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RESEARCH ARTICLE

THE ROLE AND PERFORMANCE OF MICROFINANCE INSTITUTIONS (MFIs) IN ETHIOPIA

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ABSTRACT

Ethiopia that is located in Northeastern part of Africa, has an estimated population of more than 75 million inhabitants, of which a 50% population of approximately below poverty line, Ethiopia had an estimated Gross Domestic Product(GDP) per capita in 2015 of US$ 597 (International Monetary Fund (IMF) - World Economic Outlook April 2014). Over 80% of the Ethiopian population lives in rural areas and 45% of the population lives below the official poverty line. Microfinance Institutions (MFIs) in the country are contributing to poverty reduction by providing loans and to mobilizing savings from low-income segments of the population. The objective of this paper is mainly to study the role and performance of Microfinance Institutions during the period of 2004-2014. In this study, the researcher purely used secondary data mainly from annual reports of National Bank of Ethiopia and other sources. This paper ensured some of the problems facing most of the MFIs in general and finally put forwarded possible suggestions.

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INTRODUCTION

People living in under-developed countries like Ethiopia and countries within the East-African region can access needed financial resources through the services provided by microfinance institutions. Microfinance institutions are an asset to the developing and transition countries. The services they provide are tailored to meet the needs and aspirations of the local inhabitants and emphases are towards the poor (Asmamaw Yigzaw, 2014). Microfinance institutions (MFIs) are relatively small depository financial institutions. They accept checkable deposits in small quantum and similarly give out loans in small quantum for a relatively short duration of less than one year to poor individuals and microenterprises. As financial products, microfinance refers to micro savings, micro credits or microloans and micro insurance (Nicholas Gregory Okello *et al*., 2015). Accordingly microfinance institutions are considered as the main tool by developing countries to overcome poverty through accessing financial service for the productive poor section of the society who are affected by lack of access for credit and other related financial services (Derbew Kenubeh, 2015).

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Review of Literature

The development of microfinance institutions in Ethiopia since 1996 has been a remarkable progress in poverty reduction. Numerous descriptive studies have ensured that microfinance is an effective tool to eradicate poverty in Ethiopia but evidence from quantitative studies is mixed. Derbew Kenubeh (2015), examined with the objective to identify and highlighting the key challenges facing officials of microfinance institutions by taking a case study of Amhara Credit and Saving Institution, Ethiopia and found that the officials of the institutions facing several challenges emanated from system of the organization and from the side of clients and suggested that the policy makers and institution itself should give emphasis to avoid the challenges facing officials.

Mohammad (2010), stated in his study that microfinance institutions faced many problems and suggested that the government needs to play an important role to accelerate the sector and provide essential facilities to minimize challenges and strategic policy towards the microfinance sector should be developed and design to boost and defend the challenges of in future. Mutambanadzori and Makunike (2013), Assessed some of the problems faced by microfinance institutions in Zimbabwe in providing financial services to the poor and informal sector.

Their major findings were that MFIs are facing funding challenges, have poor corporate governance structures and management Information Systems (MIS) have not been fully exploited. Further, they suggested that MFIs must be adequately regulated and be encouraged to have suitable governance structures in order to attract funding. Andinet Asmelash, (2013), chose the main objective in his study is to assess the institutional viability and financial performance and draws conclusions and makes recommendations for improving the institutional viability and financial performance of the MFIs. In this study the researcher focused the micro financing and its impact in Ethiopia by selecting three microfinance institutions in Addis Ababa to know the problems in achieving institutional sustainability and strong financial performance by taking selected indicators and also concluded that the Microfinance institutions, regardless of their social mission, are financial intermediaries and emphasized that should be financially viable and sound to achieve its mission.

Cécile Lapenu, (2000), made review in his study that the respective role of the state, the NGO and the private commercial banks in increasing their outreach and in adopting microfinance innovations and also analyzes different issues regarding regulation of MFI. The researcher stated in his conclusion that roles of the state is necessary to promote MFI. The role of the state encompasses insuring a minimum banking structure in the rural areas, subsidizing microfinance start-up capital and innovations, and investing in complementary services such as infrastructure, health, and education. The state must also develop a clear and flexible regulatory framework for MFI with the means to enforce the rules for the supervisory bodies. Further, he also concluded that efficient governance is more of a determinant than the distinction of ownership by the private or the public sector for the performances of the MFI.

Need and importance

Microfinance institutions have been primarily made to believe to come up as a tool to alleviate poverty by creating more employment opportunities for the Small and medium enterprise (SME) sector, better healthcare systems, extending small and trouble free credit to the poorer section of society for their immediate business and social needs (2015, the Menace of Microfinance in India). The need to address poverty has been viewed as an anti poverty tools of the development problems in Ethiopia because it helps the unemployed became employed, thereby increasing their income, consumption and reducing poverty. As a result, the intervention of micro finance will have a significance effect in reducing poverty at a micro and macro level (Mengistu, 1999). The poor in Ethiopia have low income that led to low investment which intern low productivity and income.

The potential demand of the poor for micro credit is enormous. However there is a limited supply of financial services to the poor. Currently the country has 35 MFIs, which were 14 of them are operating in Addis Ababa. They provide saving mobilization, loan provision and to some extent micro insurance services. By providing such financial services to microenterprise operators both in urban and rural areas, they opened up the start of making the financial sector more inclusive. It should be noted, however, that their contribution to these services is still extremely small (Getnet alemu Zwedu, 2014).

Objectives of study

The main objective of this paper is to assess the role and performance of Microfinance institutions (MFIs) operating in Ethiopia. Specifically, it ensures the need and importance and also administration of MFIs. Further, to assesses some of the problems and prospects of MFIs and finally, puts forward possible solutions to the problems.

Sources of data

In this study, the researcher used only secondary data, which is collected from various sources such as books, journals, articles, official reports of the organizations and also official websites. Particularly the main source of the data for this research paper from annual reports of National Bank of Ethiopia (NBE).

Role of microfinance institutions

A main goal of many micro finance institutions is to provide sustainable micro finance facilities to the poor to facilitate income generation and reduce poverty (Baumann, 2001). Access to credit can play a pivotal role in economic growth. Banks and lending institutions provide the services that allow people to save and invest available assets and resources, which further support and strengthens economic activity. Within underdeveloped communities, the role of microfinance institutions provides the credit access and financial services needed to develop income-earning businesses (Jacquelyn Jeanty, Demand Media). MFIs fill a needed gap within the financial services industry by offering small loans, or micro-loans, to people unable to access conventional loan services. Microfinance institutions vary in size and function with some organizations focusing entirely on microfinance, while others work as extensions of large investment banks.

MFIs provide a reliable source of financial support and assistance compared to other sources for financing. MFIs typically work alongside government organizations and also have ties with larger global organizations. To meet unsatisfied demand for financial services, a variety of microfinance institutions (MFIs) has emerged over time in Ethiopia.

The emergence and development of modern microfinance institution in Ethiopia is recent phenomenon that happens because of formal financial system like commercial banking system was very limited and could not address the financial need of poor households for the fact that they are not their ultimate target client (Derbew Kenubeh, 2015). The international monetary fund (IMF) ranks Ethiopia as among the five fastest growing economy in the world. For this economic improvement microfinance institutions have a lion’s share and the government has well recognized MFIs as one of the important tool for achieving the first millennium development goal.

Administration

The formal microfinance in Ethiopia started in 1994. In particular, the Licensing and Supervision of Microfinance Institution Proclamation of the government encouraged the spread of Microfinance Institutions (MFIs) in both rural and urban areas as it authorized them among other things, to legally accept deposits from the general public (hence diversity sources of funds), to draw and accept drafts, and to manage funds for the micro financing business (Gobezie, 2005). MFIs at present there are 35, 8 of which have activities in regional areas covering the absence of the large commercial banks. The owner ship structure of micro finance institutions in Ethiopia includes regional government, associations, non-government organizations and individuals. Although many of the micro finance institutions in Ethiopia are established as private share companies. All types of micro-finance institutions are under the supervision of the National Bank of Ethiopia (NBE). The National Bank of Ethiopia issues the license for the establishment of micro-finance institutions and they have an obligation to hand in monthly reports to the bank. Also, the NBE provides annual operational guidance to the institutions (Embassy of Japan in Ethiopia, 2008). According to the National Bank of Ethiopia, the Table No.1 shows the list of MFIs within the territory of Ethiopia at present

Performance of Microfinance Institutions

The overall progress and performance of MFIs of the Ethiopia have been presented in the below table 2 using secondary data from the annual reports of National Bank of Ethiopia during period 2004-2015.

Interpretation (2004-05 to 2014-15)

According to the National Bank of Ethiopia, the number of MFIs in the country has reached 35. By the end of 2013/14, the number of micro-finance institutions (MFIs) operating in the country reached 31. Their overall performance was encouraging as their total capital and total asset increased by 24.6 and 38.6 percent and reached Birr 5.6 billion and Birr 24.5 billion, respectively.

At the same time, their deposit mobilization and credit provision have expanded remarkably. Compared to last year, deposit mobilization of MFIs went up by 54.8 percent and reached Birr 11.8 billion while their outstanding credit rose by 31.9 percent and reached Birr 16.8 billion indicating their expanded outreach. The four largest MFIs, namely Amhara, Dedebit, Oromiya and Omo Credit and Savings institutions accounted for 74.9 percent of the total capital, 84.0 percent of the savings, 80.6 percent of the credit and 81.6 percent of the total assets of MFIs at the end of 2013-14(NBE, 2013-14).

As overall performance, According to the National Bank of Ethiopia, the number of MFIs in the country has reached 33. In 2004-05, registered MFIs total capital and total asset were Birr 0.5 billion and Birr 1.9 billion and reached to 5.7 billion and 24.5 billion in 2013-14 respectively.. Similarly their deposit mobilization and credit extension have witnessed a significant growth. That is In 2004-05 saving deposits and loan outstanding were Birr 0.5 billion and Birr 1.4 billion and reached to Birr 11.7 billion and Birr 16.8 billion in 2013-14 respectively. The ratio ranges between 69 and 84 percent for all the years implies the remaining 31 to 16 percent were in the form of other assets. The saving liability to asset ratio grew steadily and reached 48 percent in 2013-14. The sum of capital asset ratio and saving liability to asset ratio touched its highest point of 71 percent (23 percent + 48 percent) in 2013-14 and its lowest point of 57 percent (30 percent + 27 percent) recorded in 2004-05. It is apparent that the remaining balance, 29 percent for 2013-14 and 43 percent for 2004-05, are from grants, subsidized loans and commercial loans.

General Problems of microfinance institutions

Most of the MFIs in Ethiopia have been facing a number of problems that need to be addressed to enable them to improve outreach and sustainability and grow.

The major hurdles to the development of microfinance institutions in Ethiopia have been stated in Table 3 given below:

Table 1. Microfinance Institutions operating in Ethiopia

S. No.	Name of the Microfinance Institution	S. No.	Name of the Microfinance Institution
1	Amhara	19	Metemamen
2	Dedebit	20	Dire
3	Oromia	21	Aggar
4	Omo	22	Letta
5	Specialized Financial Promotional	23	Harbu
6	Gasha	24	Digaf
7	Wisdom	25	Harar
8	Sidama	26	Lefayeda
9	AVFS	27	Tesfa
10	Buusa Gonofa	28	Dynamic
11	PECE	29	Somali
12	Meket	30	Specialized Financial and Promotional Institution
13	Addis	31	Lideta
14	Mekit	32	Nisir
15	Eshet	33	Adaday
16	Wassasa	34	Rays
17	Benishangul-Gumuz	35	Gambella
18	Shashemene		

Source: National Bank of Ethiopia (Website: http://www.nbe.org)

Table 2. Microfinance Institutions Performance in Ethiopia during the period of 2004-05 to 2014-15

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Items	During 2004-05	During 2005-06	During 2006-07	During 2007-08	During 2008-09	During 2009-10	During 2010-11	During 2011-12	During 2012-13	During 2013-14	During 2014-15
Number of MFIs	25	26	28	28	28	30	31	33	31	31	35
Total Capital	568,200.0	794,600.6 (39.8)	979,265.0 (23.2)	1,339,951.5 (36.8)	1,737,402.7 (29.7)	2,375,228.0 (36.7)	2,945,970.0 (24)	3,755,479.9 (27.5)	4,536,577.6 (20.8)	5,652,005.7 (24.6)	7,187,259.5 (27.1)
Saving Deposits	509,585.5	715,953.3 (40.4)	1,039,961.6 (45.2)	1,560,971.3 (50)	2,098,742.1 (34.5)	2,658,962.0 (26.7)	3,779,089.0 (42)	5,450,593.5 (44.2)	7,611,397.0 (39.6)	11,784,059.6 (54.8)	14,832,747.4 (25.9)
Loan outstanding	1,482,153.9	1,960,469.3 (32.2)	2,735,660.4 (39.5)	4,474,976.8 (63.5)	4,936,135.2 (10.3)	5,824,489.0 (18)	6,991,986.0 (20)	9,289,642.6 (32.9)	12,781,816.6 (37.6)	16,855,556.8 (31.9)	21,827,337.3 (29.5)
Total Assets	1,904,256.9	2,550,962.8 (33.9)	3,482,657.0 (36.5)	5,340,608.7 (53.3)	6,620,630.8 (24)	7,958,194.0 (20.2)	10,156,387.0 (27.6)	13,308,200.1 (31.0)	17,700,416.3 (33.0)	24,535,850.0 (38.6)	30,562,012.20 (24.6)
Loan outstanding to asset ratio (%) (L/TA)	78	77	78	84	75	73	69	70	72	69	71
Loan outstanding to capital ratio(%) (L/TC)	261	247	279	334	284	245	237	247	282	298	304
Capital Asset Ratio (%) (TC/TA)	30	31	28	25	26	30	29	28	26	23	23
Saving liability to asset ratio (%) (SD/TA)	27	28	30	29	32	33	37	41	43	48	48

Note: Data in the parenthesis ( ) percentage change.
Source: Compiled by the researcher from Annual Reports of National Bank of Ethiopia (2004-05 and 2014-15)

Table 3. General problems of Microfinance Institutions

In view of the Government	In view of Microfinance Institutions	In view of Clients
a)Inadequate governance and management capacity b)Limited outreach c)Limited access to funds d)Unfavorable image e)Limited programs f)Limited allocation of funds etc.	a)Lack of capital b)Absence of borrowers' credit background c)Lack of performance standards d)Lack of management capacity e)Lack of training to the staff f)Lack of technical skills g)Lack of infrastructure facilities h)default borrowers i)No strict supervision and monitoring. j)Shortage of experienced human resources k)Shortage of logistics in rural areas such as road, telephone etc. l)Design and implementation of the regulatory frame work etc.	a)Non-availability of middle size loans b)Non-accessibility of MFIs services in some of the areas. c)Lack of awareness of microfinance d)Delay in application process and approval e)Defaulters f)Lack of close relationship between institution and borrowers g)High interest rates etc. h)Demand for collateral i)Less women participation etc.

The above general problems of MFIs may have the following suggestions:

Authority wise Government should

- Make appropriate policy for developing good governance
- Provide proper resource for improving management capacity
- Find the sources for accessing of required funds
- Always create favorable image
- Implement more and new programs for sustainable development
- Allocate sufficient funds for Microfinance
- Implement special and new schemes or programs for encouraging women entrepreneurs
- Spread over MFIs services where there is no accessibility

Institutional wise the MFIs should

- Find source of capital and also increase the capital
- Extend outreach amounts
- Have proper enquiry about potential background of borrower before granting of loan
- Improve of performance standards
- Improve management capacity
- Provide periodically training to the staff
- Recruit technical skill persons
- Provide awareness about institutions
- Provide infrastructure facilities
- Make arrangement of settlement of default borrowers
- Follow strict supervision and monitoring
- Recruit experienced human resources
- Accommodate for providing middle size loans also
- Frame quick process in application and approval procedures
- Take action towards make close relationship between institution and clients
- Maintenance of reasonable interest rates in favor of clients
- Customer wise the People should
- Aware of Microfinance programs and their benefits
- Prompt and built confidence to get further loan from institution
- Do timely repayment
- Proper utilization of funds

Conclusion

From this study analysis one concludes that MFIs are broadly contributing to the country's efforts to reduce poverty and enhance savings mobilization for investment and growth. By the end of 2014-15, as per the annual report of National Bank of Ethiopia (NBE), 35 MFIs have been registered with the national bank of Ethiopia and operate under the auspices of proclamation no. 40/1996 in the country (rural and urban areas) and accordingly their total capital and total asset reached Birr 7.2 billion and Birr 30.6 billion respectively. Deposit mobilization and credit offering activity also revealed a remarkable increment i.e. reached Birr 14.8 billion and Birr 21.8 billion respectively. This increment in number of microfinance institutions, growth in capital, assets, deposit mobilization and loan deployment, however is not enough to fulfill the development goal of Ethiopian economic development strategy, further the Ethiopian government has to give more emphasis to the strategy to alleviate poverty through microfinance institutions and to bring significant economic development in the country from time to time.

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