

**ADDIS ABABA UNIVERSITY**  
**SCHOOL OF GRADUATE STUDIES**  
**COLLEGE OF BUSINESS AND ECONOMICS**

DEPARTMENT OF PUBLIC ADMINISTRATION AND DEVELOPMENT MANAGEMENT  
(PADM)

THE ROLE OF MICROFINANCE INSTITUTIONS IN POVERTY REDUCTION AMONG  
THE RURAL POOR: A CASE STUDY ON OMO MICROFINANCE INSTITUTION IN  
GURAGHE ZONE OF SOUTH NATIONS NATIONALITIES AND PEOPLES REGION

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BY

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**ADDIS ABABA UNIVERSITY,  
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# Declaration

**This thesis is my original work and has not been presented for a degree in any other universities and that all sources of materials used for this thesis work have been duly acknowledged.**

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**Place and date of submission: Addis Ababa, MAY 2017**

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Tolera Tessema

The Researcher

# LISTS OF ABBREVIATION

MoFED: Ministry of Finance and Economic Development

CSA: Central Statistical Authority

SNNP: South Nations

MFI: Microfinance Institution

NBE: National Bank of Ethiopia

OMFI: Omo Microfinance Institution

CIDA: Canadian International Development Agency

ADB: African Development Bank

GDP: Growth Domestic Product

UNs; United Nations

IMF: International Monetary Fund

WHO: World Health Organization

USD: US Dollar

PPP: Purchasing Power Parity

MDGs: Millennium Development Goals

ADLI: Agriculture Development Led Industrialization

PRS: Poverty Reduction Strategy

GTP: Growth Transition Period

ASDE: Accelerated and Sustainable Development to End Poverty

PASDEP: Plan for Development to End Poverty for Accelerated and Sustainable

GB: Grameen Bank

FGD: Focused Group Discussion

SPSS: Statistical Package for Social Science

## Abstract

There has been a strongly growing interest in considering micro financing as a viable strategy for the poor. Similarly speaking, Microfinance can be a critical element of an effective poverty reduction strategy especially for developing countries. More than ever after the success of the different MFIs, the system has been duplicated in the different parts of developing world. Ethiopia is also one of the countries where microfinance has been given due consideration as a safety net for the poor to help them overcome the adversities of poverty. The services provided by microfinance institutions is desired to enable the poor to smoothen their consumption, manage their risks better, build their assets gradually, develop their micro enterprises, enhance their income earning capacity, and enjoy an improved quality of life. Microfinance institutions, as mentioned above, are basically set up with the goal of poverty reduction. Subsequently, in order to investigate the above premises, this study has undertaken empirical evidence in Omo Microfinance Institution taking a sample of 120 clients from Qebena woreda , Gurage Zone , South Region nation and nationalities to discern its contribution towards poverty reduction. Consequently the objective of this study is to find out the impact of microfinance towards poverty with a particular reference to Omo Microfinance Institution. The research work employed both quantitative and qualitative methods such as questionnaires, key informants; focus group discussions, and observations to obtain primary data. In addition, secondary sources of data have also been collected from different literature and OMFI annual progress report. The contribution of Microfinance is analyzed based on income, living condition, asset accumulation, saving, decision making power, self-confidence, business management skills along with the strength and weakness of the institution among others. Though studies found positive impact of credit and unambiguous selection criteria, but ignored examining the suitability of the methodology focusing on performance analysis in terms of financial and operational sustainability and outreach, service delivery issues of microfinance in Ethiopia. Much of their focuses have been on the microfinance institutions rather than the program targets. Even if the studies were to focus on the beneficiaries of the program they were not far from investigating whether poor people are being reached or not. The finding indicates that OMFI scheme has made positive contribution to the clients in relation to observed variables. Nevertheless significantly higher number of the clients complained about the institutions high interest rate, too small loan size, repayment policy, problematic group dynamics. Therefore, as a pointer to future endeavors, the current services of OMFI need to amend the loan size and reduce the interest rate in order to resolve the issues at hand and to fit the financial problem of the poor in the sector

**Key Words:** Microfinance Institutions, Microfinance, Microcredit, Poverty, Poverty Reduction.

# CHAPTER ONE

## INTRODUCTION

### 1.1. BACKGROUND OF THE STUDY

Even though, Microfinance is said to be an effective tool to mitigate the several social and economical problems of the rural mass, still there is a huge gap to bridge between the targeted objectives and reality. There is a need to study how microfinance institutions are functioning towards the eradication of poverty and evaluate their performances. Ethiopia is one of the least developed countries in the world. In the face of rapid growing and transforming economy, with the per capita income of the country, though it showed enhancement in recent years, is \$410 substantially lower than the regional average (World Bank, 2012). According to the report by MoFED (2011/12), the level and distribution of poverty in Ethiopia is extensive. The 2010 and the 2011 Household Income, Consumption and Expenditure Survey and Welfare Monitoring Survey of the Central Statistical Agency show that about 29.6 percent of the total population (30.4 percent in rural areas and 25.7 percent in urban areas) are living below poverty line and the survey also showing rising rural - urban poverty inequality by 17% (CSA, 2011).

The major causes of the high prevalence of poverty in Ethiopia include lack of access to financial services, employment opportunities, income, skill, education, health etc. Further noted is that provision of financial services is one of the important economic inputs in the effort to reduce poverty and empower economically marginalized segments of the society. These marginalized poor people have limited access to important economic input (credit) from traditional lending financial institutions in Ethiopia, despite the prevailing demand for credit among the poor is highly growing and largely untapped (Gowri, 2011).

The lack of access to credit for the poor is attributable to practical difficulties arising from the discrepancy between the mode of operation followed by financial institutions and the economic characteristics and financing needs of low income households. For

example, commercial lending institutions require that borrowers have a stable source of income out of which principal and interest can be paid back according to the agreed terms. However, the income of many self employed households is not stable, regardless of its size. They also look for collateral with a clear title - which many low-income households do not have (Chandra, 2010). Such prevailing inconveniences to access financial products coupled with the failure of government sponsored development financial schemes forced the rural poor to be excluded and lead a miserable life of hand-to-mouth tied to vicious cycle of poverty making every effort against poverty hopeless.

Microfinance is the financial service providing institute to the deprived group of millions of poor people both in rural and urban settings, with aim to help them in developing self-employment opportunities and engaging in various income generating activities who can never meet the tedious conditions and requirements of traditional banks (ADB, 2000a).

In Ethiopia in the last two decades, microfinance institutions have emerged as an instrument to expand financial services to poor rural and urban entrepreneurs, as providing access to financial services, principally small loans through microfinance institutions to the poor has been considered as a tool for poverty reduction, and in overall for economic development of the nation (ADB, 2000a, Morduch and Haley, 2002). Principally, easy access to financial services and institutions is a critical element for poor households\_ economic growth and improvement in their standard of livings. Improvement in living standard of the poor people of the developing countries is achieved by enhancing their income level. This phenomenon reduces poverty and causes to achieve poverty alleviation objective gradually (Tolosa, 2011).

Yitay (2011) indicated that given the legal environment in the country in the near past, interesting improvements have been witnessed not only in terms of expansion of the microfinance institutions but also in clientele number. However there appears to be limited evidence that confirms the role of these institutions in accessing credit to target marginalized poor in rural Ethiopia by having real sense of poverty reduction.

Hence, this study mainly focuses on investigating the role of microfinance institutions in carrying out their real objective of accessing credit to marginalized rural poor and poverty reduction using household survey data from rural SNNP region, Gurage zone in the two selected Woreda in the study area. It is believed that the results of the findings will be helpful for policy makers for better decisions

## **1.2 STATEMENT OF THE PROBLEM**

Poverty reduction has been an important development challenge over decades. One of the identified constraints facing the poor is lack of access to credit to enable them to take advantage of economic opportunities to increase their level of productivity and income, hence move out of poverty (Sophia, 2012).

Poverty is a multi-dimensional phenomenon related to the lack of social, economic, cultural, and political entitlements. The wide-spread poverty, with all the problems that comes with it, is the greatest challenge of our time. Poverty is a concept that applies to all humans and more seriously people in the developing world. The deadly effect of poverty on the poor people necessitated a worldwide research into ways of reducing its impact. An important tool in fighting poverty is microfinance which has gain prominence over the last few decades in countries hardly hit by the menace. Studies have shown that microfinance has chalked certain successes regarding poverty reduction. Other school of thought argue that microfinance has not had the much touched impact. (CIDA and Microfinance, 2002).

Providing small loans through microfinance institutions is taken as a means to efforts against poverty. Wolday (2003) indicated that microfinance institutions are considered as one of the important tools of reaching the poor who had no or very limited access to credit from the traditional financial sector. To enhance the poor's access to credit in Ethiopia and to promote microfinance institutions growth the government issued proclamation No. 40/1996 the microfinance law. This assisted in increasing the number of microfinance institutions operating in the country to 31 as of May, 2012 from twenty-six, as of November 2005 (NBE, 2012).

However, in Ethiopia even though microfinance programs have been considered increasingly as important safety nets of the poor, knowledge about the achievements of

these strategies remains only partial and limited, generally in the case of rural setting. Furthermore, despite the encouraging increase in number of microfinance institutions in the country, the rural poor's demand for credit remained untouched particularly due to the institutions. Microfinance can be a critical element of an effective poverty reduction strategy mostly for developing countries.

Particularly in Ethiopia there is lack of improved access and efficient provision of savings, credit, and insurance facilities to develop their businesses, enhance their income earning capacity, and enjoy an improved quality of life. There appears to be no attempt to investigate the role of Omo microfinance institution on poverty reduction among the rural poor, specifically in the context of the study area.

The objective of this paper, therefore, is to assess the role of MFI on poverty reduction, to evaluate how the MFI helps to change their (poor) economy and to point out the significance of the provision of MF service to brake grinding cycle of poverty and there, called for undertaking such type of extensive study.

### **1.3 Research Questions**

With reference to this, the researcher would like to address the following main research questions.

1. To what extent do MFIs services contribute to poverty reduction? (With respect to generation of more income & more asset holding capability)
2. What is the role of Omo microfinance institution in poverty reduction among the poor people in the study area?
3. Do the conditions and procedures set by MFIs favor the poor and low income earner clients in accessing credit?
4. What are the conditions and procedures set by microfinance institutions favor the poor in accessing credit in OMFI in the study area?
5. How could the innovative lending technologies such as joint liability lending/group lending/ can be employed to enable the poor and low income households to gain access to credit?
6. What it look likes the nature and type of loan and loan repayment capacity of the clients in the study area?

7. What are the challenges and problems of the microfinance institution in the study area?

## **1.4 OBJECTIVES OF THE STUDY**

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### **General Objective**

- To study the role of microfinance institutions in poverty reduction among rural poor in the study population.

### **Specific Objectives**

- To assess the nature and change of income as a result of the delivery of the service.
- To show whether the conditions and procedures set by microfinance institutions favor the poor in accessing credit.
- To analyze the lending methodology and regulatory instruments
- To identify how the innovative lending technologies such as joint liability lending/group lending/ can be employed to enable the poor and low income households to gain access to credit.
- To examine the nature and type of loan and loan repayment capacity of the clients.
- To explore the challenges and problems of the microfinance institution in the study population
- To assess the financial needs of the active poor and how far they include the poor in the study area
- To prepare a recommendation and suggest further area of research based on the study findings in the study population

## **1.5. SIGNIFICANCE OF THE STUDY**

This study is undertaken to assess the role of Omo microfinance institution in credit provision and reducing poverty in two selected woreda of Gurage Zone. Despite, the operation of the institution for more than fifteen years in the zone, no study has been conducted with same target as this study pursue. Hence, in addition to addressing this knowledge gap the findings of the study would point out potential areas that MFIs needed to put more efforts when providing their services to the community.

Policy makers, scholars, interested parties and government authorities will also benefit in the sense that the findings provide informed suggestions on how institutional policy can

be improved and how the community will be able to access and benefit from the services of MFIs. Moreover, the study would provide pertinent information and benefit to the community at large. Additionally, the result of the study would serve as a basis for further researches on the area and it also adds further findings on the Role of MFIs on poverty reduction among rural poor in Ethiopia.

### **1.6. SCOPE AND LIMITATION OF THE STUDY**

Today, the actual numbers of registered Microfinance institutions (MFIs) operating in the country as per the National Bank of Ethiopia (NBE, 2012) database as of May, 2012 are 31 in number. These Microfinance institutions (MFIs) operate at the different regions of the country and among them Omo Microfinance institution (MFI) is specifically operating in this region (SNNP). Nonetheless, it would have been better and exhaustive for the study if there were a chance of accommodating all Microfinance institutions (MFIs) found and operating in the region and their clients also. However, because of time, finance constraint and to make the study manageable, the study was limited only to Omo Microfinance institution (OMFI) in Gurage Zone selected Woredas and its clients.

Hence, it would not have a strong scientific justification and representativeness to generalize about the role of Microfinance institutions (MFIs) in accessing credit and reducing poverty in the entire country. Microfinance covers a wide area of issues and since there are different factors that affect the situation of the clients, this paper could not control those factors totally. However, the focal point of this study was on: institutional design (targeting the poor, lending methodology, services/products offered), and effect on income, asset holding and access to health and education facilities of poor as a result of program intervention.

### **1.7. ORGANIZATION OF THE PAPER**

This thesis is organized into five chapters. Chapter one incorporates the introduction (preliminary) parts of the study: the background of the study, the statement of the problem, objectives, significance, and scope of the study. The second chapter deals with Literature review. The third chapter gives detailed account of the study area and institution; the research design including the selection of sample; the data that will be collected and analyzed. Chapter four discusses the presentation, analysis and discussion

of findings. Finally, chapter five presents general summary of the findings, conclusion as well as recommendation.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **Introduction**

This chapter presents relevant literature, theories and concepts on basics of microfinance and poverty. First it provides the theoretical framework which consists the definition of microfinance, emergence and characteristics, regulatory framework, financial intermediary role of microfinance institutions, and it also discuss about the core concepts and definitions of poverty and current status of poverty in Ethiopia. Next the theoretical link between microfinance and poverty is touched. Then it presents the definition and conceptual framework adopted in this study and finally, it depicts about empirical evidences on related topics.

#### **2.1. What is Microfinance?**

Microfinance is the form of provision of a broad range of financial services to low-income micro enterprises and households. It is a form of financial development that has primarily focused on alleviating poverty through providing financial services to the poor (Robinson 2001). Microfinance is a bit of a catch all-term and very broadly, it refers to the provision of financial products and services targeted at low-income groups. These financial products and services include credit, savings and insurance products. The Canadian International Development Agency (CIDA) defines microfinance as the provision of a broad range of financial services to poor, low income households and micro-enterprises usually lacking access to conventional financial institutions (CIDA, 2002).

The concept of microfinance can be best captured as small, short and unsecured. It is the provision of small loans that are repaid within short periods of time, and is essentially

used by low income individuals and households who have few assets that can be used as collateral. The idea here is to enable the poor to raise their income levels and improve their standard of living; hence this is based on the belief that the goals of microfinance have been poverty alleviation and accessibility to market (Ukeje 2005).

Microfinance is not charity despite its appellation as 'poverty lending'. Principally microfinance seeks to create access to credit for the poor who ordinarily are locked out of financial services for reason of their poverty; that is, lack of command over assets. The poor are a heterogeneous group, comprising people with different kinds of deprivations and vulnerabilities. This group of people lives mostly in the country side areas.

The objective of economic policy or reform by any government therefore, should be pro-poor. As such efforts to reduce poverty must be multifaceted, since it is multidimensional and micro financing is considered a viable option. (Justin 2012). Cognizant of the more return it offers, in addition to their financial intermediation role, many microfinance institutions provide social intermediation services such as training in financial literacy, group formation, development of self confidence, and management capabilities among members of a group. Thus the definition of microfinance also extends to include both financial intermediation and social intermediation. Alen (2006) define microfinance based on its main characteristics: It is targeting of the poor, promoting small business, building capacity of the poor, extending small loans without collaterals, combining credit with savings (Tolosa, 2006).

Generally microfinance helps low income people reduce risk, improve management, raise productivity, obtain higher return on investment, increase their income, and improve the quality of their lives and those of their dependants (Robinson, 2001).

Accordingly, microfinance programs have recently been considered as an important instrument to attain the poverty reduction objectives. Scholars argued that even though microfinance is not a panacea for poverty and development related challenges, it is nonetheless an important tool in the poverty reduction programs. Similarly, they stated that although micro finance alone cannot provide infrastructures such as roads, housing, health, water supply and education services, it contributes important role in order to

realize the above interventions. In addition, it empowers the poor and provides them with the financial resources to increase income and access to social services (Wolday 2001).

### **2.1.1. Microfinance and Microcredit**

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In most research papers, the terms microcredit and microfinance are often used interchangeably, but it is important to highlight the difference between them because both terms are often confused. Though it is true that the two are similar in nature and tends to perform similar functions, Microcredit is obviously a small part or subset of Microfinance. The main difference among terms is about the range of services and the targeted clients. For example, ADB (2000) defines microfinance as the provision of a broad range of financial services such as loans, deposits, payment services, money transfers, and insurance to poor and low-income households and their micro-enterprises.

In general, Microfinance is a broader term than microcredit and covers financial services that provide a greater scope of access for the poor. Microfinance also includes imparting entrepreneurial skills and training, along with advice on many matters for a better living such as health, nutrition, educating children and improving living conditions. Tolosa (2011) states that most people think of Microfinance as providing very small loans to entrepreneurs to start small businesses. This is what is known as Microcredit and forms a large part of what is considered to be Microfinance but, as mentioned above; microfinance is the provision of a broad range of financial services to the poor, including credit.

### **2.1.2. Microfinance Institutions (MFIs)**

Microfinance institution is an organization, engaged in extending micro credit loans and other financial and non- financial services to poor borrowers for income generating and self employment activities. This very broad definition includes a wide range of providers that vary in their legal structure, mission, and methodology. However, all share the

common characteristics of providing financial services to clients who are poor and more vulnerable than traditional bank clients (CGAP, 2010).

The Micro Finance Institution (MFI) is usually not a part of the formal banking industry or government. It is usually referred to as a Non-Government Organization (Dilayehu 2010)

## **2.2. The Emergence of Micro Finance Institutions**

Since, the traditional financial institutions have failed to reach the poorest of the 9 of the population; microfinance emerged as a potential tool to fill the gap between financial institutions and needy people. The origin of micro finance is traced back to the early 1700s when Jonathan Swift, an Irishmen, had the idea to create a banking system that would reach the poor. He created the Irish Loan Fund, which gave small short term loans to the poorest people in Ireland who were not being served by commercial banks, in hopes of creating wealth in the rural areas of Ireland (Jennifer, 2010)

In the 1800s similar banking systems showed up all across Europe targeting the rural and urban poor. Friedrich Raiffeisen of Germany realized that the poor farmers were being taken advantage of by loan sharks. He acknowledged that under the current lending system, the poor would never be able to create wealth; they would be stuck in a cycle of borrowing and repaying without ever making personal economic development. Finally he founded the first rural credit union in 1864 to break this trend. In the 1950\_s donors and government subsidies were used to fund loans primarily for agricultural workers to stimulate economic growth but these efforts were short lived. The loans were not reaching the poorest farmers; they were often ending up in the hands of the farmers who were better off and didn\_t need the loans as critically as others. Funds were being lent out with an interest rate much below the market rate and there were not enough funds to make this viable long term. These loans were rarely being repaid, so the banks\_capital was depleting quickly and when the subsidized funds ran out, there was no more money to pump into the agricultural economy in the form of micro loans (Jennifer, 2010).

In the 1970s the biggest developments in micro finance occurred. Grameen Bank in Bangladesh started off as an action based research project by a professor who conducted an experiment credit program. This nonprofit program dispersed and recovered thousands

of loans in hundreds of villages. The professor tried to extend this idea to other bankers in Bangladesh, but they were afraid that it was too risky as a business and turned down the offer. However, today Grameen Bank is one of the world's largest micro finance institutions with over 7.9 million borrowers in 2011 and Grameen means rural or village in Bangladesh language (Tolosa, 2011).

### **2.3. CHARACTERISTICS OF MICROFINANCE**

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Microfinance makes easy access to financial and non-financial services to low-income people, who wish to access money for starting or developing an income generation activity. The individual loans and savings of the poor clients are small. Microfinance came into being from the appreciation that micro-entrepreneurs and some poorer clients can be bankable, that is, they can repay, both the principal and interest, on time and also make savings, provided financial services are tailored to suit their needs. Microfinance as a discipline has created financial products and services that together have enabled low-income people to become clients of a banking intermediary. According to Mohamed (2007) quoting Murray, U. and Boors, R. (2002) stated the characteristics of microfinance products which include but not limited to: -

- Small amounts of loans and savings and application procedures are simple.
- Short- terms loan (usually up to the term of one year).
- Payment schedules attribute frequent installments (or frequent deposits).
- Easy entrance to the microfinance intermediary saves the time and money of the client and permits the intermediary to have a better idea about the clients' financial and social status.
- Short processing periods (between the completion of the application and the disbursement of the loan).
- The clients who pay on time become eligible for repeat loans with higher amounts.
- The use of tapered interest rates (decreasing interest rates over several loan cycles) as an incentive to repay on time.

- No collateral is required contrary to formal banking practices. Instead of collateral, microfinance intermediaries use alternative methods, like, the assessments of clients' repayment potential by utilizing social information rather than cash flow analyses.

## **2.4. An Overview of Financial System in Ethiopia**

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Finance refers to the process by which markets deal with cash flows over time. Financial markets make possible for individuals, partnerships, and governments to borrow and lend. Institutions that perform this sort of market function, matching borrowers and lenders or traders are called financial intermediaries. Financial intermediaries include banks, Insurance Companies, and Microfinance institutions (MFIs). Financial sector can play a significant role in improving resource allocation, food security, alleviating poverty and economic growth of a country (Yitay, 2011).

The Ethiopian Financial system, generally speaking falls into two categories. These include: Formal and informal financial system. The formal financial system is a regulated sector, which is well organized and provides financial services mainly to urban areas with the exception of Microfinance institutions (MFIs). This formal financial system in Ethiopia is mainly composed of financial institutions such as banks, insurance companies and microfinance institutions. The informal financial system includes Equib (Rotating Saving and Credit Association), Eddir and others, which are not regulated by National Bank of Ethiopia (NBE) (Kassa, 2010).

Currently there are 18 private and 3 government-owned banks, 14 private and 1 governments owned insurance companies, and 31 microfinance institutions owned by regional governments, (NGOs), individuals and associations as of May, 2012 (NBE, 2012). The capacity of the conventional banking sector in Ethiopia has been too weak and bureaucratic to serve the need of the rural community.

Access to institutional credit is very limited and the majority of the rural poor get access to financial services through the informal channels. Much of demand for rural finance is met through the informal sector (Yitay, 2011). The inability of traditional banks to address the financial demand of the rural poor is the initiation to design new strategies for delivering financial services to the poor. The microfinance institutions are mainly designed to provide rural banking services and mobilizing small savings.

#### **2.4.1. Overview of Microfinance institutions development in Ethiopia** 12

Microfinance development in Ethiopia is a recent phenomenon in institutionalized form. But it has a long history in different forms. The Government efforts of delivering financial services especially credit to accelerate socio-economic development in Ethiopia may date back to the immediate post Italian occupation period with the establishment of the Ministry of Agriculture in 1943 and Agricultural Bank of Ethiopian in 1945. The main objective of the Bank was to assist small land holders whose farms had been devastated during the Italian occupation through loans to purchase agricultural inputs and repaired houses (Abebe 2006).

During the Dergue regime, a large share of credit was given to the state sector and marginalizing the private sector and the poor. Due to this, the private sector including the poor was forced to depend on self-financing and non-institutional credit. During the 1986-90 the share of domestic credit to the private sector and cooperatives averaged 4.7 and 1.1 percent respectively and the rest going to the government and public sector (Wolday, 2001). NGOs have been delivering relief and development services like emergency food, health, education and water in Ethiopia since 1970\_s.

Following the failure and unsustainability of financial services by NGOs and governments, proclamation which provides for the establishment of microfinance institutions, was issued in July 1996. Since then, various microfinance institutions have legally been registered and started delivering microfinance services.

#### **2.4.2. The Regulatory Framework for the Microfinance institutions in Ethiopia**

The delivery of efficient and effective microfinance services to the poor requires conducive macroeconomic policies and the establishment and enforcement of legal and regulatory frameworks of a country. An effective financial system provides the foundation for a successful poverty alleviation program (AEMFI 2000). The microfinance institutions are part of the formal financial system that are regulated and supervised by national bank of Ethiopia. However, regulations in the microfinance industry do not only mean government regulations; it also involves self-regulations and code of conducts introduced by networks or associations.

There are a number of regulations which affect the development of microfinance industry in Ethiopia. The most relevant and recent regulation affecting the industry is Proclamation No. 40/1996 which aims to provide for the licensing and supervision of the business of micro financing clearly indicates the requirements for licensing microfinance institutions by empowering the National Bank of Ethiopia to license and supervise them. The National Bank of Ethiopia has also issued directives, which have been consistent with Proclamation. These included setting a loan ceiling of 5,000 Birr and loan duration of one year. The interest rate has been waived and Microfinance institutions (MFIs) are now free to set their own interest rates ceiling (Yitay, 2011).

Further, in an attempt to enhance the development and soundness of the micro-financing business; Micro-Financing Business Proclamation No. 626 /2009 was ratified by the House of People's Representative. According to the Proclamation No. 626 /2009, the main purpose of a micro-financing institution shall be to collect deposits and extend credit to rural and urban farmers and people engaged in other similar activities as well as micro and small scale rural and urban entrepreneurs, the maximum amount of which may be determined by the National Bank of Ethiopia.

In line with the above mentioned proclamation, a micro-financing institution may engage in some or all of the following activities: -

- Accepting both voluntary and compulsory savings as well as any deposit.
- Extending credit to rural and urban farmers and people engaged in other similar activities as well as micro and small-scale rural and urban entrepreneurs.
- Drawing and accepting drafts payable within Ethiopia.

- Micro-insurance business as prescribed by directive to be issued by the Bank.
- Purchasing income-generating financial instruments such as treasury bills and other short term instruments as the National Bank may determine as appropriate.
- Acquiring, maintaining and transferring any movable and immovable property including premises for carrying out its business.
- Rendering managerial, marketing, technical and administrative advice to customers and assisting them to obtain services in those fields.
- Managing funds for micro and small scale businesses.
- Providing local money transfer services. 14
- Providing financial leasing services to peasant farmers, micro and small-scale urban and rural entrepreneurs in accordance with the Capital Goods Leasing Business Proclamation No. 103/1998; and engaging in other activities as specified by directives of the National Bank from time to time (Deribie et al., 2013).

### **2.4.3. The Licensing of micro-financing institutions**

Micro-Financing Business Proclamation No. 626 /2009 states that it is prohibited to engage in micro-financing business without obtaining a license from the National Bank of Ethiopia; provided however, that banks licensed under the appropriate law may engage in micro-financing business without a separate micro-financing business license.

### **2.4.4. Structure of ownership of micro-finance institutions in Ethiopia**

The ownership structure of Ethiopian Micro-Finance Institutions is the direct effect of regulatory provisions. According to the Proclamation No. 40/1996 of the Business of Micro Financing Institutions, micro-financing institution should be 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.

This legislation excluded international NGOs and other overseas agencies not to own and run microfinance institutions in Ethiopia. In support of the various regional development plans and to address the social and economic problems of regions, the regional state governments own some shares in Micro finance institutions (Deribie et al., 2013).

The current regulatory framework requires microfinance institutions to be formed as share companies owned only by Ethiopian nationals (Kassa 2010).

#### **2.4.5. Saving and Credit Needs in Ethiopia**

The Need for credit is very high among the poor in Ethiopia. According to Mubarak (2006) quoting Renee Chao et.al (2000) economically active poor people in Ethiopia who can potentially access financial services are about 5.2 million. However, it should be noted that today Microfinance institutions (MFIs) meet only less than 20 percent of the demand for financial service of the poor in the country (Ayelech, 2010). In the case of rural area, the poor requires credit basically for four reasons:-First, women and 15 1 businessmen in rural and urban area need short-term credit for their petty trading or other income generating activities. Secondly, Innovations in farming like improved seed and fertilizers increases the capital requirements of the farmer. Thirdly, most rural households remain at subsistence level and therefore, there is no surplus that can be used for the future and hence they need credit to bridge the gap of food shortage, for consumption smoothing. Lastly, People also need credit to meet their social obligation like weeding, holidays.

Similarly the need for saving is high despite the wide spread belief that the poor cannot save. One can observe that a lot of saving is taking place in different forms in rural and urban areas that are prone to risks. People save for various purposes: to manage their daily house hold finance, as insurance for unexpected crisis, to meet social obligations and to accumulate for future needs. People save outside the financial system in many forms, including Jewellery, animal, grain, etc. (DilAyehu, 2010).These forms of saving are very risky as they are subjected to pests, disease, theft, drought and loss. As a result, there is good ground to say that people will take the opportunity of saving in financial terms when available in trusted microfinance institutions.

#### **2.4.6. Informal finances in Ethiopia**

In Ethiopia, like all other developing countries, informal finance is available from various traditional institutions. The informal sources of credit at present are friends and relatives, rich farmers, traders, Eqqub, Edir and money lenders.

The significance of each of these sources varies from area to area. Of these the Equib is used as a Rotating Saving and Credit Association. A study on the establishment of rural credit in Ethiopia estimates that the volume of money revolving within the Equib is in the range of 8-10% of the GDP of the country. The development of microfinance institutions in part is to recognize and accommodate the shortcomings of the informal financial institutions (Dilayehu, 2014).

## **2.5. The Financial intermediary role of microfinance institutions** 16

Almost all microfinance institutions (MFIs) in the world focus in making credit to rural and urban poor households unemployed, underemployed and small entrepreneurs, The emphasize first, in developing income activities by providing critically needed credit facilities and technical support to the poor and then on saving mobilization. Like their counterparts in other part of the world, the mission of Omo microfinance Institution (OMFI) which is operating in the most southern part of Ethiopia, is accessing credit with the goal of poverty eradication.

Financial development plays a central role in poverty reduction. Microfinance is attractive and has been accepted as an important tool to help poor in improving the livelihoods, reducing vulnerability and fostering social as well as economic empowerment (Lousie, 2002). As wolday (2003) states the delivery of financial services have been accepted as one of the poverty reduction tools in the development paradigm; because it helps the poor to increase income, improve educational and health status if it is realized appropriately. It is believed that poor households lack access to adequate financial services for efficient risk coping.

Without some financial support, these households do not have many prospects for increasing their productivity and living standard in sustainable way. Because traditional financial sector do not have interest in lending to poor households due to lack of viable

collateral and high transaction costs (Yitay, 2011). The lack of access to credit for the poor is attributable to practical difficulties arising from the discrepancy between the mode of operation followed by financial institutions and the economic characteristics and financing needs of low income households (Chandra, 2010). Lately, microfinance programs received increased attention from the international financial institutions such as World Bank, various bodies of the UN, donor agencies and IMF. IMF focused on encouraging the creation of sound financial systems in developing countries (Abebe 2006).

Microfinance programs aiming at providing financial services to individuals who are excluded from the traditional financial sector have been launched in many developing countries including Ethiopia. Still in Ethiopia, lack of access to finance is one of the fundamental problems impeding production, productivity and income as the <sup>17</sup> use of tapered interest rates (decreasing interest rates over several loan cycles) as an incentive to repay on time and no collateral is required contrary to formal banking practices. Instead of collateral, microfinance intermediaries use alternative methods, like, the assessments of clients' repayment potential by utilizing social information rather than cash flow analyses.

In Ethiopia microfinance institution was introduced and taken as part of the government's poverty alleviation strategies aiming at facilitating rural credit access by rural households and playing a greater role in the Millennium Development Goals agenda (Ayelech, 2011). Microfinance today spread all over the country and started to give services like provision of credit for rural and urban households and small businesses, accepting deposits, drafts, and public savings.

## **2.6. Approaches of Microfinance Institutions MFIs**

There are different approaches to microfinance service provision to the poor. According to Robinson (2001), the most known approaches in microfinance development can be categorized as poverty lending vs. financial system approach and business vs. developmental approach.

### **2.6.1. Poverty Lending Vs Financial System Approach**

Both approaches share the goal of making financial services available to poor people throughout the world. However, the poverty lending approach focuses on poverty reduction through credit and other services provided by institutions that are funded by donor and government subsidies. A primary goal of this approach is to reach the poor especially the poorest of the poor with credit. Saving is not a significant part of this approach. The poverty lending approach was first realized in Grameen bank in Bangladesh. It has wide outreach to poor borrowers. But the approach has required large amount of continuing subsidies and does not meet poor people's demand for saving services. Due to these it has not proven a globally affordable model (Robinson, 2001). With the failure of credit institutions to address the grassroots (households) financial needs, the situation demanded an innovative approach to address the lower segment of the population. The new approach should correct the drawbacks of the old approach. (Ayelech, 2011). The financial system approach focuses on commercial financial intermediation among poor borrowers and savers and also emphasis is given to institutional self-sufficiency. The approach targets lending to the economically active poor people, i.e. people with the ability to use small loans for income activities and the willingness to repay and to voluntarily make required savings.

### **2.6.2. Business Vs Development Approach**

The first objective of Microfinance institutions (MFIs) is the provision of basic financial services to the poor. However, the service provision depends on their approaches. There are two contesting approaches among microfinance supporters: business approach and development approach. Business approach primarily focuses on organizational achievements such as repayment, cost recovery and profitability. Hence, their concern is how to develop the industry rather than how to develop the community. (Ayelech 2010) On the other side, development approach emphasis more on how the client is doing rather than profitability. Supporters of this approach argue that the client should participate in awareness and capacity building programs before taking their loans.

Therefore, the development approach gives emphasis not only to building institutions for sustainable provision of services, but also empowering the poor people to get the most out of the services delivered; this study adopts the development approach to assess the

functioning of OMFI and to see how the institution incorporate its financial services with other non-financial services in the area.

## **2.7. Institutional Design for the Poor**

Appropriate institutional design will lead to better achievements in reaching the target poor but may or may not necessarily lead to profitability, efficiency and sustainability because the more the program targets the poorest, the less the cost recovery and profit margin expected (Harper 2003, Ayelech, 2010). However operational sustainability basically requires a large base of clients. Recent microfinance interventions have made use of a range of product design features.

### **2.7.1. Micro finance Product Designs**

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Micro finance institutions have various product designs or methodologies which target specific clients. It uses different modals to provide financial services to the poor. MFIs approaches or modals are: individual lending, German Bank solidarity lending, and village banking models. Majority of the microfinance institutions offers and provides credit on a solidarity-group lending basis without collateral or individually. Some microfinance institutions start with one methodology and later on move or diversify to another methodology so that they do their best to include certain socio-economic categories of clients and later on move or diversify to another methodology so that they do their best to include certain socio-economic categories of clients. (Dilayehu 2014, Tollosa, 2011).

#### **2.7.1.1. Individual Lending**

Unlike microfinance institutions, there are very few traditional banks which provide individual loans to low-income people because poorer clients are considered higher risk clients due to their lack of collateral, plus the labor-intensive nature of the credits and hence the lack of profitability of small-credits.

#### **2.7.1.2. Group Lending and Joint liability lending**

Group based lending is one of the most novel approaches of lending small amounts of money to a large number of clients who cannot offer collateral. The size of the group can

vary, but most groups have between four to eight members. The group self-selects its members before acquiring a loan. Loans are granted to selected member(s) of the group first and then to the rest of the members.

Most microfinance institutions require a percentage of the loan that is supposed to be saved in advance, which points out the ability to make regular payments and serve as collateral. Group members are jointly accountable for the repayment of each other's loans and usually meet weekly to collect repayments. To ensure repayment, peer pressure and joint liability works very well. The entire group will be disqualified and will not be eligible for further loans, even if one member of the group becomes a defaulter. The credit worthiness of the borrower is therefore determined by the members rather than by the institution. While many schemes use groups to credit, Kassa (2010) stated that 20% of the population may exclude some poor people, especially when the group is formed based on resource base. However, group formation enables a transfer of default risks from the institution to the borrower, and can reduce the transaction costs of providing a larger number of small loans, but there are social costs related with this process. These social costs can be a negative restraint to group borrowing and joint liability approaches, and include coercive peer pressure, loss of faith and the likelihood that the poorest and most vulnerable will remain further stigmatized.

## **2.8. Savings Mobilization**

The other side of the coin of microfinance service delivery is saving. Saving mobilization has recently been recognized as a major force in microfinance. According to Tolosa (2011) quoting Vogel (1988) in the past, microfinance focused almost exclusively on credit provision; savings were the "forgotten half" of financial intermediation. The importance of savings mobilization has been highlighted in several papers in the context of microfinance as the lack of appropriate institutional savings facilities forces the individuals to rely upon in-kind savings, such as the savings in the form of jewelry, animals or grains. These alternative savings facilities do not guarantee the combination of security of funds, ready access or liquidity, and convenience, which are basic requirements or necessity of a depositor (Tolosa, 2011). Micro finance programs can play

a significant role for promoting savings among the poor populations, with considerable benefits both for the savers and for the program.

Savings mobilization is an interesting issue among the poor for various reasons. Mobilizing savings can facilitate development programs that are working to boost productive income and employment among low-income groups. Finally, the process of saving on a regular basis can be an important experience and can contribute to an improvement in the quality of their lives. It serves to capitalize on the productive activities, which sustain the family and thereby enhancing income of the family (Stewart et al, 2010).

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## **2.9. Human Development**

According to Harper (2003) Development is deeply related to the rising of income. However, it is true that other variables have also deep relation with development. Goals of development emphasize on the reduction of poverty rather than raising average incomes. All microfinance program targets one thing in general: human development that is geared towards both the economic and social uplift of the people they care for. Tackling poverty has taken a new and broader dimension. Now the escalating income and savings, and building the assets are not the only means to fight poverty, tackling poverty points to multidimensional concepts that emphasize on reducing unemployment, education, healthcare, food shortage etc.

It is possible to achieve those development indexes, if disposable income is increased. Without maintaining balance between income and expenditure, it is difficult to tackle poverty. Microfinance programs target both economic and social poverty. To assess the success of their efforts microfinance institutions need to measure the impact on the borrowers. The primary objective of all MFIs interventions is poverty reduction.

Poverty reduction is perceived from the economic point of view. On the other hand, MFIs interventions promote living condition of poor people by offering supportive service.

These supportive services like access to health and education services are important indicators of human development. The objective of the program is to create sustainable changes in the lives and livelihood of the poor in particular (Meyer, 2002).

## **2.10. Access to Credit**

### **2.10.1. Concepts and Definitions**

This is how and where credit is made available to the poor people or to those who need it. The principal function of credit is to transfer property from those who own it to those who wish to use it, as in the granting of loans by financial institution to individuals who plan to initiate or expand an income activity. The transfer is temporary and is made for a price, known as interest, which varies with the risk involved and with the demand for and supply of credit. Access can be defined as, the right to obtain or make use of or take advantage of something (as services or membership). A household is said to have access to a type of credit if at least one of its members has a trouble-free access for that type of credit. Similarly, a household is classified as credit constrained for a type of credit if at least one of its members is constrained for that type of credit.

In many rural areas of developing countries, lack of access to traditional financial services has been seen as a severe constraint that prevents low income households from improving their incomes and lifting out of poverty). For instance as observed in different studies over 500 million poor people in developing countries have often cited limited access to credit as the biggest challenge to their economic growth. Therefore, access to credit can refer to a situation in which a borrower is able to obtain amount of loan for which he is applying. (Sophia 2012, Dilayehu 2014)

### **2.11. Concepts and Definitions of Poverty**

Traditionally, poverty has been conceptualized in terms of income, with the poor defined as those living below a given income level. But poverty has been increasingly recognized as a multidimensional phenomenon that encompasses not simply low income, but also lack of assets, skills, resources, opportunities, services and the power to influence decisions that affect an individual's daily life (WHO 2004). The complex and multidimensional nature of poverty makes it a challenge to measure. For the sake of simplicity, an income-based measure of poverty is used most widely, as it permits comparisons between regions and countries. The World Bank, for example, defines extreme poverty as an income of less than 1USD a day, seen as the minimum amount necessary for survival. To calculate extreme poverty in an individual country, the dollar-

a-day measure is converted to local currency using the purchasing power parity (PPP) exchange rate, based on relative prices of consumption goods in each country.

Based on such calculations, the World Bank estimated that 1.2 billion people were living in extreme poverty in 2009, roughly 23.3 percent of the population of all low- and middle-income countries (Tolosa, 2011). Poverty is more than just a lack of income. He argues that by increasing the income of the poor, poverty is not necessarily alleviated. It depends on what the poor do with this money, oftentimes it is gambled away or spent on alcohol, so focusing solely on increasing incomes is not enough. The focus needs to be on helping the poor to sustain a specified level of well-being by offering them a variety of financial services tailored to their needs so that their net wealth and income security can be improved.

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### **2.11.1. Overview of Poverty in Ethiopia**

Ethiopia has a subsistence agriculture dominated economy and most of Ethiopians live in remote rural areas in chronic poverty. The first striking feature of the economy is how small the aggregate value of goods and services produced in the nation. As of 2010/11, the central statistical agency reported that the Gross Domestic Product (GDP) was Birr 506.08 billion (about US\$25.95 billion) (Abu, 2013).

By any standard, Ethiopia is one of the poorest countries in the world. Poverty in Ethiopia manifests in a number of ways and this, in fact, is attributed to a multitude of interrelated factors. Bisrat (2011) for example, has identified these factors as insufficient source of income, lack of asset/skill, poor health status, poor educational level and backward attitude of people towards work. These factors in one or another way have direct or indirect effect on the life standard of the people. For example, lack of income results in reduction of expenditure pattern, poor health leads to being unproductive, absence from work, less energetic, lack of education results in lack of skill, helplessness and so on. Although these factors are believed to be universal, there are obviously some differences between the causes, processes, and consequences of poverty among the urban and rural societies. Roughly 29.6 per cent of the population lives below the national poverty line. However, there are marked differences between rural and urban areas.

Poverty in Ethiopia is more pronounced in the rural areas as compared to the urban areas, with a uniform distribution. The situation worsened recently because of sharp increases in the prices of food and fertilizers on world markets, which made it more difficult for poor households in Ethiopia (<http://www.finance maps of the world.com>. accessed Feb, 2014). Most rural households live on a daily per capita income of less than US\$0.50. Generally, rural households have less access to most essential services. According to the latest Poverty Assessment, overall progress in reducing poverty since 1992 falls short of what is required to meet MDG by 2015 as a result of high variability in agricultural GDP and rapid population growth. Most rural households are finding it increasingly difficult to survive without recourse to seasonal or permanent urban migration in search of wage employment (Abu, 2013).

### **2.11.2. Anti- poverty Policies and Strategies in Ethiopia**

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Despite becoming a public aspiration, reducing poverty represents a major task, since poverty is a complex concept that goes beyond economic parameters (e.g. income) to include other dimensions, like: human (health, education, dignity).

Since 1992 Ethiopia has instituted a series of medium to long term plans and focused policies such as the Agriculture Development Led Industrialization (ADLI), Poverty Reduction Strategy Paper (PRSP) 2002, a Plan for Accelerated and Sustainable Development to End Poverty (PASDEP) 2005/6 - 2009/10/. In 2010 Ethiopia unveiled a Growth and Transformation Plan (GTP) for the period 2010/11-2014/15 (EPA, 2012).

As per EPA (2012) the government on its anti-poverty reduction strategy in 2002 put its objectives in its PRSP–Ethiopia. This was followed by a revised policy plan (PASDEP), the program considering among others microfinance institutions as major instruments. This policy recognizes the importance of non-agricultural sector in promoting overall growth and in addressing pressing poverty problems.

Ethiopia is currently undertaking yet another ambitious economic plan within the framework of poverty reduction strategy. The Growth and Transformation Plan (GTP) is operational for 2010/11 to 2014/15 and envisages a rapid economic growth and structural transformation with emphasis on industrial development (EPA, 2012 quoting MoFED, 2010). The core of the strategy is to alleviate poverty through achieving an average

annual real GDP growth rate of 10 to 14 percent per annum with an estimated cost of US\$ 57 billion.

## **2.12. Theoretical link between microfinance and poverty reduction/alleviation**

Poverty reduction was institutionalized in 1944, with the establishment of the World Bank at the birth of the Bretton Woods system. With the IMF assigned the tasks of stabilizing the world's economy and promoting free trade in the post WW II, the problem of poverty was delegated to the World Bank. Since the World Bank's earliest day attempts to reduce poverty have centered around large global organizations, the attempt to reduce poverty seemed hopeless (Robinson, 2001). Microfinance emerged at the beginning of a shift in development thinking. This shift mirrored change in economic thought at the time. Microfinance, as a part of a much larger effort to end poverty, will provide microfinance services specifically credit for self-employment and savings capabilities and shall focus on the world's poorest people. Microfinance is an important tool for sustainable social and economic progress, and a key strategy in ending poverty. Microfinance credit service is considered to be an essential input to increase productivity. It is believed that credit boosts income levels, increase employment at the household level and thereby alleviate poverty.

Credit enables poor people to overcome their liquidity constraints and undertake some investments. Furthermore, credit helps poor people to smooth out their consumption patterns during the lean periods of the year. By so doing, credit maintains the productive capacity of poor rural households. The professed goal of microfinance is to improve the welfare of the poor as a result of better access to small loans. (Murdoch J, 2000)

It is also argued that Microfinance institutions (MFIs) with high outreach have a greater likelihood of having a positive impact on poverty alleviation because they guarantee sustainable access to credit by the poor. Outreach is the number of clients served by MFI. As Robinson (2001) states, credit would create economic power that would generate into social power, lifting the poor out of poverty.

Microfinance appeared as a fresh solution to an old problem. It appeared to be a —win-win situation, where both financial institutions and poor clients benefit. Despite, some surveys results giving mixed results on the performance of MFIs (Morduch and Haley, 2002).Larger effort to end poverty, will provide microfinance services, specifically credit for self-employment and savings capabilities and shall focus on the world's poorest people. Microfinance is an important tool for sustainable social and economic progress, and a key strategy in ending poverty. Microfinance credit service is considered to be an essential input to increase productivity. It is believed that credit boosts income levels, increase employment at the household level and thereby alleviate poverty.

Credit enables poor people to overcome their liquidity constraints and undertake some investments (Okurut et al., 2004). Furthermore, credit helps poor people to smooth out their consumption patterns during the lean periods of the year. By so doing, credit maintains the productive capacity of poor rural households.

### **2.13. Definition and Conceptual Framework**

Poverty alleviation is central issue to the financial sector in the economy, since 26 % remains a real obstacle for many rural and urban development endeavors. Particularly rural dwellers face limited credit access where a combination of agricultural risk, scarce borrower information, and high transaction cost cause that many traditional financial service providers to be reluctant to serve the rural people. Regardless of their scale, outreach, location and the type of clients, all microfinance program interventions share the common objective to enhance access to credit for productive activity and human development, specifically the economic and social uplifting of those for whom the program is targeted(Kassa Y, (2010).

Assessing the extent of outcome as a result of micro finance program intervention is an important key to evaluate the success of the program in its major objectives, whether the program brings the desired benefits to the target group or not . Assessing micro finance impact has been the main concern of development stakeholders in order to know whether services are satisfactorily provided and providing such services to the poor has improved the living standard of the poor while reducing the poverty level (Abebe, 2006).

Considering this, the conceptual framework of this study emphasized the role of microfinance institutions in accessing credit in terms of institutional design like targeting

the poor, methodologies, and services/products offered. Having this in mind further the rationale behind this framework is to assess the effect of microfinance on the living standard of the poor as an intervention at household level. At the household level, effect may be assessed by increase in household income, saving habit, and asset accumulation as a result of the intervention.

The methodology applied in this case is the one developed by USAID's AIMS project that seeks to assess impact at household level. The rationale for using household as a unit of assessment is that for an organization aiming at providing financial services to alleviate poverty, its end result is fully assessable only in direct relationship to the lives of human beings. The result of this kind of assessment would enable the organizations to take appropriate decisions to build on their strengths and strive to concentrate on areas of clients' needs that call for much improvement.

## **2.14. Empirical Evidences**

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Empirical evidences in this section presents those research works that are done on the areas of the current topic to support the execution of the study and to reveal deficiencies in the literature. Presentation is based on the coherence of ideas and on the bases of the results of finding. There are a lot of empirical evidences that confirm the link between access to credit and economic growth of the poor in various countries all over the world indicating that access to credit of poor is indeed a significant and intricate part of the process of economic growth of any economy (Justin, 2012).

On the contrary there are also studies that found weak and negative link between providing credit to the poor and reducing their exposure to poverty as the study was conducted through sample surveys of four microfinance institutions clients, using a range of poverty concepts such as income, asset holdings and diversity, and various measures of vulnerability. (Mosley 2001).

This study found that in comparison with other anti-poverty measures, small loans through microfinance appears to be successful and relatively cheap at reducing the poverty of those close to the poverty line. Consistent with this finding, several studies

find access to credit has favorable effect on poor's economic development (Olu, 2009, Khandker 2003).

Another empirical investigation in their work is the experience of the Grameen Bank (GB) of Bangladesh in community development; they examined the GB experience with a purpose of understanding the essential elements of its operations and the factors that enabled GB to reach the poor. This study revealed that the GB has established its credentials as an institution that aims at providing credit to the landless and asset less poor in rural areas. GB credit gives the recipients the power of entitlement to society's productive goods and services with immediate effect, unlike most of the other programs for the poor that tend to create the unintended negative effect of dependency on the service providers (Dilayehu, 2014)

Further this study found that GB uses an unambiguous criterion and it was observed that the credit by itself is an insufficient factor to improve poverty conditions, and thus the GB devotes a substantial amount of resources to the improvement of the social wellbeing of its members. Some studies did not find the same result from south-east Asia using the quantitative aspects of survey data as most of the features of microfinance such as supporting income generating activities; empowering the poor; helping the poorest; creating win-win situations; creating enormous demand from society; and low interest rates are just myths that microfinance has created to take advantage of the poor and the economy and stated they become poorer through the additional burden of further debt.

Microfinance is relatively a new phenomenon in the Ethiopian context. However, different studies have been conducted in the area. One of the studies by Wolday, (2003) reviews the development of microfinance in Ethiopia taking all microfinance institutions in Ethiopia and the study analyzes the performance of microfinance institutions in Ethiopia in terms of financial sustainability and outreach. The study found that over a brief period of time, MFIs in Ethiopia have shown remarkable improvement in terms of loan outstanding and savings, the increased clientele served by the MFIs in Ethiopia and micro financing scheme has improved the clients' food security and housing condition.

## **2.15. Conclusion and Gap in the literature**

Even though so many prior scholarly researches are conducted in various aspects of microfinance service to the poor and its impact, the above reviewed empirical evidences reveal quite different results. Mosley found favorable effect of credit on the poor but his study never assessed client condition before the program.

Though studies found positive impact of credit and unambiguous selection criteria, but ignored examining the suitability of the methodology. Almost all studies conducted in Ethiopia previously reviews performance of microfinance institutions, focusing on performance analysis in terms of financial and operational sustainability and outreach, service delivery issues of microfinance in Ethiopia. Much of their focuses have been on the microfinance institutions rather than the program targets. Even if the studies were to focus on the beneficiaries of the program they were not far from investigating whether poor people are being reached or not. Findings showed that microfinance institutions improved the life of rural poor. However, the study gives no idea on the conditions<sup>29</sup> of these clients before they started to use microfinance services.

In conclusion, the review show that empirical evidences concerning the microfinance institutions role in accessing credit in rural Ethiopia focusing on assessing suitability of criteria and methodology, thereby examining its effect on poverty reduction appears to be limited. As per the researchers level of understanding there is no any research study conducted in the topic with similar targets by taking Omo microfinance institution in Gurage Zone as a case study. Hence this is an excellent time to undertake such study in this area.

## **CHAPTER THREE**

### **METHODOLOGY FOR THE STUDY**

The purpose of this chapter is to provide an overview of the study area and institution, research design and the method that was used to conduct this study. The content addressed included: the research method, research approach, data gathering and tools, the sampling method and sample selection technique, and data analysis techniques and tools.

#### **3.1. DESCRIPTION OF THE STUDY AREA AND INSTITUTION**

##### **3.1.1 The study area**

The study was conducted in the Southern Nations, Nationalities and People's Regional State (SNNPRS) which is one of the four largest Regions in Ethiopia (out of the 9 Regions and 2 City Authorities into which the country is presently divided). It has an area of 105,887.18km<sup>2</sup>. It is the most diverse Region in ethnic terms, and with an estimated population of 16,848,011. The main economic activity in the region is agriculture. With regards to financial services, there existed both formal and informal financial services,

formal which operate mainly in urban centers and informal operating in both rural and urban centers in the region (Report of SNNPR, 2015)

The Gurage zone is one of the thirteen zones of the Southern region which is located about 300 km south east from Addis Ababa, capital city of Ethiopia. It is divided in to 16 administrative Woreda. Gurage Zone is one of the most densely populated areas in the region. The majority of the population lives in rural areas. Livelihoods of the same percent are based on agriculture (farming & animal rearing). Due to the proximity to the researcher and the respondents' knowledge of local language, the two woredas in the study area were selected from the 16 woredas in Gurage Zone (Zone Report, 2015)

### **3.1.2 OVERVIEW OF OMO MICROFINANCE INSTITUTION**

Based on a broad federal food security objective of poverty alleviation through intensification of economic growth, the development of financial markets is one of the strategic interventions that the government has put in place. The Omo Microfinance Institution is established in 1997 to promote access to finance in the region particularly in rural areas of SNNP region, as part of the national food security program by the regional government, and in accordance with the licensing and supervision of micro financing institution proclamation no. 40/1996. The scheme was launched as pilot in four district of the regional states.

Today it operates in all zones in the region with a mission to contribute its part in the effort to bring about accelerated and sustainable economic development in the region by the provision of efficient , effective and sustainable financial services to economically active poor people through effective collaboration with government and non government organizations. Omo microfinance institution works for the success of government policies and strategies (OMFI Report, 2015)

## **3.2. Research Method**

### **3.2.1. Methods Adopted**

To better understand the research problem and to address the research questions, the research had adopted both qualitative and quantitative research methods. The researcher expects that, the mixture of these two approaches is advisable as it gives a more multifaceted picture by drawing on the individual strength and weakness of each method; as well as enabling discovery and verification; understanding and prediction; validity and reliability within the research design. Further, the study for achieving its stated objectives was designed to follow the nature of both descriptive and explanatory research.

For the purpose of this research, survey is the most appropriate research strategy to achieve the objectives of the study that data was gathered at particular point and time within the intention of describing the nature of the existing conditions can be compared or determining the relationships that exist between specific events .

The main benefit of this research study is that it provides information on large groups of people, with very little effort, and in a cost effective manner.

### **3.3. Study Design**

The study used cross sectional design in which data were collected and employed using quantitative and qualitative methods.

### **3.4 Data Gathering tools and procedures**

Both quantitative and qualitative data were collected using different instruments and methods such as structured and unstructured interview, Focus Group Discussion (FGD), systematic visiting, and other primary and secondary data were also used in order to collect data and pertinent information for the study. The structured interview contains on the demographic, types and nature of the business, their socio-economic conditions before and after participation in the micro-finance program, Proprietorship, employment scope and diversity and other relevant information for the study.

The primary data collection method was Focus-group-discussion and unstructured interview with key informants through close ended questionnaires prepared and distributed to both the institution and its clients. Questionnaires were prepared in English, and necessarily translated into local language for the purpose of clarity and to facilitate the data collecting process.

In addition to this method, unstructured interviews and Observation were used in order to gather additional information, for crosschecking the opinions given by the clients. The study has also employed the use of secondary data and review of various documents, journals, bulletins, proclamations, reports and other sources relevant to the research problem, Questionnaires were first administered to few respondents from both the MFI and clients as pre-test and appropriate adjustments has been made.

The close ended questions were used to collect the respondents\_ background information covering household demographic and economic variables (e.g., age, sex, marital status, family size, educational background, occupation, household assets of the respondent), institutional variables (lending method, interest rate), and other access related questions

like terms of credit, purpose and size of the credit. Besides, a wide variety of variables relating to the respondent's condition were included.

Sources of the secondary data included official records that obtained from the various governmental and non-governmental organizations, published material for the study purpose and the existing literatures were based on an assessment of articles books, reports. Data was also generated through bibliography searches and survey of internet sources. Much of key works on MFI that focuses on Ethiopia were reviewed for the present study as understanding MFI requires an understanding of the global dynamics and issues. Systematic visiting and observation were also used for data gathering as an additional means of data collection that were considered in addition to the intimate engagement in the process of interviews during the data collection procedures.

### **3.5. Sampling Method and Sample Selection**

The study employed a multistage sampling. First, out of 16 Woredas in the Gurage zone one woreda was selected purposively due to its proximity to the researcher among the kebeles. In the selected Woreda Omo microfinance were designed into many clusters for the better service delivery. Out of the clusters, 2 to 3 clusters whose walking distance within small hours from the main road were purposely selected to represent the rural area through systematic random sampling.

Finally, a sample of clients, proportional to the number of clients in each Kebele were selected by simple random sampling from the list of clients who have been participating in the program for a minimum of three years that is by Gurage Zone sub-branch office of OMFI. On the other hand, workers, managers and officers were requested to interview, FGD and to respond to the prepared questionnaires

### **3.6. Data Analysis Techniques**

#### **3.6.1 Data Presentation, Analysis, and Discussion**

Data gathered through questionnaire from the clients and microfinance institution's staffs at sub branch, semi structured interview with the manager of sub branch, records of the institution concerning its operation and additional responses from experiences of clients

on researcher's field were used for the analysis. Presentation of data was arranged in table and chart form along with percentage in a descriptive way by using simple static tools. First it presents respondents general profile, next credit service accessibility condition was discussed and finally it assessed sample beneficiaries' socio-economic condition. To simplify the data analysis, after the collection of both primary and secondary data information on the institution and clients, tabulation of qualitative data was performed. Quantitative data were analyzed using the statistical package for social science (SPSS).

### **3.6.2 Research quality issues**

Various techniques were employed to ensure data reliability and validity. In order to collect reliable data, the researcher designed the key informant interview guides, FGD guides and questionnaires through an elaborated procedure which involves a series of revisions under the guidance of the research supervisor/advisor to enhance data quality.

Also quotes from interview and statement from questionnaires were used as references to ensure reliability. The researcher used checklist of questions when making personal interviews with respondents so as to achieve data consistency and completeness. Furthermore, research assistants/enumerators were trained on administering the questionnaire, interview and discussion guides on recording of any other useful information they came across within in the field. Field notes were made and edited immediately after data collection on a daily basis. Check and comparison also made key informant interviews, FGDs and secondary data sources concurrently and pre-testing were also conducted. The data scanning and scrutiny technique were employed from available questionnaires from respondents to examine and validate the survey instrument so as to ensure the content of validity and reliability of the data collected.

### **3.6.3 Ethical considerations**

The researcher considered the research values of voluntary participation, confidentiality, anonymity to ensure protection of respondents from any possible harm that could arise from participating in the study. Thus, the researcher clearly introduced the purpose of the study as a partial fulfillment of a Masters Study programs and requested the respondents

to participate in the study on a voluntary basis such that refusal or abstaining from participating was permitted. The researcher has also assured the respondents confidentiality of the information given and protection from any possible harm that could arise from the study since the findings will be used for the intended purposes only. The respondents were promised to be provided with feedback about the findings of the study

## CHAPTER FOUR

### 4. DATA PRESENTATION, ANALYSIS, AND DISCUSSION

This chapter presents data presentation, analysis and discussion of the study. The chapter analyzes the role of Omo microfinance institution (OMFI) in credit provision. Furthermore, the contribution of the institution in terms of improving income, increase saving and in asset accumulation are being analyzed. Data gathered through questionnaire from the clients and Omo microfinance institution's staffs at sub branches in the *Qebena woreda* , semi structured interview with the manager of sub branches, records of the institution concerning its operation and additional responses from experiences of clients on researcher's field notes were mainly used for the analysis.

Presentation of data is made in tables by frequency and percentage distribution by using simple static tools. First, Institutional Profile and Outreach Performance of Omo Microfinance Institution (OMFI) respondents of general profile, and then credit service accessibility condition and beneficiaries' socio-economic condition were computed, discussed and presented.

#### 4.1 Institutional Profile and Outreach Performance of OMFI

##### 4.1.1 Institutional Profile of OMFI

###### I. Vision, Mission and Goals

The vision of Omo microfinance Institution, *OMFI*, is ~~to~~ see poor people especially active poor to have full access to institutional credit for self-employment along with eradicating poverty both in rural and urban Ethiopia and also to see the emergence of self-reliant and business-minded generation” As broadly stated Omo microfinance institution( *OMFI*) has a mission to facilitate the socio-economic empowerment of underprivileged people both in rural and urban Ethiopia and to promote research, policy and practices that encourage the improved access of poor people to support services such as training, credit, technology, information, professional and technical advice, along with

ensuring its operations as well as that of its clients to be financially and economically viable and sustainable.

The Development objective of Omo microfinance Institution (OMFI) is to enhance the socio-economic empowerment of the disadvantaged people especially women, through increasing their access to support services such as training, credit, saving and technical assistance.

Furthermore, the overall goal of the company is to make need based and sustainable micro-financial services accessible to the active poor in urban and rural areas through cost efficient methodologies. It also works to create self-employment as well as to improve and strengthen client's asset base to help attain sustainable economic development. (OMFI Annual Report, 2015)

## **II. Financial Resource**

The financial sources of Omo microfinance Institution (OMFI) include client savings, loans, and donation. Omo microfinance Institution (OMFI) has not yet reached financial self-sufficiency. In fact, its financial self-sufficiency was above 80 percent. It is slightly better than the average financial self sufficiency of Ethiopian microfinance Institutions, which was 77 percent but it is less than the average of financial self-sufficiency of African microfinance Institution that is 93.7 percent (OMFI 2014, Aziza 2012, Tsegaye, 2005).

## **III. Target Beneficiaries and Beneficiary selection criteria**

Omo microfinance Institution (*OMFI*) clients are recruited on the basis of the following criteria:

- Economic status: clients should be poor & Permanent resident of operational area
- Ability and willingness to work: active poor : active poor means people whose income throughout their livelihood activities are insufficient to cover their basic needs
- Credit worthiness and good conduct
- Willingness to take loans on peer or group collateral

#### **IV. Group Formation**

In order to form a group, eligible individuals of three to five members who know each other form a group of one. In fact the decision is made based on the expected costs and benefit from participation. A center meeting is held once a month for compulsory saving, loan installment and discussion on the economic and social issues of their environment.

In addition, Omo microfinance Institution (*OMFI*) makes capacity building efforts for both the employees and the clients. For clients, they include skill upgrading, introduction of new technologies, business orientation and experience sharing at clients meetings.

#### **V. OMFI Service Provision**

As obtained information, Omo microfinance Institution (*OMFI*) provides financial as well as non-financial services to the active poor. The financial services delivered by *OMFI* are lending and saving services, whereas Non-financial service provided by the company takes in to account the following: training, orientation service as well as monitoring and supervision.

##### **1. Financial Service**

The financial services delivered by *OMFI* are lending and saving services. The target clients eligible for its services are the active poor who are willing to engage in income generating activities of their own in rural and urban areas of the country. Omo microfinance Institution (*OMFI*) is providing its services using mostly the group based methodology. Each self-selected group, which is a central unit of *OMFI* operation, contains three to five members including their leader. What is more the center has been serving as a core body of clients to make a manageable and direct link with the institution. The center leader is the main contact person to the credit officers through which direct link is made with the institution.

As the groups are self-selected, members are expected to know each other, have similar background, enjoy trust and develop confidence. Given that group members are jointly responsible for the loan, they will take the risk if one of the group members fails to repay the loan. Besides, cooperative and individual based lending methodologies are lately introduced in to the system (*OMFI* documents).

The cooperative based loan requires physical asset or capital as collateral. Similarly the individual loan requires property or salary of permanent employees as collateral. In fact, if the client reaches higher level of loan intake he/she will be allowed to operate individually rather than on a group basis. Loan disbursements are made at a sub-branch or branch level. However, cash collections and savings mobilization activities are carried out at the center levels.

## **2. Non-Financial Services**

### **2.1. Orientation**

The other non-financial services provided by the Omo microfinance Institution (OMFI) include provision of orientation, training, monitoring and supervision. Key Informant Interview with one of the credit officer delivered that eight to ten hours orientation is regularly provided for new clients of OMFI before they join the program.

The orientation deals with the services provided, criteria to be a client, method, amount of loan provided, term of loan, and some other relevant information. Business development training about marketing, record keeping, and pricing is delivered for every client on voluntary basis for a month. On the job training is delivered for the staff to build their capacity.

### **2.2 Training**

The clients especially those engaged in group lending undergo training for about a month about entrepreneurial skills, book keeping, accounting, loan deposits and administration. The training helps the clients to appreciate what is expected of them with their loans like optimum exploitation of loan use, savings, deposits and loan repayment.

Before the initial loan is disbursed, all clients must attend some training which explains the rules of membership, savings requirement and penalties for late payment. In addition, the training will keep going for every six months to equip clients with the necessary tools and knowledge.

### **2.3. Monitoring and Supervision**

The organization aspires to be able to have a successful and default free clients. Subsequently Omo microfinance Institution (*OMFI*) is providing a monitoring and supervision service. In fact the credit officers make assessment on whether the clients diverted the loan they have taken to another purpose or so together with this the organization open a door for helping clients designed for enhanced management of the loan money.

#### **4.1.2 Outreach Performance of OMFI**

##### **I. The Number of Clients**

In analyzing the effectiveness of microfinance in alleviating poverty, it is crucial to look at the outreaches performance of microfinance Institutions. It is argued that microfinance can play an important role in poverty alleviation only if the extent of outreach is reasonably large. Conversely, if microfinance Institutions are restricted to only few geographical locations or serve only a small fraction of the population or the poor, their importance in poverty alleviation efforts would be limited. The outreach of microfinance sector can be looked at into numerous aspects among a few are the number of clients outreached and loan disbursed over the years.

Data from secondary sources revealed that with the prime vision of reducing poverty through making financial services available to the needy and thereby creating a scenario where people could live with all the power in determining their future in their own hands, OMFI is operating in overall zones SNNP regions in Ethiopia.

Currently, Omo microfinance Institution (*OMFI*) has above 164 sub branches and serving a total of more than half million active credit clients. OMFI has shown a remarkable progress in terms of outreach since its establishment as well as these days. The numbers of active clients in the study woreda, Qebebna reached in the year 2016 were over 5,000.

## **4.2. General Profile of Respondents**

Data for the analysis in this study were collected from 144 pipeline clients of Omo microfinance institution in Gurage Zone, *QEBĔNA* Woreda. The total response rate was 90 percent.

### **4.2.1. Profile of Respondents**

The overall study profile include gender, marital status, age, family size, level of education, and basic economic activity and/or occupation of respondents.

Table 4.1 below showed that the distribution of respondents by age and Sex. As it has been revealed in table 4.1 that male respondents extensively outweigh the number their female counterparts almost by three fold percent. However, the difference is still encouraging given males dominance as sole income source in the area.

There are 23 percent female respondents and 77 percent male respondents. Generally, microfinance program is anticipated to provide more financial and technical assistance to women poor from households for their income-generating activities and micro entrepreneurial activities. On the issues of women, African Development Bank(ADB) Asserts that Microfinance institutions have to bring , particularly poor women into formal financial system and should enable them access credit facilities and small savings in financial assets reducing their household poverty. Result from this study area, however, does not support the premise that microfinance should benefit more women than men. As revealed from the report and documents the number of female showed a bigger number than male in saving especially in voluntary saving.

Hence, it requires Omo microfinance institution to introduce appropriate techniques of addressing gender issue because for enhanced poverty alleviation, there is a need for equal participation of men and women in microfinance credit program.

Similarly, most of the respondents belong to the productive age bracket between 26 and 45 years old. Since one of the common objectives of microfinance is to provide increased access to financial services to the productive poor, both physically and mentally active.

Respondents aged between 36 to 45 years old are the dominant group. The second largest group is between the ages of 26 and 35 years old and the third group ages 46 to 55 followed by groups aged 25 and younger. It was 38,2 , 28 and 13.8 percent respectively. The smallest group of respondents was 11.8 percent by the aged 56 years old and above.

Hence, the majority of OMFI clients are in the productive age that they can work to change their lives by using loan in different income generating activities.

**Table 4.1 Distribution of the Respondents by Age and Sex**

<b>Sr. No</b>	<b>Description</b>	<b>N</b>	<b>%</b>
<b>1</b>	<b>Sex</b>		
	Male	111	77
	Female	33	23
	<b>Total</b>	144	<b>100</b>
<b>2</b>	<b>Age</b>		
	18-25 years	22	8.2
	26-35 years	30	28.0
	36-45 years	55	38.2
	46-55 ears	17	13.8
	Above 55years	<b>144</b>	11.8
	<b>Total</b>		<b>100.0</b>

Table 4.2 showed the distribution of sample respondents by marital status, family size, and level of education. About 80 percent of respondents are currently married. In addition, about 18 percent are single, no divorced, and .1.5 percent were widowed.

This indicates that majority of the respondents are married and evidences from the study area tells that loans to rural households who do not have acceptable collateral are mainly

directed to married clients who are believed socially secure and more responsible than unmarried, divorced, and widowed clients. This would happen to minimize the default rate and maximize the repayment rate.

It is also due to group exclusion of those clients during group formation to minimize risks of defaulter's penalty to the group.

With respect to family size, (Table 4.2) an average of each family accommodates six to seven members. From the total, 62.5 percent of sample respondents have the family size of 5 to 10, 30.5 percent respondents have a family size of 1-4, and 7 percent of respondents have a family size of 7 and above.

In general, the amount of family size per household primarily determines the amount of resources needed to support them and the dominant average family size in this study is 5-10. Concerning the literacy level of the respondents, about 9.7 percent of the sample households were illiterate, 65.3 percent were primary (1-8), 11.1 percent were high school (11-12 and) 13.9 percent were secondary school (9-10).

From this one can conclude that the majority of the study population was in the primary school and those literate households have more exposure to the external environment and information which helps them easily associate to credit sources. Even if the average number of illiterate household respondent is about 10 percent it might have negative effect on microfinance service utilization in the ability to analyze costs and benefits of any productive event related to microfinance,

**Table 4.2 Distribution of sample respondents by marital status, family size, level of education**

<b>Sr. No</b>	<b>Description</b>	<b>N</b>	<b>%</b>
<b>1</b>	<b>Marital Status</b>		
	Married	115	79.8
	Widowed	2	1.5
	Separated	-	-
	Single	27	18.7
	<b>Total</b>	<b>144</b>	<b>100.0</b>
<b>2</b>	<b>Family Size</b>		
	1-4	44	30.5
	5-10	90	62.5
	11 & above	10	7.0
	<b>Total</b>	<b>144</b>	<b>100.0</b>
<b>3</b>	<b>Educational Background</b>		
	Illiterate	<b>14</b>	9.7
	Adult literacy	-	-
	Primary(1-8)	<b>94</b>	65.3
	Secondary (9-10)	<b>20</b>	13.9
	High school(11-12)	<b>16</b>	11.1
	Other	<b>144</b>	<b>100</b>
	<b>Total</b>		

As shown in table 4.3 below the main income earning economic activity of sample respondents in which the respondents are engaged is also analyzed. Respondents were found to engage in two main activities, results show that 72.9 percent were engaged in farming and 16.7percent were engaged in petty trade (retailing of agricultural products such as cereals, coffee, and livestock) and the rest 6.2 and 4.2 percent were engaged in daily laborer and civil servant respectively.

**Table 4.3 Basic Economic Activity of Respondents**

<b>Sr. No</b>	<b>Description</b>	<b>N</b>	<b>%</b>
<b>1</b>	Farmer	105	72.9
	Petty trade	24	16.7
	Civil servant	6	4.2
	Daily laborer	9	6.2
	<b>Total</b>	<b>144</b>	<b>100</b>

It can be said that farming and petty trade are the two main occupations that the respondents are engaged in usually in mixed form. Commonly for the rural economy, farming basically involves a mix of crop production and animal husbandry.

As it was observed during the study farming is more dominant; whereas animal rearing is considered only secondary in the study area. As mentioned, agriculture involves traditional crop production and animals rearing. In addition, trade will not be far from buying and selling crops and livestock and as such majority took loans for these two major activities.

#### **4.2.2 Credit Service Accessibility Condition**

The documents review and survey data revealed that, Omo microfinance Institution (OMFI) provides mainly two broad types of services: financial services and nonfinancial services. The financial services provided by the institution are mainly in the form of loans and savings. Nonfinancial services are various types of trainings offered like financial literacy and business skill.

In order to collect information regarding the position of Omo microfinance institution in accessing credit services to rural households, respondents were asked to indicate whether they have access to loan facilities before joining *OMFI*. Accordingly, about 73.6 percent of survey respondents had no means to access financial resources previously and remaining 26.4 percent had got access to credit, either informally or formally from friends and relatives (75.6 %) , *Equb* (20.9%) and money lenders(3.5%) and No one of the respondents were taken from registered lending institutions like banks and others institution (Table 4.4)

This indicated that majority of the respondents who reported having accessed credit previously had mainly borrowed money informally from friends and relatives.

**Table 4.4: Distribution of sample respondents in their history of access to credit**

Sr. No	Description	N	%
1	<b>Previously did you have any access to credit?</b>		
	Yes	38	26.4
	No	106	73.6
	<b>Total</b>	<b>144</b>	<b>100.0</b>
2	<b>If yes, what were your sources of credit?</b>		
	Equib	30	20.7
	Friends & relatives	109	75.6
	Money lenders	5	3.5
	Bank	-	-
	<b>Total</b>	<b>144</b>	<b>100.0</b>

### **4.2.3. Credit Modalities and Client Selection**

#### **4.2.3.1. Credit modalities**

Appropriate institutional design for the poor will lead to better achievements in reaching the target poor. Micro finance institutions have various methodologies to target specific clients and they use different modals to provide financial services to the poor. Access to credit relates to the ease and ability to participate in and derive benefits from microfinance services

As it has been revealed in the study the institution provides 100 percent of its loan products to clients who request in groups by applying the system of joint liability (Table 4.5). Therefore, the institution requires group formation by potential borrowers as a precondition to access loans.

The process is self selection based group formation. In group lending, group members know each other well; they fully know if an applicant lacks the ability to repay better than the lender. A group of 3- 7 people of any sex of self selected members, after passing the institution's client selection criteria, qualifies to get credit.

Group lending basically applies like prospective clients of the institution form groups voluntarily for the purpose of accessing loans, 3—7 members form a group and a total of seven groups makes —*ma'ekel* to mean center\_ in Amharic, each *ma'ekel* having a maximum of 35 members.

Lending is carried out in groups and members are required to meet at regular intervals, and if a member defaults, then all other group members are denied subsequent loans since all individual group members are held liable and responsible for the full amount of their own and even for full repayments of their co-borrower .

Group lending consists of a variety of methodologies with central focus on joint-liability for monitoring and enforcement of loan contracts. In group lending, the loan contracts take advantage of local information and the "social assets" (in this case group pressure) at the heart of local enforcement mechanisms.

To this effect, the institution to secure loan repayment replaces traditional physical asset collateral requirement with joint liability, group or social pressure which rural households can provide. As revealed during the survey as of 2016 a total of 606 groups were formed in the study area of which 306 female and 229 were male and the rest 71 were mixed.

As indicated in the table 4.5 below all loans contracts are made on group guarantee basis and majority of respondents stated that their group formed voluntarily from neighbors (66%) and family members and relatives (20.8 percent) and kebele administration (9.7%). Regarding risk of defaulter's penalty to the group about 84 percent have never experienced failures of co-borrower in loan repayment.

But as majority form groups from neighbors and relatives through self-selection, problems of exclusion exist; excluding those who are specially considered resource poor to avoid risk of default to the group. The majority about 75 percent of the respondents reported that group borrowing was a major constraint to access credit from Omo microfinance Institution (OMFI) who required group formation as a precondition to access credit has found group borrowing inconvenient. Majority about 67.6 percent fear the risk of member default penalty followed by group formation that was 14.9 percent (Table 4.5).

“Mahfud, married and a father of three stated that —...The poor face problems to form a group, others lack freedom to access credit as needed since being in group is precondition, still others tired of meetings and some careless members. The worst of the problems is the exclusion of the poor in group formation based on available local information and a label given to him.” (Research Note)

This indicated that group lending contract tend only to help the safe borrowers, self selected to gain access to loans, not to reach the excluded.

**Table 4.5: Responses on Credit modalities**

<b>Sr. No</b>	<b>Description</b>	<b>N</b>	<b>%</b>
<b>1</b>	<b>How do you borrow?</b>		
	In group	144	100
	Individually	-	-
	<b>Total</b>	<b>144</b>	<b>100</b>
<b>2</b>	<b>If you borrow in a group how did you group yourself</b>		
	Loan officer suggested group	5	3.4
	Kebele admin. suggested group	14	9.8
	Family members and relatives	95	66.0
	Neighbors	30	20.8
	Group existed before for other	-	-
	<b>Total</b>	<b>144</b>	<b>100</b>
<b>3</b>	<b>If you borrow in group have you ever paid defaulters penalty group?</b>		
	<b>Yes</b>	23	16
	<b>No</b>	121	84
	<b>Total</b>	<b>144</b>	<b>100.0</b>
<b>4</b>	<b>Do you like the group lending system of your institution?</b>		
	Yes	36	25
	No	108	75
	<b>Total</b>	<b>144</b>	<b>100.0</b>
<b>5</b>	<b>If no, what do you dislike?</b>		
	Group formation	16	14.9
	Fears of defaulters penalty	73	67.6

	Role of field staffs	5	4.6
	Absence of regulation in the group	14	12.9
	<b>Total</b>	<b>108</b>	<b>100</b>

#### 4.2.3.2. Client selection

Prospective clients who wish to acquire credit from Omo microfinance Institution (OMFI) are required to pass and fulfill a set of requirements, which are easy and suitable. As shown in table 4.6 about 68.5 percent of respondents replied that the criteria set by the institution are not suitable, even if it is hard to set clear-cut criteria to identify appropriate clients, the institution has established some selection criteria.

According to survey data from staff members of the institution, all survey respondents agree that potential clients are those economically active poor (i.e. those who can use the loan for aimed productive purposes) but lacking necessary means to involve in any income generating activities

The requirements to access the loan includes: willingness to make prior savings, willingness to form groups, letter of approval from Kebele which shows that they are residents of respective Kebele, being resource poor and productive, age of above 18 years old. However, institutional criteria is unsuitable for major respondents, again 45 percent of sample households criticize the institutional criteria as major constraint in accessing credit, specifically pointing to higher compulsory prior saving requirement of 10% of loan. Low loan size, group lending system, and distance from the branch are the major challenges stated to access credit services.

—Bekelech, a mother five stated that, —. comments and decisions by the Credit and Saving Committee at Kebele Administration level is one of the major requirements. Getting the approval and signature of the spouse on the loan agreement form is considered as one of the essential criteria for clients to get the loan from institution. Further, adequacy of loan size to engage in income activity and distance to sub branch office where loan acquisitions and repayment are made, are our major challenges to get access to loan as she said during the data collection.”  
 Researcher Note”

**Table 4.6: Responses on client selection criteria**

<b>Sr. No</b>	<b>Description</b>	<b>N</b>	<b>%</b>
<b>1</b>	<b>Do you think that the criteria by which you are being allowed credit service are suitable?</b>		
	<b>Yes</b>	44	30.5
	<b>No</b>	100	69.5
	<b>Total</b>	<b>144</b>	<b>100</b>
<b>2</b>	<b>What are the main challenges to access credit service from the institution?</b>		
	High Interest Rate	15/100	15%
	Delay in service offering	25/100	25%
	Poor selection criteria	45/100	45%
	Low loan size	62/100	62 %
	Group lending system	78/100	78 %
	Distance from the branch	32 /100	32 %

☆ Number and percentage of yes responses taken from the total of 100 respondents with more than one option

### **4.2.3.3. Loan repayment and Interest rate conditions**

#### **4.2.3.3.1 Loan repayment**

As shown in table 4.7 about 40 percent of the respondents repaid the loan from the preceding of the business, 24 percent secure cash for repayment from friends and

relatives and 22 percent paid the balance or total amount the rest with the sale of some part of properties.

In such a way majority of clients have paid their loans in schedule (66.7 percent) and 26 percent in repayment areas and the rest, 6.9 percent repay early. Problems in repayment in arrears include losses of assets acquired by the credits (44.8 percent), consume for other household use (34.2 percent) and 21.2 percent mentioned that credit basis activities were not profitable. Regardless of the difficulties that they are facing in time of loan repayment 84.1 percent of total respondents appreciate time interval set condition for loan repayment saying suitable time interval of which 86.4 percent had an annual time of repayment interval despite its flexibility in payment schedules

#### **4.2.3.3.2. Interest rate**

The cost of money is represented by the interest rate charged on the amount of debt owed. Almost of all respondents (100 percent) in the study has a knowledge of paying interest on the amount owed, of which about 61.1 percent of clients responded are satisfied with rate of interest charged on loans, 24.3 percent somewhat satisfactory and 14.6 percent replied as not satisfactory.

#### 4.7: Responses on loan repayment and interest rate condition

Sr. No	Description	N	%
1	How do you repay your loans?		
	Sale of some property	20	13.8
	Transfer payments from family elsewhere	32	22.2
	Get other debt	35	24.2
	Proceeds from business activities	57	39.8
	<b>Total</b>	144	<b>100</b>
2	Time interval to repay		
	Weekly		-
	Monthly		-
	Quarterly		13.6
	Annually		86.4
	<b>Total</b>		<b>100.0</b>
3	<b>What is the status of your last loan?</b>		
	Repay Early	10	6.9
	Repayment in Schedule	96	66.7
	Repayments in Arrear	38	26.4
	<b>Total</b>	<b>144</b>	<b>100</b>
4	<b>If Repayment is in arrears What was the problem</b>		
	Credit based activity was un profitable	8	21.2
	Used some part of credit for household use	13	34.2
	Loss of assets acquired by the credit	17	44.8
	<b>Total</b>	<b>38</b>	<b>100</b>
5.	<b>Loan repayment time set is suitable?</b>	121	84.1
	Yes	23	15.9
	<b>No</b>	<b>144</b>	<b>100</b>
	<b>Total</b>		
6.	<b>Do you pay interest?</b>		
	Yes	144	100
	No	-	-
	<b>Total</b>	144	100

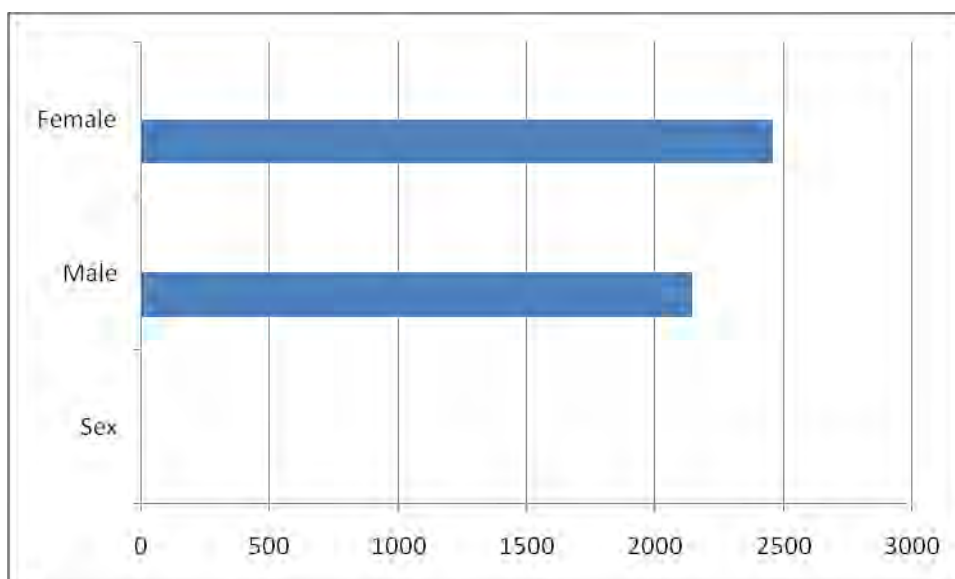
7	<b>How is the interest Rate?</b>		
	Not satisfactory	21	14.6
	Somewhat satisfactory	35	24.3
	Satisfactory	88	61.1
	Very satisfactory	-	-
	<b>Total</b>	<b>144</b>	<b>100</b>

### 4.3. Training condition

As Shown in table 4.8 the majority of the respondents said that they had got trainings at the time they are joining the program on loan terms and conditions at individual and group level Implying the absence of non-financial services particularly important business development skills and financial literacy trainings in helping the borrower to identify a viable rural income-generating activities and how to run the activities properly. 86.4 percent of the respondents who attended the training responded that the training was satisfactory.

Regarding opinions on follow up and supervision, the majority, 82.6 percent of the respondents appreciated follow ups and supervision especially at the final weeks of loan repayment. (Table 4.8)

**Chart one No of trained clients by Sex**



As it has been observed in the document and report a total of 4598 clients were trained of which 2142 were female and the rest 2456 were male. (Chart one)

**Table 4.8: Opinions on training condition**

<b>Sr. No</b>	<b>Description</b>	<b>N</b>	<b>%</b>
<b>1</b>	<b>Have you trained about loan utilization?</b>		
	Yes	129	89.6
	No	15	10.4
	<b>Total</b>	<b>144</b>	<b>100</b>
<b>2</b>	<b>If yes, has it been satisfactory?</b>		
	Yes	25	17.3
	No	119	82.6
	<b>Total</b>	<b>129</b>	<b>100.0</b>
<b>3</b>	<b>Supervision and Follow up</b>	75	52.1
	Very good		
	Good	52	36.1
	Not good	17	11.8
	<b>Total</b>	<b>144</b>	<b>100</b>

### 4.3. Loan purpose and destination

As shown in the Table 4.9: majority of respondents had long experience with institution about 65.3 percent of respondents joined the credit program within 1 to 5 years 24.3 percent less than years and the rest 10.4 percent were above 5 years period

This implied that the respondent had a better understanding of microfinance operations and loan term experiences with the institution.

Following the analysis of beneficiaries experience with the institution, the research wanted to ascertain the purpose or the main reason for joining the program and seeking credit from the institution. 40.4 percent of respondents agreed that financial problem was the main reason to join the program and 30.5 percent as service outlet nearness to home also influenced, about 20.8 percent of respondents responded that by the information obtained by ads and friends and the field staffs to join the program.

In general, credits increase the income and improve the living standards. Once clients join the credit program principally as stated above due to financial problem, the main question then was why respondents required loan facilities of a community, when it is used for income generating activities. These activities enable clients to generate income to support their families and repay their loans.

**Table 4.9 Distribution of respondents of loan history and reason for joining the program**

Sr. No	Description	N	%
1	<b>When did you start to receive credit from OMFI?</b>		
	< 1 years	35	24.3
	1 to 5 years	94	65.3
	Above 6 years	15	10.4
	<b>Total</b>	<b>144</b>	<b>100.0</b>
2	<b>Reason for joining the program</b>		
	Due to Financial problem	58	40.4

	Service means near to my home	44	30.5
	Payment is good compared to others	12	8.3
	Ads by friends and staffs	30	
	<b>Total</b>	<b>144</b>	<b>20.8</b>
			<b>100</b>

As the objective of microfinance loan is to help rural and urban resource poor to engage in income generating activities like in petty trading, agricultural farming. The borrowers themselves choose the activities. As shown in the table 4.10 and researcher's observation indicated that a large proportion of borrowers about 48.7 percent took credit for productive purposes of agriculture and agriculture related activities, to buy farm oxen and other domestic animals, and 20.1 percent borrowed for starting petty trade of retailing agricultural products.

The other category of respondents about 12.5 percent approached the institution for loans to non-income generating activities such as repayment of loans, 9.7 percent for consumption, and for bearing health and other fees, 9.0 percent.

**Table 4.10 Distribution of respondents by purposes of loan**

Sr.No	Description	N	%
1	Agriculture	70	48.7
2	Petty Trade	29	20.1
3	To settle other loan	18	12.5
4	Health & other Exp	13	9.0
6	Consumption	14	9.7
	<b>Total</b>	<b>144</b>	<b>100</b>

In fact consumption smoothing is by itself an important thing the institution is playing in the society, since the main reason for loan diversion is to meet unforeseen household

seasonal expenses such as food shortage, illness etc. which otherwise forces the household to sell its most productive assets like farm oxen and up to leasing of land at lower prices.

Therefore, as result showed borrowers come with multiple purposes in their mind for borrowing and these ranges from business related purposes to personal purposes. However, in terms of long-term development issues, clients need to get into productive activities that could help them generate incomes sustainably and to meet seasonal requirements.

#### **4.4.1. Size of loan**

The size of loan fixed also has an immense influence on choosing the type of economic activity to engage in. In general, loan size is a desired amount of loan granted by the institution to the individual borrowers Hence, loan size can determine the household's decision to join the program. The institution in the study area has set out two extreme ranges of loan sizes minimum ETB 2000 and maximum ETB7000.

Client starts with small size loan but progressing loan size between loan rounds. Survey data from the respondents revealed that majority of respondents 26.8 percent are unsatisfied with the loan size and responded inadequate and 51.3 percent said adequate but less than required and the rest 22 percent said adequate .(Table 4.11 )

Ahmed a father of five told that “...three years back small size loan like 1500 and up to 3000 has big value in the market, one can buy farm oxen or dairy cow, and with the balance cloth, shoe, etc but today even 5000 and 6000 fail to buy capable and ready farm oxen...” (Researcher Note)

At this point it is necessary to detect that, since the majority reported as not satisfied loan size it is probable , loans that are inadequate to finance the intended activity are likely to be diverted into other uses with lower outlays, more in case of borrowers lacking own funds to fill the gap.

**Table 4.11: Distribution of respondents on the basis of amount of loan size**

<b>Sr. No</b>	<b>Description</b>	<b>N</b>	<b>%</b>
<b>1</b>	<b>Amount of loan Size</b>		
	Adequate	43	29.9
	Adequate but less than required	29	20.1
	Inadequate	72	50
	<b>Total</b>	<b>144</b>	<b>100</b>

As Respondents that was asked to tell their average monthly income and expenditure between 500 to 100 Birr, and 46.8 percent make between 1000 to 2000 Birr and 25.4 percent said that above 2000 Birr. 56.3 Similarly about 56.3 percent and 36.8 percent said that their average monthly expenditure ranges 1000 to 2000 and above 2000 Birr respectively. (Table 4.12)

Though, it is very difficult to conclude that the income is solely gained from the loan advantage and hence to further examine the issue, clients were asked a series of questions to verify if they have any source of income before a loan and what would happened to their income after loan whether it is increased, decreased, or remains same.

As shown in table 4.12 three- fourth of the respondents replied that they did not have any source of income before the loan program, of which 82.4 percent of them reported that their income is increased and able them to pay the families education and health expenses and 60 percent of the respondents also mentioned that there is a difference in living and life condition and better after joining the program. (Table 4.12)

**Table 4.12 Response on Average monthly income and Expenditure**

<b>Sr. No</b>	<b>Description</b>	<b>N</b>	<b>%</b>
<b>1</b>	<b>Average monthly income</b>	-	-
	Less than 500	40	-
	500 -1000	67	27.8
	1000-2000	37	46.8
	>2000	<b>144</b>	25.40
	<b>Total</b>		<b>100</b>
<b>2</b>	<b>Average monthly Expenditure</b>	10	
	Less than 500	81	6.9
	500 -1000	53	56.3
	1000-2000	<b>144</b>	36.8
	>2000		<b>100</b>
	<b>Total</b>		
<b>3</b>	<b>Did you have any source of income before loan program</b>	108	
		36	75
	<b>Yes</b>	<b>144</b>	25
	<b>NO</b>		<b>100</b>
	<b>Total</b>	89	
	<b>If yes, your income has</b>	5	
	Increased	14	82.4
	Decreased		4.7
	Remain the same		12.9
	<b>Total</b>	<b>108</b>	<b>100</b>

#### **4.4.2. Savings condition**

Savings in Omo microfinance Institution (*OMFI*) is two types - compulsory and voluntary savings. Compulsory saving is prior savings required from borrowers, which is obligatory for loan clients and seen as partial collateral. Voluntary saving involves depositing any amount with no obligation to do so as in compulsory saving. Any amount can be saved and can also be withdrawn at request.

As revealed in table 4.13 every client is required to have saving account with the institution from where he/she borrows. The type of saving varies among savers, 61.1 percent maintaining only compulsory savings, and 38.9 percent did both compulsory and voluntary saving account. 65.9 percent respondents were reported that their saving is increased in the last twelve months, about 30 percent stated that their savings level remain the same and the rest 10.5 percent respondents were said it is decreased.

In request to the purpose of savings the majority, 32.6 percent respond that for loan repayment is their main target, followed by to get another loan( 16.7%) and 13.8 percent for social and food security and about 11 percent equally make savings for asset building and for safety of their cash, and the rest 10.4 percent saving for health and education.

**Table 4.14: Responses on savings condition**

<b>Sr. No</b>	<b>Description</b>	<b>N</b>	<b>%</b>
<b>1</b>	Do you have savings in the institution where you borrow? Yes No Total	144 - <b>144</b>	100 - 100
<b>2</b>	<b>If Yes, What types of saving?</b> Compulsory Voluntary Both compulsory and voluntary <b>Total</b>	88 - 56 <b>144</b>	. 61.0 - 38.9 <b>100</b>

<b>3</b>	During the last twelve months your savings have?		
	Increased	95	65.9
	Decreased	15	10.5
	Remain the same	44	30.6
	<b>Total</b>	<b>144</b>	<b>100.0</b>
<b>4</b>	<b>For what purpose do you save?</b>		
	Loan repayment	47	32.6
	Asset building	17	11.8
	Safety of cash	16	11.1
	Social & food security	20	13.8
	Health & education	15	10.4
	Emergencies	5	3.5
	To get another loan	24	16.7
	<b>Total</b>	<b>144</b>	<b>100.0</b>

#### 4.4.3. Improvements in lives and asset holding conditions

With the most important goal of microfinance being reducing poverty, through financial services, changes in income levels added with increase in households' asset holding capacity often used as an indicator of the effect of microfinance intervention. Since increase in income alone does not mean poverty is reduced, as it depends on what the income is used for. Table 4.15 presented the response regarding improvements on lives and asset holdings. Majority about 84.8 percent own farm oxen and dairy cows, because these assets being very important and respected assets in the society. Out of those who reported having possessions of these assets, about 9.8 percent possess these assets before a loan also. Regarding securing other essential benefits from involvement in credit program, 44.4 percent purchased additional farm and oxen, 22.9 percent improved food security, 18.8 percent constructed and repaired house, and 13.9 percent improved access to basic social services like health and education.

In request to judge the loans impact on their lives, 92 percent agreed that the loans have improved their lives of which 59.7 and 34.7 percent ranked as medium and high their standard of livings after the loan and enabled them to to get other material benefit such as purchasing of additional oxen (44%), improved food security (22.9%) , house construction and repair ( 18.8 %) and improved access to health. (13.9%)

From this one can conclude that for the majority of the respondents the loans and saving services they get from the *OMFI* has changed and improved their lives and asset holdings of the beneficiaries.

**Table 4.15: Responses regarding improvements on lives and asset holdings**

<b>Sr. No</b>	<b>Description</b>	<b>N</b>	<b>%</b>
<b>1</b>	<b>Do you own animals like farm oxen and dairy cow?</b>		
	Yes	122 22	84.8
	No	<b>144</b>	15.2
	Total		<b>100.0</b>
<b>2</b>	<b>If yes, did you own these animals in the past?</b>		
	Yes	<b>12</b> <b>110</b>	9.8
	No	<b>122</b>	90.2
	Total		<b>100</b>
<b>3</b>	<b>Other material benefit you get by joining the OMFI</b>		
	House construction/ repair	27	18.8
	Purchase additional oxen	64	44.4
	Improved food security	33	22.9
	Improved access to health	20	13.9
	<b>Total</b>	<b>144</b>	<b>100</b>
<b>3</b>	<b>Have loans improved your lives?</b>		
		130 14	92

	Yes	<b>144</b>	8
	No		<b>100</b>
	Total		
<b>4</b>	<b>Standard of lives in contrast to before loan</b>		
	High	50	
	Medium	86	34.7
	Low	8	59.7
	<b>Total</b>	<b>144</b>	<b>100.0</b>

## **CHAPTER FIVE**

### **5. SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS**

This chapter deals with the findings, conclusion and Recommendations of the research study on the role of omo microfinance institution on poverty reduction in Guraghe zone of selected woreda in South Nations Nationalities and Peoples (SNNP).

#### **5.1. SUMMARY OF FINDINGS**

The contribution of microfinance to rural poverty reduction through the provision of credit and saving facilities, insurance and money transfer services is a very viable way forward for the socio-economic developments of the rural poor. Poverty and chronic deprivation have long been a tragic aspect of human kind. Microfinance can be a very stimulant to several other economic development activities, with a very serious multiplier effect on the poor rural and overall national economy.

This study examined the role of Omo microfinance institution in Accessing credit and poverty reduction in Qebena woreda of Gurage Zone. The study basically relied on the use of primary data collected in the month of March, 2017 from randomly selected clients of the institution. In addition, secondary data, semi structured interviews, researcher's field notes and Observation were used to collect data for analysis.

As shown in the study that majority is male in productive age group and, married and also that the majority of the study population was in the primary school and those literate households have more exposure to the external environment and information which helps them easily associate to credit sources.

Farming is more dominant; whereas animal rearing is considered only secondary in the study area. As mentioned, agriculture involves traditional crop production and animals rearing. In addition, trade will not be far from buying and selling crops and livestock. As such majority took loans for these two major activities and majority of the respondents who reported having accessed credit previously had mainly borrowed money informally from friends and relatives. Loans contracts are made on group guarantee basis and majority of the groups are formed voluntarily from neighbors, family members and

relatives. Regarding risk of defaulter's penalty to the group about 84 percent of the respondents have never experienced failures of co-borrower in loan repayment.

The Findings indicated that the institution accessed credit products to majority of rural households in the area who are without channel to access credit service previously. Sample beneficiaries have long experience in the institution, each joining the program with different reasons and purposes, the major reason and purpose being financial problem and agriculture related activities.

Credit method the institution applies to provide its credit product is fully by group guarantee and group liability in the study area, a method large number of clients consider inconvenient. Prospective clients who wish to acquire credit from the institution are required to pass and fulfill a set of requirements, which are easy and suitable for majority of respondents.

Evidences from the survey data in the study area notify that beneficiaries secure cash for repayment from various sources friends and relatives, sale of part of property, transfer payment from families elsewhere being the major ones. Trainings on loan utilization unsatisfied a large portion of beneficiaries but appreciating follow ups especially at final weeks of loan repayment.

Respondents witnessed some changes in their income level and experienced favorable effect of loan in their income. Similarly, the beneficiaries' ability to settle their personal and family medical and education expense and accessibility to these services have improved after loan.

The majority of the respondents said the loans and saving services they get from the Omo microfinance (*OMFI*) has changed and improved their lives and asst holdings of the beneficiaries

## 5.2. CONCLUSION

The availability of financial services for poor households is an important contextual factor in the achievement of development goal through facilitating poor people typically poor women, to protect, diversify and increase their sources of income. OMFI is one of the Microfinance institutions (MFI) in QEBENA woreda, Gurage Zone, SNNP Region with its prime goal of improving the livelihood security of resources of poor households in rural areas. As with many MF organizations, OMFI operates on a group guarantee system and requires its members to save prior to accessing loans.

Lack of access to credit facility is a major obstacle faced by poor people around the world who want to improve their livelihood. Without capital, people cannot invest in productive activities, fuel existing dealings, and/or smooth consumption when needed, thus significantly limiting their chances of escaping poverty. In order to investigate the issue, this study examined evidences related to the role of OMFI in accessing credit and poverty reduction in Qebena woreda Gurage Zone through both primary and secondary data. Based on the data presented, this study concludes that the institution is in fact reaching the excluded poor segments in rural area with financial products.

However, since the institution strictly requires group formation by self selected potential borrowers as a precondition to access loans, the situation excludes the target productive poor from accessing credit. Data reveals that a large proportion of sample active clients are those who have their own reportable sources of income before loan, again almost all never experienced failure in loan repayment. Therefore based on data from the study area group lending methodology tends to help the safe borrowers, self selected to gain access to loans. Poor households lacking any observable valuable asset were remaining disadvantaged.

Institutional conditions and procedures like client selection criteria, loan repayment time interval, and interest rate applied currently are suitable for the majority of sample beneficiaries. Expect the group lending methodology the institution applying, for which a large mass exiting the institution.

As a whole because of microfinance program intervention majority experienced improvement in their income and ability to bear personal and family medical and other expenses. Similarly, despite its fragment effects on improving lives of beneficiaries, majority absorbed improvement in their lives, money saved, and asset hold as a result of microfinance program intervention.

The key indicators that were reviewed to assess in this study were constituents of Physical capital ( housing ,asset accumulation, clothing), Natural capital ( land cultivated, livestock),Financial capital( saving, business volume, sources of income ), Human capital ( education of children, health), Social capital ( confidence), Livelihoods outcomes( food security, increased incomes).

From this survey one can conclude that OMFI has contributed toward the achievement its goal within the Qebena woreda of Gureage Zone. Poverty on the majority of members is being alleviated, as witnessed through increased income and increased capital, Food security for the majority of members, in terms of the grain, vegetable and livestock production has also increased. Access to education for the members' children has improved, even for those who do not require school fees. Members reported that children were better fed, had books, pens and shoes for school. It has also contributed to gender empowerment. Female members are gaining substantial benefits across all type of assets. In conclusion, Omo microfinance institution(OMFI) is currently improving the livelihoods of its member of all types of livelihood capital ( physical ,natural, financial, human, and social ) thereby has a positive effect on livelihood diversification and more source of income, improve their standard of living and building assets and playing an important role in alleviating poverty in the study area,

### 5.3. RECOMMENDATIONS

Poverty reduction has become a major issue in developing policies. The contribution of microfinance institutions to rural poverty reduction through the provision of credit and Saving facilities are a viable way forward for socio-economic development of rural societies. This study showed that microfinance can be a stimulant to several other economic developments with a serious effect on rural and overall national economies. The microcredit approach to poverty reduction is “the provision of small loans to individuals, usually within groups, as capital investment to enable income generation through self employment”

The lack of proper organization, coordination, best practice and attractive services which target the poorest of the poor, accounts for the ineffectiveness of the microfinance. In the study area Market imperfections, asymmetric information and the high fixed costs of small-scale lending, limit the access of the poor to formal finance, thus pushing the poor to the informal financial sector or to the extreme case of financial exclusion. In addition, it is argued that improving the access of the poor to financial services enables these agents to build up productive assets and enhance their productivity and potential for sustainable livelihoods.

Microfinance, as a part of a much larger effort to end poverty, will provide “microfinance services, specifically credit for self-employment and savings capabilities” and shall focus on the world’s poorest people. Women’s access should be prioritized, as they are “very adaptive at saving, highly creative entrepreneurs, and consistent in ensuring that earnings go directly to meeting family needs.” Microfinance is an important tool for sustainable social and economic progress, and a key strategy in ending poverty

Therefore, the researcher would like to recommend on the following main points:-

#### 1. On Policy and Legal issues

Although governments are usually not good at lending, they play an important role in setting an appropriate policies and legal framework for the smooth operation of micro-finance institutions. The key things that a government can do for microfinance are to maintain macroeconomic stability and to avoid interest, caps that prevent

microfinance institutions from covering their costs and operating sustainably. It is advisable that institutions should be given the freedom to develop their own system, and interest rates must be addressed through appropriate regulatory legislature.

## **2. On Institutional Capacity Building**

Strong Micro Finance institutions committed to outreach and sustainability are essential for extending the permanent reach of financial services and to have a significant impact on poverty reduction. Thus, building the capacity of the institutions with a commitment to reach the poor is vital. Micro financial institutions committed to providing micro-finance services in the region require considerable technical assistance for capacity building in resource poor area, particularly true for institutions that target potential clients in resource poor areas and the poorest of the poor.

## **3. On Community Participation Mobilization**

Because micro-finance is primarily targeted to the poor who are disadvantaged, social mobilization is necessary to introduce them to a formal or semiformal, market oriented institutional environment. This is particularly true for poor women and the poorest of the poor. It is important, however, to distinguish between financial intermediation and social intermediation in designing support program. With their full participation in planning and developing programs meant for their development, full acceptance and sustainability of the program is enhanced.

## **4. ON Donor Support**

The Donors who support financial services for the poor should be advised to reach out Microfinance institutions (MFIs) that are committed to financial self sufficiency and sustainability i.e. the ability of microfinance institution to cover all its cost through interest paid by its clients and other income is a corner stone of sound micro financing services

## **5. On Gender Issues**

Many poverty reduction strategies including microfinance operations in the developing countries fail to ensure the full participation of the rural poor, especially the poor women. Since woman are the most disadvantaged in rural communities in terms of low education , access to job microfinance services should be designed in such a way that can enable them to participate and empower them. Moreover, further research should be done on the area especially on the negative effect of Microfinance institutions( MFIs) in relation to its core policy to combat poverty and how it creates access to productive capital for the poor together with human capital, addressed through education and training, and social capital, achieved through local organization building, enables people to move out of poverty and providing material capital to a poor and their sense of dignity and empower the person to participate in the economy and society .

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**Addis Ababa University**  
**Department of Public Administration and Development**  
**Management**  
**Masters Program in Public Management and Policy**

**Data Abstract Form**

**Collected By**

**This questionnaire is prepared for my thesis entitled THE ROLE OF MICROFINANCE INSTITUTIONS IN POVERTY REDUCTION AMONG THE RURAL POOR IN ETHIOPIA: THE CASE OF OMO MICRO FINANCE INSTITUTION IN GURAGE ZONE for Masters Program in Public Management and Policy, Addis Ababa University, Department of Administration and Development Management.**

I am currently conducting a research work titled The Role of Microfinance Institutions in Accessing Credit and Poverty Reduction in Rural Ethiopia: In the Case of Omo Microfinance Institution in Gurage Zone SNNPR. The purpose of this questionnaire is to assess the role of Microfinance Institutions in Accessing credit and poverty reduction and the results will be used to inform policy makers and development planners in the country with practical facts about the part played by Microfinance Institutions in accessing credit and poverty reduction, especially in the study area.

All the information you provide is totally sought for academic purposes and shall be kept strictly confidential. Your answers will be combined anonymously with other participants. Please kindly give your genuine response and share your experiences regarding the information requested on the following information.

## Thank you in advance for your cooperation

### 1. Respondent's Profile

#### 1.1. Gender

Male  Female

#### 1.2. Marital status

Married  Widowed  Divorced/separated  Single

#### 1.3. Age

18 -25  26-35  36-45  46-55  Over 56

#### 1.4. Family size

Less than 4  5-10  11 and Above

#### 1.5. Level of education

Illiterate  Adult literacy  Primary (1-8)  Secondary(9-10)  
High School (11-12)  Other \_\_\_\_\_

#### 1.6. Occupation

Farmer  petty trade  daily laborer  Civil servant

### 2. Credit service accessibility condition

#### 2.1. Previously did you have any Access to Credit?

Yes  No

#### 2.2. If yes, what were your sources of credit?

Equib  Friends& relatives . Money lenders  Banks

#### 2.3. When did you start to receive credit from Omo micro financing institution?

Date \_\_\_\_\_ Month \_\_\_\_\_ Year \_\_\_\_\_

#### 2.4. What is your reason to take a loan and/or for joining the credit program

. Due to financial problem  Service (vicinity to home)   
Payment compared to other sources  Advertisement by field staff friends

#### 2.5. For what purpose did you borrow (more than one possible)?

Agricultural production  Petty trade  To pay back other loan   
Others

Consumption  . Health and education expense

#### 2.6. What do you think about the amount of loan, provided by the institution?

Adequate  Adequate but less than required  Inadequate

#### 2.7. How do you borrow?

Individually  In Group

#### 2.8. If you borrow in group, how did your group form itself?

Kebele administration suggested group members   
Loan officer suggested group members   
Family members and relatives   
Group existed before for other reason  Neighbors

#### 2.9. If you borrowed in group, have you ever paid defaulter\_s penalty to the group?

Yes  No

**2.10.** Do you like the group lending system of your institution?

Yes  No

**2.11.** If your answer is No Why?

Group formation  Weekly group meeting   
Risk of defaulter's penalty to the group  Role of field staff   
Absence of binding regulation in the group  Other (explain)

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**2.12.** Do you think that the criteria by which you are being allowed to get access to credit Services are suitable?

Yes  B. No

**2.13.** What are the main constraints/ challenges to access and use credit from the institution?

High interest rate for loan  Bureaucracy in service delivery   
Poor Criteria in selection.  Short repayment period   
Low amount of loan  Distance to the institution   
Group lending

### **3. Loan repayment condition**

**3.1.** How do you repay your loans?

Sale of some property  Transfer payments from family or relatives   
Get other debts  Proceeds from trade

**3.2.** In what time interval do you repay?

Weekly  Monthly  Semi- annually  Yearly

**3.3.** What is the status of your last loan repayment?

Repaid early  Repayment in Schedule  Repayment in arrears

**3.4.** If your response for above question is repayment in arrears, what was the problem for the credit to be in arrears?

Credit based activity was unprofitable  Used some of the credit for household living expense  Loss of assets acquired by the credit/loan

**3.5.** Is the loan repayment time interval set by OMFI suitable for you?

Yes  No

### **4. Interest rate condition**

**4.1.** Did you pay interest for the loans?

Yes  No

4.2. How is the interest rate?

Not satisfactory                       somewhat satisfactory   
Satisfactory                       Very satisfactory.

## 5. Training condition

5.1. Have you been trained about loan utilization and business aspects?

Yes                       No

5.2. If yes, has it been satisfactory?

Yes                       No

5.3. In general, what is your opinion about training, follow up and supervision provided by the institution?

Excellent     Very good     Good     Not Good

## 6. Socio-Economic condition of the respondent

6.1. Your average monthly income in birr

\_\_\_\_\_

6.2. Your average monthly expenditure in birr

\_\_\_\_\_

6.3. Did you have your own income source before joining this credit program?

Yes                       No

6.4. If yes, after joining the loan/credit program what would happened to your personal/family income: Income has

Increased                       Decreased                       Remains the same

6.5. Were you able to pay you and your family medical and education fee before involvement in Omo microfinance institutions credit Program?

Yes                       No

6.6. If yes, how do you explain the differences (in terms of before and after joining the credit/loan program) in affording to pay?

Better before joining the credit program   
Better after joining the credit program   
Remains the same

## 7. Saving condition

7.1. Do you have savings at the institution from where you borrowed?

Yes                       No

7.2. If yes, what type of savings?

Compulsory     Voluntary     both (compulsory and voluntary)

7.3 During the last 12 months have your cash savings?

Decreased  Increased  Remains the same

7.4 For what purpose do you save? (More than one possible).

Loan repayment  Asset Building   
Safety of cash from theft or damage   
Social & food Security  Health and Education expenses   
Emergencies  To get another loan

## 8. Asset holding condition

8.1. Do you own farm oxen and dairy cow?

Yes  No

8.2. If yes, did you own these animals in the past?

Yes  No

8.3. What material benefit you get by joining OMFI?(you can select more than one )

House Construction  Purchase additional oxen  Improved food security   
Improved health and able to send children to school

8.4. Have the loans improved your lives?

Yes  No

8.5. Generally, how would you rank your standard of living in contrast to before program?

High  Medium.  Low  Don\_t know

**Thank you for your cooperation Again**

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**Department of Public Administration and Development**  
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1. Criteria (s) your institution use to select the potential clients (please tick the criteria (s))

- Willingness to form credit group and joint-liability
- Readiness to put 10 % prior saving requirement
- Willingness to save, then after each month
- Support letter from Kebele
- Being above age of 18.
- Being resource poor and active
- Other \_\_\_\_\_

2. What do you think are the major achievements of your institution?

- . Serves large number of the poor
- . Provides high quality financial services

C. Low costs

- Other \_\_\_\_\_

3. Which of the followings do you think is/are challenges to your institution?

- Less saving habits.  Limited loan products
- Absence of legal title of assets in rural areas.  The legal environment is not conducive enough.  Shortage of experienced human resources  other -----

4. What could your microfinance institution do to improve its services?

- . Lending individually  increasing loan size  Better savings facilities
- Other (mention)

5. What services does your microfinance intuition offer?

- Loans  Savings facilitates  Training  other

6. Assessed size of potential borrowers, if any \_\_\_\_\_

7. Active borrowers by the end of 2008E.C \_\_\_\_\_

8. Total drop outs in borrowers by the end of

2007E.C \_\_\_\_\_

2008 E.C. \_\_\_\_\_

9. Loan size (In birr)

Minimum Loan size \_\_\_\_\_ Maximum Loan size \_\_\_\_\_

10. What is the current lending methodology of your intuition?

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11. What method do you use to determine the MFI\_s role on the client and /or community?

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12, Any other comments

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**Thank you in advance for your cooperation again!!!!**