

**ADDIS ABABA UNIVERSITY**  
**COLLEGE OF BUSINESS AND ECONOMICS**  
**DEPARTMENT OF PUBLIC ADMINISTRATION AND DEVELOPMENT**  
**MANAGEMENT**

**A Comparative Analysis of Credit Service Provision in Selected Private Commercial Banks versus Micro Finance Institutions in Addis Ababa: Eligibility Criteria, Prioritized Sectors and Efficiency of Service Provision**

**By**

**Tsehaye G/Michael**

**A thesis submitted to the department of Public Administration & Development Management of Addis Ababa University In Partial fulfillment of the requirement for the Degree of Masters in Public Management and Policy (MPMP)**

**October, 2018**

**Addis Ababa, Ethiopia**

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This is certify that the thesis prepared by Tsehaye G/Michael entitled “A Comparative Analysis of Credit Service Provision in Selected Commercial Banks versus Micro Finance Institutions in Addis Ababa: Eligibility Criteria, Prioritized Sectors and Efficiency of Service Provision” which is submitted in partial fulfillment of the requirements for the Degree of Masters in Public Management and Policy (MPMP), complies with the regulations of the University and meets the accepted standards with respect to originality and quality.

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## **Abstract**

The main objective of the study was to make comparisons between private commercial Banks and micro finance institutions in respect of four variables and the challenges therein. A descriptive statistical analysis technique was employed in addition to the adoption of Efficiency Matrix Model applied by Dima et.al (2016). Questionnaires were administered on a sample frame selected with purposive sampling technique rationalizing on the relevance of the samples and not their quantitative representativeness to the general population for the purpose of this specific research. Against any prior perceptions, both institutional formations exhibited more similarities when it comes to operational efficiencies and risk appetite. The study found out those stringent regulatory restrictions, capital and infrastructural challenges categorically limited the financial sector's growth ambitions amid the now familiar financial inclusion discourse. Size of the loans is to be the factor determining the depth of analysis and scrutiny. Given the visible disparity in size of the loans at Banks and MFIs, flexibility in evaluation criteria demonstrated consistent difference.

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## **Acronyms**

CGAP	Consulting Group to Assist to the Poor
EBDSN	Ethiopian Business Development Service Network
GDP	Gross Domestic Product
MFIs	Micro Finance Institution
NBE	National Bank of Ethiopia
NGO	Nongovernmental Organization

# CHAPTER ONE

## 1. Introduction

### 1.1 Background of the Study

A key component of Ethiopia's development strategy is the establishment of sustainable microfinance institutions' serving large numbers of poor people. While non-governmental organizations (NGO's) credit schemes and informal source of finance have existed in Ethiopia for many years, the government instituted a legal and policy frame work for MFI's in 1996 through proclamation 40/1996 (GebrehiwotAgeba and WoldayAmha, 2001).

These days, both number and coverage of financial institutions in specific commercial banks and microfinance institutions' exhibited tremendous increase. However both institutional formations have their own constraint in reaching the majority. Commercial banks could not address financial needs of poor households for the very fact that they are not their ultimate target clients. On top of that, the transaction costs and risks involved in serving poor households are perceived to be too high. Similarly microfinance institutions could not finance large business firms due to their financial constraint and to outreach large number of households. (Helms and Brigit, 2006)

Microfinance services were launched by Non-Governmental Organizations (NGO), with a strong welfare and relief orientation towards the poor population. They entered in to the micro credit sector to provide credit services to poor rural households and urban micro entrepreneur under programs supported by donors and international NGOs. Later, taking in to account to the non-sustainability of NGOs credit schemes, the government established legal frame work for the establishment and operation of Microfinance Institutions (MFIs). (GebrehiwotAgeba and Wolday Amha, 2004)

Financial sectors play crucial role in economic growth and industrialization via channeling funds from surplus units the depositors, to the deficit units, the borrowers, in the process gaining from the spread of different interest charged. Their intermediation role can be said catalyst for the economic growth (Funso, Kolde and Ojo, 2012). The role and importance of banks of modern economy is enormous (Bikker, 2010; Rashid, 2010; Altan, Beduk and Yusufazari, 2014) and its products/services which it provides growing in terms of depth, the number of institutions and

amount of money that managed by such institutions. The roles of such banks are paramount in developing countries like Ethiopia where the financial market is underdeveloped and non-existent

We live in world of credit. Thus it is important for everyone to know and understand the many advantages and benefits of credit, as well as the possible limitations arising from the use of credit. With such knowledge and experience, we are in a position to use credit more wisely (Robert H. Cole, 1992)

Therefore, studying credit service efficiency standards and achievements at different financial institutional formations i.e. commercial banks and microfinance institutions will help to draw some strong experience to be adopted by the other financial institution with contextualizing the internal realities and may close the knowledge gap exists on customers.

## **1.2 Statement of the Problem**

The financial institutions performance is perceived as the replica of economic activities of the economy. The stage of development of the banking industry is a good reflection of the development of the economy (Misra and Aspal, 2013).

Successful microfinance institutions must reach large number of clients and become financially self-sufficient. Central purpose of micro finance is to provide large numbers of very poor people with access to quality financial services. To do so financial self-sufficiency is very important. Being self-sufficient is the only way for financial institutions to grow. With the objective of mobilizing resources and enhancing investments, financial institutions have irreplaceable roles in economic development of a country. Being one and may be category of financial institutions, banks have a very determinant role in the healthy functioning of the economy.

Though the number and coverage of financial institutions have been increased in the country, there is still unsatisfied financial demand in the market. (NBE Annual Report, 2016/17) Besides, there are many citizens in the country who have no clear idea in financing operational differences between those two types of financial institutions.

The two financial institution formations found in Ethiopia are assumed to have their own structure and lending procedure. However, apart from their capital (financial) formation both institutions

have their own place in terms of prioritized sector, understanding the client, and designing appropriate products, manage risk to the institution and enhance value to the client, keeping administrative costs low and charging market based interest rates. These issues depend on one way or another on operational efficiency of the financial institutions and vice versa.

The lending service in two selected private commercial banks and two selected microfinance institutions will be compared by taking evidences from the concerned staffs of different positions of the institutions. Evaluation in comparison to the financial institutions is an effective measure and indicator to the gap where correcting measure is required. Therefore, the research will answer the under mentioned research questions and will help to the institutions to identify efficiency matter weakness areas and to work against. Better operational efficiency is a major factor for reasonableness of the service charge and sustainability of the service in the future.

### **1.3 Objective of the Study**

#### **1.3.1 Research Questions**

- What are the differences and similarities in eligible criteria adopted by Commercial Banks and Micro Finance Institutions in providing credit services?
- What are the prioritized business ventures favored by Commercial Banks and micro Finance Institutions?
- Which of the two financial institutions (i.e. Commercial banks and Micro Finance Institutions) can provide more efficient credit services to customers?
- What are the measures taken by these two institutions (Commercial banks and Micro Finance Institutions) to improve the efficiency of credit service provision to their customers?

### **1.3.2 General Objective**

The overall objective of the study is to compare credit service provision in selected Private Commercial Banks and Micro Finance Institutions in Addis Ababa in terms of eligibility criteria, prioritized sectors and efficiency of service provision.

### **1.3.3 Specific Objective**

- To compare specific similarities and differences in terms of eligibility criteria applied at those financial institutions.
- To compare prioritized business ventures or business areas at the financial institutions i.e Commercial banks and Micro Finance Institutions.
- To compare the degree of service efficiency at those financial institutions and applied correcting measures
- To compare capability of the financial institutions from different aspects that helps an institution to be more efficient and challenges faced during operating their business.

### **1.4 Significance of the Study**

The finding of the study provides relevant information to both the stockholders and the stake holders on the areas of their performance which needs improvement when compared to one another.

It has also try to show the real operational boundary between the two financial institutions beyond their capital structure mainly in credit operation. Furthermore, it gives insight about the current situations and operational performance of the two financial institutions to the regulatory body, shareholders, investors and managers.

### **1.5 Scope of the Study**

The research is limited to cover comparison on credit activity performance in two selected private commercial banks (United Bank Share Company and Addis International Bank Share Company) and two selected micro finance institutions (Addis Credit and Saving Lideta sub city and Nisir

Microfinance). However, there are about 18 commercial banks in the town and 35 microfinance institutions in the country by the end of June 30, 2017. (NBE report, 2016/17)

Therefore, all the decisions on the number of representing financial institutions and sample size are made considering time and budget constraint has been faced.

## **1.6 Ethical Consideration**

The information collected from the research samples (concerned staffs) is kept highly confidential. Besides, great effort has been exerted to minimize leading (push to bias) kind of questions up on preparing the questionnaire. Moreover, no positive or negative reinforcing approaches are used to gather the information.

## **1.7 Organization of the Study**

In Chapter 1, it describes about commercial banks and microfinance institutions significance in economic development. Then, the research problem and formulate the problem statement, research objectives, and research questions are described. Lastly, significance of the study is discussed. This chapter includes a description of the research design, chosen data collection methods, sampling design, research instrument and method of data analysis.

In Chapter 2, a review of the past studies concerning the area of this research which include a detailed explanation in the area of both commercial bank and microfinance institutions credit service. Why efficiency is fundamental for both institutional formations.

In chapter 3, this chapter includes a description of the research design, chosen data collection methods, sampling design, research instrument and method of data analysis.

In Chapter 4, a series of analyses of the data collected are included. Descriptive analysis consists of respondent's demographic profile and frequency.

Chapter 5 comprises a summary of the statistical analysis, discussion of major findings and lastly some recommendations are provided.

## **CHAPTER TWO**

### **2. Literature Review**

#### **2.1 Banking**

It was in 1905 that the first bank, the “Bank of Abyssinia”, was established based on the agreement signed between the Ethiopian Government and the National Bank of Egypt, which was owned by the British. Its capital was 1 million shillings. (Fasil and Merhatibeb, 2012) According to the agreement, the bank was allowed to engage in commercial banking (selling shares, accepting deposits and effecting payments in cheques) and to issue currency notes. The agreement prevented the establishment of any other bank in Ethiopia, thus giving monopoly right to the Bank of Abyssinia. The Bank, which started operation a year after its establishment agreement was signed, opened branches in Harar, Dire Dawa, Gore and Dembi- Dolo as well as an agency office in Gambela and a transit office in Djibouti. Apart from serving foreigners residing in Ethiopia, and holding government accounts, it could not attract deposits from Ethiopian nationals who were not familiar with banking services. (Fasil and Merhatibeb, 2012)

Currently there are about 18 commercial banks operating in the country out of which 16 banks are privately owned and the remaining two are state owned. Besides due to the recently communicated requirement of National Bank of Ethiopia (NBE) to work on increasing numbers of their branches by all commercial banks for deposit mobilization purpose the number shows tremendous increase.

The Ethiopian financial sector has remained safe and sound besides being well capitalized and profitable. Commercial banks have opened 956 new branches in 2016/17 alone, which raised the total number of branches to 4,257 from 3,301 a year ago. Banks have also increased their deposit mobilization (by 29.8 percent), loan collection (by 25.9 percent) and loan disbursement (by 23.8 percent). Their non-performing loan was within the required level. Similarly, insurance companies and microfinance institutions have scaled up their services by expanding their network and product diversification. Capital goods finance companies have also stepped up their operation and there are visible signs of improvement. (NBE Annual Report, 2016/17)

It is strongly believed and stated in banking literatures that ownership and structure matters in the performance of the banking sector; in particular, government ownership of banks is argued to be

less efficient than private ownership (Bonin, 1998). Moreover, according to Boubakri (2002) excessive private ownership may limit access to credit to many parts of the society. Banks play a key role in improving economic efficiency by channeling funds from resource surplus unit to those with better productive investment opportunities. Banks also play key role in trade and payment system by significantly reducing transaction costs and increasing convenience (NCA, 2006). In less monetized countries, like Ethiopia, whilst financial sector is dominated by banking industry, effective and efficient functioning of MFI's has significant role in accelerating economic growth. ( GebrehiwotAgeba and WoldayAmha, 2001)

A first consideration relating to bank performance concerns the concepts of risk and diversification. Shareholders balance their appetite for maximizing expected profits and minimizing costs with the amount of risk they are willing to take. Abstracting from speculative motives, shareholders are generally assumed to be indifferent to the distribution of profits, receiving a return on their investment in the bank either through an increase in the bank's share price or through dividends received. If all banks share the same risk-return preferences, or if the risk-return relationship can be described by some relatively simple homothetic continuous function, then there is no serious problem with the fact that we do not know how to control for a bank's risk preferences.(Hughes et al., 2000)

This is different, however, in a situation where some banks are highly risk-averse and not well diversified. Such banks have different preferences, forego high-risk, high-return opportunities and optimize towards an altogether different maximum performance. (De Young et al., 2001)

New products come about due to new innovations, which are driven by the urge to realize more profits. This leads to the innovation of personal loans that were a fairly new phenomenon in the Banking industry. A review of the latter day innovations on development and improvements of the personal loan products would lead to determination of the factors influencing performance in the banking industry.

Attitude towards success and profit making intentions is to try what used to be very difficult to obtain (Bagozzi et al, 1992) such that even the banking industry is being offered in the streets through personal selling by bank employees to accelerate growth. The literature available and reviewed was based on research carried out in Europe and Asia. The "persistence of profits" theory

takes its formal name from Mueller's (1990) compilation of several studies from different countries. The process of competition involves the need to study the dynamics of companies' profits, since profits are generated in the process of competition.

When thinking about profits above norm, it usually leads to think about monopolies. Monopolies are viewed as the antithesis of competition because of the malfunctions and misallocation often attributed to the existence of few buyers or sellers. So, the ideas of monopoly and competition do not match well. But, and according to the theory of "persistence of profits" monopolistic attributes are present in many firms and industries not meaning that they are not in perfect competition.

Competition takes the form not of lower prices for an existing set of products but of new improved ideas, and these in turn are property of the individuals who created them and his/her/their employers" (Muller, 1990). Competition for a new product is competition for a newly created monopoly. With time, the monopoly disappears as other firms imitate and improve upon the new product.

Recent years have been marked by a shift in theory and empirical evidence on the effect of competition on bank soundness. While the earlier literature points predominately towards a negative trade-off between competition and bank soundness (e.g., Keeley, 1990; Hellmann, Murdock, and Stiglitz, 2000; Hauswald and Marquez, 2006), recent theory and evidence suggest a positive link between the two (Koskela and Stenbacka, 2000)

Industrial organization literature indicates that competition increases efficiency of firms (e.g., Tirole, 1998). At the same time, the banking literature suggests that more efficient banks have better screening and monitoring procedures in place, and are consequently less likely to suffer from non-performing loans (e.g., Petersen and Rajan, 1995; Berger and DeYoung, 1997; Williams, 2004). Based on these arguments, we see that efficiency could be the conduit through which competition makes banks more financially sound. The correct identification of the underlying transmission mechanism by which competition translates into bank soundness has important bearing for safety and soundness regulation.

First, uncovering the primary transmission channel allows focusing regulatory and supervisory actions more precisely. Second, policymakers will obtain feedback on i) how changes in the

regulatory environment affect bank efficiency, and ii) on how efficiency affects bank soundness. Third, the findings from our analyses may indicate possible directions for future policymaking regarding competition in banking.

Study by Goodhart et al. (1998), reveals a rapid structural change in financial markets spurred by the acceleration in financial innovation and further questions the capacity of existing specialized regulators because: The financial activities have become increasingly complex, as evidenced by the emergence of financial conglomerates. The question is whether a series of agencies supervising parts of a complex financial institution can have a good grasp of developments taking place in the institution as a whole.

According to Abraham and Taylor (2000) an effective financial Regulation should be based on the following seven key principles: Clear Objectives – The regulator should have a clear mandate set out in its enabling legislation. Independence and Accountability - Decisions by the regulator within its sub-sector should not be subject to undue influence from the Minister or any other parties. The principal officer and top management should have an element of security of tenure or at least clear rules governing their removal. Similarly, their recruitment should be done transparently and competitively and their remuneration should not be significantly discordant with that of senior officials in the regulated entities. In addition, there must be a mechanism for the regulator to be held accountable by the regulated industry while avoiding regulatory capture by the industry. Adequate Resources - The regulator must have adequate funding. Adequate resources are a prerequisite to enable the regulator recruit, train and retain a cadre of experienced professional staff. In addition, the regulator requires resources for timely and effective data collection and processing. Effective Enforcement Powers – The regulator must be able to take enforcement measures against all the players that it is required to regulate. These powers should include, powers to: (a) Require information to be provided; (b) Assess probity of owners and managers of regulated entities; (c) Inspect the operations of regulated entities; (d) Intervene in operations of regulated entities including removal of managers; (e) Revoke licenses or registration; and, (f) Sanction entities or individuals

Comprehensiveness of Regulation –Regulation should clearly be comprehensive and not leave any unregulated areas, so called regulatory gaps. Also, this requires regulators to have some flexibility

to respond to innovations which may result in new products which were not envisaged at the time of establishment of the regulatory structure.

Cost-Efficient Regulation – The direct cost of regulation in terms of levies and fees should clearly be reasonable and not an undue burden on the regulated institutions.

Market Developments and Industry Structure - Regulatory structure should mirror the sectors being regulated. Different countries have different industry structures and each country should seek to have a regulatory structure tailored to this other than attempting a one-size-fits-all structure or borrowing those in other countries.

## **2.2 Microfinance Institutions**

Over the past centuries, practical visionaries, from the Franciscan monks who founded the community-oriented pawnshops of the 15th century to the founders of the European credit union movement in the 19th century (such as Friedrich Wilhelm Raiffeisen) and the founders of the microcredit movement in the 1970s (such as Muhammad Yunus and Al Whittaker), have tested practices and built institutions designed to bring the kinds of opportunities and risk-management tools that financial services can provide to the doorsteps of poor people. (Helms, Brigit, 2006).

The history of micro financing can be traced back as far as the middle of the 1800s, when the theorist Lysander Spooner was writing about the benefits of small credits to entrepreneurs and farmers as a way of getting the people out of poverty. Independently of Spooner, Friedrich Wilhelm Raiffeisen founded the first cooperative lending banks to support farmers in rural Germany. (Helms, Brigit, 2006)

The modern use of the expression "micro financing" has roots in the 1970s when organizations, such as Grameen Bank of Bangladesh with the microfinance pioneer Muhammad Yunus, were starting and shaping the modern industry of micro financing. Another pioneer in this sector is Akhtar Hameed Khan. (Helms, Brigit, 2006)

Access to finance by poor households in Ethiopia is primarily through informal systems; including money lenders, traders, friends, relatives, edirs and equibs (informal group based savings and credit association).

Non-Governmental Organization (NGO) credit schemes and informal sources of finance have existed in Ethiopia for many years, the government instituted a legal and policy framework for MFIs in 1996 through proclamation 40/1996 (Gebrehiwot Ageba, Wolday Amha, 2004). Since then, 35 MFIs have registered with the National Bank of Ethiopia and operate under the auspices of this proclamation. (NBE web site)

Microfinance is the category of financial services offered to lower income people, where the unit size of the transaction is usually small (“micro”), typically lower than the average GDP per capita, although the exact definition varies by country. Starting in the 1970s, well-known pioneers, such as Grameen Bank in Bangladesh and ACCION in Latin America, demonstrated that poor people can be creditworthy. Today, microfinance covers the full range of financial services\_ credit, savings, remittances, insurance, and leasing among others. These are increasingly provided by the diverse set of financial service providers.

The commercial opportunity in microfinance is catching the interest of main stream banking. The February 2005 issue of the banker carried a special feature on microfinance. The editorial of this issue stated “Bankers are only just realizing that poor have needs just like anyone else and that giving them the opportunity to help themselves not only works, but can open up the global financial markets to an entirely new customer market and asset class” (Jennifer Iserh, Lead Microfinance Specialist, CGAP; and David Poteous Consultant)

Microfinance has been an important tool in poverty alleviation, empowerment of women and in bringing about financial inclusion. These institutions have faced a lot of issues about its performance and sustainability. Microfinance institutions have been viewed as an important tool in poverty alleviation and financial inclusion. It is an important sector which would improve the living conditions of the poor and lead to the development of the country. Some of the issues faced by microfinance institutions include high interest rates, multiple lending, and coercive method of recovery and lack of transparency.

The MFI incur high operating costs because of their business model which is the door step service delivery model. They incur these costs because of training of staff and small loan sizes. These higher operational costs are the major reasons for higher interest rates of the MFIs. These operating costs could be reduced by the use of technology. The borrowers being low income rural population

are often uneducated and it is required for the microfinance institutions to educate the borrowers. Educating the borrowers is important for the microfinance institutions in order to enhance their outreach. Service centers should set up banks in the rural areas to improve the outreach of microfinance services.

Establishment of sustainable microfinance institution serving large number of people is one of key components of Ethiopia's development strategy. The objective of MFIs is quite similar across organizations. They focus on reducing poverty and vulnerability of poor households by increasing agricultural productivity and incomes, diversifying off farm source of incomes, and building household asset. They seek to achieve these objectives by expanding access to financial services through large and sustainable microfinance institutions. (GebrehiwotAgeba and WoldayAmha, 2001)

Proclamation 40/1996 further spells out a supervisory role for NBE's Microfinance Supervision Division in approving managing directors and renewing MFI license to operate on annual basis.

Government play an important role in the development of financial systems designed to offer services to the poor. This in turn has an impact on the activities of the commercial banks and MFIs that provide those services. Experience demonstrated that this role can be constructive in some cases but counterproductive in others. This unit is still young and the IFAD project includes a substantial component to build the capacity of the unit through staff training, the formulation of procedures and manuals, and the development of a sound framework for external audit that complements the supervision function. The proclamation is amended through directives. Several new directives are expected to come in to effect any day and which will provide more flexibility in loan size, repayment terms, and forms of collateral and lending methodologies. This is a profound change and will contribute to the development of more demand driven and market oriented approach than has been possible in the past. Other directives will ensure lower levels of liquidity risk and ensure the safety of deposits through equity capital requirement.

Though research on microfinance institutions is plenty they are restricted mainly to financial performance, outreach and loan repayment aspect. Even their comparisons are also done on these aspects (Besely and Coate, 2001)

However, microfinance institutions can also be looked upon as service organizations providing financial services to the rural and urban poor section of the society. But, there is scant research as per existing literature, on the aspect of end-users satisfaction level of MFI's least research being found on specific analysis of service performance based on satisfaction of recipients of microfinance i.e the poor section of the society. This aspect is very important as there is ample evidence in service management and marketing literature that customer satisfaction leads to better performance (Morgan and Rego, 2006).

Microfinance in Ethiopia has been described as both fascinating and frustrating. Fascinating because of the scale, disciplined, and entrepreneurial way the industry has developed with limited outside influence. Frustrating because of the governance and ownership issues that are difficult to pin down and reconcile in relation to industry defined good practice. Other issues relate to portfolio risks associated with agricultural loans, capacity building challenges, and the need for more diversified products and services. (Gebrehiwot Ageba and WoldayAmha, 2001)

MFI governance can be defined as a system that links the shareholders to the board, the management, the staff, clients, and the community at large.

In regarding to the capacity issue, the IFAD appraisal report found weaknesses in financial system, MIS system, business planning, human resource management, governance issues, regulation and supervision issues and a need for product diversification.

Ethiopian MFIs are in the enviable position of being able to draw on considerable worldwide experience and expertise in MFI system development (not without pain). The challenge will be adapting this experience to Ethiopia and building local capacity to deliver high quality and effective training and technical assistance.

## **2.3 Regulation and Supervision**

**Legal Reserve Requirement;** - In many developing countries, legal reserves on deposits are extremely high, discouraging deposit mobilization. Banks are less likely to utilize their own scarce funds, for microenterprise programs in this environment.

**Reporting Requirement:** - Bank regulatory and supervisory authorities generally require frequent and detailed reports from commercial banks. These reporting requirements were originally designed for institutions with fewer, larger transactions. Because microfinance programs tend to have thousands of loans, reporting data on each loan is costly and impractical

**Loan Classification and Provisioning:-** In most countries, authorities require that banks establishment reserves based on the quality of their loan portfolio. ( Gebrehiwot Ageba and Wolday Amha, 2001)

Key Principles of Microfinance Institutions Endorsed by the G8 Sea Island Summit 2004 (CGAP)

1. The poor need variety of financial services, not just loans. Just like everyone else, poor people need wide range of financial services that are convenient, flexible, and reasonably priced. Depending on their circumstances, poor people need not only credit, but also savings, cash transfers, and insurance.
2. Microfinance is a powerful instrument against poverty access to sustainable financial services enables the poor to increase incomes, build assets, and reduce their vulnerability to external shocks. Microfinance allows poor households to move from every day survival to planning for the future, investing in better nutrition, improved living conditions, and children's health and education.
3. Microfinance means building financial systems that serve the poor. Poor people constitute the vast majority of the population in most developing countries. Yet, an overwhelming number of the poor continue to lack access to basic financial services. In many countries, microfinance continues to be seen as a marginal sector and primary development concern for donors, governments, and socially- responsible investors. In order to achieve its full

potential of reaching a large number of the poor, microfinance should become an integral part of the financial sector.

4. Financial sustainability is necessary to reach significant numbers of poor people. Most poor people are not able to access financial services because of lack of strong retail financial intermediaries. Building financially sustainable institutions is not an end in itself. It is the only way to reach significant scale and impact far beyond what donor agencies can fund. Sustainability to financial provision services to the poor. Achieving financial sustainability means reducing transaction costs, offering better products and services that meet client needs, and finding new ways to reach the unbanked poor.
5. Microfinance is about building permanent local financial institutions. Building financial systems for the poor, means building sound domestic financial intermediaries that can provide financial services to the poor people on a permanent basis. Such institutions should be able to mobilize and recycle domestic savings, extend credit and provide a range of services. Dependence on funding from donors and government including government financed development banks will gradually diminish as local financial institutions and private capital markets mature.
6. Microcredit is not always the answer: - microcredit is not appropriate for every one or every situation. The destitute and hungry that have no income or means of repayment need other forms of support before they can make use of loans. In many cases, small grants, infrastructure improvements, employment and training programs and other tools for poverty alleviation. Whenever possible, such non-financial services may be more appropriate tools for poverty alleviation. Wherever possible, such non-financial services should be coupled with building savings.
7. Interest rate ceilings can damage poor people's access to financial services. It costs such 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 and their costs and their growth and sustainability will be limited by the scarce and uncertain supply of subsidized funding. When governments regulate interest rates, they usually set them at levels too low to permit sustainable microcredit. At the same time, micro lenders

should not pass on operational inefficiencies to clients in the form of prices (interest rates and other fees) that are far higher than they need.

8. The government role is as an enabler, not as a direct provider of financial services. National governments play an important role in setting a supportive policy environment that stimulates the development of financial services while protecting poor people's savings. The key thing that government can do for microfinance are to maintain macroeconomic stability, avoid interest rate caps, and refrain from destroying the market with unsustainable subsidized and high delinquency loan programs. Governments can also support financial services for the poor by improving access to markets infrastructure. In special situations, government funding for sound and independent microfinance institutions may be warranted when other funds are lacking.
9. Donor subsidies should complement, not compete with private sector capital. Donors should use appropriate grant, loan and equity instruments on a temporary basis to build the institutional capacity of financial providers, develop supporting infrastructure (like rating agencies, credit bureaus, audit capacity, etc), and support experimental services and products. In some cases, longer term donor subsidies may be required to reach sparsely populated and otherwise difficult to reach populations. To be effective, donor funding must seek to integrate financial services for the poor in to local financial markets: apply specialist require that financial institutions and other partners meet minimum performance standards as a conditional for continued support: and plan for exit from the outset.
10. The lack of institutional and human capacity is the key constraint. Microfinance is a specialized field that combines banking with social goals, and capacity needs to be built at all levels, from financial institutions through the regulatory and supervisory bodies and information systems, to government development entities and donor agencies. Most investments in the sector, both public and private, should focus on this capacity building.
11. The importance of financial and outreach transparency. Accurate, standardized and comparable information on the financial and social performance of financial institutions providing services to the poor is imperative. Bank supervisors and regulators, and more

importantly, the poor who are clients of microfinance need this information to adequately assess risk and return.

Operational efficiency is defined as the capability of an institution to deliver products and/or services to its customers in the most cost-effective manner possible while ensuring that the quality of its products services and processes remain high. The reduced internal costs that result from improved operational efficiency can enable an institution to strengthen its market position and/or extend its services to additional, otherwise unprofitable target groups and regions, and/or achieve higher profit margins or lower prices. . (Dima, Taytana, Dolgaya, Till and Michael, 2016)

The continued commercialization of the microfinance industry and the market forces it has unleashed are powerfully impacting the field and the priorities of the relevant players. More specifically, increased competition, discriminating customers, growth and institutional development demands, regulation and donor fatigue are placing new pressures on MFIs. The number of institutions serving the once-neglected microfinance market is increasing, as is the quantity and sophistication of clients served. Neither competitors nor knowledgeable customers tolerate complacency. Hence MFIs must better leverage their scarce resources to survive let alone succeed. This pressure is particularly acute for MFIs operating in market sectors that are highly competitive or particularly challenging to reach such as poorer clients or rural areas (Brand and Gerschick, 2000).

Credit risk: Quality of the portfolio as an indicator of credit risk measures how well the MFI are collecting their loans. A loan is considered to be at risk if the payment on it is more than 30 days late and therefore has a risk of not being repaid. This will have an effect on the earnings of the MFIs, and therefore it may also have a negative effect on the performance (CGAP, 2006; Mersland, 2011). Janner (2012) too, indicated that portfolio quality has a negatively significant effect on sustainability signaling that sustainability will decrease due to a marginal increase in portfolio at risk. Gwasi and Ngambi(2014) predicted indeterminate result to their hypothesis that performance can be explained by MFIs specific factors and found evidence to support that increased exposure to credit risk is associated with lower MFI sustainability, given that credit granting is the principal source of revenue for these institutions. According to them this negative relationship attests that a higher portfolio at risk would block good financial results. This finding is consistent with Peter

(2012), Richman and Aseidu (2012), Soltane (2012) which identified credit risk as the biggest risk faced by the MFIs globally.

## **2.4 Efficiency is a Precondition for Sustainable Institutional Growth**

In the years leading up to the global financial crisis, many microfinance institutions experienced rapid growth. In this context, portfolio performance indicators often remained excellent, hiding deeper seated structural problems. When the crisis hit, it soon became apparent that some of the boats lifted by the rising economic tide were actually leaking money at an astonishingly high rate. The dominant focus on pursuing rapid growth had often relegated efficiency considerations to a back seat, and once the tide turned, many banks found that they could no longer cover their high operational costs.

Many banks reacted by going to the other extreme. They hastily implemented radical cost cutting measures that negatively affected other aspects of their operations, or they cut back the scale and scope of their services, achieving short-term cost reductions but compromising their longer-term potential for growth. Other banks secured additional external funding to keep the boat afloat, a temporary measure that left the underlying inefficiencies untouched. Investors and banks need to pay continuous and consistent attention to operational efficiency, in good years and in bad years, to ensure that such harmful dynamics give way to trajectories of healthy, long-term, sustainable institutional growth.(Dima, Taytana, Till and Michael 2016)

## **2.5 Efficiency is Precondition for Broadening and Deepening Financial Inclusion**

Microfinance has done an amazing job at giving millions of poor people around the world access to formal financial services. Now that many markets have matured, most low hanging fruit has been picked. At the same time hundreds of millions of people around the world, most of them living in rural areas, still lack access to formal financial services. Many others have only access to a narrow range of services; for example, they may not be able to open savings accounts. Banks will only be able to deliver a broader range of products and services, increase their rural presence and deepen their outreach to underserved client groups, e.g. smallholders, if they keep reducing their operating costs. (Dima, Taytana, Till and Michael 2016).

## **2.6 Efficiency may Help to Make Credit more Affordable for the Poor**

While there is no academic consensus on the drivers of microfinance interest rates, the 2013 CGAP study (see also above) pointed out that over half of the average 27% in annual interest paid by microfinance clients goes towards covering lending institutions' operating expenses. Operating expenses are a stronger driver of high interest rates than the cost of capital, loan losses, and institutions' profit combined, as the chart below illustrates.(Dima, Taytana, Till and Michael 2016)

As per the research report issued by Ethiopian Business Development Service Network (EBDSN) in 2004 under the title Loan Conditions of Commercial Banks and Micro Finance Institutions in Ethiopia the following are identified as required documents and eligible criteria for loan processing in the financial institutions.

## **2.7 General Documents Required by the Banks from Customers During Loan Request**

Written application that clearly indicates, among others, the amount and purpose of the loan requested, license as appropriate, financial statements (audited as necessary) , business plan, project feasibility study (for new projects), an ownership certificate for assets or merchandise offered as collateral, memorandum and articles of association (for legally established companies), NegaritGazetta, power of attorney (for agents), management profile, official letter of consent from the board of management (where applicable), authority to conclude loan contract (for companies not specified in their Articles of Association).

Any person or enterprise engaged in the following sectors is eligible for the services: domestic trade, foreign trade, factories, services, transport, mining, construction, agriculture, hotel and tourism.

**The eligible criteria and business sectors considered at microfinance institutions are:**

Permanent residence in the City, should engage in micro and small enterprise activities, unemployed youth and women with strong commitment and potential for self-employment, willingness and full commitment to engage in income generating activities, willingness to be organized into credit group and take loans through group collateral, he/she should be above 18 years of age (working age).

**Buying and selling activities such as:**

Grain and cereal selling § Street vending, dairy product selling, poultry products selling, selling of readymade and cultural cloth, shoes, plastic sheets, household utensil, traditional food and drinks, newspapers, books and lottery vending, firewood selling, spice selling, selling of electronic equipment, and many others

**Services**

Hair dressing/beauty salons and barbers, tailoring, small restaurants, plumbing and maintenance of electronic equipment and shoes, cloth washing, mechanics, and cart transport.

**Handicraft and production activities**

Embroidery, wood and metal works, weaving, leather and bamboo craft, gold and silver smiting, paper bag production, candle production, and stove making.

**Empirical Review**

Most researches conducted in the area are concentrated on financial performance of those institutions. However, BFC (Business and Finance Consulting) has conducted a research on Potential for Cost-Reducing and Efficiency-Increasing Measures in Financial Institutions in the year Dec, 2015 using efficiency matrix and for the purpose six commercial banks across the world were chosen and the following results were found.

The study identifies and discusses four factors that can drive lenders to address operational efficiency challenges:

- Earnings pressure
- Outreach pressure
- Escalating payroll costs
- Competition on service quality

The main driving force for change in the case study banks has been earnings pressure. For example, when a micro-lender transforms into a fully functioning bank and takes on new commercially minded investors in the process, the earnings pressure becomes more acute due to these investors' demands for higher profits. This happened in the case of BaiTushum in Kyrgyzstan that was motivated to improve its earnings by optimizing its lending processes and centralizing some functions in the process of transformation into a full-service bank, when it took on commercial investors with higher growth and profitability expectations. An extreme form of earning pressure occurs when low or negative earnings threaten the viability of an institution, management is forced to take action to ensure institutional survival. Such existential threats usually result from unmanaged costs that increase faster than income. Another strong motivator for change is outreach pressure, which occurs when inefficient operations serve as a barrier to geographical expansion, the targeting of new customer segments, or the addition of new product lines such as agricultural loans. Three of our case study banks adopted a range of innovations designed to overcome the outreach challenges generated by the specific operating environments of Madagascar, DRC, and Mozambique. For example, Access Bank of Madagascar used a combination of mini-branches, agricultural input and machinery supplier partnerships, and its own agricultural warehouses (for warehouse lending) to reach farmers that could not be viably reached through a standard branch model.

High costs of skilled staff can also drive efficiency improvements. A rise in labor-related costs can spur banks to seek ways to reduce staffing levels, often by simplifying, streamlining and automating processes. Low efficiency in banks often translates into lower service quality for their clients, forcing them to navigate excessive red tape, make multiple visits to branches, or endure long waiting periods. Conversely, when banks take action to improve their service quality in order to

attract new clients or retain more existing ones, they frequently improve their own efficiency in the process.

Despite the fact that operating costs are a major component of the interest rates paid by clients of microfinance institutions, operational efficiency only raised more interest in the industry after the global financial crisis of 2008. The microfinance industry, along with other financial institutions, suffered from growth in non-performing loans, a drop in earnings, and a loss of investor appetite from abroad, which finally forced some of them to start rethinking their operating models. Today, as the global financial sector stabilizes, the notion of change is declining in intensity. While competition and environmental factors will continue to provide some incentive for financial institutions' management to change, it will be up to investors, boards of directors, and other stakeholders to provide additional motivation for efficiency improvement. To do this, all stakeholders involved need a framework to measure efficiency which is not purely based on simple numerical ratios, but is balanced with assessments of process efficiency, organizational effectiveness and other more qualitative type of indicators. Only with the holistic approach of identifying and approaching inefficiencies along the lines presented in this report can the mission of microfinance be achieved in a sustainable manner. (Dima, Taytana, Till and Michael 2016)

Empirical analysis of global MFI performance shows that loan size is the strongest determinant of efficiency performance. (Mix market 2011) While arguments for measuring efficiency based on the number of customers have been made within the microfinance community, these make the most sense in a financial inclusion context; whereas asset and income based ratios make more sense in a financial performance context. A simple way to improve operational efficiency metrics is for microfinance providers to increase the size of loans, not least because efficiency is most frequently measured in relation to income and the size of the loan portfolio, disregarding the number of customers served. (Mix market 2011)

As per the research on potential for cost-reducing and efficiency-increasing measures in financial institutions six categories of methods that present financial institutions with opportunities to increase operational efficiency. These are:

- **Value proposition changes** — changing an institution’s business model to serve more profitable customer segments, offer less labor-intensive products, and/or exclude riskier clients
- **Organizational structure optimization** — streamlining procedures to eliminate redundancies and bottlenecks
- **Process optimization** — removing steps in processes that do not add value and automating other steps
- **Technology implementation** — a well-directed use of technology for driving customer self-service for routine transactions
- **Alternative delivery channels** — reduce the cost of routine transactions by moving them outside branches to other channels such as agent banking and mobile branches
- **Company culture** — empowering employees to regularly suggest and implement small improvements

The consultants found considerable scope for efficiency improvements in all case study banks. This may appear surprising at first glance, but as they have argued further above, inefficiencies accumulate naturally as institutions and their environments evolve. Thus, improving operational efficiency is an open ended undertaking: a bank that optimizes its efficiency today may have to recalibrate its systems again tomorrow to operate efficiently as organizational, market, or regulatory contexts change. Optimizing efficiency means continually adapting an institution to ever-evolving internal and external environments. (Dima, Taytana, Till and Michael 2016)

## **CHAPTER THREE**

### **3. Methodology**

The research mainly focuses on comparing credit service activities in two selected private commercial banks (United bank Share Company and Addis International Bank Share Company) and other two microfinance institutions (Addis Credit and SavingLideta Sub City and Nisir Microfinance). In doing so, both quantitative and qualitative data is used. The information has been collected from their respective concerned personnel using well-designed questionnaire.

To address the issue, descriptive methodology has been used to compare private commercial banks and microfinance intuitions credit activity. For the study, both primary and secondary data is used. The secondary data include different written documents of the institutions like credit policy and procedure and research reports of other individuals in the area. In the data presentation tabulation, percentages and means are used.

This section describes the method applied in carrying out the study. It includes the research design, target population, sampling technique, instruments of data collection and data analysis.

#### **3.1 Research Design**

This paper has used descriptive research design to explain the differences and relationship in terms of service efficiency, priority sectors and eligible criteria between private commercial banks and microfinance institutions. The study has attempted to identify the similarity and differences among commercial banks and microfinance institutions credit service efficiency.

Efficiency matrix model applied by Dima Cazacu, Tatyana Dolgaya, Till Brucker, Michael Kortebusch (May, 2016) up on studying Potential for Cost Reducing and Efficiency Increasing Measures in Financial Institutions on six international banks has been adopted and applied as major evaluating criteria which affects efficiency of the financial institutions.

#### **3.2 Target Population**

Most problems that we encounter in business will have a unique population of affected entities. These could be individuals such as employees, managers, general stakeholders, etc, or even

inanimate in nature, such as organizations, business sectors, countries, and departments in companies. We usually cannot collect data from all of these members due to financial cost, time taken, a multitude of other reasons.

However, provided we take a sufficiently large sample, i.e. a subset from the population, we can usually make quantifiable predictions of the properties of interest in the population by using statistical techniques. If the sampling approach used is appropriate, and the sample obtained is sufficiently large, this is usually accurate enough for our purposes.

Sampling, thus, can be understood as a process of selecting samples from a group or population to become the foundation for estimating and predicting the outcome of the population as well as to detect the unknown piece of information. The objective of selecting a sample is to achieve maximum accuracy in our estimation within a given sample size and to avoid bias in the selection of the sample. This is important as bias can attack the integrity of facts and jeopardize the outcome of a research.

Hence, purposive sampling method is adopted since the relevance of the samples and not their quantitative representativeness to the general population is more important for this specific research. Accordingly, employees of the selected institutions who are directly involved in credit operations – notably appraisal and approval – are selected all along the credit hierarchy of the selected institutions. Thus, Branch managers, Loan Supervisors & Loan Clerks working at Branches and Customer Relationship Officers working at head office of the two selected commercial banks (United Bank Share Company and Addis International Bank) and the other selected two Microfinance Institutions (Addis Credit and Saving and Nisir Microfinance) staffs who have credit related job title and working in the area.

### **3.3 Sample Size and Data Collection Techniques**

#### **Sample Size**

In addition to the purpose of the study and population size, three criteria usually will need to be specified to determine the appropriate sample size: the level of precision, the level of confidence or risk, and the degree of variability in the attributes being measured (Miaoulis and Michener, 1976)

Purposive sampling is used to select the sample from the population as it allows the researcher to study a certain cultural domain with knowledgeable experts within. In order to ensure an adequate sample to conduct the analyses in this study, the sample size were 93 out of which 9 are not collected and 7 rejected because were not filled properly and the remaining 77 are considered.

#### **Data Collection Techniques**

Well-designed questionnaires are used to collect data and administered to the selected sample respondents. It contains majorly close ended questions and very few open ended questions. A likert scale model is used to evaluate efficiency factors, measures taken by the institutions and challenges affecting operational efficiency. The questionnaires are hand delivered to the respondents.

The drop-and-pick method of distribution is used to administer the research instrument, because of the need to collect detailed and well thought out responses. The method will offer the respondents time and privacy to fill in the questionnaire at their convenience.

### **3.4 Data Analysis**

Both quantitative and qualitative techniques of data analysis are applied. The data from the questionnaires are coded and the response on each item put into specific main themes. Collected data are coded and analyzed using Statistical Packages for Social Sciences (SPSS) through which the mean of the overall evaluating criteria are computed. Moreover, it generates the general descriptive statistics with table format.

## CHAPTER FOUR

### 4. Data Presentation and Analysis

This chapter comprises several analyses including descriptive and comparative analysis. SPSS 20 statistical software is used to compute the results collected from respondents statistically. Demographic information of respondents is presented in the form of tables to give an overview of respondents' profile. Descriptive analysis is being used to find out the frequency of respondent's answer.

#### 4.1 Respondents Profile Considered for the Research

##### 4.1.1 Educational Qualification

Educational qualification of respondents working for micro finance institutions is summarized in the following table

**Table 1:** Educational Qualification

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid				
Diploma	26	83.9	83.9	83.9
Bachelor of Art	4	12.9	12.9	96.8
Others	1	3.2	3.2	100.0
Total	31	100.0	100.0	

As per the responses gathered majority of employees working for microfinance institutions are diploma holders which is 83.9% out of the total sample and the remaining 12.9% and 3.2% have Bachelor degree and other level of education respectively.

For commercial banks respondents the following result are found out

**Table 2:** Educational Qualification

	<b>Frequency</b>	<b>Percent</b>	<b>Valid Percent</b>	<b>Cumulative Percent</b>
BA degree	26	56.5	56.5	56.5
Master's Degree	20	43.5	43.5	100.0
Total	46	100.0	100.0	

The response reveals that majority of the respondents are BA degree holders that is 56.5% and surprisingly the remaining 43.5 have 2<sup>nd</sup> degree. Therefore, when compared with microfinance institutions academic level of credit related staffs of commercial banks is higher than the microfinance institution staffs.

### 4.1.2 Job title

Job title of respondents is summarized in the following tables

**Table 3:** Commercial banks respondents

	Frequency	Percent	Valid Percent	Cumulative Percent
Assistant Branch Manager	5	10.9	10.9	10.9
Credit Analyst	8	17.4	17.4	28.3
Valid Loan Officer or Clerk	21	45.7	45.7	73.9
Other Credit Related Job	12	26.1	26.1	100.0
Total	46	100.0	100.0	

**Table 4:** Microfinance respondents

	Frequency	Percent	Valid Percent	Cumulative Percent
Branch Manager	1	3.2	3.2	3.2
Assistant Branch Manager	2	6.5	6.5	9.7
Valid Credit Analyst	2	6.5	6.5	16.1
Loan Officer or Clerk	2	6.5	6.5	22.6
Other Credit Related Jobs	24	77.4	77.4	100.0
Total	31	100.0	100.0	

The result revealed majority of respondents from commercial banks are loan officers while in the microfinance institutions credit related job title option is selected. However, the researcher have asked to some of those microfinance respondents verbally regarding the job titles given to them and make sure that even if most of the staffs are not given the title of loan officer or clerk or being accountant and cashier they are obliged to accomplish credit and savings related tasks. Therefore

the result tells that microfinance institutions are not strictly staffing criterions to assign as credit staff due to the need to use their employees for different tasks.

### 4.1.3 Work Experience

Experience of both micro finance and commercial bank staff respondents has been summarized in the following tables

**Table 5:** Year of Service in the institution Microfinance Institution respondents

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Less than One Year	6	19.4	19.4	19.4
1-3 years	13	41.9	41.9	61.3
4-6 years	11	35.5	35.5	96.8
7-9 years	1	3.2	3.2	100.0
Total	31	100.0	100.0	

**Table 6:** Year of service in the institution Commercial Banks respondents

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Less than one year	10	21.7	21.7	21.7
1-3 Years	11	23.9	23.9	45.7
4-6 Years	9	19.6	19.6	65.2
7-9 years	7	15.2	15.2	80.4
More than Ten Years	9	19.6	19.6	100.0
Total	46	100.0	100.0	

From both results above it is understood that majority of microfinance institution credit and credit related staffs have been served from one to three years and it is about 41.9%. The same is true for commercial banks it is about 23%. However, when compared against the categories given as an

alternative for respondents majority of credit staffs of commercial banks year of service lays in the categories of more than four years or more than 54% of the total population.

#### 4.1.4 Related Work Exposure

Respondents were asked if they have served at other financial institutions in credit service and related task or not. And this question is considered to draw conclusion on existence of similarities or difference among different financial institutions. However, as per the response from respondents who are working for microfinance institutions majority of them or about 80.6% have no other work experience in the area. On the other hand respondents from commercial banks have expressed that about 67.4% have served at least for one financial institution before. The overall results collected from respondents are tabulated below.

Respondents of Microfinance Institution

**Table 7:** Other Institution Related Exposure

	Frequency	Percent	Valid Percent	Cumulative Percent
Yes	6	19.4	19.4	19.4
Valid No	25	80.6	80.6	100.0
Total	31	100.0	100.0	

Respondents of Commercial Banks

**Table 8:** Other Institution Related Exposure

	Frequency	Percent	Valid Percent	Cumulative Percent
Yes	31	67.4	67.4	67.4
Valid No	15	32.6	32.6	100.0
Total	46	100.0	100.0	

#### **4.1.5 Existence of Major Difference in Credit Service Provision Process among Different Financial Institutions they have Served**

From the total respondents of micro finance institutions only 19.4% or six respondents have served other financial institution before. And from those respondents majority of them or 66.7% or four respondents have supported the existence of major difference in the service provision process and the remaining takes it as similar. On the other hand majority of respondents from the commercial banks about 61.3% supported the presence of similarity in credit service process among different financial institutions. Besides, the results found are summarized in the following tables.

Respondents from Microfinance Institutions

**Table 9:** Presence of credit service process difference among Financial Institutions

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	4	12.9	66.7	66.7
	No	2	6.5	33.3	100.0
	Total	6	19.4	100.0	
Missing	System	25	80.6		
Total		31	100.0		

Respondents from Commercial Banks

**Table 10:** Presence of major credit service process difference among Financial Institutions

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	12	26.1	38.7	38.7
	No	19	41.3	61.3	100.0
	Total	31	67.4	100.0	
Missing	System	15	32.6		
Total		46	100.0		

Moreover, as can be seen from the result of microfinance staffs response regarding their exposure at other financial institution is very minimal or 19.4% of the total respondents only it is very difficult to draw conclusion on the presence of similarity or not among financial institutions.

## 4.2 Service Provision Priority Areas and Major Criteria Applied for Credit Service

To analyze major emphasized criteria and prioritized sectors the questionnaire designed has two set of questions with variety of alternatives. For the first one or service provision priority areas about seven major business areas were given for the respondents and required to rank them one to seven based on their institution priority for the credit service. Up-on data encoding for 1<sup>st</sup> leveled value is 1 and for the 2<sup>nd</sup> is 2 and so on. As a result the mean value directly reveals rank of the business sector for service priority. The results found from both institutional formations are summarized below.

Respondents from Microfinance Institutions

**Table 11:** Prioritized Business Sector

	<b>N</b>	<b>Minimum</b>	<b>Maximum</b>	<b>Mean</b>	<b>Std. Deviation</b>
Agriculture	15	1	7	5.20	1.971
Domestic Trade	31	2	7	2.39	1.022
Manufacturing	29	2	7	4.38	1.147
Import	13	5	7	5.54	.660
Export	13	3	6	5.15	1.281
Construction	31	1	5	2.94	.680
Transport Service	31	1	4	1.13	.562
Valid N (list wise)	13				

Respondents from Commercial banks

**Table 12:** Prioritized Business Sector

	<b>N</b>	<b>Minimum</b>	<b>Maximum</b>	<b>Mean</b>	<b>Std. Deviation</b>
Agriculture	46	2	7	6.39	1.273
Domestic Trade	46	2	5	3.28	.750
Manufacturing	46	2	4	2.48	.722
Import	46	1	7	3.96	1.534
Export	46	1	3	1.09	.412
Construction	46	2	6	4.70	.940
Transport Service	46	4	7	5.98	.774
Valid N (list wise)	46				

As can be observed from the above, even if microfinance institutions are not evolved in facilitating international trade or both export and import are not priority business sectors but still there is significant difference for the remaining business sectors. For example transport business is prioritized by microfinance institutions while it is last resort for commercial banks. Moreover, manufacturing is the 2<sup>nd</sup> best prioritized business sector but it is found around 4<sup>th</sup> place for microfinance institutions.

Some commonly applied criterions were also presented in the questionnaire to be marked by respondents if used by their institution or not and up on computing the result all alternatives were presented as variables and given a yes or no option while encoding them and yes option leveled as 1 and no option leveled as 2. Finally the following results are drawn.

Respondents from Microfinance Institutions

**Table 13:** Loan Process Request Evaluating Criteria

	N	Minimum	Maximum	Mean	Std. Deviation
Business Sector	31	1	2	1.68	.475
Length of Relationship with the Inst.	31	1	2	1.81	.402
Type of Collateral	31	1	2	1.23	.425
Management Team	31	1	2	1.71	.461
Risk Level	31	1	2	1.90	.301
Volume Of Loan Requested	31	1	2	1.26	.445
Profitability or Prospect	31	1	2	1.32	.475
Credit History	31	1	2	1.84	.374
Others	0				
Valid N (list wise)	31				

Therefore, as per the above result it can be concluded mostly applied criterions are type of collateral, volume of loan requested and profitability and prospect. The remaining are not given weight at the microfinance institutions and as a result the respective mean reveals more than 1.5 or closer to not an option or are not used as loan request evaluating criteria.

Respondents from Commercial Banks

**Table 14:** Loan Process Request Evaluating Criteria

	N	Minimum	Maximum	Mean	Std. Deviation
Business Sector	46	1	2	1.15	.363
Length of relationship with the inst.	46	1	2	1.28	.455
Type of Security or Collateral	46	1	2	1.30	.465
Management Team	46	1	2	1.59	.498
Risk Level Of the Business	46	1	2	1.28	.455
Volume of loan requested	46	1	2	1.48	.505
Profitability and Prospect	46	1	2	1.22	.417
Credit History	46	1	2	1.24	.431
Others	0				
Valid N (list wise)	46				

Opposite to microfinance institutions commercial banks are applying almost all alternatives as their loan request evaluating criteria. In addition, respondents were given to mention if their institution is using other evaluating criteria by letting others option with empty space. However, no one respondent has added any other criteria in the space provided.

### 4.3 Efficiency of Credit Service Provision

To compare service efficiency of the two financial institution formations, seven set of questions were presented in the questionnaire designed. Those set of questions are prepared considering them as factors which can directly affect level of efficiency of a financial institution. These are loan product and volume, customer filtering mechanism, level of risk taking, organizational structure, credit assessment, level of technology utilized and paper elimination when unnecessary. The results are presented in the following tables. The level of achievement of the financial institutions with regard to considered dimensions in the eyes of their respective employees is leveled from strongly dis agree (1) to strongly agree (5). Therefore, factors with minimum average (mean) are where the institution has lower strength or quality or supported by respondents (strongly agree).

#### Respondents from Microfinance Institutions

**Table 15:** Considered Efficiency Factors

Factors Considered	N	Minimum	Maximum	Mean	Std. Deviation
Increasing loan products	31	2	5	3.03	.983
Customer filtering mechanism	31	3	5	3.81	.749
Risk taking enough	31	2	5	2.71	.864
Clear organizational structure	31	3	5	4.10	.396
Risk based Credit assessment	31	2	5	3.55	.768
Installed up to dated technology	31	2	4	2.45	.768
Eliminated paper where possible	31	1	5	2.74	.855
Valid N (list wise)	31				

Respondents from Commercial Banks

**Table 16:** Considered Efficiency Factors

<b>Factors Considered</b>	<b>N</b>	<b>Minimum</b>	<b>Maximum</b>	<b>Mean</b>	<b>Std. Deviation</b>
New loan products to increase loan size	46	2	5	3.89	.849
Strength of risky customer filtering mechanism	46	1	5	3.70	.866
Risk taking enough	46	1	5	2.57	.935
Clear organizational structure	46	1	5	3.39	.954
Risk based credit assessment	46	2	5	3.87	.619
Installed up to dated technologies	46	1	5	3.39	1.043
Eliminated Paper where possible	46	1	5	3.59	.832
Valid N (list wise)	46				

As can be observed from the above tables the overall mean of the commercial banks employees response is higher than microfinance respondents, which means closer to the best response or strongly agree. Moreover, when compared for every single question except for presence of clear organizational structure and customer filtering mechanism commercial banks have performed well. On other hand both institutional formations have been exhibited as risk averters.

However, surprisingly customer filtration, risk taking enough and establishment of clear organizational structure are preferably supported by microfinance employees as being done well by their companies than commercial bank respondents.

#### **4.4 Measures Taken by the Financial Institutions to Improve the Service Efficiency**

To improve their efficiency they were assumed to remove insignificant duplication of tasks, reduce cost of routine transactions, design training programs which enable staffs to be more efficient, empower employees to help them bring new ideas supports the company, apply good

account recording system for an on time decision making and motivate employees to make them deliver better. In those aspects the following results have been gathered from respondents.

Respondents of Microfinance Institution

**Table 17:** Considered Correcting Measures

Factors Considered	N	Minimum	Maximum	Mean	Std. Deviation
Removed duplication of tasks	31	2	5	3.77	.762
Reduced the cost of routine transactions	31	1	5	3.77	.884
Designed Continuous Training	31	1	5	2.74	.815
Empowered Employees	31	2	5	3.45	.768
Good account recording system	31	2	5	2.45	.850
Motivating Employees	31	2	4	2.65	.709
Valid N (listwise)	31				

Microfinance intuitions have performed better in reducing cost of routine transactions and removing insignificant duplication of works but also revealed there has been weaknesses in establishing good account recording system and motivating their employees. The overall mean of the result exhibited to be 2.72 closer to neutral response.

**Table 18:** Considered Correcting Measures

Considered Factors	N	Minimum	Maximum	Mean	Std. Deviation
Removed duplication of work	46	2	4	3.07	.854
Reduced routine transactions	46	1	4	2.83	.973
Designed continuous training programs	46	1	4	3.15	1.032
Empowered employees	46	1	5	2.89	.948
Implemented good account recording system	46	3	5	3.83	.643
Motivates employees	46	1	4	3.15	.942
measure	46	2.17	4.33	2.8913	.64714
Valid N (list wise)	46				

Commercial banks reveals strength in establishing good account recording system and the remaining factors have been weighted for about 3 point or closer to neutral opinion. Even reducing routine transactions and empowering employees are weighted less than three which means respondents do not agree that their company have done improvements in these regard.

#### **4.5 Challenges to Efficient Service Provision**

Around six elements were presented in the standard questionnaire as challenges which can affect level of efficiency and most of them are external factors and only earning pressure and employee’s salary can be taken as internal even if salary inflation is also highly affected by the external environment in addition to the internal willingness and commitment. The assumed challenges are earning pressure from the shareholders, government requirements having an effect of escalating cost, employees salary, very tough competition from the industry, scarcity of professionals in the

labor market and customer level of understanding and behavior. Therefore, respondents view in this respect is summarized in the following tables.

Respondents from Microfinance Institutions

**Table 19:** Considered Challenges

Considered Factors	N	Minimum	Maximum	Mean	Std. Deviation
Earning Pressure	31	2	5	2.94	.998
Government Requirement	31	2	5	3.87	.718
Employees salary increment	31	2	5	3.48	.926
Tough competition in the industry	31	3	4	3.97	.180
Qualified professionals scarcity	31	2	5	3.23	.617
Customer behavior and level of understanding	31	2	5	3.55	.961
Valid N (list wise)	31				

Respondents of Commercial Banks

**Table 20:** Considered Challenges

Considered Factors	N	Minimum	Maximum	Mean	Std. Deviation
Earning Pressure	46	1	4	3.15	.729
Government Requirement	46	1	5	3.83	.926
Employee Salary Increment	46	1	4	2.70	.940
Tough Competition in the Industry	46	2	5	3.74	.773
Qualified Professional Scarcity	46	1	5	2.76	1.015
Customers behavior and level of understanding	46	2	5	3.35	.971
Valid N (list wise)	46				

Therefore, the result revealed that tough competition in the industry and government requirements are weighted as common challenges of the financial institutions. On the other hand customer level of understanding and behavior gets more weight for microfinance institutions as they majorly deal with lower level business persons or entities. However, it is also one challenge for the commercial banks with slight difference in the mean of respondents when compared with microfinance respondents.

## **CHAPTER FOUR**

### **5. Summary of Findings, Conclusions and Recommendations**

This chapter provides the summary of the findings from chapter three based on the objectives of the study. Moreover, this chapter will discuss about conclusion, recommendation for future research and implication of the study. It was a very crucial chapter as it would make summary of the whole research, conclude and make recommendations.

#### **5.1 Summary of Findings**

The results vivid that credit eligible criteria or factors applied for evaluating credit request are get wider in commercial banks than micro finance institutions. As per the result gathered commercial banks consider almost all alternatives given by the researcher which are the business sector engaged in, length of relationship with the institution, type of security or collateral, management team, risk level of the business, volume of loan requested, profitability of the business and its prospect and previous credit history while microfinance institutions emphasized on type of collateral, volume of loan and business profitability and prospect.

The business sectors prioritized by those financial institutions also exhibited distinction on given around seven major areas of businesses. Microfinance institutions are favorably supporting transport sector in the first place followed by domestic trade and services and construction. In the other hand commercial banks prioritize export business followed by manufacturing and domestic trade and services. Here surprisingly transport business is a priority for microfinance institutions and almost last resort for commercial banks. However, domestic trade and services has got similar place at both financial institution formations.

The overall service efficiency of the financial institutions were evaluated using seven factors which are new credit product development, strong customer filtering mechanism, level of risk taking, organizational structure, risk based credit assessment, installed technology and elimination of paper where possible. According to those factors in most of them including the overall mean both of the financial institutions are similar. However major differences are observed in applied technology and elimination of paper where unnecessary. In this regard, microfinance institutions get the lowest

rank. Besides in being risks taking enough both financial institutions were ranked as not risk taking enough.

Measures taken to improve the efficiency of credit service provision were also evaluated based on six criteria which are minimized duplication of task, reduced cost of routine transactions, offered well designed continuous training program, empowered employees to enable them regularly suggest and contribute small improvements, implemented good account recording system and motivating employees. Again according to those factors very close results have been collected in four of the factors. However major difference revealed in reduced cost of routine transactions and good account recording system. Therefore respondents of commercial banks do not agree their institution have reduced enough cost of routine transactions and on other hand good account recording system is replied as one major gap in microfinance institutions.

Finally the researcher has tried to assess the major challenges in improving efficiency of credit service provision and assumed six factors these are earning pressure from shareholders, government regulation and requirement, employees salary increment, tough competition in the industry, scarcity of qualified professionals in the area and customer behavior and level of understanding. Here also the challenges weighted are almost similar and both financial institutions' respondents give more weight to government requirement and the existing competition in the industry. Moreover, customer behavior and level of understanding is a common challenge for the institutions with higher degree for microfinance institutions.

## **5.2 Conclusion**

There is an immense competition in the financial sector because of the growing nature of the industry. However, both financial institution formations are not risk taking enough which hinders the level of outreaching more potential customers. Government requirements and regulations are common challenges together with customer behavior and level of understanding. Microfinance institutions have clear draw back in installing up to dated technologies and good account recording system. It is very difficult to move forward for a financial institution without having adopted well organized account recording system. Furthermore the microfinance institutions loan request evaluating criteria are narrow when compared with that of commercial banks. These may affect level of confidence on collecting back to the extended loans.

### **5.3 Recommendation**

- Each financial institution should develop and create differentiated products/services according to its resources and strengths.
- Being risk taking doesn't mean that the financial institution will not undertake analysis in depth. Therefore, both financial institutional formations should improve their level of risk consideration.
- Both financial intuition formations should simplify their credit service process to make it easy for their respective customers. At the same time increase the level of transparency which will help to handle the challenge arise from customer's undesirable behavior.
- Commercial banks should work on cost reduction of routine transactions and empowered their staff's to enable them regularly suggest and contribute small improvements.
- Microfinance institutions should work on establishing up to dated technologies which coincides with their capacity and volume of transaction. Besides establishing very organized account recording system that enables to generate prompt reports should not be given time.

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## ANNEX

### QUESTIONNAIRE

#### For Selected Employees of Commercial Banks and Microfinance Institutions

#### Dear Respondent

This questionnaire forms part of a research on “**A Comparative Analysis of Credit Service Activities in Selected Commercial Banks versus Micro Finance Institutions in Addis Ababa: Eligibility Criteria, Prioritized Sectors and Efficiency of Service Provision**” in partial fulfillment of the requirements for the Degree “Masters in Public Management and Policy”. The questions presented below enables me to gather information to undertake this study.

The information you provide will be kept confidential and used only for the intended research purpose.

Thank you for your co-operation.

#### A. General Questions

1) The financial institution currently you are working for

Commercial Bank ( ) Microfinance Institution ( )

2) Educational qualification

Diploma ( ) Bachelor of Art ( ) Master’s Degree ( ) Others( )

3) Your Job title in the institution

Branch Manager ( ) Assistant/Deputy Manager ( ) Loan Supervisor/Credit Analyst ( )

Loan Officer/ Clerk ( ) Other Credit Related Job Title ( )

4) Year of service in the Institution

Less than 1 Year ( ) 1- 3 Years ( ) 4–6 Years ( ) 7 – 9 Years ( ) 10 Years  
and above ( )

5) Do you have work experience in the area at other financial institution before?

Yes ( ) No ( )

If your answer is yes for the above question, Please answer the following two questions

6) In how many financial institutions have you served before

Only One ( ) Two - Three ( ) Four – Five ( ) More than Five ( )

7) There is major difference between financial institutions in credit service provision

Yes ( ) No ( )

**B. Service Provision Priority**

8) Which of the following criteria your company uses to extend credit facilities? You can tick more than one alternative.

Business Sector ( ) Length of relationship with the institution ( )

The type of Collateral/Security ( ) Management team of the business ( ) Risk level of the business ( ) The volume of Loan requested ( ) Profitability of the business and its prospect ( ) Previous Credit History ( ) others ( )

9) If your institution is using other than the above listed criteria please state them

.....  
.....

10) Rank the following business sectors 1- 7 based on your company priority to extend credit service

Agriculture

Construction

Domestic Trade and Services

Transport

Manufacturing Business

Import Business

Export

For the following questions please put  $\sqrt$  sign in the space provided

<b>C. Efficiency of Credit Service Provision</b>						
<b>No</b>	<b>Item</b>	<b>Strongly Agree</b>	<b>Agree</b>	<b>Neutral</b>	<b>Disagree</b>	<b>Strongly Disagree</b>
11.	The company is working on increasing the loan size by designing(developing) and offering new loan products					
12.	The company has strong customers filtering mechanism to exclude riskier clients					
13.	The company is risk taking enough to reach large number of clients					
14.	The company has clear organizational structure or easy for communication					
15.	The company has implemented risk based credit assessment					
16.	The company has installed up to dated technologies to facilitate the credit service provision as well as minimize cost					
17.	The company has eliminated paper where possible					

<b>D. Measures taken to improve the efficiency of credit service provision</b>						
18.	The company has removed duplication of tasks along the credit service provision					
19.	The company has reduced the cost of routine transactions by moving them outside branches through means such as agent banking					
20.	The company has well designed continuous training program helps to maximize operational efficiency					
21.	The company empowered employees to regularly suggest and contribute small improvements					
22.	The company has implemented good account recording system by which can generate updated information any time					
23.	The company is working on motivating its employees to enable them support efficient service provision.					
<b>E. Challenges to efficient credit service</b>						
24.	The company is facing strong earning pressure from owners(Shareholders)					
25.	Government requirements and/or business strategy of the company to outreach large number of customers is hindering efficiency of the company					
26.	Employees salary increment(adjustment) is made frequently and looks escalating expense of the company					
27.	The company faces very tough competition in the industry as a result up rises its operational expense					
28.	The company is facing a challenge in having qualified professionals from the market					
29.	Customers behavior and level of understanding to the service requires the company to incur additional cost					