

Analyzing the micro finance sector in:

Ethiopia



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General

General data (per end of 2004) ¹	
GDP per capita (PPP)	USD 801
GDP growth	8.9 %
Consumer price inflation	10.9 %
Population	74 million
Informal economy	40.3%
Exchange rate (Birr/USD)	8.67

Ethiopia is one poorest countries in the world, receiving relatively much emergency aid but relatively little support for structural development.

Micro/meso level

Formal micro finance started in Ethiopia in 1994. Micro enterprises are defined as those business enterprises whose capital is not exceeding Birr 20,000 other than high technological and consultancy service institutions.

Detailed information for all 9 commercial banks and 20 of the 23 MFI's is available in a document² from EBDSN (see below under networks). The commercial banks are not or hardly involved in micro credit activities. The 23 MFI's reach around 900.000 credit clients and saving clients. The two biggest MFI's (ACSI en DECSI) serve over 700.000 clients. Gobezie (2005a) estimates that 10-12% of the demand is currently covered by MFI's. Focus is mainly urban or peri-urban. Interest rates are between 7 and 15%, but the lower rates often include 3% service charges. Loan sizes are generally between 1.000 and 5.000 Birr. In the formal banking sector, interest rates are around 10%.

Some MFI's also have credit facilities for the SME sector with bigger loans. Group lending is most common, with no additional collateral required, but individual loans also occur with co-signing as collateral. The bigger MFI's have operational self sufficiency (ACSI and DECSI over 200%, Oromia 150%), among the smaller MFI's, some most are also operational self sufficient (with rates just above 100%) but others are not (rates around 60-70%). Nominal return on equity 7,7% (inflation adjusted: 6,3%)³.

Savings are compulsory for most MFI's with 3-4% interest offered. ACSI did a research among the target group and found that 80% have some kind of savings. Credit is mainly given for productive purposes: agriculture, micro enterprises, trade, services. Gobezie (2005a) calls it a unique feature of the Ethiopian micro finance sector that it finances mainly agriculture. Other services offered by some MFI's include voluntary savings, pension payments, micro insurance (e.g. for health expenses) and local transactions. Number of borrowers per staff is between 100 and 250, averaging close to 200. Some MFI's (like ACSI) focus on women (ACSI: 80%), but most MFI's report percentages female borrowers between 40 and 60%. In a research of ACSI (Gobezie 2005a), only 40% of female clients reported that they handle the loans themselves.

Group lending is the dominant model. This model fits the socio-cultural context of communal solidarity. Due to the fact that Ethiopia is sparsely populated, groups sizes are sometimes reduced to 4 or 5. Houses, land and crops cannot be officially used as collateral.

Dutch investors in the MFI sector in Ethiopia are Stichting Doen/Triodos, ICCO, NOVIB, Oikocredit, Rabobank Foundation.

The government of Ethiopia established in 1998 a federal government institution FeMSEDA⁴ (with regional offices ReMSEDA's). This agency has as its objective to Encourage, Coordinate & Assist institutions engaged in service provision to the development & expansion of Micro & Small Enterprises in the country at large.

¹ www.viewswire.com

² <J:\Advies & Onderzoek\Wouter\Library\Economic Development\Micro finance\Ethiopia - Loan conditions.pdf> or on www.bds-ethiopia.net, document on internal area.

³ PRSP progress report 2004

⁴ www.telecom.net.et/~femseda

Gobezie (2005a) reports the following 'gaps' in the rural finance sector:

- The inefficiency gap: the current achievements lag behind the potential supply because of inefficiency, especially in rural areas. Gobezie complains about the charity orientation of some NGO's involved in micro finance, (e.g. subsidized interest rates) through which local markets are being distorted, giving unequal opportunities to comparable clients.
- The insufficiency gap: between potential supply and legitimate demand (loans that can be expected to be repaid). This gap can be closed through innovation and developments of more institutional and human infrastructure for rural finance.
- The feasibility gap: the gap between what is politically expected and what is reasonable: not all rural households do have a demand for credit. Cost benefit analyses are needed to find out what is socially desirable and possible.

Informal financing sector

Gobezie (2005a) states that the rural financial landscape in Ethiopia remains dominantly informal. Admasie et al. (2003) did research on the informal financial sector in Ethiopia and found that informal credit provision is very common: 69% of the research sample (rural area) partook in one or more forms of informal borrowing. Both friends / relatives and private lenders are sources of informal credit. Loan sizes average Birr 470 (range Birr 4 – 7,000). Interest on cash for cash credit is 5-15% per month or 50-100% in six months. Half of the sample groups found these rates reasonable. Bargaining is often based on extending the loan period against the same interest rate. Several forms are:

- Intermittent lenders. Highest interest: average 10.5% per month (=231% p.a.). These rates are higher than the maximum rate set by government and therefore these moneylenders operate secretly when the ceiling on interest rates was still in use (till 1998).
- Tied or untied credit from informal money lenders:
 - cash for cash
 - cash for commodity (e.g. repayment in grain after harvest)
 - commodity for commodity (often used by traders and farmers)
 - commodity for cash (e.g. lending grain and collecting cash upon repayment)
- Informal traditional associations as
 - *Equb*: a traditional ROSCA system. Gobezie (2005a) mentions an estimated 8-10% of the GDP involved in these systems.
 - *Iddir*: provides social and economic services to members during times specified of mourning and gives opportunity for small loans during other crises.
 - *Iqqub*: weekly saving group with 10-100 members. Loans are also given with 8-12 months duration. Collateral is required for such loans. Second highest interest rates.
 - *Meskel Aksiyon*: mechanism for saving money to buy meat during *Meskel*, Christmas and Easter festivals.

Some systems (money lenders, *Iddir*, *Iqqub*) accept rich persons as guarantor. Legally valid written promises are also acceptable as collateral, pension cards needed to collect pension are also used. Followers of all religions are involved in informal lending systems, but Muslims slightly less.

Networks

Networking is well developed in Ethiopia. The Africa Microfinance Network has a member network in Ethiopia: the Association of Ethiopia Microfinance Institutions (AEMFI)⁵. This network with 21 members is active in doing research, in offering technical assistance and in lobby and advocacy for a better enabling environment.

Another network is the Micro Enterprise Development Forum (MEDF)⁶. This network with 33 member ngo's has key activities on research, advocacy, information and skills exchange, database development, evaluation and training.

The Ethiopian BDS Network (EBDSN)⁷ with 31 members (both public and private). In collaboration with the Ethiopian Chamber of Commerce⁷ they publish the website: www.bds-ethiopia.net. This site provides very complete information on all 21 MFI's and 9 commercial banks and insurance companies,

⁵ African Avenue, Bole, P.O. Box 338 Code 1110, aemfi@telecom.net.et, <http://www.aemfiethiopia.org>. Wolday Amha is board secretary.

⁶ P. O. Box 13047, Addis Ababa, Ethiopia - Telephone 251-1-668008 medf@telecom.net.et

⁷ <http://www.ethiopianchamber.com/>

including their loan conditions, interest rates, types of collateral needed, subsequent loan cycles and so on. It also publishes a monthly newsletter on BDS and contact information on all kinds of actors on the field of business development,⁸ including email addresses of all MFI's, donors, embassies involved with economic development. Apart from such information, the site also offers various materials about setting up enterprises, writing business plans, training materials, investment guidelines, taxation systems, quality systems; both in English and Amharic. Moreover, this site is very well kept up to date.⁹

Other networks, not specifically for micro finance are the Christian Relief and Development Association (CRDA), the Technical and Vocational Education and Training Network (TVET) and the donor network: Private Sector Development and Trade Workgroup.

Macro level

Ethiopia's macro economy is relatively stable, in terms of inflation, policies and politics, although the constant problems with Eritrea are a threat to the stability of the environment. Worldbank rates Ethiopia's business environment at rank 101 and the ease of getting credit at 114. Legal rights index (extent to which the law is designed to expand access to credit) is 5 (region: 4.4).

The regulatory framework for the MFI sector is from 1996. MFI's have to be registered and licensed by the National Bank of Ethiopia (NBE) with a minimum of Birr 200,000 (Gobezie, 2005b). This bank is responsible for regulation through the Micro Finance Supervision Division. It has 17 directives for MFI's. In 1998 the ceiling on interest rates is removed and can now be determined by each MFI. The reason for removing this ceiling is to be better able to achieve both operational and financial self sufficiency. In 2002 a minimum interest rate of 3% was set to be paid on deposits. Until recently, the maximum loan size was set at Birr 5,000 with a view to focus on the poor. However, this limit is also removed. Maximum loan size now is 0.5% of the MFI's capital and loans above Birr 5,000 should not be more than 20% of the total disbursement.

Foreign non-financial involvement is encouraged by the Ethiopian government, but financial involvement is prohibited. Banks must be owned by Ethiopians, while no person is allowed to hold more than 20% of the shares. Therefore also MFI's have to be established as share companies and the capital must be owned by Ethiopian nationals. The reason behind this is the fear that foreign investors will focus on private returns instead of reaching the poor. However, this also blocks foreign loans to MFI's. What happens is that national owners act as fronts for the real owners: foreign investors for initial capital (Gobezie, 2005a).
Summary of regulatory framework in Gobezie (2005b)¹⁰.

Poverty Reduction Strategy Paper (2002, progress report 2004)

The PRSP gives attention to micro finance and summarizes the legal and regulatory framework. It recognizes the need for expansion of the micro finance sector and calls savings mobilization an 'achieved best practice'. It states that the NBE plans to transform MFI's into rural banks and to facilitate the flow from commercial banks to MFI's.

The Rural Financial Intermediation Programme (RUFIP) managed by the Development Bank of Ethiopia's (DBE's) RUFIP unit plans to reach 1.5 – 2 million rural household with funds from IFAD and ADB and to build skills in non-collateral based lending, and improve linkages between rural finance and the formal banking sector.

SWOT analysis

General SWOT is in the sector analysis and are not repeated here.

Strengths	Weaknesses
<ul style="list-style-type: none"> • Well developed networking and information provision • Good focus on the poor and on 	<ul style="list-style-type: none"> • Unfair competition from subsidized MFI's • Lack of transparency in capital ownership • Almost exclusive focus on the poorest of

⁸ Password for internal documents area is 'go'.

⁹ Some documents are obtainable from an internal area. The password for this area is 'go'.

¹⁰ Getaneh Gobezie is also an active communicator. He responded positively to questions by email.

<ul style="list-style-type: none"> agriculture • Use of savings reduces donor dependence • 	<p>the poor leaves out target group just beyond this level “missing middle”</p> <ul style="list-style-type: none"> • Too narrow range of products and methodologies, e.g. capital assets cannot be used as collateral • Lack of capacity, mainly lack of human capital, partly due to lack of incentives for staff development • Weaker in rural areas • Relatively small proportion of women (40%)
Opportunities	Threats
<ul style="list-style-type: none"> • The regulatory framework is much more liberalised, thus giving opportunities to offer more diverse products to a variety of target groups through various methodologies. • Flow of funds from commercial banks to MFI's is encouraged 	<ul style="list-style-type: none"> • Poor infrastructures (e.g. roads) block poor from access. Also problem of distance. • Lack of business skills, risk taking attitude, willingness to enter non-traditional activities (e.g. blacksmithing, pottery, tannery, weaving) • Poorest have no income to pay back → no demand for micro finance

Recommendations for projects and programmes

- Integration of business skills in VET
- Integrate micro finance with training and other business development services
- Offer integrated services, including saving facilities and micro insurance
- Providing guarantees is acceptable for banking sector and could help MFI's get funds from local commercial banks
- Problem of missing middle → give attention to transfer from micro enterprise to SMED; offer BDS and financial services for this target group
- Focus on rural areas. Government plans to reach many rural households through RUFIP. Look for possibilities to link up.

Literature:

- General sources: mixmarket, microfinance gateway, CGAP.
- Poverty Reduction Strategy Paper Ethiopia, 2002 and Progress report 2004.
- Gobezie, Getaneh, 2005a. Livelihoods Through Micro-enterprise Services? Assessing Supply and Demand Constraints for Microfinance in Ethiopia (With Particular Reference to the Amhara Region). Paper Presented at the 3rd International Conference on the Ethiopian Economy.
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- Alisei, 2004. Various authors. Workshop proceedings on trends, challenges and other key issues in micro finance development in Ethiopia, December 9-10, 2004 Addis Ababa.
- Assefa Admasie, Gebrehiwot Ageba and Mulat Demeke, 2003. Rural Finance in Ethiopia: Assessment of the Financial Products of Microfinance Institutions. AEMFI Occasional Paper 12.

On www.bds-ethiopia.net there are many articles and overviews available for download.

Appendix 1. Loan conditions of banks and MFI's

See link in text