Scheme, initiated in 1990 under the Market Towns Development Project, implemented in 1994.

While many NGOs Programmers that emphasizes both credit and savings began in early 1990s. For example, the REST Credit Scheme of Tigray (RCST) (own Dedebit Credit and Savings Institution, DECSI) was launched in 1993; Sidama Saving and Credit scheme (now Sidama Microfinance Institution) was established in 1994; Oromia Credit and Saving Scheme (Now Oromia Credit and Saving S.C.) Started in 1996 (Gebre hiwot Ageba).

The formulization of the Micro finance institutions, micro credit used to be provided in a fragmented and unplanned manner even during the early 1990s. The micro credit scheme was donor driven rather than an outcome stemming from a clear policy direction and development strategy. Their outreach and impact also remained Limited (IFAD 2001).

Another feature of these credit schemes is that all was trying to address the credit delivery service alone. The provision of savings facilities, which is essential for a sustained credit service delivery, was completely ignored. The failure of the formal banks to provide banking

facilities, on the one hand, led the unsustainability of the NGO's credit scheme on the other hand, led the government to issue out a legal framework for the establishment and operation of micro finance institutions. Currently there are 35 microfinance institutions in Ethiopia, licensed and registered by NBE, following the issuance of proclamation No. 40/1994.

2.1.5. The Development of Microfinance Institutions

Creating a financial system capable of lending to micro-enterprises and low-income households is an integral part of the World Bank's strategy for developing the indigenous private sector and alleviating poverty. Micro-enterprises typically foster little productive employment growth, but they do alleviate the severe unemployment that threatens the survival of the poor in Africa.

Micro-enterprises often need access to very small loans to survive and grow as demand fluctuates. They rely heavily on the informal system of relatives, suppliers' credit, savings and credit associations, and moneylenders for their financial needs. The performance of international best-practice institutions shows that the self-employed repay their loans at high rates and are willing to pay high rates of interest in order to obtain access to financing. The key challenge in micro-enterprise development is to strengthen the capacity of the financial system—both informal and formal—to lend sustainably to micro-enterprises (Pitamber, 2003).

2.1.6. Main Sources of fund for Microfinance Institutions

Microfinance institutions (MFIs) have three main sources to fund their growth: debt, equity, and deposits (for those allowed to mobilize deposits). Debt financing means borrowing money and not giving up ownership. Debt financing often comes with strict conditions or covenants in addition to having to pay interest and principal at specified dates. *Source: MIX Market, 2007-2010. See data in Cross-Market Analysis.*

Donors have been active in microfinance for a long time .Most of them have published a renewed version of their strategy in microfinance during the UN 2005 year of Microcredit. Many areas of consensus have emerged in the donor's community after almost 30 years of

microfinance in developing countries. Goods or “best” practices have been drawn and are extensively shared in the sector. For instance, there is clear consensus that the primary role of government in this field is to control or facilitate the macroeconomic framework and to correctly regulate microfinance in order to protect customers and enable microfinance activities. However, experience has taught us that it is very difficult to manage microfinance services in countries with high inflation or during and after a macroeconomic crisis. Donors must therefore help government to achieve macroeconomic stability.

2.1.7. Loan portfolio

Loan portfolio refers to the loans that have been made bought and are being held for repayment. Loan portfolios are major asset to banks, and other lending institutions. The value of loan portfolio depends not only on the interest rates earned on the loans, but also on the quality or likelihood that interest and principal will be repaid. Loan portfolio quality is of great significance to Savings and Credit Cooperative Societies (SACCOS), because it determines the ability of the amount invested (Loan portfolio) to yield returns. This usually expressed in terms of loan repayment rate (qualitatively and quantitatively), arrears, and/or portfolio at risk rate (Mushi 2004).

According to Humaira (2000), the cost of being in arrears is not only terrible for the institution’s image, but also in terms of the institution’s sustainability. It is known by everyone that in a situation of arrears, institutions are faced with a lack of portfolio turnover, which will lead to an erosion of the institution. It has been seen in institution that fall into arrears that the clients usually inform themselves for the chance that the institution will fail and debt begins to grow rapidly.

An emerging base of commercially oriented MFIs are supporting small scale urban upgrading projects, such as water ,drainage, sanitation, road paving ,electricity, telecommunications, along with home improvement. These loans, which carry fees and interest rates sufficient to cover operating and funding costs, have been issued under three modalities, which are described below: (Ivo and Jeff, 2003)

- ▶ **Microenterprise loans.** The MFI issues a loan to small-scale service providers for investment and/or working capital purposes. The micro entrepreneur then charges users for the service provided, with corresponding revenue applied to repay the MFI loan. This model has been applied in Guatemala, Mexico, Kenya, and Paraguay.
- ▶ **User group-based loans.** Technical assistance providers, often the MFIs themselves, mobilize and assist user groups in the design, implementation, operation, and maintenance of the urban upgrading project. The MFI then provides a loan to cover part of the subproject investment (between 30 to 70 percent of the total cost) with remaining funding secured via a subsidy provided by a government or donor agency. This model has been successfully applied in Guatemala.
- ▶ **Individual household (consumer) loans.** Individual families, based on combined household income, receive a consumer loan from the MFI. The household then applies the loan proceeds to cover its cost-sharing of a community infrastructure asset. Similarly, home improvement loans are provided under commercial terms and conditions to support household service connection fees, addition of on-site water and sanitation facilities, and purchases of lot with basic services. This model has been applied in Indonesia, India, Bolivia and Mexico (Ivo and Jeff, 2003)

These community infrastructure lending programs have varied significantly in terms of lender legal status, rural-urban focus, borrower profile, and credit terms and conditions. However, the use of the above referenced nontraditional forms of collateral and expedited loan appraisal procedures, combined with the expectation of follow-up credit, has proven critical in terms of fostering high loan repayment rates for these small-scale infrastructure assets-many of which are indeed characterized by free rider issues. Given that the MFI is typically the only source of financial services (both credit and savings) available to the borrowers they have incentives to maintain themselves in good standing.

2.1.8. Micro-finance and Poverty Alleviation

Most poor people manage to mobilize resources to develop their enterprises and their dwellings slowly over time. Financial services could enable the poor to leverage their initiative, accelerating the process of building incomes, assets and economic security.

However, conventional finance institutions seldom lend down-market to serve the needs of low-income families and women-headed households. They are very often denied access to credit for any purpose, making the discussion of the level of interest rate and other terms of finance irrelevant. Therefore the fundamental problem is not so much of unaffordable terms of loan as the lack of access to credit itself (Kim 1995)

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

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

2.2. Key Principles of Microfinance

When Microfinance institutions were emerged before 30 years ago, they have the overriding concerns of eradicating poverty and helping the poor by providing them different financial services. Thus, unlike the mainstream banks, they have the social objectives of helping the

poor who do not have any means to access any form of loans. Here under are the basic principles of MFIs. These principles were developed and endorsed by CGAP¹ and its 31 member donors, and further endorsed by the Group of Eight leaders at the G8 Summit on 10 June 2004.

- 1. Poor people need a variety of financial services, not just loans.** Like everyone else, the poor need a range of financial services that are convenient, flexible, and affordable. Depending on circumstances, they want not only loans, but also savings, insurance, and cash transfer services.
- 2. Microfinance is a powerful tool to fight poverty.** When poor people have access to financial services, they can earn more, build their assets, and cushion themselves against external shocks. Poor households use microfinance to move from everyday survival to planning for the future: they invest in better nutrition, housing, health, and education.
- 3. Microfinance means building financial systems that serve the poor.** In most developing countries, poor people are the majority of the population, yet they are the least likely to be served by banks. Microfinance is often seen as a marginal sector—a “development” activity that donors, governments, or social investors might care about, but not as part of the country’s mainstream financial system. However, microfinance will reach the maximum number of poor clients only when it is integrated into the financial sector.
- 4. Microfinance can pay for itself, and must do so if it is to reach very large numbers of poor people.**

Most poor people cannot get good financial services that meet their needs because there are not enough strong institutions that provide such services. Strong institutions need to charge enough to cover their costs.

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

- 5. Microfinance is about building permanent local financial institutions.** Finance for the poor requires sound domestic financial institutions that provide services on a permanent basis. These institutions need to attract domestic savings, recycle those savings into loans, and provide other services. As local institutions and capital markets mature, there will be less dependent on funding from donors and governments, including government development banks.
- 6. Microcredit is not always the answer. Microcredit is not the best tool for everyone or every situation.** Destitute and hungry people with no income or means of repayment need other kinds of support before they can make good use of loans. In many cases, other tools will alleviate poverty better—for instance, small grants, employment and training programs, or infrastructure improvements. Where possible, such services should be coupled with building savings.
- 7. Interest rate ceilings hurt poor people by making it harder for them to get credit.** It costs much more to make many small loans than a few large loans. Unless micro-lenders can charge interest rates that are well above average bank loan rates, they cannot cover their costs. Their growth will be limited by the scarce and uncertain supply soft money from donors or governments. When governments regulate interest rates, they usually set them at levels so low that Microcredit cannot cover its costs, so such regulation should be avoided. At the same time, a micro-lender should not use high interest rates to make borrowers cover the cost of its own inefficiency.
- 8. The role of government is to enable financial services, not to provide them directly.** National governments should set policies that stimulate financial services for poor people at the same time as protecting deposits. Governments need to maintain macroeconomic stability, avoid interest rate caps, and refrain from distorting markets with subsidized, high-default loan programs that cannot be sustained. They should also clamp down on corruption and improve the environment for micro-businesses, including access to markets and infrastructure. In special cases where other funds are unavailable, government funding may be warranted for sound and independent microfinance institutions.

9. Donor funds should complement private capital, not compete with it. Donors provide grants, loans, and equity for microfinance. Such support should be temporary. It should be used to build the capacity of microfinance providers; to develop supporting infrastructure like rating agencies, credit bureaus, and audit capacity; and to support experimentation. In some cases, serving sparse or difficult-to-reach populations can require longer-term donor support. Donors should try to integrate microfinance with the rest of the financial system. They should use experts with a track record of success when designing and implementing projects. They should set clear performance targets that must be met before funding is continued. Every project should have a realistic plan for reaching a point where the donor's support is no longer needed.

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

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

2.3. Competition and Performance of Microfinance Institutions

In the early years of the development of microfinance, the idea of providing microloans to the poor as a way to alleviate poverty mainly appealed to and attracted social investors and non-government organizations (NGOs). Yet, over the years microfinance has proven to be a successful, and even profitable, model of financial intermediation.

This has attracted increasing interest from commercially oriented providers of microfinance, among which are also (international) commercial banks. Profit-oriented MFIs thus have become increasingly important, which according to some observers has also led to a change in focus of microfinance from being socially-oriented "poverty lending" approach – focusing on reducing poverty through providing financial services and funded mainly by donors, government subsidies and other concessional funds – to an institution-oriented "financial systems" approach – focusing on commercially viable financial intermediation to the poor with an emphasis on institutional financial self-sufficiency (see, e.g., CGAP, 2001; Hulme and Arun, 2009; Cull et al., 2009a). Increased competition among MFIs is one of the outcomes following the increasing role of profit-oriented institutions and the change of status by NGOs from non-profit to profit making (Commercialized) institutions.

When discussing the impact of competition, outreach, loan collection, efficiency and profitability as measures of social and financial performance of MFIs. These are generally accepted outcome measures of MFI performance (Jansson et al. 2003; UNDP, undated).

a. Competition and Outreach

The relationship between competition and outreach of microfinance institutions is ambiguous. On the one hand, a decrease of monopoly rents and market shares associated with increased competition may compel MFIs to expand their market base and explore new markets and (poorer) clients, implying an increase of outreach. On the other hand, however, if increased competition is associated with rising defaults and falling profits (see also below), MFIs may engage in more cautious lending by extending loans only to borrowers they consider safe and cost effective. This may reduce outreach, as lending to new and unexplored markets, as well as lending to poorer clients, is generally considered to be more risky and costly.

b. Competition and Loan Repayment and Portfolio Quality

Increased competition may trigger an increase in loan supply in case new institutions enter the market. Research has shown that increased loan supply may lead to multiple-loan taking (referred to as "double-dipping" in the literature) by clients, resulting in heavy debt burdens

and low repayment rates (see, e.g., McIntosh and Wydick, 2005 and McIntosh et al., 2005). Moreover, increased competition may also put pressure on MFIs to increase output and lower costs, which may lead them to relax lending and client selection standards and reduce costly monitoring and screening procedures. This in turn may increase default rates. We therefore expect a negative association between increased competition and loan repayment performance and/or loan portfolio quality due to increased default rates. Increased competition and the associated deterioration of lending portfolios of MFIs is a growing concern and some microfinance experts have expressed their frustration regarding the upward trend in defaults and over-indebtedness (Rosenberg, 2010).

c. Competition and Cost Efficiency

In principle, increased competition puts pressure on MFIs to become cost efficient. With increased competition, MFIs need to find ways of delivering services at lower costs to ensure them a competitive edge. Yet, competition may also lead to higher costs. First, as argued above, competition may result in borrower over-indebtedness, lower repayment performance and increased default rates. Lower levels of repayments and increased default rates add to the costs MFIs' lending activities. Second, with increased competition in the market for microfinance, MFIs may also not only have to compete for clients and market shares, but also for capital and labor inputs. Thus, interest rates at which they borrow money and loan officer salaries may rise, leading to higher costs. To conclude, the association between intensified competition and cost efficiency is not clear a priori.

d. Competition and Profitability

Increased competition is expected to be associated with falling profit rates. As MFIs come under competitive pressure, leading to declining market shares and monopoly rents, they are expected to report lower profit rates, to the point where it is no longer attractive for new institutions to enter the microfinance market.

2.4. Women and Microfinance Institutions

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

Microfinance empowers the poor, the program aims to make more women participate to become employers and change the household as a whole. The microfinance program play a vital role in women's empowerment, mostly females have more ability in controlling assets and knowledge of social issues in nature (Zeman, 1999)

A study conducted by Rose (2004), notifies how access to financial services has improved the status of women within the family and the community. Women have become more assertive and confident, in some regions where women's mobility is strictly regulated; women have become more visible and better able to negotiate in the public sphere. Women own assets, including land and housing, and play a major role in decision making

According to women's affairs ministers meeting 2007 MFIs targeting women and benefit from the program because women's repayment rates is higher. Even though MFIs in Ethiopia aim to participate women's in 50% of the credit service, still they face problems by being women in a society. Women in Ethiopia face a lot of problems especially in rural areas; often face the dual burden of productive and reproductive roles; they need to travel on average half a day to fetch water for household consumption, bearing children and looking after their households. The program encourages women to participate and become self-employed in the

industry, but still they took smaller loan of 22% on average lower than those taken by men and the profit margins is much lower (Gobezie,2004)

2.5.Arguments against the Micro-financial Sector

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

2.6. Possible Challenges of Microfinance Institutions

Microfinance institutions important for the society but to have face quite a specific set of challenges include: inadequate donor funding, insufficient support from government, improper regulations, lack of standardized reporting and performance monitoring system for microfinance institutions. Numerous challenges are ahead of microfinance sector like increasing competition, innovative and diversified products, profitability; stability limited management capacity of MFIs etc. On the other hand, the rapid increase in poverty along with other opportunities is paving way for the growth of this sector and offering a huge

market potential for microfinance (Muhammed, 2010). According to (Irobi 2008) found in his study that the major challenges of microfinance institutions are communication gaps and inadequate awareness; insufficient support from government , inadequate donor funding ,less attention on financial sustainability of MFIs, lack of adequate loan or equity capital to increase loan-able funds ,high turnover of MFI staff, limited support for human and institutional capacity building ,illegal government and NGO operations that spoil the market , and lack of standardize reporting and performance monitoring system for MFIs .

On the other hand, major challenges that face microfinance institutions are default risk inherited from borrowers, inadequate donor funding and lack of understanding of the definition and concept of microfinance by the client (Dahir 2015)

2.7.Challenges of Microfinance Institutions in Ethiopia

The Microfinance Institution in Ethiopia is growing with an incredible speed changing the lives of the poor. Besides the good things, according to Wolday (2008), Befkadu (2007), Fikirte (2011) and Woldemicheal (2010) stated below are some challenges faced by MFIs.

- ◆ Internal challenges such as shortage of loan able funds for further expansion, high turnover of employees, poor customer handling, poor documentation, not use computerized system, no training given by the institutions, the institutions couldn't consider the customer complaints and don't take corrective action.; and external challenges such as high credit risk due to poor loan repayment, high competition with conventional banks and improper interference of third party in the decision of loan approval (Fikirte K. Reta, 2011)
- ◆ Illegal government and NGO operations, which spoiled the market. (Woldemicheal, 2010)
- ◆ Limited outreach particularly for female (Befekadu, 2007)
- ◆ Limited in product development and innovations due to the regulatory framework influencing the type and development products; the owner (mother NGO,

government or shareholders) not clear defining the products; absence of competition; high risk and high cost developing new products; and limited capacity of the institutions to develop financial products (Wolday Amaha, 2008).

- ♦ Rural agriculture related challenges due to seasonality nature of the agricultural loans are creating pressures on the markets; absence of well-developed small, medium or large scale irrigation practices (Ataklti Kiros, 2007).

2.8.Core Performance indicators for Microfinance institutions

Experience has shown that funding agencies' microfinance interventions produce better results when design, reporting and monitoring focus explicitly on key measure of performance .Unfortunately, many projects fail to include such measurement. However, those five core indicators offer basic tools to measure performance of MFIs (CGAP, 2009)

1. Outreach (breadth of outreach) –how many clients are being served?
2. Client poverty level (depth of outreach) – how poor are the clients?
3. Loan repayment/collection performance (portfolio quality)- how well is the lender collecting its loan
4. Efficiency – how well does the MFI control its operating costs?
5. Financial sustainability (profitability)- is the MFI profitable enough to maintain and expand its services without continued injections of subsidies donor funds ?

These are the core indicators recommend in good practice guidelines for funders of micro finance Institutions. The performance of Microfinance institution is also best evaluated in light of the institution's context and stage of development note where the MFI's key strategic moves may have adverse short-term financial consequences but positive long-term effects. MFIs' achievement can be evaluated in terms of social performance and financial performance. Two of the indicators breadth of outreach and client poverty level (depth of outreach) captures social dimensions of performance (Lafourcade, et.al, April 2005, p. 6). In general indicators of outreach include:

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

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

Portfolio quality, financial sustainability and efficiency are the three indicators of financial performance. MFIs earn financial revenue from loans and other financial services in the form of interest fees, penalties, and commissions. Financial revenue also includes income from other financial assets, such as investment income. Micro finance Institutions financial activities also generate various expenses, from general operating expenses and the cost of borrowing for provisioning to the potential loss from defaulted loans. Profitable institutions earn a positive net income (i. e. operating income exceeds total expenses). (CGAP, 2009)

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

1. Outreach (breadth of outreach) – Expanding the number of clients being served is an ultimate goal of almost all microfinance interventions. But rapid expansion sometimes proves to be unsustainable, especially during an MFI's early years when it needs to

design its products and build its systems. It has very seldom been useful for funders to pressure MFIs for rapid expansion. The best measurement of outreach is straightforward : *(CGAP, 2009) The number of clients or accounts that are active at a given point in time*

- 2. Client poverty level (depth of outreach)** - Average Outstanding Balance is roughly related to client poverty, because better-off clients tend to be uninterested in smaller loans. But the correlation between loan balances and poverty is very far from precise. Low loan sizes do not guarantee a poor clientele. Likewise, growth in average loan size does not necessarily mean that a MFI is suffering “mission drift.” As an MFI matures and growth slows, a lower percentage of its clients are first-time borrowers, and average loan sizes will rise even if there has been no shift in the market it is serving.

Funders who want to reach very poor clients should usually look for MFIs that are already committed to a low-end clientele, rather than trying to encourage higher-end MFIs to change their market (CGAP, 2009).

Many not all, microfinance projects are expected to reach poor clients. There are various techniques for measuring client poverty levels, some quite expensive and others simpler, but as yet there is no widespread agreement on any one of them. If the project does not use a more sophisticated indicator, it should at a minimum report the following rough proxy for the poverty level of loan or savings clients at a point in time:

Avg. Outstanding Balance = *Gross amount of loans or savings outstanding*

Number of active clients or accounts

- 3. Loan repayment/collection performance (portfolio quality)-**

Reporting of loan collection is a minefield. Some indicators cover-up rather than clarify the true situation. Moreover, terminology and calculation methods are not always consistent. Therefore, whenever any measure of loan repayment, delinquency, default, or

loss is reported, the numerator and denominator of the ratio should be explained precisely. MFIs' self-reported collection performance often understates the extent of problems, usually because of information system weaknesses rather than intent to deceive. Collection reporting should be regarded as reliable only if it is verified by a competent independent party (CGAP, 2009).

The standard international measure of portfolio quality in banking is Portfolio at Risk (PAR) beyond a specified number of days:

PAR (x days) = Outstanding principal balance of all loans past due more than x days

Outstanding principal balance of all loans

The number of days (x) used for this measurement varies. In microfinance, 30 days is a common breakpoint. If the repayment schedule is other than monthly, then one repayment period (week, fortnight, and quarter) could be used as an alternative.

Many young or unsophisticated MFIs do not yet have loan tracking systems strong enough to produce a PAR figure. Most of these, however, should be able to calculate Loans at Risk (LAR), a simpler indicator that counts the number of loans instead of their amounts. As long as repayment is roughly the same for large loans and small loans, LAR will not differ much from PAR.

LAR(x days) = number of loans more than x days late

Total number of outstanding loans

When an MFI "writes off" a loan, that loan disappears from the MFI's books and therefore from the PAR or LAR. Thus, it's useful when reporting these measures to include a description of the MFI's write-off policy. (For instance, "the MFI doesn't write off loans," or "the MFI writes off loan amounts that remain unpaid more than 6 months after the final loan payment was originally due.")

4. **Efficiency:-** The most commonly used indicator of efficiency expresses non-financial expenses as a percentage of the gross loan portfolio. Efficient institutions minimize costs of delivering services. The efficiency of a MFI can be calculated in various ways; it may be measured by costs per borrower and costs per saver as indicators of efficiency.

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

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

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

Operating Expense Ratio = Personnel and administrative expense

Period-average gross loan portfolio

The Operating Expense Ratio is the most widely used indicator of efficiency, but its substantial drawback is that it will make an MFI making small loans look worse than an MFI making large loans, even if both are efficiently managed. Thus, a preferable alternative is a ratio that is based on clients served, not amounts loaned:

$$\text{Cost per Client} = \frac{\text{Personnel and administrative expense}}{\text{Period-average number of active borrowers} \times \text{GNI per capita}}$$

If one wishes to benchmark an MFI's Cost per Client against similar MFIs in other countries, the ratio should be expressed as a percentage of per capita Gross National Income (which is used as a rough proxy for local labor costs).

5. Financial Sustainability (Profitability):- In banks and other commercial institutions, the commonest measures of profitability are Return on Equity (ROE), which measures the returns produced for the owners, and Return on Assets (ROA), which reflects that organization's ability to use its assets productively.

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

Subsidies to credit institutions can take several forms:

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

$$\text{ROE} = \frac{\text{After-tax profits}}{\text{Starting (or period-average) equity}}$$

Starting (or period-average) equity

$$\text{ROA} = \frac{\text{After-tax profits}}{\text{Starting (or period-average) assets}}$$

Starting (or period-average) assets

These are appropriate indicators for unsubsidized institutions. But donor interventions more typically deal with institutions that receive substantial subsidies, most often in the form of grants or loans at below-market interest rates. In such cases, the critical question is whether

the institution will be able to maintain itself and grow when continuing subsidies are no longer available. To determine this, normal financial information must be “adjusted” to reflect the impact of the present subsidies. Three subsidy-adjusted indicators are in common use: Financial Self-sufficiency (FSS), Adjusted Return on Assets (AROA), and the Subsidy Dependence Index (SDI). These measures are more complex than the indicators discussed previously, and there are slight variations in the ways of calculating each of them.

According to AEMFI (2007), operational self-sustainability (OSS) takes into account the extent that financial revenue covers financial expenses, impairment losses on loans and operating expenses without performing adjustments for non-lending activities or other revenue like donation/grant and government support.

$$\text{Operational self-sustainability (OSS)} = \frac{\text{Financial revenue}}{\text{(Financial expense + impairment losses on loans + operating expenses)}}$$

According to Meyer (2002:4), measuring financial self-sustainability of MFIs demands that maintain better financial accounts and follow accepted accounting practices that give full clarity for revenue, expenses, loan recovery, and potential losses.

Financial Self-sufficiency (FSS) is a subsidy-adjusted indicator frequently employed by donor-funded microfinance NGOs. It measures the ability of the MFI to cover its adjusted costs from adjusted revenues (largely interest received) without grants (donation). MFIs with FSS exceeding 100% rates is indicating of a long-run sustainability (financially self-sufficient) and also if the FSS is below 100%, at that point the MFI has not still attained financial breakeven.

$$\text{Financial Self-sufficiency (FSS)} = \frac{\text{Adjusted financial revenue (excluding grants)}}{\text{Adjusted (financial expense + impairment losses on loans + operating expense)}}$$

The Subsidy Dependence Index (SDI) The SDI is a financial tool developed to measure the reliance of an institution on subsidies. The index measures how much the average lending interest rate would have to be increased to compensate for complete and immediate subsidy

elimination. The lower the SDI, indicated that the more sustainable the institution (Yaron, 1994). SDI measures how much an MFI would have to increase its lending interest rate in order to cover all of its costs including adjustments. An SDI above zero means that the MFI still needs subsidy to operate—i.e., it has not achieved financial sustainability.

2.9. Institutional and Operational Arrangements of Micro Finance Institutions

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

MFIs operate in a niche market because they address the needs of those clients who are considered ‘high risk’ by bigger banks. High risk groups or individuals are characterized as those with very few assets, requiring very small loans, high degree of close follow-up, business appraisal and evaluation, as well as those engaged in activities whose income is fluctuating such as small-holder farmers or petty traders. Thus, the MFIs cater for a market with an operationally acceptable demand level and where clients can be protected from the unreasonable conditions of the informal money-lenders

Such MFIs, however, charge high administrative costs and higher charges for risk coverage, which is in addition to the market interest rates, and taking advantage of the niche market for micro-loans. In Ethiopia, studies suggests that, other than agricultural credit, repayments are

required to start immediately, starting the week after the loan has been disbursed, and repayments are in weekly installments (Pitamber, 2003)

2.10. Empirical Literature Review

Researches have been conducted about assessment of microfinances performance by different researchers.

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

A study by **Morduch (2000)** indicates that less than 1% of MFI are sustainable and no more than 5% will ever be. Though this statement was issued with regard to NGOs and donor-funded MFIs, it has created awareness on the challenges facing the industry in general.

A survey by **Robert Cull (2007)** and others on the performance of leading MFIs in 49 countries finds interesting results. It founds over half of surveyed MFIs are profitable after making adjustment of subsidies. It also identified no evidence of tradeoff between being profitable and reaching the poor.

Mohammed (2015) examined the challenges facing microfinance institutions in poverty eradication stated that the microfinance institutions has a positive impact on alleviation of poverty among poor people on the other hand major challenges that face microfinance institutions are default risk inherited from borrowers, inadequate donor funding and lack of understanding of the definition and concept of microfinance by the client, communication gap, improper regulations by the government etc.

Research made by **Manos and Yaron (2009)** on the major issues in evaluating the performance of Microfinance institutions; their finding that there is a trade-off between outreach and sustainability in the short term. The researchers' analysis was based on Production Possibility Frontier (PPF). As stated by the investigators' results, in the short term whenever the MFIs are on the production frontier there is desirably a trade-off between improving financial sustainability and expanding outreach. In contrast, in the long term it is likely to increase both outreach and financial sustainability by using scale of economies, advancing operational methods, and starting innovations.

The research made by **Hassan and Sanchez (2002)** on efficiency analysis of MFIs in developing countries of the world using data 45 MFIs from regions of Latin America, South Asia and MENA. Their assessment was using data envelopment analysis (DEA) based on 5 year data in conditions of both production and intermediation method. Their studies indicate that South Asian MFIs have greater efficiencies than their equivalents in Latin America and MENA regions. The cause of inefficiency in MENA and Latin America are clear technical which shows that MFIs in the regions are either degenerative (wasting) resources or are not making sufficient outputs. Hence, the researchers also recommend MFIs to improve their pure technical efficiencies so as to make the most of social wealth.

As per **Nawaz (2009)** conducted a research on Efficiency and Productivity of Microfinance: Including the role of subsidies on 204 Microfinance Institutions in 54 countries using Data Envelopment Analysis and Malmquist index as analysis technique. His result have disclosed an average 1% rise in entire factor productivity with subsidy and an average 0.8% reduce in total factor productivity without subsidies.

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

Lakew (1998) examines POCSSBO's micro financing program contribution to poverty reduction. He found that after the credit program employment opportunity for the beneficiaries have been created. He also noted that the credit program of POCSSBO had

positive effect on income and saving of the clients. In addition, He stated that medical, education and nutrition access of the clients had been improved.

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

Borchgrevink and et. al (2005), studies marginalized groups, credit and empowerment for the case of Dedebit Credit and Saving Institution (DECSI) of Tigray. The study finds that female household heads are extremely marginalized groups; and also, young households', rural landless households and urban house-renting households are the other marginalized groups. Trough two-phase assessment, the study found that the DECSI's program has had a positive impact on the livelihood of and as well enhanced the social and political position of many clients. Concerning the constraints for economic development, the study noted poor rainfall, small farm size, and shortage of labor during peak agricultural seasons as the main constraints. Similarly, the main constraints in non-farm business 6 POCSSBO stands for Project Office for Creation of Small Scale Business Opportunities and the office were established in 1995.ventures are low return and lack of demand. However, credit is not the main constraining factor for expanding economic activity, except that in urban areas. The study further noted that DECSI's heavy involvement in credit delivery in the region has more or less satisfied to most of the people with some exceptions in the urban areas.

Adeno Kidane (2007) made a study on one of the largest MFIs in Ethiopia Amhara Credit and Saving Institution (ACSI). His result shows that ACSI has served more than half a million clients. Over 1.6 million loans have been disbursed worth ETB 1.5 billion. By 2005, the institution was operationally and financially self- sufficient at 119.9 and 115.3% respectively. ACSI is among a few MFIs that are able to achieve the highest efficiency at the lowest cost per borrower. The operating cost was as low as five cents in 2005. ACSI also has a high portfolio quality, as delinquency rates are around 1.9%.

Duressa (2009) stated that majority of the MFIs in Ethiopia are not yet financially and operationally sustainable, especially he concluded that MFIs owned by government are better

in their performance than MIFs funded by NGOs in terms of their financial and operational sustainability. In terms of outreach, NGO supported Ethiopian MFIs are limited to the project areas where they undertake their development activities, therefore; they have scattered and limited outreach. **Chala and Bessie (2016)** review Factors Affecting Performance of Microfinance Institution in Bale Zone, Oromia Region. They found that Loan size is the main financial attribute that gives more value to microfinance clients to determine borrowing decision.

2.11. Conclusions and Knowledge Gaps

Even though, the aforementioned, the empirical reviews try to point to out their finding as per their study area, it doesn't necessarily mean that the finding applies for all microfinance institution.

Previous studies in other developing countries in microfinance Institutions show that there is a direct relationship between performance and sustainability. It is also indicated that outreach, portfolio quality, profitability and efficacy has significantly influence performance of MFI's.

Moreover, studies that have been conducted in Microfinance Institution funded by NGO's in terms of their financial and operational sustainability shows that most NGO-supported MFIs are very small and have limited outreach; with scattered operational areas following the NGO development project areas .This has weakens their financial position due to the high costs involved in transport and communication

Based on this, the focus of this study made an attempt here to assess the financial and operational performance of Vision Fund microfinance Institution S.C and forwarded detail drawing of the findings, conclusions and recommendations with all degree that it is going to help to identify the gaps in the research.

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

This chapter outlines the general methodology used to conduct the study. It specifies the research design, target population, sampling design, data sources and data types, and method and instruments of data collection and analysis.

The main objective of this research study focuses on the problems related to the financial and operating performance of Vision Fund Micro Finance Institution S.C. To achieve this objective the researcher were used survey descriptive research design.

3.1. Research Design

Research design is an overall scheme or program as well as plan and structure of investigation conceived to obtain answers to research questions. The researcher has used descriptive research design; use to emphasize business constraints that contribute towards MFI's performance and attempts were also made to provide specific predictions about reasons of performance (causes of success or failure).

Descriptive research is a study designed to depict the participants in an accurate way. The three main ways to collect this information are: Observational, defined as a method of viewing and recording the participants. Case study, defined as an in-depth study of an individual or group of individuals. Source study.com/academy/lesson.

Descriptive research is also used to describe characteristics of a population or phenomenon being studied. It addresses the characteristics used to describe the situation or populations are usually some kind of categorical scheme also known as descriptive categories. Descriptive research generally precedes explanatory research. Shields,P and Rangarja ,N (2013)

Data type and Data Source

Primary and secondary data constituted the sources of information for this research paper.

Primary data

Semi- structured interviews was used to get the unbiased opinion of respondents regarding factors that affect the financial and operating performance of the MFI, the problems in the growth and expansion of MFI, and lack of business development services.

A semi-structured interview is a qualitative method of inquiry that combines a pre-determined set of open questions (questions that prompt discussion) with the opportunity for the interviewer to explore particular themes or responses further (Edwards, 2013)

A semi-structured interview is a meeting in which the interviewer does not strictly follow a formalized list of questions. They will ask more open ended questions, allowing for a discussion with the interviewee rather than a straightforward question and answer format. The interviewer may prepare a list of questions but does not necessarily ask them all, or touch on them in any particular order, using them instead to guide the conversation. In some cases, the interviewer will prepare only a list of general topics to be addressed, called an interview guide (Alison, 2017)

Respondents involved in this study included the Institution Chief Executive Officer, Finance Manager, Human resource Manager, Risk & Compliance Senior Manager, Chief Operations Manager, Senior Operations Manager, Legal and Loan Recovery Officer and Business Development and Marketing Senior Manager. These data collection instruments make it very convenient for respondents to give the information needed for the analysis. The researcher physically visited to the offices to conduct the interviews based on the respondents' convenient time and dates.

The flexible nature of these data collection instruments have given the researcher the opportunity to review some of the responses obtained. Interviewees and respondents had the chance to build on their responses or give further explanation when the need arose in the data collection process.

Secondary Data

The secondary data were obtained from the operational annual reports and audited financial statements of the institution and also related published documents have been reviewed. The information were covered a period of five years from year 2012 to 2016. This category of data is mainly found in the print and electronic media meant for public consumption. The use of this type of information is so beneficial in several ways to this specific study.

3.2. Sampling technique

The ultimate objective of sampling is to select a set of elements from a population. The researcher used purposive sampling method is used to provide a diverse range of cases relevant to a particular phenomenon or event.. The researcher purposively selected the populations into separate groups both financial and operational performances were proportionately represented. Purposive sampling is commonly used non- probability sample that is selected based on characteristics of a population and the objective of the study.

As per the study the institution under consideration (VFMFI) has been in operation since 1999 as a regulated and legally registered Microfinance service provider. This institution operates in 56 branch networks and 5 sub offices around the country and having loan portfolio and saving balance of ETB 504 million and ETB 228 million respectively. The number of active clients and total employees as of June, 2016 end of the fiscal year reached 102,656 and 579 in that order. The institution is part of the Vision Fund International Global network providing financial empowerment as part of World Vision and over 76,000 children's with 15% saving accounts annually. Since 2009 the institution using digital financing system or Core banking system even other local banks were not using this system before. Moreover, to learn more about the sector the financial and operations reports of the institutions have been intensely referred.

3.3. Data Analysis Methods

Both primary and secondary sources of data were analyzed using both qualitative and quantitative methods. Data analysis marked through a descriptive analysis method.

Descriptive statistics were used to provide details of the various factors that affect the performance of the MFI. In this respect, frequency distributions were used to evaluate the effects of the various factors on the performance of VFMFI, and Excel was used for the data processing.

CHAPTER FOUR

DATA ANALYSIS AND INTERPRETATION

4.1 Introduction

As stated by The Association of Ethiopian Microfinance Institutions (AEMFI) there are 35 member of MFIs providing microfinance activities in the areas of credit delivery, saving, money transfer, and pension payment services in 8 of the 11 regional states/administrative organs of the EFDRE. MFIs offer extensive of financial services comprising lending, savings, insurance, money transfer, collecting taxes on behalf of tax authorities, paying pension payments etc to low income people and clients. MFIs developed within less than 20 years in Ethiopia and are the well-known financial services providers for the poor people in the urban & rural areas. The government support MFIs by means of tax exemption and other empowerment processes.

Vision Fund Microfinance Institution S.C.(VFMFI) is one of the MFI has been in operation since 1999 as a regulated and legally registered Microfinance service provider. Since then the Institution has been in business to cater services to its clients in the capital and three regional states namely Oromia, Amhara, and Southern Nations Nationalities and Peoples' Region (SNNPR) and Addis Ababa city Administration.

In order to find the major outputs of the study and to suggest important recommendations, the gathered data must be analyzed and discussed and thereby interpreted appropriately. Thus, the analysis and important findings of the study are discussed under this chapter. This study examined the financial and operating performances of Vision Fund Microfinance Institution (S.C) by consolidating all necessary data from head office. Hence, the results of the study's analysis stated below are extracted and analyzed from audited financial statements and Operational reports of the stated MFI. The analysis also incorporated information obtained through semi-structured interview with the officials in the institution VFMFIs.

The result of the interview held with Vision Fund Microfinance Institution (S.C) has also been in the data review, analysis and interpretation thereof. Moreover, to learn more about the sector the financial and operations reports of the institutions have been intensely referred.

4.2 Results of Data Review and Analysis

The analysis of the data obtained was conducted primarily both by reviewing the audited financial statements and other relevant of the institution as well as addressing the responses to the interview questions. Accordingly, the analysis reviews, analyzes and interprets the results of the interview respondents and document review concurrently.

4.2.1 What are the funds sources of Vision Fund Microfinance Institution? Has it diversified its sources?

The result (of the study) revealed that the fund sources of the Institution have been diversified with different sources of income. Generally, it has got its sources of income from its interest on loan portfolio, fees commission for loan portfolio, other financial revenue like foreign exchange rate and interest on investment. Deposit financing sources for those allowed to mobilize savings are other sources of funds for the institution including child saving funds for generosity of supporters enables to offer life-changing financial services to people living in poverty. Child saving financing was originally initiated by World Vision for about 76,000 children participating in saving 15% of the annual donation to the needy children. The fund is the liability for the VFMFI which means that after some years it has to reimburse the donated amount to the donor organization from its return. Another source of debt financing of the Institution is borrowing from other lending organizations such Development Bank of Ethiopia, water org, Vision Fund International, EU loan fund, USID loan fund etc. Equity and donor funding financing is other sources of finance for the institution and generate higher income throughout the year. Thus, this indicates that VFMFI has diversified its sources of income from various sources and it is one factor to strength its long-term sustainability of the institution stay in the market. The detail sources of income shown below:-

Table1: Trend Analysis of Sources of Funds

| Funding Sources | 2012 | 2013 | 2014 | 2015 | 2016 |
|-----------------------------|--------------------|--------------------|--------------------|-----------------------|--------------------|
| Deposit or saving Financing | 56,253,195 | 92,833,350 | 136,020,106 | 186,137,717.83 | 228,863,831 |
| Debt Financing | 32,498,029 | 65,462,839 | 63,677,149 | 35,907,681 | 45,914,067 |
| Equity Financing | 121,149,783 | 185,901,928 | 226,586,128 | 271,586,378 | 329,815,137 |
| Donation ETB | 52,870,390.00 | 51,601,490 | 24,429,432 | 9,578,595 | 18,741,050 |
| % of Donation | 20% | 13% | 5% | 2% | 3% |
| Total | 262,771,397 | 395,799,607 | 450,712,815 | 503,210,371.83 | 623,334,085 |

Source: Researcher's Own Construction- 2017

As shown in table 1 above, the saving mobilization amounts increased throughout the study period. In the year 2012, the amount was ETB 56,253,195 which turned to become 228,863,831 in the year 2016. This indicates that the deposit amount for saving mobilization has shown four fold increments within the study of five consecutive year's .However, starting while debt financing during the same period depicted a decreasing and fluctuating pattern. The equity financing of the institution has increased based on profitability and donation.

Donor funding amount decreased over the year under consideration which indicates that the institution has shifted its financing sources from by the external subsidy sources to others. As shown above, the deposit mobilization and equity financing by the institution has dramatically increased from year to year.

4.2.2 What do the performances of the Institution look like both financially and operationally over the study period 2012-2016?

In this study, the researcher tried to encompass the major performance measurement indicators used by different scholars in studies of MFIs so far. Moreover, under each performance measurement indicators, certain ratios which are assumed best describe the performance and fit the data on hand are applied to measure the Institution's performance. The performance measurement indicators that are discussed under the study are: 1) Outreach (breadth of outreach), 2) Client poverty level (depth of outreach), 3) Loan repayment or

collection performance (portfolio quality), 4) Efficiency, and 5) Financial sustainability (profitability).

i. Trend analysis on operating and financial performance(2012-2016)

Trend analysis is the assessment of a company’s financial statements and indicators over time to determine how action affects results of the microfinance institutions performance. Since the financial statements for a single period cannot show much about the institution, a trend analysis covering five years from 2012 to 2016 were used to show VFMFI’s performance.

1. Trend Outreach Performance of VFMFI from the year 2012-2016

Outreach is used for the effort by microfinance institutions to extend loans and financial services to an ever-wider clients (breadth of outreach) and particularly toward the poorest of the poor people (depth of outreach).

Breadth of outreach is the provision of significant benefits to large numbers of a particular target individual or group and also depth of outreach is the provision of significant benefits to particularly disadvantaged people or members of a broader target individual or group.

According to Consultative Group to Assist the Poor (CGAP 2009) stated that the greatest measurement of outreach breadth is the number of active borrowers and the measurement of outreach depth (poverty level of client) is outstanding gross loan portfolio.

a. Outreach (breadth of outreach): This is the best measurement of breadth outreach and it is straightforward:

The number of clients or accounts that are active at a given point in time

Table 2: Trend of Breadth Outreach Indicators (2012-2016)

| Indicators | Years of operation | | | | | Average |
|----------------------------|--------------------|-------|-------|-------|---------|---------|
| | 2012 | 2013 | 2014 | 2015 | 2016 | |
| Number of active borrowers | 59219 | 63023 | 55924 | 83013 | 102,656 | 72749 |

Sources: *Researcher's own construction, 2017*

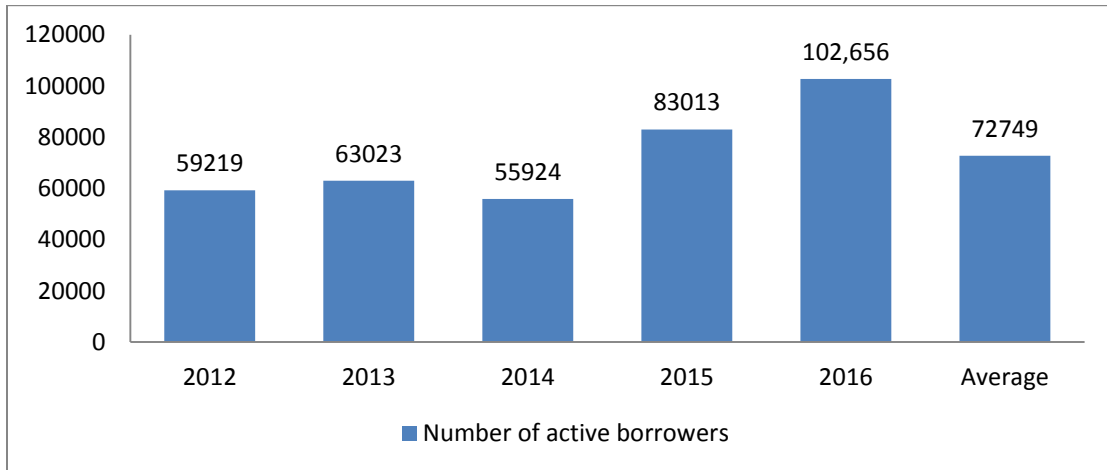


Figure1- Breadth of Outreach Indicator

The institution has on average 72,749 numbers of clients that are active from the year 2012-2016. Therefore, this shows that the institution is providing significant benefits to large numbers of a particular target individual or groups in its operational area. Expanding the number of clients being served is an ultimate goal of almost all microfinance interventions.

b. Client Poverty Level (Depth of Outreach): There are various techniques for measuring client poverty levels report. Henceforth, the following rough proxy for the poverty level of loan or savings clients at a point in time:

$$\text{Average outstanding loan balance per borrower} = \frac{\text{Gross Amount of Loans Outstanding}}{\text{Number of Active Borrowers}}$$

$$\text{Average Outstanding loan balance per borrower (2012)} = 181,075,805/59231$$

$$\text{Average Outstanding loan balance per borrower (2012)} = \underline{3,057}$$

$$\text{Depth of Outreach} = \frac{\text{Average Outstanding loan balance per borrower}}{\text{GNI per Capital/Exchange rate}}$$

$$= \frac{3,057}{390}$$

$$17.9078$$

$$= \underline{43.8\%}$$

Table 3- Trend of Depth Outreach Indicators (2012-2016)

| Indicators | Years of operation | | | | | Average | Industry Average |
|---|--------------------|--------|--------|--------|--------|---------|------------------|
| | 2012 | 2013 | 2014 | 2015 | 2016 | | |
| Average outstanding loan balance per borrower | 3,057 | 4,344 | 5,098 | 4,837 | 4,911 | 4449 | \$250 |
| Depth of outreach (USD) | 43.80% | 44.90% | 50.10% | 45.80% | 41.40% | 45.20% | 20% |

Sources: Researcher's Own Construction- 2017

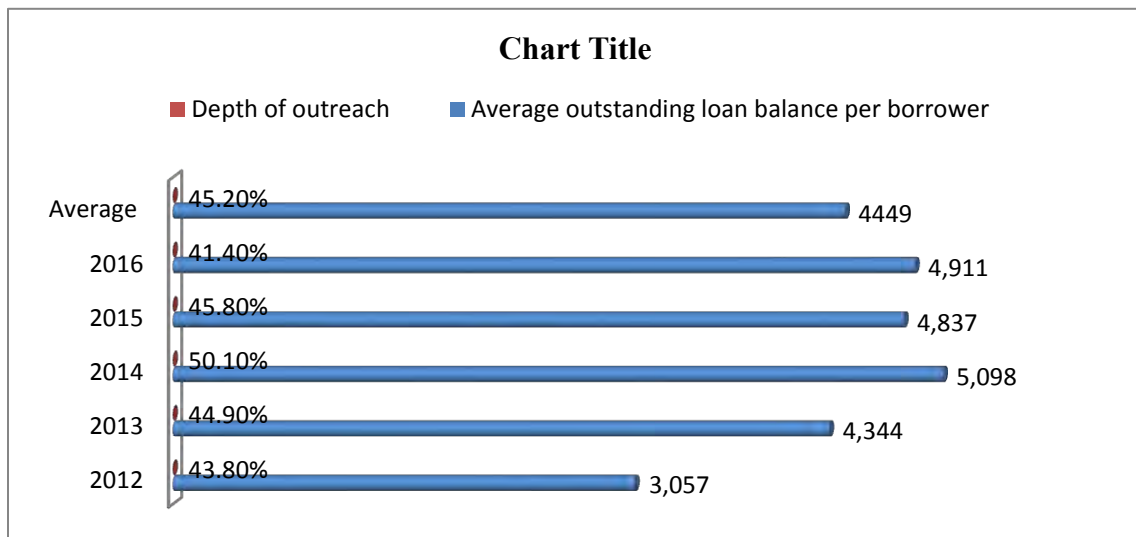


Figure 2- Depth of Outreach Indicator

As per the above mentioned two benchmarks, average outstanding loan balance per borrower is ETB 4,449 which is approximated to USD 254 and percent of depth of outreach per capital GNI on average throughout the year is 45.2%. As per the industry average benchmark has shown above percent of depth of outreach greater than the expected 20%. Accordingly, this indicates that clients of VFMFI are not the poorer but the borrowers of VFMFI were classified as microfinance institution borrower.

c. Trend performance by Breadth & Depth Outreach (Year 2012-2016)

i. Percentage of Female borrowers

Females are hardly served by traditional financial institutions because most of them in the developing world particularly in Ethiopia are less educated plus low income earners of the society. This is because they could not get collaterals to be served by the conventional financial institutions and are unable to paying their debt as contrasted to males. On the other side, they contain half part of the population in Ethiopia.

ii. Average Outstanding Saving Balance

The average outstanding savings balance consist only savings that clients have not withdrawn. Average outstanding savings balance is approximately related to client poverty because rich clients tend to be no interest in smaller deposit accounts. But the relationship between account balances and poverty is far from exact. Low account sizes do not guarantee poor clients. Similarly, growth in average loan size does not essentially denote that the microfinance institution is suffering from “mission drift.” A lot of MFIs have in sequence ladder of loan sizes for clients.

Average deposit balance per depositors= Gross Value of All Deposit Accounts

Number of depositors

Depth of outreach by deposit = Average Deposit Balance Per Depositors

GNI per capital /Exchange rate

The following table shows the trend of outreach breadth & depth performance by VFMFI from the year 2012 -2016

Table 4- Breadth and Depth of Outreach Performance (2012-2016)

| Indicators | Years of operation | | | | | Average |
|---|--------------------|-------------|-------------|-------------|-------------|-------------|
| | 2012 | 2013 | 2014 | 2015 | 2016 | |
| Number of active borrowers | 59219 | 63023 | 55924 | 83013 | 102656 | 72767 |
| % of Female borrowers | 65% | 66% | 63% | 58% | 54% | 61% |
| Gross loan portfolio | 181,075,805 | 273,790,853 | 285,129,472 | 401,503,700 | 504,165,717 | 329,133,109 |
| Average loan balance per borrower /GNI per capita | 43.80% | 44.90% | 50.10% | 45.80% | 41.40% | 45.20% |
| Number of depositors | 202,835 | 243,184 | 239,134 | 271,275 | 311,192 | 253,524 |
| Outstanding savings (in ETB) | 56,247,566 | 119,534,040 | 136,020,106 | 186,137,718 | 225,486,567 | 144,685,199 |
| Average deposit account balance /GNI per capital | 4% | 5% | 0,05 | 6% | 6% | 5% |

Sources: Researcher's Own Construction- 2017

Females usually face more problems than male in accessing financial services particularly loan. Thus, the number of females served is mostly measured as another criterion of operational coverage of microfinance. VFMFI's overall outreach performance of the female borrowers indicates that a significant increase through the study period of 2012-2016 was on average 61% which is greater than 50% of the total borrowers.

The level of deposits mobilized by VFMFI has shown a substantial increase from ETB 56,247,566 in the year 2012 to ETB 228,863,834 in 2016 on average ETB 144,685,199 which indicates that the clients' potential for savings has risen.

2. Trend Performance of Portfolio Quality by VFMFI –(Year 2012-2016)

The loan portfolio is the highest vital asset of microfinance institution. Loan portfolio quality which is also referred to as loan repayment of microfinance reviews how the microfinance institution measures, monitors, and manages its loan portfolio, together with delinquency and write-offs. Portfolio quality indicates the risk of loan delinquency and influences the future earnings and the microfinance institution's ability to extend outreach and serve current clients.

This is the most making known of the five performance areas. A money lender’s ability to collect loans is essential for its success: if delinquency is not maintained to very low levels, it can rapidly spin out of control. Moreover, loan collection has verified to be a powerful proxy for general management competence.

PAR (x days) = Outstanding principal balance of all loans past due more than x days

Outstanding principal balance of all loans

Let take how to calculate PAR value of year 2012 financial year

E.g Portfolio at risk (PAR) > 30 days = 2,445,179 = 1.35%

181,075,805

Table 5- PAR >30 Ratio and Write-off Trend

| Indicators | years | | | | | Average | Industry Average |
|---|-----------|---------|---------|-----------|-------|-----------|------------------|
| | 2012 | 2013 | 2014 | 2015 | 2016 | | |
| PAR>30 days ratios (Non-performing loans) | 1.35% | 1.78% | 6.35% | 3.41% | 4.68% | 3.51% | 5% |
| Write-off ratio | 2,326,004 | 677,128 | 650,604 | 1,946,836 | - | 1,120,114 | |

Sources: Researcher’s Own Construction- 2017

The higher PAR shows low loan repayment rates, as sign of inefficient microfinance institution. The greater the PAR, the higher inefficient the microfinance will be and, so, the less financially sustainable of the microfinance institution. The National bank threshold indicated that < 5% of portfolio at risk has acceptable loan repayment rate in addition to this, CGAP (2009) stated that as a rough rule of thumb when dealing with uncollateralized loans, PAR or LAR (30 days or one payment period) more than 10%, or ALR more than 5% must be minimized quickly or they will spin out of control.

A decreasing PAR indicates a healthy loan portfolio. The above result of PAR> 30 Days on average is 3.51 % and this reflects that VFMFI had acceptable PAR > 30 Days throughout the year. This was indicated that better follow-up activities made to the clients throughout the

year because PAR or LAR more than 10% and 5% respectively dealing with uncollateralized loans. However, write-off ratio was decreased on percentage from 2,326,004 to 0 from the study period 2012 to 2016.

Write-off ratio decreases at 0% in 2016 which was due to the fact the institution planned during last two years it started dealing with its loan defaulters for repayment through various means like negotiations and litigation in court. As the result, the percentage of write –off getting Zero balance.

3. Trend performance of Sustainability & Profitability of VFMFI (Year 2012-2016)

In banks and other commercial institutions, the popular measures of profitability are Return on Equity (ROE), which measures the returns produced for the owners, and Return on Assets (ROA).which reflects that organization’s ability to use its asset productively.

$$\text{ROA} = \frac{\text{After-Tax Profits}}$$

Starting (or period-average) Equity

$$\text{ROA} = \frac{1,491,427}{(252,874,492+168,042,907)/2/9*12}$$

$$= \frac{1,491,427}{(252,874,492+168,042,907)/2/9*12}$$

$$= \underline{0.9\%}$$

$$\text{ROE} = \frac{\text{After-Tax Profits}}$$

Starting (or period-average) assets

$$\text{ROE} = \frac{1,491,427}{(119,799,189 +71,780,997)/2/9*12}$$

$$= \frac{1,491,427}{(119,799,189 +71,780,997)/2/9*12}$$

$$= \underline{2,1\%}$$

Table 6- ROA and ROE Trend Analysis (2012- 2016)

| Indicators | Years of operation | | | | | Average | Industry Average |
|------------|--------------------|-------|-------|--------|--------|---------|---------------------|
| | 2012 | 2013 | 2014 | 2015 | 2016 | | |
| ROA | 0.90% | 4.60% | 5.60% | 8% | 7.60% | 6.66% | Best practice > 6% |
| ROE | 2.10% | 9.80% | 9.80% | 15.86% | 14.10% | 11.28% | Best practice > 15% |

Sources: Researcher’s Own Construction- 2017

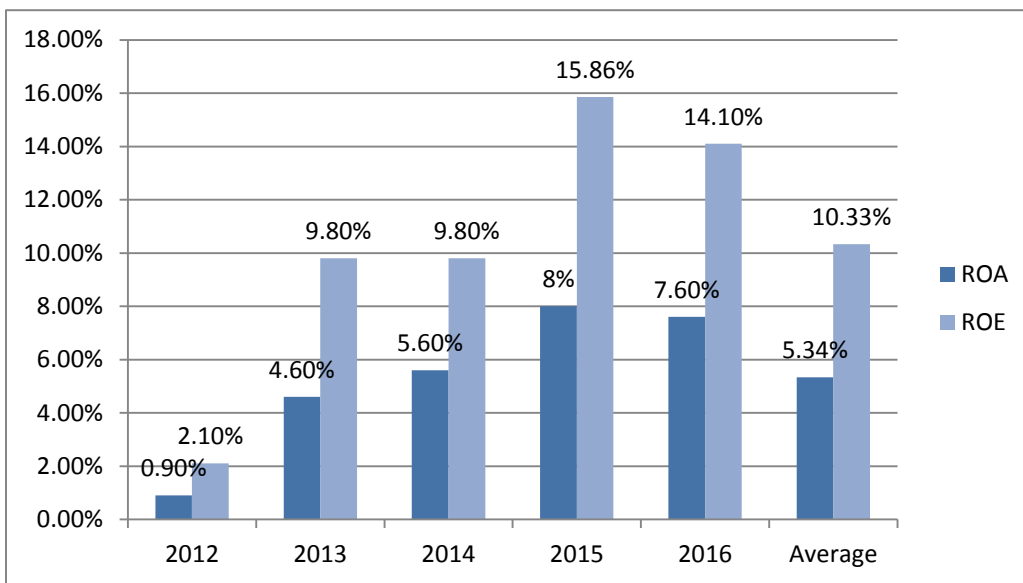


Figure 3- Profitability Indicator of ROA & ROE

The Vision Fund Microfinance Institution has recorded positive financial results in which it managed to generate net income after tax during the period under investigation. The ROA and ROE has to be 6.66% and 11.28% on average respectively from the year 2012 to 2016. Hence, from profitability point of view, the trend performance of VFMI in terms of ROA was successful greater than 6% on average through the rates change considerably over the years, On the contrary, VFMI was unable to attain ROE throughout the year it is indicated that 11.28% . This was under the industry average 15% best practice and then the result of ROE is below breakeven

Table7- Operational Self-sufficiency (OSS) & Financial Self-Sufficiency (FSS) (2012-16)

| Indicators | Years of operation | | | | | Average | Industry Average |
|------------------------------------|--------------------|------|------|------|------|---------|------------------|
| | 2012 | 2013 | 2014 | 2015 | 2016 | | |
| Operational self-sufficiency (OSS) | 105% | 125% | 131% | 146% | 139% | 129% | 100% |
| Financial self-sufficiency (FSS) | 74% | 99% | 108% | 110% | 114% | 101% | 100% |

Source: researcher’s own computation from financial statements

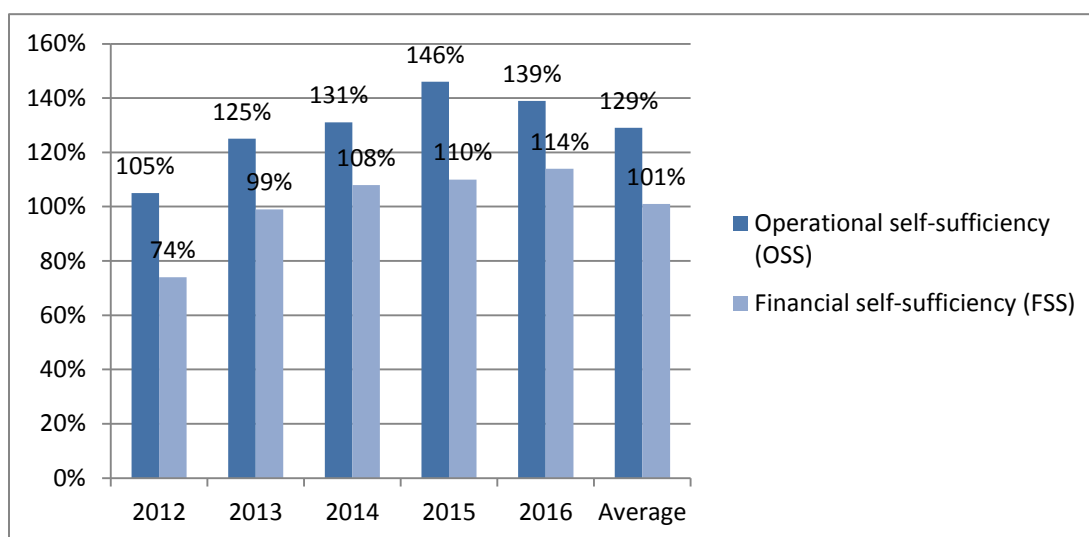


Figure 4- Profitability indicators of OSS & FSS

Financial Self-sufficiency (FSS) is a subsidy-adjusted indicator frequently employed by donor-funded microfinance NGOs. It measures the ability of the MFI to cover its adjusted costs from adjusted revenues (largely interest received) without grants (donation). MFIs with FSS exceeding 100% rates is indicating of a long-run sustainability (financially self-sufficient) and also if the FSS is below 100%, at that point the MFI has not still attained financial breakeven.

Operational self-sustainability (OSS) takes into account the extent that financial revenue covers financial expenses, impairment losses on loans and operating expenses without

performing adjustments for non-lending activities or other revenue like donation/grant and government support.

In reference to the above table 7 and figure 4, VFMFI performed well in terms of operational self-sufficiency because on average it achieved more than the threshold level of 1(or 100%). The average financial self-sufficiency of VFMFI in the considering years was 1.01 (or 101 %) that was above the breakeven point of 1 (100%). On the contrary, VFMFI was unable to attain financial self-sufficiency in the year 2012 and 2013 by 74% and 99% respectively. This was under the breakeven point of 1 and then the result of FSS is below breakeven. This means VFMFI was subsidize and donated by external parties in the year 2012 and 2013.

Generally, based on the above results from operating and financial sustainability and profitability angle, it is found that VFMFI was goes up the ladder of sustainability and profitability measures during the study period, i.e., from year 2012-2016.

4. Trends in Efficiency and Productivity of VFMFI (2012-2016)

Efficiency and productivity indicators give an indication of how well an institution performs operationally. Productivity indicators reflect the amount of output per unit of input while efficiency indicators also take into account the cost of the inputs and/or the price of outputs.

Since these indicators are not easily manipulated, they are more readily comparable across institutions than profitability indicators such as Return on Equity and Return on Assets. On the other hand, productivity and efficiency measures are less comprehensive indicators of performance than those of profitability.

The most commonly used indicator of efficiency expresses non-financial expense as a percentage of the gross loan portfolio.

Operating Expense Ratio= Personnel and Administrative Expense

Period –Average Gross Loan Portfolio

Cost per borrower ratio= Operating Expense

Average Number of Active Borrowers

Average loan balance per borrower= $\frac{\text{Gross Loan Portfolio}}{\text{Number of Active Borrowers}}$

Personnel productivity ratio=Borrowers per staff member

Personnel productivity ratio= $\frac{\text{Number of Active borrowers}}{\text{Number of personnel}}$

Loan Officer Productivity= $\frac{\text{Number of Active Borrowers}}{\text{Number of Loan Officers}}$

Table 8- Trend in Efficiency and Productivity Ratio (2012-2016)

| Indicators | Years of operation | | | | | Average |
|-------------------------------------|--------------------|------|-------|------|------|---------|
| | 2012 | 2013 | 2014 | 2015 | 2016 | |
| Operating Expenses Ratio | 32% | 21% | 20% | 20% | 20% | 23% |
| Cost per Borrower | 801 | 814 | 1,047 | 840 | 884 | 877 |
| Average loan disbursed per borrower | 3631 | 4857 | 7248 | 5588 | 5816 | 5428 |
| Personnel Productivity ratio | 104 | 116 | 129 | 165 | 177 | 138 |
| Loan officer Productivity | 279 | 328 | 309 | 359 | 354 | 325 |

Source: Researcher's own computation from financial statements

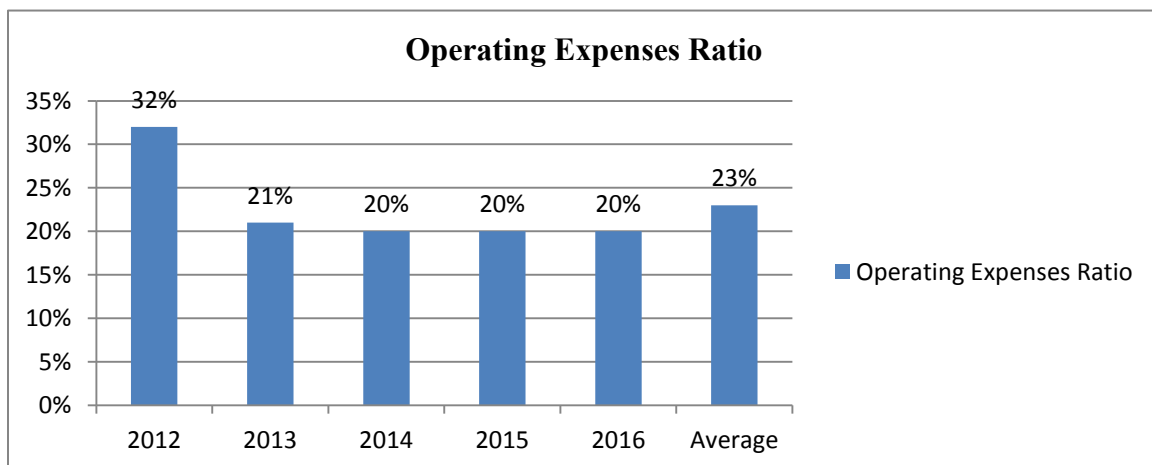


Figure 5 -Trend in Operating Expense Ratio

Based on the above table and figure, it was observed that almost there was a declined trend in operating expense ratio parameter in the VFMFI (from 0.32 to 0.20 on average 0.23). As a result, it can be inferred that the institution was improved efficiency in providing loan to its clients.

Cost per Borrower

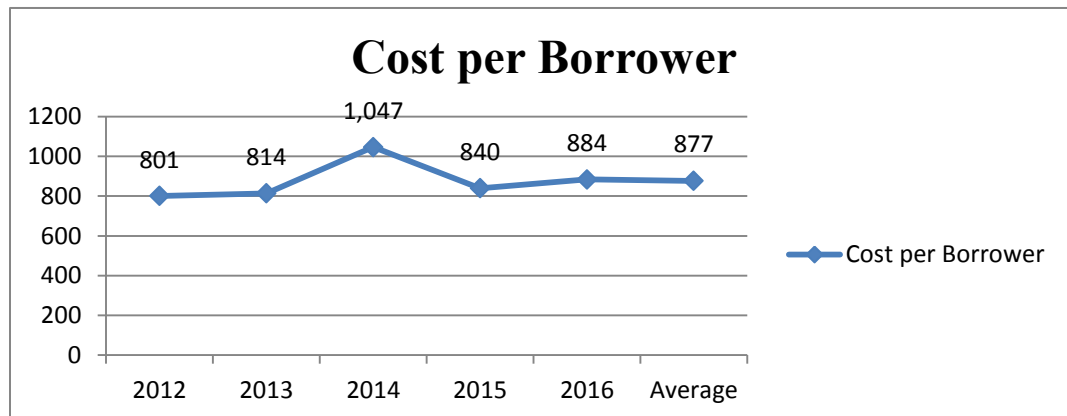


Figure 6 -Trend in cost of borrowers

In this view, the VFMFI incurs an average cost of ETB 877 to serve a single borrower. Besides, during the years observed that VFMFI's cost per borrower indicates a rise of ETB 1047 in the year 2014 when compare with year 2012 the highest to serve single borrower. Hence, this it can be concluded that VFMFI on average spends least (efficient) ETB 877 in operating and administrative expenses for serving a single client. Thus, VFMFI performs well in serving a single client in earlier than in later years of the study period.

Average loan disbursed per borrower

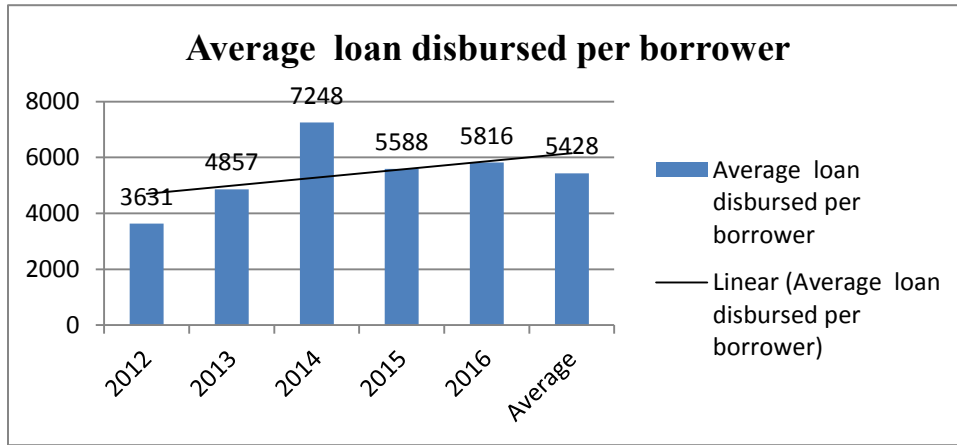


Figure 7 -Trend analysis on Average Loan Disbursed per Borrower

The average loan disbursed per borrower index in the above table 8. & figure 7- indicates that there was increase in the average amount of loan disbursed to borrowers or clients from the year 2012 to 2016. VFMFI on average disburses ETB 5, 428 of loan per single borrower in those years of operations. From this it can be concluded that the VFMFI disbursed satisfactory average loan per a single borrower.

Personnel Productivity Ratio

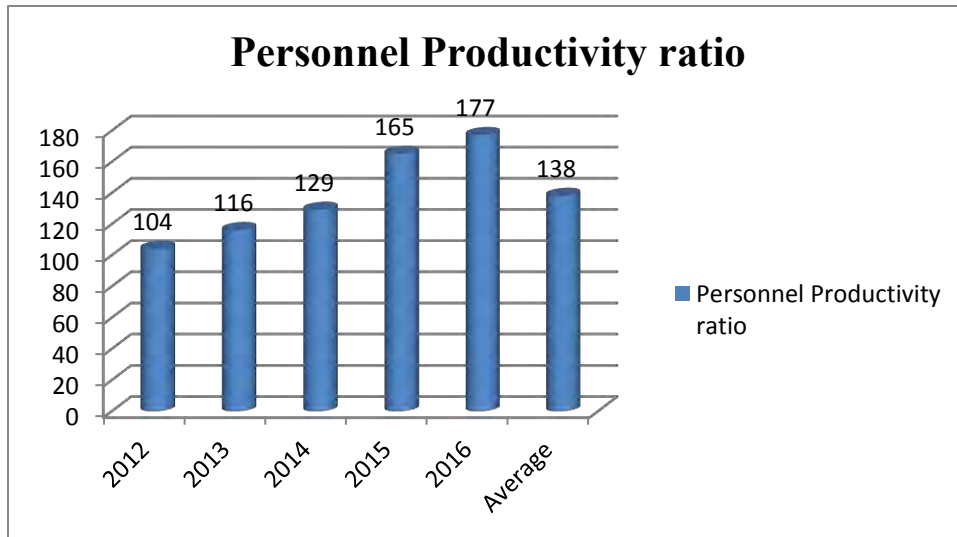


Figure 8-Trend in personnel productivity ratio

Loan Officer Productivity

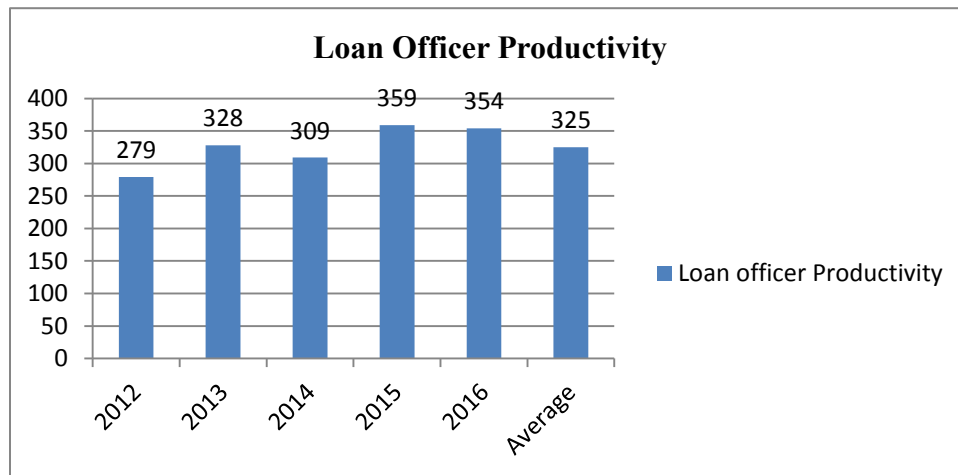


Figure 9-Trend in Loan officer productivity ratio

The last two indicators personnel and loan officer productivity ratios in the above table 8- and figures 8 and 9 are important ratios for any financial institution since personnel costs are mostly the highest operating expense.

The two indicators calculated above measure the size of the case load (the number of active clients) each loan officer takes in addition to how much borrowers are served by a single staff. The larger the ratios indicate that better efficient for the institution. Each loan officer under the VFMFI on average served 325 borrowers and also a single staff member on average served 138 borrowers. From the above analysis and discussion, it has been observed that VFMFI is more efficient on the prior years.

4.2.3 Is VFMFI financially and operationally sustainable?

As per the independent indicator variables, VFMFI was sustainable both financially and operationally with the following detail. One of the indicators that VFMFI has working for its financial sustainability is Loan repayment /collection performance (portfolio quality). Based on the below analysis portfolio at risk is a healthy loan portfolio. The detail is shown below:-

Table 9- PAR>30 Days and Write-Off Ratio on Sustainability of VFMI

| Indicators | years | | | | | Average | Industry Average |
|---|-----------|---------|---------|-----------|-------|-----------|------------------|
| | 2012 | 2013 | 2014 | 2015 | 2016 | | |
| PAR>30 days ratios (Non-performing loans) | 1.35% | 1.78% | 6.35% | 3.41% | 4.68% | 3.51% | 5% |
| Write-off ratio | 2,326,004 | 677,128 | 650,604 | 1,946,836 | - | 1,120,114 | |

Source: Researcher’s own computation 2017

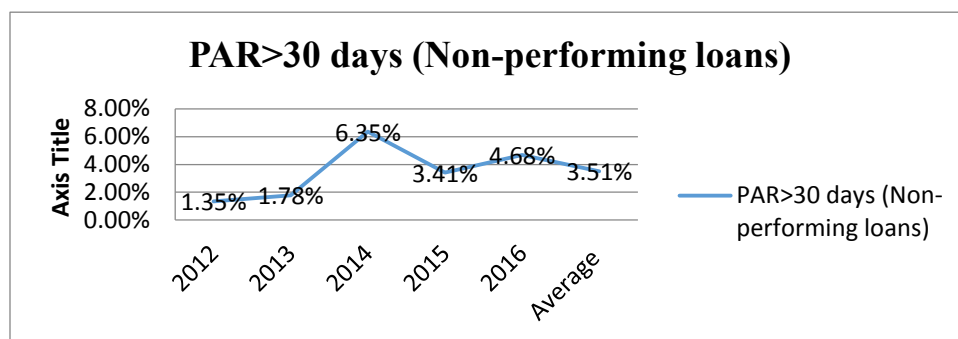


Figure10- PAR>30 days (Non-Performing Loans)

A decreasing PAR indicates a healthy loan portfolio. The above result of PAR> 30 Days on average is 3.51 % and this reflects that VFMI had decreased PAR > 30 Days throughout the year. This has been indicated that higher follow-up activities made to the clients throughout the year. In relation to the financial sustainability (profitability) performance of VFMI, the result shows that dramatically increased throughout the study period:

Table 10- Operating Profit for the organization

| Indicators | Years | | | | | Average |
|------------------|-----------|------------|------------|------------|------------|------------|
| | 2012 | 2013 | 2014 | 2015 | 2016 | |
| Operating profit | 3,268,938 | 24,364,346 | 16,730,186 | 38,351,444 | 60,996,634 | 28,742,310 |

Source: researcher’s own computation from financial statements



Figure 11- Operating profit for the organization

As shown above, VMFI’s operating performance revealed that on average the institution’s profitability index increased by 20% per year. The growth rate between years 2012 to 2016 as percentage it is indicated that 353%. This reveals that the institution has acceptable financial sustainability as measured by its profitability over the study period. The actual profitability results were greater than the target for each fiscal year as shown in table 10 and figure 11.

Table 11- Operating and Financial Self –Sufficiency of VFMFI

| Indicators | Years of operation | | | | | Average | Industry Average |
|------------------------------------|--------------------|------|------|------|------|---------|------------------|
| | 2012 | 2013 | 2014 | 2015 | 2016 | | |
| Operational self-sufficiency (OSS) | 105% | 125% | 131% | 146% | 139% | 129% | 100% |
| Financial self-sufficiency (FSS) | 74% | 99% | 108% | 110% | 114% | 101% | 100% |

Source: researcher’s own computation from financial statements

Regarding the operating self-sufficiency and financial self-sufficiency of the institution, VFMFI performed well throughout the study period which means that on average it achieved more than the threshold level of 1(or 100%). The average financial and operating self-sufficiency of the institution are 129% and 101% respectively. The figures show that both

FSS and OSS are above the breakeven point of 1 (100%) that implies VFMFI is sustainable and percentage of sufficiency also increased.

The sustainability measurement of performance indicator in relation to VFMFI is Efficiency and productivity indicators give an indication of how well an institution performs operationally.

Table 12- Operating Expenses and Personal Productivity Ratio of VFMFI

| Indicators | Years of operation | | | | | Average |
|------------------------------|--------------------|------|------|------|------|---------|
| | 2012 | 2013 | 2014 | 2015 | 2016 | |
| Operating Expenses Ratio | 32% | 21% | 20% | 20% | 20% | 23% |
| Personnel Productivity ratio | 104% | 116% | 129% | 165% | 177% | 138% |

Source: researcher's own construction

During the study period indicated that the operating performance ratio of the institution has decreased from 32% in 2012 to 20% in year 2016 and also personal productivity ratio indicated that better efficient for the institution for example, the ratio of productivity in the year 2012 was 104 however, the year 2016 it is increased by 177 on average 138. This all explained that the institution is operationally sustainable.

4.2.4 What are the challenges and opportunities that VFMF encountering?

During the study period, the final questions that should be addressed were questions related expected challenges and opportunities for VFMFI. Every business starts by undertaking the necessary preliminary study which includes observing the opportunities in the market or industry. Likewise, Vision Fund Microfinance Institution, as Microfinance in the country, has various favorable conditions- opportunities- for the attainment of its ultimate goals. Hence, the following are some of the identified by the management of the Institution the opportunities for the Institution both for its survival as well further advancement of achievements. Also, there are also anticipated challenges that may face the industry in general the institution in particular. Hence, this section of the study presents first the opportunities followed by the challenges.

A) Opportunities: The detail opportunities are discussed as follows.

1. Families are able to send their children to school and to cover health care expense for their family members. Very few clients are able to build assets and enhance income earning capacity.
2. VFMFI is recognized as a very effective developing tool. This contributes to socio-economic status of targeted community especially women-oriented financing. This can relate with Women entrepreneur development program (WEDP May 25, 2017) the objective of the Women Entrepreneurship Development Project for Ethiopia is to increase the earnings and employment of Micro and Small Enterprise, or MSEs owned or partly owned by the participating female entrepreneurs in the targeted cities. This will be achieved by: i) tailoring financial instruments to the needs of the participants and ensuring availability of finance; and ii) developing the entrepreneurial and technical skills of the target group and supporting cluster, technology and product development for their businesses. There are three components to the project, the first component being access to microfinance. The aim of the component is to facilitate access to financial services for female growth-oriented entrepreneurs by providing working capital and investment finance through a dedicated line of credit. At the same time, the component aims at improving the capacity of existing Micro-Finance Institutions to serve female growth-oriented entrepreneurs with tailored financial products. The second component is the entrepreneurial skills, technology and cluster development. The aim of this component is to develop growth-oriented women entrepreneurs' skills, facilitate their access to more productive technologies that can raise their incomes, and help unleash synergies from clustering. Finally, the third component is the project management, advocacy and outreach, monitoring and evaluation and impact
3. The industry is evolving into an increasingly commercial operation to serve a larger segment of potential market with its 56 branches across the country.
4. Government's Growth and Transformation Plan II (GTPII)'s growth and expansion strategy (May, 2016) clearly indicated that the plan to increase domestic savings concerns both private and public savings. The share of private savings in GDP is planned to rise from 16.6 percent in 2014/15 to 19.8 percent by 2019/20. To this end, from monetary and

financial policy perspective, the nominal interest rate will be set in such a way that real interest rate is positive. Besides, policies that encourage banks and microfinance institutions (MFIs) to expand their capital and branch will be pursued. Along with these, strategies to enhance contractual saving (such as private pension fund, health insurance and insurance premium) instruments will be implemented. Pension proclamation will also be revised to cover all private employees.

5. Branch network expansion, introduction of Mobile & Agent banking services, scaling up of saving mobilization and SME financing and human resource development are among key areas of focus that the government has already set targets for MFIs where Vision Fund was striving as its focus areas.
6. Tax exemptions by the government to MFI's are one of the biggest opportunities for the institutions impacted the growth for future endeavor.
7. Holistic Development Services: VFMI has giving holistic development service to poor community focus on children and women .Besides its microfinance program the institution has manages to provide different loan products such as :Family loan, individual loan, business loan, agribusiness loan, agricultural loan enterprise loan Women Entrepreneurs Development Program (WEDP) Loan and Water Sanitation and Hygiene (WASH) products.

B) Challenges

Though the Institution has the aforementioned opportunities, VFMI may encounter the various challenges when carrying out its activities. Based the interview responses by VFMI higher officials and review of internal documents, the researcher gathered the following responses pertinent to the institutional challenges. These include:-

1. The institution is being highly challenged by a high staff turnover due to big market competition by other MFIs and banks. The staff dissatisfaction is attributable uncompetitive benefits packages and work load. This might affect the institution for high training cost for new staff recruitment process, the operational activity of the institution to achieve its target.
2. Lack of appropriate trainings to staff for financing and banking area has brought low level of technical understanding of banking and finance service. The respondents of the

interview addressed that there is a big gap between needs for training and conducting the training throughout the previous years.

3. There is high credit risk: The risk of default on a debt that is because of borrowers' failure to make required payments.
4. Inadequate awareness of the client's about the MFIs work and sometimes they borrow the money without adequate knowledge for how to invest.
5. Poor customer handling – Evaluation of customer satisfaction with services of the institution not established and an employee of the organization who are serving the clients not develop their capacity with training for how to handle customer complaints.
6. High risk and high cost developing new products

CHAPTER FIVE

CONCLUSIONS AND POLICY IMPLICATIONS

5.1. Conclusions

The results of the data analysis and discussion, and pertinent interpretation based on the discussion were presented in chapter four. This chapter first concludes the study carried out on the financial and operating performances of VFMFI. The role of microfinance institutions is primarily alleviation of poverty by providing financial services to the poor people and microenterprises, and this has become an accepted principle. However, this key role can be performed only if the microfinance institutions are sustainable, .i.e., they can operate in the long-run without subsidies and donations from external supporters.

The performance of microfinance institutions can be analyzed from two viewpoints; first, an assessment of historical performance based on the analysis of financial statements. Second, performance of the institutions is measures as an evaluation of their potential and ability to survive in the long-run. Performance is the development towards the mission of financial growth. This mission is to make the lives of the poor people getting better. MFIs do this by making more outreach, loans and deposits used by the poor people. Sustainability is the ability to repeat and to continue performances of the microfinance institutions in the future.

The study evaluates the performances of VFMFI in relation to fund sources and fund sources diversification mechanism, and the performance of the institution over the study period 2012 to 2016 using different measurement indicators such outreach in breadth and depth, financial sustainability and profitability, portfolio quality, and efficiency and productivity. It also evaluates the financial and operational sustainability and to identify the possible challenges and opportunities facing by the institution. It reviewed the relevant literatures on these five core performance indicators of microfinance institutions and those literatures help as a point of view to the results presented below.

The overall conclusion is that fund source of funds for the institution has diversified with different sources. Generally, the institution has got its sources of income from its interest on loan portfolio, fees commission for loan portfolio, and other financial revenue like foreign

exchange rate interest on investment. Deposit or saving mobilization is one of sources of income for VFMFI. Based the analysis of data made earlier the study indicates that the institution's capacity for saving has increased on the years under study. In addition to this, child saving funds which is donated by WVE is another source of finance for the microfinance as the saving or deposit investment for the institution from WVE. Such funds, in fact, are liabilities for the institution since the institution will reimburse the donated amount to the donor organization. Nevertheless, the data analysis explained the funding sources are decreased from year to year. In terms of debt service funds, VFMFI also generates funds through borrowing from government banks and donors. Equity financing is the other sources of financing for the institution. As per the data analysis on table 4.1, the equity funding balance from profit and donor funding are increased over the study period. Regarding donor funding sources it has been observed that it decreased for the consecutive years. The overall trend shows that the institution has made good attempts to diversify its sources of funds.

In terms of financial and operational performance of the institution, the study examined based on the core performance indicators discussed in chapter two. One of the performance indicator observed here is outreach. Outreach can be seen through breadth (number of clients) and in depth (client poverty level) as per the data analysis shown that number of clients has become increasing on average 72,749 over the study period. This indicates that VMFI provides essential benefits to a large number of the target individuals or groups in its catchment areas of the country.

Regarding the depth or client poverty level of VFMFI, on average, the outstanding loan balance per borrower is ETB 4,449 and percent of depth of outreach per capital GNI on average during the study period is 45.20%. Consequently, based on the benchmark set by the study evaluation (CGAP assessment tool) if an average outstanding loan balance below 20% of per capital GDP or USD 250 is regarded as a rough indication that clients are very poor. But, the results of this study reveals that the figure 353% which indicates the clients of VFMFI are not the poorer rather they are better classified as the borrowers of VFMFI as per the above benchmark.

The results of the study also disclose that the percentage of female borrowers is 61% within the study period which implies that the institution has achieved successfully its mission statement of addressing women by giving specific opportunity to access loan and empowering them through creating awareness about how to save and deposit. In terms of other outreach indicators like Gross Loan Portfolio Growth which is shown as 329,133,109 on average per year, Average loan balance per borrower per GNI per capital 45.20% on average, Number of depositors on average 252,524, outstanding savings 144,685,199 on average per year and Average deposit account balance/GNI per capital increased per average 0.052% per year. Generally, the outreach performance of VFMFI considered in the study is increasing over the study period.

Collection performance or portfolio quality of the institution is increased throughout the study period like PAR >30 days on average indicated that 3.51% and write-off ratio was decreased on percentage from 0.1 % to 0% from 2012 to 2016. This was observed the institution achieved its planned deals with the defaulters for the settlements of their outstanding balances such means as negotiations or litigation in court. As a result, the percentage of write –off got a zero balance. Further, the result indicates that high delinquency makes financial sustainability impossible. As a rough rule of thumb when dealing with uncollateralized loans, PAR or LAR (30 days or one payment period) above 10 percent or ALR above 5 percent which must be reduced quickly or they will spin out of control (CGAP delinquency OP). This was indicated that higher follow-up activities made to the clients Accordingly, the decreased PAR and LAR explained that a healthy loan portfolio is maintained in the institution.

Financial Suitability or Profitability of VFMFI is discussed in the research paper using four common indicators such as return on assets (ROA) and return on equity (ROE), Operational self-sufficiency (OSS), and financial self-sufficiency (FSS).

In terms of Financial sustainability of the institution, Return on Asset (ROA) and Return on Equity (ROE) has recorded positive financial results in which the institution was managed to generate net income after tax. The ROA and ROE happened to be 6.66% and 11.28% on

average respectively from the year 2012 to 2016. This reflects that VFMFI has the ability to deploy its assets in a profitable manner and the return produced on the owner's investment.

Regarding the Operational self-Sufficiency (OSS) and Financial Self-Sufficiency (FSS) of VFMFI, the result shows that 134% and 105% of OSS and FSS has been attained respectively on average during the years under study. Therefore, based on the benchmark set by scholars Yaren, Jacob (1992), if FSS and OSS is below 100 %, then the MFI has not yet achieved financial breakeven and percentage of sufficiency also increase. Henceforth, the percentage of OSS and FSS on average achieved more than the threshold level of 1 (or 100%). In general, VFMFI was profitable and its performance is in a good condition for account of profitability ratios.

The remaining performance indicator of VFMFI is efficiency and productivity indicators which give an indication of how well an institution performs operationally. Based on the given analysis on average indicates that operating Expense ratio is 23%, cost per borrower ETB 877, Average loan disbursed per borrower is ETB 5,428, personal productivity ratio is 138 and loan officer productivity has shown 325. According to Schreiner et.al (2001) measured in terms of costs as a percentage of amounts on loan, tiny loans are more expensive to make than large loans. Only a few extremely efficient MFIs have an Operating Expense ratio (OER) below 10%; Commercial banks making larger loans usually have OERs well below 5 percent. The average OER of MFIs reporting to *the micro banking Bulletin* is about 30 percent which probably reflects considerable inefficiency. Depending on the above criteria, it can be concluded that VFMFI has been efficient in providing loans to its clients.

With respect to the financial and operational sustainability of VFMFI, it was observed that the profitability index of the microfinance was dramatically increased by 20% per year while the OSS and FSS financial sustainability index were increased by more than the benchmark 100%. In addition to this, Return on Asset (ROA) and Return on Equity (ROE) has recorded positive financial results in which it managed to generate net income after tax. This all explained that the institution has a big financial sustainability with regard to its profitability within the study period.

Finally, this study addressed the questions concerning the challenges and opportunities that VFMFI might have come across during earlier years of the institution operations and are expected in the years to come. Accordingly, the institution experienced some challenges while carrying on its operations such as communication gap between the client and the institution, inadequate awareness of the client, high staff turnover, poor customer handling issues, lack of trainings to staff and high credit risk.

Regarding the opportunities of the institution, in spite of the above stated challenges, Vision Fund Microfinance Institutions also realized some favorable conditions for the attainment of a goal and further advancement of its current success. These opportunities include:

- 1) The national population is growing very fast. This contributes towards the growth of the outreach of the microfinance institution.
- 2) The industry is evolving into an increasingly commercial operation. This is an opportunity for VFMFI to serve a larger segment of potential market with its 56 branches across the country;
- 3) The MFI's annual and strategic plan is formulated in such a way that it is aligned with Government's Growth and Transformation Plan II (GTPII)'s growth and expansion strategy;
- 4) VFMFI has giving holistic development service to poor community focus on children and women. Moreover, its microfinance program the institution has different loan products such as: Family loan, individual loan, business loan, agribusiness loan, agricultural loan enterprise loan Women Entrepreneurs Development Program (WEDP) loan and Water sanitation and hygiene (WASH) products.

5.2.Policy Implications

In light of this study, the following policy issues and further research areas identified for the financial and operational performances of the case institution.

1. The fund sources and fund diversification mechanism: The institution has attempted to diversify its funding sources using debt financing, equity financing, deposit or saving

financing, and donor financing. The findings show that the microfinance is being self-reliant internally. The donation amounts that constituted 20% of the total funds sources during 2012 has now become only 3% of the figure. The Child Savings component, which has been given from World Vision Ethiopia, was stopped starting 2017. Therefore, the decline in the donation and entire cessation of the Child Savings Funds would have a clear negative implication on the funds sources of the institution.

2. The study revealed that VFMFI is profitable and financial sustainable which can stand without injection of donor funds. However, the institution is contemplating to broaden its operational area beyond the catchment areas of the WVE which would entail additional operating and administrative expenses. On the contrary, as discussed above, its two funds sources have stopped. Henceforth, VFMFI has to devise alternative and reliable means of financing itself so as to survive as well as remain competitive in the industry. It should use its maximum and full effort to increase its outreach to the target people. In general, the greater the numbers of borrowers, the better sustainable microfinance institutions are.
3. As shown in the result, the portfolio at risk PAR >30 days and write-off ratio of the institution has decreased on percentage below the benchmark within study period 2012 to 2016. The percentage of write –off was declined to a zero balance. However, the institution should design other alternative mechanism to move towards highest collection performance for future implementations to keep its consistency and sustainability.
4. In related with return on assets and return on equity of VFMFI figure indicated greater than zero which reflects that the institution are able to use its assets productivity. In assess of the fact that these parameters are the means to survive and grow to provide sustained service to the poor without any subsidize and support of fund from external parties. Hence forth, this should be performed on it to move toward highest return and to get performance consistency or stability.
5. VFMI was doing well in terms of profitability and sustainability both in connection with operational and financial self- sufficiency to cover their expenses and pass the minimum threshold level grow and sustain by their own. Operational and financial self-sufficiency is very important in the commercialization of microfinance. Generally, based on the above result from financial sustainability and profitability angle, it is found that VFMFI

was going up the ladder of sustainability and profitability measures during the periods of the study from year 2012-2016.

6. VFMFI was found to be cost efficient as shown the analysis and discussion part of this paper. Hence, VFMFI should continue to keep its efficiency through keeping both cost per borrower and cost per saver better communication, improved lending products, new technology, or combination of these improvements in order to minimize cost of operation and run sustainably with no subsidy.
7. In order to increase its opportunity in the industry the institution should be competitive for in all areas of the market like, diversify loan products to its customer to generate high income, aligned with Government's Growth and Transformation Plan II (GTPII)'s growth and expansion strategy because the GTP gives big opportunity for Small and medium enterprises (SME) and MFIs to involve and invest their capital in the country to increase the economy.
8. In terms of high staff turnover, the institution that forces to lose the most experienced employees. Lack of staff development primarily affects staff motivation and then the performance of institution itself. Hence, the institution should develop and put in place clear staff development strategy such as, carrier structure with attractive pay scheme and staff training policy. VFMFI should consider introducing performance related incentive system and packages of benefits based on their financial capability. Moreover, it is important to work closely with employees to understand their challenges in related to work load and conduct appropriate trainings. VFMFI should develop staff training policy and the policy could be adopted to allocate certain percentage of personnel cost for staff development each year to be built in annual plan.

Generally, this is not a definitive study of VFMFI in terms of financial and operating performance. A lot of factors could influence the selected five basic performance measures including data quality and non-optional variables in terms of MFI characteristics and variation in the operating environment. However, the findings from this study work provide basic indicators on the performance of VFMFI considered into account the five core

measures. Therefore, the concerned institution can use the output of the study too see their operating and financial performance level in terms of the indicators included in the study.

Lastly, the study attempted to assess Vision Funds Microfinance Institution's Financial and Operational Performance over a period of five years. And, this may be a mile stone for other researches which may consider the entire life performance of the microfinance institution through other parameters or in comparison with other microfinance institutions.

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Appendices

Appendix A

Interview Questionnaires

A. FINANCIAL AND OPERATING SUSTAINABILITY

1. Do you have business strategy to achieve financial and operating sustainability? Explain
2. In terms of growth (profit, portfolio, and new job creation and quality services) are you customer focused?
3. In your opinion, is your organization sustainable (Financially and operationally)? How?
4. Does the operational strategy accommodate necessary business time lines (like to meet market opportunities) Please Explain?
5. Does your operational strategy maintain flexibility as achievement (like changing of market may require new product development?) Please explain?
6. What are the internal and external factors that affect your performance towards your financial and operating sustainability? Internally and Externally?

B. FINANCING SOURCES

7. Do you have quantitative risk assessment, measurement and mitigation plan?
8. What is the social mission of your organization other than making profit?
9. What are the funds sources of Vision Fund Microfinance Institution? Has it diversified its sources?

C. SAVINGS MOBILIZATION

10. What is the company strategy to be self-sufficient in capital adequacy? (hence you have donor partners)

D. INSTITUTION CAPACITY

11. Do you have staff training and engagement dep't or officer? What is your strategic plan to capacitate your staff to increase the staff performance? Do you have domestic /international training experience to your staff?
12. When we compare with other MFIs what is the unique features of VFMFI?
13. About child fund financing now this donation ceased by World Vision start from 2017 is there any impact of the sustainability of the institution?

E. LOAN PORTFOLIO

- 14.** Is the interest received on loans sufficient to cover operational costs of the institution?
How?
- 15.** What are the causes for default?
- 16.** What action do you take for non-performing loans?

Appendix B

Vision Fund Microfinance Institution S.c
Consolidated Operational Report
For the year ended 2012 to 2016

| No | Paticulars | Sex | 2012 | 2013 | 2014 | 2015 | 2016 |
|----|-------------------------------|-------|----------------|----------------|-------------|-------------|-------------|
| 1 | Number of staff | M&F | 567 | 435 | 433 | 502 | 579 |
| 2 | No of loan offer | M&F | 212 | 192 | 181 | 231 | 290 |
| 3 | No of new clients | Total | 22157 | 8311 | 11659 | 33541 | 37407 |
| 4 | Number of active client | Total | 59231 | 63024 | 55924 | 83013 | 102656 |
| 5 | Amount of loan disbursed | Total | 199,415,795.00 | 310,366,393.00 | 358336795 | 486316392 | 723036993 |
| 6 | Amount collected | Total | 129415600.7 | 247,543,823.83 | 361964866.7 | 367995328 | 620374976 |
| 7 | Loan outstanding | Total | 181075804.5 | 273,790,853.00 | 285129472 | 401503700.4 | 504165717.2 |
| 8 | Total client with outstanding | Total | 59231 | 63024 | 55924 | 83013 | 102656 |
| | | | | | | | |

Appendix C

Vision Fund Microfinance Institution S.C
Consolidated Operational Report of PAR (Delinquent)
For the year ended 2012-2106

| Days | Service | No of clients | 2012 | No of clients | 2013 | No of clients | 2014 | No of clients | 2015 | No of clients | 2016 |
|-----------------------|---------|---------------|----------------|---------------|----------------|---------------|----------------|---------------|----------------|---------------|----------------|
| Current Loans | Loan | 12,487 | 176,891,228.20 | 14,132 | 265,227,879.90 | 15,443 | 256,612,688.95 | 23,485 | 377,190,778.00 | 28,112 | 474,467,105.26 |
| 1-30 days past due | Loan | 541 | 1,739,397.50 | 661 | 3,693,007.32 | 1,066 | 10,413,785.60 | 1,132 | 10,612,044.66 | 1,127 | 6,126,869.65 |
| 31-60 days past due | Loan | 230 | 710,687.50 | 285 | 1,318,248.34 | 464 | 3,642,225.04 | 452 | 3,280,497.86 | 687 | 3,667,944.92 |
| 61-90 days past due | Loan | 156 | 373,406.20 | 218 | 1,045,552.72 | 301 | 1,680,255.67 | 286 | 1,447,124.36 | 444 | 2,298,345.11 |
| 91-120 days past due | Loan | 105 | 243,241.80 | 168 | 665,004.22 | 219 | 1,635,105.07 | 211 | 1,124,347.37 | 378 | 1,965,584.43 |
| 121-150 days past due | Loan | 95 | 213,654.20 | 127 | 479,012.18 | 227 | 1,807,402.67 | 174 | 718,626.81 | 317 | 1,940,438.56 |
| 151-180 days past due | Loan | 98 | 144,178.30 | 90 | 329,183.59 | 209 | 1,711,228.03 | 142 | 729,562.66 | 275 | 1,546,528.10 |
| >180 days past due | Loan | 351 | 760,010.80 | 324 | 1,032,964.73 | 946 | 7,626,780.97 | 1,226 | 6,400,718.67 | 2,102 | 12,152,901.14 |
| Total | | 14,063 | 181,075,804.50 | 16,005 | 273,790,853.00 | 18,875 | 285,129,472.00 | 27,108 | 401,503,700.39 | 33,442 | 504,165,717.17 |

Appendix

Vision Fund Microfinance Institution (S.C.)

Organizational structure

