Science for resilient livelihoods in dry areas

Ethiopian Microfinance Assessment Report: A case for entrepreneurship skills development for youth in sheep fattening

Esayas Mulatu Morka[1] and Jane Wamatu[2]

[1] Business development consultant
[2] ICARDA

October 2020

WORKING PAPER

ISSN 2709-7757

9 772709 775008 00220

About ICARDA

Established in 1977, the International Center for Agricultural Research in the Dry Areas (ICARDA) is a non-profit, CGIAR Research Center that focusses on delivering innovative solutions for sustainable agricultural development in the non-tropical dry areas of the developing world.

We provide innovative, science-based solutions to improve the livelihoods and resilience of resource-poor smallholder farmers. We do this through strategic partnerships, linking research to development, and capacity development, and by taking into account gender equality and the role of youth in transforming the non-tropical dry areas.

Address

Dalia Building, Second Floor, Bashir El Kasser St, Verdun, Beirut, Lebanon 1108-2010.
www.icarda.org

Disclaimer

CGIAR

A CGIAR Research Center

cgiar.org

Table of contents

Abbreviations

ACSI	Amhara Credit and Saving Institution
ADSCI	Addis Saving and Credit Institution
AEMFI	Association of Ethiopian Microfinance Institutions
AVF	African Village Financial Services
DECSI	Dedebit Credit and Saving Institution
ETB	Ethiopian birr
MFIs	microfinance institution
NBE	National Bank of Ethiopia
NGO	non-governmental organization
OCSSC	Oromia Credit and Saving Share Company
OMI	Omo Microfinance Institution
RUSACCO	rural saving and credit cooperative
SACCO	saving and credit cooperative
SFPI	Specialized Financial and Promotional Institute
SMEs	small and medium-sized enterprises
VSLA	village savings and loan associations

Executive summary

Finance is one of the key elements in addressing development issues in Ethiopia. Finance plays a leading role in guiding development interventions in the country. Implementing development strategies or programs (poverty reduction, rural development) requires finance and financial systems. If the objective is to deliver financial services to the excluded and develop an inclusive financial system in the regions, there is a need to have well-functioning financial systems and institutions in place. In order to increase outreach, expansion of branches, efficiency, inclusiveness, appropriateness, innovations, and sustainability, there is a need for interventions/supports at banks, microfinance and rural saving and credit cooperatives (RUSACCOs)/ saving and credit cooperatives (SACCOs) at both providers' and client levels.

This assessment of all types of financial services focuses particularly on the landscape and performance of microfinance institutions (MFIs) in Ethiopia. Microfinance refers to a broad range of financial services made available to low-income clients; particularly women. The services include loans, saving, insurance and remittance. The clients of MFIs mostly belong to low income households and have limited access to formal financial services. MFIs serve a market segment that is considered 'high-risk' by formal banks. Small households possess fluctuating income, very few assets and require a very small loan size, a high degree of close follow-up and business appraisal. Financial transactions with these clients call for careful appraisal and close post-disbursement follow-up. MFIs offer a much-needed financial service; mainly to the informal sector, which otherwise depends on exploitative money lenders.

To summarize the status and performance of the MFIs in Ethiopia, the data from the Association of Ethiopian Microfinance Institutions (AEMFI) from March 2018 can be used. This data shows that there are 34 MFIs in Ethiopia. These MFIs have a total capital of close to 12 billion Ethiopian birr (ETB) serving around 4.5 million clients in all parts of Ethiopia. The conventional services provided by MFIs include collecting savings, providing group and individual loans, micro leasing activities, micro insurance and domestic money transfer services. Though there are newly emerged MFIs in the country over the last several years, the industry is largely dominated, in regard to market share, by the top five MFIs: Amhara Credit and Saving Institution (ACSI), Dedebit Credit and Saving Institution (DECSI), Oromia Credit and Saving Share Company (OCSSC), Addis Saving and Credit Institution (ADSCI), and Omo Microfinance Institution (OMI), who are all government affiliated and have a combined market share of 80%.

Penetration of financial access points is relatively low in Ethiopia; per 100,000 adults, there are 7.2 commercial bank branches, 3.7 MFI branches, 16.3 points of sale, and 3.6 automated teller machines (ATMs). The government's Growth and Transformation Plan II includes a mandate for banks to increase their branch network by 30% each year over the next five years and develop 50 agents per branch. Use of financial services in Ethiopia is low; 65% of Ethiopian adults are unbanked, principally due to a perceived lack of sufficient funds and distance to financial institutions. Only 4% of adults reported having a debit card and no credit cards are available, while only 11% of adults reported borrowing money from a formal financial institution.

However, use of informal financial services is common; 56% of adults over the age of 15 reported that while they did not have a bank account, they saved, borrowed, and insured their property through informal means. Of all adults, 62% reported some savings in the last year, but only 26% saved in financial institutions. Additionally, as of September 2018 there were over two million mobile money accounts, though less than 20% were active, as reported by the National Bank of Ethiopia (NBE).

Unlike its neighbors Kenya, Tanzania, and Uganda, or other developing countries, Ethiopia has not liberalized its banking sector. As a result, the Ethiopian banking sector remains unaffected by global financial distress and the impacts of globalization. The government of Ethiopia understands the potential benefits of financial liberalization but fears that liberalization may result in a loss of control over the economy and may not be economically beneficial. Consequently, the banking sector remains closed to foreign investment in Ethiopia. Foreign citizens may not own Ethiopian banks – in full or in part, or open banks, branch offices, or subsidiaries of foreign banks, or purchase shares of Ethiopian banks. Furthermore, banking is one of the sectors the government is considering protecting for a longer period of time, although they are considering opening the financial sector up to allow diaspora Ethiopians to invest in the finance sector.

Despite all the restrictions in Ethiopia, there are some companies with foreign owners operating as technology service providers for mobile or e-wallet banking. As these technology service providers are not regulated by the NBE, these foreigners are allowed to provide the technology as long as the access to accounts and agent recruitment are handled by an Ethiopian financial institution, such as commercial banks or MFIs.

Formal microfinance services: as stated above, only 22% of the adult population has access to formal financial institutions. In Ethiopia, all the formal financial institutions are domestic and there are currently no international financial institutions operating. In the country, there are 19 commercial banks, 17 insurers, and 34 MFIs registered by the NBE across the nine regions and two city administrations of Addis Ababa and Diredawa. Apart from the Commercial Bank of Ethiopia and the Development Bank of Ethiopia, all other banks were established within the last two decades. Among the formal financial institutions, banks target the urban and peri-urban areas, whereas MFIs mostly serve rural households. The widely available financial products of banks are saving, enterprise and personal loans, letters of credit for export transactions, and recently some have started mobile and digital banking. MFIs offer saving and micro loans for small and medium-sized enterprises (SMEs) and farmers. In this regard, there are huge gaps in geographic coverage, types of financial service products, and stringent requirements to access loans for investment, working capital for large enterprises, or start-up loans for farmers. In addition, young people find it hard to access business start-up loans from the formal financial institutions due to a lack of collateral and a lack of financial literacy training. Limited access to finance means young people have to obtain finance to start or expand a business from the informal sources such as RUSACCOs, SACCOs, village savings and loan associations (VSLA), family, or friends. Generally, the lack of diversified financial products and limited geographic coverage of formal financial institutions coupled with challenges to access skills training, agricultural inputs, and markets exacerbate youth unemployment in rural and urban areas.

Semi-formal and informal financial services: given the limited coverage of the formal financial institutions, most of the population in Ethiopia resort to semi/informal financial sources to address their financial needs. In addition to family, relatives, and friends, RUSACCOs, SACCOs and VSLAs play significant roles in the provision of financial access to rural communities, including youth. SACCOs are considered semi-formal because they are registered under the Cooperative Promotion Agency at the local level, whereas VSLAs are informal and groups are formed on a voluntary basis. The informal financial services (SACCOs and VSLAs) are predominantly supported by development projects. Until the formal financial service infrastructure develops, SACCOs and VSLAs will remain vital sources of small loans and a means to developing a saving culture, as well as provide financial literacy. In addition to SACCOs and VSLAs, Iqub, a saving and lending group, and Idir, a village-level insurance mechanism covering costs of funerals and sickness, play significant roles in providing financial services in the informal sector.

The formal institutions, which are transplanted from industrial countries, seem largely inappropriate to Ethiopian realities. High costs per transaction, complex bureaucratic lending procedures, elaborate paperwork, high collateral requirements, and delays are some of the factors which prevent effective utilization of the existing banking facilities. Moreover, the low interest rate (6%) offered to savers does not provide an incentive to the public due to the higher annual inflation rate.

Digital financial services: compared to east African countries, digital finance services in Ethiopia are nascent. Digital finance, especially mobile and agent banking, started in 2015 after the NBE issued a directive to permit a few banks and MFIs to start the service. Currently, banks and MFIs, in collaboration with technology companies (Kefya, Gebeya, Belcash and M-birr), provide mobile and agent banking services in different regions.

The only regulated bodies in the country that can directly engage in mobile and agent banking are banks, MFIs, and insurance companies. Ethiopia is an outlier among its peers when it comes to usage of digital financial services. Only 0.3% of Ethiopians have a mobile money account – compared to 73% of Kenyans. Similarly, no one in Ethiopia reported paying for a utility bill using a mobile phone account in a 2017 survey, while 82% of Kenyans had used this technology for this purpose. Ethiopia is mostly a cash-based society due to low financial literacy, the government's heavy restrictions on the digital financial sector, and the unreliability of internet connectivity and electricity. Even though the penetration of mobile money is one of the lowest in the world, there is increasing penetration of mobile phone ownership in the country. According to Ethio telecom, there are more than 40 million SIM cards actively used in the country. This presents a unique opportunity to increase mobile money accounts and higher financial inclusion in the rural areas of Ethiopia

1 Background of MFI development in Ethiopia

Since the 1970s, many non-governmental organizations (NGOs), such as World Vision, Save the Children, Christian Children's Fund, and Care, have directly provided credit services to their organizational and project beneficiaries. Even though the size, term, and condition of these loans differ from one another, the majority charge very low interest rates. Loans are usually in default, with a significant proportion overdue, meaning some MFIs report a poor credit portfolio. After a series of consultations between 1992 and 1995 involving concerned government bodies and the NGOs, it was agreed to establish a specialized institution – governed by a board of trustees – which would handle the financial interventions of NGOs.

The Ethiopian government issued its first microfinance legislation in 1996 (proclamation 40/1996) with the aim of providing microfinance services to the poor by deposit-taking MFIs . The main objectives of these institutions are to deliver loans, micro saving, micro insurance, money transfers, and leasing to the large excluded population in the country in a cost-effective and sustainable way. At the end of the day, the intervention of MFIs in the country should contribute to a positive and measurable impact on the wellbeing of millions of households. Before the specialized institution could be established, the proclamation 40/1996 prohibited other forms of organizations to provide similar financial services to the newly regulated MFIs. Proclamation 40/1996 allowed for the establishment of deposit-taking MFIs and supported the development of the microfinance sector for the subsequent decade. The microfinance sector has, as such, experienced a notable change from humanitarian-oriented organizations (e.g. NGOs) to specialized MFIs targeting financial sustainability and outreach.

2 Methodology

The MFI landscape assessment was compiled from desk reviews of secondary data and key informant interviews of selected MFI chief executive officers, managers, experts, and development practitioners. The data of 34 MFIs, classified in three peer group categories based on their portfolio size (small, medium and large), were used to examine the performance of the microfinance sector. The classifications allow comparisons of MFIs among the groups within Ethiopia. In other words, the peer group classification of MFIs has the advantage of comparing performance among similar institutions in order to analyze the impact of different internal and external factors on institutional performance.

3 The current context of MFIs and their performance

Development of MFIs in Ethiopia now has legal support, as government proclamation 40/1996 paved the way for their establishment. Consequently, various MFIs have been legally registered and started delivering microfinance services. MFIs spread across rural and urban areas and extend legitimate deposit services to the public with the power to draw and accept drafts, as well as manage funds for microfinance businesses. The Ethiopian microfinance sector is unique. It is relatively new compared to the sector across the rest of world. The average age of Ethiopian MFIs is 10 years. However, it has witnessed rapid growth and has an aggressive drive to achieve scale, broad geographic coverage, dominance of government-backed MFIs, focuses on rural households, provides both credit and saving services, and emphasizes sustainability.

Ethiopian microfinance is no longer confined to micro credit. A broad range of services like micro savings, micro insurance, and micro pension are provided. Thus, the sector has progressed from micro credit to microfinance, and now to financial inclusion. To become a sustainable development tool, microfinance needs prudent regulation. The challenge remains to find ways to regulate the sector and its heterogeneous players with social missions and with a plethora of operating models, sizes, and scales. Moreover, despite the huge saving mobilization efforts of MFIs, they have only satisfied a very limited proportion of the demand for loans.

The potential demand for financial services in Ethiopia is huge. However, the existing supply of financial services to the poor is very limited. The major sources of financial services in Ethiopia are commercial banks, MFIs, SACCOs, government development programs, some semi-formal financial services like Iqubs and Idirs, and informal financial sources like money lenders, traders, and suppliers of credit. Recently, MFIs are playing a vital role in providing micro credit services to the poor to address their lack of access to financial services.

Currently, according to the AEMFI data (March 2018), there are 34 MFIs with a total capital of close to ETB12

Figure 1. Informal types of finance in Ethiopia.

Savings and Credit Cooperatives (SaCCos)

- Total no. of members is ~ 4 million
- Total capital is estimated at ~ 11 billion Birr
- Have immense potential in financing short-term agriculture loans and off-farm income
- Major challenges faced by SACCos are weak institutional capacity, narrow product range and inappropriate loan security requirements.

Indigenous Finance

Indigenous finance entities give micro insurance, burial, savings, and loan services. They include friends/relatives (~66%), moneylenders (~14%), Iddir (~7%), and others (include equb, mahber, estimated at ~13%).

Iddir is a burial services saving community-based organisation (CBO) registered under the Ministry of Labour and Social Affairs:

- They engage in other services, including kindergartens, construction of buildings, training migration workers, etc.
- In Addis Ababa, 7,500 Edirs exist with 250 households as members. Members contribute 105 Birr each, totalling ~2.3 Birr/annum in savings.
- National estimate of edir savings is ~25.2 billion Birr/annum.
- Total savings are 50 Billion ETH Birr for the period 2015-2017.
- Major challenges reported by Iddirs include: less priority on investment compared to companies, lack of land for administration office and burial area.

Source: Job Creation Commission Study 2019.

billion, serving around 4.5 million clients in Ethiopia. The services provided by MFIs include collecting savings, providing group and individual loans, micro leasing activities, micro insurance, and domestic money transfer services. The industry is largely dominated in market share by the top five MFIs (ACSI, DECSI, OCSSC, ADSCI, and OMI) who are all government-affiliated and have a collective market share of approximately 80%.

In addition, there are 19,000 SACCOs nationwide, representing 3.8 million active savers. However, these institutions are considered weak and do not provide services on a sustainable basis. The NBE aims to leverage these SACCOs for financial inclusion. Knowledge of the sector has shown that the government of Ethiopia's aim to place at least one SACCO in each kebele to serve 1,000 to 1,400 households appears to be working in most areas. Oromia and Tigray regional states put the most effort in capacitating SACCOs for better financial inclusion – and other regions are catching up.

There is a serious lack of access to financial services for smallholder farmers and SMEs in the rural areas. However, the existence of MFI branches and SACCO institutions is solving this issue in many regions. Even though the reach of MFI branches and SACCO extends to *kebele* and sometimes village levels, both institutions face liquidity issues to satisfy the loan demand of smallholder farmers and SMEs. Liquidity and loan product issues worsen when the required amount of loans is higher.

4 Key findings of the assessment

Key findings from secondary sources and key informant interviews are summarized in the sections below. They include peer group classification and barriers to access to finance.

4.1 Peer group classification

Peer group classifications allow MFIs to understand relative trends and drivers in their own performance (profitability, efficiency and productivity, and scale and outreach) by comparing to similar institutions. It also supports transparency, which is necessary to improve institutional performance and have greater access to diversified sources of funding for growth. Performance of 34 MFIs in this report are examined based on their age, size (number of borrowers), and scale of operation (gross loan portfolio).

Year of establishment

Based on maturity of their microfinance operations, the 34 MFIs are classified into three groups (new, young, and mature). The age of an MFI represents the difference between the year the institution started its operations and the year the institution submitted its last audited financial report (Table 1).

Size (number of borrowers)

Outreach is measured by the total number of borrowers served by MFIs. MFIs are classified into three groups — small, medium, and large. These are defined in Table 2.

Table 1. Classification of MFIs by age: New, young, and mature.

Category	Definition	MFIs under this category
New	Less than or equal to five years old	Somali, Lideta, Afar, Rays, Nisir, Adeday, Debo
Young	Five to eight years old	Lefayeda and Dynamic
Mature	Older than eight years old	ACSI, ADSCI, Aggar, African Village Financial Services (AVFs), Benishangul, Buusaa, DECSI, Digaf, Harbu, Gasha, Meklit, Metemamen, OCSSC, OMI, PEACE, SFPI*, Wasasa, Vision Fund, Shashemene, Eshet, Sidama, Letta, Harar and Dire

Note: * Specialized Financial and Promotional Institute.

Table 2. Classification of MFIs by size: Small, medium and large.

Category	Definition	MFIs under this category
Small	MFIs with less than or equal to 15,000 active borrowers	Aggar, AVFS, Degaf, Letta, Meklit, Shashemene, Lefayeda, Dynamic, Harar, Dire, Somali, Gasha and Lideta, Nisir, Adeday, Debo
Medium	MFIs with 15,001 to 50,000 active borrowers	Benishangul, Harbu, PEACE, SFPI, Eshet, Metemamen, and Sidama
Large	MFIs with more than 50,000 active borrowers	ACSI, ADSCI, Bussa, DECSI, OCSSC, OMI, Wasasa, and Vision Fund

Table 3. Classification of MFIs by scale: Small, medium and large.

Category	Definition	MFIs under this category
Small	MFIs with gross loan portfolio of less than or equal to ETB10 million	Degaf, Lefayeda, Dynamic, Afar, and Lideta
Medium	MFIs with gross loan portfolio between 10 million and ETB50 million	AVFS, Harbu, Letta, Meklit , Shashemene, Harar, Dire, Somali, and Gasha
Large	MFIs with gross loan portfolio of greater than ETB50 million	ACSI, ADSCI, Aggar, Benishangul, Bussa, DECSI, Metemamen, OCSSC, OMI, PEACE, SFPI, Wasasa, Vision Fund, Eshet, and Sidama

Scale (loan portfolio)

Institutional scale in the report is measured by the size of an MFI's loan portfolio. The scale or size of MFIs' loan portfolios are categorized into three groups (Table 3).

4.2 Barriers to access to finance

The major barriers to accessing credit service for the poor are high and rigid collateral requirements, which the poor are unable to afford, high transaction cost associated with small size loans, non-inclusiveness of formal financial institutions to these people, and complicated and lengthy loan processing procedures. These obstacles make it hard for the poor to go to the bigger formal institutions for their credit needs, making MFIs and SACCOs the first choice for addressing the financial service needs of smallholder farmers, pastoralists, agro-pastoralists, and MSE operators. The delivery of financial services to the poor requires that financial systems use an innovative approach for appropriate targeting and credit delivery mechanisms to sustain the productive use of loans.

The MFI sector is mainly constrained by three factors; 1) financial infrastructure, 2) policy and 3) financial literacy.

Financial infrastructure: the overall financial system is least developed in Ethiopia. Particularly, MFIs are constrained by limited payment systems, the lack of core banking services, mainly analog operations, and the fact that they are operating in rural parts of the country meaning they are adversely affected by limited internet and electricity. Their outreach is very traditional and involves high transaction costs to reach the last mile.

Policy and regulatory framework: Ethiopia's financial services' regulatory and policy framework is restrictive and limited to local investors. This has limited growth and innovation in the financial sector. Specifically, MFIs are limited to offering basic saving and credit services. Recently, three MFIs started offering Sharia-compliant, interest-free financial services in the Somali, Afar and Southern Oromia regions. This has improved inclusiveness, but not has not reached the critical mass.

Financial literacy: as rural literacy and numeracy is still low, the financial literacy rate is very low in the country – particularly in rural areas. The lack of proper financial literacy training has hampered people seeking formal financial services as well as managing their finances properly. A huge amount of money circulates in the informal market as most cash is kept "under the pillow" in the majority of rural households. Intervention is needed to improve the financial literacy of people, both for conventional and digital financial services.

Figure 2 summarizes the challenges in the Ethiopian financial market.

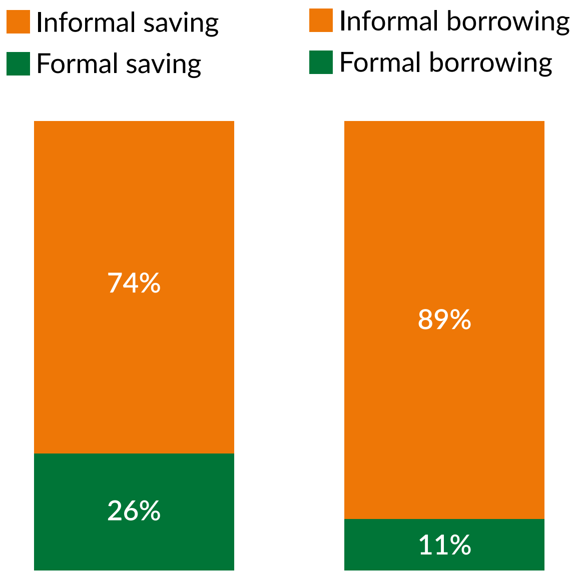
4.3 Key finding: Saving trend

MFIs also provide micro saving to enable poor and low-income people to store their money safely and to give them the possibility of earning a return on savings (Ledgerwood 1999). Savings can help households build up assets to use as collateral; it can also help them better meet seasonal consumption needs, finance major expenditures, and self-insure against major shocks. Various studies find that the poor can and do save,

Figure 2. Challenges in the Ethiopian financial market.

Snapshot of fornal financial institutions

Size of the formal sector



Entities in the formal sector

Banks

- 18 is number (2 state owned, other private)
- Total number of bank branches is 4,757 (bank branch to population ratio stood at 1:20,286.5 people)
- Capital = 85.8 billion ETH Birr
- 0.03% use mobile accounts
- 33 mobile subscribers in Ethiopia

MFIs

- 35 in number (5 are state owned)
- Capital = 13 billion ETH Birr
- MFIs have a total of 317 branches and 568 sub-branches
- Collectively hold 6% of fornal financial sector assets

Challenges in the formal financial sector

Access to finance is the biggest obstacle for firms in Ethiopia due to three identified reasons:

- Underdeveloped financial infrastructure: Refers to payment systems (interoperable systems), telecommunication (limited internet and phone coverage) and electricity (power outages).
- Limited regulatory framework and innovative financial products: Framework not updated and non-inclusive new innovations such as leasing, e-commerce, and consumer protection.
- Financial literacy: Low levels of public understanding on formal financial products and usage.

	Ethiopia	Sub-Saharan Africa
Firms with a bank loan/line of credit (%)	32.8	20.7
Proportion of loans requiring collateral (%)	85.8	86
Value of collateral needed for a loan (% of the loan amount)	296.2	219.5

Source: Job Creation Commission Study 2019.

although these savings are rarely in liquid financial form, and also reveal that the large majority of poor savers lack access to safe and sound institutions for depositing their savings. There are two types of savings: compulsory and voluntary. Figure 3 shows the Ethiopian MFIs saving trend and saving outreach data.

Figure 3. Ethiopia's MFIs saving trend (2010–17).

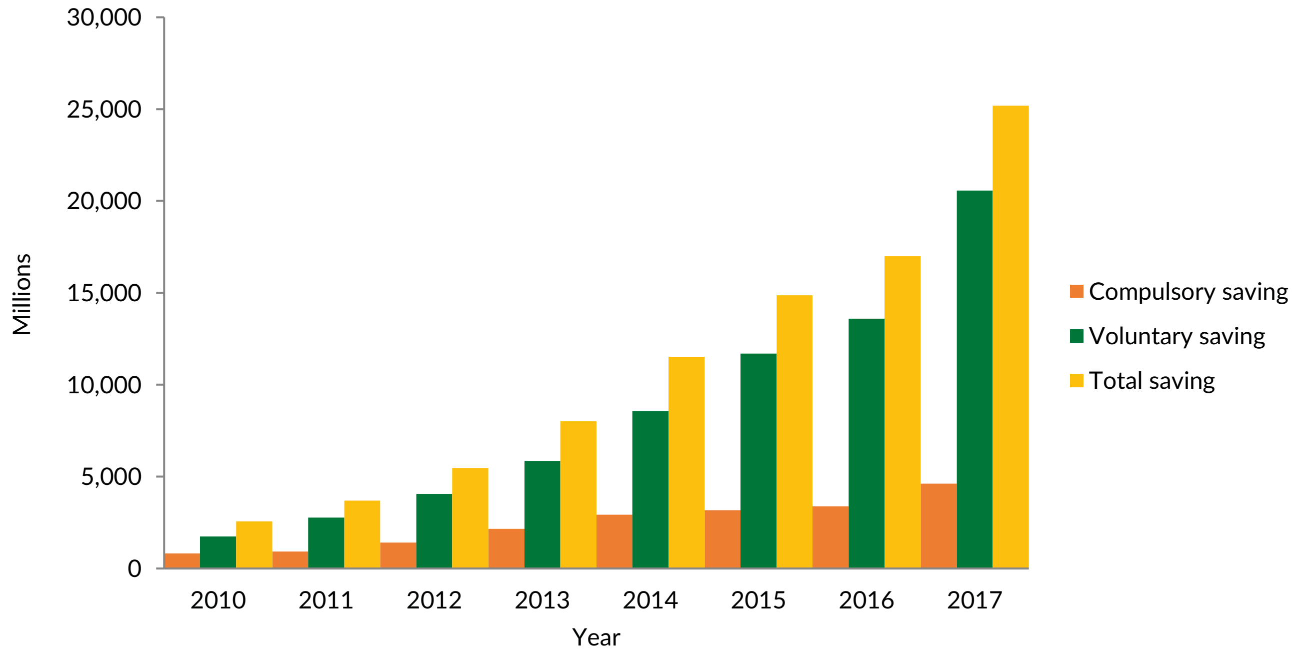


Table 4. Saving performance.

No.	Name	Voluntary saving	Compulsory saving	Total saving
1	ACSI	12,779,284,360	1,061,655,340	13,840,939,700
2	ADSCI	747,330,000	663,405,000	1,410,735,000
3	Aggar	70,165,911	35,657,947	105,823,858
4	AVFs	899,108	6,552,808	7,451,916
5	Benshangul	41,074,006	31,321,964	72,395,970
6	Bussa Gonofa	3,721,017	25,697,494	29,418,511
7	DECSI	2,461,457,122	157,170,485	2,618,627,607
8	Dire	142,303,759	90,158,817	232,462,576
9	Digaf	332,915	283,867	616,782
10	Eshet	15,349,209	9,026,791	24,376,000
11	Gasha	-	5,298,377	5,298,377
12	Harbu	21,418,039	18,721,763	40,139,802
13	Letta	726,870	1,211,640	1,938,510
14	Meklit	14,801,977	22,196,591	36,998,568

15	Metemamen	55,129,529	23,085,156	78,214,685
16	OCSSC	2,603,257,908	1,696,710,616	4,299,968,524
17	OMI	2,068,411,188	565,801,086	2,634,212,274
18	PEACE	16,267,164	42,475,070	58,742,234
19	SFPI	56,614,959	43,360,840	99,975,799
20	Kendil	5,116,421	3,433,461	8,549,882
21	Sidama	59,812,677	30,785,317	90,597,994
22	Wasasa	79,466,190	99,703,353	179,169,543
23	Vision Fund/Wisdom	249,280,530	126,296,094	375,576,624
24	Harar	43,469,508	8,513,006	51,982,514
25	Lefayeda	1,478,793	173,557	1,652,350
26	Dynamic	575,470	141,708	717,178
27	Gambella MFI	11,211,151	11,763,261	22,974,412
28	Tesfa	14,460	51,544	66,004
29	Somali	128,592,854	78,080,402	206,673,256
30	Lideta	2,994,174	2,040,012	5,034,186
31	Nisir	100,859,549	3,919,364	104,778,913
32	Afar	3,081,845	2,877,525	5,959,370
33	Adeday	48,336,254	13,265,779	61,602,033
34	Debo	94,721	6,000	100,721
	Total	**21,832,929,638**	**4,880,842,035**	**26,713,771,674**

Source: AEMFI 2018

The poor can save money in a safe place to meet emergency, consumption, and liquidity needs. Clients can invest in a variety of different products that provide security, especially during difficult times such as old age and disability. Voluntary savings are by far the most frequent source of funding for micro enterprise startups and expansion. Savings deposits enable households to accumulate savings for the future and better prepare for unexpected emergencies.

The large majority of poor savers lack access to safe and sound institutions for depositing their savings. MFIs need to provide micro saving to enable poor and low-income people to store their money safely and give them the possibility to earn a return on savings (Ledgerwood 1999). We can distinguish between two types of savings: compulsory savings and voluntary.

Compulsory savings

Compulsory savings can be considered as part of a loan product rather than an actual savings product in that it works as collateral for the loan received. There has been some criticism of MFIs' compulsory savings because many of the savings accounts come with so many strings attached that they hardly look like savings accounts (Armendariz and Morduch 2010). Compulsory savings have been used by the Ethiopian MFIs to build a saving culture. Under the five-year micro and small enterprise development strategy, youth ready to start micro and small enterprises are expected to save 20% of the project cost before accessing a loan from an MFI.

Voluntary savings

Voluntary savings are funds that individuals or organizations may voluntarily deposit or withdraw. It is not an obligatory part of accessing credit services and is provided by the MFIs to borrowers and non-borrowers. Voluntary savings are less burdensome than compulsory savings, but are still not optimal (Ledgerwood 1999).

4.4 Key finding: Credit outreach and portfolio

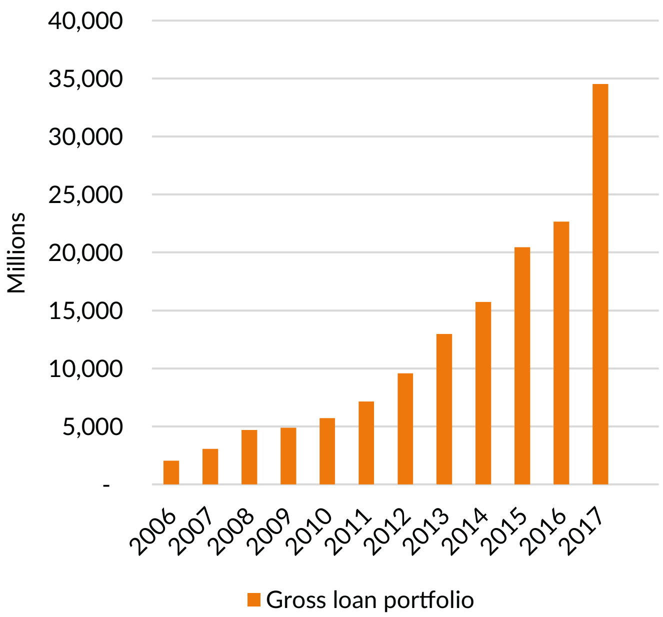
Outreach of MFIs is measured in terms of the number of active clients (i.e. clients with outstanding loans), loan size, number of savings clients, volume of savings, percentage of loans to clients below poverty line, percentage of female clients, the level of transaction costs levied on the poor, and the extent of client satisfaction with respect to financial services. Measuring the outreach of MFIs focuses on estimating their breadth and depth (the socioeconomic level of clients that MFIs reach).

According to the AEMFI, in 2014, the 28 MFIs in Ethiopia delivered loans to 3.4 million clients. The two largest MFIs, namely ACSI and OCSSC, account for 52% of all borrowers. The five largest MFIs (ACSI, OCSSC, DECSI, ADSCI, and OMI) accounted for 89% of total clients. The contribution of ACSI and OCSSC in terms of domestic savings mobilization was 37% and 18%, respectively. Loan outreach has increased since 2014.

Table 5. Ethiopian MFIs loan trends and loan per borrowers (31 March 2018).

Year	Gross loan portfolio	No. of active borrowers	Loan per borrowers (ETB)	Growth of loan
2006	2,045,114,853	1,299,896	1,573.29	
2007	3,058,547,333	1,700,396	1,798.73	50%
2008	4,691,424,443	2,172,823	2,159.14	53%
2009	4,883,799,488	2,197,688	2,222.24	4%
2010	5,706,372,461	2,325,914	2,453.39	17%
2011	7,152,069,840	2,480,810	2,882.96	25%
2012	9,589,633,775	2,637,625	3,635.71	34%
2013	12,968,659,835	3,149,740	4,117.37	35%
2014	15,728,454,325	3,365,951	4,672.81	21%
2015	20,460,321,121	3,807,162	5,374.17	30%
2016	22,663,745,058	3,862,531	5,867.59	11%
2017	34,532,724,630	4,818,515	7,166.67	52%

Figure 4. Trend of gross loan portfolio.



As of June 2014, Ethiopian MFIs reach over 3.4 million borrowers, with a total outstanding loan portfolio of ETB19 billion and a mobilized ETB11 billion in deposits. Despite the obvious disadvantages of the MFIs, such as poor communication and infrastructure, weak legal systems, and inadequate technical and institutional capacity, compared with other sub-Saharan countries, the sector has been growing at a remarkable pace. However, even with sectoral outreach to over 3.4 million clients, overall market penetration remains relatively low. Studies indicate that approximately 80% of Ethiopian rural poor households remain without access to formal financial services. As per the projection of Wiedmaier-Pfister et al. (2008), an estimated 10.4 million borrowers will require access to financial services over the next decade, which will require an investment of over ETB106 billion in on-lending funds.

Table 6. MFIs client performance.

No.	Name	No. of active borrowers	No. of women borrowers	Loans outstanding
1	ACSI	1,066,475	647,433	14,725,785,288
2	ADSCI	294,106	141,260	2,481,786,000
3	Aggar	14,248	3,718	304,385,235
4	AVFs	11,478	7,116	18,280,033
5	Benshangul	37,583	5,566	143,051,701
6	Bussa Gonofa	67,787	50,840	161,153,151
7	DECSI	412,546	102,905	3,323,805,730
8	Dire	10,327	6,495	251,694,551
9	Digaf	223	182	572,599
10	Eshet	15,406	5,162	53,534,199
11	Gasha	5,544	-	17,697,629
12	Harbu	29,432	11,987	106,350,428
13	Letta	1,637	574	6,499,590
14	Meklit	7,134	2,963	98,490,653

Credit outreach

15	Metemamen	20,473	13,307	153,149,980
16	OCSSC	946,577	320,048	7,671,301,143
17	OMI	1,276,163	384,549	4,115,224,123
18	PEACE	19,014	14,179	134,690,727
19	SFPI	25,465	14,360	214,850,170
20	Kendil	3,636	1,210	29,340,110
21	Sidama	60,404	18,121	174,325,888
22	Wasasa	56,984	24,454	307,507,784
23	Vision Fund/Wisdom	139,354	69,286	838,080,686
24	Harar	9,355	4,860	95,398,756
25	Lefayeda	350	262	1,197,684
26	Dynamic	152	42	951,144
27	Gambella MFI	12,446	-	44,909,933
28	Tesfa	269	-	407,041
29	Somali	26,815	19,469	581,689,561
30	Lideta	3,073	2,576	9,006,495
31	Nisir	720	182	49,255,211
32	Afar	1,820	1,082	9,448,869
33	Adeday	15,868	14,541	107,482,247
34	Debo	21	8	1,503,666
	Total	**4,592,885**	**1,888,737**	**36,232,808,004**

Source: AEMFI 2018

4.5 Key finding: MFI capital

Table 7. MFIs outreach data for the 1st quarter 31 March 2018.

No.	Name	Total assets	Total liabilities	Total capital
1	ACSI	23,520,659,187	18,260,707,448	5,259,951,739
2	ADSCI	3,365,103,000	2,104,868,000	1,260,235,000
3	Aggar	379,093,717	181,294,182	197,799,535
4	AVFs	26,880,542	15,101,096	11,779,446
5	Benshangul	180,996,794	117,388,921	63,607,872
6	Bussa Gonofa	190,962,805	116,403,864	74,558,941
7	DECSI	4,990,955,589	4,016,047,253	974,908,336
8	Dire	376,219,209	279,898,820	96,320,389
9	Digaf	1,765,814	806,696	959,118
10	Eshet	59,802,430	38,504,333	21,298,097
11	Gasha	20,732,067	15,952,049	4,780,018
12	Harbu	156,997,862	126,393,283	30,604,579
13	Letta	6,117,700	5,605,420	512,280
14	Meklit	112,726,295	65,705,466	47,020,829
15	Metemamen	184,255,438	111,098,305	73,157,133
16	OCSSC	11,383,509,745	9,091,499,680	2,292,010,065
17	OMI	5,794,756,900	5,344,700,485	450,056,415
18	PEACE	171,130,508	110,282,052	60,848,456
19	SFPI	329,161,420	221,565,36	107,596,057
20	Kendil	52,006,488	33,765,778	18,240,710
21	Sidama	193,542,960	136,933,627	56,609,333
22	Wasasa	519,813,573	360,265,224	159,548,349
23	Vision Fund/Wisdom	989,014,413	545,417,383	443,597,030
24	Harar	116,844,214	91,884,345	24,959,869

25	Lefayeda	3,607,161	1,703,440	1,903,721
26	Dynamic	1,058,287	733,826	324,461
27	Gambella MFI	48,979,286	24,412,080	24,567,206
28	Tesfa	862,000	262,800	599,200
29	Somali	1,229,725,286	1,131,394,064	98,331,222
30	Lideta	11,847,902	5,592,622	6,255,280
31	Nisir	121,526,952	106,261,389	15,265,563
32	Afar	58,872,152	12,571,883	46,300,269
33	Adeday	186,788,894	74,248,896	112,539,998
34	Debo	9,482,870	179,912	9,302,958
	Total	**54,795,799,460**	**42,749,449,986**	**12,046,349,474**

Figure 5. Distribution of MFIs in Ethiopia by region.

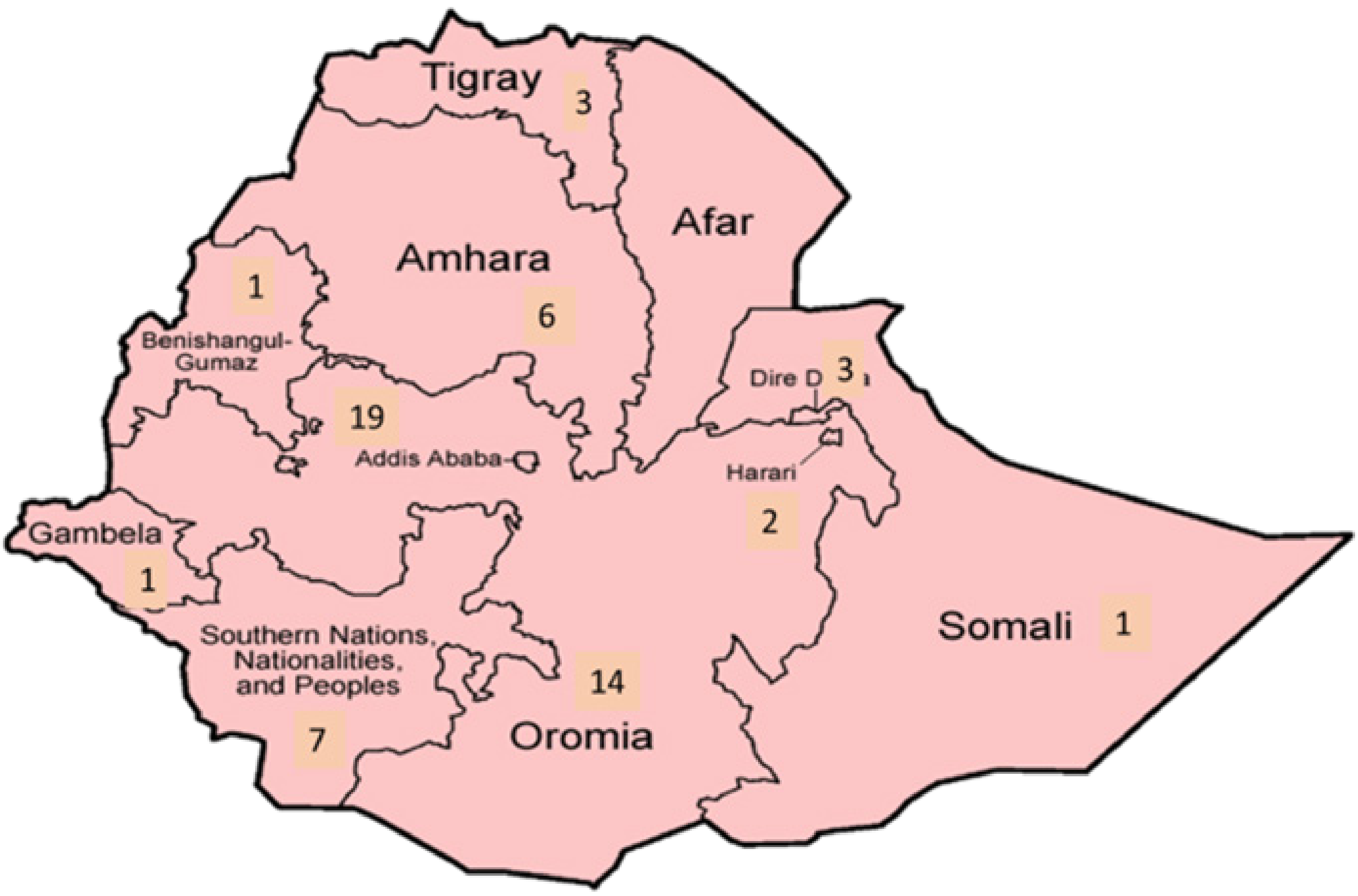
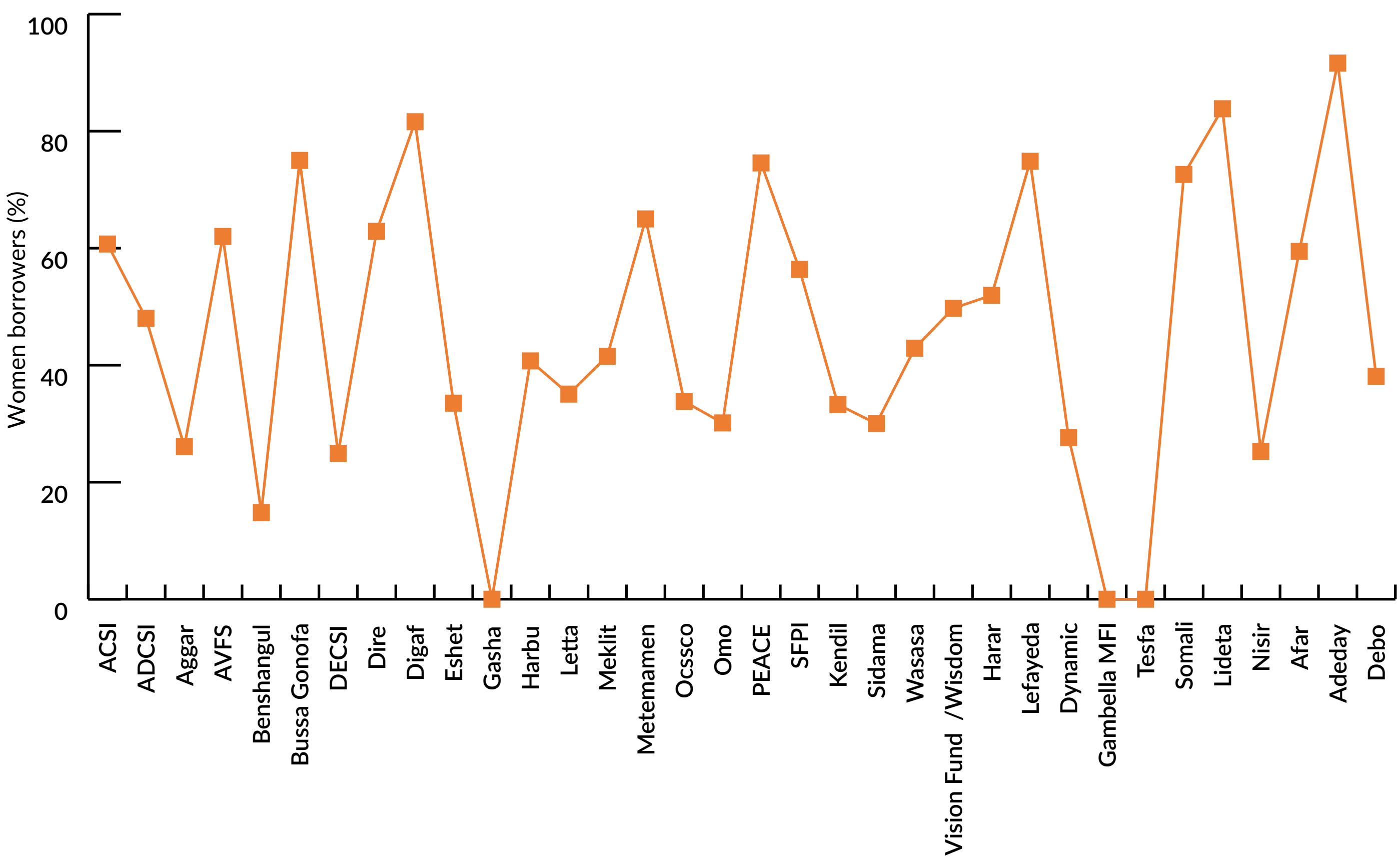


Figure 6. Trend of gross loan portfolio.



4.6 Key finding: Mapping of MFI based on geographic presence

Almost all regions and city administrations have at least one operating MFI; with an especially large concentration operating in the Addis Ababa and Oromia regions. Figure 5 shows the distribution of formal MFIs in Ethiopia.

4.7 Comparison of women vs. men MFI clients

The mission and vision of Ethiopian MFIs is to deliver financial services to low-income clients. To this end, many of the MFIs achieved expanded outreach (depth) by targeting the client groups that are most vulnerable, such as women and/or people with very low incomes (Helms 2006). In 2014, 52% of the 34 MFIs' clients were women. However, the proportion of female clients was higher in the small and medium MFI categories compared to the large MFI group.

5 Challenges, threats, and opportunities

5.1 Challenges

Policy, legal and regulatory issues

- Government and NGO parallel operations are currently distorting the microfinance markets. There is a growing threat from the side of the government. NGOs, donors, and other entities provide uncollectible loans which violate the microfinance law and directives of the NBE; NGOs and donors still mix loans and charity. The supply of donor-subsidized and soft loans is hindering the development of sustainable MFIs. However, NGOs can be involved in capacity building of MFIs and clients by participating in training, supplying hardware and other facilities that reduce their overhead costs, and by providing loan capital.
- A well-functioning and efficient legal system is a very important factor, necessary to enhancing the performance of the MFIs. Clear property right laws are critical to implementing availing collateral support and asset-based lending. The legal system in Ethiopia is very weak in facilitating microfinance activities. Moreover, the lack of a foreclosure law for MFIs to introduce the individual lending methodology presents another challenge.

Outreach

- Limited outreach, particularly with respect to women, is a serious issue for MFIs in Ethiopia. Women account for about 38% of clients. This is partly the result of supply-driven financial products, which are not tailored to meet the needs of women. MFI staff members are predominantly male, which may also deter female involvement.
- The exclusion of very poor and disadvantaged groups is a serious issue which should be revisited. This could partly be the result of the inherent problem of group lending methodology itself and the overemphasis of some MFIs on financial sustainability.
- There is an absence of feasible microfinance activities in pastoralist areas – particularly in the Afar and Somali regions.
- The high dropout rate of clients is also a challenge for MFIs in their bid to expand outreach and efficiency.

Risk

- Drought, seasonality of rural activities, and local market failures negatively affect the performance of MFIs.

Products, services and research

- Although the MFIs have made many efforts to address the financial needs of the poor, they have excluded the most impoverished. MFIs have used group lending methodology, which helps the poor to self-select programs. The methodology is a powerful instrument in addressing poor households' lack of property collateral. However, the approach screens out the critically poor from accessing loans from an MFI.
- The MFIs in Ethiopia do not provide flexible and responsive financial services to clients but instead focus entirely on delivering a single product. MFI expanded outreach should include saving and insurance products and provide diversified services to clients. The MFIs should be involved in developing varieties of loan products. The product development efforts are affected by the capacity of MFIs to develop new products.
- The group lending methodology used by all MFIs in Ethiopia is successful in delivering financial products to the poor without property collateral and with reduced transaction cost. However, clients who regularly repay their loans on time have complained about this methodology. They indicated that the group collateral or liability encourages default. Thus, the methodology needs to be revisited.
- MFIs in Ethiopia have limited products to meet the needs of the Muslim community in both urban and rural areas.

Capacity building

- Weak management information systems have affected the efficiency of MFIs significantly. This is aggravated by a lack of standard software, skilled manpower, and infrastructure to support a management information system network in remote areas.
- There is an absence of business development services to clients. Although the MFIs follow the minimalist approach to reduce cost and attain operational and financial self-sufficiency, NGOs and government could provide business development services to clients. There is also a marketing problem and the lack of a marketplace for MSE operators.

- MFIs are limited in terms of trained manpower, equipment transport facilities, offices, research, and innovation. Additionally, MFIs do not have the capacity to assess and manage their risks.
- There is high turnover of MFI staff; particularly senior staff. New personnel are trained in-house, supported with some training from AEMFI and other providers.
- There is a lack of standardized reporting and performance monitoring system. It is believed that all MFI information should be published and made public, yet this is currently not the case.
- There is a lack of market research to understand the needs of clients.
- Although it is limited, fraud, embezzlement, and weak internal control systems were identified in MFIs.
- MFIs' marketing strategy is weak.
- There is a lack of appropriate tools for measuring social performance.
- The multiple loans taken by clients are becoming a challenge to MFIs. This is aggravated by the absence of credit bureau information exchange.

Other external factors

- The poor infrastructure in Ethiopia affects MFIs' outreach and sustainability. This increases transaction costs and affects the sustainability and profitability of the MFIs.
- Demand side factors affect outreach of MFIs.

The missing middle

- The Ethiopian financial sector lends to the micro level through SACCOs/informal institutions, to small institutions through MFIs, and to bigger institutions through commercial banks. In Ethiopia, enterprises labeled as medium do not receive mid-term loans or high working capital loans. Most agro-processors, like sheep fattening enterprises, are categorized as 'medium', making them part of the 'missing middle' in society.

5.2 Threats

Production and price risk

- Since a significant part of the loan portfolio of Ethiopian MFIs is for rural enterprises, there is a high covariant risk caused by recurrent drought. Moreover, the price fluctuation of agricultural products negatively affects repayment and the sustainability of MFIs.

Inflation

- The past single-digit inflation rate in Ethiopia was conducive for the microfinance industry. However, if the recent increase in inflation continues, it will have a serious, negative impact on the activities of MFIs.

Politicizing microfinance

- MFIs need support from the government. However, government at various levels should not be involved in the direct delivery of microfinance.
- MFIs should be independent in governance and management of their operations. Politicians (from both ruling and opposition parties) should not use microfinance as a tool to buy votes.

Distortion of the market by donors and NGOs

- Donors and NGOs have been very supportive in providing seed capital and building the capacity of MFIs in the last decade. However, some donors, such as World Bank, are providing subsidized credit in the name of food security projects.

The risk of creating an uneven playing field

- If MFIs with similar characteristics and missions have different access to sources of capital at widely differing prices as a result of special preferences, such as differential access to sources to low-cost funds, they will have difficulty competing effectively.

5.3 Opportunities

Huge unmet demand

- There is huge demand for microfinance services in Ethiopia. Currently, MFIs provide only about 20% of the potential demand of poor households. This gives MFIs opportunities to increase outreach and deliver demand-driven financial services to the poor. Developing appropriate products and establishing specialized microfinance services for women and the Muslim community will have a clear impact on expanding outreach.

Development of telecommunication and power services

- The government of Ethiopia has been investing a large amount of resources in building roads, improving telecommunications and power services in the last five years. This will result in opportunities to increase outreach and improve the management information system.

Growing interest of social investors

- Microfinance in Ethiopia is part of the financial sector. Foreign investors are not allowed to invest in this sector, including the microfinance industry. A number of social investors have shown keen interest in MFIs. If there is liberalization of the financial sector (allowing the involvement of foreign investors in the sector), this could attract social investors and other development partners in the industry.

Growing interest of the private sector in microfinance

- The participation of the private sector in the microfinance industry is very weak. However, there is a growing interest of private investors in established MFIs with the potential to profit from the activity.

Competition

- Although there is currently very limited competition among MFIs, between MFIs and formal banks, and between MFIs and SACCOs, this will most likely change in the future. Competition should be seen as an opportunity for MFIS to increase efficiency, improve services, and attract potential clients.

Transformation and commercialization of microfinance

- Some of the MFIs have grown significantly given the limited services provided by formal banks. MFIs can become involved in providing universal banking without diverting from their original mission of providing financial services to poor households.

Implications for smallholder sheep farmers

In rural areas, financial sector development is recognized as a prerequisite to growth and poverty reduction. The goal of microfinance is to provide a 'booster shot' and financing that leads to self-sufficiency for smallholder farmers and talented youth entrepreneurs. Thus, the poverty cycle can be broken by facilitating and encouraging an entrepreneurial spirit in the quest for self-reliance and economic empowerment, through business expansion and growth.

Role of MFI in the livestock sector in Ethiopia

Studies have revealed that MFIs in Ethiopia grant loans for rural smallholder farmers engaged in livestock production. According to Widmeyer-Pfister et.al. (2008) clients use the various MFI loan schemes primarily to purchase production inputs for livestock, to start new businesses, and to expand existing enterprises.

Specifically, Amhara credit and saving institution grants loans to farmers engaged in small ruminant fattening, poultry, and related livestock businesses. These loans are usually provided on a group guarantee basis and are mostly short term.

Similar studies, commissioned by DECSI and Norwegian People's Aid, revealed that compared with non-clients, the DECSI clients receiving diverse loans for various complementary enterprises experienced improvements in income, asset holdings, consumption, and assets. The DECSI clients also have more food security and were less vulnerable to food emergencies. Likewise, in Tanzania, borrowers' income and asset values are almost twice those of non-borrowers (REPOA 2005). In 2010, World Bank researchers Deininger and Lu also found that there are significant economic gains from loan participation by smallholder farmers, which is translated in terms of betterment of household nutrition, increased asset accumulation, higher levels of consumption, and consumption smoothing.

Role of MFIs in youth empowerment in Ethiopia

One of the major loan products MFIs have for youth is the youth revolving fund – provided by the Ethiopian government and aiming to increase youth employment in the country. Tigray is one of the major regions where this revolving fund is available. A study by Etbarek (2008) indicates that though the revolving fund is showing positive results, it is not without limitations. There are few commercial banks in rural areas and the population is highly detached; therefore, they are not in a position to benefit from credit. In addition to this, the criteria for eligibility of credit is difficult to fulfill, given farmers' present situation. However, due to collateral (budget security) given by the Tigray region government, credit is arranged from the commercial Bank of Ethiopia to farmers to purchase and distribute inputs and cereal. Activities are being undertaken to launch rural banks in different parts of the region. However, they are unable to sufficiently satisfy the high demand for credit for various reasons including:

- In some places rural banks are located far away from the beneficiaries (western Tigray)
- Interest is high in relation to payment ability of farmers
- Bureaucratic activities
- It requires 'group collateral'

Given the above state of affairs, credit service is expanding throughout the region and the reimbursement experience is encouraging. The impact assessment has made it clear that through the implementation of most of the 16 micro projects, the target households' livelihoods have significantly improved in terms of increasing both household consumption level and resilience against risks of food insecurity on a sustainable basis. This, in turn, has provided evidence of promising potential for scaling up such income generating activities, thereby improving the wellbeing of an increasing number of food insecure households (Alemayehu 2006).

6 Recommendations

- As the main issue of providing loans to youth is the lack of collateral, using the group guarantee method is preferable.
- If youth employment creation is achieved through developing enterprises with mid-term loan demand, MFIs should be equipped to provide that for youth.
- In cases where borrowers are not eligible for group lending or do not have group members that they can lend to, they should be eligible for a guarantee scheme by another guarantor outside of the MFI.
- As providing loans through SACCOs is cheaper and less risky, project should consider facilitating credit through strong SACCOs.
- Project should be aligned with current/running government priorities and projects, with the ability to align impacts and utilize existing infrastructures and systems of financial institutions.
- Enable MFIs to scale up youth saving/loan products.
- Work with MFIs to provide business development training to youth borrowers so lenders' risks are reduced.
- Inclusion of MFIs will provide the microfinance industry with a valuable resource for smallholder farmers and youth product development, as well as stakeholder engagement.
- The regional governments in collaboration with development partners should build capacity for smallholder farmers and youths to use credit efficiently and enforce laws for defaulters

7 References

Alemayehu, G., A. Shimeles and D.Z. Gurara. 2006. *Finance and poverty in Ethiopia: A household level analysis*. WIDER Working Paper Series RP2006-51, World Institute for Development Economic Research (UNU-WIDER).

Armedáriz, B. and J. Morduch. 2010. *The economics of microfinance*. MIT Press, Cambridge, USA

Deininger, K. and L. Yanyan. 2013. Economic and social impacts of an innovative self-help group model in India. *World Development* 43: 149–163.

Etbarek, G. 2008. *Impact of revolving credit fund in northern Ethiopia: The case of Atsbi-Womberta, Tigray*. Mekele University, Mekele, Ethiopia.

Gebrehiwot, A. 2006. A study on the impact assessment of income generating activities in Ethiopia. *Eastern Africa Social Science Research Review*, 22(1): 63-86.

Helms, B. 2006. *Access for all: Building inclusive financial systems*. World Bank, Washington, DC, USA.

Job Creation Commission. 2019. *Assessment on crowdfunding*. FDRE Job Creation Commission, Addis Ababa, Ethiopia.

Ledgerwood, J. 1999. *Microfinance handbook: An institutional and financial perspective*. World Bank, Washington, DC, USA.

REPOA (Research on Poverty Alleviation). 2005. *Access to formal and quasi-formal credit by smallholder farmers and artisan fishermen: A case of Zanzibar*. REPOA, Tanzania.

Wiedmaier-Pfister, M., D. Gesesse, W. Amha, R. Mommartz, E. Duflos, and W. Steel. 2008. *Access to finance in Ethiopia sector assessment study. Volume 2*. German Technical Cooperation within the Engineering Capacity Building Project, Ethiopia.