

MBA 152

**“Governance Practices of Ethiopian  
Micro Finance Institutions (MFIs):  
A Study of Selected Units”**

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**Advisor: Prof. Murthy G. Krishna**



**Addis Ababa University  
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Title: **Governance Practices of Ethiopian MFIs: A Study of Selected Units**

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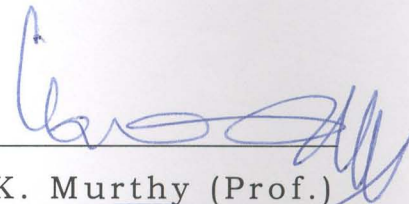
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**Statement of Approval**

This is to certify that Ato Frezer Ayalew has completed a research paper entitled **“Governance Practices of Ethiopian MFIs: A study of Selected Units”** under my guidance. I also approve that his work is appropriate enough to be submitted in partial fulfillment of the degree in Masters of Business Administration.

Date



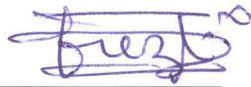
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## Declaration

I hereby assert that this study entitled "**Governance Practices of Ethiopian MFIs: A Study of Selected Units**" is my own original work and has not been presented by anybody; for any degree or diploma in any other university and all materials used for the project work have been duly acknowledged.

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March 22, 2007

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## Table of Contents

Pages

<b>CHAPTER ONE</b> -----	<b>1</b>
<b>1. INTRODUCTION</b> -----	<b>1</b>
1.1 BACKGROUND OF THE STUDY-----	1
1.2 STATEMENT OF THE PROBLEM-----	3
1.3 OBJECTIVES OF THE STUDY-----	4
1.4 SIGNIFICANCE OF THE STUDY-----	4
1.5 SCOPE & LIMITATION OF THE STUDY-----	5
1.6 RESEARCH METHODOLOGY-----	5
1.7 ORGANIZATION OF THE STUDY-----	6
<b>CHAPTER TWO</b> -----	<b>8</b>
<b>2. REVIEW OF LITERATURE</b> -----	<b>8</b>
2.1 LEGAL FRAMEWORK PERTAINING TO THE MANAGEMENT OF SHARE COMPANIES-----	8
2.2 DEVELOPMENT OF MICRO FINANCE IN ETHIOPIA -----	12
2.3 CONCEPT OF CORPORATE GOVERNANCE-----	14
2.3.1 What is Corporate Governance?-----	14
2.3.2 Need for Corporate Governance-----	16
2.4 CORPORATE GOVERNANCE PRINCIPLES-----	18
2.4.1 Size and Manner of Composition of Board members-----	18
2.4.2 Turnover Rate and Remuneration of Board Members-----	20
2.4.3 Board Meetings-----	20
2.4.4 Board Committees-----	21
2.4.5 Responsibilities of the Board-----	22
2.5 PRACTICES OF MICRO FINANCE GOVERNANCE IN OTHER COUNTRIES-----	26
2.5.1 Governance practice in Uganda-----	26
2.5.2 Ownership structure and Governance practice in the developing world-----	28
<b>CHAPTER THREE</b> -----	<b>32</b>
<b>3. Governance of MFIs in Ethiopia</b> -----	<b>32</b>
3.1 OVERVIEW OF MFIs PERFORMANCE IN ETHIOPIA-----	32
3.2 CHARACTERISTICS OF SAMPLE MFIs AND RESPONDENTS-----	38
3.3 ANALYSIS AND DISCUSSION OF FINDINGS-----	40
3.3.1 ASSESSMENT ON THE OWNERSHIP STRUCTURE OF SAMPLE MFIs-----	40
3.3.2 BOARD SIZE, COMPOSITION AND STRUCTURE-----	53
3.3.4 GOVERNANCE PRACTICE OF MFIs-----	63
<b>CHAPTER FOUR</b> -----	<b>75</b>
<b>4. CONCLUSIONS &amp; RECOMMENDATIONS</b> -----	<b>75</b>
4.1 CONCLUSIONS-----	75
4.2 RECOMMENDATIONS-----	77

Bibliography

Appendix:

Appendix i) Questionnaire

Appendix ii) Copy of Proclamation No. 40/1996

Appendix iii) Copy of NBE directive No. MFI/03/96

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## List of Acronyms

- ACSI:** Amhara Credit and Saving Institution
- AEMFI:** Association of Ethiopian Microfinance Institutions
- ASX:** Australian Stock Exchange
- AVFS:** Africa Village Financial Service
- BODs:** Board of Directors
- CEOs:** Chief Executive Officers
- CGAP:** Consultative Group to Assist the Poor
- DBE:** Development bank of Ethiopia
- DECSI:** Dedebit Credit and Saving Institution
- GDP:** Gross Domestic product
- MDIs:** Micro Finance Deposit Taking Institutions
- MF:** Micro Finance
- MFIs:** Micro Finance Institutions
- PEACE:** Poverty Eradication and Community Empowerment
- NBE:** National Bank of Ethiopia
- NGOs:** Non Governmental Organizations
- SFPI:** Specialized Financial and Promotional Institution



## Abstract

The history of formal microfinance sector in Ethiopia has counted a decade of age. During its existence, the sector has achieved success with respect to reaching and satisfying the micro financial need of the relatively marginalized section of the society. Yet, there exists tremendous unmet demand for the service. In addition, the sector since its existence has been facing a number of challenges hindering its growth and sustainability. Among these challenges, the issue of governance is one of the most pressing challenges facing the sector.

This study examines the practices of governance among MFIs with a focus on ownership structure and corporate governance. To this end, this paper made a study on 16 sample MFIs drawn from the sector and identified a number of weaknesses associated with the governance practices of the surveyed MFIs. Accordingly their ownership composition, effectiveness of board composition, functions and responsibilities are not in line with best microfinance governance practices.

The form of ownership that almost all MFIs exhibited i.e. nominal shareholding has been found to be uncondusive for effective exercise of governance in relation to ensuring commitment and putting in place proper responsibility and accountability among boards that are drawn from shareholders. Thus, local governance standards, code of conduct for boards and risk management guidelines are so far non-existent in the sector.

In addition, the poor functioning of dividend policy, performance management system are among the weaknesses revealed in the study. In light of the findings of the study, recommendations that could address the observed weaknesses are forwarded.

# CHAPTER ONE

## 1. INTRODUCTION

### 1.1 BACKGROUND OF THE STUDY

The business of micro finance as a formal channel of providing financial services to the low income section of the society that are alienated from the conventional banking system is a recent practice worldwide and is more recent sector in Ethiopian context (only about a decade ago). Micro finance was initially introduced as a tool of reducing poverty through provision of credit to the poor and enabling them to engage in income generating activities. The CGAP<sup>1</sup> defines micro finance as the business of providing financial services (loan and savings) to the low-income people who don't have access to the conventional banking system. On the other hand, the Ethiopian proclamation issued to license and supervise the business of micro financing (proclamation no.40/1996) defines micro finance as an activity of extending credit in cash and in kind to peasant farmers and/or urban small entrepreneurs.

Many years ago, the business of micro finance was operating by governments and NGOs through a subsidized and donor supported credit program. However, at that time, the services were offered in a less organized, informal and unsustainable basis. Accordingly, with the intention of bringing these scattered programs into a formal, sustainable, legal and regulated one, a proclamation for the licensing and supervision of micro finance business was promulgated and enacted.

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<sup>1</sup> Christen ,Lyman, Rosenberg 2003,Guiding Principles on Regulation and Supervision of Micro finance, CGAP/The World Bank Group,1818 H Street, N.W, Washington,D.C.20433 USA CGAP stands for Consultative Group to Assist the Poor and is a group of 29 donor agencies that support micro finance

Among others things, the proclamation specified the areas of business that the MFIs are legible to undertake and also determined the form of organization of the business. To this end, micro finance was considered as part of the financial sector of the country providing many of the services given by banks with the exception of transactions involving foreign currencies such as rendering banking service related to international trade (letter of credit) and handling of international money transfer.

Moreover, the MFIs are required to be established as share companies whose owners are Ethiopian nationals and or organizations owned by Ethiopian nationals. Following this proclamation, the credit programs that were operating before the issuance of the law transformed themselves into micro finance institutions formed as share companies.

As at end of December, 2006, 28 MFIs are licensed by the National Bank of Ethiopia. However, one of these MFIs has ceased its operations and closed the business. The remaining 27 MFIs are operating in the different regions of the country. As at December 31<sup>st</sup> , 2006, these MFIs in aggregate have total assets, total deposit and total capital of Birr 2.8 billion, Birr 823 million and Birr 872 million, respectively. Moreover, the MFIs are serving over 1.5 million clients across the country.

This being the case, the sector has been facing various challenges and problems. Among these, financial, operational, regulatory and governance are the major ones to mention.

However, the focus of this study is on the issue of governance. According to Rock and et.al (1998)<sup>2</sup>, Governance in the context of micro finance is

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<sup>2</sup> Rock, Otero, Saltzman 1998, Principles and Practices of Micro finance Governance, Micro enterprise Best Practices, Development Alternatives, inc, 7250 Woodmont Avenue, Suite200, Bethesda, MD 20814 USA

defined as the process by which boards of directors through management guides the institution in fulfilling its corporate mission, protecting the institutions assets and promote the healthy operations of the institution. The exercise of good governance in any corporate organizations particularly in financial institutions is a decisive factor for the smooth, healthy and sustainable operations. The study deals with assessment and analysis of the governance practice of Ethiopian MFIs and tries to forward recommendations in light of best practices.

## **1.2 STATEMENT OF THE PROBLEM**

Governance particularly in the context of Micro financial institutions where a significant amount of the fund is coming from public depositors (29%) and other long-term liabilities (23%) as at end of December 2006, is gaining increasing importance. As MFIs grew in outreach, assets (increased mobilization of public deposit), they require clear articulation on how boards ensure effective governance.

In most Ethiopian MFIs, no one in the institution either at the board or management level has a financial stake in the institution. Thus, since most MFIs boards in Ethiopia do not personally lose anything as a result of failure of their institution, the issue of ensuring good governance becomes complex. Moreover, reward schemes for the persons involved in the governance of an MFI in the form of compensation, dividend sharing and performance tied incentives have implication on the quality of governance.

The presence of devoted and motivated board members that gives due attention to the affairs of the MFI and the possession of adequate knowledge and exposure to the operation of MFIs is a critical factor for

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the effective exercise of good governance. In addition, the independent functioning of boards from other dominating board members within an MFI (or parent organization of the MFIs) has got significant bearing on the effective exercise of governance. Due to the peculiar characteristics of MFIs (serving relatively poor section of the society), conflict of interest between social and financial objective of shareholders and the capacity to strike balance between the two among boards significantly affects the effective exercise of governance.

### **1.3 OBJECTIVES OF THE STUDY**

The general objective of the study is to assess the current corporate governance practice of MFIs, identify the challenges and problems associated with it, identify the causes of the problems and propose possible solutions that might improve the quality of governance with a focus on ownership structure and corporate governance practices.

The study tried to address the following specific issues and questions:

- Who owns the institutions?
- Is the current ownership structure and governance exercise conducive to the growth and sustainability of MFIs?
- Are the MFIs adopting good corporate governance practices in light of the internationally recommended practices?
- What improvements are required in order to bring about good governance?

### **1.4 SIGNIFICANCE OF THE STUDY**

As Micro financing is a relatively new phenomenon, this study makes observation on the ownership and governance practices of MFIs operating in Ethiopia and makes specific recommendation regarding best practices of governance. Moreover, the findings of this study will inform

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stakeholders (shareholders, boards, management, regulators, etc) on key problems areas related to the practice of good governance and will initiate these stakeholders to contribute their share by finding ways of mitigating the identified problems.

In addition, this study helps individual MFIs to look at their respective governance practices as seen from the perspective of the industry. Moreover, this study will initiate and serve as a ground to undertake further studies or researches related to the topic.

### **1.5 SCOPE & LIMITATION OF THE STUDY**

The scope of the study is limited to the Ethiopian micro financing industry (MFIs licensed by NBE). The study focuses on understanding and assessing the governance practice being exercised by MFIs operating in the industry and suggesting possible recommendations in light of observed weaknesses. To this end, 16 sample MFIs operating in the industry were reached and assessed.

As to its limitations, there might be a possibility for information asymmetry by the respondents. To this end, the researcher has tried to explain the major purpose of the study and mitigate the possibility. In addition, board members of some MFIs were inaccessible for various reasons.

### **1.6 RESEARCH METHODOLOGY**

**Data Source:** The study used both primary and secondary data. As part of the primary data, a comprehensive questionnaire (a copy is placed as appendix I at the end of the report) was designed and distributed to the General Managers and board chairpersons of sample MFIs with the objective of obtaining information related to their capital structure,

shareholders background, board composition and the relationship of boards with the general managers in a way that explains the nature of governance. In addition, interviews with selected general managers and board chairpersons were conducted to obtain detailed information. As part of the secondary data, publicly available information like the commercial code of the country, proclamation and directives issued to regulate and supervise the sector were consulted.

In addition, various literatures and studies conducted on the subject were reviewed from sources like Internet, AEMFI etc and financial and operational database of NBE got referred.

**Sample Design:** As of December 31<sup>st</sup>, 2006, the micro finance industry constituted 27 licensed MFIs (as 1 MFI ceased operation). From these MFIs, 16 MFIs (representing 60% of the total MFIs) were taken to conduct the survey. In choosing the sample, a convenient sampling method with attempt of including MFIs with varied years of establishment and geographical area of operation were used.

**Data Analysis:** The data collected from the surveyed MFIs were compiled and analyzed through the use of computer applications like excel spreadsheet. Accordingly, tables, ratios, percentages and charts constituted the analysis part.

## **1.7 ORGANIZATION OF THE STUDY**

The paper is organized of four chapters. In the first chapter, a global view of the sector and its development in Ethiopia with brief consultation of literature will be made. Moreover, this chapter contains information regarding the statement of the problem, objectives of the study, significance of the study and scope of the study. In addition, the data

source and methodology adopted in dealing with the study is presented. The second chapter deals with the presentation and analysis of literatures that are of relevance and importance to the topic being discussed. Accordingly, international corporate governance principles and corporate governance experience of other countries were discussed.

In the third chapter, data's that are collected from the surveyed MFIs through questionnaire and interview with the objective of providing information on the actual governance practices and associated challenges will be presented and analyzed. The fourth and the final chapter draw conclusions and recommendations in light of the findings of the study.

## Annex I

### List of MFIs included in the Survey

1. Omo Microfinance Institution
2. Specialized Financial and Promotional Institution
3. Gasha Microfinance Institution
4. Wisdom Microfinance Institution
5. Poverty Eradication and Community Empowerment Microfinance Institution
6. Eshet Microfinance Institution
7. Bussa Gonofa Microfinance Institution
8. Africa Village Financial Services Microfinance Institution
9. Harbu Microfinance Institution
10. Wasasa Microfinance Institution
11. Dire Microfinance Institution
12. Benishangul Gumuz Microfinance Institution
13. Agar Microfinance Institution
14. Degaf Microfinance Institution
15. Metemamen Microfinance Institution
16. Shashemene Iddirs Yelimat Agar Microfinance Institution

## CHAPTER TWO

### 2. REVIEW OF LITERATURE

#### **2.1 LEGAL FRAMEWORK PERTAINING TO THE MANAGEMENT OF SHARE COMPANIES**

Businesses owing to the types of goods and service they provide to their customers and the form of ownership structure they are formed have got their respective legal framework that serves as a basis for directing and governing their operations. In Ethiopia, the commercial code that was issued in 1960 defines and stipulates the different forms of ownership structure and other related legal aspects that business companies are required to adhere to. Moreover, in accordance with the provisions of the commercial code, concerned government bodies and other stakeholders promulgate different proclamations pertaining to the conduct of such businesses and then are endorsed by the house of the parliament.

Accordingly, the proclamation<sup>3</sup> issued to license and supervises the business of micro finance i.e. proclamation No. 40/1996 (a copy is placed as appendix II at the end of this report) among other things states that MFIs are required to be established as Share Company. According to the Commercial code of Ethiopia (1960), Share Company is defined as a company whose capital is fixed in advance and divided into shares and whose liabilities are met only by the assets of the company. Thus, the

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<sup>3</sup> Proclamation No.40/1996, Licensing and Supervision of Micro financing Institutions Proclamation, Addis Ababa, July,1996

liabilities of the shareholders are limited only to the extent of their shareholding. On the other hand, as MFIs in Ethiopia are considered part and parcel of the overall financial system of the country, proclamation No. 40/1996 prohibits foreign nationals or organizations owned by foreign nationals from owning MFIs shares. The fact that MFIs are established as share companies entails that their supreme governing body is the General Assembly followed by the Board of Directors and then the executive management of the company.

Jansson and et. al (2004) <sup>4</sup> argues that since organizing MFIs as share company allows for distribution of risk, improved oversight (check and balance system), prompt re-capitalization through sell of shares and promotion of balanced control of owners through appropriate capital structures, share company is the most appropriate legal form of conducting financial intermediation activities.

The Commercial Code of Ethiopia (1960) stipulates that the minimum and the maximum number of shareholders in a given share company to be between the range of 3 and 12. The board has got its own chairman as elected by the board and a secretary. Moreover, with the intention of providing incentive and ensuring of good governance, the code allows remunerations to be paid to members of the board of directors as determined by the general meeting. In addition, the members of the board of directors are also entitled to receive a specified share of the total profit of the company within a given financial year as specified in the articles of association of the company.

The duties of the directors as stated under Article 362 of the Commercial Code of Ethiopia include:

- *Keeping regular records of the management and of the meetings*

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<sup>4</sup> Jansson, Rosales and Westley 2004, Principles and Practices for Regulating and Supervising Micro finance, Inter-American Development Bank, 1300 New York Avenue, N.W. Washington, D.C.20577

- *Keeping accounts and books*
- *Submitting the accounts to the auditors and an annual report of the company's operation including a financial statement to the meeting*
- *Convening meetings as provided in the articles of association*
- *Convening a general meeting where three quarters of the capital are lost*
- *Setting up the reserve funds required by the law or the articles of association*
- *Applying to the court where the company stops payments with a view either to a composition with creditors or the winding up of the company.*

However, on top of the above duties specified in the code, the bylaws of the respective companies stipulate further duties, responsibilities and accountability of the general assembly, the board and that of the General Manager. The bylaws include articles of association of the company (that govern the operation of the company) and memorandum of association (that contains information related to the names of shareholders, manner of shareholdings, number and powers of directors etc).

The directive issued by the National Bank of Ethiopia, i.e. directive No. MFI/03/96<sup>5</sup> puts minimum educational and experience background for chief executive officers (CEOs) and Board members of MFIs.

Accordingly, the CEO of an MFI should possess BA degree in the field of social sciences and should have a minimum of three years of work experience in a senior post in a financial institution or related institutions. Moreover, the nominee is required to get a formal approval of the National bank of Ethiopia (NBE). On the other hand, members of the board of directors in the same directive are required to complete only

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<sup>5</sup> Directive No.MFI/03/96, Criteria for Selection of officers and Directors, NBE, 1996, Addis Ababa, Ethiopia

grade 12 and are not required to get approval by the NBE. Rather the MFIs are simply required to notify the selected members to NBE.

Article 364 of the Commercial Code (1960) stipulates that the liabilities of the directors to the company be:

- *Directors shall be responsible for exercising the duties imposed on them by law, the memorandum of association and resolutions of meetings, with care due from an agent.*
- *Directors shall be jointly and severally liable to the company for damage caused by failure to carry out their duties*
- *Directors who are jointly and severally liable shall have a general duty to act with due care in relation to the general management*
- *Directors shall be jointly and severally liable when they fail to take all steps within their power to prevent or to mitigate acts prejudicial to the company, which are within their knowledge*
- *Directors shall be responsible for showing that they have exercised due care and diligence*
- *A director shall not be liable where he is not at fault and has caused a minute dissenting from the action which has been taken by the board to be entered forthwith the directors*

This being the case, the regulatory body i.e. National Bank of Ethiopia has not so far issued code of conduct that could augment accountability and foster effective exercise of board's duties and responsibilities. On the other hand, if we look at the experience of other African countries, for example the case of Ugandan MFIs, the MDI act of Uganda<sup>6</sup> have clearly defined various issues including the type of ownership and governance structure, duties and responsibilities of the board, size of the board and frequency of meetings of the board, situations where all the directors of

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<sup>6</sup> Micro finance Deposit-Taking Institutions Act of Uganda, which was issued in the year 2003 and Statuary requirements issued in the year 2004.

MDIs shall jointly or severally be liable, issues that disqualify from being board member, situations where boards of directors report in writing to the central bank and other related issues.

## **2.2 DEVELOPMENT OF MICRO FINANCE IN ETHIOPIA**

Many authors and donor agencies have defined the business of micro finance in different ways. Christen and et.al (2003)<sup>7</sup> defined micro finance as the provision of banking service to lower income people, especially the poor and the very poor. On the other hand, Labie (2000)<sup>8</sup> defined Micro finance as organizations that are set up in order to finance small and micro-enterprises, which are excluded from traditional banking practice.

From the definitions given above by the authors, it could be understood that the orientation of MFIs is towards the provision of financial services to the relatively poor people who are denied of access to the conventional banking system but those who could be productive if the necessary finance is provided to them.

It is understood that the low-income section of the population in developing countries have little or no access to conventional banking service. Therefore, their participation in economic development is either limited or denied.

However, it is believed that the poor can actively participate in economic and political systems of their respective countries and can achieve economic empowerment through time.

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<sup>7</sup> Christen ,Lyman, Rosenberg 2003,Guiding Principles on Regulation and Supervision of Micro finance, CGAP/The World Bank Group,1818 H Street, N.W, Washington,D.C.20433 USA

<sup>8</sup> Labie 2001, Corporate governance in micro finance organizations: a long and winding road, University de Mons-Hainaut, Faculty Warocque, Mons,Belgium

In Ethiopia, the provision of financial services to the poor has been going on for several years by projects designed by government ministries and Non-Governmental Organization (NGOs). Several international and indigenous NGOs also used to operate micro credit schemes as a component of their integrated program. The NGOs were having unbalanced social objective and their primary objective was to disburse loans without giving due attention to the credit worthiness of the borrower and the repayment of the loan.

Moreover, the effort they were exerting to improve the quality and efficiency of their lending operations and thereby achieve growth was limited.

Meanwhile, these programs had benefited many of their immediate beneficiaries and their families. They also had introduced the very concept of micro credit and micro finance among the society. However, these unstructured and unprofessional efforts by government offices and NGOs had limitations i.e. the orientation of the service was towards project concept (lacks sustainability), there was high level of loan default, and the sole source of loan able funds were only donors and hence the program were extremely donor dependent.

In response to the exhibited deficiencies and after careful observation of the existing situation, the government came up with proclamation No. 40/96. This proclamation gave NBE the power and responsibility to license and supervise MFIs and provided operators with a legal and policy framework under which micro-financing business should be operated in Ethiopia. Then after, few of those informally operating schemes and others newly established schemes instituted themselves as a micro-financing share companies.

As at December 31<sup>st</sup>, 2006, 27 MFIs have been licensed by NBE (as one MFI has ceased operation) and are operating across the country. Moreover, these institutions serving around 1.5 million people in aggregate have mobilized a total deposit of Birr 823 million and have outstanding loan balance of Birr 2.2 billion<sup>9</sup>

## **2.3 CONCEPT OF CORPORATE GOVERNANCE**

### **2.3.1 What is Corporate Governance?**

Many authors have defined and explained the concept of corporate governance in different ways. Rock and et.al (1998)<sup>10</sup> defined corporate governance as the process by which a board of directors through management guides an institution in fulfilling its corporate mission and protects the institution's assets over time.

Here, the board of directors on behalf of the shareholders is established with the objective of providing oversight and guidance to the managers of an institution. In the above definition, the role of board of directors was given much prominence in defining and explaining the concept of corporate governance.

On the other hand, a Consensus Statement of the Council of Micro Finance Equity Funds (2005)<sup>11</sup> defined governance as a system of people and process that keep an organization on track and through which it makes major decisions.

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<sup>9</sup> Source: Micro finance Supervision Department (MFSD) of NBE

<sup>10</sup> Rock, Otero, Saltzman 1998, Principles and Practices of Micro finance Governance, Micro enterprise Best Practices, Development Alternatives, inc, 7250 Woodmont Avenue, Suite 200, Bethesda, MD 20814 USA

<sup>11</sup> The Practice of Corporate Governance in Shareholder-Owned Micro finance Institutions 2005, Council of Micro finance Equity Funds

The statement in broader terms listed the functions of governance to be:

- To uphold the organization's goals and mission.
- To guide the organization's major strategic directions.
- To maintain an organization's health over time and to mitigate risks.
- To ensure accountability throughout the organization.

Moreover, the statement underscored that board of directors are the pivotal point through which many players connect to governance and it included the following actors that have key role in micro finance governance:

- Entities that oversee the institutions' financial health: regulators and auditors
- Providers of financing: lenders, investors, and depositors
- Stakeholders who depend on the organization: customers and employees and the larger community

ASX corporate Governance council (2003)<sup>12</sup> addressed the concept of corporate governance by defining it as a system by which companies are directed and managed.

Moreover, the council stated that corporate governance influences how the objectives of the company are set and achieved, how risk is monitored and assessed, and how performance is optimized.

In addition, the council (ibid) stated that the existence of good corporate governance structures in a given business encourages companies to create value (through entrepreneurship, innovation, development and

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<sup>12</sup> Principles of Good Corporate Governance and Best Practice Recommendations 2003, ASX Corporate Governance Council, Australian Stock Exchange (ASX), Australia

exploration) and provide accountability and control systems commensurate with the risks involved.

From the above definitions and discussions given to explain the concept of corporate governance, it could be understood that governance is a systematic effort by which many actors (with varied degree of involvement) such as boards (being pivotal one), regulators, auditors, depositors and the larger public etc lead and guide a company towards achievement of its corporate missions, creation of value to the company, mitigation of risks, and ensuring of accountability and control system across the company.

### **2.3.2 Need for Corporate Governance**

For the last few years, corporate governance principles have received more attention from academics and practitioners of the micro finance field, particularly when dealing with topics of long-term sustainability and institutionalization. There are several reasons for this trend. First, the micro finance community has experienced some major failures where it clearly appeared that; among other reasons for these failures inadequacy of governance practice was to blame.

Second, the tremendous growth and the institutionalization process experienced by some organizations have provided an interesting area for further research aimed at improving internal control mechanisms, especially mechanisms linked to board action.

Third, the establishment of mutual funds as part of the shareholders structure and/or to connect the micro finance organizations with capital markets has also played an important role (Labie, 2003).

The importance of institutionalizing and ensuring corporate governance in the Micro finance sector could be viewed from the nature of the business itself. Jansson et.al (2004) argues that micro credit is crucial for millions of low-income people who depend on it to finance their business activities. It states that in Latin America, micro enterprises together constitute more than 90% of all businesses, employ over half of the labor force and produce approximately 20% of the regions GDP.

Thus, the issue of governance has been found to be one of the major prerequisites for the realization of employment creation, promotion of entrepreneurial culture and development of the micro enterprise sector through creating well-managed MFIs with high level of sustainability and increased outreach. On the other hand, the Council of Micro Finance Equity Funds (2005) argues that since financial institutions manage other people's money, their boards carry special responsibility-fiduciary responsibility-to maintain the value of those resources.

Thus, it is only through institutionalizing and implementation of corporate governance practice that boards could discharge their responsibilities as enshrined by law and ensure that the organization protects those resources.

On top of ensuring the stability and sustainability of the operations of MFIs, the exercise of good corporate governance practice in addition helps for enhancing the reputation of MFIs and boosting the confidence of depositors, creditors, investors etc. In general, since the sector is growing and expanding in terms of total loan portfolio, public deposit and outreach with increased risk appetite, exposure and assumption of responsibility to huge sums of money, the management and the board should put in place good corporate governance practices and maintain high standard of performance.

## 2.4 CORPORATE GOVERNANCE PRINCIPLES

### 2.4.1 Size and Manner of Composition of Board members

Generally, the size or number of board members should be large enough so that the board functions effectively without overburdening its members. The Consensus Statement on the Council of Micro Finance Equity Funds (2005) argues that seven to nine members appears both a common and ideal board size, though effective boards may have as many as eleven or more. The statement underscores that board having fewer than seven members is an unadvisable one.

With regards to the composition of boards, Rock et.al (1998) explains that the quality of board members is particularly important at two levels: one to hold the management accountable and to respond to external actors and issues of accountability.

Effective governance depends primarily on the skills and characteristics of the individual directors. Collectively, these attributes should represent a diverse set of experiences, backgrounds, areas of expertise, ethnicity and gender.

The following skills are important assets to any MFI board<sup>13</sup>:

**Business sense:** A micro finance board must have a solid business sense, with some financial expertise in financial analysis and financial

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<sup>13</sup> Rock, Otero, Saltzman 1998, Principles and Practices of Micro finance Governance, Micro enterprise Best Practices, Development Alternatives, inc, 7250 Woodmont Avenue, Suite 200, Bethesda, MD 20814 USA

auditing. The first one allows boards to understand and measure the performance of the MFI whereas the second one will provide them the capacity to assess the strength of the internal control mechanism of the institution.

**Micro finance experience:** Although there exists scarcity on individuals possessing such experience, it is valuable to include some individuals possessing same.

**Financial markets expertise:** Individuals who understand the local financial markets and know the players, as well as understand or have experience in international financial markets, can be important contributors as board members.

**Legal and regulatory expertise:** All MFIs, but especially those that have entered the regulated financial sector or are considering such a change, will benefit from individual directors who bring legal expertise to their boards.

**Marketing Expertise:** With increasing competition, MFIs are being required to more aggressively "sell" their products to micro enterprise customers. Because marketing is still a relatively new area for MFIs, directors with expertise in this field and in product development can provide guidance to MFIs.

**Public relations:** MFIs must be concerned with the image they project to the public at large and must be able to conduct outreach campaigns.

**Technology Expertise:** Increasing competition, emphasis on cost reduction, and the increasing complex nature of micro finance operations require that MFIs enhance the information technology they use.

**Fund raising:** For the non-profit MFI, board members are expected to play an active role in fund raising. Individuals with prior experience and contacts represent a significant asset.

## 2.4.2 Turnover Rate and Remuneration of Board Members

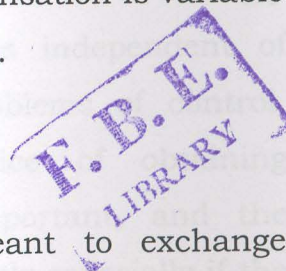
Given that the boards of most shareholder-owned MFIs are tied directly to ownership, term limits and rotation are often ignored, but this is not good practice. At a minimum, the boards of privately owned MFIs should regularly examine the performance of individual members, the size of their board, the skills on the board and potential needs for adding to the board or rotating existing members.

With regards to the compensation of BODs, the Consensus Statement of the Council of Micro Finance Equity Funds (2005) argues that compensation is important to help attract skilled people to the board and ensure that board members take their responsibilities seriously.

For instance, the statement explains that a renowned MFI in Bolivia named "Bancosol" pays a per meeting fee for both board and committee meetings. It also gives board members a 50 percent additional fee if annual targets are met. The chair is compensated for his additional effort. Thus, from the experience of "Bancosol" MFI, we can learn that the compensation scheme the MFI implement is different for members that serve the MFI at chairperson level and or at special committees within the board. Moreover, we can also learn that the compensation is variable to some extent and is tied to annual performance goals.

## 2.4.3 Board Meetings

Meetings that took place at board level are meant to exchange information and make key decisions pertaining to the affairs of the MFI in a manner that lead it towards the successful achievements of its stated objectives and goals.



The majority of board work takes place between meetings, both through committees and during informal exchanges, especially between Chairperson and CEO. Therefore, board meetings should be structured to quickly deal with routine financial and operating reports and leave adequate discussion time for strategic issues. Boards should regularly meet in executive session without management presence to discuss matters that may be particularly sensitive regarding management.

#### **2.4.4 Board Committees**

It is believed that the existences of special committees within a board that deal with specific issues of their respective specializations such as risk management, audit, promotion etc are valuable for the overall effectiveness of the board's task. Committees should meet before formal board meetings and report their progress, and findings to the board in an oral report at board meetings, supported by minutes of the committee meetings, which may follow later.

A Consensus Statement on the Council of Micro Finance Equity Funds (2005) identified the following types of special board committees as common:

***Audit / Finance Committee:*** This committee must have strongly qualified members. It meets with external auditors independent of management to understand whether there are problems of control, accounting, or financial statements. The practice of obtaining management letters from external auditors is important, and the committee must meet with the internal auditor regularly especially if the internal auditor reports to CEO.

***Executive Committee:*** This committee normally meets between formal board meetings. Its mandate should be clear: not to take authority away

from the board but to assist the board in carrying out its role. If the board meets frequently, for example monthly, there may be no need for an executive committee.

**Compensation/ Personnel Committee:** This committee determines compensation for the CEO and other senior management and provides guidance on overall compensation increases and incentives. It deals with the adequacy of human resources in the MFI and the sensitive issue of management succession.

**Risk Management/ Investment Committee:** This committee examines issues such as portfolio risks, maturity and foreign exchange mismatches, and the need for financial resources in the form of long-term loans, equity investment, and the like.

**Temporary Committees:** Ad hoc committees are formed for a limited time period to oversee specific issues (e.g. nominating committee to nominate new board members).

#### **2.4.5 Responsibilities of the Board**

Often the responsibilities of members of the board of directors along with their duties are stipulated in the legislation of the country where that company is operating. Moreover, such duties and responsibilities are included in the bylaws of company's like in the Articles and/or memorandum of association of the company's.

This being the case, Rock et.al (1998) categorized the major responsibilities of boards into five categories:

**Legal Obligations:** This responsibility requires that boards need to ensure the compliance of their respective institutions with regards to its own bylaw, procedures and other legal requirement. Moreover, in cases of MFIs that have a regulated status, the boards must ensure that the

institution understands and abides by the regulatory requirements that frame its activities.

**Relationship between board and executive:** This area requires board clarity about the roles and responsibilities of each, and the complementarities of these roles. As part of this role, the board must ensure management accountability by hiring competent professionals as executives, establishing clear goals for their performance, monitoring executive performance closely, and confronting weakness when they exist.

**Setting policy and providing strategic Direction:** Boards must work closely with management in carrying out this role to ensure congruence between the institutions strategic thinking and its operations.

**Fiduciary Obligations:** Boards must ensure that the financial solvency of the institution is maintained. This responsibility requires oversight of resources available to the institution, their use to achieve the institutions mission and their proper management overtime.

**Board Assessment of its own Performance:** A board must evaluate itself on a regular basis. Thus, the board has responsibility to renew its membership with infusion of new directors, and to evaluate its own decision making process.

Similarly, CGAP<sup>14</sup> Focus Note (No.7) explained that Fiduciary, Strategic, Supervisory and Management Development are the four specific roles that boards are required to discharge. Accordingly, the board is responsible to safeguard the interest of all stakeholders (fiduciary), participate in the setting of long term strategy, manage risk and approve plans (strategic), delegate authority to the board and supervise management in the execution of the approved plans (Supervisory) and supervise the selection, evaluation, and compensation of senior management team and plan the succession of CEO (Management

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<sup>14</sup> Consultative Group to Assist the Poor (CGAP) is made up of 29 international donor agencies that support Micro finance.

development). Thus, both authors have similar position with regards to specific roles that boards assume.

On the other hand, ASX<sup>15</sup> Corporate Governance Council (2003) recommends 10 essential corporate governance principles that boards are required to put in place and ensure across their companies. The essential corporate governance principles that the council recommends include:

**Lay solid foundations for management and oversight:** The Company's framework should be designed to enable the board to provide strategic guidance for the company and with effective oversight of the management and to clarify the respective roles and responsibilities of the management and the board.

**Structure the board to add value:** The board should be structured in way that allows itself to properly understand and competently deal with the current and emerging issues of the business and effectively challenge the performance of the management.

**Promote ethical and responsible decision-making:** Standards of ethical behavior and code of conduct should be in place for the company's directors and key executives who have the opportunity to materially influence the integrity and strategy of the business

**Safeguard integrity in financial reporting:** The company should have a structure that can review and authorize the truthfulness and factual presentation of the company's financial position through audit committees, external auditors etc

**Make timely and balanced disclosure:** The Company should disclose all material aspects that are of concern to many users of the statements

**Respect the rights of shareholders:** Respect the rights of shareholders and facilitate the effective exercise of their rights through communicating

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<sup>15</sup> Australian Stock Exchange

effectively with them, giving access to balanced and understandable information, facilitate and ease their participation in general meetings

**Recognize and manage risk:** Establish a sound system of risk oversight and management and internal control. The system should be designed to identify, assess, monitor and manage risk.

**Encourage Enhanced Performance:** Directors and executives should be equipped fairly with knowledge to discharge their responsibilities fairly and their work should be reviewed.

**Remunerate fairly and responsibly:** A company should adopt a remuneration policy that attract and maintain talented and motivated directors and employee's so as to encourage enhanced performance of the company.

**Recognize the legitimate interests of stakeholders:** As companies have a number of stakeholders other than the normal shareholders like clients, regulators, employees etc, they have to recognize and respect the legitimate interest of these stakeholders.

## 2.5 PRACTICES OF MICRO FINANCE GOVERNANCE IN OTHER COUNTRIES

### 2.5.1 Governance practice in Uganda<sup>16</sup>

A study on Governance Needs of Ugandan Micro finance Institutions (2005) states that MFIs found in Uganda has got a wide range of ownership structure. The study states that there are various types of ownership status in Uganda.

The different classification of MFIs in Uganda is presented as follows:

- **Companies limited by guarantees having NGOs status:** These institutions or MFIs maintain two legal forms. The first is that they are licensed as NGOs and secondly are registered as companies limited by guarantees. They were originally formed with the objective of services other than Micro finance services and are giving Micro finance services with their other social or welfare services.
- **Companies limited by guarantees without having NGOs status:** These institutions are similar to the above except the fact that the law under which they get registered vary. Thus, the law that governs NGOs i.e. NGOs have to be strictly for non-profit doesn't govern these types of institutions.
- **Companies limited by shares:** These are companies founded by some few individuals and sometimes a donor and some locals. Shareholders having board members that are accountable to the owners own the MFIs.

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<sup>16</sup> This section is adapted from a study made on the Governance Needs of Ugandan Micro finance Institutions (MFIs), by the Association of Micro finance Institutions of Uganda (AMFIU), 2004, Uganda

- **Saving and Credit cooperative societies:** The MFIs under this structure are owned by their members and each member has got a stake in the MFI.
- **Pure NGOs:** The MFIs found in this structure are NGOs with Micro finance component along other social activities of the NGO. The NGOs deliver the micro finance services without being incorporated as liability companies.

The owners of the above diverse institutions among others include: Non Governmental Institutions; International Investment Companies; Local investors; Government; Staff members and others. Thus, unlike the case in Ethiopia, foreigners like the international investment groups and other foreign investor's are allowed to own or engage in micro finance business. Thus, according to the study, the involvement of foreign investment companies has enabled Uganda to attract equity investment, introduce new technology and improve ownership and governance structure.

Similar to the case in Ethiopia, Uganda's Micro finance Deposit-Taking Institution (MDI's) are required to get license from the central bank of Uganda and are required to be organized as Share Company. Moreover, there exists a specified MDI act stating that no person or group of related persons shall hold more than thirty percent of the total shares of an institution. The act also provides some flexibility in the percentage of shareholding (to be owned by a single or group of related persons) that if any person or group of related persons holds more than 30 % of the share, it is required to reduce the percentage of the shareholding to appropriate level (i.e. 30%) within five years from commencement of the act.

The responsibilities of the board, finance manager, internal auditors and external auditors are clearly articulated in the MDIs act (issued in 2003).

This is beneficial for strengthening and enhancing the governance system of MDIs.

The study moreover explains that practices of governance vary from MFIs found in one legal structure or tier group to MFIs found in other structure or groups. Accordingly, most of the MFIs board members particularly those from the lower category lack practical experience in micro finance or general financial sector operations.

In general, qualification and exposure to the sector, dedication to serve their institutions and degree of guidance and support being delivered by members of the board to their respective management decline as one goes from the upper graded MFIs to the lower graded MFIs.

### **2.5.2 Ownership structure and Governance practice in the developing world<sup>17</sup>**

According to a study conducted by Kaddaras and Rhyne (2004), the ownership structure and corporate governance practices of shareholder owned MFIs found in the developing world<sup>18</sup> varies widely. According to the study, the ownership structure of the surveyed MFIs that are found in the above mentioned regions appeared quite mixed with the number of shareholders ranging from 3 to 112. Moreover, the type of shareholders included a wide variety of players both local and international NGOs, private social and commercial investors, individuals and staff members of the organization. The study drew and identified four models of ownership among the responding institutions. These models are briefly described as follows:

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<sup>17</sup> This section is adapted from a study conducted on characteristics of Equity investment in Micro finance, James Kaddaras and Elisabeth Rhyne, 2004 , Council of Micro finance equity Funds.

<sup>18</sup> These Developing Countries are drawn from Latin America and Caribbean, Eastern Europe, Asia, Africa and the Middle East

The first model includes MFIs that transformed from NGOs whereby the original NGO remains a significant shareholder in the resulting MFI holding a substantial minority. Here the local NGOs retain very significant control in most of the cases of the transformed MFIs.

The second model of ownerships includes institutions with a small group of mainly international shareholders working together. In this model, the ownership is fairly evenly distributed among the handful of investors (foreign) and local investors play relatively a minor role.

The third model included MFIs that are majority owned subsidiaries of local private banks. In this case the bank has generally selected a few additional shareholders who bring specific skills or perspectives into the ownership group. This model is peculiar due to the fact that it represents significant local private commercial capital.

The fourth model of ownership involves institutions with a relatively large number of local shareholders both organizations and individuals. The shareholders were brought through equity raising effort made by the original sponsors.

From the above discussion, it can be learned that the surveyed MFIs that are found in the different regions of the developing world exhibited four models of ownership. Accordingly, the models included MFIs that are transformed by local NGOs and majority owned by same, MFIs that are owned by foreign investors and whose shareholding is evenly distributed among them, MFIs that are subsidiaries of local private banks and their capital being majority owned by the local banks and MFIs owned by large number of local individual and organizational investors.

With regards to the composition of board members, it showed uniformity in that of the 21 respondents, 18 had boards between the ranges of 5 - 8.

Moreover, board of directors representing shareholders outnumbered independent directors.

Of the 21 surveyed institutions, the existence and type of board committee's showed greater variation. Accordingly, fifteen of the 21 MFIs have audit committees. Only four of the MFIs have asset liability management (liquidity committees) and risk committees. Two institutions have credit committees at the board level and another two have compensation committee that determines the executive level compensation.

As to the remuneration policies for board of directors, seven of the 21 MFIs reported the existence of policies in place to remunerate the service of their boards. Two of the seven MFIs pay their chairperson a greater remuneration than that paid to other board members.

From the seven MFIs that remunerate their boards, two have a policy of paying additional remuneration for board members who assume additional responsibility as result of being member in board committees.

Regarding the relationship of the board of directors to the General Manager of the MFI, the study attempted to gather information on issues pertaining to evaluation and the compensation of the General Manager. Accordingly, sixteen of the 21 responding institutions reported that there exists a job description for the general manger/ managing director, although in three of those cases, the MFIs stated the description is contained in the charter or bylaws of the company. Three MFIs reported that there is no job description for the General Manager and two MFIs did not answer this question.

With regards to the existence of explicitly stated performance goal for the General Manager other than what is stated in the business plan or

budget of the MFI, only three of the 21 responding MFIs replied that there exist such annual performance goals for the General Manager.

The General Managers of the surveyed MFIs stated the following to be the greatest challenges facing their institutions:

- Difficulty of maintaining a balance between the MFIs social and financial objectives
- Problematic composition of their current board of directors
- Less value addition from the board of directors
- Lack of commitment to work for the MFI transparently and raise the quality of corporate governance

The study concluded that corporate governance practice of MFIs surveyed varied widely. Although the responses of MFIs indicated the existence of good corporate governance, the study revealed significant room for improvements in many cases. According to the study, the tradition of strong corporate governance in the least developed countries and in countries emerging from economies featuring central planning proved to be found at its infancy. The study also forwarded specific practical recommendations that would enhance the practice of good corporate governance practice. Some of the recommendations of the study include increased use of board committees and independent directors, more formal process for hiring, evaluating and compensating the general manager and the establishment of clear policies regarding conflicts of interest and director responsibility.

## CHAPTER THREE

### 3. Governance of MFIs in Ethiopia

#### 3.1 OVERVIEW OF MFIs PERFORMANCE IN ETHIOPIA

As at December 31<sup>st</sup>, 2006, a total of 27 Micro Finance Institutions (MFIs) serving around 1.5 million clients are operating across the country. The institutions are providing their services with their operational offices (branch and sub-branches) that are extended throughout the country. As can be seen under Table 2 of this chapter, the MFIs with the exception of some regions i.e. Afar, Somali and Gambella are operating in all the remaining regions of the country.

The following table shows the number of MFIs licensed by NBE starting from the promulgation of the Micro finance law in 1996 up to end of the year 2006.

**Table 1: Number of MFIs licensed**

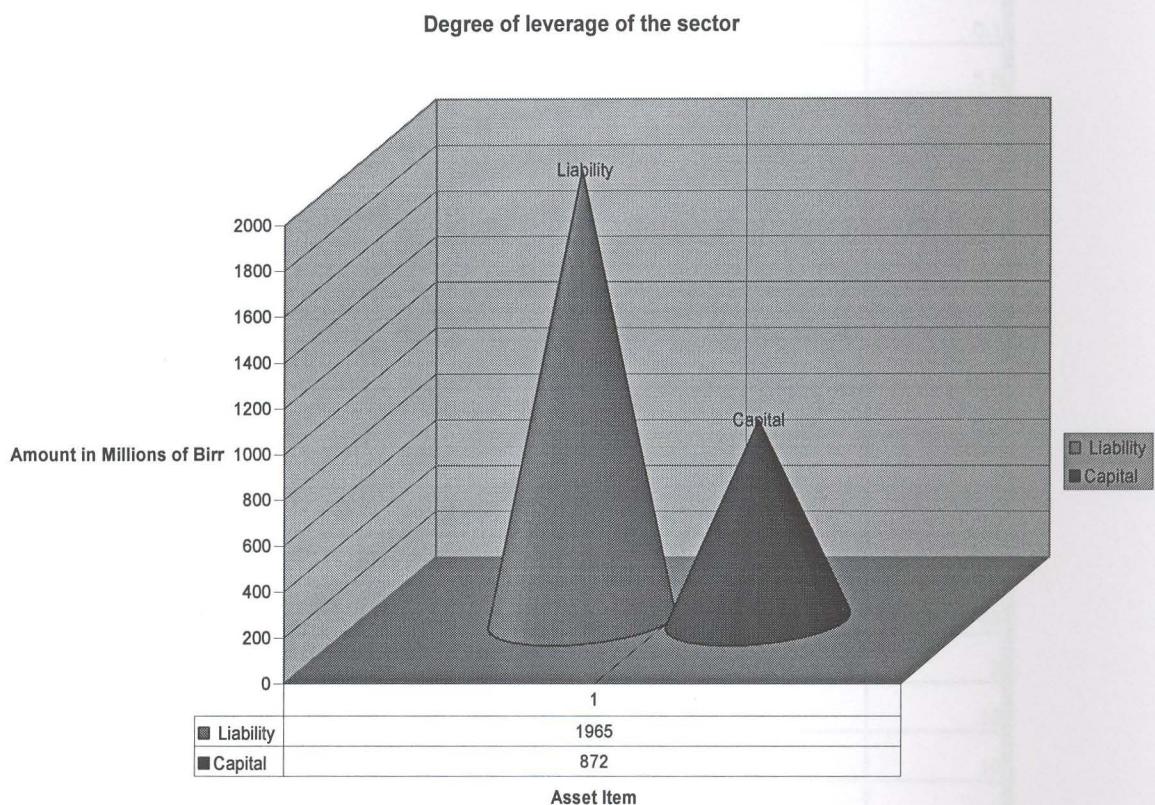
Year	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Total
No.	5	5	3	4	2	2	1	2	3	1	28*

**Source:** NBE database

Note\*: One MFI has discontinued its operation and has ceased to exist.

According to data obtained from NBE, the consolidated balance sheet of the MFIs as at December 31<sup>st</sup>, 2006, shows that the total assets of the sector has reached Birr 2.8 billion which is around \$325.6 million.

Regarding the composition of total assets, as of December 31, 2006, net outstanding loan accounted the highest share (74.2%), followed by cash in bank (10.2%), other assets (6.0%), fixed assets (5.5%), short term investment (2.7%), cash on hand (1.3%) and long term investment (0.1%). Thus, loan portfolio, necessitating effective governance and management for maintaining its quality and productivity is the biggest asset of MFIs (like other financial institutions). MFIs leverage or pull funds either from shareholders in the form of equity (or donation) or through accessing commercial or subsidized borrowing. To this effect, the MFIs in Ethiopia raised significant proportion of their assets from debt.



Thus, the total liability of the industry as of December 31<sup>st</sup>, 2006, amounted Birr 2 billion. Moreover, as can be seen in Table 2, total deposit financing 38% of the gross outstanding loan and 29% of total

assets of the sector stood at Birr 823 million. On the other hand, total capital leveraging only 31% of the total asset of the industry reached Birr 872 million.

**Table 2: Consolidated Balance Sheet of the Sector  
As at December 31<sup>st</sup>, 2006**

Items	Birr in Millions	% to total assets
Assets		
Cash on hand	38	1.3
Cash in banks	288	10.2
Short term investment	78	2.7
Loans	2168	76.4
Provision	-62	-2.2
Net loans	2106	74.2
Long term investment	2	0.1
Fixed Assets & Inventory (B.V)*	154	5.5
Other Assets	171	6.0
<b>Total Assets</b>	<b>2837</b>	<b>100.0</b>
Liabilities & Capital		
Savings	805	28
Other Deposits	18	1
Borrowing From NBE	0	0
Borrowing from other banks**	132	5
Borrowing from non banks	25	1
Other short term liab.(A/p)	342	12
Other long term liabilities	643	23
<b>TOTAL LIABILITIES</b>	<b>1965</b>	<b>69</b>
Paid up Capital (Share holders)	96	3
Donated Equity	270	10
Other Capital Account	290	10
Retained Earnings	85	3
Profit/Loss	131	5
<b>TOTAL CAPITAL</b>	<b>872</b>	<b>31</b>
<b>Total liabilities &amp; Capital</b>	<b>2837</b>	

Source: National Bank of Ethiopia

Note: \* -original cost less depreciation, \*\*- DBE and other bank loans

Table 3 shows the positions that each MFI holds with regards to total assets, total deposit and gross loan outstanding. Thus, from the 27 MFIs, the market shares of MFIs that are supported by regional governments account for a significant proportion.

With regards to earning, the micro finance industry for the quarter ended December 31<sup>st</sup>, 2006, earned a net operational profit of Birr 32.7 million and the operational self-sufficiency ratio of the sector stood at 151.7%. Here, it should be noted that not all MFIs are generating operational profit and there are MFIs that are still incurring loss.

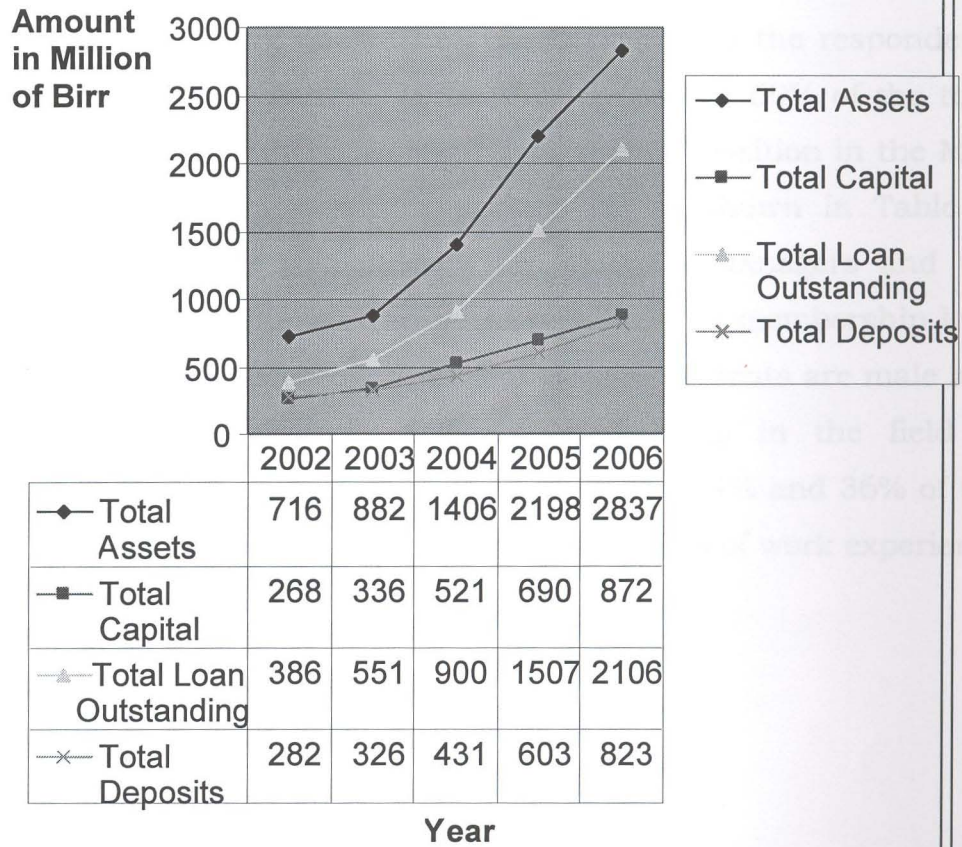
47.3	24.1
17.9	25.2
0.3	0.7
7.0	12.1
10.1	18.9
27.1	28.1
2.1	2.1
140.5	222.4
10.3	14.4
24.7	31.1
18.4	26.0
19.8	25.2
2.1	3.7
3.3	5.0
4.5	15.7
3.4	5.0
3.0	4.1
0.3	0.4
0.3	0.5
0.3	0.6
106.3	2837.1

**Table 3: Financial Data of MFIs**  
**As at December 31, 2006 (Figures in Millions of Birr)**

N.o	MFIs	Regions	Total Deposit	Net loan Outstanding	Total Asset
1	ACSI	Amhara	365.8	678.6	842.4
2	DECSI	Tigray	201.0	719.3	1039.6
3	OCSSCO	Oromia	93.0	226.6	274.9
4	Omo*	SNNPRS	51.2	106.9	144.0
5	SFPI*	A.A, Oromia	7.3	19.6	23.2
6	Gasha*	A.A, Oromia	5.1	11.8	17.6
7	Wisdom*	Amhara,SNNPRS, Oromia	12.9	47.3	54.3
8	Sidama	Sidama,SNNPRS	6.0	17.9	25.2
9	Asseer	A.A	0.3	0.3	0.7
10	AVFS*	A.A, Oromia	2.4	7.0	12.1
11	Bussa Gonofa*	Oromia	2.4	10.1	14.9
12	PEACE*	Oromia,SNNPRS, Amhara	6.0	27.1	29.2
13	Meket	Amhara	0.4	2.1	2.7
14	Addis MFI	A.A,	43.7	140.6	222.8
15	Meklit	A.A, Oromia	4.6	10.3	14.4
16	Eshet*	Oromia	2.9	24.7	31.1
17	Wassassa*	Oromia	5.6	18.4	26.0
18	Benishangul Gumuz*	Benishangul	6.0	19.8	25.8
19	Shashemene Iddirs*	Oromia	0.7	2.1	3.7
20	Metemamen*	A.A, Oromia	0.1	3.5	5.1
21	Dire*	Dire Dawa	1.2	4.5	15.7
22	Agar*	A.A	1.5	3.4	5.6
23	Harbu*	Amhara, Oromia	1.5	3.0	4.1
24	Ghion	A.A, Amhara	0.3	0.3	0.6
25	Leta	SNNPRS	0.0	0.5	0.8
26	Digaf*	A.A	0.4	0.5	0.6
27	Harar	Harari			
	Total		822.7	2106.3	2837.1

**Source:** National Bank of Ethiopia, Note\*: These MFIs are included in the sample

**Growth Trend of Four Selected Balance Sheet  
Items of the MF sector  
End of Year**



As can be observed in the above chart, the aggregate assets, total capital, loan outstanding and total deposits of the sector have shown an increasing trend over the years starting from 2002-2006.

### **3.2 CHARACTERISTICS OF SAMPLE MFIs AND RESPONDENTS**

The MFIs that are included in the sample are of differing size, ownership structure, geographical location (work environment) and varied years of establishment. Moreover, the sample MFIs was drawn from both loss making and profit making ones. The characteristics of the respondents that are drawn from the sample MFIs (that constitute 60% of the total MFIs operating in the country) as identified by their position in the MFI, sex, age, education level, work experience etc is shown in Table 4. Accordingly, 60% of the respondents are General Managers and the remaining 40% are found either at board chairman or membership level of their respective MFIs. Moreover, 84% of the respondents are male and over 86% of the respondents, majorly specializing in the field of economics possess at least BA degree. In addition, 44% and 36% of the respondents have 5-10 years and more than ten years of work experience or exposure in micro finance, respectively.

**Table 4: Characteristics of Respondents**

Classification Bases	Characteristics of Respondents		
	Composition	Number	Percentage
Position In the MFI	Board Chairman	6	24
	Board Member	4	16
	General Manager	15	60
		25	
Sex	Male	21	84
	Female	4	16
		25	
Age	20-30 years	1	4
	31-40 years	6	24
	41-55 years	16	64
	Above 55 years	2	8
		25	
Marital Status	Married	22	88
	Single	1	4
	Widowed	1	4
	Divorced	1	4
		25	
Education Level	Below Diploma	1	4
	Diploma	2	8
	First Degree	17	68
	M.A, MSC, MBA, PHD	5	20
	Other		0
		25	
Field of Specialization	Accounting	6	24
	Management	4	16
	Economics	11	44
	Others	4	16
		25	
Work Experience in Micro finance	Less than 2 years	2	8
	2-4 Years	3	12
	5-10 Years	11	44
	More than 10 Years	9	36
		25	

**Source:** Collected from questionnaire

### **3.3 ANALYSIS AND DISCUSSION OF FINDINGS**

#### **3.3.1 ASSESSMENT ON THE OWNERSHIP STRUCTURE OF SAMPLE MFIs**

Governance is theoretically the natural outcome of ownership structure and composition in which a company is operating. In Ethiopia, like the case in most other countries, the basic premises among others for transforming unlicensed, unregulated and informal providers of micro finance service to a formal and regulated one is to improve their ownership structure and governance practices and enable them be sustainable and efficient MFI. Thus, the composition of ownership is of utmost importance for the healthy functioning of an MFI and it has a direct bearing on the locus of control of the entity and hence decision-making. Ownership influences mission and direction and has also significant effect on stability, sustainability and access to funding during the time of crisis or for growth need and it has also effect on the public confidence of the MFI.

In the following table, the ownership structure of MFIs that are included in the survey is presented with respect to identity of the owners, percentage shareholding and the size of shareholders.



**Table 5:****Ownership Structure of Sample MFIs**

No.	MFIs	Regional Government	Public organizations/ Associations	Local NGOs	Staff or Affiliates of Founding NGOs	Private Individuals/ companies	Clients	Total no. Of Shareholder
1	Omo	1 (80%)	10%	10%				5
2	SFPI		2 (19.7%)	2 (19.7%)	1 (9.85%)	2 (50.75%)		7
3	Gasha			1 (34.1%)			873(65.9%)	874
4	Wisdom				25 (67.6%)	12 (32.4%)		37
5	PEACE			1 (16%)		14 (84%)		15
6	Bussa Gonofa			1 (93%)	15 (7%)			16
7	AVFS					7 (100%)		7
8	Eshet			1 (20%)	5 (80%)			6
9	Digaf					5 (100%)		5
10	Wasasa			1 (20%)	6 (80%)			7
11	Metemamen			1 (60%)	8(40%)			9
12	Agar					475 (100%)		475
13	Harbu				11 (100%)			11
14	Shashemene				2(3%)	1735(58%)	1098(39%)	2835
15	Dire	1 (97%)	4 (0.4%)			2 (2.6%)		7
16	Benishangul	1 (40%)	4 (60%)					5

**Source:** Collected from questionnaire

At first glance of the data in Table: 5, the range of ownership patterns appears quite mixed, with the number of shareholders within one MFI ranging from 5 to 2835, and types of players including a wide variety of shareholders i.e. regional governments, local NGOs, clients, public organizations/associations and private individuals with the exception of international players.

As indicated in the table below, three of the MFIs (19%) responded that the number of shareholders in their MFI is equal to that of board

members. This creates problem related to ensuring of accountability on the governance system of their institutions and in allowing sufficient turnover on the part of board members.

Another question asked in the survey was whether or not their shareholders size is sufficient for permitting effective governance. As a result, 60% of the respondent's believed that the number of shareholders found in their MFI is sufficient. However, it should be noted that although adequate size of shareholder has a positive impact on the quality of governance (through enabling BODs turnover, improving accountability etc), what more importantly matters is the commitment and capacity of shareholders in ensuring quality governance in their institution.

**Table 6: Shareholders Size**

Question	Response						
	Yes		No		Do not Know		Total
	No.	%	No.	%	No.	%	No.
Is no. of shareholders equal to that of Board members	3	19	13	81			16
Do you think that current no. of shareholders is sufficient	15	60	8	32	2	8	25

**Source:** Collected from Questionnaire

### I) Models of Ownership

The crucial issue in designing MFIs ownership structure is to assure that the ownership group works effectively together. A more prevalent model is a group of investors each holding a substantial minority of shares whereby controls is often asserted through blocs of like-minded

institutions who act together. Moreover, a model whereby well articulated special provisions in bylaws like code of conduct, memorandum of association and articles of associations are in place and implemented accordingly helps for securing better control and governance.

In the part to follow, different models of ownership based on responses of the surveyed institutions and the characteristics of shareholders in which the majority belongs and their level of shareholding is identified and presented.

**Regional Government Based MFIs:** In this model, three of the samples MFIs that are majorly owned by their respective regional governments are included. The extent of ownership by these regional governments ranges from 40% to 97% (in the case of one MFI) and the remaining minor shares are divided among other public organizations and associations for the purpose of fulfilling the legal requirement of being a share company. In this model of ownership, power and control is concentrated in the hands of the regional governments that hold quite significant equity share of the MFIs. Here, the effective functioning of check and balance system is hampered and the legal provision that limits single shareholding to the extent of 20% is dishonored. In addition, since BODs of such institutions are drawn from governmental offices, they are mostly highly ranked government officials. Hence, these board members are preoccupied in pursuing other responsibilities and lack sufficient time to devote in discharging their responsibilities.

**NGO Based MFIs:** This is another model whereby 8 of the surveyed MFIs belong. In this model, NGOs playing the major role in the affairs of the MFIs have got stake in the shares of the MFIs in one way or other. In the case of one MFI where the NGO is an international one, the shareholders of the MFI are entirely composed of the staff of the NGO (having

Ethiopian nationality) and other private individuals/companies. In the case of one MFI, two commercial banks showed up interest and invested in the shares of the MFI. In the remaining cases, local NGOs involved themselves as shareholders of the MFI (in 1 MFI possessing 93% of the total share) and by letting their staff members to be shareholders of the MFI with their names (the fund being generated from the NGO).

In this model, the MFIs are basically there to promote and implement the social missions and objectives of the founding NGO through provision of micro finance service to the poor (social return being given priority over that of financial return). As the shareholders are coming from similar field of discipline, it is unlikely that diverse ideas and opinions that bear a positive impact on the operations of the MFI are brought up, discussed and employed.

**Client Based MFIs:** This model includes two institutions whereby the majority of shareholders are clients of the MFIs itself. In this model, similar to the model discussed above, the original initiators and providers of the fund are the NGOs themselves. However, instead of making affiliated individuals of the NGOs as shareholders, the founding NGOs of these client based MFIs opted to make the MFI a community based one and organized their previous beneficiaries to be shareholders of the MFI by even donating money (some cases) that will enable the beneficiaries (clients) to buy shares. In this ownership model, the major governance problem emanates from lack of knowledge and basic skill on the part of clients that will enable them to supervise and oversee the operation of the concerned MFIs.

**Private individuals/company based MFIs:** In this final model, three MFIs claimed that their shareholders are purely (100%) individuals who invested their own money to the MF business in expectation of receiving dividends. However, this response is in contrary to the observation of the

researcher in that only one of the MFIs (among the three) is known to have pure investors having pure commercial objective and the equity capital entirely coming from pockets of shareholders without raising funds from donors.

As discussed above, revealing diversity as to the nature of shareholders, size of shareholders and percentage shareholding, four models are identified and discussed. The finding of the study moreover revealed that the sector so far has not attracted private, local commercial capital (except in few cases) and the shareholding of almost all MFIs is tied either to regional governments or other organizations. This pattern adversely affects the quality of governance practice and the prudent and sustainable operations of the MFIs.

The respondents were also asked to provide their opinions as to the reasons for limited participation of the private sector in micro finance. Accordingly, respondents among other factors attributed the relatively less profit potential of the sector to be the major reason for not attracting private capital. In essence, the concept of profitability is a culmination of factors arising from internal factors (efficiency & effectiveness) and external factors like government, legal and regulatory environment etc.

**Table 7: Factors that limited participation of the private sector**

<b>Factors</b>	<b>No. of Responses</b>	<b>Percentage to total responses (%)</b>	<b>Rank</b>
<b>Less profit potential</b>	18	36	1
<b>High Credit Risk</b>	17	34	2
<b>Unfair competition</b>	4	8	4
<b>Problematic lending Methodology</b>	4	8	4
<b>Strict Regulation</b>	7	14	3
<b>Others</b>		0	5
<b>Total</b>	50	100	

**Source:** Collected from questionnaire

To this effect, respondents forwarded a number of recommendations that must be worked out for the increased participation of private investors in the Micro finance business. As the issue is a policy oriented one, most of the recommendations that are forwarded by respondents directed towards the role that government could play.

The major recommendations forwarded by the respondents are summarized as follows:

- The sector should be fully commercialized by making the prior agenda of the sector a business one instead of poverty alleviation.
- Government should control and avoid any unlicensed operators of the business as they distort the market and micro finance should be promoted as a legal and formal financial institution.
- The Government should revise (relax) its regulation pertaining to the prohibition of foreigners from owning MFIs share
- The major risk of MFIs that is believed to make private investors be reluctant to show interest and invest in micro finance is credit risk.

Thus, in order to mitigate that risk, the central bank should facilitate the introduction of a well functioning contract enforcement mechanism with respect to collateral registration and authentication, issuance of foreclosure law etc.

- The role of government in micro finance business should be limited or avoided and particularly the provision of subsidized lending operations should be discouraged and stopped.
- Intensive education, publicity and promotional activities on the role that MFIs could play and the environment in which MFIs operate should be made on rigorous and continuous basis.
- Equal level playing field should be exercised for all formal and legal actors of the business, fair competition should be in place and local administrations should provide equal support for all MFIs involved in the business.
- As the pay back period for MF business is relatively high, the issue of tax exemption and/or tax holiday for MFIs should be unequivocally decided and applied.
- Moreover, establishment of different form of MFIs likes credit only MFIs in a tier system approach should be studied and implemented.

Thus, all concerned parties should consider the recommendations identified and should play their respective role as to the realization of same.

## **II) Legal provisions related to the organization of MFIs**

It is to be recalled that the Ethiopian law (proclamation no. 40/1996) states that only institutions that are formed as share companies should carry out Micro finance business and the ownership of such businesses should only be limited to individuals/organizations with Ethiopian nationality. However, this provision has been so far a controversial one



and therefore is important to have a look at the views and opinions of the operators (MFIs) from different angles.

As can be observed in the table below, the majority of shareholders felt that organizing MFIs as share companies has helped them in ensuring check and balance system in their institutions.

To this end, 24% and 52% of the respondents said that share company form of organizing MFIs has been highly effective and effective in ensuring check and balance system, respectively. On the other hand, 16% of the respondents in total denounced the effectiveness of the system and replied that the system is less effective (8%) and ineffective (8%) while 8% of the respondents have no opinion on the matter. Most of the respondents that favored share company form of ownership justified that share company form helps for building check and balance system, raising funds through sell of shares when needed etc.

**Table 8: Response Pertaining to the Legal Structure of MFIs**

Question	Response										
	Highly Effective		Effective		Less Effective		Ineffective		No opinion		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	No.
<b>Effectiveness of organizing MFIs as S.Co.</b>	6	24	13	52	2	8	2	8	2	8	25
	Highly App.		Moderate App.		Least App.		Inapp		Indifferent		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	No.
<b>Appropriateness of prohibiting foreigners from owning MFIs shares</b>	3	12	2	8	8	32	10	40	2	8	25
	Highly Sat.		Sat.		Less Sat.		Unsat.		Indifferent		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	No.
<b>Degree of satisfaction on payment of Subscribed Capital</b>	3	14	7	32	8	36	4	18			22
	Strongly Agr.		Agr.		Disagree		Strongly Disagr.		Indifferent		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	No.
<b>Agreement on 20% limit for single shareholding</b>	4	17	8	33	5	21	3	12	4	17	24

**Source:** Collected from questionnaire

On the other hand, significant number of respondents that favored this form of ownership put conditions like permission of foreign owners (social investors, international investors etc) and considerations for other additional choices of ownership instead of limiting Share Company to be the only means.

With regards to the appropriateness of prohibiting foreigners from owning MFIs shares, only 12% and 8% of the total respondents reacted that the prohibition is highly appropriate and moderately appropriate, respectively. On the other hand, 32% and 40% of the total respondents denounced this provision by responding as least appropriate and totally inappropriate, respectively. The remaining 8% replied that they are in different as to the appropriateness of the law. Thus, the stand of the majority of operators with regard to this important and crucial issue is that the prohibition should be lifted or at least relaxed. To this end, respondents were asked to state the benefits and costs that foreigners bring to their MFI if were allowed to own their shares.

Accordingly, most of them stated the following as the major benefits:

- Introduction of new working system, capacity, knowledge and international experience
- Better management system, control, accountability and enhanced governance
- Increased capital base, better accessibility of services (outreach) and thereby enjoying economies of scale

On the other hand, the respondents stated the following as costs (disadvantages):

- Mission drift
- Repatriation of foreign currency, capital flight
- Adversely affecting local operators through posing fierce competition

However, it would be plausible to state that some few respondents felt no cost as to permitting foreigners to own their shares particularly that of social investors. There are strong arguments that international investors can bring important assets to the MFIs on top of strictly the financial

one. Moreover, the relative lack of appropriate local sources of investment highlights one of the main rationales for international investment in micro finance. Thus, in a nutshell, given the level of poverty and the size of tremendous unmet micro finance demand, it would be reasonable to at least relax the limit (review the provision) through appropriate and rigorous analysis of the benefits and costs involved at both micro and macro levels.

The other point of concern is the law that prohibits a single shareholder of a Micro financing institution Share Company not to own more than 20% of the total capital of the company. However, it has been observed in the previous discussion that some institutions have dishonored this requirement. This being the case, respondents were asked to express their level of agreement and provide justifications on the issue by considering the reality prevailing on the ground i.e. the majority (or all in some cases) of the capital required for establishing MFIs is originating from one source.

Accordingly, 17% of the respondents expressed their strong agreement on the presence of the limit and 33% of the respondents expressed their agreement on the limit. On the other hand, 21% and 12% of the respondents expressed their disagreement and strong disagreement, respectively. The other 17% remained indifferent. Thus, from the above response, it can be deduced that significant number of the respondents are not in favor of the provision that sets the limit. Accordingly, respondent's that expressed their agreement or disagreement argued differently. Respondents that are in favor of the limit argued that through such limit, it would be possible to combat dominance and monopoly by few or single shareholders (by limiting voting power of shareholders) and helps the decision of the board not to be dominated by the single interest of dominant shareholder. On the other hand, by considering the reality prevailing on the ground, respondents that are against the limit refuted

the previous idea and denounced the appropriateness of the limit. These respondents provided the following rationales for their position:

- Because of such limit, de-facto investors (nominal shareholders) proliferate in a really single shareholder (be it government or donor) institutions
- Donors will be reluctant to raise or inject additional capital as share capital and hence the capital adequacy of the MFIs will get adversely affected.
- The limit hampers efforts of voluntary organizations that work to access the needy and serve their micro financial needs.
- Given the few number of investors interested to invest in micro finance, it would be better to let investors invest individually and invest as much as possible.
- The focus should be in creating conducive legal framework with primary focus on creating sustainable access and broader outreach of services and at the same time by maintaining best industry standards and practices.

Substantiating the justifications provided above, the respondents from the surveyed MFIs rated the level of subscription capital payment of shareholders to be least satisfactory (36%) and unsatisfactory (18%). Some of the reasons cited by respondents for the least performance of shareholders in paying their subscription include:

- The subscribed capital of the MFI is written in the bylaws only for fulfilling legal purpose.
- The source of fund used to raise the paid up capital of some institutions is that of donors and subsequent cash outlay of such donors/NGOs is limited by budget.
- There is no incentive on the part of shareholders as they have sentiment that additional capital will not entail return to investors.

- In MFIs where clients are the majority of shareholders, clients are economically poor and they do not have the capacity to raise additional fund
- Finally, serious concern and commitment on the part of the board and management is cited as a reason.

Generally, the ownership structure of sample MFIs appeared to be quite mixed and complex. Moreover, the various issues raised and discussed pertaining to the issue of ownership exhibited diversity of opinions and views being aggravated by the vague role and objectives of MFIs i.e. being primarily a societal or business oriented one.

### **3.3.2 BOARD SIZE, COMPOSITION AND STRUCTURE**

#### **I) Size of Board**

The size of the board is an important factor that affects the efficient and effective functioning of boards. Theoretically, size of the board should not have to be too much or too few and should strike a balance by considering factors like frequency of meetings, scope of operation, timely decision making and the like. The commercial code of Ethiopia puts the minimum size of BODs to be three.

In contrast to the variation existed while discussing the ownership structure of sample MFIs, the size of boards showed relative uniformity among institutions. Accordingly, 10 of the 16 MFIs (63%) had boards comprising of 5 members. The remaining MFIs had boards comprising of 6 (6%), 7(19%) and 9(13%) members.

**Table 9:****Size of Boards**

Size of the Board	Frequency	%
5	10	63
6	1	6
7	3	19
9	2	13

**Source:** collected through questionnaire

**II) Composition of Boards**

With regards to the composition of boards, data obtained from NBE on the educational and experience profile of board members is discussed in the part to follow.

According to NBE directive that deals with the minimum qualification criteria of CEOs and board members of MFIs, i.e. NBE directive no. MFI/03/96, BODs of MFIs are required to only complete high school with an ability to read and grasp reports, especially financial statements. Besides, it requires that members of BODs preferably have adequate managerial experience in business and/or similar organizations and at least be 25 years old. On the other hand, CEOs are required to hold a minimum of first degree in the field of social science with a minimum of 3 years experience in a senior post in financial or related institution. Viewing the requirements set for CEOs and BODs of MFIs, one can easily appreciate the huge gap between the two. Thus, with such minor qualification requirement as compared with that of CEOs, BODs will not be in a position to effectively supervise and monitor the operations of their MFIs and evaluate the performance of the executive management.

As can be observed under Table 10 of this section, members of BODs of all MFIs pretty much fulfill the minimum educational qualification requirement of NBE.

**Table 10: BODs Profile of MFIs in Ethiopia, as at June, 2006**

Description	Qualification Level							
	PHD	MSC or MA	BSC or BA	LLB	Diploma	ACCA	12 <sup>th</sup>	10
Related to Social Science Field of study*	4	35	35	4	8	1		
Unrelated to Social Science field of study**	3	16	12	-	10	-		
Field of study not specified	3	9	1	-	2	-	9	3
<b>Total</b>	10	60	48	4	20	1	9	3

**Source:** NBE database

**Note\*:** Related field of study to social science include economics, management, accounting and other related fields.

**\*\*** Unrelated to social science field include field of studies such as medicine, engineering, veterinary science, theology, plant science etc.

From Table 10, it can be observed that 38.7% of the BODs hold MSC or MA degree followed by those holding BSC or BA degree, which constitute 31%. The remaining BODs hold diploma (13%), PHD (6.5%) and high school certificate (5.8%). Thus, as stated before, all the BODs pretty much fulfill the minimum requirement.

This being the case, what is equally important is the exposure and experience that boards possess with respect to the specific nature and peculiarities of the sector, the environment in which it operates and the like. Thus, a board drawn from different fields like banking, business,

law etc with sound knowledge of the micro finance sector is presumed to be the best composition.

**Table 11: Composition of BODs**

Question	Response										
	Strongly Believe		Fairly Believe		Do not Believe		Do not Know		No opinion		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	
<b>Believe in having professionally mixed BODs</b>	6	24	11	44	7	28	1	4			25
	Highly Necessary.		Necessary		Least Necessary		Unnecessary		No opinion		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	
<b>Necessity of having board sub-committees</b>	5	21	13	54	6	25					24
<b>Necessity of making use of Advisory Boards</b>	4	16	12	50	4	17	4	17			24
	Weekly		Biweekly		Monthly		Quarterly		Irregularly		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	No. %
<b>Frequency of Board Meeting</b>	1	6			2	13	9	56	4	25	16
	Very High		Fairly High		Medium		Low		Do not Know		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	
<b>Rate of BODs turnover</b>			1	4	6	24	14	56	4	16	25

**Source:** collected through questionnaire

Respondents of the surveyed MFIs were asked to express the intensity of believe they have in possessing a professionally well mixed board. To this end, 24% of them said that they have a strong believe and 44% replied that they have a fair believe. On the other hand, 28% of the respondents claimed that they don't believe that their board has got a well-mixed composition and 4% responded that they do not know about the situation.

It is highly presumed that the best way of discharging boards responsibility is through division and assignment of specific tasks among members and setting up of committees. Many authors have unequivocally recommended such practices and many countries across the world are practicing it. With regards to the presence of special board committees and advisory boards, greater similarity prevailed among the surveyed MFIs. This is to say that only one of the surveyed 16 MFIs has special committees within the board and another one has advisory board that is drawn from sources other than the shareholders. The remaining MFIs have not set up special committees within their board and do not have advisory boards too. When the respondents are asked on the necessity of having special sub-committees within their board that deals with specific assignment and responsibility, 21% of them felt that it is highly necessary and another 54% felt the need as necessary. The remaining 21% felt the need to be least necessary. As to the necessity of making use of advisory boards on top of the existing one, 16% of the respondents felt that it is highly necessary and another half of the respondents (50%) considered the need as necessary.

On the other hand, 17% and 17% of the respondents replied that it is least necessary and unnecessary. This group of respondents that failed to acknowledge the necessity of using advisory boards in their MFI provided various reasons. Therefore, current development stage of the MFI, possession of adequate board composition and high cost of employing such boards are cited as reasons in 50%, 33% and 17% of the cases.

board sub committees, more frequent meetings couldn't be made possible. To this end, respondents were asked to forward their views regarding the problems that led to non-punctuality of making such meetings. The reasons forwarded by the respondents are summarized in the following table.

**Table 13: Reasons for not conducting meetings regularly**

<b>Reasons</b>	<b>Frequency</b>	<b>%</b>	<b>Rank</b>
<b>BODs are overburdened with other assignments</b>	16	70	1
<b>BODs do not have any incentive to hold meetings</b>	4	17	2
<b>No issues to be discussed at regular intervals</b>	3	13	3
<b>Geographical location of BODs is scattered</b>			

**Source:** collected through questionnaire

As per the responses of respondents that acknowledged absence of regular meetings on the part of their boards, over burdening of boards with other assignments, lack of motive and incentive on the part of the board and absence of issues to be raised and discussed at regular interval were cited as problems with frequency of 70%, 17% and 13%, respectively.

Thus, geographical disparity of board members was not at all raised as concern and the majority of respondents attributed preoccupation and overburdening of their members in other obligations as a cause for conducting meetings on irregular basis.

Moderate turnover of BODs by respecting the legal framework in which MFIs operates is considered to be an important factor for bringing new blood and mind to the board membership level. With this regard, the Ethiopian law puts the maximum term of BODs, if elected twice, to be six years. In view of this, 56%, 24% and 4% of the surveyed respondents

rated the turnover of their boards to be low, medium and a fairly high one. Thus, this finding revealed that turnover of boards in the majority of the cases is low.

### **3.3.3 Dividend and Compensation policies**

In instilling good corporate governance in MFIs, the existence of a drive or motive that would trigger the performance of individuals that take part in governance (like BODs, management) is an essential one. Among the different factors that enable BODs and management perform effectively; financial motive is an important one.

Thus, as they will have something to lose if their MFI fails; the existence of real financial stake on the shares of MFIs by BODs is presumed to boost the effective and efficient functioning of same.

The surveyed MFIs were asked about their dividend policy, existence of remuneration to BODs and other incentive packages. To this effect, 69% of the responding MFIs replied that they don't have a policy of distributing dividends to their shareholders.

A question asked in the survey was for what purpose the profits of these institutions (if any) serve. Accordingly, the MFIs responded that the profit will be ploughed back or reinvested in the business itself for expansion purpose. In one of the MFIs case, the board chairman is not even clear as to the purpose for which the profit (if any) of the MFI serves. From the surveyed MFIs that have dividend distribution policy in their bylaws, only one MFI (client based MFI) so far distributed dividend to its shareholder (clients) once. The remaining MFIs responded that as they are still in the arena of loss and haven't generated adequate internal capacity, they haven't distributed dividends to their shareholders. Thus, shareholders

and /or boards of almost all MFIs included in the survey haven't so far got the privilege to earn dividends for any one of the above two reasons.

**Table 14: Dividend and Compensation policy**

Question	Response						
	Yes		No		Do not Know		Total
	No.	%	No.	%	No.	%	No.
<b>Does Co. bylaw allow distribution of dividends</b>	5	31	11	69			16
<b>Are BODs paid remuneration for their service</b>	8	50	8	50			16
<b>Are BODs or management members paid incentive along with the performance of the MFI</b>	2	13	13	81	1	6	16
<b>Is the incentive paid to BODs proportional with the work demanded by the MFI</b>	3	33	6	67			9

**Source:** collected through questionnaire

As to the existence and attractiveness of remuneration of boards, 8(50%) of the MFIs responded that they remunerate boards for the service they provide. The boards of the remaining half MFIs are not paid remuneration.

**Table 15:****Effect of Incentive on depth of governance**

Question	Response										
	Strongly Believe		Believe		Least Believe		Do not Believe		No Opinion		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	No.
<b>Does attractive incentive package to BODs entail deep governance exercise</b>	10	40	7	28	1	4	3	12	4	16	25

**Source:** collected through questionnaire

In addition, among the MFIs that remunerate their board, 67% of the respondents don't believe that the amount paid to BODs is commensurate with the work demanded by the MFIs. With regards to the application of incentive package, 81% of the respondents replied that boards do not receive incentive that is tied with the performance of MFIs. On the other hand, 2 of the 16 institutions indicated the existence of incentive system that is tied with the performance of the institution and another respondent from one of the MFIs disclosed his lack of knowledge as to the presence and application of the system. Hence, the result of the study revealed that variable incentive compensation scheme based on the performance of the MFIs is not applicable in most of the MFIs.

Another question asked in the survey was the degree to which respondents believe with the relation or impact between existence of attractive incentive package and exercise of deep governance by BODs.

Accordingly, 40% and 28% of the respondents respectively said that they strongly believe and believe with the notion that attractive incentive package to BODs entail deep governance exercise. On the other hand, 4% of the respondents expressed their least believe in the relation between the two and 12% of them do not believe that attractive incentive package

to BODs results in deep governance exercise in their MFI. In general, the result of the survey shows that application of dividend and compensation system on the key players of governance is in contrary to the principle of corporate governance that dictates financial incentive and reward be applied.

### **3.3.4 GOVERNANCE PRACTICE OF MFIs**

The establishment and implementation of good corporate governance practices is a key issue for corporations generally, but is essential for the well-being and long-term prospects and sustainability of MFIs in particular. The MFIs in Ethiopia operate within legal and regulatory frameworks issued by the initiation of NBE. However, the framework provides little guidance to boards of directors on appropriate corporate governance principles. Thus, given lack of generally accepted standard coupled with the newness of the industry, the sector is exposed to this challenge.

#### **I) Board Functions**

As per the interview made with the MFIs, the majority of them have no separate risk management unit that is institutionalized in their structure. Moreover, the supervisory body i.e. NBE has not so far issued risk management guideline for the boards of MFIs. This being the case, 61% and 35% of the respondents rated the risk management capacity of their boards to be adequate and less adequate. On the other hand, 4% of the respondents replied that their boards have inadequate risk management capability. When asked about the possession of real financial stake by owners (boards) of their MFIs, 63% of the MFIs replied that the majority of the boards do not have real financial stake in the MFI.

On the other hand, 37% of the MFIs claimed that the majority of "owners" have real financial stake. However, as per the observation of the researcher, this number is highly exaggerated as only few owners of MFIs so far raised their own funds and invested in micro finance with the expectation of receiving dividends from their investment.

No. of MFIs		No. of Owners		Total	
No.	%	No.	%	No.	%
1	4	1	4	1	4
2	8	2	8	2	8
3	12	3	12	3	12
4	16	4	16	4	16
5	20	5	20	5	20
6	24	6	24	6	24
7	28	7	28	7	28
8	32	8	32	8	32
9	36	9	36	9	36
10	40	10	40	10	40
11	44	11	44	11	44
12	48	12	48	12	48
13	52	13	52	13	52
14	56	14	56	14	56
15	60	15	60	15	60
16	64	16	64	16	64
17	68	17	68	17	68
18	72	18	72	18	72
19	76	19	76	19	76
20	80	20	80	20	80
21	84	21	84	21	84
22	88	22	88	22	88
23	92	23	92	23	92
24	96	24	96	24	96
25	100	25	100	25	100

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**Table 16:**

**Board Functions**

Question	Response										
	Highly Adequate		Adequate		Less Adequate		Inadequate		Do not Know		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	No.
<b>Risk management capacity of BODs</b>			14	61	8	35	1	4			23
<b>Does the majority(all) owners have real financial stake in the MFI</b>	Yes		No		Do not Know				Total		
	No	%	No.	%	No		%		No		
	6	37	10	63					16		
<b>Frequency of visits made by BODs to operational offices</b>	Very Often		Sometimes		Rarely		Not At All		Do Not Know		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	No.
	1	4	13	54	9	38	1	4			24
<b>Who is primarily responsible for ensuring compliance</b>	The Board		The GM		The exe. Mgt.		Board & GM		All		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	No.
	3	13	4	17			3	13	14	57	24
<b>Degree of agreement in the assumption of fiduciary responsibility by BODs</b>	Highly Agree		Agree		Disagree		Strongly Disa.		Indifferent		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	No.
	3	13	14	58	5	21	1	4	1	4	24
<b>Has the board set cash withdrawal limit for the mgt.</b>	Yes		No		Do not Know				Total		
	No.	%	No.	%	No.		%		No.		
	6	37	10	63							
<b>Does BODs receive management letter of external auditors</b>	16		100		0				16		

Source: collected through questionnaire

On the other hand, although the majority of MFIs asserted that their owners (serving as boards) do not have a real financial stake, 71% of the respondents expressed their agreement in the assumption of fiduciary responsibility that could arise as a result of BODs failure to discharge their roles and responsibilities and failure of their MFIs. The remaining 21% expressed their disagreement and 4% expressed their strong disagreement to this complex situation. Meanwhile, respondents were asked to provide their opinion as to who should be primarily responsible for ensuring compliance of legal and regulatory provisions. Accordingly, the majority of the respondents (57%) replied that it should be the responsibility of all stakeholders i.e. boards, General Manager and the executive management. On the other hand, 17% of them replied that it should be the responsibility of the General Manager and the remaining 13 % each replied that it should be the responsibility of the board and the board with the GM, respectively.

As to the control aspect of the board, all MFIs board receives and review the management letter of external audit reports. However, with regards to bank account control, only 37% of the MFIs board set limit for cash withdrawal by the executive management. The remaining MFIs allowed their executive management to operate the bank account of their MFIs freely. With regards to the frequency of work visit by BODs, 54% of the respondents answered that their boards visit operational offices sometimes. 4% of the respondents indicated that their boards visit their MFI often. On the other hand, 38% replied that the visits made by boards are considered as rare phenomena and 4% replied that their board do not at all pay visit to their MFI.

## II) Internal Control

The existence and effective functioning of Internal control system that ensures a systematic way of appraising whether every staff of the MFI confirms to the policies and procedure with regard to the MFIs operations, financial system and other regulatory concerns is a determinant factor for the success of MFIs.

With this regard, 14 of the sample MFIs responded that they have got a separate internal audit/control unit that is theoretically in charge of performing the above stated tasks. However, 2 MFIs responded that they have-not so far institutionalized such unit in their organogram. Thus, significant unanimously across the MFIs is observed as to the existence of such separate unit. Meanwhile, the body to which these units or departments are accountable shows variation among MFIs. To this end, 71% of the MFIs responded that their internal audit unit is accountable to the General Manager and 29% of the MFIs said that the unit is accountable to boards.

**Table 17: Internal Control**

Question	Response						
	Yes		No		Do Know	Not	Total
	No.	%	No.	%	No.	%	
<b>Is there separate internal audit unit/department</b>	14	87.5	2	12.5			16
	G.M		Board				
<b>To whom is the internal audit/control accountable to</b>	10	71	4	29			14

**Source:** collected through questionnaire

Representatives of the sample MFIs having internal audit unit/department argued differently as to why their unit/department is accountable to either the board or the General Manager. To this end, some replied that it is appropriate to make the unit accountable to the General Manager as it improves fast decision-making and taking of prompt corrective (remedial) measures. Moreover, they explained that as most internal control involves routine audit functions being performed at grass root level and prompt action of the General Manager is required, it would be appropriate to structure the unit under the control of the GM. In addition, some MFIs responded that given the current development level of their MFIs, it would be appropriate to give the manager such responsibilities. Others that have argued against the above stated that as internal control is a watch dog of the management itself and the General Manager is subject to the auditing of major financial decisions made by him, it would be appropriate to ensure the independent functioning of the audit department. Moreover, they strongly argued that the audit process should have to be performed free of pressure and influence from the management.

### **III) Executive Management Supervision and Control**

Performance Evaluation of the General Manager and or the executive management on continuous basis is essential to make sure that they are performing to the best interest of shareholders. In addition, recognition of their efforts through various incentive mechanisms is believed to enhance the commitment of the management.

**Table 18: Performance Evaluation of Executive Management**

Question	Response										Total No.
	Highly Sat.		Sat.		Less Sat.		Unsat.		Indifferent		
	No.	%	No.	%	No.	%	No.	%	No.	%	
<b>Degree of satisfaction on the basis &amp; regular performance evaluation practice of senior management members</b>	7	28	14	56	2	8	2	8			25
	Yes		No		Do not Know		Total				
	No.		%		No.		%				
<b>Does the GM has separate job description</b>	9		56		7		44				16
<b>Are there annual performance goals explicitly stated for the GM</b>	4		25		12		75				16

**Source:** collected through questionnaire

Respondents of sample MFIs were asked to provide information on the exercise of performance management and evaluation of senior management members. To this end, the majority of the respondents expressed their high satisfaction (28%) and satisfaction (56%) on the basis and regularity of such performance evaluation. Meanwhile, only 56% of the MFIs have prepared and issued job description for their General Managers.

The General Managers of the remaining MFIs do not have separate job description and their duty and responsibilities is stated in the company documents (Articles & Memorandum of Association) broadly. However, as the nature of the business may pose specific peculiarities to each MFI, specific, detailed and comprehensive job description is lacking among these 44% of the MFIs.

In addition, the boards of 75% of the MFIs do not set explicitly stated annual performance goals for their General Managers. However, they stated that these goals are contained in the business plan and financial plan of each institution.

However, as almost all sample MFIs do not apply board committee; specialized unit within the board is not currently responsible for the regular and effective evaluation of senior management members.

#### **IV) Board-Management Relationship**

As discussed in the previous sections and sub-sections, the study questionnaire asked a number of questions about the flow of communications b/n boards and management on issues like board meetings, performance evaluation etc. In this section, the reply of respondents with regard to two questions i.e. prevalence of conflict of interest and contact b/n the two is presented and discussed.

**Table 19:**

**Board Management Relationship**

Question	Response											
	High		Moderate		Low		Do not exist		No opinion		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%
<b>Prevalence of conflict of interest b/n BODs &amp; mgt.</b>			2	8	6	25	16	67			24	
	GM		Senior Mgrs.		Staff Members		All		Do not Know		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%
<b>Who has got direct contact with BODs (chairman)</b>	17	68	1	4			7	28			25	

**Source:** collected through questionnaire

Accordingly, in contrary to the observation of the researcher, 67% of the respondents claimed that conflict of interest b/n the board and the management do not at all exist in their MFIs. The remaining MFIs appreciated the existence of such conflict in their MFIs and rated the prevalence as moderate (8%) and low (25%). Meanwhile, although the answerers of the respondents say so, the sector in general is viewed as a sector where conflict b/n social and business objectives prevail. This is substantiated by the fact that in some cases, the board involves itself in client selection (selecting clients that are viewed to be illegible in the eyes of the management), in limiting the maximum average loan size of the MFI (with the belief that majority of the loan should go to the poor) and in pressurizing the management not to set an interest rate that is enough to absorb their cost and make them sustainable.

On the issue of contact between the board and management, 68% of the respondents replied that only the General Manager is legible to deal with board members and 28% of the respondents claimed that general manager, senior management members and the staff together have contact and can deal with board members. The finding of the study in this aspect reveals that it is the General Manager who has got the majority of contact with board members. On the other hand, respondents were also asked to define the nature of relationship that BODs and GM make in their MFI. To this end, strategic partnership was cited in 11 cases while all types of relationships i.e. coach and player, strategic partnership and advisor to the manager were cited in 9 of the cases.

**Table 20: Board Management Relationship**

Relationship b/n BODs & GM	Frequency
Coach and Player	1
Strategic partnership	11
Advisor to the manager	7
All	9

**Source:** collected through questionnaire

#### **V) Respondents General comments on Governance and its challenges**

The respondents were asked to indicate what their greatest governance challenges are. Consequently, they indicated their challenge and leveled each challenge in the continuum ranging from least challenging to most challenging. Accordingly, as can be observed in the table below, pressure from external parties (government & donors), lack of independent board,

conflict of interest between social and business objective, absence of real financial stake by BODs and Lack of sufficient knowledge by BODs were cited as challenge in an increasing order of intensity. Thus, it could be understood that intervention from government and donor's steaming from nominal stake of the majority of BODs (owners) was rated as the most challenging one.

**Table 21: Governance Challenge Faced by MFIs**

Challenge	1	2	3	4	5	Weighted response
Lack of sufficient knowledge by BODs	4	6	6	2	6	3
Lack of independent BODs	2	1	2	1	15	4.2
Conflict of interest b/n social and business objective	1	4	3	5	11	4
Pressure (intervention) from donors, govt.	1		4	2	14	4.3
Absence of real financial stake by BODs	3	5	2	3	9	3.5

**Source:** collected through questionnaire

When asked to provide their general comment on the issue of governance, the respondents among others expressed the following:

- The law that prohibits foreigners should be lifted, as the real investors are them. Thus, they should be allowed at least 49% ownership with limit on repatriation of profit. Otherwise no much prospect is envisaged in improving the governance of MFIs through local efforts only.

- The composition and mix of BODs and owners should be enhanced.
- Possession of real financial stake and commercialization of MFIs is at the heart of ensuring effective governance.
- The NBE should provide capacity building and training support to members of board of directors

## CHAPTER FOUR

### 4. CONCLUSIONS & RECOMMENDATIONS

#### 4.1 CONCLUSIONS

This paper has tried to look at the governance practices of Ethiopian Micro finance Institutions (MFIs) in light of best international experiences and practices. Moreover, as the quality of governance is a clear reflection of the composition of ownership structure, the paper has also tried to deeply look at the ownership structure of sample MFIs and its implications on the exercise of governance. To this end, the following conclusions are made:

- The corporate governance practices of most surveyed MFIs showed similarities and their response doesn't indicate the prevalence of good practice in their MFIs. Board members of most MFIs do not have awareness and hence do not apply best practice corporate governance in their MFIs. Thus, strong corporate governance in the sector is still in its infancy after a decade of period.
- The existence of poor incentive package for those already in charge of exercising governance coupled with the prohibition of foreign ownership that led to the creation of de facto (nominal) shareholders who doesn't bear any financial risk if things go wrong and financial loss materializes weakened the governance practice of MFIs.
- Given the above peculiar shareholding style, poor incentive system and the fact that almost all MFIs are dividend non-paying, the

issue of exercising effective governance even if BODs have the capacity to do so remains to be a puzzle.

- The micro finance sector in its decade year's existence as formal financial intermediary failed to attract private local commercial investors.
- Lack of clear policy between social and commercial objectives of MFIs, a nation wide strategy that articulates about the ultimate goals and objectives of micro finance, transformation path of MFIs and the role that donors and government play contributed to the poor governance exercise in the sector.
- Although NBE directive (MFI no. MFI/03/96) has put minimum educational criteria; the criteria are far below the criteria required for CEOs. Moreover, the directive has not put in place the appropriate mix of expertise required to be maintained at board level in terms of professional mix.
- Although most MFIs acknowledged the necessity of having sub committees with in their board and advisory board, they failed to act so and improve their governance practices.
- A legal framework that governs the legal operational modalities of the sector is put in place. However, no local governance standard was put in place by either the regulatory body or the network association of the MFIs. To this effect, although the major role of BODs is risk management, risk management guideline that specifies the risks involved in MFIs, the roles expected of each party and the approach for managing them is not prepared and issued to the sector. In addition, code of conduct that specifies the ethical standards needed to be respected by BODs is not prepared and issued too.

Accordingly, the issue of commercializing MFIs, improving the legal provision pertaining to ownership issue and developing and promulgating of a detailed Micro finance guideline remains a challenge to be overcome by all stakeholders.

## **4.2 RECOMMENDATIONS**

In light of the above conclusions drawn and the finding of the study, the following recommendations are forwarded:

- By basing on past experience of the sector and international experience, the ownership composition including consideration of allowing foreign investors (particularly the social investors) and alternative form of establishing MFIs has to be re-studied and implemented in a manner that enhance the current governance practice of the sector.
- Factors that have contributed to the limited participation of the private sector e.g. poor law/contract enforcement mechanism and legal system, lack of equal level playing field, limited support of local governments etc should be tackled and appropriate measures should be taken by concerned government authorities.
- The issue of commercializing MFIs by clearly making a vital decision as to the prime objectives of MFIs (social or business) should be done and all MFIs should be required to revise their modalities and act in favor commercialization.
- Local governance standards, risk management guidelines, code of conduct and others that clearly specify the responsibilities of BODs and unequivocally create accountability should be designed and issued to the sector by the appropriate government body.

- The NBE should have to revise the current minimum qualification requirement of BODs and should also set appropriate board composition mix (with regards to professional mix and experience) to be maintained by MFIs.
- The boards should scale up their level of exposure and skills pertaining to the operations of MFIs through paying exposure visits to renowned MFIs and by participating in important trainings.
- In order to divide responsibilities and make prompt and informed decision, the MFIs should start the habit of organizing sub-committees within their board. Moreover, by reviewing the capacity, time availability (work load) of BODs and operational scope of their respective MFIs, use of advisory boards should be adopted among the MFIs
- Appropriate incentive package that takes into account the cost structure of MFIs, volume of work to be discharged and others should be designed and implemented among the MFIs with a bid of scaling up the commitment and depth of governance exercise by boards.
- The boards of MFIs should have to continually monitor and appraise the performance of their executive management members by setting appropriate performance goals. To this effect, job descriptions with specific responsibilities should be prepared and annual performance goals should be set for the General Managers. In addition, incentives that are tied with the achievement of these performance goals and performance of MFIs in general should be implemented.

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# Appendix

## Appendix I

### Section I: Background Information

1. Position in the MFI:

General Manager  Board chairman  Board member

2. Sex: Male  Female

3. Age: 20 - 30  41 - 55   
31-40  above 55 years

4. Martial Status: Married  Single   
Widowed  Other \_\_\_\_\_

5. Educational Level:

Below Diploma  M.A, MSC or MBA   
Diploma  PhD.   
First Degree  Other (please Specify) \_\_\_\_\_

6. Field of specialization:

Accounting  Economics   
Management  Others (please specify) \_\_\_\_\_

7. Work experience/exposure to micro finance:

Less than 2 years  5 - 10 years   
2 - 4 years  More than 10 years

### Section II: Ownership Assessment

1. How many shareholders own your institution shares \_\_\_\_\_
2. From these shareholders, what is the number and percentage share (%) of the following units?

Shareholders	Number	Percentage Share (%)
Regional Government		
Public organizations		

Local NGO's		
Staff members or affiliates of the founding NGO		
Private individuals/companies		
Clients		
others		

3. Do you think that the current number of shareholders is sufficient to exercise effective governance?

Yes  No  Do not know

4. In your institution, is the number of shareholders equal to that of board members?

Yes  No  Do not know

5. Is organizing MFIs as Share Company effective in relation to ensuring check and balance system in your institution?

Highly effective  Less effective  No opinion   
 Effective  Ineffective

6. In your opinion, how do you see the law that prohibits foreigners from owning MFIs shares?

Highly appropriate  Inappropriate   
 Moderately appropriate  Indifferent   
 Least appropriate

7. What form of organization do you think is appropriate for MFIs and what is the justification behind that? \_\_\_\_\_

\_\_\_\_\_  
 \_\_\_\_\_

8. What benefits and costs do you think your MFI gets as a result of allowing foreigners to own your institution share?

o Benefits: \_\_\_\_\_  
 \_\_\_\_\_

o Costs: \_\_\_\_\_  
 \_\_\_\_\_

9. How do you rate the level of payment of subscribed capital by the respective shareholders of your institution as a whole?

Highly satisfactory  Less satisfactory   
 Satisfactory  Unsatisfactory

10. If your response to the above question is less satisfactory or unsatisfactory, what do you think are the major reasons?

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11. Considering the fact that the majority (or all in some cases) of the capital required for establishing MFIs is originating from one source, do you agree (makes sense) with the provision stipulating that "a single shareholder should not own more than 20% of the total capital of an MFI"?

Strongly agree  Disagree  Indifferent   
Agree  Strongly disagree

12. How do you justify your response for the above question?

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13. In your opinion, what do you think is (are) the major reason(s) for the limited participation of the private sector in micro financing business?

Less profit potential  Problematic lending Methodology   
High credit risk  Strict or less enabling regulation

Unfair competition

Others (please specify) \_\_\_\_\_

14. What recommendations do you make for the increased participation of the private sector (capital) in micro finance?

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### Section III: Board Composition and Structure

1. How many board members currently exist in your institution? \_\_\_\_\_
2. Do you believe that the current number and professional mix of BODs is adequate to ensure effective governance in the institution?  
Strongly believe  Do not believe   
Fairly believe  Do not know
3. How frequently does the board hold meetings in your institution?  
Weekly  Biweekly  Monthly   
Quarterly  On irregular interval
4. What problems can you cite as an example for not conducting board meeting at a regular interval or as stated in the bylaws of the institution?
  - o Board members are overburdened with other assignments

- Board members do not have any incentive to hold meetings and monitor the overall performance of the institution
- There are no as such issues worth to be discussed with such intervals
- The geographical location of members of BODs is scattered
- Others (please specify) \_\_\_\_\_

5. How do you rate the turnover of board members in your institution?

Very high  Medium  Do not know

Fairly high  Low

6. What is the focus of agendas of board meetings in your institution?

Policy related issues  Disciplinary issues

Credit assessment  Promotion and staff salary & benefit issues

Others \_\_\_\_\_

7. Are there special committees with in your board such as Risk management committee, Audit committee, Credit committee, and Promotion committee etc that deal with specific issues?

Yes  No  Do not Know

8. If your response to the above question is no, to what extent do you believe with the necessity of having such sub committees?

Highly necessary  Least necessary

Necessary  Unnecessary

9. a) Is there advisory board other than the formal board?

Yes  No

b) If there is advisory board, what does it perform?

\_\_\_\_\_

10. Is it necessary to make use of Advisory board in your institution?

Highly necessary  Least necessary

Necessary  Unnecessary

11. If you feel that it is least necessary or unnecessary to make use of Advisory board, what is the major reason(s) behind?

- Hiring such boards is costly to the institution
- Professional mix and capacity of current board members is adequate
- The current stage of development of the MFI doesn't deserve such boards
- Other(please specify) \_\_\_\_\_

#### Section IV: Dividend and Compensation Policy

1. Does your company bylaw (articles and memorandum of association) allow shareholders to earn dividend from the profit of the institution?

Yes  No

Although company bylaw allows, shareholders have signed disclaimer agreement

2. If your answer to the above question is "No or there exists disclaimer agreement", for what purpose does the institution's profit (if any) serve

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3. If your answer to question No. 1 is "yes", have you so far distributed dividends to shareholders and if not why? Please give the details for the last five years

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4. Are board members of your institution paid remuneration for the service they provide

Yes  No

5. Are boards or management rewarded incentive along with the performance of the institution?

Yes  No  Do not know

6. Do you think that the incentive made to board members is proportionate with the work of the board demanded by the institution (if any)

Yes  No  No opinion

7. To what extent do you believe that existence of attractive incentive package to boards entail positive implication on the depth of governance they exercise in your institution

Strongly believe  Least believe  No opinion

Believe  Do not believe

### Section V: Current Governance Practice

1. What kind of reports are presented to the board and how frequent are they submitted?

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2. How do you evaluate the exercise of regular performance evaluation of senior management members and the basis of evaluation?

Highly satisfactory  Less satisfactory

Satisfactory  Unsatisfactory

3. Has the board set any limit for the management (withdrawal limit) in operating the bank accounts of the institution?

Yes  No  Do not know

4. Do boards receive the management letter of external auditors along with the formal audit report?

Yes  No  Do not know

5. What types of risks are existing in your institution?

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6. How do you judge the risk management capacity and effort of board members?

Highly adequate  Less adequate   
Adequate  Inadequate

7. How frequently boards pay visit to the operational offices of the institution?

Very often  Rarely   
Some times  Not at all

8. Who do you think is primarily responsible for ensuring compliance of your institution with respect to the applicable laws and regulations?

The board  The executive management members   
The general manager  All

9. Does the majority (or all in some cases) of board members or general assembly members have real financial stake in the institution?

Yes  No

10. To what extent do you agree with the assumption of fiduciary responsibility of boards in cases where boards are represented by organizations or do not have real financial stake in the institution?

Highly agree  Disagree  Indifferent   
Agree  Strongly disagree

11. Is there separate internal audit and control unit within the institution?

Yes  No

12. If your answer to the above question is yes, then to whom is the unit accountable to?

The board  The General Manager

13. To whom do you think the internal audit unit should be accountable and why?

14. How prevalent conflicts of interest exist between the management and boards?  
 High  Moderate  Low  Do not exist

15. Who has got direct contact with boards (or board chairman)?  
 General Manager  Staff Members   
 Senior Managers  All

16. Does the general manager have separate job description other than what is stated in the institutions bylaw?  
 Yes  No  Do not know

17. Are there annual performance goals explicitly stated for the general manager other than business plan, budgets of the institution etc?  
 Yes  No  Do not know

18. How do you express the relationship between the Board & General Manager?  
 Coach and player  Advisor to the manager   
 Strategic Partnership  All

19. What specific governance challenges are faced by your institution? (1 being the most challenging to 5, least challenging) (Please mark √ in the corresponding item.

Item	1	2	3	4	5
Lack of sufficient Knowledge and exposure on the sector by the boards					
Lack of independent board directors					
Conflict of interest between social and financial objectives					
Pressure or intervention from donors, gov'ts etc					
Absence of real financial stake by Boards, shareholders					

20. Provide your general comment pertaining to the governance practice of your institution

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_



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## FEDERAL NEGARIT GAZETA

OF THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

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አዲስ አበባ — ሰኔ ፳፰ ቀን ፲፱፻፹፰

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2<sup>nd</sup> Year No. 30  
ADDIS ABABA - 5<sup>th</sup> July, 1996

**ማውጫ**  
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**CONTENTS**  
Proclamation No. 40/1996  
Licensing and Supervision of Micro Financing Institutions Proclamation ..... Page 245

አዋጅ ቁጥር ፵/፲፱፻፹፰  
ለአነስተኛ ብድር አቅራቢ የገንዘብ ድርጅቶች ፈቃድ ስለመስጠትና ሥራቸውን ስለመቆጣጠር የወጣ አዋጅ  
የአነስተኛ ብድር አቅራቢ የገንዘብ ድርጅቶችን እንቅስቃሴ በኢትዮጵያ የገንዘብና የፋይናንስ ፖሊሲዎች ውስጥ ለማካተት የሚያስችል ሕጋዊ ሥርዓት ሊዘረጋ ስለሚገባ፤  
በሀገሪቱ በሥራ ላይ የዋሉት የገንዘብና የባንክ ሕጎች ዝቅተኛ የገጠር ገበሬዎችንና በሌሎች አነስተኛ የምርትና አገልግሎት ሥራ የተሰማሩ ሰዎችን የብድር ፍላጎት ለማሟላት የሚችሉ አነስተኛ ብድር አቅራቢ የገንዘብ ድርጅቶችን መቋቋም የማያመቻቹ በመሆኑ፤  
ለአነስተኛ ብድር አቅራቢ የገንዘብ ድርጅቶች ፈቃድ ስለመስጠትና ሥራቸውንም ስለመቆጣጠር የሚያስገባ ሕግ ማውጣት አስፈላጊ ሆኖ በመገኘቱ፤  
በኢትዮጵያ ፌዴራላዊ ዲሞክራሲያዊ ሪፐብሊክ ሕገ መንግሥት አንቀጽ ፶፭ (፩) መሠረት የሚከተለው ታውጋል።

PROCLAMATION NO. 40/1996  
A PROCLAMATION TO PROVIDE FOR THE LICENSING AND SUPERVISION OF THE BUSINESS OF MICRO FINANCING INSTITUTIONS  
WHEREAS, it needs to provide for a legal regime that brings the activities of micro financing institutions within Ethiopia's monetary and financial policies;  
WHEREAS, the monetary and banking laws in force do not provide for micro financing institutions catering for the credit needs of peasant farmers and others engaged in small-scale production and service activities;  
WHEREAS, it has become necessary to legislate on the licensing and supervision of the business of micro financing institutions;  
NOW, THEREFORE, in accordance with Article 55(1) of the Constitution of the Federal Democratic Republic of Ethiopia, it is hereby proclaimed as follows:

**ክፍል አንድ**  
**ጠቅላላ**  
ኧ አዋጅ ርዕስ  
ይህ አዋጅ “ የአነስተኛ ብድር አቅራቢ የገንዘብ ድርጅቶች ፈቃድ አሰጣጥና ቁጥጥር አዋጅ ቁጥር ፵/፲፱፻፹፰ ተብሎ ሊጠቀስ ይችላል።”

**PART ONE**  
*General*  
1. *Short Title*  
This Proclamation may be cited as the "Licensing and Supervision of Micro Financing Institutions Proclamation No. 40/1996."

የንድፍ ዋጋ }  
Unit Price } 2.40

ነጋሪት ጋዜጣ ፖ.ሣ.ቱ. ቁጥ. ፩  
Negarit G.P.O.Box 80,001

**፪. ትርጓሜ**

የቃሉ አገባብ ሌላ ትርጉም የሚያሰጠው ካልሆነ በስተቀር በዚህ አዋጅ ውስጥ፤

- ፩. “ ባንክ” ማለት የኢትዮጵያ ብሔራዊ ባንክ ነው፤
- ፪. “ ኩባንያ” ማለት በንግድ ሕጉ አንቀጽ ፫፻፬ በተሰጠው ትርጉም መሠረት የተቋቋመ፣ አክሲዮን በሙሉ በኢትዮጵያ ዜጎች እና/ወይም ሙሉ በሙሉ በኢትዮጵያ ዜጎች ባለሀብትነት በተቋቋሙ ድርጅቶች የተያዘ፣ በኢትዮጵያ ሕግ መሠረት የተመዘገበና ዋና መሥሪያ ቤቱ በኢትዮጵያ ውስጥ የሆነ የአክሲዮን ማኅበር ነው፤
- ፫. “ አነስተኛ ብድር የማቅረብ ሥራ” ማለት መጠናቸው በባንኩ የሚወሰን ብድርጅትን በጥሬ ገንዘብ ወይም በዓይነት ለገጠር ገብተኛ ገበሬዎች ወይም በከተማ አነስተኛ የምርትና አገልግሎት ሥራ ላይ ለተሰማሩ የማቅረብ እንቅስቃሴ ነው፤
- ፬. “አነስተኛ ብድር አቅራቢ የገንዘብ ድርጅት” ማለት በገጠርና በከተማ አካባቢዎች አነስተኛ ብድር የማቅረብ ሥራ እንዲያካሂድ በዚህ አዋጅ መሠረት የተፈቀደለት ኩባንያ ነው፤
- ፭. “አባላት” ማለት በአነስተኛ ብድር አቅራቢ የገንዘብ ድርጅት ውስጥ የሚቋቋሚያ አክሲዮን የዘወ ወይም በድርጅቱ የተዘጋጀ ማናቸውም ዓይነት የአባልነት ስምምነት ተፈራራሚዎች ናቸው፤
- ፮. “የቡድን ዋስትና” ማለት ከመካከላቸው በማንኛውም አባል ላልተከፈለ ብድር የተበዳሪዎች ቡድን አባላት በአንድነትና በነጠላ ባለአዳ ለመሆን ግዴታ የሚገቡበት የዋስትና ስልት ነው፤
- ፯. “ቁጠባ” ማለት የአነስተኛ ብድር አቅራቢ የገንዘብ ድርጅት አባላት የሚያስቀምጡት ሊወጣ የማይችል የግዴታ ቁጠባ ወይም መደበኛ ቁጠባ ነው፤
- ፰. “ተቀማጭ” ማለት በሂሳብ ባለቤት በማናቸውም ጊዜ በከፊል ወይም በሙሉ ሊወጣ የሚችል መደበኛ ወይም መደበኛ ያልሆነ ቁጠባ ነው፤
- ፱. “ዲሬክተሮች” ማለት የአነስተኛ ብድር አቅራቢ የገንዘብ ድርጅት የቦርድ አባላት ናቸው።

**፫. ዓላማና ተግባር**

- ፩. የአነስተኛ ብድር አቅራቢ የገንዘብ ድርጅቶች ዓላማ ከፍተኛ መጠን በባንኩ የሚወሰን ብድር በጥሬ ገንዘብ ወይም በዓይነት መስጠት ነው።
- ፪. አነስተኛ ብድር አቅራቢ የገንዘብ ድርጅት በዚህ አዋጅ ውስጥ በተደነገጉት ሁኔታዎች መሠረት፣ የሚከተሉትን ሥራዎች በሙሉ ወይም በከፊል ሊሠሩ ይችላል፤
  - ሀ) የቁጠባ ገንዘብ እንዲሁም፣ በተጠየቀ ጊዜ የሚከፈልና በጊዜ ገደብ የሚከፈልን ጨምሮ፣ ተቀማጭ ገንዘብ መቀበል፤
  - ለ) በኢትዮጵያ ውስጥ ተከፋይ የሚሆኑ የሃዋላ ወረቀቶች ማውጣትና መቀበል፤

**2. Definitions**

In this Proclamation, unless the context otherwise requires:

- 1) “Bank” means the National Bank of Ethiopia;
- 2) “Company” means a share company, as defined under Article 304 of the Commercial Code, the capital thereof owned fully by Ethiopian nationals and/or organizations wholly owned by Ethiopian Nationals and registered under the laws of, and having its head office in, Ethiopia;
- 3) “Micro financing business” means an activity of extending credit, in cash or in kind, to peasant farmers or urban small entrepreneurs, the loan size of which shall be fixed by the Bank;
- 4) “Micro financing institution” means a company licensed under this Proclamation to engage in micro financing business in rural and urban areas;
- 5) “Members” means the shareholders of a micro financing institution or signatories to any type of membership arrangement created by such institution;
- 6) “Group guarantee” means a guarantee mechanism whereby a group of borrowers undertake to be liable jointly or severally to defaulted loan of any one of them;
- 7) “Savings” means non-withdrawable mandatory or regular savings of members of a micro financing institution;
- 8) “Deposits” means any regular or irregular savings which may be withdrawn partially or totally at any time by the account holder;
- 9) “Directors” means members of the board of a micro financing institution.

**3. Purpose and Duty**

- 1) The purpose of micro financing institutions is granting credit, in cash or in kind, the maximum amount of which shall be determined by the Bank.
- 2) Subject to conditions set under this Proclamation, a micro financing institution may carry out some or all of the following activities:
  - (a) accepting savings as well as demand and time deposits;
  - (b) drawing and accepting drafts payable within Ethiopia;

**፪. ትርጓሜ**

የቃሉ አገባብ ሌላ ትርጉም የሚያሰጠው ካልሆነ በስተቀር በዚህ አዋጅ ውስጥ፤

- ፩. “ ባንክ” ማለት የኢትዮጵያ ብሔራዊ ባንክ ነው፤
- ፪. “ ኩባንያ” ማለት በንግድ ሕጉ አንቀጽ ፫፻፬ በተሰጠው ትርጉም መሠረት የተቋቋመ፣ አክሲዮን በሙሉ በኢትዮጵያ ዜጎች እና/ወይም ሙሉ በሙሉ በኢትዮጵያ ዜጎች ባለሀብትነት በተቋቋሙ ድርጅቶች የተያዘ፣ በኢትዮጵያ ሕግ መሠረት የተመዘገበና ዋና መሥሪያ ቤቱ በኢትዮጵያ ውስጥ የሆነ የአክሲዮን ማኅበር ነው፤
- ፫. “ አነስተኛ ብድር የማቅረብ ሥራ” ማለት መጠናቸው በባንኩ የሚወሰን ብድርጅትን በጥሬ ገንዘብ ወይም በዓይነት ለገጠር ገብተኛ ገበሬዎች ወይም በከተማ አነስተኛ የምርትና አገልግሎት ሥራ ላይ ለተሰማሩ የማቅረብ እንቅስቃሴ ነው፤
- ፬. “አነስተኛ ብድር አቅራቢ የገንዘብ ድርጅት” ማለት በገጠርና በከተማ አካባቢዎች አነስተኛ ብድር የማቅረብ ሥራ እንዲያካሂድ በዚህ አዋጅ መሠረት የተፈቀደለት ኩባንያ ነው፤
- ፭. “አባላት” ማለት በአነስተኛ ብድር አቅራቢ የገንዘብ ድርጅት ውስጥ የሚቋቋሚያ አክሲዮን የዘወ ወይም በድርጅቱ የተዘጋጀ ማናቸውም ዓይነት የአባልነት ስምምነት ተፈራራሚዎች ናቸው፤
- ፮. “የቡድን ዋስትና” ማለት ከመካከላቸው በማንኛውም አባል ላልተከፈለ ብድር የተበዳሪዎች ቡድን አባላት በአንድነትና በነጠላ ባለአዳ ለመሆን ግዴታ የሚገቡበት የዋስትና ስልት ነው፤
- ፯. “ቁጠባ” ማለት የአነስተኛ ብድር አቅራቢ የገንዘብ ድርጅት አባላት የሚያስቀምጡት ሊወጣ የማይችል የግዴታ ቁጠባ ወይም መደበኛ ቁጠባ ነው፤
- ፰. “ተቀማጭ” ማለት በሂሳብ ባለቤት በማናቸውም ጊዜ በከፊል ወይም በሙሉ ሊወጣ የሚችል መደበኛ ወይም መደበኛ ያልሆነ ቁጠባ ነው፤
- ፱. “ዲሬክተሮች” ማለት የአነስተኛ ብድር አቅራቢ የገንዘብ ድርጅት የቦርድ አባላት ናቸው።

**፫. ዓላማና ተግባር**

- ፩. የአነስተኛ ብድር አቅራቢ የገንዘብ ድርጅቶች ዓላማ ከፍተኛ መጠን በባንኩ የሚወሰን ብድር በጥሬ ገንዘብ ወይም በዓይነት መስጠት ነው።
- ፪. አነስተኛ ብድር አቅራቢ የገንዘብ ድርጅት በዚህ አዋጅ ውስጥ በተደነገጉት ሁኔታዎች መሠረት፣ የሚከተሉትን ሥራዎች በሙሉ ወይም በከፊል ሊሠሩ ይችላል፤
  - ሀ) የቁጠባ ገንዘብ እንዲሁም፣ በተጠየቀ ጊዜ የሚከፈልና በጊዜ ገደብ የሚከፈልን ጨምሮ፣ ተቀማጭ ገንዘብ መቀበል፤
  - ለ) በኢትዮጵያ ውስጥ ተከፋይ የሚሆኑ የሃዋላ ወረቀቶች ማውጣትና መቀበል፤

**2. Definitions**

In this Proclamation, unless the context otherwise requires:

- 1) “Bank” means the National Bank of Ethiopia;
- 2) “Company” means a share company, as defined under Article 304 of the Commercial Code, the capital thereof owned fully by Ethiopian nationals and/or organizations wholly owned by Ethiopian Nationals and registered under the laws of, and having its head office in, Ethiopia;
- 3) “Micro financing business” means an activity of extending credit, in cash or in kind, to peasant farmers or urban small entrepreneurs, the loan size of which shall be fixed by the Bank;
- 4) “Micro financing institution” means a company licensed under this Proclamation to engage in micro financing business in rural and urban areas;
- 5) “Members” means the shareholders of a micro financing institution or signatories to any type of membership arrangement created by such institution;
- 6) “Group guarantee” means a guarantee mechanism whereby a group of borrowers undertake to be liable jointly or severally to defaulted loan of any one of them;
- 7) “Savings” means non-withdrawable mandatory or regular savings of members of a micro financing institution;
- 8) “Deposits” means any regular or irregular savings which may be withdrawn partially or totally at any time by the account holder;
- 9) “Directors” means members of the board of a micro financing institution.

**3. Purpose and Duty**

- 1) The purpose of micro financing institutions is granting credit, in cash or in kind, the maximum amount of which shall be determined by the Bank.
- 2) Subject to conditions set under this Proclamation, a micro financing institution may carry out some or all of the following activities:
  - (a) accepting savings as well as demand and time deposits;
  - (b) drawing and accepting drafts payable within Ethiopia;

- ሐ) በንብረቱ ዋስትና ወይም በሌላ አካሄድ ለድርጅቱ ሥራ የሚውል ገንዘብ መበደር፤
- መ) ዓላማቸው ገቢ ማስገኘት የሆነ እንደ ግምጃ ቤት ሰነዶች ያሉ የንግድ ወረቀቶችን መግዛት፤
- ሠ) ሥራውን የሚያከናውንባቸውን ሕንፃዎች ጨምሮ ማናቸውንም የሚንቀሳቀስና የማይንቀሳቀስ ንብረት በባለቤትነት መያዝ፤ መንከባከብና ለሌሎች ማስተላለፍ፤
- ረ) ለደንበኞቹ የምክር አገልግሎት መስጠት፤
- ሰ) በከተማና በገጠር በአነስተኛ ሥራ ላይ ለተሰማሩ ወገኖች ገቢ የሚያስገኙ ፕሮጀክቶችን ማበረታታት፤
- ሸ) ለተበዳሪዎች የሥራ አመራር፣ የገበያ ፣ የቴክኒክና የአስተዳደር ምክር መስጠትና በነዚህም መስኮች አገልግሎት እንዲያገኙ መርዳት፤
- ቀ) አነስተኛ ብድር ለማቅረብ ሥራ ዓላማ የሚውል ገንዘብ ማስተዳደር፤ እና
- በ) በተለምዶ በአነስተኛ ብድር አቅራቢ የገንዘብ ድርጅቶች የሚሠሩ ሌሎች ሥራዎችን መሥራት።

ከፍል ሁለት  
ለአነስተኛ ብድር አቅራቢ የገንዘብ ድርጅቶች  
ፈቃድ ስለመስጠት

- ፩. አነስተኛ ብድር የማቅረብ ሥራ ለማካሄድ ስለሚያስችሉ ሁኔታዎች
- ፪. አነስተኛ ብድር የማቅረብ ሥራ ለማካሄድ ከዚህ የሚከተሉት ሁኔታዎች መሟላት አለባቸው፡
  - ሀ) ከባንኩ ፈቃድ ማግኘት፤ ✓
  - ለ) በከባንያ ቅርጽ መቋቋም፤ ✓
  - ሐ) በባንኩ የተወሰነውን ገብተኛ መነሻ ካፒታል በባንክ ማስቀመጥ፤ እና
  - መ) ዲሬክተሮችና ሌሎች ኃላፊዎች ባንኩ የሚያወጣቸውን መመዘኛዎች መጥናው መገኘት።
- ፫. አዲስ ዓይነት የሆኑ ሌሎች ገንዘብ አስተላላፊ አካላት አነስተኛ ብድር የማቅረብ ሥራ ላይ እንዲሳተፉ ለማስቻልና ከዚህ አዋጅ ዓላማ ጋር ለሚዛመድ ምክንያት የዚህ አንቀጽ ንዑስ አንቀጽ (፩) ማናቸውም ድንጋጌ በአመልካቹ ላይ ተፈጻሚ እንዳይሆን ባንኩ የውሳኔ ሀሳብና አስተያየት ለሚኒስትሮች ምክር ቤት አቅርቦ ያስወስናል።
- ፬. ተጨማሪ ሁኔታዎችን ስለመደንገግ
- ፩. ፈቃድ ከመስጠቱ በፊት መሟላት ያለባቸውን ማናቸውንም ተጨማሪ ሁኔታዎች ባንኩ በየጊዜው በሚያወጣቸው መመሪያዎች ሊደነግግ ይችላል።
- ፪. ባንኩ ከፈቃድ ጋር የተያያዙ ዝርዝር ሁኔታዎችን ለመለወጥ ወይም ለማሻሻል ሲፈልግ ለውጡን ወይም ማሻሻያውን ሥራ ላይ ለማዋል ካሰበበት ዕለት ፵፭ ቀናት አስቀድሞ ለሚመለከታቸው አነስተኛ ብድር አቅራቢ የገንዘብ ድርጅቶች ያሳውቃል።

- (c) borrowing money for its business purposes against the security of its assets or otherwise;
- (d) purchasing such income generating financial instruments as treasury bills;
- (e) acquiring, maintaining and transferring of any movable and immovable property including premises for carrying out its business;
- (f) providing counseling service to its clients;
- (g) encouraging income generating projects for urban and rural micro-operators;
- (h) rendering managerial, marketing, technical and administrative advice to borrowers and assisting them to obtain services in those fields;
- (i) managing funds for micro financing business; and
- (j) engaging in other activities customarily undertaken by micro financing institutions.

PART TWO

*Licensing of Micro Financing Institutions*

4. *Conditions Required to Engage in Micro Financing Business*

- 1) To carry out micro financing business, the following conditions shall be fulfilled:
  - (a) obtain a license from the Bank; ✓
  - (b) be formed as a company;
  - (c) deposit with a bank the minimum initial capital required by the Bank; and
  - (d) that the directors and other officers meet requirements set by the Bank.
- 2) The Council of Ministers may, upon recommendation by the Bank, exempt an applicant from the requirements of any of the provisions of sub-Article (1) of this Article in order that other innovative financial intermediaries engage in micro financing business and for other causes consistent with the objective of this Proclamation.

5. *Prescribing Additional Conditions*

- 1) The Bank may issue directives at any time and prescribe additional conditions to be complied with before a license is issued.
- 2) Where the Bank intends to change or vary the terms and conditions attached to a license, it shall notify the concerned micro financing institutions of such intentions forty-five (45) days before the date it proposes to carry same into effect.

፮. ፈቃድ እንዲሰጥ ስለሚቀርብ ማመልከቻ

- ሀ) አነስተኛ ብድር የማቅረብ ሥራ ለማካሄድ እንዲፈቀድ የሚቀርብ ማመልከቻ የሚከተሉትን መያዝ ይኖርበታል፡
  - ሀ) ሥራው ሊካሄድ የታሰበበትን አካባቢ (የዋና መሥሪያ ቤቱንና የቅርንጫፍቱን አድራሻ ማመልከት)፤
  - ለ) የመሥሪያቱን ስም፣ የሥራ መስክ፣ የመኖሪያ አድራሻና ዜግነት፤
  - ሐ) ድርጅቱ የተቋቋመበትን ቅርጽ ዓይነት፤
  - መ) ድርጅቱን ለመመሥረት የተደረገውን ስምምነት፤
  - ሠ) ለድርጅቱ ሊሰጥ የታቀደውን ስያሜ፤
  - ረ) የአዎንታዊነትን መሥሪያ አባል፣ የታሰበ ዲሬክተሮችና የኃላፊዎችን የሕይወት ታሪክ መረጃ፤
  - ሰ) በተሬ ገንዘብና በዓይነት የተደረገውን መጥጫ የድርሻ መጠን እና በዓይነት የተደረገውን መጥጫ አገማመት፤
  - ሸ) ድርጅቱ ሊሠራቸው ያቀዳቸውን ተግባሮችና እነዚህ ህገም ለማከናወን አመልካቹ ሊጠቀሙበት ያቀዳቸው ሁኔታዎች፤ እና
  - ተ) ባንኩ እንዲቀርብለት የሚጠይቃቸው ሌሎች አገባብነት ያላቸው መረጃዎች።
- ቁ) ፈቃድ እንዲሰጠው የሚጠይቅ አመልካች ማመልከቻውን በሚያቀርብበት ወቅት ባንኩ የሚወስነውን የህንድ መመርመሪያ ክፍያ ይከፍላል።
- ቆ) ፈቃድ የተሰጠው አመልካች ፈቃዱ ከተሰጠው ጊዜ እንስዮ በአሥራ ሁለት (፲፪) ወራት ውስጥ ሥራውን መጀመር ይኖርበታል።
- ቇ) ከባንኩ በትድሚያ ይሁንታ ሳያገኝ ማናቸውም አነስተኛ ብድር አቅራቢ የገንዘብ ድርጅት ከተፈቀደለት አካባቢ ውጪ ለመስራት አይችልም።
- ቈ) ማናቸውም አነስተኛ ብድር አቅራቢ የገንዘብ ድርጅት ባንኩ የሚወስነውን ዓመታዊ የፈቃድ ማደሻ ክፍያ ይከፍላል።

፯. ሥራ እንዲጀመር ስለመፍቀድ

ማናቸውም አነስተኛ ብድር አቅራቢ የገንዘብ ድርጅት ሥራውን ከመጀመሩ በፊት ባንኩ በሚያወጣቸው መመሪያዎች የተመለከቱ ሁኔታዎችን እንዲያሟላ ሊጠየቅ ይችላል።

፰. ፈቃድ ከሌላቸው ድርጅቶች ገንዘብና የሚተላለፉ የገንዘብ ሠነዶችን ስለማስመለስ

ማንኛውም ሰው በዚህ አዋጅ መሠረት የሚካሄዱ ሥራዎችን ያለፈቃድ ከሠራና በዚህ ድርጊት አማካኝነት የተቀበለው ገንዘብ ወይም ንብረት ካለ ባንኩ ይህ ገንዘብና ንብረት ምን ሊደረግ እንደሚገባ ትዕዛዝ እንዲሰጥለት ለፌዴራሉ ከፍተኛ ፍርድ ቤት ለማመልከት ይችላል። ፍርድ ቤቱም ገንዘብና ንብረቱ ለአስተማሪዎች ወይም ለባለንብረቶች በአፋጣኝና በተቀላጠፈ መንገድ እንዲመለስ የሚያስችል ትዕዛዝ ይሰጣል።

፱. ፈቃድ ስለመሠረዝ

አነስተኛ ብድር አቅራቢ የገንዘብ ድርጅት ከዚህ በሚከተሉት ማናቸውም ምክንያቶች ፈቃዱ በባንኩ ሊሰረዘበት ይችላል፤

- ሀ) ፈቃድ በተሰጠው በአሥራ ሁለት (፲፪) ወራት ውስጥ ሥራውን ሳይጀምር ሲቀር፤
- ለ) ሥራውን ሲያቆም፤
- ሐ) የመክሰር ውሳኔ ሲሰጥበት ወይም እንዲፈረስ ሲወሰን፤

6. Application for License

- 1) An application for license to carry out micro financing business shall contain the following:
  - (a) the prospective place of operation (indicating that of the head office and branches);
  - (b) the name, occupation, residence and nationality of the founders;
  - (c) form of organization of the undertaking;
  - (d) memorandum of association of the undertaking;
  - (e) proposed name of the undertaking;
  - (f) biographical data on each of the founders, proposed directors and officers;
  - (g) the proportion of contribution in cash and in kind and the manner of valuation of contribution in kind;
  - (h) the proposed transactions and operations of the undertaking as well as the manner for carrying out same; and
  - (i) such other relevant information as the bank may require.
- 2) An investigation fee, prescribed by the Bank, shall be paid at the time of submitting the application for license.
- 3) An applicant issued with a license shall commence operations within 12 (twelve) months from the date thereof.
- 4) No micro financing institution shall, without the prior consent of the Bank, operate outside the area for which it has been issued with a license.
- 5) Every micro financing institution shall pay such annual license renewal fee as the Bank may prescribe.

7. Authorization of Commencement of Operation

Any micro financing institution may, before commencing operations, be required to meet certain conditions prescribed in a directive to be issued by the Bank.

8. Recovery of Monies and Securities Received by unlicensed undertakings

Where any unlicensed person undertakes activities carried out pursuant to this Proclamation, and holds monies or property obtained through such act, the Bank may apply to the Federal High Court for orders in respect of the disposition of same; the High Court shall give orders for the speedy and efficient return of such monies or property to the depositors or owners thereof.

9. Revocation of License

The license of a micro financing institution may be revoked by the Bank for any of the following reasons:

- 1) where it fails to commence operations within a period of 12 (twelve) months following the issuance of license;
- 2) where it ceases to carry on its activity;
- 3) where it is declared bankrupt or decided that it be liquidated;

፱. ባንኩ በቅድሚያ በጽሑፍ ሳይፈቅድ ከሌላ አንስተኛ ብድር አቅራቢ የገንዘብ ድርጅት ወይም ባንክ ጋር ሲጥሃድ፤ ወይም

፺. በተሳሳተ መረጃ ላይ ተመስርቶ የተመዘገበ መሆኑ ሲረጋገጥ።

፲. እንደገና ለመመዘገብ ስለሚቀርብ ማመልከቻ

፩. አንስተኛ ብድር አቅራቢ የገንዘብ ድርጅት የሚያንቀሳ ቅሰው የቁጠባ ገንዘብ ብር ፩ ሚሊዮን (አንድ ሚሊዮን ብር) ሲደርስ እንደገና ለመመዘገብ ማመልከት አለበት።

፪. ድርጅቱ በዚህ አንቀጽ ንዑስ አንቀጽ (፩) መሠረት ሲያመለከት፤ ባንኩ ባወጣቸው መመሪያዎች ውስጥ የተጠቀሱ ተጨማሪ ሁኔታዎችን እንዲያሟላ ሊገደድ ይችላል።

፲፩. ስለ ድጋፍ

፩. ባንኩ ተገቢ ነው ብሎ ሲያምንበት ማናቸውም አንስተኛ ብድር አቅራቢ የገንዘብ ድርጅት በሚቋቋምበት ወይም ሥራውን በሚያካሂድበት ወቅት የሚጠይቀውን ቴክኒካዊ ድጋፍ ይሰጣል።

፪. አንስተኛ ብድር አቅራቢ የገንዘብ ድርጅቶች መልሶ ለማብደር ወይም ለካፒታል ማስፋፊያ የሚያውሉት የብድር አገልግሎት ወይም ማናቸውንም እርዳታ ከውጪ ሀገር ለማግኘት ይችላሉ።

፫. በዚህ አንቀጽ ንዑስ አንቀጽ (፪) መሠረት የሚገኝ ብድር ወይም እርዳታ በቅድሚያ የገንዘብ ሚኒስቴርን ይሁንታ ማግኘት አለበት።

ከፍል ሦስት

የፌዴንሰ ግዴታዎችና ደንቦች

፲፪. ዝቅተኛ የካፒታል መጠን የባንኩ ሥልጣንና ተግባር

፩. አንስተኛ ብድር ለማቅረብ ሥራ ፈቃድ ለማግኘት የሚጠየቀው ዝቅተኛ የተከፈለ ካፒታል መጠን ባንኩ በሚያወጣው መመሪያ ይወሰናል።

፪. ባንኩ ከዚህ የሚከተሉትን ጉዳዮች በሚመለከት መመሪያዎችን ለማውጣት ይችላል፤

ሀ) አንስተኛ ብድር አቅራቢ የገንዘብ ድርጅቶች ለማንኛውም ግለሰብ ወይም ቡድን ስለሚሰጡት ከፍተኛ የብድር መጠን፤

ለ) ስለብድር መክፈያ ጊዜና የአሰጣጥ ሥነ ሥርዓት፤

ሐ) ስለወቅታዊ ሪፖርት አቀራረብ የሂሳብ አያያዝ ዘዴ እና የሂሳብ መዝገብ አያያዝ ሥርዓት፤

መ) ብድርን አስመልክቶ በየጊዜው ስለሚደረግ ጥቅል ምርመራና ስለአዲት፤

ሠ) ስለተጠያቂነት፣ ስለመዋቅር፣ ስለቁጠባ ዘዴና ስለገንዘብ ክንውን ደረጃዎች፣ እና

ረ) ለአንስተኛ ብድር አቅራቢ የገንዘብ ድርጅቶች ስለሚውሉ ልዩ የወለድ ተመን አወሳሰን።

፫. ባንኩ ከዚህ የሚከተሉትን የማከናወን ኃላፊነት አለበት፤

ሀ) ባንኮችና ሌሎች የገንዘብ ድርጅቶች አንስተኛ ብድር በማቅረብ ሥራ ላይ እንዲሳተፉ ወይም በዚህ መስክ ሥራቸውን እንዲያስፋፉ ማስረታታት፤

ለ) ለአንስተኛ ብድር አቅራቢ የገንዘብ ድርጅቶች ሠራተኞች ሥልጠና መስጠት ወይም ሥልጠና እንዲያገኙ ሁኔታዎችን ማመቻቸት፤

4) where it is amalgamated with another micro financing institution or bank without prior written authorization of the Bank; or

5) where confirmed that its registration was effected on the basis of false information.

10. Application for re-Registration

1) where the savings mobilized by a micro financing institution equals Birr 1,000,000 (one million Birr) it shall apply for re-registration.

2) where application is made under sub-Article (1) of this Article, it may be required that additional conditions prescribed by directives issued by the Bank be met.

11. Assistance

1) Where it deems it appropriate, the Bank shall extend technical assistance requested by a micro financing institution while being organized or in the course of operations.

2) Micro financing institutions may obtain line of concessional credit or any assistance from foreign sources for the purpose of on-lending or capitalization.

3) Any credit or assistance to be obtained under sub-Article (2) of this Article shall require the prior approval of the Ministry of Finance.

PART THREE

Financial Requirements and Limitations

12. Minimum Capital Requirement and Powers and Responsibilities of the Bank

1) The minimum paid-up capital required to obtain license for micro financing business shall be determined by directives to be issued by the Bank.

2) The Bank may issue directives governing the following:

(a) limits on the maximum credit extended by micro financing institutions to any individual or group;

(b) the loan period and procedures;

(c) periodic reporting, the accounting system and the keeping of books of accounts;

✓ (d) periodic surveys of loan and audits; ?

✕ (e) standards regarding accountability, structure, savings system and financial performance;

(f) setting of special interest rate applicable to micro financing institutions.

3) The Bank shall have the responsibility to:

(a) encourage banks and other financing institutions to engage in micro financing business or to expand their activities in same;

(b) offer or facilitate training for the personnel of micro financing institutions;

ሐ) ገቢዎች ገቢ ያለው የገብረተሰቡ ክፍል የበለጠ ጥቅም እንዲያገኝባቸው እንደ እቅብ የመሳሰሉ ባሕላዊ የቁጠባ ተቋሞችን ማበረታታትና ማዳበር፤

መ) በሕግ በተሰጠው ሥልጣን መሠረት አነስተኛ ብድር በማቅረብ የሥራ መስክ ላይ የሚውለው ኢንቨስትመንት በተለይ በገጠራቱ ኢትዮጵያ እንዲያደግ ማድረግ።

**፲፫. መጣመርና መቀላቀል**

በተጎራባች አካባቢዎች የሚንቀሳቀሱ የአነስተኛ ብድር አቅራቢ የገንዘብ ድርጅቶች መጣመርና መቀላቀል የሚበረታታ ይሆናል፤ ባንኩም ተገቢ ነው ብሎ የሚያምንበትን ማበረታቻ ለእንዲህ ዓይነቶቹ ድርጅቶች ይሰጣል።

**፲፬. ቅርንጫፍችን ስለመክፈት**

፩. ማናቸውም አነስተኛ ብድር አቅራቢ የገንዘብ ድርጅት ቅርንጫፍ ሥራውን በጀመረ በአሥራ አምስት (፲፮) ቀናት ውስጥ የቅርንጫፉን መክፈት ማሳወቅ አለበት።

፪. አነስተኛ ብድር አቅራቢ የገንዘብ ድርጅት ቅርንጫፍ ቢሮዎችን ስለሚከፍትበትና ሥራቸውን ስለሚያካሂድበት ሁኔታ ባንኩ አጠቃላይ መመሪያዎችን ሊያወጣ ይችላል።

**ከፍል አራት  
ጠቅላላ ሁኔታዎች**

**፲፮. የብድር አገልግሎት አሰጣጥ**

አነስተኛ ብድር አቅራቢ የገንዘብ ድርጅቶች ለአባላትና አባል ላልሆኑም ብድር ሊሰጡ ይችላሉ። ሆኖም በቡድን ጥስትና የሚካሄዱ የብድር መርሀ-ግብሮች ተባብሮቻቸውን የድርጅቶቹ አባል ለማድረግ መጣር ይኖርባቸዋል።

**፲፯. መሠረታዊ የጥንቃቄ ሥርዓት**

አነስተኛ ብድር አቅራቢ የገንዘብ ድርጅቶች በአጠቃላይ ሊከተሉት የሚገባ መሠረታዊ የጥንቃቄ ሥርዓት ባንኩ በሚያወጣው መመሪያ የሚወሰን ይሆናል።

**፲፰. ክልከላዎች**

ከባንኩ በቅድሚያ ይሁንታ ካላገኘ በስተቀር ማናቸውም አነስተኛ ብድር አቅራቢ የገንዘብ ድርጅት ፤

፩. በመቀላቀል ወይም በሌላ በማናቸውም መንገድ የንግድ ሥራውን መሸጥ ወይም የባለሀብትነት መተላለፍን የሚያስከትሉ ማናቸውንም ዓይነት ስምምነቶች ወይም ውሎች ማድረግ ወይም አወቃቀሩን መቀየር ፤

፪. በመደበኛ የሥራ ተግባሩ አፈጻጸም ካልሆነ በስተቀር ንብረቱን በሙሉ ወይም በክፍል በኢትዮጵያ ውስጥም ሆነ በውጭ ሀገር ለሌላ ሰው ማስተላለፍ ወይም በሌላ መንገድ ባለቤትነቱን ማዛወር ፤

፫. የካፒታሉን መጠን መቀነስ ወይም

፬. የመመስረቻ ጽሑፉን ማሻሻል ወይም ሥራውን እንዲያካሂድ ፈቃድ ያገኘበትን ስም መቀየር ፤

አይችልም።

**፲፱. ለሥራ መሪነት ፈቃድ ስለሚያስፈልግበት ሁኔታ**

ከዚህ በታች የተመለከቱት ዓይነት ግለሰቦች ከባንኩ በቅድሚያ በጽሑፍ ካልተፈቀደላቸው በስተቀር ፣ የአነስተኛ ብድር አቅራቢ የገንዘብ ድርጅትን ሥራ ለመምራት አይችሉም፤

(c) promote and develop traditional savings institutions such as Iqub in order that the low-income section of society benefit most from them; and

(d) promote investment in micro financing business, especially in rural Ethiopia, pursuant to powers vested in it under the law.

**13. Consolidation and Merger**

Consolidation and merger of micro financing institutions operating in adjacent areas shall be encouraged and such incentives as the Bank deems appropriate shall be granted to them.

**14. Opening of Branches**

1) Every micro financing institution shall notify its having opened a branch office, within fifteen (15) days of the commencement of operation of such branch.

2) The Bank may set general guidelines on donations of opening and operating branch offices by micro financing institutions.

**PART FOUR**

**General Conditions**

**15. Extending of Loan Services**

Micro financing institutions may extend loan to members as well as to non-members. However, such credit schemes as operating under group guarantee shall exert themselves to bring borrowers into membership of the institutions.

**16. Minimum Operational Prudence**

The minimum prudential framework of operation in respect of all micro financing institutions shall be in the manner and form to be prescribed by the Bank.

**17. Prohibitions**

Without the prior approval of the Bank no micro financing institution may:

1) enter into any arrangement or agreement for the sale or disposal by amalgamation or otherwise of its business or effect self restructuring;

2) transfer or otherwise dispose of the whole or any part of its property, whether inside or outside Ethiopia, other than in the ordinary course of its business;

3) effect reduction of its capital; or

4) amend its memorandum of association or alter the name under which it is licensed.

**18. Circumstances Requiring Approval for Managerial Responsibility**

The following shall not be allowed to manage micro financing institutions without the prior written approval of the Bank:

- ፩. በኢትዮጵያ ውስጥም ሆነ በውጭ ሀገር የመክሰር ውሳኔ የተሰጠባቸው ወይም ስለኪሳራው ከገንዘብ ጠያቂዎቻቸው ጋር ስምምነት ያደረጉ፣ ወይም
- ፪. በኢትዮጵያ ውስጥም ሆነ በውጭ ሀገር እምነት በማገዳል ወይም በአታላይነት ወንጀል የተፈረደባቸው።

**፲፱ የግብር ነፃነት**

አነስተኛ ብድር አቅራቢ የገንዘብ ድርጅቶች ከገቢ ግብር ነፃ የሚሆኑበትን ጊዜና አፈጻጸሙን የመወሰን ሥልጣን በዚህ አዋጅ ለገንዘብ ሚኒስቴር ተሰጥቶታል።

**፳፻ ልዩ ኃላፊነት**

ማናቸውም አነስተኛ ብድር አቅራቢ የገንዘብ ድርጅት ዝቅተኛ ገቢ ያለው የኅብረተሰብ ክፍል፣ በተለይም በገጠር አካባቢዎች፣ ብድር ሊያገኝ የሚችልበትን ፖሊሲ በማውጣት መፈጸም እና ለዚህም ዓላማ የብድን ዋስትና የንብረት ዋስትናን የሚተካባቸውን መንገዶች ሥራ ላይ ማዋል ይኖርበታል።

**ከፍል አምስት  
ልዩ ልዩ ድንጋጌዎች**

- ፳፩. የመተባበር ግዴታ  
ይህን አዋጅ ሥራ ላይ በማዋል ረገድ ባንኩ ሲጠይቅ የሚመለከታቸው አካላት የመተባበር ግዴታ አለባቸው።
- ፳፪. ስለ ሂሳብ ምርመራ  
ማናቸውም አነስተኛ ብድር አቅራቢ የገንዘብ ድርጅት ከተጣራ ዓመታዊ ትርፉ ላይ ለባለአክሲዮኖች ከማከፋፈል በፊት ሂሳቡ በባንኩ ተቀባይነት ባለው ነፃ አዲተር መመርመር አለበት።
- ፳፫. ተፈጻሚነት ስለማይኖራቸው ሕጎች  
ከዚህ አዋጅ ጋር የሚቃረኑ ሕጎች በዚህ አዋጅ የተሸፈኑ ጉዳዮችን በተመለከተ ተፈጻሚነት አይኖራቸውም።
- ፳፬. ተፈጻሚነት ስላለው ሌላ ሕግ  
በዚህ አዋጅ ባልተሸፈኑ ጉዳዮች ላይ የባንክ ሥራ ስለመኖር ቀድሞ ስለመቆጣጠር የወጣው አዋጅ ቁጥር ፹፬/፲፱፻፹፮ እንዳስፈላጊነቱ እየተቃኘ ተፈጻሚ ይሆናል።
- ፳፭. መመሪያ የማውጣት ሥልጣን  
ባንኩ ይህን አዋጅ በሚገባ በሥራ ላይ ለማዋል መመሪያዎችን ሊያወጣ ይችላል።
- ፳፮. የመሸጋገሪያ ድንጋጌ  
፩. ይህ አዋጅ ከመጽናቱ በፊት አነስተኛ ብድር በማቅረብ ሥራ ላይ የተሰማሩ ድርጅቶች ከአዋጁ ድንጋጌዎች ጋር በሚጣጣም መልኩ እስኪዋቀሩ ድረስ በነበሩበት ሁኔታ ሊቀጥሉ ይችላሉ።  
፪. አዋጁ በተጠቀሱት ድርጅቶች ላይ ተፈጻሚ ሳይሆን ሊቆይ የሚችልበት ሁኔታና የጊዜ ገደብ ባንኩ በሚያወጣው መመሪያ መሠረት ይወሰናል።

- 1) persons declared bankrupt or who have made a compromise with their creditors, whether in Ethiopia or elsewhere;
- 2) persons convicted of offences of breach of trust or fraud, whether in Ethiopia or elsewhere.

**19. Tax Exemption**

The Ministry of Finance is hereby empowered to determine the period, manner and condition of exemption of micro financing institutions from income tax.

**20. Special Responsibility**

Every micro financing institution, shall devise and execute a policy whereby the low-income section of society, especially in rural areas, get access to credit and to this end it shall implement such means of substituting group guarantee for property collateral requirement.

**PART FIVE**

*Miscellaneous Provisions*

**21. Duty to Cooperate**

Where so requested by the Bank, all concerned bodies shall have the duty to cooperate in the implementation of this Proclamation.

**22. Audit**

Accounts of micro financing institutions shall be audited annually by an independent auditor acceptable to the Bank prior to the payment of dividends to shareholders.

**23. Inapplicable Laws**

Any law inconsistent with the provisions of this Proclamation shall not apply to matters provided for under this Proclamation.

**24. Other Applicable Law**

With respect to matters not covered under this Proclamation, the Licensing and Supervision of Banking Business Proclamation No. 84/1994 shall apply, mutatis mutandis.

**25. Power to Issue Directives**

The Bank may issue directives necessary for the proper implementation of this Proclamation.

**26. Transitory Provisions**

- 1) Undertakings engaged in micro financing business, prior to the coming into force of this Proclamation, may continue in their previous form until reorganized in compliance with the provisions of this Proclamation.
- 2) The conditions and time limit of non-applicability of this Proclamation to such undertakings shall be determined in directives to be issued by the Bank.

፳፮. አዋጅ የግንጸናዐት ጊዜ

ይህ አዋጅ ከሰነድ ቁጥር ፻፲፱፻፹፮ ዓ.ም. ጀምሮ የጸና ይሆናል።

አዲስ አበባ ሰነድ ቁጥር ፻፲፱፻፹፮ ዓ.ም.

ዶ/ር ነጋሶ ጊዳዳ

የኢትዮጵያ ፌዴራላዊ ዲሞክራሲያዊ ሪፐብሊክ

ፕሬዚዳንት

27. *Effective Date*

This Proclamation shall come into force as of the 5<sup>th</sup> day of July, 1996.

Done at Addis Ababa, this 5<sup>th</sup> day of July, 1996.

NEGASO GIDADA (DR.)

PRESIDENT OF THE FEDERAL DEMOCRATIC  
REPUBLIC OF ETHIOPIA

ብርሃንና ሰላም ማተሚያ ድርጅት ታተመ  
BERHANENA SELAM PRINTING ENTERPRISE

# Appendix III



የ ኢ ት የ ጽ ያ ብ ሔ ራ ዊ ባ ን ክ

NATIONAL BANK OF ETHIOPIA

ADDIS ABABA

TELEGRAPHIC ADDRESS

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TELEX 21020

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ADDIS ABABA

LICENSING AND SUPERVISION OF  
THE BUSINESS OF  
MICRO-FINANCING INSTITUTIONS

Directive No. MFI/03/96

CRITERIA FOR SELECTION OF OFFICERS AND DIRECTORS

1. Issuing Authority

These directives are issued by the National Bank of Ethiopia pursuant to the authority vested in it by Article 41 of the Monetary and Banking Proclamation No. 83/1994 and by Article 4(1) (d) of the Licensing and Supervision of the Business of Micro-Financing Institutions Proclamation No. 40/1996.

2. Criteria for Selection of the Chief Executive Officer

2.1 Education

A minimum of first degree in the field of social science or equivalent in relevant field.

2.2 Employment

A minimum of three (3) years experience in a senior post in a financial institution or related institutions.

2.3 Age

A minimum of 30 years.

2.4 Marital Status

Preferably married or responsible to a family.

3. Criteria for Selection of Members of the Board of Directors

3.1 Education

Completion of high school education with ability to read and grasp reports, especially financial statements.

3.2 Employment

Members of the Board of Directors shall preferably have adequate managerial experience in business and/or similar organizations.

3.3 Age

A minimum of 25 years.

These directives shall enter into force as of 21st day of October 1996



*Dubale*  
Dubale Jale  
Governor

National Bank of Ethiopia