

Addis Ababa University
School of Business and Public Administration
Department of Accounting and Finance

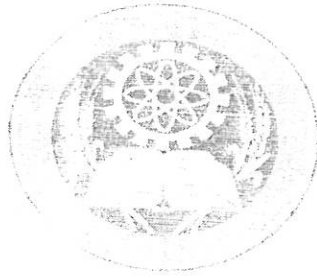
**The role of Microfinance Institutions on Poverty
Reduction and improving the living standard of poor
people: *the case of Lemu and Bilbilo Woreda***

A Thesis Submitted to the Department of Accounting and Finance, School of Business and
Public Administration, Addis Ababa University in partial fulfillment of the Requirement of
Degree of Masters of Science Accounting and Finance

By: Tolosa Negese

Advisor: Dr. Venkati Ponnala

June, 2011



41

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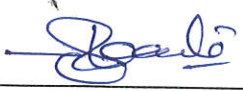
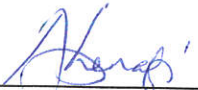
School of Business and Public Administration
Post Graduate Program in Accounting and Finance

The role of Microfinance Institutions on Poverty
Reduction and improving the living standard of poor
people: the case of Lemu and Bilbilo Woreda

By:

Tolosa Negese

Approved by Board of Examiners:

_____	_____	_____
Chairman of Department	Signature	Date
Graduate Committee (DGC)		
<u>Dr Venkatesh Pannala</u>	<u></u>	<u>22/06/2011</u>
Advisor	Signature	Date
<u>Ashraf Beyene (phd)</u>	<u></u>	<u>22/06/2011</u>
Examiner	Signature	Date

Declaration of Authenticity

I, the undersigned, declare that the material presented to Addis Ababa University is my own work or has not been presented for a degree in any other university and that all sources of material used for the thesis have been duly acknowledged.

Name-----Tolosa Negese-----

Signature----------

Place: Addis Ababa University

Date of submission: June, 2011

This is to certify that the above declaration made by the candidate is correct to the best of my knowledge.



Dr. Venkati Ponnala
(Thesis Advisor)

22/06/2011

Date

Acknowledgements

I would like to express my sincere thanks to many individuals who helped me through my paper with Addis Ababa University.

First and foremost, to my adviser, Dr. Venkati Ponnala for his meticulous guidance, and long days he spent on the paper; to the friends of mine, for their continued care and interest; to my family and relatives for understanding and supporting; and especially to decease of my best friend Sintayehu Guda for encouraging me in my life and study.

I would like to express my heartfelt thanks to the staff of Oromia Credit and Saving Share Company, Buusaa Gonofa, and Poverty Eradication and Community Empowerment Microfinance Institution for providing me with all necessary documents and information.

Table of Contents

	Pages
Acknowledgements -----	i
Table of Contents -----	ii
List of Tables -----	v
List of Charts -----	vi
Abbreviations -----	vii
Abstract -----	viii
CHAPTER ONE	
Introduction to the Study -----	1
1.1. Introduction -----	1
1.2. Statement of the Problem -----	3
1.3. Objectives of Study -----	4
1.3.1. General Objective -----	4
1.3.2. Specific Objectives -----	4
1.4. Research Question -----	5
1.5. Significance of the Study -----	6
1.6. Scope and Limitation of Research -----	7
1.7. Organization of the Paper -----	8
CHAPTER TWO	
Literature Review -----	9
2. 1. What Is Microfinance? -----	9
2.2. Characteristics of Microfinance -----	11
2.3. Microfinance and Microcredit -----	13
2.3.1. Micro finance Institutions (MFIs):-----	14
2.4. Genesis of Micro Finance -----	14
2.4.1. Profile of Microfinance in Ethiopia-----	15
2.4.2. Trends in Microfinance-----	15
2.4.3. Classification of MFIs in Ethiopia -----	16
2.5. Methodology of Microfinance -----	17

2.5.1. Group Lending-----	17
2.5.2. Individual Lending-----	18
2.5.3. Credit Unions-----	18
2.5.4. Village Banking-----	19
2.6. Solidarity-----	19
2.7. Liquidity-----	20
2.8. Human Development-----	21
2.8.1. Health Program-----	23
2.8.2. Education Program-----	23
2.8.3. Food Security Program-----	23
2.9. Livelihood Security and Microfinance-----	24
2.9.1. Material Benefits of Micro Financing-----	25
2.9.2. Non-Material Benefits of Microfinancing-----	26
2.10. Definition and Status of Poverty-----	27
2.11. Role of Microfinance in Serving Very Poor People-----	30
2.12. Savings Mobilization and Improving Living Conditions-----	31
2.12.1. Savings Mobilization-----	31
2.12.2. Living Standard-----	34
2.12.3. Improvement of Living Standard-----	34
2.13. Microfinance and its Role in Poverty Reduction Reflection about Theories-----	37
CHAPTER THREE	
Research Methodology-----	44
3.1. Introduction-----	44
3.2. Research Method-----	44
3.2.1 Data-----	45
3.2.1.1. Sampling Method & Sample Selection-----	45
3.2.1.2. Sample Size-----	46
3.2.1.3. Data Collection and Instruments-----	46
3.2.1.4. Data Analysis-----	47

CHAPTER FOUR

4.1. Background of the Study Area-----	48
4.2. Description of OCSSCO, BG and PEACE and their Program -----	49

CHAPTER FIVE

Research Findings and Analysis-----	52
5.1. The Introduction -----	52
5.2. Clients Characteristics, Loan and Saving History Loan Usage -----	52
5.2.1 Demographic Characteristics of Respondents -----	52
5.3. Loan history and loan usage -----	57
5.3.1. Loan History -----	57
5.4. Purposes for which the Money Borrowed and its Actual Destination (its Usage) --	61
5.5. Household Income and Savings -----	66
5.5.1. Impact on Savings -----	68
5.6. Overall Impacts of Microfinance Institutions on Clients -----	74

CHAPTER SIX

Summary, Conclusion and Recommendations -----	78
6.1. Summary-----	78
6.2. Conclusions-----	78
6.3. Recommendation -----	79
6.3.1. Recommendations for future study: -----	79
6.3.2. Recommendations for Microfinance Institutions and Clients-----	79
References-----	81
Appendixes	

List of Tables

Table 5.1: distribution of clients taken on the basis of location and gender -----	53
Table 5.2: Sample respondents by age-----	54
Table 5.3: Distribution of sample respondents by education, occupation and religion --	55
Table 5.4: Marital status of the respondents -----	56
Table 5.5: Reasons for joining the program -----	57
Table 5.6: Respondents' loan history -----	58
Table 5.7: Lending methodology and Group formation -----	58
Table 5.8: Amount of loan owed by clients -----	59
Table 5.9: Clients' opinions on training about loan utilization -----	60
Table 5.10: Purposes for which the money borrowed and its actual destination -----	62
Table 5.11: (a) Loan repayment status -----	64
Table 5.11 (b) Loan repayment status-----	64
Table 5.12: Clients' income level and source of income-----	67
Table 5.13: Respondents' saving types and purpose of saving -----	69
Table 5.14: trends of household saving -----	71
Table 5.15: Rejoining decision and perception of family members -----	72
Table 5.16: overall benefits and living standard level -----	75

List of Charts

Chart 5.1: Percentages of sample respondents by age -----	54
Chart 5.2 Occupation of the sample respondents-----	56
Chart 5.3: Marital status of the sample respondents -----	57
Chart 5.4: Amount of loan owed by clients -----	60
Chart 5.5: Purpose for which the money borrowed -----	63
Chart 5.6 Actual destination of the money borrowed-----	63
Chart 5.7: Loan repayment performance of the sample respondents -----	66
Chart 5.8: purposes of saving by the Sample respondents -----	71
Chart 5.9: Rejoining decision by the sample respondents -----	73
Chart 5.10: Perception of family members -----	73
Chart 5.11: Material benefit received by the sample respondents -----	76

Abbreviations

ACSI:	Amhara Credit and Saving Institution
ADCSI:	Addis Credit and Saving Institution
AEMFI:	Association of Ethiopian Microfinance institutions
BG:	Buusaa Gonofa
DECSI:	Dedebit Credit and Saving Institution
IFAD:	International Fund for Agricultural Development
MBB:	Micro banking Bulletin
MFI:	Micro Finance Institution
NBE:	National Bank of Ethiopia
NGO:	Non Governmental Organization
PEACE:	Poverty Eradication and community Empowerment
ASE:	Agri-service Ethiopia
OCSSCO:	Oromia Credit and Saving Share Company
SFPI:	Specialized Financial and Promotional Institution
WOCCU:	World Council of Credit Unions



Abstract

Traditionally, poverty was understood primarily as material deprivation, as living with low income and low consumption characterized by poor nutrition, poor living conditions, low health & education level and inability to attain a minimal standard of living. Reducing, if possible eradicating poverty is unquestionable. Thus, microfinance programs have been considered as one of the main tools in poverty reduction in recent development agenda. It is an important economic input in the effect to reduce poverty by supporting marginalized active poor of the society. Studying the role of microfinance institution on poverty reduction and improving the standard of living is important to assess its viability on poverty reduction and living conditions. The main objective of this study is to find out whether the provision of microfinance services of MFIs in Lemu and Bilbilo has reduced poverty and brought changes on the living standards of clients. So on the light of my research objective; I have developed my research question, which is: What is the role of Microfinance on poverty reduction and uplifting the living standards of the poor people in Lemu and Bilbilo?

I consider myself between the Positivist and Interpretivist researcher. Because, my main goal is not only to find out the mechanism of microfinance in Lemu and Bilbilo, but also to find out that how this mechanism reduce poverty and helps poor people to improve their living standards as: income, savings etc. By doing so, I believe that it will give me an upper hand, especially when it comes to finding answers to the questions raised in the problem statement.

Primary data were collected through close-ended structured questionnaire from clients and staff members of each institution and semi-structured in rearview with the manager of each institution. Secondary data were gathered from different published and unpublished relevant materials. The study mainly applied analytical approaches such as frequencies and percentages. The findings of the study indicated that the OCSSCO, PEACE AND BG'S micro financing scheme has improved the clients' food security, ability to send children to school, and housing condition.

Key words: Role, poverty, microfinance, standard of living, poverty reduction.

CHAPTER ONE

Introduction to the Study

1.1. Introduction

Improvement in living standard of the poor people of the developing countries is achieved by enhancing their income level or purchasing power. This phenomenon reduces poverty and causes to achieve poverty alleviation objective gradually. Thus poverty alleviation and income level enhancement are similar in nature. Considerable studies have been carried out on poverty alleviation. The impact of poverty in developing countries results in short and long run social and economic effects. Various international organizations highlight poverty as international phenomenon from time to time and must be addressed on priority basis.

In the last two decades, there are too many changes in the microfinance sector like introduction of micro insurance, diversification of products and flexible loan fit to the cash flow of the borrowers. Microfinance, with the core objective of provisioning of financial services to the poor segments of the society, contributes its role in the form of financial development with primarily focus on poverty alleviation. Most of the people perceive microfinance in narrow sense that it is about micro-credit for poor people but it has broader dimensions including, micro-insurance, transactional services and most important are the savings.

Microfinance has demonstrated its potential to assist the poor to make significant strides towards reducing their exposure, improving their purchasing power, paying for basic healthcare and bearing their children s education expenses (Littlefield et al., 2003). Many microfinance institutions (MFIs) have evidenced to work purely on profitable basis without considering the basic objective of microfinance and some others provide microfinance facilities by having real

sense of poverty alleviation. Together, these facts have attracted a great deal of donor of money and a wide variety of organizations into the microfinance sector.

The rest of the paper is organized that: second part presents review of research literature, third part contains research methodology, fourth part talk about background of the study area and description of the MFI under study, fifth section includes results and discussion a last sixth portion incorporates summary, conclusions and recommendations.

1.2. Statement of the Problem

The introduction of MFIS is seen as the best alternative source of financial services for low income earners in rural areas a means to raise their income, hence reducing their poverty level. However, evidence has shown that these MFIs have limited coverage, poor organizational structures and some are donor driven.

Microfinance also has been increasingly acknowledged as a significant tool for poverty reduction in development. There has been an extensive debate on the success of microfinance institutions for poverty reduction and improving living standard. A number of literature debates suggest microfinance institutions for poverty reeducation and improving living standard. A number of literature debates suggest microfinance institutions as a panacea to poverty reduction and improving living standard. However, argument from the literature review in this study showed that although microfinance may have positive impacts on poverty reduction, it is unlikely to be an easy solution to poverty reduction. The extent to which microfinance institutions can be effective in poverty reeducation is still questionable.

This research will examine the effect of microfinance institutions on poverty reduction and improving living standard. The research will be done at Lemu & Bilbilo woreda as a case study. The study focuses on identifying how MFIs can lead to poverty reduction and improving living standard. In addition, the study also will examine the extent to which MFIs leads to greater income levels and sustainability for the society.

1.3. Objectives of Study

1.3.1. General Objective

The objective of this research study is to assess the role of Oromia credit & saving, Bussaa Gonofa savings and credit, and Poverty Eradication and Community Empowerment in poverty reduction and the upliftment of living conditions of poor by income, production and welfare as well as programme outreach in providing those social benefits to its clients, based on the information that will be collected from a field survey: at the household level of randomly selected five villages in Lemu & Bilbilo districts in Arsi zone.

1.3.2. Specific Objectives

The study centered on the following specific aspects:

- To assess whether MFIs direct their services to the poor population and micro and small business (particularly in rural areas) and whether conditions and procedures for credit favor these target groups.
- To assess whether the customers reached by these schemes improved their general performance in terms of wealth, creation of employment and generation of income.
- To examine the nature of loan and loan repayment capacity
- To assess whether MFIS has negative or positive impact on poverty reduction.
- To assess whether the poorest can benefit from microfinance from both an economic and social well-being point –of –view
- To assess the extent MFIs operation in Lemu & Bilbilo woreda has brought about positive changes in the standard of living of people who access their services.

1.4. Research Question

The above mentioned objectives will be achieved when the research have an overview of role of microfinance for poverty reduction and up liftmen of living standard. Following main and further sub questions are made to achieve the set objectives of the study.

What is the role of microfinance in poverty reduction and on improving living standards in Lemu & Bilbilo woreda?

To answer this research question, the following sub-questions are formulated.

Q1. To what extents do MFIS services contribute to poverty reduction? (This means an increase in MFIs customers' wealth i.e. generation of more income & creation of more employment opportunities)

Q2. Do the conditions & procedures set by MFIs favor the poor and low income earner clients?

Q3. Do the target groups receive adequate MFIS services and benefited from the services?

1.5. Significance of the Study

The research is important because, as per the researcher knowledge no research had been done on the role of MFIs on poverty reduction and improving living standard particularly in Lemu and Bilbilo woreda. So, this study will be of benefit to the MFIs, policy makers and community at large. The study explores and recommends potential areas that MFIs need to put more efforts when providing their services. On the other hand policy makers will also benefit in the sense that the findings provide informed suggestions on how policy can be improved with improved and easy to implement policies the community will be able to access and benefit from the services of MFIs.

In the long run, the study will be milestone for other researchers who want to conduct a further research on the same area and it will improve literature on Role of MFIs on poverty reduction and improving living standard and improve public lender standing of the role these institutions in their living standard.

1.6. Scope and Limitation of Research

The research is restricted to Oromia credit & saving, Bussaa Gonofa savings and credit, and Poverty Eradication and Community Empowerment in Lemu & Bilbilo woreda specifically on five randomly selected villages and thus, the sample for this study will be taken at this location. This woreda has been chosen as study site due to several beneficial reasons such as money of the peoples use this institution as significant tool for poverty reduction, it save transportation cost for the research and other . Some of the constraint that forced the researcher to bound (limit) the area are time, financial and other problems which may lead to unmanageability of the work to be performed. Even though large sample is essential for in-depth understanding of the role microfinance institutions in reducing poverty and improving living standard of societies, the study is limited to only five kebeles out of 25 kebeles due to time and financial limitation.

1.7. Organization of the Paper

This study has six chapters. The first chapter introduces the problem background of the study and presents the framework to give readers a basic idea of this research. Besides research objective, research question rationale of the study, its significance and limitations of the study, definitions and key concepts will be also discussed. The second chapter is Literature review. This is the core part of this thesis and the prime purpose of this chapter is to provide the readers' insight about the theories involved in this work, which is the base of our investigation and past research in the topic. The third chapter gives detailed account of the research design including the selection of sample; the data will be collected and analyzed. Furthermore, this chapter will provide a discussion about the method used to select the target respondents and justification for selecting the target respondents. The source of measures selected to analysis data and justification for their choice also will be discussed in this chapter. Chapter four starts with overview of Lemu and Bilbilo, which is followed by the short description of OCSSCO, Bussaa Gonofa and PEACE. Chapter five will discuss the presentation and discussion of results and the implication for future research and the limitation of the study will be then presented.

Finally, conclusion about the research will be compiled and comments will be provided about the study will be presented in chapter six. This chapter will concludes with general overview of summary of the findings as well as recommendations

CHAPTER TWO

Literature Review

This literature review will assess the basic issues in the role of microfinance institutions in poverty reduction and improving the living standard of a society. An attempt is made to capture and present what is available in the literature from recent books and theoretical papers written by well known authors in the subject. Effort is also made to discuss also recent countries experience in the role of microfinance institutions in poverty reduction and improving the living standard and take lessons by adapting to the Ethiopian context. Let us first look in to definition and the main concepts behind these related areas.

2. 1. What Is Microfinance?

Microfinance is the provision of financial services to low-income poor and very poor self-employed people (Otero, 1999 cited in Marzys, 2006). Only a small fraction of the world population has access to financial instruments, essentially because commercial banks consider the poor people as unbankable due to their lack of collateral and information asymmetries.

These financial services according to Ledgerwood (1999) generally include savings and credit but can also include other financial services such as insurance and payment services. Schreiner and Colombet (2001, p.339) define microfinance as “the attempt to improve access to small deposits and small loans for poor households neglected by banks.” Therefore, microfinance involves the provision of financial services such as savings, loans and insurance to poor people living in both urban and rural settings who are unable to obtain such services from the formal financial sector.

The term microfinance refers to small-scale financial services- primary credit and savings- provided to people who operate small enterprises, provide services, fish farm or herd, and to other individuals or groups at local level of developing countries both rural and urban areas (Robinson, 2001). Mostly the term microfinance refers to the provision of financial services to low-income clients; however some microfinance organizations also provide insurance and payments. In addition to financial intermediation, many microfinance institutions (henceforth MFIs) provide social intermediation services such as group formation, development of self-confidence, and training in financial literacy and management capabilities among members of a group. Thus the definition of microfinance extends to include both financial intermediation and social intermediation. Furthermore, microfinance is not simply banking; it is a development tool as well and as such, its activities also involve provision of small loans, typically for working capital; informal appraisal of borrowers and their investments; collateral substitute, such as group collateral or compulsory savings, secured savings products etc (Ledgerwood, 1999).

Alen 2006 (cited Aryeetey, 2005) also defined microfinance based on its main characteristics: its targeting of the poor, promoting small business, building capacity of the poor, extending small loans without collaterals, combining credit with savings, and charging commercial interest rates. Saving services allow savers to store excess liquidity for future use and to obtain return on their investment. On the other hand, credit services involve the use of anticipated income from current investment or consumption. 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. Wolday (2001) 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. Cognizant of the advantages it offers, development practitioners and donors have in recent years given considerable emphasis to microfinance activities as a tool to empower the poor and provide them with the financial means to increase access to social services and reduce poverty. This is so because having access to microfinance services means having access to productive resources through loan and saving products. In addition, from socio-political point of view, being a member of a microfinance institution or a rural credit association means accepting the existing institutional social structure in place to undertake the given activities, which in turn can lead to attitude changes in daily life (Wolday 2001). On the same issue Wolday (2001) also put forth, although microfinance alone cannot provide roads, housing, water supply, education and health services, it can certainly play an important role in making the above interventions realized.

2.2. Characteristics of Microfinance

Microfinance gives 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.

According to Murray, U. and Boros, R. (2002, p. 10-11) the characteristics of microfinance products include:

- Little amounts of loans and savings.

- Short- terms loan (usually up to the term of one year).
- Installments made up from both principal and interest, which amortized in course of time.
- Higher interest rates on credit (higher than commercial banks rates but lower than
- 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.
- Application procedures are simple.
- 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 running cash flow analyses, which is based on the stream of cash flows, generated by the activities for which loans are taken.

2.3. Microfinance and Microcredit

In the literature, 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 both are similar in nature and tends to perform similar functions, Microcredit is obviously a small part or subset of Microfinance.

Edelito Sangco (2009,p.10-11) *Microfinance* is defined as the "provision of a broad range of financial services such as deposits, loans, payment services, money transfers and insurance products to the poor and low-income households, for their micro-enterprises and small businesses, to enable them to raise their income levels and improve their living standards." In summary, microfinance is not only about microcredit or small business start-up loan provided by microfinance institutions to a micro-entrepreneur who want to engage in micro enterprise but also the provision of other financial services like micro insurance. Typically, individuals with very little income experience great difficulty in taking advantage of things like savings opportunities and insurance products. Often, low incomes go hand-in-hand with a lack of collateral and credit, making it difficult for the poor to obtain loans, invest, and enjoy insurance protection. Microfinance seeks to eliminate this problem, providing microinsurance, microloans, and other financial services to low-income people.

Microcredit is the term used to identify small loans that are made to individuals and entities that would otherwise not be able to obtain any type of credit. Often referred to as microloans, microcredit is extended to people who have no collateral to pledge for a bank loan, or who are currently unemployed or lack an acceptable credit history. The main function of microcredit is to

provide financial services to those that do not qualify for standard sources of credit and assist them in achieving a better quality of life (Edelito, 2009).

In short, Microfinance is a broader term than microcredit and covers financial services that provide a greater scope of success for the poor. The financial services include savings, insurance, housing loans and remittance transfers. Microfinance also includes imparting entrepreneurial skills and training, along with tips and advice on many matters for a better living such as health and sanitation, nutrition, importance of educating children and improving living conditions.

2.3.1. Micro finance Institutions (MFIs):

A microfinance institution is an organization, engaged in extending micro credit loans and other financial services to poor borrowers for income generating and self employment activities. An MFI is usually not a part of the formal banking industry or government. It is usually referred to as a Non-Government Organization (Aquiunnessa, 2000)

2.4. Genesis of Micro Finance

The origin of Micro finance or micro credit can be traced to the 1976 when Mohammed Yunus set up the Grameen Bank experiment on the outskirts of Chittagong University Campus as an experiment. Grameen we mean 'rural or village' in Bangladesh language. These Grameen banks provide loans to the poor who do not have anything to put up for collateral. Grameen banks are the largest rural financial institution in Bangladesh. Their lending guidelines and procedures are mainly for women, 97% are women. In terms of clients, Grameen Bank is doing very well.

2.4.1. Profile of Microfinance in Ethiopia

Formally in Ethiopia started in 1994-95. In Particular, the licensing and supervision of Institution proclamation of the government encouraged the Spread of Institutions (MFIs) in both rural and Urban areas as it authorized them among other things, to legally Accept deposits from the general public (hence diversify sources of funds), to draw and accept drafts, and to manage funds for the Micro financing business. Following the issuance of this proclamation the microfinance industry of Ethiopia showed a remarkable growth in terms of outreach and sustainability. Furthermore, the National Bank of Ethiopia issued a new directive on May 2002 to improve the regulation limits on loan size (Br. 5000), repayment period (one year), and lending methodology (social collateral).

Currently, there are 29 licensed MFIs reaching about 2.2 million active borrowers with an outstanding loan portfolio of approximately 4.6 billion birr (implementation completion report, MTDP, 1999, cited in Asmelash, 2003).

Considering the potential demand, particularly in rural areas, this satisfies only an insignificant proportion.

2.4.2. Trends in Microfinance

Out of 30 registered MFIs across the country 14 MFIs are very active in their activities by the end of the year 2008. These 14 MFIs are contributed almost all 95 per cent of total microfinance business. These 14 MFIs are given 4.2 billion Birr to the needy during the year with 1.9 million active borrowers. Among these MFIs, ACSI occupies first rank in its activities whereas Harbu occupied the place in granting loans to needy. In concern to active member ship also the same

trend follows in case of first position but Letta occupies the last place. In the year 2000, there were 3 MFIs in the country namely, ACSI, OCSSCO and Sidama respectively.

These together have granted loans Birr 13,086,616 with active borrowers of 176,629 during the year. During 9 years period, there is tremendous growth rate in terms of loan granting and active borrowers.

2.4.3. Classification of MFIs in Ethiopia

The standard classification of MFIs in terms of size according to the Micro banking Bulletin (MBB) is those having a GLP of less than 2 million dollars are small, those having a GLP of between 2 and 8 million dollars are medium and those above 8 million dollar GLP are large (AEMFI Bulletin, 2011).

Based on this scheme,

- the largest MFIs in this sample are Amhara Credit and Saving Institutions (ACSI), Dedebit Credit and Saving Institution (DECSI), Oromia Credit and Saving Share Company (OCSSO) and OMO,
- the medium sized are Busa Gonofaa (BG), Poverty Eradication and Community Empowerment (PEACE), Addis Credit and Saving Institution (ADCSI) and Wisdom, and
- The smallest MFIs are Metemamen, Wasasa, Meklit, Eshet, Gasha, Specialized Financial and Promotional Institution (SFPI), Africa Village Financial Service (AVFS), and Sidama.

So the samples for my study are from the largest MFIs and medium sized. These include Oromia Credit and Saving Share Company and Busa Gonofaa (BG), Poverty Eradication and Community Empowerment (PEACE).

2.5. Methodology of Microfinance

Majority of the microfinance institutions offer and provide credit on a solidarity-group lending basis without collateral. There is also a range of other methodologies that microfinance institutions follow. Some microfinance institutions start with one methodology and later on move or diversify to another methodology so that they do not exclude certain socio-economic categories of clients. So it becomes important to have a basic understanding of methodologies and activity of microfinance institutions.

2.5.1. Group 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 creditworthiness of the borrower is therefore determined by the members rather than by the MFI. Average loans range from US\$100 to

US\$200 for a period of 3-12 months. The loan amount varies from country to country. Average loan amounts tend to be higher (\$500 or more) in countries in transition of adapting to this system. On one hand, the group formation guides to lower transaction costs for microfinance institutions, but on the other hand 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 excluded or further stigmatized. Such social costs are higher in some societies than in others, depending upon underlying social relations (which influence the ease/difficulty of group formation) and the distances that people must travel to participate in group activities. In rural areas, these costs can be higher.

2.5.2. Individual Lending

Unlike microfinance institutions, there are very few conventional financial institutions 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.

2.5.3. Credit Unions

Credit unions are the organizations that are formed on the basis of financial relation of savings and loans between its members. They accumulate savings from its members and provide short-term credit to the needed members. The demand for loans in general exceeds the supply of savings. In most rural areas credit unions are still the solitary source of deposit and credit services, besides the informal financial market. Because credit unions have social as well as commercial objectives, they may have a key role to play in offering pro-poor financial services. It

has been observed that some women have not benefited much from the credit unions because the level of savings required is too high.

Credit unions have achieved financial self-sufficiency within the last few decades. According to one statistics from the World Council of Credit Unions (WOCCU), by the end of the 1980s there were about 17,000 credit unions in 67 developing countries around the world. These unions maintain nearly 9 million members and 60% of these members are from Africa and the Caribbean Islands. These credit unions handled approximately US\$2 billion in deposits and share capital.

2.5.4. Village Banking

Village banking is a kind of financial services model that assists poor communities to establish their own credit and saving associations, or village banks. Village bank provides non-collateralized loans to its members and a place to invest savings and promote social solidarity. The sponsoring agency provides loan for the village banks and village banks in turn provide individual loans to its members. Peer pressure and peer support among the members are considered as the bank guarantees of these loans, to ensure repayment where small working capital is repaid every four to six months by its borrowers. Borrowers start with a very small loan and gradually they establish loan ceiling. Loan sizes depend on the amount which borrower has saved. Member's savings are kept for the purpose of lending or investing to increase the resource base of the bank. Commercial standards are applied to determine interest rates and fees.

2.6. Solidarity

According to Aryeetey (2005), almost all microfinance institutions believe in motivating repayment through group solidarity or group liability. For example, village banks put emphasis on loans to finance income-generating activities and savings. Providing loan to the individual

through groups is an unconventional policy. In this policy, banks does not expect from group members to meet the collateral requirements. The basis of this methodology is the mutual trust among the group members. The groups member are usually lend money on unsecured basis, just using five-person group guarantee, whereby each individual is responsible for the repaying loans among the selected group. This principle of micro-credit is borrowed from the Grameen Bank of Bangladesh.

Solidarity group lending schemes involve the formation of groups. In these groups some or all members are jointly liable for each individual's loans, thereby creating an alternative to conventional loan requirements (which poor people can rarely fulfill). From the lenders' perspective such joint liability lending 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 (Montgomery 1996).

However, this methodology engages women clients in financial activities in which female solidarity is created through promoting shared visions and goals and developing collective strengths. It can serve as a powerful tool for progressive social change as long as it fosters critiques of dominant cultural ideologies. It helps to elevate awareness and empowerment in society, especially among the women clients.

2.7. Liquidity

With respect to increasing savings products for the rural poor, Mohindra (2005) stated that, more emphasis has to be placed on liquidity and low transaction costs than on attractive interest rates. Financial institutions arrange reliable options for obtaining liquid funds quickly when needed (a line of credit for example) and for safely investing excess liquid funds at reasonable returns.

MFIs collect obligatory savings from the clients on weekly or monthly basis, before further loans are disbursed. When the loan is disbursed, the net amount received by the client is after the deduction of first installment. So the first installment for the loan is already taken by the lender as soon as loan is sanctioned. Clients are allowed to withdraw at the end of the loan term, after a set number of weeks, months or years or when they terminate their membership.

To explore the nature of liquidity problems faced by the entrepreneurs is now one of the important issues in field of microfinance. Various reasons have been suggested to explain the liquidity problems, which MSE face. These encompass risk aversion, relation to fears for repaying the loan that might result in the loss of possessions, an inability and reluctance to attend weekly meetings, a hesitant to guarantee other people's loan, and rejection of 'poorest of the poor' by wealthier group members.

2.8. Human Development

According to Harper M. (2003) Development is deeply related to rising 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 cater 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 the poverty. Tackling poverty points to multidimensional concepts that emphasizes on reducing unemployment, infant mortality, maintaining essential healthcare, sanitation, food, nutrition basic hygiene, establishing gender equality etc. On the other hand, how these kinds of development can be achieved? 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 are important indicators of human development. The objective of this program is to create sustainable changes in the lives and livelihood of the poor in particular. As a strategy for removing poverty, microfinance institutions emphasize on improving the health of the poor, which is a main concern worldwide and particularly in low-income countries, where the burden of disease is heaviest. The relationship between poverty and ill health has been characterized as synergistic and bidirectional. Poverty confines the capacity to produce health and ill health leads to further impoverishment that diminishing the potential of individuals and households to improve their economic status (Sumanasekera, 2002).

Poverty reduction strategies (PRSs), like micro-credit programs, may pilot to health benefits. There is a growing recognition that poor health is a dimension of poverty; therefore, one potential result of poverty reduction is progress in the health of the poor. PRSs can adopt various forms. Ghalib Asad (2007) review of potentially pro-health PRSs included community and micro-enterprise economic development, agriculture and food policies, education policies, macroeconomic policies, and environment or infrastructure investments to improve the supply of safe water and basic sanitation.

Human development has close relation with few other development programs, some of them are described below.

2.8.1. Health Program

Health intervention has been an integral part of the MFIs. Different organizations apply different or similar policy to identify the health problems, undertake rigorous experimentation and try to explore and then apply suitable, affordable and culturally acceptable technology. Throughout the work process, they measure and monitor its implementations and recommends corrective actions to modify methods of implementation of program, health message, training and management, where needed.

2.8.2. Education Program

Another important goal of all MFIs is to spread the light of education throughout the society. Development through this program, along with the health program, indicates human development among the people. Their effort and mission is to build up a society free of poverty, illiteracy and disease. Their goals are to expand education opportunities for disadvantaged children and provide them with necessary technical and financial support.

2.8.3. Food Security Program

In the developing countries, achieving household food security remains a critical objective of rural development. This can be done in principle by escalating agricultural productivity and off-farm income, thus improving the capability of households to steady their income and food purchasing power. *Food security, at the household level, is defined in its most basic form as access, by all people at all times, to the food needed for a survival* (Zeller, M. & Meyer, 2002).

2.9. Livelihood Security and Microfinance

Sylvia (2003 p.4) defines a livelihood as comprising "...the capabilities, assets (including both material and social resources) and activities required for a means of living."

Beroff, etal (2000 p.10) states that livelihood security is "basic to well-being" and that security "refers to secure rights and reliable access to resources, food, income and basic services. It includes tangible and intangible assets to offset risk, ease shocks and meet contingencies."

Johnson and Rogaly (1997, p.304) defines livelihood security as "a family's or community's ability to maintain and improve its income, assets and social well-being from year to year."

Concern also state that livelihood security is more than just economic well-being as they define livelihood security as "the adequate and sustainable access to and control over resources, both material and social, to enable households to achieve their rights without undermining the natural resource base". Livelihood security therefore, like poverty, is not just about income, but includes tangible and intangible assets, and social well being.

Johnson and Rogaly (1997, p.122) state that "NGOs aiming for poverty reduction need to assess the impact of their services on user's livelihoods." They argue (1997) that in addressing the question of the impact of microfinance, NGOs must go beyond analysing quantitative data detailing the numbers of users, and volumes and size of loans disbursed, to understanding how their projects are impacting on clients' livelihoods. They state (1997, p. 118) that the provision of microfinance can give poor people "the means to protect their livelihoods against shocks as well as to build up and diversify their livelihood activities". A livelihood security approach according to Coleman (1999) aims for a holistic analysis and understanding of the root causes of poverty and how people cope with poverty. They identify livelihood shocks such as natural disasters and

drought, the social, political and economic context, and people's livelihood resources such as education and local infrastructure as factors affecting people's livelihood security. Therefore, when analysing the impact microfinance is having on livelihood security, as is the objective of this dissertation, a holistic analysis of people's livelihood security must be conducted, rather than just focusing on the material/economic impact microfinance is having on the livelihoods of the poor.

2.9.1. Material Benefits of Micro Financing

Microfinance initiatives can play an effective role in addressing material poverty, the physical deprivation of goods, services, and the income to attain them. MFIs can help people become more economically secure. This, in turn, has a multiplier effect on people's standard of living, enhancing basic household welfare, such as food security, nutrition, shelter, sanitation, health and education services. MFIs can help prevent and extricate people from debt.

Oftentimes, they liberate low-income households from moneylenders with outrageous interest rates that often reach 100% annually. Savings and credit services help people start or improve their own small businesses, providing income generation and employment for themselves and their families.

Credit can be used as working capital so that clients' efforts become more productive; for example, clients can buy rice or grains in bulk at wholesale prices and resell it at retail prices or buy a refrigerator to keep produce fresh. As clients become more productive, their income increases and they are able to accumulate savings for other investments and emergencies.

Savings serve as reserves for important household expenditures (such as school fees and funeral costs), and as insurance against sudden crises (such as illness, natural disaster, or theft) that can

otherwise result in destitution for people already living at the poverty line. In many cases low-income people want to save, and have been saving in a variety of traditional ways. MFIs can build upon Africa's traditional savings ethic to enhance outreach and quality of services. It is important to keep in mind that for any financial service to have a lasting impact on poverty eradication, it must be flexible and innovative to adapt to their needs of its clients.

2.9.2. Non-Material Benefits of Microfinancing

Microfinance initiatives offer more than just material benefits; they can also address issues associated with "non-material" poverty, which includes social and psychological effects that prevent people from realizing their potential. Microfinance initiatives individually and collectively empower people. A steady income, a savings account, training, and the discipline to honor loan repayments usually raise the self-esteem and status of clients, in societies where they are often treated as second-class citizens. MFIs often utilize microfinance groups to provide training in financial management, legal rights, business management, as well as other support services.

Principles of collective organization and solidarity empowered people to bargain for higher wages, better work conditions, health services, child-care, and common forms of insurance to protect their lives and livelihoods.

MFI participants, especially women, are often empowered to speak out more, assume leadership roles, and address issues beyond their workplace, such as domestic violence. For many women, the group is the first opportunity to meet formally with other women to discuss problems and develop joint action. The groups serve as a channel of information. For example, members may tell each other about counseling services that have been established for women victims of

violence and drug and alcohol addicts. Many women participants experience a change in their household and community status. Some experience an increase in financial responsibilities when their husbands noticed that they are involved in lucrative activities.

2.10. Definition and Status of Poverty

According to the World Bank's (2000) definition of poverty, "A condition of life so characterized by malnutrition, illiteracy, and disease as to be beneath any reasonable definition of human decency". It is a condition in which a person of community is deprived of the basic essentials and necessities for a minimum standard of living. Since poverty is understood in many senses, the basic essentials may be material resources such as food, safe drinking water and shelter, or they may be social resources such as access to information, education, health care, social status, political power, or the opportunity to develop meaningful connections with other people in society.

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 (World Health Organization, 2004).

Poverty also frequently overlaps with and reinforces other types of social exclusion, such as those based on race, gender or ethnicity. This more comprehensive understanding of poverty also better captures how the poor themselves define their situation (World Bank, 2000/2001).

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 US\$1 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. While the definition of very poor people used in this paper is based on income, the programs and approaches explored in the following sections address many aspects of extreme poverty, not income levels alone.

Poverty is more than just a lack of income. Wright (2000) highlights the shortcomings of focusing solely on increased income as a measure of the impact of microfinance on poverty. He states that there is a significant difference between increasing income and reducing poverty (2000). He argues that by increasing the income of the poor, MFIs are not necessarily reducing poverty. It depends what the poor do with this money, oftentimes it is gambled away or spent on alcohol (2000), 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” (Wright, 2000, p.40) by offering them a variety of financial services tailored to their needs so that their net wealth and income security can be improved. In general, it can be shown as follows:

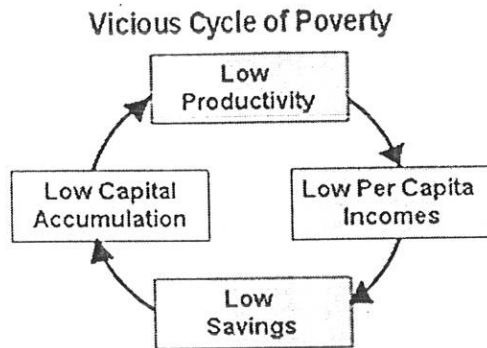


Figure 1. vicious Cycle of Poverty (Adapted from Guinnane 2007)

It is commonly asserted that MFIs are not reaching the poorest in society. However, despite some commentators' skepticism of the impact of microfinance on poverty, studies have shown that microfinance has been successful in many situations.

According to Hashemi (2006 p.2) "various studies...document increases in income and assets, and decreases in vulnerability of microfinance clients". They refer to projects in India, Indonesia, Zimbabwe, Bangladesh and Uganda which all show very positive impacts of microfinance in reducing poverty. For instance, a report on a SHARE project in India showed that three-quarters of clients saw "significant improvements in their economic well-being and that half of the clients graduated out of poverty" (2006, p.2).

Singh (2009) states that microfinance is a tool for poverty reduction and while arguing that the record of MFIs in microfinance is "generally well below expectation" he does concede that some positive impacts do take place. From a study of a number of MFIs he states that findings show that consumption smoothing effects, signs of redistribution of wealth and influence within the household are the most common impact of MFI programmes. Mosley (2001, p.109) in a comprehensive study on the use of microfinance to combat poverty, argue that well-designed programmes can improve the incomes of the poor and can move them out of poverty. He state

that “there is clear evidence that the impact of a loan on a borrower’s income is related to the level of income” as those with higher incomes have a greater range of investment opportunities and so credit schemes are more likely to benefit the “middle and upper poor” (2001, p.109-112).

Mayoux (2001, p.52) states that while microfinance has much potential, the main effects on poverty have been:

- credit making a significant contribution to increasing incomes of the better-off poor, including women,
- microfinance services contributing to the smoothing out of peaks and troughs in income and expenditure thereby enabling the poor to cope with unpredictable shocks and emergencies.

Hulme (2000) show that when loans are associated with an increase in assets, when borrowers are encouraged to invest in low-risk income generating activities and when the very poor are encouraged to save; the vulnerability of the very poor is reduced and their poverty situation improves.

2.11. Role of Microfinance in Serving Very Poor People

By providing small loans and savings facilities to people who are excluded from commercial financial services, microfinance has become a strategy for reducing poverty. Access to credit and deposit services is a way to provide the poor with opportunities to take an active role in their respective economies through entrepreneurship, building income, bargaining power and social empowerment among poor women and men.

Although most MFIs aim to reach poor people, it has become increasingly apparent that they rarely serve very poor people. According to Hickson (1999), Most MFIs reach the “upper poor” in much greater numbers than the “very poor.” The extent to which microfinance programs are able to reach the poorest of the poor remains an open debate.

Certain practitioners argue that it is important to have permanent operations based on a wider geographic outreach, with quality financial products delivered by competitive, efficient microfinance institutions. This approach to breadth of outreach is based on a long-term view of microfinance services and the belief that, in many cases, there is a limit to depth of outreach. This approach thus accepts a trade-off between sustainability and reaching very poor people. Other practitioners argue that microfinance should make reaching very poor people a priority because credit is a human right in the fight against economic exclusion. This approach requires narrow targeting of very poor people.

Both breadth and depth of services are very important for the microfinance industry. What has become apparent, however, is that very poor people are unlikely to be served by microfinance programs unless these programs are intentionally designed to reach them. In order to design products and services for this target market, it is important to better understand the factors that contribute to the dire conditions of very poor people (Hickson, 1999).

2.12. Savings Mobilization and Improving Living Conditions

2.12.1. Savings Mobilization

Savings mobilization has recently been recognized as a major force in microfinance. In the past, microfinance focused almost exclusively on credit; savings were the "forgotten half" of financial intermediation (Vogel 1988). The importance of savings mobilization has been highlighted in

several papers in the context of microfinance (Wisniwski 1999). Few analyses have been shaped in order to take an in-depth look at the savings mobilization strategies, which are employed by various institutions and are then compared to the results.

Deficiency of savings facilities creates problems at three levels: (i) at the individual level, (ii) at the level of the financial institution; and (iii) at the level of the national economy.

At the individual level, the lack of appropriate institutional savings facilities forces the individual to rely upon in-kind savings, such as the savings in the form of gold, animals or raw materials, or upon informal financial intermediaries, such as Rotating Savings and Credit Associations (ROSCAs) or money-keepers. These alternative informal savings facilities do not guarantee the combination of security of funds, ready access or liquidity, positive real return and convenience, which are basic requirements or necessity of a depositor (Wisniwski 1999).

Microenterprise programs can play a significant role for foster savings among the poor populations, with considerable benefits both for the savings and for the programs.

According to Harper, *“Domestic Savings provide the assets for the economy’s investment in future production. Without them, the economy cannot grow unless there are alternative sources of investment”*. People’s propensity to save varies significantly. Common astuteness states that as a person’s disposable income increases, so does his or her capacity and willingness to save. Persons, who are living at subsistence or near subsistence levels, often we call them low-income groups, thought to be among those who are least able to contribute to economic savings. It is demonstrated that most of the developing countries, where the poor constitute the great majority, have a lower propensity to save. It has been concluded that ‘the poor cannot save’. Exploring issues related to saving mobilization, among the poor people who are self employed in productive

activities, is one of the important purpose of this study. Experiences from the empirical findings have shown that many low-income people have the capacity to save and they usually do it through informal channels. Informal approaches for savings engross the formation of alternative structures, like group or associations, through which people undertake financial activities such as lending and savings (Harper 2003).

There is enormous literature available, based on surveys, case studies, regional and cross-country analysis, focusing on the nature of the savings capacity and ways of saving of poor. Many affirm that not only do the poor save, but their savings have substantial implications for policy and resource mobilization for financial markets and national economies (Miracle et al. 1980). Savings mobilization is an interesting issue among the poor for various reasons. Mobilizing savings lift up important considerations for 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 empowering experience for people used to living at the margin, 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.

Informal savings schemes exist throughout the developing world. Most of the pertinent in this perspective are the rotating savings and credit associations (ROSCAs). These are informal institutions in which group of individuals come together to save, share risks, and borrow. These kinds of informal organizations can be found in many countries, with different names and almost among all sections of the society. Rotating saving and credit associations are organized spontaneously among socially homogeneous groups with the strength of each group varying from

six to fifty people. These groups depend on a leader, who is usually the founder and he or she is responsible for the collection and distribution of the resources. Members make a fixed amount of payment into a pot and the total assets are distributed at fixed intervals among the members in turn. The distribution of the funds is agreed upon by lottery, seniority in the group, or another established arrangement. All informal credit and savings activities, work on the principle of rotating access to a capital fund, which is continuously fed by the members' contributions. The interest rates charged from borrowers, depends on the length of the term for which loan is taken (Harper 2003).

2.12.2. Living Standard

Standard of living is the name given to a general demographic measure that attempts to combine a variety of conditions - such as education, purchasing power, and healthcare -into a measurable statistic. It is distinct from the related, but more nebulous, measure known as *quality of life*, which also considers more subjective factors, like leisure opportunities and happiness. This measure is used in a number of ways, most often in comparative economics that rank countries against one another in the financial health of their citizens.

2.12.3. Improvement of Living Standard

Improving standard of living of rural people is not an easy task. It requires efforts and challenges from all sources involved. Pascal (2006) stated, "The way in which credit-generated income is used is probably impossible to dissociate from the way in which income as a whole is used and the profit achieved represents an adequate accumulation of money at the end of the loan cycle." A village without credit has lower levels of income and assets than the average for the villages with

credit. Non-clients and former clients have lower income than clients. A majority claim turned has out a profit.

Yin Chheng Sorn(1997) stated that the micro-finance plays an increasingly major role in providing capital for farmers and potential businesses, or for people to organize businesses, so it should be developed based on high efficiency and sustainability. Similarly, the rural credit plays an important role in creating, supporting and expanding businesses as well as in increasing productivity, which generates income and raises living standards.

The rural credit and microfinance constitute an important ingredient in the process of enhancing productive activities and productivity. Any access to capital allows people to take an advantage of and enhance economic opportunities. However, there are various credit services that are needed, such as consumption loans, farm production loans, non-farm production loans, etc. But the approach to these or promoting sustainable financial services for the poor is one that attempts to take a long-term programmatic view towards the development of a viable financial sector (Robert,1997).

The government considers the rural financial sector as sole important mechanism to reduce poverty and to develop the economy because the rural financial sector plays its role to increase and expand businesses and productivity in generating incomes for upgrading people's living standards. Vuthara & Chea(2007) stated some organizations have developed a clear mission in order to help improve living standards of the rural poor and to create a sustainable access to financial services for rural communities and micro-enterprises . They have also established clear objectives by providing financial services to help the poor communities to build up their capacity,

to help them through the provision of credit and saving services, and to assist the alleviation of rural poverty and raise living standards for the rural population.

Moreover, the institution is really an impact that is expected to produce in the level of income of the individuals that is served by the institution, as well as in the level of income of the communities where the program is present. Successful supports of the villagers would probably be required to support small solidarity loans (Robert 2002). However, the lack of fund for purchasing instruments and work cattle for agricultural production or for creating, extending, and improving businesses has been a major reason of low incomes gained by the people. It further indicated that credit activities bring benefits such as income generation of farmers and rural people, labor generation for rural people in the area, preventing an outflow of people from villages to the city for jobs, and improving family economy.

Claudio (1997) indicated that some borrowers who face capital constraints and have good investment alternatives may be able to make a profitable use of loans and pay high interests to cover MFI costs. It is likely that there are other clients who have received benefits from some family consumption and avoided assets sales and informal loans in times of distress, but these impacts might have been too suitable to be easily detected in a quantitative assessment.

The main important thing is that it requires policies and programs that foster the participation of the poor in processes of economic growth by creating employment opportunities, by increasing the access of the poor to income generating assets, by raising productivities of their assets, both physical and human, and by allowing them to manage risks better (Claudio, 1997).

Operations of moneylenders are also useful to improve the standard of living of the poor even if it is frequently more cost-effective than those of specialized farm-credit institutions, cooperatives and commercial banks that the government uses to supplant moneylenders.

Through credit service and assistant from organization staff, people could be able to start the additional jobs to earn more income to support and improve the living standards for their families.

Income from income generation activities is used primarily for consumption. These activities could grow into larger micro enterprises and small-scale enterprises; the small ones employ family labor while the larger require hired labor. These larger enterprises are more suited to individual lending.

Having greatly satisfied the food security issue, the focus has shifted to include promoting yet higher improved family diet and expanding opportunities for income generation from fish production and better livestock. The effectiveness and sustainability of production depend on the appropriate mix of production inputs (Taucher, 2000).

2.13. Microfinance and its Role in Poverty Reduction

Microfinance has a very important role to play in poverty reduction according to proponents of microfinance. Wolday (2003) states that studies have shown that microfinance plays three key roles in poverty reduction. It:

- helps very poor households meet basic needs and protects against risks,
- is associated with improvements in household economic welfare,

- helps to empower women by supporting women's economic participation and so promotes gender equity.

Marzys (2006 p.10) illustrates the various ways in which “microfinance, at its core combats poverty”. She states that microfinance creates access to productive capital for the poor, which together with human capital, addressed through education and training, and social capital, achieved through local organization building, enables people to move out of poverty (2006). By providing material capital to a poor person, their sense of dignity is strengthened and this can help to empower the person to participate in the economy and society (Marzys 2006).

The aim of microfinance according to Marzys (2006) is not just about providing capital to the poor to combat poverty on an individual level, it also has a role at an institutional level. It seeks to create institutions that deliver financial services to the poor, who are continuously ignored by the formal banking sector. Laura and Rosenberg (2006) state that the poor are generally excluded from the financial services sector of the economy. So MFIs have emerged to address this market failure. By addressing this gap in the market in a financially sustainable manner, an MFI can become part of the formal financial system of a country and so can access capital markets to fund their lending portfolios, allowing them to dramatically increase the number of poor people they can reach (Marzys 2006).

Hulme and Mosley (1996), while acknowledging the role microfinance can have in helping to reduce poverty, concluded from their research on microfinance that “most contemporary schemes are less effective than they might be” (1996, p.134). They state that microfinance is not a panacea for poverty-alleviation and that in some cases the poorest people have been made worse-off by microfinance.

Ryan, P. (2005, p.110) finds five major faults with MFIs. He argues that:

- they encourage a single-sector approach to the allocation of resources to fight poverty,
- microcredit is irrelevant to the poorest people,
- an over-simplistic notion of poverty is used,
- there is an over-emphasis on scale,
- there is inadequate learning and change taking place.

Wright (2000,p.6) states that much of the skepticism of MFIs stems from the argument that microfinance projects “fail to reach the poorest, generally have a limited effect on income...drive women into greater dependence on their husbands and fail to provide additional services desperately needed by the poor”.

In addition, Wright says that many development practitioners not only find microfinance inadequate, but that it actually diverts funding from “more pressing or important interventions” such as health and education (2000, p.6). As argued by Navajas et al (2000), there is a danger that microfinance may siphon funds from other projects that might help the poor more. They state that governments and donors should know whether the poor gain more from microfinance, than from more health care or food aid for example. Therefore, there is a need for all involved in microfinance and development to ascertain what exactly has been the impact of microfinance in combating poverty.

Considerable debate remains about the effectiveness of microfinance as a tool for directly reducing poverty, and about the characteristics of the people it benefits (Chowdhury, Mosley and Simanowitz, 2001). Sirajul (2008) argues that it is notoriously difficult to measure the impact of

microfinance programmes on poverty. This is so she argues, because money is fungible and therefore it is difficult to isolate credit impact, but also because the definition of 'poverty', how it is measured and who constitute the 'poor' "are fiercely contested issues" (2008, p.3).

Poverty is a complex issue and is difficult to define, as there are various dimensions to poverty. For some, such as World Bank, poverty relates to income, and poverty measures are based on the percentage of people living below a fixed amount of money, such as US\$1 dollar a day (World Bank, 2003).

Reflections about Theories

One of the most important elements need to be discussed is that in which aspects the above-mentioned theories are linked to my study. Firstly, I am going to investigate the role of microfinance institutions in poverty reduction and improving the living standards of the poor people in Lemu & Bilbilo woreda. Income is one of the important elements of living standards as well as of savings. The MFIs are providing loans to the poor not only to increase their income but also to mobilize their savings. By mobilizing savings, poor people can secure their future and feel safe. For this reason, I have emphasized more to know the situation about the income and savings of poor community of the society. Apart from these, other factors that contribute to human development, like education, level of access to treatment facilities and housing are also included in my investigations as these variables are also related to the core program and methodology of microfinance. I made endeavor to explore and find out to what extent poverty reduced and the standard of living of poor people has been influenced since they joined the microfinance program. The other necessary methodology of microfinance is solidarity, which is the base of microfinance. From theory, we already know that how solidarity (Group lending) works as a

synergy of microfinance. Previous studies have also shown that solidarity is a powerful tool of microfinance to reduce the risk and to keep the capital safe.

According to Aguilar 1999, the aim of integrating the poor into the economic circuit through microfinance programmes is to alleviate poverty by creating income and jobs, and consequently promote development. To that end, participants of microfinance programmes are expected to invest the micro-loans in productive activities (Rahman1999 p.75) that generate enough income enabling the low-income households to exit from poverty; expand their businesses; and improve the quality of their lives (Morduch 2000 p.159-161).

In this regard, Webster and Fidler (1996 p.23) stated that clients of microfinance programs have higher and more stable income, increased household expenditures for basic needs, employment opportunities, nutritional intake and better children's education than they did prior to their participation . Aguilar (1999) said that the poor undoubtedly benefit from microfinance services in growing levels of health care and education expenditures, better income, and better quality of nutrition, asset holdings, and weights of preschool children.

To put poverty-reduction intervention of microfinance programmes in a nutshell, they reach the poor in need of credit, and the poor pull themselves out of poverty through income generating activities and empowerment (Gulli and Berger 1999 p.17).

Empirically, however, not all microfinance programmes have led to reduction in poverty. In this regard, Rahman (1999 p.68) said that "...there are still many borrowers who become vulnerable and trapped by the system; they are unable to succeed."

According to Hulme (2000 p.26), calling micro-credit 'microdebt' help us be more realistic as it increases borrower debt-liability, and anxiety and tension among household members (Rahman

1999). Moreover, Hulme (2000 p.26) wrote, "Outside Bangladesh the microfinance industry has not even scratched the surface of poverty." On top of that, Hulme (2000) and Rahman (1999) reported that the poor are very frightened about getting in to debt, and female clients of microfinance service of the Grameen Bank committed suicide when they faced problems with repaying loans

No study, to the best of my knowledge, has done on the role of microfinance in poverty reduction and improving the living standard of the society on these areas. I can say no any research conducted on the same area on microfinance issues in general.

The following figure (1), presents the working model of my thesis. The aim of this model, subsequently my thesis, is to investigate the research question based on the theories and the primary data, I will collect.

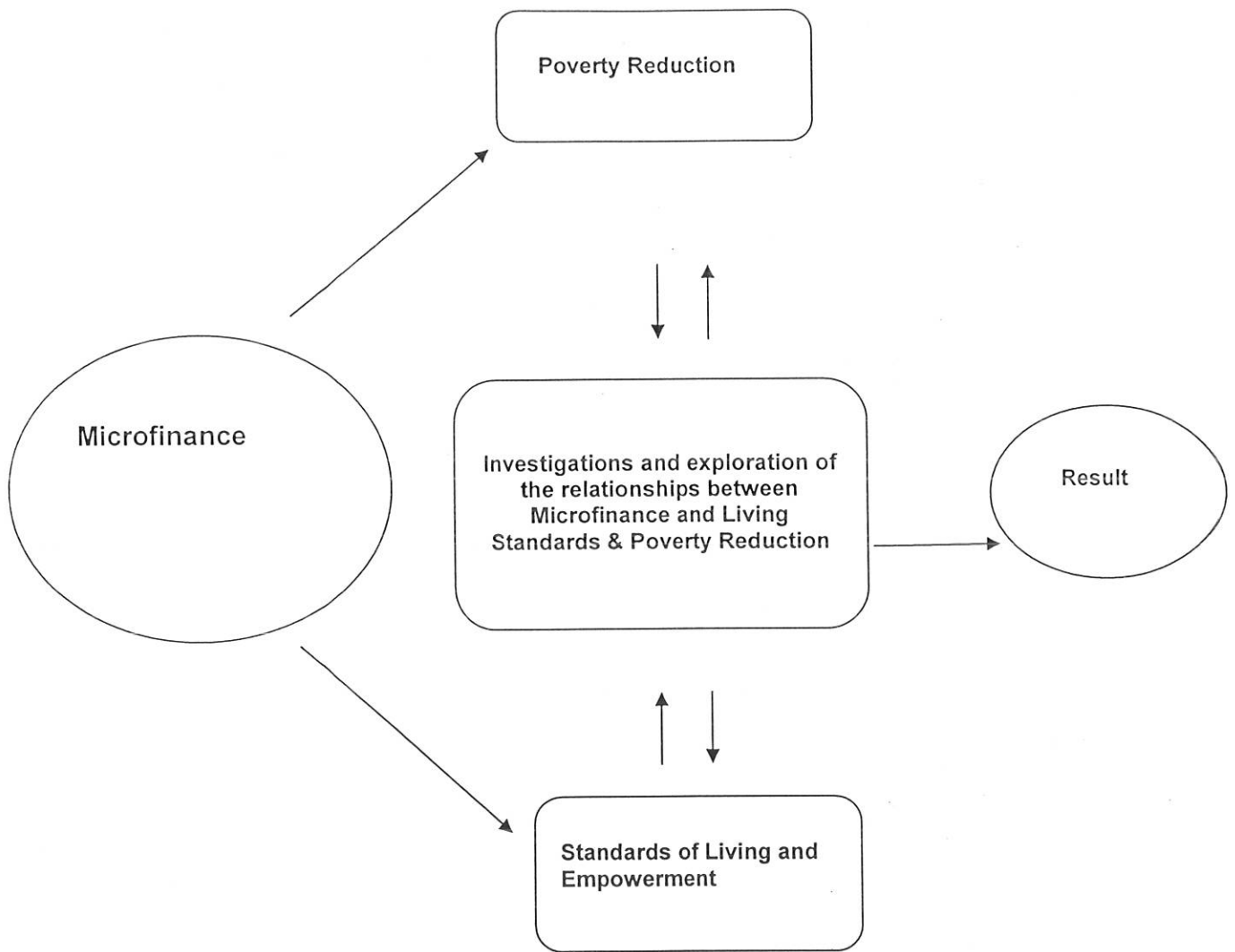


Figure: 2: Working model of this thesis (Adapted from Mohammed Anisur)

CHAPTER THREE

Research Methodology

3.1. Introduction

The purpose of this chapter is to describe the research methodology used in this study. The chapter elaborates the research design, sample design, Data collection and instruments, statistical tools employed, and contingency plans.

The study use both quantitative and qualitative data. Primary and secondary sources of data are also used in this study. For primary data generation, respondents were drawn from each MFIs' customers. The respondents comprised MFIs' clients, managers of enterprises and staff members of the microfinance institutions. The information gathered from MFIs' included the distribution of their clients (major villages), lending mechanisms, types of clients and financial products offered.

3.2. Research Method

The over all objective of the study to assess the Role of MFIs on poverty reduction and improving living standard in Lemu and Bilbilo woreda. The researches designs are both descriptive and explanatory nature. Descriptive research is used to generate information on the phenomena of interest that already exists (Fink, 1995). Where as explanatory research is concerned with the explanation of a condition or problem, usually in terms of cause-and-effect relationships (Churchill, 1995).

For the purpose of this research, it seems that a survey is most appropriate research strategy to achieve the objectives of the study. Survey gather data at particular point in time within the

intention of describing the nature of the existing conditions can be compared or determining the relationships that exist between specific events (Abiy et al, 2009).

The major benefit of survey studies is that they provide information on large groups of people, with very little effort, and in a cost effective manner. Also surveys allow researchers to assess a wider variety of behaviors and other phenomena than can be studied in a typical naturalistic observation study (Marczyk et al, 2005).come

The researcher expected that, the mixture of this two approaches were give useful for coming to gather the quantitative and qualitative (mixed) approaches is advisable as it gives a more complex picture by drawing on the individual strength and weakness of each methods; as well as enabling discovery and verification; understanding and prediction; ,validity and reliability within the research design (Jarratt,1996).

3.2.1 Data

3.2.1.1. Sampling Method & Sample Selection

In this study, non- probability sampling was used. There were two foot steps involved in sampling the population for the study covering the two dimensions. Firstly, the sampling units, that is to say the place where the questionnaires and interview has been conducted was selected. Thus, judgmental sampling will be used to choose those units. Secondly the selection of respondents for whom the questionnaires has been distributed and interview has been conducted, here the convenience sampling method has been used (i.e. respondents will be selected based on their convenience and availability).

In short, the population for my study encompasses the people who have been engaged in microfinance activities for at least two years and live in Lemu & Bilbilo woreda. When they have assessed the role of different microfinance institutions in Ethiopia, for instance, Asmelash (2003) and Bamlaku (2004) in their studies of the impact of ACSI on its client in Enemay woreda, impact of DECSI on its clients in Ganta-Afeshum woreda respectively, used clients of more than one and observed the changes over those clients. This argument also supported by Hulme(2000).

Accordingly the researcher chosen the people with a long experience in micro finance activities, because they well informed and knows much about the advantages and disadvantages about MFIs, so they can reflect better to my questionnaire.

3.2.1.2. Sample Size

The study has been conducted in on three microfinance institutions which include Oromia credit and saving institution, Bussaa Gonofa and Poverty Eradication and Community Empowerment. Altogether five villages are selected i.e. Bokoji 01, Bokoji 02, Kula, Bitana and Kilole. So respondents have been selected from each village. Altogether 250 respondents have been selected for the study. The sample has been selected on the basis of the number of customers these institutions has in each village.

3.2.1.3. Data Collection and Instruments

The study has employed different methods of data collection, where by both primary and secondary data was collected. The questionnaire contained approximately 30 closed questions. Questionnaires were administered to both MFIs and clients to collect the primary data. A questionnaire is a method for drawing out, recording, collecting information and is useful when the researcher wishes to gather large amount of factual and simplistic data that can be quantified

and made into statistical evidence (Creswell, 2003). The questions were first prepared in English language and translated to “Afan Oromo” to facilitate the data collecting process. In addition to this method, semi structured interviews will be conducted in order to gather relevant additional information. Observation and documentary reviews will be also used.

The study will also use secondary data, and the main sources will be various official documents and reports relevant to the research problem, Questionnaires will be first administered to few respondents from both the MFIs and clients as pre-test and appropriate adjustments will be made.

3.2.1.4. Data Analysis

After the collection of both primary and secondary data information on both the MFI and clients, tabulation of data has been performed. Results have been reported in both tables and a written form. Frequency and percentage have been reported. The information that has been analyzed on MFI included general profile, clients ‘outreach and the market, product and services provided, impact assessment, and future plan and constraints. On the side of clients, the issues that have been analyzed include general profile, types of services received from MFIs , conditions for service accessibility, and future plan and constraints for growth and its role in improving living standard and reducing poverty.

Some Quantitative data has been analyzed using the statistical package for social science (SPSS) that was chosen because it can take data from almost any type of file and use them to generate tabulated reports, chart, perform descriptive statistics. A summary of percentage and tabulation of field data was used to examine the impact of Oromia credit and saving institution, Bussaa Gonofa and Poverty Eradication and Community Empowerment’s intervention towards improving the welfare of the clients.

CHAPTER FOUR

4.1. Background of the Study Area

Lemu and Bilbilo Woreda is one of the Arsi Zone woredas, covering a land size of 81,400 hectares with a total population of 189,289. The capital town of the woreda is Bokoji; the art of producing good distance runners like kennebisa, Derartu, Dibaba's sisters and so on. Out of the total population, eight- seven percent of the population lives in rural areas where farming is their main activities. The woreda has twenty-five kebeles and the temperature of the woreda ranges from 6 degree centigrade to 20 degree centigrade. This woreda is divided into three distinct geographical areas with different proportion: namely the low land 12.25 percent which is small part of the woreda, midland 47.90 percent and the highland which constitutes the remain percent. The majority of the total areas of the woreda are flat and comfortable for agriculture and other investments. Kaka and Galema are two of the mountains having on altitude of 4140 and 3627 meters above sea level respectively. Additionally, there are some hills like Horagala, Jiso, Bursaa, Damota, and Nageso. Lemu and Bilbilo woreda is endowed with fifteen rivers and streams such as Katar, Hangara, Laga gurach, Kaliti, Calallaka, etc are permanently flowing through out the year. The dominate soil types that covered the woreda are Nitosoils which have good agricultural potentiality with high water carrying capacity. The woreda is also rich in natural forest and wild animals. Kemelekemele and Galema forest are the major forest in the woreda. These forests are also the home of different wild animals including Very attractive seasonal birds, which are not found in areas where there is no forest. Major types of wild animals that found in the woreda are Hyena, Tiger, Lion, Pig, Monkey, Fox, Tirign, wild goat, and Borofa. There is no any reserved area for wild life conservation.

Agriculture, which is rain fed and irrigation are dominated by small and a subsistence holder are the backbone of the habitants of the woreda. Regarding financial service sector, in lemu and Bilbilo woreda, there are two banks, which are commercial bank and oromia cooperative bank. In addition to these formal financial institutions, there are three informal financial institutions. The woreda recognizes that providing small load or savings to poor communities is a vital strategy to the development of the communities. In connection to this, rural credit services have been provided financial services actively and directly to poor communities through out the woreda. This research has conducted on the role of these microfinance institutions in poverty reduction and improving the living standard of the recipients of these MFIs' Financial Services.

4.2. Description of OCSSCO, BG and PEACE and their Program

Based on the experience and model developed by the Gramee microfinance, the first microfinance service in Ethiopia was introduced as an experiment in 1994 when the relief society of Tigray (REST) attempted to rehabilitate drought and war affected people through rural credit scheme (Yohannes, 2006). Although the development of microfinance institutions in Ethiopia started very recently, the industry has shown a remarkable growth in terms of out reach, particularly in number of clients.

According to proclamation No 40/1996, National bank of Ethiopian (NBE) issued for licensing and supervision of microfinance activities. NBE registered OCSSCO in August 1997. Since it has been registered; OCSSCO has been involved in assisting resource poor people through the provision of financial resources.

The general objective of OCSSCO is to alleviate poverty and promote economic development through the provision of credit and saving services.

The specific objectivity of OCSSCO includes, achieving house hold level food security in Oromia, increasing house hold income and improving the over all economic and social condition of rural house holds (AEMFI, 2000).

Currently, the organization has more than 90 sub-branches. The sub-branch is the basic organization and potential operational unit. That is all loans are processed, approved, disbursed and followed up.

AS AEMFI (2011) quarterly bulletin, OCSSCO managed to provide credit and saving services to 364,584 clients. Out of this, 39% were women borrowers. This institution is the third microfinance in terms of market share-borrowers next to ACSI and DECSI. It has started its operation on Bokoji since 1998 E.C. Currently, the institution has 1,952 active borrowers and 21 small and micro enterprises at this sub-branch.

Poverty Eradication and community Empowerment (PEACE here after) microfinance institution share company was founded in 1999. It takes over the micro-credit activities previously run by its mother organization; Agri-service Ethiopia (ASE), a local NGO that has been undertaking integrated rural development activities for more than 40 years in Ethiopia. MFI is formed as Share Company under the Ethiopian law. It is licensed by the National Bank of Ethiopia (NBE) to provide microfinance services.

WWB network member PEACE known as the “bank for women”-is working the food security of thousands of poor households. PEACE is owned by Agri-service Ethiopia and fifteen other individuals. The total paid up capital of the institution was birr 1,288,000. This microfinance started operation in 2000 by opening office in three regional state; Oromia, Amhara, and South Nation Nationalities and peoples where Agri-service Ethiopia as running its micro-credit project.

PEACE MFI currently offers group loans through network of 16 branches located in the above mentioned regions.

The general objective of the institution has identified the following objectives to guide its operation in order to fulfill its vision and mission. The objectives of the PEACE microfinance institution are to: provide increased access to financial services to the productive poor, empower them through viable activities and attain food security of thousands of poor household level, contribute to transformational and sustainable development by working toward permanent job creation and profitable productive activities with integration to rural development programs. Promote saving mobilization, create an enabling environment for more positive impacts, provide competitive quality and efficient services on continuous basis, grow in to soil and mature financial intermediary by charging appropriate fees and interest.

CHAPTER FIVE

Research Findings and Analysis

5.1. The Introduction

The present chapter analysis the role of microfinance institutions on reducing poverty and improving the living standard of beneficiaries. Further more, the contribution of these MFIs in terms of improving in come, increase saving and in asset building. Data gathered through questionnaire to the clients and microfinance institutions' staffs and semi structured interview with the manager of each branch and records of the MFIs concerning their operation and responses from clients were mainly used for the analysis. Presentation of data is made in table form along with percentage in a descriptive way by using simple static tools.

5.2. Clients Characteristics, Loan and Saving History Loan Usage

5.2.1 Demographic Characteristics of Respondents

The demographic characteristics of the respondents such as their ages, gender, marital status, level of education, occupation, religion and location any have direct or indirect relations with the way they use the loan or other financial services.

In addition to these, my assessment point out a clear direction of the individual and house holds demographic characteristics such as number of dependent and working groups in the family.

The following paragraphs summarize the sample respondents' demographic characteristics.

Table 5.1: distribution of clients taken on the basis of location and gender (*valid n=173*)

Name of Kebeles	Number of respondent						Total
	OCSSCO		BG		PEACE		
	Male	Female	Male	Female	Male	Female	
Bokoji	21	4	9	0	-	20	54
Bitana	10	0	5	10	-	20	45
Kilole	10	6	10	10	-	-	36
Kula	10	3	5	20	-	-	38
Total	51	13	29	40	-	40	173

Source: Survey data

The distribution of respondents in the above reveals that from the total 173 valid respondents, 93 are female. The majority of the respondents were urban dwellers who taken from Bokoji town. The gender composition of the sample respondent is nearly proportional i.e. 53% and 47% of female and male respectively. Poverty Eradication and community Empowerment (PEACE here after) is known as the ‘Bank for women’. As the table above indicates, all of the sample respondents taken on this institution are female. This implies that the institution is gender sensitive which means the percentage of women borrowers is greater than 50%. Similarly, Buusa Gonofa’s percentage of women borrowers exceeds men borrowers. So, this microfinance is also gender sensitive. Inversely, Oromia Credit and saving share company (OCSSCO) is non-gender sensitive. PEACE microfinance has no clients on both Kula and Kilole.

Table 5.2 reveals that most of the sample respondents are adult. One the common objective of the ‘microfinance’ is that to provide increased access to financial services to the productive poor, empower them through viable activities and attain food security and household level. Accordingly, the majority of the sample respondents (about 74.4%) are found in the age interval of 26 to 34 and 35 to 44 year which is productive age category of the society. Only around 10% of the sample respondents are found in the age interval above 55 year.

Table 5.2: Sample respondents by age

Description	Indicator	Frequency	Percentage
Age	Less than 25	-	-
	26 - 34	69	39.8%
	35 - 44	53	30.6%
	44 - 54	34	19.7%
	Above 55	17	9.9%

Source: Survey data

Chart 5.1: Percentages of sample respondents by age

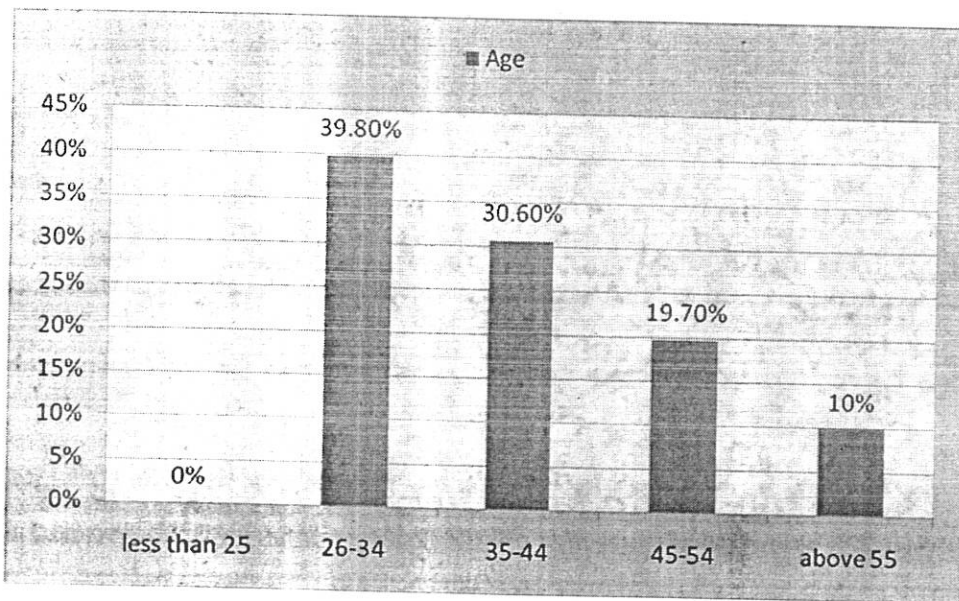


Table 5.3: Distribution of sample respondents by education, occupation and religion

Demographic characteristics	Indicators	Frequencies	percentage
Status of education	Illiterate	69	39.8%
	adult literary	26	15.0%
	primary	51	29.5%
	secondary and high school	27	15.7%
	Total	173	100%
Occupation	Agriculture	119	68.8%
	Trade	54	31.2%
	Civil servant	-	-
	Retired	-	-
Religion	Orthodox	87	50.3%
	Muslim	59	34.1%
	Protestant	27	15.6%
	Total	173	100%

Source: survey data

Table 5.3 indicates the distribution of the sample respondents by education, occupation and religion. It reveals that the majority of the respondents 95 (54%) lies in the range of illiterate and adult literacy. Only 78 (45%) of the sample respondents are located in the range of primary and secondary school. Out of total illiterate and adult literacy respondents, 51 (53.7%) are female and the remaining percentage (46.3%) are male.

Regarding to the sample respondents' occupation 119 (69%) of respondents are farmer in profession and business people 54 (31%). No civil servant and retired client. Their professional field is shown by the following chart.

Chart 5.2 Occupation of the sample respondents

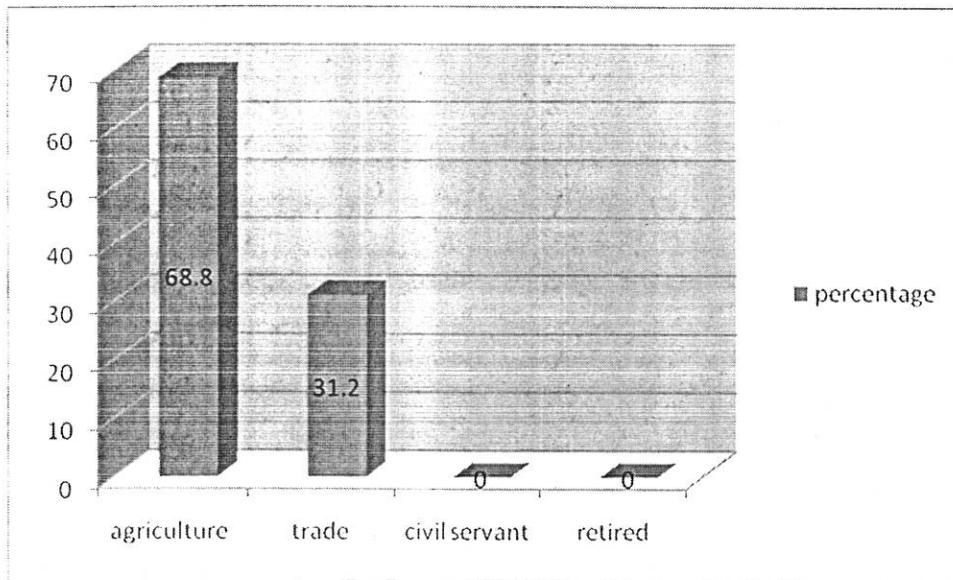


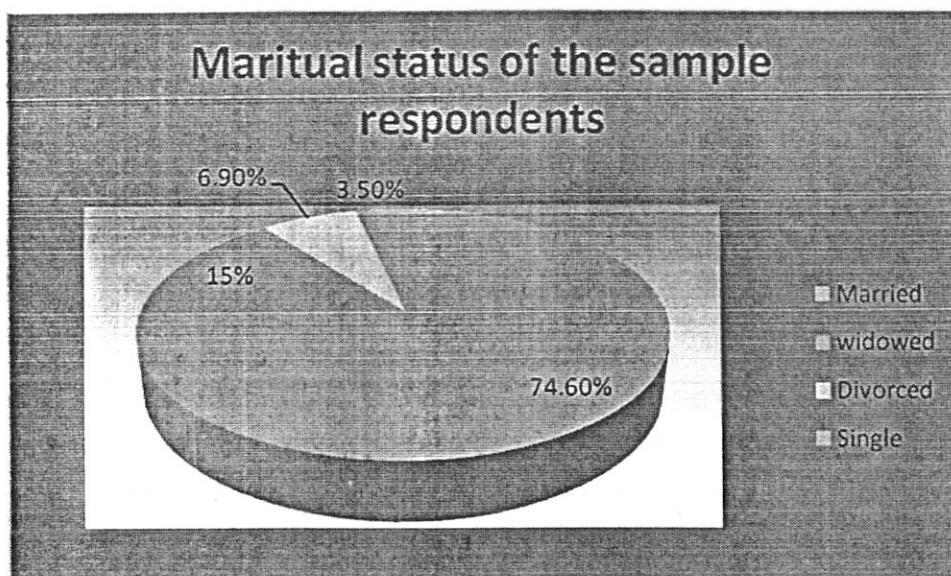
Table 5.4: Marital status of the respondents

Indicators	<i>Marital status of the respondent</i>				Total
	Married	Widowed	Divorced	Single	
frequency	129	26	12	6	173
Percent	74.6%	15.0%	6.9%	3.5%	100%

Sources: survey data

According to the table above out of the total respondents, 74.6% are married, 3.5% are single, 6.9% are divorced and 15% are widowed. This indicates that majority of sample respondent are married and have at least two independent group.

Chart 5.3: Marital status of the sample respondents



5.3. Loan history and loan usage

5.3.1. Loan History

Table 5.5: Reasons for joining the program

Indicators	What is (are) the reason(s) for joining the program?				
	Financial problem	Close to home	To get experience and good job	Payment is good	For children's education
Frequency	141		26	4	2
Percent	81.5%		15%	2.3%	1.2%

Source: survey data

As clearly shown in table 5.5, almost all sample respondents (which is around 82%) have said the main reason for joining the programme is due to financial problem. 26 (15%) of the respondent said their reasons for participating in the programme is to get experience and get a good job.

Table 5.6: Respondents' loan history

<i>Description</i>	<i>Indicator</i>	<i>Frequency</i>	<i>Percent</i>
Have you ever borrowed money from a microfinance institution before?	Yes	128	74%
	No	45	26%
	<i>Total</i>	<i>173</i>	<i>100%</i>
How many times you took loan?	Two	67	38.7%
	More than two	106	61.3

Table 5.6 indicates whether they have borrowed money from microfinance Institution or not and how many times they took the loan. As indicated in the table, out of the sample respondents, 67(38.7%) respondents reported that they have participated in the programme for two years. 106 (61.3%) respondents replied that they have taken the loan for more than two years. Rural active clients have longer duration than urban active clients. Since microfinance's lending policy regulated that any client cannot pass to the next cycle and took the next loan cycle unless the first loan is repaid, this has improved performance and on time repayment.

Table 5.7: Lending methodology and Group formation

<i>Description</i>	<i>Responses</i>	<i>Frequency</i>	<i>Percent</i>
Method of receiving the loan	In group	171	98.88
	Individually	2	1.02
How did your group form it self	Neighbors	113	65%
	Group existed before	29	17%
	Family members and good friends	31	18%
	Suggested by loan officer	-	-

Source: survey data

Table 5.7 shows that almost all clients around (98.8%) received loans by forming group which means using group-lending methodology. The table also reveals that 65% of the respondent



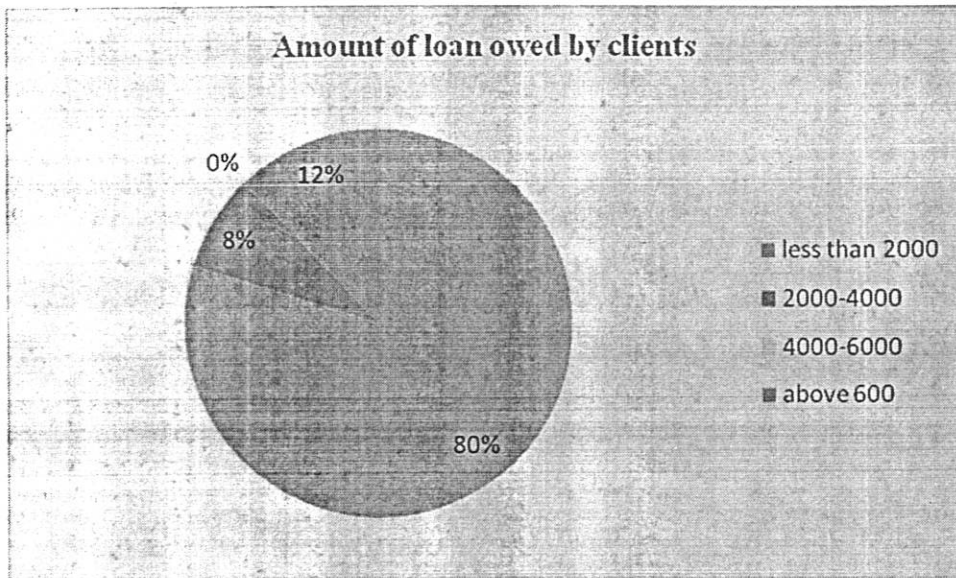
replied that they form their group by neighbors. 18% of the sample respondent reported that they organized (form a group) from family members and good friends. All most all of group members know each other before forming a group. Their groups have, on average, three to six members where all group members are accountable in case any one in their group fails to repay the loan.

Table 5.8: Amount of loan owed by clients

<i>Description</i>	<i>Indicators</i>	<i>frequency</i>	<i>Percent</i>
How much loan you received this year?	Less than 2000	138	79.8%
	2000-4000	14	8.1%
	4000-6000	--	--
	Above 6000	21	12.1%

As clearly shown in tale 5.8, most of the sample respondents (about 80%) reported that the amount of loan they received was less than two thousand. Only 8% of the respondents have taken the loan amount that range from two thousands to four thousands. Urban clients who are organized as small micro enterprises have taken larger loan size which range from fifteen thousands to maximum fifty thousand. As the table indicates, 12% of the sample respondent clients have reported that they borrowed relatively large amount of money. Respondents also reported that in spite of the benefit of the credit provision in improving the income of their household, the size of the loan the institution have allowed is too small. This according to them limited their capacity. So they are forced to engage in activities that ask them little effort and provide them with quick return over that would enable them to pay their debt timely. According to them, the smaller the size of the loan, the will be the chance to engage in profitable activities. The amount of loan owed by the clients of three microfinance institutions is also indicated using pie chart as follows:

Chart 5.4: Amount of loan owed by clients



Source: Survey data

Table 5.9: Clients' opinions on training about loan utilization

Description	Responses	Frequency	Percent
Have you been trained about loan utilization?	Yes	168	97%
	No	5	3%
Has it been satisfactory	Yes	152	87.8%
	No	21	12.2%

Source: Survey data

The above table shows whether clients have trained about loan utilization or not and whether they are satisfied with the training or not. Accordingly, almost all (97%) replied that they have received enough training about loan utilization. Above 88% of clients reported that the training about loan utilization has been satisfied. In general, most the respondents are trained and satisfied with training about loan utilization provided by each microfinance institution.

5.4. Purposes for which the Money Borrowed and its Actual Destination (its Usage)

In general, credits increase the income and improve the living standard of a community, when it is used for income generating activities. These activities enable clients to generate net income to support their families and repay their loans. In table 5.10, the large majority of clients (about 72% of the sample respondents) reported that they borrow the money for agricultural production. Some of the sample respondents have reported that they borrowed for both agricultural production and consumption purposes. But almost more than 41.5% of the respondents said that the actual destination (the money borrowed) are invested on non-income generating activities such as consumption and pay back other loan. This 41.5% is a combination of sample respondents that invested their loan on non-profitable activities such as consumption and pay back other loans. Only 51.5% of the sample respondents reported as their loan was invested on income generating activities (to start their income generating activities). Out of this, which means out of the money invested on income generating activities, 36.4% was invested on agricultural production followed by small business activities (start new and expand existing business) which is 15%. Relatively smaller proportion of loan is used for service provision (education, health expenses and other) constitutes 7%.

The use of the loan for unintended purpose and consumption is significant. Urban clients have used the loan for intended purpose compared with rural clients.

Table 5.10: Purposes for which the money borrowed and its actual destination

<i>Description</i>	<i>Indicators</i>	<i>Frequency</i>	<i>Percent</i>
For what purpose did you borrow?	Agricultural production	124	71.7%
	Consumption	7	4.0%
	Education and health	5	2.9%
	To pay back other loan	-	
	To start new & expand existing business	37	21.3%
	Total	173	100%
For what purpose have you actually used the last loan	Agricultural production	63	36.4%
	Consumption	53	30.6%
	Education and health	12	7.0%
	To pay back other loan	19	10.9%
	Start or expand business	26	15.1%

Source: Survey data

Chart 5.5: Purpose for which the money borrowed

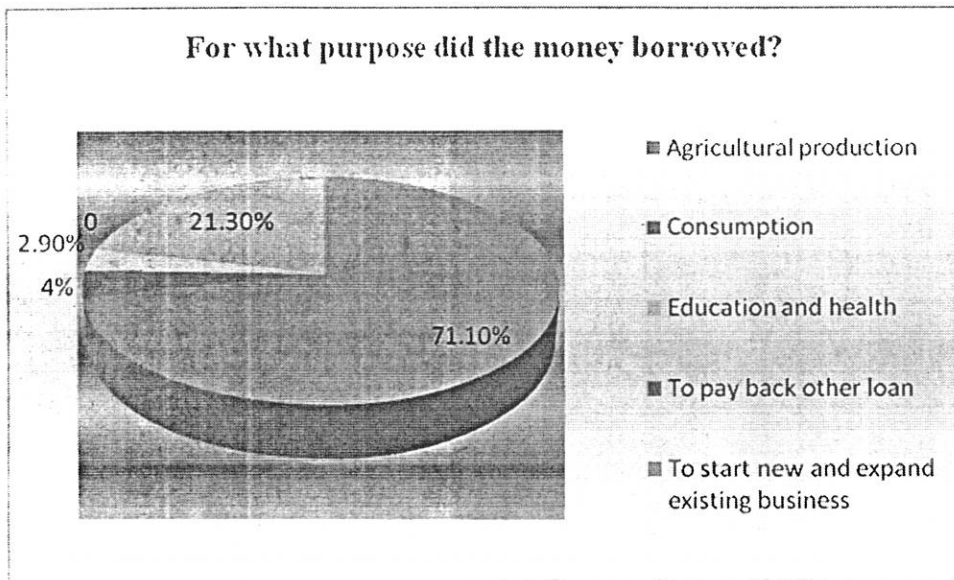


Chart 5.6 Actual destination of the money borrowed

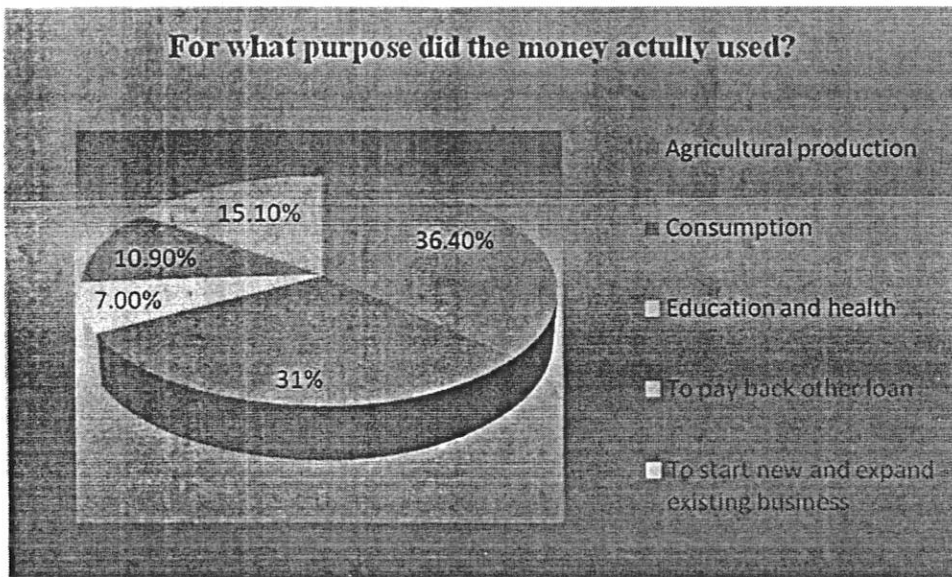


Table 5.11: (a) Loan repayment status

Description	Responses	Frequency	Percent
Is it easy to repay the principal plus interest?	Yes	71	41.1%
	No	102	58.9%

Source: Survey data

One can see loan repayment capacity may show the positive or negative impact of the credit on the clients. The assumption is that if the clients used (invested) the loan on productive activities or income generating activities, they can pay their loan plus interest easily. Otherwise, the credit may increase indebtedness on clients. Table 5.11(a) clearly indicates, about 59% of sample respondents reported that it is not easy to repay the loan. When I relate the response with the usage of loan, the majority who said it is not easy to repay the principal plus interest are those who used their loan for unintended purposes and those who invested on non-income generating activities. Almost all those invested on an income generating activities reported that it is easy to repay the loan accordingly.

Table 5.11 (b) Loan repayment status

Description	Indicators	Frequency	Percent
Loan repayment performance	Early	36	20.8%
	At to schedule	112	64.7%
	Lately	25	14.5%
How is the interest rate on your saving?	Not satisfactory	107	61.8%
	Some what satisfactory	49	28.3%
	Satisfactory	17	9.9%
	Very satisfactory	-	-
Repayment period	Short	110	63.6%
	Satisfactory	63	36.4%
	Long	--	--

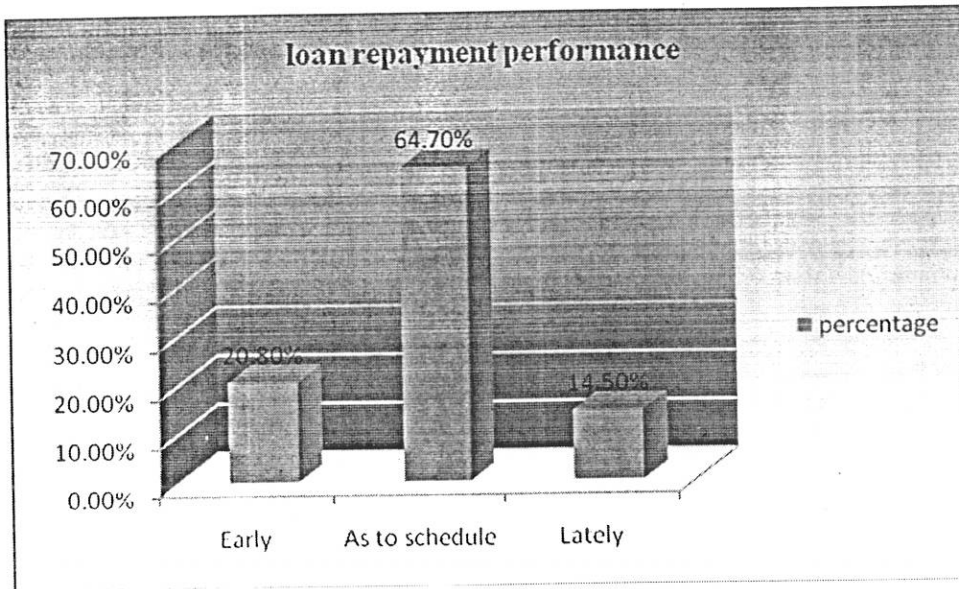
Source: Survey data

Table 5.11 (b) also indicates that around 85.5% of clients repaid their loan early and in accordance with schedule of the institutions. Few clients (about 15%) were unable to repay their loan according to the schedule. Urban clients had better repayment status than rural clients.

Clients' opinion about interest rate indicate, the institutions have two types of interest rates, 16 percent on lending and 4 percent interest on savings. Most of the sample respondents reported that the interest rate on saving is somewhat satisfactory (28%) and satisfactory (10%). However, 61.8% of the sample respondents complained that the lending interest rate is too high as compared with saving interest rate. They complained by saying interest rate on saving is not satisfactory. None of the sample respondents reported that the interest on saving is very satisfactory.

On the other hand, about 64% of respondents reported that the loan period is short. The data also revealed that 36% of the respondents have reported that the loan repayment period is satisfactory. There is no client that reported that the loan repayment is long. Loan repayment performance of the sample respondents can be shown graphically as follows:

Chart 5.7: Loan repayment performance of the sample respondents



5.5. Household Income and Savings

Households with higher income levels have more choices, can better meet their basic needs and have better opportunities. The assumption is that the client is expected to benefit from the loan in terms of improving income, consumption expenditure and diversify the sources of income which indirectly improve the living standard of the client.

Table 5.12: Clients' income level and source of income

<i>Description</i>	<i>Responses</i>	<i>Frequency</i>	<i>Percent</i>
What is your monthly income , on average	Less than birr 100	-	--
	From 101 to birr 200	98	56.7%
	From 201 to birr 300	21	12.1%
	Above birr 300	54	31.2%
Do you have source of income before the loan?	Yes	24	14%
	No	149	86%
Do you own animal? Before loan After loan	Total	173	100%
	Yes	42	25%
	No	131	75%
	Yes	57	33%
	No	116	67%

Source: Survey data

As indicated in the table above, the large majority of the sample respondents (57%) had an income, on average, from birr 101 to birr 200. However, the majority of the respondents reported that their average monthly income is rising. Most of the respondents that replied as their income is rising are those who engaged in income generating activities. Only 12% of the sample respondent had monthly income, on average, from birr 201 to 300.

On the other hand, as reported by the respondents, none of the sample respondents had a monthly income less than birr 100 and the households that had a monthly income above birr 300 constitutes 31%. Those who invested their loan on profitable activities have higher monthly income than those who used for non-income generating activities. The overall responses of the sample respondents' monthly income, on average, have indicated an improvement after they took

the loan. Only few respondents reported no change on their income per month, after they took the loan.

As indicated in table 5.12, the large majority of the sample respondents (86%) had not any source of income while few (14%) respondents had source of income before they took the loan. Similarly, the respondents asked whether they have animal before and after they took the loan. The results also reveal that most of the respondent, (75%) reported that they have not owned animal before and after taking the loan. Some of them (around 25%) have animals before taking the loan. Only few respondents replied that they own animals after joining the programme. This constitutes around 33%.

5.5.1. Impact on Savings

There are two types of savings compulsory and voluntary savings. Compulsory saving is normally enforced and started immediately as soon as the loan is approved for the program participant. Compulsory saving includes compulsory group saving, compulsory center saving and compulsory individual saving. Group saving is a deduction of 10% of loan disbursed to an individual. This group saving is serves as collateral for the group members. Compulsory individual savings ranges from birr three to six and compulsory center saving ranges from birr two to four per month.

Table 5.13: Respondents' saving types and purpose of saving

<i>Description</i>	<i>Responses</i>	<i>Frequency</i>	<i>Percent</i>
Do you have savings?	Yes	173	100%
	No	-	-
What types of saving?	Voluntary		
	Compulsory	173	100%
	Both(voluntary& compulsory)	67	38.7%
For what purpose do you save?	Loan repayment	94	54.3%
	Safety of cash	11	6.3%
	Social security	5	2.9%
	Food security	16	9.2%
	Education and medical	2	1.2%
	Agriculture	26	15.0%
	Asset building	19	10.9%
What is the source of money for saving?	Business and farm	76	44.0%
	Local lenders	61	35.3%
	Friends	36	20.7%

As clearly shown in the above table, all of the sample respondents have saving account at the institutions from where they borrowed the money. The table also indicates that 100% of the sample respondents have reported that they have compulsory saving at the institutions. This indicates that they have higher compulsory saving than voluntary saving. Only 67 (38.7%) respondents replied that they have individual (voluntary) and compulsory saving at the institution.

When respondents were asked about their source of money for saving, 76 (44.0%) of the sample respondents reported that the money was from business profit (most of these respondents are those who used their money or the loan to expand their existing business and those who started

new businesses like retailing and the likes. On the other hand, 97 (56%) of the sample respondents have reported that their source of money for their saving was money borrowed from local lenders and friends.

The respondents also asked for what purpose they save. The responses in the table reveals that most of the sample respondents 94 (54.3 %) reported that they save their money for loan repayment and (25.9 %) replied that they save for agriculture and asset building.

The remaining purposes, this means safety of cash, social security, food security and education and medical constitute only 19.8%.

Chart 5.8: purposes of saving by the Sample respondents

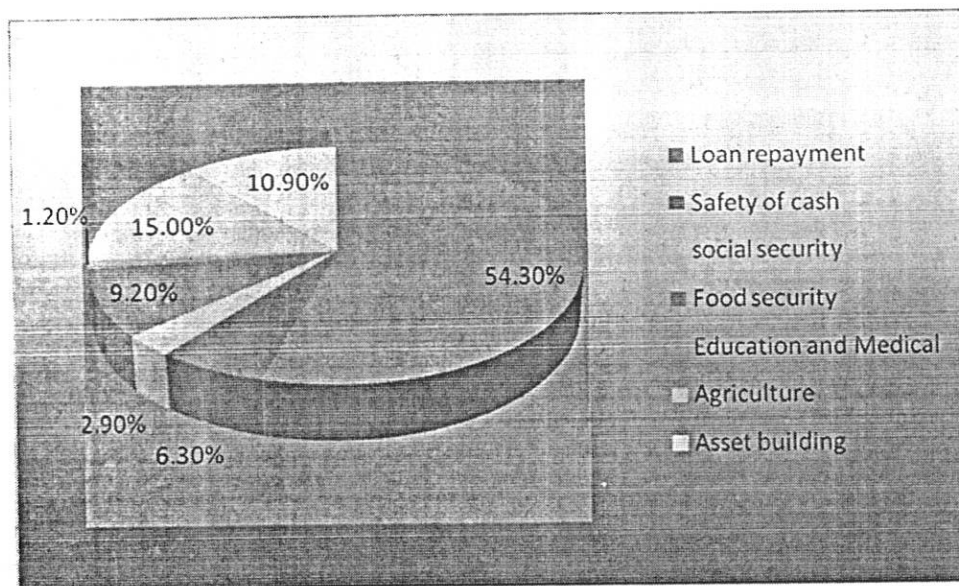


Table 5.14: trends of household saving

During the last years, have your cash saving				<i>Total</i>
Indicators	Increased	Remain the same	Decrease	
Frequency	113	26	34	173
Percent	65.3%	15.0%	19.7%	100%

Source: - survey data

Micro finance is expected to improve the long term economic and social security of its clients through wealth creation, income increase, asset building, etc which can be resulted from saving. The assumption is that the intervention of the microfinance through the provision of financial services, especially credit that aimed at enhancing the welfare and economic situation of its clients by availing adequate finance to engage them in income generating activities. On the other hand, if the loan is used for non-productive activities such as consumption, microfinance intervention will not bring the intended roles, which are poverty reduction and improving the standard of living.

Respondents were asked to give information about their saving trends during the last years. Participation in microfinance service has an expectation that leads to increase in household saving. Accordingly, out of the sample respondents, 113(65%) of the respondents replied that their saving has increased in the past years, 26(15%) of the sample respondent reported that their saving has not experienced change and 34 (20 %) of the sample respondents replied that their saving has decreased in the previous two years.

Most of the respondents, who replied as their saving increased during the last two years, are those who invested their loan on profitable activities. All of the enterprises organized as small micro enterprise have reported that their saving increased during the last years.

Table 5.15: Rejoining decision and perception of family members

<i>Description</i>	<i>Responses</i>	<i>Frequency</i>	<i>Percent</i>
Considering rejoining the program	Yes	127	73.4%
	No	15	8.6%
	Undecided	31	18.0%
Immediate family members opinion about the program	Favorable	107	61.8%
	Unfavorable	43	24.8%
	No opinion	23	13.4%

Source: Survey data

An attempt was made to know their decision regarding to rejoin the program or not. Accordingly, 127(73.4%) of the sample respondents replied that they have decided to participate in the program. The majority of these respondents who decided to rejoin the program are those who invested their loan on profitable activities. All clients that organized as small and microenterprises reported that they decided to work with their loan providers. Even most of the respondents who used their loan for consumption purpose reported that they will rejoin the program if the institution accept them. They added, since we don't have other source for our survival we don't have alternative rather rejoining the program. Only 15 (8.6%) of the sample respondent reported that they have decided not to rejoin the program. The remains respondents

told me that they will decide being on the time. The majority of the participants' family opinion about the program was positive (favorable). The rejoining decision and family's opinion are shown separately by the following charts.

Chart 5.9: Rejoining decision by the sample respondents

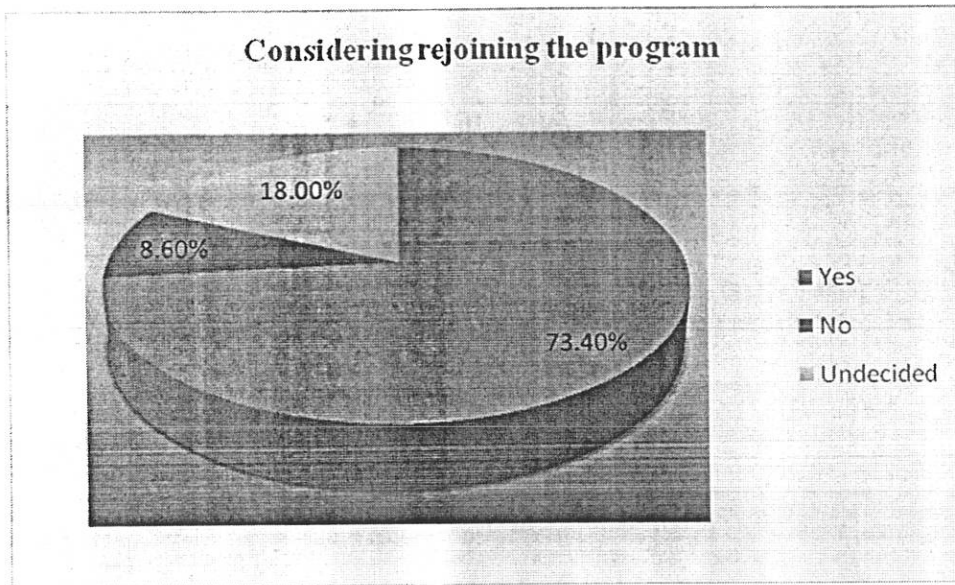
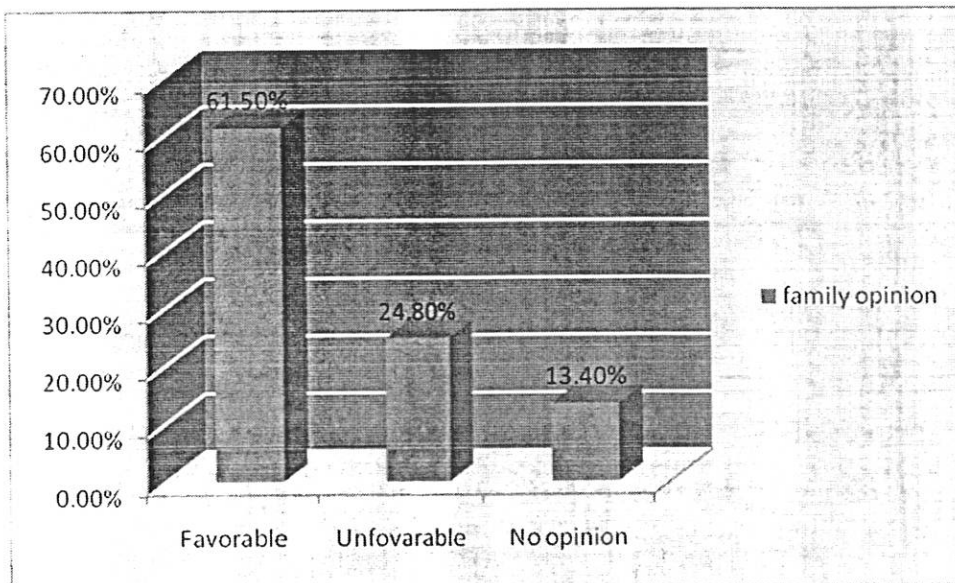


Chart 5.10: Perception of family members



5.6. Overall Impacts of Microfinance Institutions on Clients

Microfinance involvements are expected to support client in ensuring food security, which is one of the main objectives of the institution and the prime concern of all household is ensuring food security (Tsehay and Mengistu, 2002). The condition of diet (nutrition) is an important factor in the well being of the household members. Thus, the assumption of this variable is that the participants of the microfinance scheme will have a better household diet. Based on the survey study, it shows that the average monthly revenue of small business clients is more than monthly expenses and it generates average monthly profits. A great significant percentage of respondents expressing their living conditions have improved since they obtained loans. This improvement leads to improved in food security, house construction, able to send children to school, improved family health, purchase additional oxen and saving. Accordingly, 62 (35.8%) of the sample respondents reported that their food security is improved. 11 (6.4%) respondents replied that they can construct new house after they joined the program. As children and other school age dependents of the poor house holds have marginal access to educational facilities, credit provision for income generating activities is expected to improve this situation (Birhanu, 1999). Most of the sample respondent replied that they able to send children to school and improved food security. In general, around 84% of the sample respondents reported that their living conditions have improved since they obtained loans.

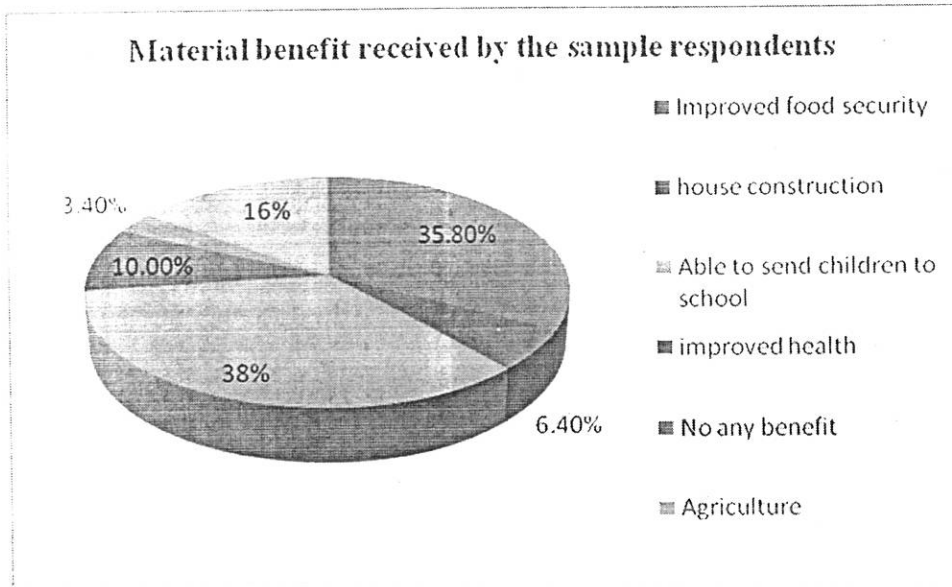
Table 5.16: overall benefits and living standard level (valid n = 173)

<i>Description</i>	<i>Indicators</i>	<i>Frequency</i>	<i>Percent</i>
What material benefit you get by joining the program	Improved food security	62	35.8%
	House construction	11	6.4%
	Able to send children to school	66	38.2%
	Improved health	19	10.0%
	Purchase additional oxen	6	3.4%
	No any benefit	28	16.1%
How Satisfied are you with your current standard of living?	Satisfied	89	51.5%
	Neither satisfied nor dissatisfied	67	38.6%
	Dissatisfied	13	7.5%
	Don't know	4	2.4%

Source: Survey data

The survey results regarding how satisfied the clients with their current standard of living reveal that 89(51.5%) of the sample respondents have reported that they are satisfied with their current living standard. 67(38.6) of the sample respondents reported that they are neither satisfied nor dissatisfied with their current standard of living. About 8% of the sample respondents have replied that they are not satisfied with their current living standard. Percentages of material benefits received by the participants of MFIs are shown in the following chart.

Chart 5.11: Material benefit received by the sample respondents



As it was mentioned in the methodology part of this research, there was a questionnaire to MFIs' staff and interview with the manager of each microfinance institutions. Based on this questionnaires and interview, an attempt was made to know the view of these sample respondents with the OCSSCO, BG, and PEACE'S micro financing scheme in the study areas.

From questionnaires for the staffs, information gathered in r elating with the cell phone services and the transportation. The sample respondents reported that all of the areas that they are operating currently have phone and transportation services.

Regarding the amount of group size over the three years the respondents of each microfinance institution replied that the amount of their group size has dramatically increased for last three years. The staffs were also asked to list some of their institution strengths. Accordingly, all staffs' of OCSSCO reported as the institution has good personal evaluation, low default rate, and financial statements are audited. Around 86% of the sample respondents added some other strength of their institution. As to these staffs, women are well represented in the field agent staff. On the other hand, lack of long term planning and expected increases in demand for loan capital

not fully funded are listed by around 57% of the sample respondents as the weaknesses of their institution. The remaining 43% of the sample respondents replied that the company has no any weakness.

Information was collected on the goals of their institution. The findings of the study indicates that, around 94% of the respondents replied that the goal of there organizing is to serves large number of poor. Only 71% of the sample respondents have reported that their organization's goals are providing high quality financial serviced and serve large number of clients.

Furthermore, staffs' were asked about the criteria their institution use to select the potential clients, all of the sample respondents replied that willingness to join credit group of self selected members, willingness to save, and support letter from kebele and being above age of 18 and below 60 year are the major criteria. However, 57% of sample respondents reported that in addition to the above criteria, their institution use prior experience of saving and loan repayment.

The survey result regarding the services that institution is offering, all respondents reported that their institution offer loans, training, saving facilities and women empowerment similarly ,the respondents around 86%of the sample respondent reported that their main challenge that constrain not to be efficient is less saving habits. The result also shows that 71%of the sample respondents reported that the challenges that constraint their MFI not to be efficient is that many donors are not keen about MFIs and reluctant to fund. Limited loan product is also reported by 47% of the sample respondents as another construction for their institution.

Respondents were also asked what their institution could do to improve their services. Accordingly, 75% of the sample respondents reported that the institution should have quicker access to loan. On the other hand, 83% and 72% of the sample respondents reported that the institution should provide higher loan amount and better saving facilities respectively. Only 28% of the sample respondents were recommends their institution to provide individual loans

CHAPTER SIX

Summary, Conclusion and Recommendations

6.1. Summary

To sum up, the study has used questionnaire and semi-structured interviews as a major source of data and used table, figure, charts and text for analysis to assess the role of microfinance institutions in reducing poverty and improving the living standard of those who joined the program with respect to income increase, asset building, and saving within the clients before and after the availing of loan.

The data analysis shows us that the main reason by clients for joining the programme is due to financial problem and most of them have participated in the program for long period of time. The analysis also shows that there is somewhat significant increase in income, asset building and saving of the households after the availing of loan from the Micro Finance Institutions.

6.2. Conclusions

The present study concludes that the Microfinance Institution has a great role in increasing the income, asset position and saving and improve food security, improve ability to send a children to school, house quality and so on which can directly contribute to poverty reduction and improving the living standards of the loan members. From the above discussions, it is also concluded that microfinance is efficiently serving the poor by providing timely loan and by allowing them to save as much as they can.

6.3. Recommendation

6.3.1. Recommendations for future study:

The present study has recommended the following points for understanding future studies by the researchers:

- (i) The study could have provided better results if more number of kebeles had been covered.
- (ii) Take a long time to deal with this issue as it is broad and benefit thousands of Ethiopian poor community and if focus group discussion is added the result will be more fruitful.

6.3.2. Recommendations for Microfinance Institutions and Clients

Further more; the following recommendations are also made on the basis of this study for microfinance institutions and clients of the microfinance institutions.

- Microfinance institutions ought to make an effort to increase the Loan size to meet the requirements of borrowers. This is based more on suggestion of clients organized as small and microenterprises. According to these clients, the loan was not sufficient to run the projects as it is initially proposed.
- When the researcher see the training provided by these microfinance institutions, they have provided training on utilization of loan sufficiently and many clients who have business Knowledge are benefited from better utilization of the loan. But follow up on the actual destination of the money borrowed is less. So, the institutions should work hard on post-loan evaluation.

- Most clients complained on the amount of interest rate on lending money. The researcher also recommends the Microfinance institutions to decrease their interest as much as possible so that more and more applicants can avail microfinance facilities.
- As indicated in the discussion part, most clients used their loan for unintended purposes. The researcher's recommendation to these clients this means for those who used their money for other purposes is that before borrowing the money please identify the income generating area and invest the money on that area so that you will be benefited from the program.



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Appendices

Questionnaires for field interview
Questionnaire for Client

Name of interviewer: _____

Date of interview: ___/___/2011

Village _____

Lending Institution _____

Language in which interview was conducted: _____

Introduction

I am one of the students of Addis Ababa University studying Accounting and Finance. As partial requirement of the program I am undertaking a research study titled the role of Microfinance Institutions in poverty reduction and improvement in living standard a case of Oromia credit and saving Share Company, Bussaa gonofa and PEACE in Lemu and Bilbilo Woreda.

The purpose of this questionnaire is to assess the role of Microfinance Institutions in poverty reduction and improvement in living standard and the results will be used to inform policy makers and development planners in the country with practical facts about the role of Microfinance Institutions in poverty reduction and improvement in living standard, especially in the people of Lemu and Bilbilo Woreda. Your individual answers will be kept strictly confidential. Your answers will be combined anonymously with all the others we talk with to form a report. I would highly appreciate and hope for your kind cooperation.

Part I. Borrower's Profile

* **Gender** male Female

* **Marital status** Married Widowed divorced/separated Single

* **Age** Less than 25 25-35 35-45 46-55 over 56

* **Level of education**

Illiterate adult literacy primary

Secondary high School other

* **Kebele** Bokoji 01 Bokoji 02 Kula kilole Bitana

* **Religion** orthodox Muslim Protestant

* **Occupation** business person civil servant farmer Retired

Questions

1. What organization (s) do you get your credit from?

- Oromia credit and saving share company
- PEACE
- Bussaa gonofa
- Other(specify)_____
-

2. Reasons for joining the programme

- Due to financial problem
- For my children's education
- Close to home
- Payment is very good as compared to other organisation
- To get experience and get a good job
- Payment is very good

3. Have you ever borrowed money from a microfinance institution before this time?

- Yes
- No

4. How did your group form itself?

- neighbors
- loan officer suggested group members
- group existed before for other reason
- other:_____
- family members and good friends

5. Have you been trained about loan utilization?

- Yes
- No

6. If yes, has it been satisfactory?

- Yes
- No

7. Amount of loan owed by Oromia credit and saving, Bussaa gonofa or PEACE clients

- Less than 2000
- 4000-6000
- 2000-4000
- 6000-8000

8. In the last 3 years do you normally harvest enough food crops to last the whole year?

- Yes
- No

9. What is your priority in life?
- Good health
 - Food security
 - Children's education,
 - Other(specify) _____
10. Do you have savings at the institution from where you borrowed?
- Yes
 - No
11. If yes, what type of savings?
- Compulsory
 - Both (compulsory and voluntary)
 - Voluntary
 - Others (specify) _____
12. During the last 12 months have your cash savings?
- Decreased
 - Increase
 - Stayed the same
13. For what purpose do you save? *You can select more than one.*
- Loan repayment
 - Education
 - Safety of cash (from theft or damage)
 - Medical
 - Social Security
 - Emergencies
 - Food Security
 - Agriculture
 - Asset Building
14. How do you repay your loans?
- proceeds from business
 - Get other debts
 - Sale of some property
 - Other(specify) _____
 - Transfer payments from relatives
 -
15. How is the interest rate?
- Not satisfactory
 - Satisfactory.
 - Somewhat satisfactory
 - Very satisfactory.
16. Is it easy to repay the principal amount plus interest?
- Yes
 - No

17. Did you ever fail to repay in time?

- Yes
- No

18. For what purpose did you borrow?

- education
- health expenses
- agricultural production
- consumption
- to pay back other loan
- other: _____

19. For what purpose have you actually used the last loan (more than one possible answer):

- education
- health expenses
- agricultural production
- service provision
- consumption
- to pay back other loan
- other: _____

20. What is your monthly income?

- Less than birr 100
- From birr 101 to birr 200
- From birr 201 to birr 300
- Above birr 300

21. Do you own animals?

- Yes
- No

22. Did you own animals in the past?

- Yes
- No

23. Have the loans improved your lives?

- Yes
- No

24. What material benefit you get by joining Oromia credit and saving, Bussaa gonofa or PEACE

- Improved Food Security
- House Construction
- Able to send children to school
- Improved health
- Purchase additional oxen
- Other benefit(specify)

25. Generally, how would you rate your standard of living?

- High
- Medium
- Low
- Fairly high
- Fairly low
- Don't know

26. Generally, how satisfied are you with your current standard of living?

- | | |
|--|--------------|
| <input type="radio"/> Very satisfied | Satisfied |
| <input type="radio"/> Neither satisfied nor dissatisfied | Dissatisfied |
| <input type="radio"/> Very dissatisfied | Don't know |

27. Considering rejoining the Oromia credit and saving, Bussaa gonofa or PEACE credit scheme?

- | | |
|---------------------------|---------------------------------|
| <input type="radio"/> YES | <input type="radio"/> undecided |
| <input type="radio"/> No | |

28. Immediate family members' opinion about the Oromia credit and saving, Bussaa gonofa or PEACE programme

- | | |
|-----------------------------------|---|
| <input type="radio"/> Favorable | <input type="radio"/> Want me to rejoin |
| <input type="radio"/> Unfavorable | <input type="radio"/> No opinion |

End of questionnaire - Thank you for your time!

Questionnaires

Dear respondents

I'm student who is studying for a master degree in Accounting and Finance at Addis Ababa University.

This academic questionnaire is to investigate the role of microfinance in poverty reduction and improving the living standard in Lemu & Bilbilo Woreda. I sincerely invite you to spend a few minute by filling out the questionnaire below. No personal information will be made public. Please be assure that your answer will be kept in strict confidentiality and take a time to fill out this questionnaire as accurate as possible. Your help is crucial for this research and also for future understanding of the role of microfinance in poverty reduction and in the improvement of living standard. I deeply appreciate your kind cooperation.

Thank you.

Faithfully Yours,

Dr. Venkati ponnala

Advisor

Department of Accounting & Finance

Addis Ababa University

Tolosa Negese

Student

MSc. Program

Addis Ababa University

Questionnaire of microfinance institutions (MFIs)

Name of the institution _____

Acronym _____

Telephone (Office) _____

E-mail Address _____

Position of the respondent _____

To be filled up Enumerator (branch level)

1. Cell phone service.

Yes No

2. Is there regular land transportation (indicated by public transport such as bus , horse cycle,
Other means of road transport)

Yes No

3. Amount of Group size for last three years

Stable

Decreased

Increased

we don't know

4. What are the strengths of your institution

MFI charges what
appears to approximate
a market rate of interest

Ratio of head office staff
to field staff

Low staff turnover

Looks reasonable

Good personal
evaluations

Low default rate

Pay incentives for field
agents

Financial statements
are audited

Most funds kept in
bank where safe

- Women are well represented in the field agent staff.

5. What are the goals of your organization?

- Serves large numbers of the poor
- Provides high quality financial services
- Low costs
- Other (specify)_____

6. Criteria (s) your institution use to select the potential clients (please tick the criteria (s))

- Willingness to join credit group of self selected members
- Willingness to co-guarantee the loan of fellow group members.
- Prior experience of saving and loan repayment
- Willingness to save
- Support letter from Kebele
- Being above age of 18 and below 60 old.
- Other (specify)_____

7. Which of the followings are challenges that constrain the MF is operation not to be efficient?

- Many donors are not keen about MFIs and reluctant to fund.
- Less saving habits.
- Limited loan products
- Absence of legal title of assets in rural areas
- Some clients are not victory they opt for immediate benefits in illegal way.
- Less willingness from commercial banks to lend to MFIs without collateral
- The legal environment is not conducive enough in enforcing the loan contract
- Shortage of experienced human resources
- Other (specify)-----

8. What are the reasons why the protest women and men don't participate in micro credit programs?

- Self exclusion (lack confidence, skills and market contacts)
- Shortage of time
- Peer group exclusion peer groups (as well as staff) may have a tendency to experience repayment difficulties.
- High loan floors can also make credit inaccessible for the poorest.
- Supply- side factors (e.g inability to identify remunerative income generating opportunities).

9. What could your microfinance institution do to improve their services?

- Quicker access to loans
- Higher loan amounts
- Better savings facilities
- Individuals loans
- Other _____

10. What services does your microfinance intuition offer?

- Loans
- Savings facilitates
- Training
- Women empowerment
- Other _____

Respondent's characteristics

Now that you have filled the questionnaire, I sincerely appreciate your time and effort to answer the above questions. Your answer will be treated in strict confidence. For my information, would you please indicate the following questions.

- ☐ Gender male ☐ Female ☐
- ☐ Marital status Married ☐ Widowed ☐ divorced/separated ☐ Single ☐
- ☐ Age Less than 25 ☐ 25-35 ☐ 35-45 ☐ 46-55 ☐ over 56 ☐
- ☐ Level of education
 Illiterate ☐ adult literacy ☐ primary ☐
 Secondary ☐ high School ☐ other ☐

Addis Ababa University
School of Graduate Studies
Faculty of Business and public Administration
Department of Accounting & Finance

Interview question

Institution _____ Enumerator _____ Date _____

Dear Respondent

The purpose of this questionnaire is to gather information to write a research paper on the role of microfinance in poverty reduction and improving the living standard of society in Lemu & Bilbilo woreda. Personal response of interviewees would be kept confidentially and there would not be any link between status on the program and responses. Therefore, you are kindly requested to give accurate information as much as possible.

Thank you.

Part I. the respondent

Name _____

Age _____

Education level _____

F. B. A.
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Part II. Questions

1. Have you had any problems keeping focused on the primary mission of your institution? Do you? Do you have any plans to modify your missions? Review client breakdown and average loan size in light of response.
2. Number of Employees _____ Gross Loan portfolio and _____ Active borrowers by the end of 2002 _____ Size of MFI in Assets _____
3. Minimum Loan size (In birr) _____ Maximum Loan size _____
4. What is the current lending methodology of your institution?
 - Group lending
 - Individual lending
 - Credit Unions
 - Village Banking
 - Self help group
 - Other(specify) _____
5. Which sectors of the community are not currently being served and have the most potential?
6. What method do you utilize to determine the MFI's impact on the client and /or community? *If there are written impact studies, ask for copy.*
7. How do you ensure that your loans ultimately are used for productive purposes (& not consumer)? Does the MFI conduct any post-loan evaluations that verify the actual destination of the money?