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Short Study on Microfinance

Ethiopia

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List of Acronyms

ACSI	Amhara Credit and Savings Institution
ADA	Amhara Development Association
ADB	African Development Bank
AFCAP	Microfinance Capacity Building Program in Africa
AEMFI	Association of Ethiopian Microfinance Institutions
AWDA	Amhara Women's Development Association
BRAC	Bangladesh Rural Advancement Committee
CGAP	Consultative Group to Assist the Poorest
CIDA	Canadian International Development Agency
CRDA	Christian Relief and Development Association
DECSI	Dedebit Credit and Savings Institution
DFID	Department for International Development (United Kingdom)
ESRDF	Ethiopian Social Rehabilitation Development Fund
EU	European Union
FINNIDA	Finnish International Development Association
FAO	Food and Agriculture Organization
GOE	Government of Ethiopia
IFAD	International Fund for Agricultural Development
MF	Microfinance
MFI	Microfinance institution
MIS	Management information system
NBE	National Bank of Ethiopia
NGO	Non governmental organization
OCSI	Oromia Credit and Savings Institution
OMI	Omo Microcredit Institution
ORDA	Organization for Rural Development of Amhara
RUFIP	Rural Financial Intermediation Programme
RUSACCO	Rural Savings and Credit Cooperative Organization
SACCO	Savings and Credit Cooperative Organization
SFPI	Specialized Financial and Promotional Institution
SME	Small and Medium Enterprise
UNCDF	United Nations Capital Development Fund

UNDP	United Nations Development Programme
USAID	United States Agency for International Development
Br.	Ethiopian Birr (Br. 8.69 = US$1)
Edir	Informal group based social network/funeral fund
Ekub	Informal group based social network/social fund
Kebele	Local level government administrative unit
Wereda	District level government administrative unit

1. Purpose of the report

The purpose of this short study is to improve understanding of the operation of microfinance institutions (MFIs) in Ethiopia with particular attention to the Amhara Credit and Savings Institution (ACSI). The findings will serve as background for the development of Sida's country strategy for Ethiopia. The 13-day study was carried out in April 2002 in Addis Ababa and Bahir Dar by an independent consultant based in Ethiopia. It involved issue-based discussions with representatives of Ethiopian MFIs, the Association of Ethiopian Microfinance Institutions (AEMFI), and donor organizations supporting microfinance in Ethiopia (Annex 4). It also involved a review of secondary sources of information on microfinance in Ethiopia, including project documents, background papers, and research reports (Annex 5).

2. Overview of microfinance in Ethiopia

2.1 Existing status of microfinance institutions

A key component of Ethiopia's development strategy is the establishment of sustainable microfinance institutions serving large numbers of poor people. While non-governmental organization (NGO) credit schemes and informal sources of finance have existed in Ethiopia for many years, the government instituted a legal and policy framework for MFIs in 1996 through Proclamation 40/1996 (Gebrehiwot Ageba, 2002). Since then, 20 MFIs have registered with the National Bank of Ethiopia and operate under the auspices of this Proclamation.

Rapid growth and development since 1996

Similar to microfinance approaches in many other parts of the world, MFIs in Ethiopia focus on group-based lending and promote compulsory and voluntary savings. They use joint liability, social pressure, and compulsory savings as alternatives to conventional forms of collateral. Currently, the Proclamation requires MFIs to provide credit through group based lending methodologies. It allows MFIs to mobilize savings but restricts the size of MFI loans to a maximum of Br. 5,000 and the repayment term to no more than one year. An earlier ceiling on the interest rate was lifted in 1998 so interest rates are no longer restricted under this law. Interests rates vary across organizations. MFIs in Ethiopia provide both non-agricultural and agricultural loans. While both types of loans are provided through group lending methodologies, the agricultural loans generally require a one-time or balloon payment at the end of the loan term, while other loans typically are paid on a weekly or monthly basis. A few MFIs also provide financial services beyond savings and credit. Two government supported MFIs manage remittances for about 100,000 pensioners each month. At least one MFIs has initiated money transfer services on a pilot basis.

The objectives of MFIs are quite similar across organizations. They focus on reducing poverty and vulnerability of poor households by increasing agricultural productivity and incomes, diversifying off farm sources of income, and building household assets. They seek to achieve these objectives by expanding access to financial services through large and sustainable microfinance institutions. Strategies driving most MFIs in Ethiopia involve community and participatory approaches; encourage

the participation of women; promote savings mobilization; and emphasize long-term sustainability. While financial sustainability is a stated goal of most MFIs, profit making does not emerge as a dominant theme at this time.

The Ethiopian microfinance industry has undergone tremendous growth and development in a very short period of time. Today, 20 registered MFIs provide savings and credit services to more than 500,000 households in rural and urban areas across the country. To put the extraordinary growth of Ethiopian MFIs in perspective, as of December 2000, Dedebit Credit and Savings Institution (DECSI) was the fourth largest MFI in Africa, in terms of total number of clients (187,470). ACSI was the sixth largest with 143,520 clients[1]. Only eight MFIs in Africa had more than 100,000 clients. This remarkable growth of new MFIs in less than five years is unprecedented in Africa.

Table 1

Outreach of Twelve Largest MFIs in Africa, December 2000[2]

People's Bank of Nigeria	Nigeria	607,000
Nigerian Agricultural and Cooperative Bank	Nigeria	359,390
Country Women Association of Nigeria	Nigeria	220,000
Dedebit Credit and Saving Institution	Ethiopia	187,470
Association d'Appui aux Conducteurs de Chariots du Zaire	Democratic Republic of Congo	170,000
Amhara Credit and Savings Institution	Ethiopia	143,520
CARE Niger	Niger	131,000
Malawi Rural Finance Company Ltd.	Malawi	165,540
Federation des Caisses Populaires du Burkina Faso	Burkina Faso	72,000
Farmers Development Union	Nigeria	63,106
Pride Tanzania	Tanzania	44,322
Reseau des Caisses d'Epargne	Senegal	32,000

Key actors

Access to finance by poor households in Ethiopia is primarily through informal systems, including moneylenders, traders, friends, relatives, *edirs* and *ekubs* (informal, group based savings and credit associations). Poor households have almost no access to formal commercial banking institutions or savings and credit cooperatives. The approximately 700 savings and credit cooperative organizations (SACCOs) in Ethiopia are urban, employee-based cooperatives (for example, Ethiopian

[1] These figures were collected by the Microfinance Summit for their global outreach report. The figures for Ethiopia were verified by Dr. Wolday of AEMFI. At the time these figures were collected, the top three MFIs in the world in terms of client outreach were BRAC (Bangladesh) with 3,000,000 clients; Grameen Bank (Bangladesh) with 2,380,000; Association of Asian Confederation of Credit Unions (Thailand) with 2,011,635 clients. BRI in Indonesia reaches 2,715,609 clients, but only 125,000 are classified as poor.

[2] From Microcredit Summit 2001 Report (www.microcreditsummit.org). All things constant, ACSI's current outreach figures of 196.000 would make then the fourth largest in Africa.

Airlines). While some service cooperatives provide credit and savings, very few rural savings and credit cooperatives exist.[3]

In this context, since 1996 MFIs have been playing an increasingly important role in providing financial services to poor households throughout Ethiopia. Government supported MFIs have contributed largely to the growth and development of the MFI industry. Among the 20 registered MFIs, six are supported by the regional governments of Tigray, Amhara, Oromia, Southern People's Nation, Addis Ababa, and Benishangul. The regional government of Dire Dawa has an application pending with the National Bank of Ethiopia. Regional governments support these MFIs financially and through grassroots level government administrative organizations. MFIs supported by the regional governments typically have extensive geographic spread across *weredas* within their regions. A large majority of their clients are from rural households (except Addis Ababa region). One feature of the government supported MFIs is that they offer both agricultural and non-agricultural credit. A portion of the agricultural credit is extended under a somewhat controversial government agricultural extension program to provide term credit for seeds and fertilizer. Recent figures show that government backed MFIs have approximately 467,000 outstanding clients, or 92 percent of all microfinance clients in Ethiopia (Annex 1).

Government Backed MFIs →	· Amhara Credit and Savings Institution (ACSI) · Dedebit Credit and Savings Institution (DECSI) · Oromia Credit and Savings Institution (OCSI)	· Omo Microfinance Institution · Addis Credit and Savings Institution · Benishangul Microfinance Institution
Other MFIs →	· Specialized Financial and Promotional Institution · Gasha Microfinancing · Wisdom Microfinancing Institutions · Mekket Microfinance Institution · PEACE Microfinance Institution · Eshet Microfinance Institution	· Wasasa Microfinance Institution · Asser Microfinancing · Africa Village Financial Service · Buussa Gonofa Microfinance · Meklit Microfinance Institution · Shasemene Eddir Yelimat Agar MFI (SEYAMFI) · Metemamen

While government backed MFIs dominate the scene, there are 14 other smaller MFIs operating throughout the country. Similar to all MFIs, they are registered as share companies. In addition to being smaller, many are linked to the activities of national and international non-governmental development organizations including, for example, World Vision, Catholic Relief Services, and Christian Relief and Development Association. While some have grown out of NGO credit activities operating before 1996, others have been newly established. Several smaller MFIs are linked to community-based organizations actively involved in informal finance, like *edirs* (for example, Shasemene Eddir Yelimat Agar MFI and African Village Financial Services). Others complement credit and

[3] ACDI/VOCA has established six pilot rural savings and credit cooperatives in Ethiopia through a program supported by USAID. Oromia Region is exploring the feasibility of establishing a cooperative bank.

savings with business training. Five of the fourteen NGO programs operate in urban areas (mostly Addis Ababa), and the remaining nine operate primarily in rural areas (mostly in Amhara, Oromia, and Southern regions). Recent figures show that these smaller MFIs have about 42,000 outstanding clients, accounting for about 8 percent of all MFI clients in Ethiopia (Annex 1).

Source of funds

A feature of all Ethiopian MFIs is that they are actively involved in savings mobilization, which is explicitly sanctioned by the microfinance law. Thus, they are in a position to play a financial intermediary role, a standard 'best practice' of microfinance. Savings are central to their operations and provide an important source of funds for lending, especially in the larger MFIs. Two types of individual savings include compulsory savings (which stay with the MFI until the client leaves the program) and voluntary savings (which the client can withdraw any time). In addition, schools, *edirs,* and churches deposit institutional savings. Overall, savings as a percentage of outstanding portfolios exceed 50 percent (IFAD 2001). As an important service for clients and source of funds for MFIs, savings mobilization will remain central to their future strategies.

Besides savings, donated equity finance from regional governments has been a critical source of capital for government supported MFIs. Other sources of donated equity finance for MFIs include donor organizations, foreign NGOs, churches, other associations and (Annex 1). Support for equity capitalization of MFIs from international donors has been relatively modest to date. Up to now, Sida is one of the few bilateral (or multilateral) donors to provide large amounts of capital funding through its support for the Amhara Credit and Savings Institutions (ACSI). Most donor organizations have preferred to support capacity building. So far, loans – soft and commercial – have not played a role as a source of MFI funds. This is all about to change if/when the International Fund for Agricultural Development's (IFAD's) Rural Financial Intermediation Programme (RUFIP) is approved. This program will provide large amounts of capital funds to MFIs through both loans and grants (Annex 2).

Outreach[4]

The Ethiopian microfinance proclamation requires MFIs in Ethiopia to use group based lending methodologies. Most Ethiopian MFIs use a solidarity group approach, whereby clients join into groups of 5 to 7 members and co-guarantee each other's loans. These groups meet on a weekly or monthly basis to make loan repayments and savings deposits. Working through groups is an effective means to expand outreach and reduces the transaction costs for MFIs. A few MFIs deliver services through traditional social groups (primarily *edirs*), whose members also guarantee each other's loans. The co-guarantee mechanism within the groups serves as an alternative form of collateral. While this works well

[4] AEMFI currently is undertaking a comprehensive baseline survey of MFIs in Ethiopia to support the development an industryled performance monitoring system. It will include information on a wide range of issues related to outreach, financial and operational performance, ownership and governance. The survey will be completed in April 2002 and in May 2002 the information will be integrated into a computerized data base using software provided by the Microfinance Bulletin.

for non-agricultural loans, the covariant nature of agricultural risks makes it more problematic as a guarantee mechanism for agricultural loans.

Based on available outreach figures from 2001 and 2002, Ethiopia's 20 MFIs currently reach approximately 510,000 outstanding clients. Achieving this level of outreach in a short time is very impressive. However, the unmet demand for financial services remains high. According the IFAD's October 2001 RUFIP appraisal report, the potential demand for microfinance in rural Ethiopia is estimated to be between 4.2 and 5.5 million households. Currently, MFIs reach approximately 10 percent of this market. Demand is likely to be unmet in the short and medium term (IFAD 2001). Estimates of the urban market for microfinance were not available, but what ever it is, it remains largely unmet.

A socioeconomic profile of clients shows that 78 percent of MFI clients reside in rural areas (Table 1, p. 7, IFAD 2001). Five government backed MFIs serve primarily rural areas and one serves Addis. Among the smaller non-government supported MFIs, five are urban-based programs and nine are more active in rural than urban areas. With respect to gender, the urban-based programs reach a larger proportion of women, who comprise from 60 to 85 percent of all clients. Overall, approximately forty one percent of all microfinance clients are women (IFAD, Table 1, p. 7, 2001). The rural-based government supported MFIs reach large absolute numbers of women but, proportionately, less than half of all their clients are women (the nascent Benishangul program is an exception as 60 percent of their 425 clients are women).

While microfinance in rural Ethiopia has been seen to support a narrow range of economic activities (mostly agriculture production and grain trade), loans actually have supported households engaged in a surprisingly wide range of activities. A 2001 DECSI study shows more than 71 different economic activities supported through their program. This includes 14 different agricultural activities, 25 handicraft and processing activities, 24 petty trading activities, and 8 service activities (DECSI 2001 as quoted in Wolday, 2002). There is considerable scope, however, for microfinance to play more of a role in diversifying non-farm activities through new products and services – a key challenge for improving household incomes and productivity in rural areas.

In terms of geographic spread, microfinance programs operate in six regions, Amhara, Tigray, Oromia, Southern, Addis Ababa, and Benishangul. A recent study considered the potential for extending microfinance services to four remote Regions of the country, Somali, Afar, Gambella, and Benishangul. Significant constraints notwithstanding, microfinance is likely to be a component of a pastoralist project in Afar and Somali Regions supported by IFAD, the World Bank, and FAO. While the regional government of Benishangul has established a microfinance program, there are no formal microfinance activities underway in Gambella. As mentioned earlier, the regional government of Dire Dawa has an application for registering an MFI pending with the National Bank of Ethiopia.

Regarding coverage within regions, DECSI in Tigray has the widest coverage of any MFI, reaching 84 percent of households in the region with potential demand for microfinance. ACSI and three other MFIs in

Amhara reach approximately 13 percent of households in the region with potential demand. Coverage of in Southern Region is 6 percent, and in Oromia is two percent. Coverage in other regions is virtually nil. There is considerable scope throughout most of the country for expanding the outreach of microfinance services.

Performance

According to the IFAD's RUFIP appraisal report, Ethiopia's 20 MFIs operate through a network of approximately 500 branches and sub-branches, have outstanding loans of over USD 33 million and have mobilized net savings around USD 16 million. In addition, government-supported MFIs have delivered input supply credit totaling more than USD 29 million to approximately 780,000 farmers. Average loan sizes range from USD 27 to USD 325. Figures show that MFIs have sustained high repayment rates ranging from 94 to 100 percent (Annex 1).

Although Ethiopian MFIs have not yet reached financial sustainability (similar to many MFIs worldwide), several have achieved operational sustainability whereby they cover their operating costs. Sustainability can be attained through a combination of scale, portfolio growth, operational efficiencies, and sufficient income from interest, fees and other sources to cover costs. Sustainability requires access to capital funds, good policies, strong organizational and management capacity, incentives, and products and services that meet the needs, preferences, and opportunities of clients. Today, Ethiopian MFIs are very much aware of these issues and working on improving performance in all these areas. AEMFI has initiated a program to monitor the performance of MFIs through regular collection of performance data and the establishment of benchmarks based on microfinance best practices.

Regulatory and supervisory framework

A view on principles that should guide the governance of MFIs in Ethiopia's

"Regulatory frameworks governing the microfinance industry should ensure that the MFI has a sound portfolio performance; low delinquency or default rate; high diversification to reduce the risk of specializing in the delivery of one loan product; ensure the safety of deposits through equity capital; ensure lower levels of liquidity risk; provide regular and high quality financial information and reduce the risk arising from dependence on subsidy and influence of donor."

(Wolday Amha, General Manager AEMFI, 2001)

Under Proclamation 40/1996, all MFIs are required to register with the National Bank of Ethiopia as share companies under the commercial code. The regulatory framework of the proclamation establishes the roles and responsibilities of the board of directors and management of MFIs. It further establishes loan size ceilings, lending methodologies, and other parameters of operation. It requires that MFIs deposit a minimum of Br. 200,000 with a bank and submit external audited reports on an annual basis. Re-registration is required once the MFI mobilizes deposits greater than Br. 1 million.

Proclamation 40/1996 further spells out a supervisory role for NBE's Microfinance Supervision Division in approving managing directors and renewing MFI licenses to operate on an annual basis. This unit is still young and the IFAD project includes a substantial component to build the capacity of this unit through staff training, the formulation of procedures and manuals, and the development of a sound framework for external audit that complements the supervision function.

In addition to NBE, self-regulation will play an increasing role in the future. With support from Ireland Aid, AEMFI is developing its capacity to play a role in promoting self-regulation within the industry. It is conducting a baseline survey, developing a computerized information system (with support from Microfinance Bulletin), and will develop benchmarks and performance monitoring indicators based on best practices. RUFIP also will support this AEMFI initiative.

The Proclamation is amended through directives. Several new directives (expected to come into effect any day) will provide more flexibility in loan size, repayment terms, forms of collateral, and lending methodologies. This is a profound change and will contribute to the development of a more demand driven and market oriented approach than has been possible in the past. Other directives will ensure lower levels of liquidity risk and ensure the safety of deposits through equity capital requirements.

Impact

Given the relative youth of the Ethiopian microfinance industry, there has been limited attention to client level impact monitoring and impact assessment. Findings from the few available studies suggest that access to microfinance credit and savings has positive effects on the well being of clients and their households:

- a Sida supported study of ACSI clients in two *weredas* of South Wollo indicates that microfinance is reaching vulnerable groups and reducing their vulnerability. The study did not find much difference in the poverty level of ACSI clients, but across the board poverty. Clients are either farmers or rural entrepreneurs. Access to ACSI financial services has contributed to household asset formation (including financial assets in the form of savings), economic diversification, women's leadership development and community empowerment. Another important impact is that ACSI has introduced a proper credit culture, moving rural households away from the "soft image" of credit (Hailu 1999).
- a study of DECSI clients in Tigray shows over 70 different farm and non-farm economic activities supported by its loans. Twenty percent of borrowers surveyed used their loans to start a new activity, suggesting a willingness to take risks. A majority of clients reported a considerable initial impact of loans on their incomes and well-being, although this impact tapers off over time. These impacts resulted from increased agricultural production through use of oxen, retrieval of previously rented out land, renting out more land, and increasing the scale of trading activities. Sustained impacts were dependent on continued access to credit. Income increases were used for food, clothing, and education. Impacts could be significantly improved

through further diversification of income sources, to reduce risks (Meehen 2001).
- a Red Barna study to explore the impacts of microfinance on children found a positive impact on children's education. It found no evidence that children shifted from school to work in borrower households. It found positive impacts on savings, spending for medicine, livelihoods, and women's empowerment. (personal conversation, Daniel Gesese, SFPI, January 2002).

Well-designed impact assessments can play a role in *proving* whether or not participation in microfinance programs contributes to change in the lives of clients, their enterprises, households, and communities. This is important for donors, policy makers, investors, and other decision makers who must justify their investments in microfinance (MF). Impact assessments also can play a role in *improving* impacts by generating information on the financial needs, preferences, and opportunities of the poor, and using this information to improve the design of programs, products, and services so they can have more impact. Ultimately, positive impact (i.e., satisfied clients) is intricately linked to performance and sustainability. If approved, the IFAD project includes an impact assessment component that should provide an opportunity to encompass both the proving and improving role of impact studies.

Donor support

Until recently, large-scale donor support for Ethiopian MFIs was tentative. In part, this relates to heavy government involvement in and direction of the industry and problems in the legal/regulatory structure that violated some industry-defined good practices. One issue was rigidly defined, supply-led rather than market driven products, services, and interest rates. As mentioned above, new directives have (and will) lift some of these restrictions. In addition, there were concerns about other governance and ownership issues and a 'wait and see' attitude. Sida was one exception with its support to ACSI in 1998. Ireland Aid and international NGOs including World Vision, Catholic Relief Services, Save the Children USA, Plan International, ACORD, Action Aid, CARE (and others) were other exceptions, with their support for several smaller MFIs. More recently, an increasing number of other donor organizations have joined efforts to support the development of the industry – USAID, African Development Bank, Packard Foundation, and IFAD.

The funding environment has changed considerably over the past two years, especially with the growing interest among well-endowed bilateral and multi-lateral donor agencies in supporting MFIs – both for capacity building and for capitalization. Reasons offered by donors for this change include:

- A demonstrated *track record* of many Ethiopian MFIs in terms of outreach, growth, discipline.
- A growing body of information from other places on the *impacts* of microfinance on improving the lives and well-being of the poor.
- The existence of *tested products, systems, and approaches* that effectively deliver financial services to the poor.
- Increasing *professionalization* of the microfinance field, the establish-

ment of standards, and a growing number of successful (as well as unsuccessful) examples throughout the world to learn from.

- Microfinance is *no longer a 'homeless' field* or discipline. There are more than 10,000 microfinance institutions throughout the world. In addition, there are microfinance departments in banks and microfinance officers within development agencies. There are courses at universities and a large body of academic and practitioner literature on microfinance. Many training programs focus on development of MF technical and managerial skills, systems development and management. AFCAP, C-GAP and other training programs focus exclusively on capacity building for microfinance institutions. There are regular global and regional microfinance conferences (e.g., the Microfinance Summit). Yearly short courses at Boulder, Manchester, and New Hampshire attract practitioners and promoters from all over the world.
- New directives in Ethiopia's microfinance law that will allow for *more flexibility*, including those related to interest rates, loan amount ceilings, lending methodologies, forms of collateral, and loan repayment periods.
- Finally, the *momentum created by IFAD's RUFIP program* has also spurred the interest of other bilateral and multilateral donor agencies that actively support microfinance in other countries. Two years of preparations for this program have generated a lot of systematic information on MFIs, identified many strengths and weaknesses, and prompted discussion and debate on a range of issues from product development to ownership. The project has reviewed the performance of many MFIs and identified specific capacity building needs. It has identified changes in the microfinance law (Proclamation 96/40) needed to improve the performance and impact of microfinance institutions.

Six donor organizations in addition to Sida have large funds for microfinance programs in their pipelines: IFAD has a USD 88 million seven year program to provide capital funds and capacity building support to Ethiopian MFIs. The Government of Ethiopia (GOE) has requested USD 37 from the African Development Bank to co-fund the IFAD program. The European Union, the United Nations Development Programme (UNDP), and USAID also have smaller, but still large-scale projects in their pipelines to complement the IFAD program. Packard Foundation will provide USD 6 million for an integrated credit and reproductive health program in two regions (Annex 2).

2.2 The role of the Association of Ethiopian Microfinance Institutions (AEMFI)

Mandate

AEMFI was registered in 1999 as network for microfinance institutions in Ethiopia. Its mandate is to promote best practices in the industry, facilitate sharing of experience and information, and provide a forum for debate and dialogue on policy issues governing microfinance activities. It does this through activities including workshops, research, information exchange, exposure visits, training, and other networking activities.

Membership is open to MFIs, NGOs, banks, and individuals who are involved in microfinance activities. A seven member ad hoc board oversees activities. It consists of representatives from four government backed MFIs, two other MFIs, and director (who is a non-voting member of the board). Currently, all 20 MFIs in Ethiopia are members of AEMFI.

A number of organizations were involved in early efforts to establish the network, including DECSI, ACSI, and OCSI, the World Bank and Red Barna Ethiopia, UNDP and Women's World Banking, World Vision Ethiopia, Pact Ethiopia and CRDA. Its close links with government supported MFIs is reflected in its origins, the composition of the advisory board, and the location of its office in space in a building shared by the Tigray and Amhara regional development associations.

AEMFI works out of a small office with a staff of six (director, training coordinator, performance monitoring officer, communications officer, administrative assistant and part-time junior accountant). While funding proposals have been written to many different organizations,[5] main supporters so far have included Pact Ethiopia, African Development Bank's AMINA program, and Ireland Aid. AEMFI has carried out workshops in collaboration with other organizations in including, among others, World Vision Ethiopia, the SEEP network, Norwegian People's Aid, and AFCAP.

Accomplishments

Since 1999, AEMFI has played a key role in the development of the MFI industry. The organization has produced a number of very good research reports on current topics in the field (product development, regulatory frameworks, business development services, the implications of changes in the interest rate, and an upcoming study on ownership issues). AEMFI's Microfinance Development Review (journal) includes overview information on the MFI sector, background information on specific MFIs, and articles on topics related to microfinance policies, operations, and practice. The reports are well written. Topics are linked to the Ethiopian context and thoughtfully covered.

As a support network, AEMFI effectively provides a focal point or 'home' for MF in Ethiopia. It has been effective in bringing Ethiopian MFIs together through forums, workshops and publications. It facilitates exchange between and among MFIs and the National Bank of Ethiopia (the government's regulatory body). AEMFI is an important link between MFIs and the NBE on issues related to the microfinance proclamation and its directives (changes). It has provided forums for MFIs to discuss the proclamation and its directives and to offer input on related issues. It conducts research that has fed into changes in the proclamation. It has played an active role at the policy/regulatory level.

AEMFI also is a bridge to the international MF community. It is a contact point for international donors seeking information on the industry. It provides a channel to ideas, experiences and good practice from other places through publications, training workshops, seminars, and sponsorship of exposure visits to MFIs outside of Ethiopia.

[5] By July 2000, AEMFI had submitted funding proposals to USAID, European Union (EU), Action Aid, World Bank, SOS FAIM, UNDP and ESRDF (Wolday, 2000).

AEMFI has an excellent staff. The dedication, knowledge, and organizational abilities of the director and his staff have been key to AEMFI's accomplishments to date. The director played an important role in the design of RUFIP, which has helped to insure that the needs of all MFIs were considered in its design.

The importance of AEMFI's role in bringing visibility and vitality to the sector, connecting practitioners and policy makers to worldwide experience, and supporting capacity building processes cannot be underestimated. To date, its key accomplishments have been promoting issue-based dialogue and critical debates, technical and networking support, information exchange and capacity building support. It played a role in reducing some earlier tensions between the larger and smaller MFIs. All MFIs have benefited from AEMFI and greatly appreciate its role. A key asset is a strong director with experience in finance and research.

As a network, AEMFI cannot do everything. While it tries to support members in many ways, AEMFI's mandate is not representational. It does not play a direct role in representing MFIs, for example, when they face problems or pressures from government officials at the local level. Another issue that has come up is how AEMFI selects people to include in its activities (when resources are insufficient to include everyone). While it tries to be inclusive, it sometimes has to be selective. This suggests scope for AEMFI to improve its communication with members on opportunities and criteria for selecting people to participate in activities sponsored by the network.

Future prospects

AEMFI is 'teed up' to play a central role in MFI capacity building over the coming years. Several donor projects will support capacity building through AEMFI: IFAD, ADB, UNDP, EU, and Ireland Aid. The general approach to MFI capacity building in Ethiopia places primary emphasis on the use of indigenous, Ethiopian resources for capacity building rather than use of outside individuals or institutions. AEMFI will play an important role in lining up these local resources.

In the context of RUFIP, AEMFI is slated to play a role five key areas:

- promoting the participatory development of financial sector policies and regulations;
- facilitating the growth of the microfinance industry in the access deficit regions;
- establishing a reliable database on the status and performance of microfinance institutions;
- coordinating research, surveys and training activities on best practices; and
- encouraging the participatory development of benchmarks and performance indicators for self-regulation.

A recently approved Ireland Aid project provides core support for AEMFI's secretariat. It also directs capacity building activities to AEMFI members in collaboration with two non-Ethiopian institutions. The first is AFCAP (Nairobi) for training activities. The second is the MicroBanking Bulletin (Washington, D.C.) for performance monitoring and benchmarking activities.

AEMFI itself does not typically provide training. Rather, it works with local training partners (these will include Furra, Mekelle University, Banking Institution, AACC, and AU). However, to improve local capacity to provide microfinance training and technical assistance, AFCAP will be involved in Ethiopia for the first time. In collaboration with AEMFI, it will select 6-8 Ethiopians to teach Accounting, Financial Analysis, Delinquency, and Business Planning through a training of trainers course (the emphasis is on building local capacity for capacity building!).
The AFCAP model typically focuses on training private sector technical service providers. However, they have altered the model in Ethiopia by also involving MFI practitioners and University people, in addition to private sector service providers. Given the extensive capacity building needs of MFIs and the emphasis on use of local resources, strengthening local MFI training and technical assistance providers will be is a key challenge for AEMFI and the MFI community at large.

One issue will be AEMFI's ability to manage its own growth as it expands its role in capacity building. The new performance monitoring and training activities build on previous experience, but significantly expand the scope of (and international exposure to) work in this area. AEMFI has two staff people focused in these areas (a training coordinator and a performance monitoring officer) and will draw on outside local consultants and training resources as necessary. At this point, however, they do not plan to expand the staff beyond the current level. The use of consultants will enable them to be more flexible and responsive to emerging needs. Another issue will be managing multiple donors and not getting caught between competing agendas. Given its growth and expansion, AEMFI recognizes the need for a business plan and will carry out this exercise in the very near future. The business planning process will enable AEMFI to think through options and map out an action plan for this new phase of growth.

2.3 Issues

Microfinance in Ethiopia has been described as both fascinating and frustrating. Fascinating because of the scale, disciplined, and entrepreneurial way the industry has developed with limited outside influence. Frustrating because of governance and ownership issues that are difficult to pin down and reconcile in relation to industry defined good practice. Other issues relate to portfolio risks associated with agricultural loans, capacity building challenges, and the need for more diversified products and services.

Governance

MFI governance can be defined as a system that links the shareholders to the board, the management, the staff, clients, and the community at large. Several governance issues emerged during the course of this study as discussed below. Information was primarily from the IFAD appraisal report and an AEMFI's Working Paper Number 2 by Dr. Wolday.

Ownership

– According to the RUFIP appraisal report, to enhance the transparency and healthy growth and sustainability of the industry, there is a

need to revisit ownership issues. Right now, regional governments, non-profit civil organizations, local NGOs, and individuals representing foreign NGOs own MFIs (the shareholders). Both larger and smaller MFIs have equity structures supported by foreign donors who have contributed initial capital, but are not listed as shareholders. Shareholders often act as fronts who cannot sell or transfer the shares and forego their claim on profits or dividends. As a result, they often do not have a real stake in the organization.

- Among some larger MFIs, for example ACSI, funds from foreign and other donors are on the books as 'donated equity'. These donors can monitor the use and management of the funds (while the project is underway), but are not shareholders. In any case, the law does not allow foreign participation in ownership. The issue that this raises is that shareholders do not match up with the equity structures.
- Although MFIs are set up as private share companies, they do not distribute dividends or profits to their shareholders (they don't have any yet). Typically, their articles of Association state that the dividends are to be utilized for the benefit of the target group – the poor. As such, shareholders are not investors, and private capital investment for all practical purposes does not exist. Because the shareholders are nominal, they may not have sufficient interest to control or guide the management of MFIs. Nor may they be willing or able to provide capital if the MFI is in a crisis (Wolday 2000).
- Other issues that the shareholder/equity structure mismatch raise: (1) what happens to profits generated by donated equity funds (presumably they are plowed back in keeping with the development objectives of the institution); (2) in the event of sale (in the case of privatization) or liquidation how are the donated equity funds handled?
- The absence of clients in the ownership structure of most MFIs has also been raised. In general, the level of client awareness of management and ownership structures is low. MFIs should do more create awareness and develop appropriate mechanisms to facilitate the process of client participation in ownership. Client ownership should strengthen their identity with the institution, reduce the drop out rate, enhance the equity base, and improve the public image of MFIs, accountability and transparency.
- A related issue the importance of encouraging MFIs to access private sector equity, particularly by commercial banks. This could add to capital strength and facilitate linkages with the banking system.
- In general, ownership diversification could enhance the quality of MFI financial services, ensure healthy growth, transparency, and help in achieving long-term sustainability. As part of the process of considering ownership diversification, there is a need to revisit the legal framework that restricts direct 'foreign' participation in the equity.
- In addition to diversification of ownership, the IFAD appraisal identifies a need for MFI management to enhance their long-term shareholder value and at the same time protect the interests of other stakeholders through healthy governance practices of disclosure, transparency, role of directors, degree of accountability to the shareholders, lenders and overall public good. To this end, RUFIP includes

plans for a study of ownership and governance issues, identify best practices for good governance, and hold a policy level workshop on the topic. AEMFI currently has a bid out for a similar study.

Board issues

- Board members are not the owners of invested capital in MFIs. Since they do not have a financial stake in the institutions, they need other positive incentives (Wolday 2000)
- Another issue is the lack of professionalism and MFI expertise and experience on some boards. Board members often are civil servants, social workers, and NGO representatives. While they often have a strong commitment to poverty alleviation and development, many boards do not have sufficient experience or skills (or the right mix) to oversee the policies and efficient management of MFIs. While they are dedicated and committed, they may not always have a businesslike approach. There is a need for restructuring boards (to have mix of competencies required); need for training board members; need for regular assessment of MFI boards.

Other governance issues

- In a 2000 working paper, AEMFI argues that governance issues are fundamentally the same in MFIs supported by regional governments and in others supported mainly by international NGOs. The report asserts that all MFIs in Ethiopia have government support, and all depend on donor support as a major source of loan funds.

> *"There are no basic differences in terms of the structures, process of control and the content of governance between the two groups. The actual difference between the two categories of MFIs lies in the support the MFIs obtain from the grass root level government administration. One hardly observes any conflict of interest and use of the MFIs in meeting a specific political agenda. Some argue the support form the government has assisted these MFIs to have relatively higher repayment rates and lower transaction cost. In some of the international NGO supported MFIs, the parent NGOs influence the board and also affect the activities of the MFIs. This indicates that the relationship between the parent NGO and the MFI is not clear."* [6]

  While this point may be well taken, it begs the question of a political overlay in MFI ownership and policies and the possible use of public resources (donor funds) and state infrastructure to support a political agenda.
- Governance and ownership issues will be important to pursue in the context of moves towards privatization and the creation of rural micro-banks.

Capacity building challenges

The capacity building needs of microfinance institutions are extensive. They are discussed in detail in various project papers, for example,

[6] Wolday Amha, 2000. "Review of Microfinance Industry in Ethiopia: Regulatory Framework and Performance." Occasional Paper No. 2. Wolday Amha. August. Addis Ababa: AEMFI. P. 17

appraisal reports, AEMFI publications, and MFI business plans. One concerns is that the large sums of grant equity funds to be provided through the RUFIP program may be a disincentive for MFIs to improve operational efficiencies. To avoid this possibility, the program places heavy emphasis on capacity building.

In terms of capacity building needs, the IFAD appraisal report found 1) weaknesses in financial systems; 2) weaknesses in MIS systems; 3) weaknesses in business planning; 4) weaknesses in human resource management 5) governance issues; 6) regulation and supervision issues; 7) a need for product diversification. In terms of capitalization needs, the review found insufficient capital to expand outreach. Several other project documents, research studies, and MFI business plans confirm the need for capacity building in these areas. To access capital funds through the RUFIP program, MFIs will need to prepare to meet the requirements. As detailed in Annex 2, MFI's, with significant support from donor organizations, will focus on the following areas of capacity building in the coming years:

- developing business plans;
- developing financial and accounting systems;
- developing MIS systems to monitor financial and portfolio performance;
- promoting staff development and training – technical training, banking skills training, financial training, management training, training on operational policies and procedures;
- developing MIS/monitoring systems to track performance in large, rapidly growing MFI's like ACSI. Development of MIS systems for different sizes of MFIs (small, medium and large) based on the use of best practices and procedures;
- supporting for external audits
- strengthening the supervision and monitoring capacity of the Microfinance Supervision Division within the National Bank of Ethiopia.
- promoting self regulation through AEMFI based on the development of benchmarks and performance monitoring indicators based on best practices monitoring

Ethiopian MFIs are in the enviable position of being able to draw on considerable worldwide experience and expertise in MFI systems development and capacity building – developed over the past 20 years in other countries (not without pain). The challenge will be adapting this experience to Ethiopia and building local capacity to deliver high quality and effective training and technical assistance.

Portfolio risks

A continuing area of debate between donors and MFIs is the inclusion of agricultural loans in their portfolios. This relates primarily to government backed MFIs (including ACSI). Several concerns about these agricultural loans have been raised. One is the inherent risk of agricultural loans and the failure of group guarantee mechanism to work with agricultural loans. Some argue that microfinance systems and methodologies are more appropriate for non-agricultural activities. Another

concern is the lack of control by the MFIs over disbursement and collection of funds and other operational and policy decisions regarding the government agricultural loans. Perhaps the most frequently voiced concern is the heavy-handed collection procedures by agricultural extension agents. These practices run the immediate risk of negative impacts of forced repayment on individuals and the longer-term risk of undermining other MFI operations. A related concern is that the adoption of seed and fertilizer packages and loans may have been forced on some people to meet target driven quotas. The recent introduction of alternative collection procedures (using local *kebele* groups and not agricultural extension agents) will not reduce the inherent risk of the loans and, while it is still too early to tell, may not necessarily be less heavy handed. A key area of debate between some donor organizations and Ethiopian MFIs is whether they should be involved in production credit at all, especially government loan packages, partly because of the risks and problems these programs have created.

Partly due to pressure from Sida, ACSI has reduced the proportion of 'irregular' agricultural loans (government input loans) in their portfolio. In previous years, 75 percent of all Amhara regional government input loans were channeled through ACSI. According to ACSI's managing director, today only 20 percent of these loans are channeled through ACSI. However, ACSI now has its own 'regular' agricultural loans and 53 percent of their portfolio is agricultural credit (including livestock). To reduce the risks associated with balloon payments, the repayment terms for a portion of its 'regular' agricultural loans now require repayment in four installments.

Diversification of products and services.
Up to now, Proclamation 1996/40 has limited Ethiopian MFIs to standardized credit and savings products delivered through a group lending methodology. It restricts loan size to Br. 5,000 and limits loan terms to one year. It requires credit and savings to be provided through group guarantee mechanisms. This approach, while known and tested, has restricted MFIs to a narrow range of products and services that do not always meet the needs, preferences and opportunities of the rural poor. This 'supply led' approach is likely to have contributed to high turnover of clients in some MFIs (with the associated costs) and somewhat limited impacts on poverty and vulnerability.

These legal restrictions on MFI products are about change. Following several years of dialogue and debate on the need for more diversified products and services, a new (draft) directive was circulated to MFIs in April 2002. If approved, it will lift the ceiling on loan size – not to exceed 0.5 percent of the total capital of a microfinance institution for any individual – for a portion of loan portfolios. It will extend the maximum repayment period to five years. It will permit lending to people who are not members of groups on the basis of physical or other collateral.[7] This is welcome news for the development of a more market-oriented, demand driven industry.

[7] National Bank of Ethiopia, April 12, 2002 letter to General Managers of all Microfinance Institutions, directive No. MFI/17/2002.

Changes in the law will enable MFIs to consider a wider range of loan products (e.g., housing loans, individual business development loans, school fee loans, top up loans). New product development also can open the door to new savings or insurance products. It will enable Ethiopian MFIs to broaden their approach, to move beyond the provision of 'credit for enterprise development' towards 'financial services for the poor'.

New product development for the poor is un-chartered territory for most MFIs in Ethiopia and elsewhere in the region. The required systems, skills, processes of change, and associated risks are not well understood. But there are some important lesson emerging from other places.

- One lesson is the importance of market research to understand the financial needs and preferences of clients (and potential clients). Product development requires an understanding of how borrowing and saving fits into their money management strategies to meet day to day needs, manage risk, and take advantage of opportunities. This is important for ensuring that the terms, conditions, and delivery of financial products correspond to the financial cycles of the clients. This can reduce risks both for clients and for lenders' portfolios. Market research is also useful in designing products and services that meet the needs of different groups among the poor (they are not all the same!).
- In addition to market research, a systematic product development process should include developing product concepts and prototypes, costing and pricing, and pilot testing before roll out.
- Introducing new and/or improved products can have wider implications for an MFI in terms of its policies, procedures, staffing, costs, portfolio risk, and so on. It can increase costs, introduce new risks, require different outreach systems, depend on new staff skills or systems, and/or create other institutional 'wrinkles'. New product development is a promising and important development in the industry that can significantly improve prospects for healthy growth and improved impacts. However, it should be approached with caution and care.

By responding appropriately to the needs, preferences and opportunities of clients, new and improved products and services can play an important role in improving program performance and impact.

Donor coordination

Donor coordination in supporting the microfinance industry will be critical in the coming years. This will be especially important in the context of the RUFIP program given its scale and complexity. It will make very large amounts of capital available to MFIs to expand their portfolios. It is also important, given the considerable capacity building needs that exist in this still young industry.

Bilateral and multi-lateral donors now meet periodically. However, as donor support for MFI's expands and diversifies, more regular meetings will be important. Given the tendency for staff turnover, a record of these meetings would be useful to ensure institutional memory (if this is not already done). It also would seem reasonable to involve international non-governmental donors working in Ethiopia in these meetings, as they

also are key actors in the field and have a lot to offer in terms of experience and technical expertise.

Issues related to governance, privatization, performance monitoring and benchmarking, and improving client level impacts are likely focal points for donor coordination. Regularizing modalities for providing donated equity capital would also seem to be an important issue. For donors providing capacity building support to the same MFIs, information exchange on this will be important to complement and avoid duplication of efforts.

In some places outside of Ethiopia, when the level of donor support to individual MFIs becomes very large (i.e., tens of millions of dollars), donor consortiums have been formed to coordinate assistance efforts. These consortiums serve as a mechanism for donors to pool funds in response to single (rather than multiple) proposals, and jointly to carry out monitoring, evaluation, and appraisal activities (e.g., BRAC, Grameen Bank, Proshika in Bangladesh). While it is probably too early to consider this now, this type of arrangement might facilitate the further growth and healthy development of large scale MFIs in the future (although this idea may be irrelevant if plans for decentralizing MFIs move forward).

3. Microfinance in Amhara Region

3.1 Regional overview

Five MFIs currently operate in Amhara region, ACSI, Wisdom, and Meket, Eshet and PEACE. They currently reach approximately 212,000 active clients, or about 10 percent of households with a demand for credit. ACSI is by far the largest MFI in the region, with an outreach of 196,000, or 92 percent of all clients. Smaller MFIs reach only 8 percent of all clients.

In addition to these MFI programs, several NGOs in Amhara are channeling loan funds to borrowers through service cooperatives, mostly for agricultural activities. These include primarily Luthern World Federation and Oxfam United Kingdom.

3.2 Amhara Credit and Savings Institution (ACSI)

ACSI was registered as a microfinance share company in 1997 and since then has grown into one of Ethiopia's leading microfinance institutions. It currently provides financial services to almost 200,000 poor rural households in Amhara region, comprising 40 percent of all active microfinance clients in the country. It operates through its headquarters in Bahir Dar, 10 branch and 162 sub-branch offices covering all *weredas* in the region.

ACSI's shareholders include the regional government (25 percent), Amhara's regional development association, ORDA (35 percent), Amhara Development Association (20 percent), Amhara Women's Development Association (10 percent) and Endeavor (10 percent). ACSI has more than 1,000 staff members and strong leadership in the form of its both the current and former General Manager (the former General Manager has remained with ACSI as the Chairman of the Board. He left in November 2001 to become the Vice President of the Amhara Region and Head of the Regional Government's Capacity Building Bureau). The main sources of donor funds in addition to Sida have been UNDP, Canadian International Development Association (CIDA), Action Aid, and ESRDF (Chao Beroff, et al 2000).

Table 2

Microfinance Institutions in operating in Amhara region

Name	Geographic area of operation	Number of active borrowers[8]	Percent women 1/01[9]	Percent rural	Equity ownership[10]	Source of funds[11]
Amhara Credit and Savings Institution (ACSI)	Amhara Region 10 branches 162 sub branches	196.000[12]	47	78	25% Regional Government 75% NGOs & Associations	Savings Regional Government Sida USAID PACT Dutch Packard Foundation Pact Ethiopia
Wisdom Microfinancing Institutions	Amhara Region	8,535	30	85	100% individuals	Savings World Vision USA World Vision Canada USAID/ Washington under DAP program (guarantee loan program)
Mekket Microfinance Institution	Amhara Region	2,300	85	100	100% individual	
PEACE Microfinance Institution	Amhara Oromia Southern 7 branches	3,177[13]	62	100	16% NGOs & Associations 84% Individual	
Eshet Microfinance Institution	Amhara 3 branches	2,397[14]	54	70	20% NGO/Associations 80% Individuals	

3.2.1 Update on program design and strategy

ACSI extends credit and savings services through a group lending methodology. It also provides local money transfer services and manages pension payments for the government. ACSI integrates its financial services with activities of government organizations and development associations promoting food security and poverty alleviation. In addition to supporting the government's agricultural input program, it has (or will have) links to other government development programs such as water point development, reproductive health programs, and housing. Through these efforts, it supports the government's policy of decentralization to *wereda* level.

Interest rate: In late 2001, ACSI raised its interest rate on loans from 12.9 percent on a declining balance to 15 percent flat rate. This followed earlier reluctance to have poor clients "subsidize inefficient operations" through high interest rates. However, by early 2001, even after achieving large-scale outreach and improving administrative efficiencies by cutting costs to the bone, ACSI was still unable to achieve financial self-sufficiency. According to ACSI's General Manager, there were two reasons: the low interest rate and financial management (adjusted return on assets

[8] Source: Unless otherwise noted, these are January 2001 figures cited in IFAD's October 2002 RUFIP appraisal report, Table 1, P. 7

[9] Source: Wolday 2002 (op cit) Table 3

[10] Source: Gebrehiwot Ageba, 2002

[11] Based on available information from secondary sources. May not reflect all sources.

[12] Updated figure from ACSI, April 2002. This figure does not include clients in the pipeline waiting for loans. The total number of clients served by ACSI to date is 275,000.

[13] Updated figure April 2002

[14] Updated figure, April 2002

and problems with on-time cash management because of problems in their MIS). Following a study indicating that clients were less concerned about interest rates than the lack of productive investment opportunities, and showing they paid much higher interest rates for informal credit, ACSI raised the interest rate to 15 percent (flat rate) in November 2001. ACSI is monitoring the effects of this change both on clients and on its financial performance.

Savings: ACSI offers two forms of savings: compulsory savings, which are required to access loans; and voluntary savings. It currently has thousands of clients who are savers only – not borrowers – indicating a demand for savings services by rural households. ACSI recently streamlined the design of its compulsory savings, which previously consisted of three separate accounts for each saver. These three accounts have been consolidated into one, which has reduced the time and costs of managing these funds. Although the savings rate recently was reduced to 2–3 percent by commercial banks in Ethiopia, ACSI has not yet changed its 6 percent rate on savings. It is cautious, given the risks associated with recent increases in the interest rate on loans (clients are still adjusting to this change).

Sources of funds: To date, ACSI's loan portfolio has been funded through savings and donated equity capital. Other potential sources of funds include soft loans and commercial loans. ACSI's has been very successful in mobilizing savings to fund the portfolio (savings comprise around 50 percent of the amount of outstanding loans) and this will continue to be an important part of their strategy in the future. Donated equity funds, including those that will be provided by Sida, will be an important for their growth.

ACSI completed a five-year strategic business plan in 2001. It includes an assessment of its clients, markets, competition, collaborators and the regulatory and economic context in which it operates. It further describes an institutional assessment (of its programs, board and management issues, human resource issues, administrative capacity, financial management, and financing issues). It identifies critical issues related to products and services, marketing, institutional resources and capacity, budgets, financial management, and financing. It presents a comprehensive strategy to address these issues. The plan is well conceived and presented. Without repeating all of the details here, the main emphasis will be on:

- Consolidating systems, staff, and programs following a period of rapid growth;
- Promoting portfolio growth by deepening outreach through market penetration in its current areas of operation
- Improving management information systems and monitoring, to improve information and financial flows between sub-branch and branch offices, strengthen internal controls, monitor portfolio performance, and improve financial planning and management.
- Improving profitability, sustainability and financial independence by improving operational efficiencies, charging market based prices for services, and diversifying its sources of funds.
- Improving human resources by training staff at all levels, reviewing compensation packages, and introducing staff incentives;

- Linking financial services to other development activities in the region and supporting the government's policies to decentralize development to the *wereda* level
- Emphasizing aggressive savings mobilization
- Developing new and diversified products and services (approval of the new directives in the law will be necessary to fully pursue the diversification strategy). Possibilities include: introduction new lending methodologies (individual loans, village banking, and possible use of *edirs*); introduction of new products (insurance, time deposits; money transfer services). Given the costs and potential risks associated with the introduction of new products and services, donated equity capital (such as the funds donated by Sida) can play an important role in this process.
- Focusing on client level issues through market surveys of client satisfaction (and adjusting the design of products if necessary to improve client retention rates), developing alternative targeting tools to insure outreach to poor household,

3.3 Issues

The issues discussed in Section 2.3 all relate to ACSI – governance, capacity building, donor coordination, the risk of agricultural loans in the portfolio, and diversification of products and services. Some specific points related to ACSI:

Risk of agricultural loans in the portfolio

- ACSI's general manager described a new system for disbursing and collecting the 'irregular' agricultural loans linked to the government's seed and fertilizer packages. While the new system will remove agricultural extension agents from the process, it will involve a new group of community members acting independent of ACSI. How this new system works and the effectiveness of the government guarantee fund for these loans should be monitored. While the number and proportion of irregular agricultural loans in ACSI's portfolio has declined, they still pose a risk.
- Projections in ACSI's strategic business plan show the number of 'irregular' fertilizer loans in the portfolio declining significantly from approximately 67,000 in 2001 to 4,000 in 2005. (they already declined from 129,000 to 67,000 between 2000 and 2001).
- ACSI also has its own 'regular' agricultural loans. To address the risk of balloon payments, it is working on changing the terms of loans to allow for repayment in 3 or 4 installments and to permit the use of a portion of the loan funds for side (non-farm) activities. The interest rate on agricultural loans with multiple payments will be lower than the 18 percent flat rate on the single payment loans. However, one issue that has come up is the dissatisfaction of clients with multiple payment loans because more frequent installments also mean more frequent collection of compulsory savings.
- 53 percent of ACSI loans are for agriculture and, according to the general manager, they will remain a major part of lending for ACSI.

Managing growth

- ACSI's business plan projects continued large scale growth in the coming years, expanding to more than 500,000 clients by 2005 with large inflows of funds (Table 3).
- The upcoming external audit (supported with USAID funds) will very important for identifying problem areas to address and managing ACSI's future growth. This will be ACSI's first external audit, so it is a big job. Bids for the audit are now being reviewed. New directives in the Proclamation will penalize MFIs that do not submit external audits on an annual basis, to avoid similar situations in the future.
- Retaining clients will be very important for ACSI's healthy growth. A comparison of cumulative and outstanding outreach figures shows a turnover of 50,000 clients since 1997 (for a variety of reasons). This suggests scope for an impact assessment that focuses on client satisfaction, reasons for drop outs, impacts on different groups of clients (they are not all the same!), impacts of different products and services, and impacts of financial services linked to other development activities. The aim of this assessment should be improving (rather than proving) impact.

Managing new product development and diversification

- As mentioned in Section 2.3, there are risks and costs associated with the introduction of new products and services. It sometimes requires changes in systems, approaches, and staff skills. Given the importance of this for ACSI and its limited experience in this area, careful thought and planning will be required. ACSI may want to consider involving staff in international training on market research for microfinance and on new product develop processes.

Table 3

ACSI Projected inflows from grants and borrowed funds over the next five years (Ethiopian Birr)

GRANT FUNDS	
Unrestricted grants	Br. 40,350,000
Sida	6,500,000
IFAD	33,850,000
Restricted grants for portfolio	41,500,000
Sida	38,000,000
Other	3,500,000
Restricted grants for operation	2,400,000
USAID	950,000
Other	1,450,000
Restricted grants for other assets	4,650,000
USAID	2,150,000
Other	2,500.000
TOTAL GRANTS	**Br. 88,900,000** (US$10,337,209)

BORROWED FUNDS	
Borrowed funds –concessional rate	107,000,000
IFAD	60,000,000
USAID	47,000,000
Borrowed funds –commercial rateCBE farm input loans	179,500,000
TOTAL BORROWED FUNDS	**Br. 286,500,000** (US$33,313,953)

Source: ACSI Strategic Business Plan (2001-2005) Summary. September 2001

Change in leadership

– In November 2001, ACSI's General Manager was appointed Vice President of the Region and Head of the Bureau of Capacity Building. However, he has retained an active role in ACSI as the Chairman of the Board. ACSI's Head of Finance was appointed General Manager at this time. Trained as an accountant and auditor, he is a highly respected professional who has played a key role in ACSI's growth and development since its inception. He participated in the Boulder course on microfinance several years ago and had visited large-scale microfinance programs throughout the world. The transition in leadership has been facilitated by a continued close relationship and frequent communication between the current and former GM.

Donated equity funds

– When ACSI receives equity funds from donors, these funds are listed on the books as 'donated equity.' ACSI's donors freely monitor use of loan funds and ACSI operations. One issue, however, is the modalities through which funds (i.e. Sida funds) are channeled from donors through the regional government of Amhara to ACSI. The modality is not formalized (it has been described as a silent or informal agreement). Clarification of transfer mechanisms and ownership of the funds should be addressed to avoid any future confusion.
– At this point, according to the General Manager, ACSI does not manage the funds on behalf of the government (some other MFIs in Ethiopia manage funds for other institutions for a fee). Rather, it assumes ownership of the funds. With respect to Sida funds, ACSI is accountable to Sida (not necessarily the regional government). Sida has full rights to monitor and assess ACSI's use of funds at all levels during the project period.
– Donors have provided large amounts of donated equity to MFIs, but are not represented as shareholders, board members, or in ACSI's management. It therefore would seem important to clarify any outstanding issues related to use of the funds, use or distribution of profits (if any) generated by donated equity funds, and dispensation of these funds (or proceeds) in the event of liquidation (or sale in the case of privatization). These are important governance and funding issues that apply to ACSI and other MFIs as well.
– ACSI will support housing loans (once the loan amount ceiling is lifted). ACSI also supporting integrated credit/reproductive health programs in collaboration with regional government and Packard

Foundation. ACSI will also participate in water point project supported by FINIDA.

In sum, ACSI has grown into the largest and one of the most dynamic MFIs in Ethiopia. It has benefited from energetic, determined, and intellectually engaged leadership. It has a disciplined approach and a hard working and committed staff. Its systems are improving. It increasingly is linked to and learning from worldwide experience in microfinance. ACSI's management has been very successful in raising donor funds to support its growth and development. It is a focal point for capacity building support by USAID, and is 'on the screen' for several other sources of donor support in the next few years. It has demonstrated a more flexible approach over time – reflected in changes in the interest rate, diversification of products and services (and plans for new product development), and re-configuration of disbursement and collection procedures for the irregular fertilizer loans. With its sights sharply focused on outreach, sustainability, and impact, it will continue to play a leading role in the development of Ethiopia's microfinance industry.

4. Summary

Very generally, the MF industry in Ethiopia to date can be characterized by:

- Rapid growth
- An aggressive drive to achieve scale, especially in government supported MFIs
- Emphasis on wide geographic coverage, especially in government supported MFIs
- Dominance of government backed MFIs
- Dominant focus on rural households
- Involvement in both agricultural and non-agricultural lending
- Promotion of both credit and savings
- Emphasis on sustainability
  - Less reluctance than previously to charge higher interest rates for credit
  - Strong emphasis on operational efficiency
  - Strong emphasis on portfolio growth, especially in government supported MFIs
- Discipline
- Strong leadership
- Recognition of capacity building needs
- Concern for impacts on poor households and communities
- Recognition of the importance and benefits of diversifying products and services reflected in new directives in the Proclamation which allow for more flexibility in products and services
- Recognition of need to study problems related to governance and ownership
- Progress in improving regulation and supervision of MFIs through the NBE and self-regulatory processes overseen by AEMFI
- Ethiopian driven – history of filtering (and sometimes rejecting) outside influence and advise. However, as an increasing number of MFI professionals participate in exposure visits to MFIs in other regions and outside training, there is more openness, but still caution, to outside technical and financial support for capacity building in certain areas. This is reflected in the terms of reference for the IFAD project.

In this context, AEMFI is playing a key role in disseminating information within the industry, offering forums for issue-based exchanges, promoting training, and linking MFI professionals to worldwide experience in microfinance through exchange visits and information dissemination. While it has close links to government supported MFIs, it works hard to balance the interests of both the larger and smaller MFIs in its networking role. Forums for debate provide a structure for airing issues and AEMFI's role in helping to shape the policy environment is evident.

If it is approved, the IFAD project will go a long way to help MFIs meet unmet demand for credit, further increase the scale of outreach, and strengthen the capacity of MFIs, the NBE and other MFI sources of support. Some concerns about the program have been raised related to the huge scale of this program relative to the absorptive capacity of MFIs and other donor support and the possibility of reinforcing the imbalance in scale between large government backed and smaller MFIs. Another concern is that if for any reason it is not approved, MFIs may be counting too much on it.

These concerns notwithstanding, microfinance in Ethiopia is in its ascendancy. The desire to expand outreach as rapidly as possible in part is in keeping with (and reflects) the government's drive for devolution. MFIs appear to have a genuine desire to 'stand on their own feet' and to have an impact. MFIs are now paying more attention than ever to the sustainability of their operations – recognizing the need to increase interest rates, improve the management and efficiency of programs, and train professional staff and board members. This all bodes well for the future.

ACSI is positioned to play an ever more visible role as it grows into one of the largest MFIs in Africa. Sida support has been instrumental in the growth and development of ACSI.

Towards a Sida Strategy

While beyond the scope of this paper, the findings from this review suggest the possibility for strategic interventions is three areas:

Transparency

- clarification of governance structures and how they operate; who owns the equity funds provided by donors to MFIs; and possibilities for and implications of foreign ownership;
- implications of current ownership and governance structures if MFIs are privatized and/or transformed into decentralized rural banks or micro banks;
- political influence in policies, regulation, operations and ownership of the microfinance industry; and
- transparency of information regarding delinquencies and defaults related to agricultural loans and rapid expansion through external audits.

Diversification

- of household *economic activities* and sources of income;
- of microfinance *products and services;*
- of *ownership* of microfinance institutions

- of *institutions* providing financial services to the poor (is there a role for private banks in microfinance? Is there a role for support to smaller MFIs, to urban-based MFIs, to RUSACCOs, to other cooperative based organizations; to other member based organizations); and
- of *donor support for microfinance* (smaller, more flexible forms of donor support to fill in the gaps and fund innovative, creative, and experimental things).

Focus on Clients

- at this stage in its development, the Ethiopian microfinance industry is focused largely on developing sustainable MF institutions. There is recognition of capacity building needs in the areas of systems development, performance monitoring, staff development, governance, regulation and supervision, etc. There also is recognition of capitalization needs. The RUFIP program and other donor programs are addressing these issues in various ways. At this point, however, there is relatively less attention to clients: their financial service needs, preferences and opportunities, and how financial services can respond to their needs, help them manage risk, allow them take advantage of opportunities, and contribute to the reduction of poverty and vulnerability. Sida could play an important role in keeping these issues on the table and supporting efforts to improve understanding of the "demand side" of microfinance.

Annex 1: Outreach and Portfolio Information on Ethiopian MFIs [Based on available information, 2000-2002]

Name & Registration Date	Geographic area of operation	Number of active borrowers[15]	Percent women 1/01[16]	Percent rural	Average loan size (Br)[17]	Repayment rate (Average, 2001)	Equity ownership[18]	Services offered	Source of Funds	Comments
Amhara Credit and Savings Institution (ACSI) 1997	Amhara Region 10 branches 162 sub branches	196.000[19]	47	78	900	98.7%	25% Regional Government 75% NGOs & Associations	Credit Savings Money Transfer Pension payments	Savings Regional Government Sida USAID PACT Dutch Packard Foundation PACT	Links credit to various Govt development programs in region Recent rapid expansion Moving towards consolidation 10% coverage 10 branches 162 subbranches 15% flat rate
Dedebit Credit and Savings Institution (DECSI) 1997	Tigray Region	187,550	41	80	600	98	25% Regional Government 75% NGOs & Associations	Credit Savings Manage pension funds	Savings REST Norwegian Action Aid Small donors	War/drought recent affect on repayments Demobilized soldiers deposit payments in DECSI as savings Consolidation phase 90% population coverage
Oromia Credit and Savings Institution (OCSI) 1997	Oromia Region	37,000	12	99	1000	92.5	25% Regional Government 75% NGOs & Associations	Credit Savings	Shareholder contributions ESRDF, International NGOs Savings	Links to Oromia Self Help Organization

[15] Source: Unless otherwise noted, these are January 2001 figures cited in IFAD's October 2002 RUFIP appraisal report, Table 1, P. 7
[16] Source: Wolday 2002 (op cit) Table 3
[17] Source: Wolday 2002 (op cit) Table 3
[18] Source: Gebrehiwot Ageba, 2002
[19] Updated figure from ACSI, April 2002. This figure does not include clients in the pipeline waiting for loans. The total number of clients served by ACSI to date is 275,000.

Name & Registration Date	Geographic area of operation	Number of active borrowers[15]	Percent women 1/01[16]	Percent rural	Average loan size (Br)[17]	Repayment rate (Average, 2001)	Equity ownership[18]	Services offered	Source of Funds	Comments
Omo Microfinance Institution 1997	Southern Region	39,342	35	95	600	97	80% Regional Government 19.5% NGOs & Associations 0.5% individuals	Savings Credit Manage Pension funds	Savings	
Specialized Financial and Promotional Institution 1997	Addis Ababa[20]	6,261[21]	80	1	1000	98	80% NGOs & Associations 20% individuals	Credit Savings Manage funds for non-MFI NGOs through partnership program (MSF)	Japanese ICCO-Dutch Managed funds of non-MFI NGOS Savings	Linked to unit for small business training
Gasha Microfinancing 1998	Addis Ababa	3,217	85	-0-	800	86	61.9% NGO 38.1% individuals	Credit Savings	Action Aid	Linked to ProPride urban community development programs Technical business advise, Business skills training by Propride
Wisdom Microfinancing Institutions 1998	Amhara Region	8,535	30	85	755	98	100% individuals	Credit Savings 12.5% flat rate 2% application fee	World Vision USA World Vision Canada USAID/Washington under DAP program (guarantee loan program)	

[20] Experimenting with a pilot project that lends to two cooperatives in Oromia for on-lending to clients
[21] Updated figure January 2002

Name & Registration Date	Geographic area of operation	Number of active borrowers[15]	Percent women 1/01[16]	Percent rural	Average loan size (Br)[17]	Repayment rate (Average, 2001)	Equity ownership[18]	Services offered	Source of Funds	Comments
Sidama Microfinancing Institution 1998	Southern Region Sidama zone	6,390[22]	60	90	1800	90	70% NGO 30% individual Shareholders are staff of Sidama	Credit Savings	Ireland Aid	Hope to reach 44,000 clients by 2003/4 Linked to Business Development training provided by SDP. Chairman of board active in management
Mekket Microfinance Institution 1999	Amhara	2,300	85	100	400	N/a	100% individual	Credit Savings		
PEACE Microfinance Institution 1999	Amhara Oromia Southern 7 branches	3,177[23]	62	100	682	99.4%	16% NGOs & Associations 84% Individual	Credit Savings		
Addis Credit and Savings Institution 2000	Addis Ababa Region	7,000	70	-0-	1300	N/a-	96.7% Regional Government 3.3%NGOs & Associations	Credit Savings		
Eshet Microfinance Institution 2000	Amhara 3 branches	2,397[24]	54	70	500	100	20% NGO/Associations 80% Individuals	Credit Savings		
Wasasa Microfinance Institution 2000	Oromia 2 branches	1,862[25]	54%	77%	498	100	20% NGOs & Associations 80% Individual	Credit Savings		Registered in 2000
Asser Microfinancing 1998		3,100	-0-	73	750	N/a	97% NGOs 3% Individual	Credit Savings		

[22] Updated figures as of April 2002
[23] Updated figure April 2002
[24] Updated figure, April 2002
[25] Updated figure, April 2002

Name & Registration Date	Geographic area of operation	Number of active borrowers[15]	Percent women 1/01[16]	Percent rural	Average loan size (Br)[17]	Repayment rate (Average, 2001)	Equity ownership[18]	Services offered	Source of Funds	Comments
Africa Village Financial Service 1998	Addis Ababa	731[26]	60	-0-	1500	93.3	100% Individual	Credit Savings Manage funds for non-MFI NGOs	CARE	Links to enterprise and entrepreneurship training program. Organize through Kebele based edirs
Buussa Gonofa Microfinance 1999	Oromia (ICCO, WSM)	2,758	85	87		93.3	19.6% NGO & Associations 80.4% Individual		ICCO WSM	Owned by Hundee-Oromo Grassroots Development Initiative
Meklit Microfinance Institution 2000	Addis Ababa (GTZ/ECA)	1,001	73	-0-	700	99.4	91% NGOs & Association 9% Individual	Credit (24% flat rate) Savings Manage funds for Progynist @ 14% flat rate	GTZ/ECA	Linked to Progynist urban development programs
Benishangul Microfinance Institution 2000	Benishangul region (Regional govt)	425	60	100		N/a	20% Regional Government 50% NGOs & Associations 30% Individual	Credit Savings		
Shasemene Edddir Yelimat Agar MFI 2000	Oromia Shasemene (ACORD)	200 *(44 Idirs)*	58		1275	N/a	100% Individual	Credit Savings	ACORD Edir funds	Group lending through Edirs
Metemamen 2001	Oromia Nazeret (Catholic Relief Services)						100% Catholic church dioceses [to confirm]	Credit Savings	Catholic dioceses USAID	

Sources:

IFAD, Africa II Division, Programme Management Department, 2001. *Ethiopia: Rural Financial Intermediation Programme (RUFIP) – Appriasal Report. Main Report and Annexes.* Table 1(confidential report for official use only). October

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[26] Updated figures as of January 2002

ANNEX 2: OTHER DONOR SUPPORT FOR MICROFINANCE IN ETHIOPIA[27]

IFAD

IFAD will soon finalize a new, seven-year, $88.7 million program to support microfinance capacity building and capitalization in Ethiopia. The Rural Financial Intermediation Programme (RUFIP) will be by far the largest donor program in Ethiopia and is larger than any other single MFI program supported by donors in the AFCAP region.

Purpose: The purpose of the program is to enhance the outreach of financial services to rural households living below the poverty line. This will be achieved through a national, sector-wide investment that addresses key institutional and policy issues critical for the development of a vibrant and sustainable rural financial system.

Goals and objectives: To alleviate rural poverty through sustained increase in agricultural production, productivity, and family incomes. The project seeks to strengthen capacity of MFIs and RUSACCOs to expand outreach to 1.5 million rural poor households in Ethiopia. The program is designed to empower rural households, especially women; improve regulation and supervision of MFIs, provide equity and credit funds to fill a portion of the liquidity gap for both MFIs (59%) and RUSACCOs (70%).

Amount: USD 88.7 Million – 19% for institutional development and 78% for equity and credit funds. It is anticipated that the total project will be co-financed by IFAD (USD 25.7 million) ADB (USD 37.5 million requested by GOE), Development Bank of Ethiopia and commercial banking system (USD 20 million) for equity and line of credit.

Time frame: seven years starting 2002

Implementing partners: To be managed by the National Bank of Ethiopia through the microfinance monitoring unit and a national steering committee. Funding sources include IFAD, African Development Bank, Government of Ethiopia, the Development Bank of Ethiopia, and commercial banks. Irish Aid and USAID will complement program support through grant co-financing in the course of implementation (described below). EU and UNDP will also collaborate and coordinate their assistance with this project (described below).

Activities:

- *Institutional development* The purpose of this component is to strengthen the capacity of MFIs and rural SACCOs to expand outreach 1.5 million rural poor households. It will focus on staff skill development, financial accounting practices, and information and management systems.
- *Improved regulation and supervision* This will include staff training, formulation of procedures and manuals, development of sound framework for external audit that complements the supervision function. It will support the development of self-regulatory processes by strengthening the institutional capacity of AEMFI to develop benchmarks and performance monitoring indicators for MFIs based on best practices.
- *Equity and credit funds* This is the largest part of the project.

[27] Based on available information. Does not cover everything.

IFAD estimates the net liquidity gap of MFIs over the next seven years to be $100 million. IFAD will provide $59.5 million to bridge this liquidity gap through equity support and credit funds, including $20 million from the domestic banking system. In addition, program will provide credit funds of $6.8 million to RUSACCOs against a liquidity gap of $10 million.

– *Program coordination and management* The program activities will be coordinated by a Program Coordination and Management Unit (PCMU) established within the Development Bank of Ethiopia (DBE). The head of the unit will report directly to the chief Executive, DBE. The PCMU will be responsible for coordinating programme activities, managing the line of credit and equity, performance monitoring and evaluation, and coordinating with AEMFI, commercial banks, service providers, National Bank of Ethiopia, and co-financers. DBE will establish a Programme Management Committee to guide the PMCU. In addition, the National Bank of Ethiopia will establish a National Rural and Microfinance Policy Steering Committee to address emerging policy issues in rural finance.

Notes:

– No locally based contact person for IFAD
– Initial debates revolved around the balance in allocation of funds for capacity building vs. capitalization. Government supported MFIs push for more emphasis on capitalization and continuing support for agricultural loans. First IFAD team pushed for more emphasis on capacity building, support for smaller MFIs, and emphasis on non-agricultural rather than agricultural finance. Government linked MFIs argued that IFAD – which focuses on agricultural development – could not be involved in a rural credit program without support for agriculture.
– Some concern that the large amounts allocated for equity and loan capital funding will distort the incentives to offer savings services. Also concerns that the sector does not have the absorptive capacity for this huge amount of funds.
– Considered by some donors as the 800 pound gorilla on the scene. Some donors have bowed out of previously planned activities either to avoid duplication or because the small size of their funds would not make a difference relative to this project (e.g., DFID completely bowed out of support for microfinance).
– Support from this project seems unattainable by some smaller MFIs
– Appraisal documents provide more information on the sector than previous available in one place.
– Project rationale sees policy framework in Ethiopia as "conducive to the growth of MFIs and politically independent savings and credit cooperatives."
– Project paper discusses the need to revisit the current legal provisions that restrict foreign ownership of MFIs.
– Provides a framework and rationale for other donors to support microfinance in Ethiopia. Identifies priority issues, gaps, problems, and risks (including risks of political involvement in sector).

– Emphasis on new product development, diversification of products and services and impact assessment reflect an effort to balance the supply and demand sides of microfinance in the program design.

Ireland Aid[28]

Ireland Aid signed a new two-year project in January to support capacity building of the MFI industry. Previously, they provided capital and training to start up of SidaMA Microfinance Institution in Sidama Zone, Southern Region (which is linked to other Ireland Aid development programs in the region). This is seen to complement the larger IFAD program.

Purpose: Capacity building support to help to prepare the Ethiopian MF industry for a planned investment ($87.7 million over 7 years) from IFAD and their potential partners. The Ireland Aid project will focus on building capacity and improving regulation and supervision within the MFI industry in Ethiopia.

Goals and objectives: To reduce vulnerability and income poverty of the rural and urban poor by increasing their access to credit and savings.

Amount: Euro 571,380 ($506,128). Out of this, $157,940 will support AFCAP costs and $348,188 will support local costs. AFCAP is a regional MFI capacity building program based in Nairobi promoted by C-GAP.

Time frame: 2002–2004

Implementing partner: AEMFI will be the collaborating partner. The project will direct capacity building activities to AEMFI members in collaboration with AFCAP (Nairobi) and MicroBanking Bulletin (Washington, D.C.). Local training partners would include Furra, Mekelle University, Banking Institution, AACC, and AU.

Activities:

– *Training.* For both senior management level and middle and lower management level: in business planning and financial modeling; accounting and financial analysis; audit; new product development. Intend to reach 250 practitioners of AEMFI's member institutions AEMFI will collaborate with AFCAP in carrying out this training. The training program will reach 40 senior level managers and 250 middle and lower level managers. [about Br.2.8 million or roughly $1000 per trainee.]
– *Performance monitoring.* Support to develop a system to monitor the performance of partner organizations. Baseline survey on performance; consultative meeting with MF practitioners on MIS/monitoring issues; software installation and testing performance; training in data base management; publication and distribution of monitoring information; fixed assets. AEMFI will collaborate with Micro Banking Bulletin will contribute software and provide TA in testing benchmarking tools.
– *Workshops and conferences.* Topics will include Agricultural Loans: Problems and prospects (2002); Bi-annual general meeting and Conference (partial coverage 2003); and Sustainability of Ethiopian MFIs (2004).

[28] From project agreement, January 2002

– *Research.* Topics will include a small study on governance and ownership issues (2002) and possibilities of linking commercial funding with microfinance activities (2004) – to follow the sustainability workshop.
– *Experience sharing visits.* AEMFI members to visit Indonesia in 2002.
– *Administration.* 10% training salary for new training coordinator; 100% Executive Director's salary for two years. [Director's salary is approximately Br. 5,000 or $588 per month.]

Notes:
– Ireland Aid will focus it MF support more to the Federal level and shift away from the Regional level.
– Their support for microfinance is poverty focused, but in the context of institutions that can stand on their own two feet.
– They see a role for credit to support other development activities.
– They anticipate participation in the IFAD RUFIP program. The current project complements the RUFIP program.

European Commission[29]
EU is just starting a new micro and small enterprise development program. As a new donor on the MF scene in Ethiopia, EU now has a tender out to establish a project management unit that will oversee project activities. The EU's approach will give priority to funding smaller and weaker MFIs and to covering geographic areas not currently covered by other MFIs (urban areas outside Addis; rural areas not served by bigger MFIs).

Goals and objectives: Support for microfinance is seen to be part of the EU's emphasis on food security, private sector development, and poverty reduction.

Implementing partner: EU currently has a tender out to establish a project management unit. The project will have a steering committee.

Amount: Euro 7 million

Activities:
– *Capacity building* for MFIs, MFI support organizations (AEMFI) and SME support organizations. (Chambers of Commerce)
– *Business Service delivery*
– *Microfinance Fund:* grants to MFIs for on-lending

Notes:
– EU originally was to support NBE MFI monitoring unit but took this out of their support because it would duplicate IFAD.

UNDP[30]
Purpose: To complement the IFAD program of support through grant financing of MFI capacity building activities, small capital grants, and support to the National Bank of Ethiopia.

Goals and objectives: Focus on food security and agri cultural development – support for MF seen to be part of this for enhancing sustainable livelihoods for women. To promote professionalization and commercial viability of the MFI sector.

[29] Discussion with Kurt Cornelis, April 18, 2002
[30] From draft concept paper, January 2002

Proposed amount: $1,958,388

Proposed time frame: 3 years

Proposed implementing partners: National Bank of Ethiopia; AEMFI; program committee comprised of program investors and supervisors; approximately 4 promising MFIs to be selected by the program committee; capacity building experts to be selected by participating MFIs; UNDP Ethiopia and SUM/UNCDF.

Proposed activities:

- *Capacity building:* for MFIs in priority areas including: business and strategic planning; management information systems; new product development (focused on quality of services and needs of clients); prudential management of savings deposits; effective governance through professional board orientation and training; financial performance monitoring; and exposure to microfinance sound practices. ($738,838 for workshops and capacity building relationships; $142,000 to AEMFI)
- *Microcapital grants:* for flexible use with the purpose of strengthening MFI capacity to meet their overall business plan objectives. Examples of how these grants could be used include to purchase assets, to cover operating shortfalls, or to purchase additional technical support. ($750,000)
- *Support to National Bank Ethiopia:* for high quality training opportunities for key staff (e.g. Boulder), exposure visits to microfinance institution and to countries with significan experience in supervision and sound regulation of licensed MFIs – to be determined by NBE. ($186,000)

Notes:

UNDP is looking to ADB, EU, DFID, and Finnish Cooperation and Ireland Cooperation for co-funding.

- Potential co-funders of EU project, as per ADB report: ADB; EU; Finish Cooperation; Ireland Aid.
- Geographic areas of focus: Tigray, Oromiya, Southern, Amhara regions.
- Harmonization very important.
- Will consider geographic balance; types of organizations.
- Gaps in policies have negatively affected MFIs. Interest rate;

MF must not be seen in isolation, must be linked to other activities.

African Development Bank[31]

ADB currently provides support to the microfinance industry in Ethiopia through its AMINA project. This project provides support primarily for MFI capacity building in 10 African Countries. It is managed from ADB headquarters by the AMINA unit and microfinance experts.

AMINA support in Ethiopia is directed though AEMFI. To date, it has involved workshops, study tours and conferences. Remaining activities in the action plan include training in credit management and business planning. This project will soon transform into a Central Microfinance Unit within the Bank. It will have microfinance specialists and continue to work through capacity building groups such as AEMFI,

[31] From Back to Office Report, January 2002

but with greater use of third party regional and sub regional technical service providers.

Purpose: The purpose of the AMINA project is to promote capacity building, policy dialogue, and information dissemination.

Time frame:

Amount:

Implementing partner: The AMINA project provides support to 12 partner MFIs in Ethiopia through AEMFI. Partners include large government supported and smaller MFIs.

Activities:

- Capacity building: Training in credit management and business plan; MFI database – partner MFIs must submit financial reports; Supply of computers to MFIs (delays due to request for greater transparency and need to ensure that MFIs without tax exemption will pay customs and taxes themselves) four training courses; international training course for NBE staff;
- Policy dialogue: Two policy reform workshops; two study tour (Kenya and Bangladesh 4/01); support to AEMFI for Bahir Dar conference.
- Information dissemination: Publications including proceedings from Bahir Dar conference; findings form exchange visits; report on exchange visits.

Future of the ADB support: ADB anticipates being a major co-financer of IFAD's RUFIP project, indicating support in the amount of USD 37.5 million out of a total of USD 88.7 million. The government of Ethiopia submitted an official request to the Bank group to co-fund the project in November 2000. This ADB support will be primarily be for capitalization. It also anticipates collaboration between AMINA and UNDP's proposed Microfinance Support Program in areas related to capacity building.

USAID

USAID currently provides support to two microfinance institutions in Ethiopia, ACSI and WISDOM, both operating in Amhara Region. USAID/Ethiopia provides capacity building support to ACSI in several areas, including MIS development and external audit. USAID/Washington's Office of Microenterprise Development provides approximately $2 million to WIDSOM. In addition, USAID/Ethiopia is currently reviewing proposals for a microenterprise development program that will include a component to support capacity building for microfinance institutions in Amhara region. Other components of the program include business and technical skill training; a pilot market demand-led development activity; and rural technology generation, development and promotion.

Purpose: The purpose of the MFI capacity building component of the new project is to strengthen the capacity of existing MFI's to efficiently provide financial services (saving and credit to rural households). The project will involve the development, pilot testing and implementation of an in-service training program for ACSI to increase the capacity of MFI practitioners, including boards of directors, managers, credit and savings

officers and accountants. While the training will focus on the ACSI, this approach will allow for the use of the materials developed by MFI's throughout Ethiopia.

Strategic objective: support for microfinance is focused on rural household production and productivity increase.

Time frame: 54 months (contingent on review after 36 months)

Amount:

Collaborating partners: The training program will be developed in collaboration with the Amhara Savings and Credit Institute (ASCI) at the regional level and AEMFI at the national level. USAID has not yet selected the contractor who will responsible for implementing the project.

Activities:

- Training needs assessment.
- Curriculum/module development, curriculum/module testing, and refinement for both short-term (in-service) training and specialized short courses.
- Study tours.
- Materials development and publication.
- Training-of-trainers.
- Short-term technical assistance to ACSI and other MFIs to improve management and help diversify financial products. This assistance, which is not currently available in Ethiopia, is expected to include specialized subject areas related to financial and portfolio management, and the development of new financial products. Specific assignments will be identified based on MFI requests, with the requesting MFI required to provide local travel and per diem costs, and included in the Annual Work Plan.
- Current and future support to ACSI will include MIS development, external audit: training for microfinance practitioners, short-term technical assistance, and some capital costs for Branch and sub-branch operations in food insecure *weredas.*

Notes:

- *HIV/AIDS* modules will be included in the micro-finance practitioner and business skills training programs.
- The project will monitor the *nutritional impact* of increase household access to rural financial services and business skills training.
- The project will advise and assist PVO/NGO micro-finance and micro-enterprise development to help them specifically address *gender concerns* and relevant issues.

Packard Foundation

Packard will provide support to ACSI and Omo Microcredit Institution ($3 million each) for an integrated reproductive health and credit program. Packard will provide equity finance to support credit activities targeted to women in selected Zones/*Weredas*; and support to regional governments entities that will be involved in delivering reproductive health services. In addition, Packard will support an operational research component to improve understanding of the impact of an integrated program on reproductive health outcomes. A four cell design will study

impacts on reproductive health outcomes of the following interventions: credit only, credit and reproductive health, reproductive health only, and nothing.
[information incomplete – insufficient time to meet with Packard. This information was provided by ACSI]

ANNEX 3: Note on Government Involvement in Microfinance Institutions

The situation

- The Government and the EPRDF have been important actors in promoting the growth and development of the microfinance industry in Ethiopia.
- Rural credit plays an important role in EPRDF policies. The party and its affiliates have an interest in playing a pivotal role in the economy. As part of this strategy, they are involved as investors in various economic sectors as associations, organizations, and individuals.
- Over the past six years, there has been involvement of party affiliated development associations, organizations, and individuals as shareholders, board members, and managers of government supported microfinance institutions (MFIs). This suggests the influence of the ruling party and its affiliates in the policies and operations of government supported MFIs. As such, they cannot be considered politically independent institutions.
- Information was not available on the extent to which the earlier EPRDF policy regarding rural credit may have been modified in recent years.
- Party members describe their party affiliation as separate from their work in microfinance. Party members describe themselves as members of the party in their individual capacities, but work on microfinance in their professional capacities.
- This issue is widely understood, but not openly discussed within the industry. Nevertheless, several questions have been raised regarding party influence in the operations of party backed MFIs at the local level: does party officials influence who gets access to loans? Is there any discrimination? Is there political pressure to repay loans even if the effects on borrowers may be negative?
- The close link between the state and the party is an issue that cuts across many government- linked programs, not just microfinance. It affects many donor-supported programs.
- Because of government involvement and limited transparency regarding ownership, some donors have been reluctant to support MFIs. Nevertheless, the dominance and scale in outreach of these institutions in Ethiopia and their potential role as agents of development – in promoting food security, building assets, increasing production and productivity, and addressing issues of poverty and vulnerability – means they cannot be ignored.
- It is important to note that while government-backed MFIs reach more clients than other MFIs (over 90 percent of all microfinance clients are from government backed MFIs) 14 out of 20 MFIs are not government-backed.
- The relationship of the government and party to the microfinance industry raises several critical issues. What have been the benefits of this involvement up to now? What are the longer-term risks? To what extent do donors acknowledge this involvement in providing support?

What strategies are donor agencies pursing to mitigate the risks of party influence or political interference in the industry? What are the implications of this involvement for smaller, non-government supported MFIs and rural savings and credit cooperatives (RUSACCOs)?

Positive aspects of government and party support and involvement in MF industry

- Government and party support has contributed tremendously to the rapid growth and development of the industry.
- It has been important for maintaining an indigenous, Ethiopian-driven industry.
- It has permitted retention of certain principles – a commitment to serving the poor and widespread geographic coverage of services, especially in rural areas. In other countries, commitment to these objectives by MFIs often gives way to more pragmatic objectives of financial sustainability and profitability which can reduce or limit a commitment to the poor and wide geographic coverage.
- Government and party links have invoked a high degree of discipline and commitment by individuals at all levels, which is a key strength. Long hours of work by many people have been a 'subsidy' to the industry.
- It has promoted a strong degree of intellectual engagement and systematic and thorough consideration of issues among promoters and practitioners in the industry.
- Government links and support have facilitated the mobilization of capital resources through regional government, regional development associations, and other sources.
- The government, with party support, was instrumental in instituting Proclamation 96/40, which provides a legal framework for the industry. While seen by some as a means for the government to control the MFI industry (to the extent this may be true, people are hesitant to talk openly about it), and recognizing some inherent problems in it, the Proclamation provides a structure for oversight, regulation, protection, and discipline that is absent in many other places. Subsequent revisions of this proclamation have been based upon open consultations between government supported and other MFIs. Changes that have been made, which reflect a degree of flexibility, openness to learning through experience, and basic interest in healthy growth and development of the industry.

Risks

The track record of the government-supported/party linked MFIs is impressive. It is unlikely that the rapid growth and development would have happened without a strong push and support from government and party officials. Their efforts must be acknowledged, along with others who have worked hard to build MFIs that provide financial services to large numbers of rural and urban poor households. While not suggesting any impropriety on the part of those involved, the longer-term risks of political involvement in the microfinance industry are important to consider.

- If the ruling party changes, support and connection to government structures by party dominated MFIs cannot necessarily be relied upon. Operations may be vulnerable given their dependence on government infrastructure at the local levels, such as local committees, *kebele* officers and offices, and government guarantee of funds.
- One concern is the politically linked drive to include agricultural loans in the portfolios of government supported MFIs (this is relevant to ACSI). Several concerns about these agricultural loans have been raised. One relates to the inherent risk of agricultural loans and the inappropriateness of group guarantee mechanisms for agricultural loans in the event of covariant risks. Another concern is the lack of control by the MFIs over disbursement and collection of funds and other policies that are controlled by the Ministry of Agriculture extension agents. A frequently voiced concern is the heavy-handed collection procedures by agricultural extension agents and the resulting negative impacts of forced repayment on some individuals. This poses a longer-term risk of undermining MFI operations[32]. A related concern is that the adoption of seed and fertilizer loans may have been forced on some people to meet target driven quotas. The recent introduction by ACSI of alternative collection procedures (using local groups and not agricultural extension agents) may not necessarily address the issue of political interference.
- Political pressure to keep interest rates low and savings rates high (particularly in the context of the recent drop in the savings rate by other banks) could undermine the longer-term financial sustainability of MFIs without other subsidies.
- Political pressure at local level can distort the market. For example, government policy has been described as "coverage, not competition". In the politically motivated rush to disburse loans as widely as possible (especially in newer areas where government supported MFIs are working) sometimes professional or trained staff are lacking, and lower standards for selecting clients and disbursing and collecting loans are applied. This can jeopardize the program itself. It also can seriously undermine non-government supported MFIs with a more professional and disciplined approach. Moreover, political influence may influence decisions about who gets loans and create interference or social pressure on how people use their loan funds.
- The near monopolistic position of government supported MFIs also poses the risk of distorting the market – government subsidies to their operations makes it difficult for other MFIs to compete.
- Lack of transparency about political involvement is a disincentive to donors and investors who manage public funds that cannot be used to support political organizations and other donors and investors who are committed to supporting non-political institutions.
- Party involvement makes the industry vulnerable to criticism that it is being used as a political tool to promote and reinforce party linked

[32] It is important to note that maintaining repayment discipline is a key issue for all MFIs. When MFIs crack down on late payments and delinquencies, they often face severe criticism and their motives are questioned. Such criticism can undermine their operations. When inexperienced or untrained field staff responsible for collection use inappropriate collection tactics, they jeopardize the standing of the MFI in the process. Peer pressure to repay loans at times also can become heavy handed. Good practice is to have clear and transparent delinquency policies that are consistently, fairly, and sensitively applied. Even if loans are written off the books, follow up efforts to collect loans should be continued.

government policies. Whether this is good or bad is open for debate. For example, in support of the government's decentralization policy, ACSI is planning to provide housing loans and loans for the development of other services at the *wereda* level. This will support the movement of government employees and professional staff to this level (this will not be possible until the new MF directive that permits a larger loan size and repayment term is approved).

Donor strategies to deal with risks

Current donor strategies to deal with these risks include:

- Support rural savings and credit cooperatives and the cooperative sector in general as a non-political or de-politicized alternative to government-party backed MFIs. Focus on member education and effective member participation in RUSACCOs. Direct support to politically independent RUSACCOs.
- Put pressure on government-party backed MFIs – regarding agricultural loans in portfolio; regarding appropriate collection practices; regarding transparency of operations; regarding flexibility in their approaches.
- Support the development of self-regulatory processes – to avoid the risk of political interference in supervision and regulation through National Bank of Ethiopia (NBE). However, it is not entirely clear that AEMFI (who will oversee the self regulation process) is politically independent.
- Provide support to strengthen the independence of the central bank as it is responsible for regulation and supervision.
- Support policy dialogue seminars.
- Support a study by AEMFI of ownership structure and governance of MFIs (just starting).

Two donor documents mention strategies to deal with the risks of political interference in MFIs:

- The IFAD 2001 RUFIP appraisal document identifies political interference in loan recovery as a risk for MFIs, and suggests support for rural savings and credit cooperatives (RUSSCOs) as a way of mitigating these risks (as non-political alternatives in rural areas to party influenced MFIs). USAID also mentioned support for RUSSCOs as alternative, non-political, business organizations.
- IFAD identifies another risk being ownership and control of MFIs (by whom is left unstated) and RUSACCOs being coopted by special interest groups or compromised by political interference. It suggests development of self-regulatory processes as ones means of minimizing this risk. It also sees periodic top management policy dialogue seminars as a way to minimize this risk. Member education and member participation in RUSACCOs is mentioned as another way to mitigate this risk.
- Another IFAD concern is that NBE's regulatory and supervisory function could be subject to interference from political and vested

interests. To mitigate this risk, the document suggests dialogue and supervision missions to ensure effective regulation and supervision and that the government's commitment to strengthen the independence of central bank is followed.

- A June 2000 USAID Microenterprise Sector Assessment Report (Hochswhwender *et al*, 2000) discusses this issue in reference to ACSI:

> *"The EPRDF is prominently represented on the ACSI board. Though this is currently a strong point, it could become a liability with any change in the party in power. Also, it has the potential for introducing loan policy mandates that could threaten the viability of the MFIs so influenced. It is unrealistic to expect this pattern of governance to change in the near future. And this point is not made to suggest any impropriety on the part of those party leaders in their execution of their MFI governance functions. However, for the long term development of a strong microfinance industry in Ethiopia, there needs to be to the extent possible a de-politicization of MFIs." (pp 20–21)*

- While not a stated donor strategy, mitigating the risks of political influence and control of MF should also emphasize providing more targeted support to strengthen the capacity and promote the growth of non-government supported MFIs in Ethiopia. This should involve support to mitigate political interference in their operations at national, regional, zonal, *wereda*, and *kebele* levels.

Views of smaller non-government supported MFIs on these risks

- One view is that although larger, government supported MFIs have a near monopoly on resources, there is no evidence of direct interference with smaller non-government supported MFIs. Another view is that non-government supported MFIs are not totally free to play a role given the monopolistic position of government supported MFIs.
- Given the uneven playing field at this point, there is some concern that the design of the IFAD program is likely to reinforce the monopoly of the larger government supported MFIs. It may be difficult for the smaller ones to access equity and credit funds through the NBE.
- One donor mentioned the possibility that delays in the registration of one non-government supported MFIs may have been because it has access to substantial outside resources and therefore could become a real competitor to government backed MFIs at some future point.

Reference to ACSI

- The EPRDF is prominently represented as board members of ACSI.
- Most points mentioned above also relate to ACSI.
- There is no suggestion of any impropriety in the way ACSI has operated.
- Ownership of equity funds provided by Sida and other bilateral and multilateral donors through the Regional Government of Amhara are not clear. Are they ACSI funds? Or are they Regional Government funds managed by ACSI? The provision of funds from the regional

government to ACSI has been described as a silent or internal agreement (not in writing). ACSIs general manager describes two types of equity: shareholder and donor. But it is not clear what happens to donor equity funds in the longer term. These ownership issues are clearly linked to the question of government and/or party influence. It will be important to clarify the issue of ownership structure and political links, especially in the context of the government's new rural development policy that discusses the transition of government/party backed MFIs to smaller, private (?) rural banks and micro banks and privatization.

– The extent of party involvement, influence, and control in the MF industry is not clear to outsiders. While there is increasing transparency in the operations of MFIs, the political overlay in policies, decision-making and ownership is not fully understood. Donors do not always know what they are buying into.

Summary

Government involvement in the Ethiopian MFI industry raises the question of trade offs between appropriate discipline and excessive control, and how it affects risks. Party influence at the local levels may be high but, at the same time, outreach is extensive, corruption is low, and repayment rates are good – all desirable conditions for MFIs. Moreover, the government has embedded microfinance as a key pillar of the government rural development policy. For the most part, much of the industry has been established on good principles of practice.

Generally, the role of government and the state is not well understood in the trajectory of microfinance experience worldwide. In Ethiopia, government led devolution is pushing participatory development to the local level. Because MF has a role to play in supporting development at the *wereda* level, the administrative strategy of devolution seems to be having a liberalizing effect on MF policies (e.g., deregulating interest rates, increasing loan size, extending repayment periods, diversifying lending methodologies). However, it is a two edged sword: on one hand, it can provide a base for genuine local participation; on the other hand, it can promote party penetration and local control.

With devolution of decision-making and power to *wereda* level, it may be important to raise awareness among local officials of the legal rights established by the Proclamation that establishes freedom of MFIs to operate throughout Ethiopia. The proclamation places no geographic restrictions on MFIs if they are registered. In some places, *kebele* officials have sought written agreements with MFIs to give them permission to operate in their localities. It is important that legal rights of free operation established by the proclamation are respected.

There also appears to be scope for the government to develop a policy on how to promote private sector participation in microfinance. At this point, there appears to be a lack of vision regarding the respective roles of the party, government, and private sector in the evolution of the microfinance industry.

Further issues to explore

What is the match between existing structures of ownership and longer-term prospects for growth and development of the industry?

Is the foundation for the microfinance industry being laid out by the state appropriate for establishing participation and productive partnerships between government, external investors, and individuals?

The issues of privatization, the possible transition of MFIs to decentralized, rural micro banks, and the role of the government and party in this process warrant further exploration.

ANNEX 4: LIST OF PEOPLE INTERVIEWED

Ms. Hiwot Tadesse
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Mr. Aidan Fitzpatrick
Development Attache
Embassy of Ireland

Mr. Eric Kosgren
Embassy of Sweden

Mr. Akog Laike
National Programme Officer
Rural Development
Embassy of Sweden

Mr. Kurt Cornelis
Economic Advisor
European Union

Mr. Asfaw Mekonnen
Country Coordinator
Agency for Co-operation and Research in Development (ACORD)

Mr. Tadesse Kassa
Deputy Head of Government
Head of Capacity Building Bureau
Amhara National Regional Government
(Bahir Dar)

Mr. Mekonnen Yelewemwessen
General Manager
Amhara Credit and Savings Institution (S.C)
(Bahir Dar)

Ms. Kibre Dawit
African Village Financial Services

Ms. Ade M. Lekoetje
Assistant Resident Representative
UNDP Ethiopia

Mr. Getachew Asamenew
Assistance Resident Representative
UNDP Ethiopia

Mr. Wolday Amha
Director
Association of Ethiopian Microfinance Institutions (AEMFI)

Mr. Kurt Rockeman
USAID

Mr. Solomon
Eshet Microfinance Institution*

Mr. Tezera Kebede
PEACE Microfinance Institution*

Roland Pearson**
Programme Director – AFCAP
(Nairobi)

* Telephone conversation, April 25, 2002
**Email communication, April 24, 2002

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