



Graduate School of Development Studies

Microfinance as a Strategy for Poverty Reduction:

A Comparative Analysis of ACSI and Wisdom
Microfinance Institution in Ethiopia

A Research Paper presented by:

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in partial fulfilment of the requirements for obtaining the degree of
MASTERS OF ARTS IN DEVELOPMENT STUDIES

Specialisation:
**Local and Regional Development
(LRD)**

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The Hague, The Netherlands
November, 2008

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Acknowledgements

I would like to express my sincere gratitude to Dr Peter Knorrington, my supervisor, for his unreserved comments, advice, suggestions and guidance he made on the paper from the inception to the completion of the study. His smooth guidance all the time allowed me to convert the anxiety in to strength.

I am very much indebted to Professor Bert Helmsing, for his sharp comments and comprehensive suggestions at the capacity of second reader. His enriched knowledge has guided me to bring this study in this shape.

My sincere thanks go to Dr Nicholas Awortwi, convenor of LRD, for his inspiring advice since the inception of the RP to make the focus clear. I also would like to thank Dr Erhard Berner and Dr Joao Guimaraes, for sharing their research experience and giving their advice during the consultation meetings prior the research design.

I also deserve my appreciation to fellow participants of LRD program for their comments and suggestions during research design and draft research presentation. Particularly, I appreciate the efforts made by Raphael Ngatia Kanothi and Abdulahi Abdi Aden as discussants.

I greatly acknowledge ACSI staff members Mr Getaneh Gobezie and Mr Tewabe Ayesheshim and Wisdom officials Mr Worku Tsega and Mr Dereje Tadesse who helped me a lot by providing relevant data for this study.

My foremost thank goes to Mr Anagaw Derseh (Bahirdar University) and Mr Yimenu Bawoke (Addis Ababa) for their valuable help in collecting relevant documents and sending it to me on time.

I never forget the contribution of my wife Yichalu Zelalem and my son Tewodros Kassa for their valuable help and encouragement throughout my study period. Finally, I would like to give my great appreciation for my mother, brothers, sisters and all my relatives and friends for their encouragement and financial support.

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List of Acronyms

ACSI	Amhara Credit and Savings Institution
AEMFI	Association of Ethiopian Microfinance Institutions
ADA	Amhara Development Association
ADLI	Agricultural Development Led Industrialization
ADP	Area Development Programme
AWA	Amhara Women's Association
ANRS	Amhara National Regional State
BDS	Business Development Services
CBE	Commercial Bank of Ethiopia
GDP	Gross Domestic Product
HDI	Human Development Index
HPI	Human Poverty Index
IFAD	International Fund for Agricultural Development
MDG	Millennium Development Goals
MFI	Micro Finance Institution
MoFED	Ministry of Finance and Economic Development
NBE	National Bank of Ethiopia
NGO	Non-governmental Organization
ORDA	The Organization for the Rehabilitation and Development of Amhara
PASDEP	Plan for Accelerated and Sustained Development to End Poverty
PRSP	Poverty Reduction Strategic Paper
RUFIP	Rural Financial Intermediation Program
SDPRP	Sustainable Development and Poverty Reduction Programme
SIDA	Swedish International Development Cooperation Agency
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
WVE	World Vision Ethiopia

Abstract

Microfinance has been widely accepted as a viable policy option for poverty reduction by the donor community, international organizations, governments and non-governmental organizations. In order to investigate this underlying premise, this study examined empirical evidence in Ethiopia to check if microfinance is a good poverty reduction strategy. For this purpose, the two cases (ACSI and Wisdom) were analyzed based on Design, outreach, financial performance, sustainability and impact framework. The study found that Microfinance is indeed a strategy for poverty reduction in Ethiopia. However, the contribution of cases depends on their approach. ACSI is efficient, profitable, and sustainable MFI and best reflects the business approach. However, it is less effective in achieving its development mission and reaching the poorest clients in the region. Although Wisdom is financially less efficient, productive and sustainable, its strong link with WVE helps to work relatively better in its development objectives.

The review of the impact studies shows that both cases have positive impact on their clients, especially on income diversification, health and nutrition, housing and empowerment of the poor. However, the evidence at country level shows that there has not been any significant decline in the overall levels of poverty. This could be partially due to the fact that the microfinance programs have not been very successful in including the poorest. Thus, microfinance is better used as an instrument along with other development interventions rather than a poverty reduction strategy in isolation. Microfinance alone can not defeat poverty. It should be integrated with other development interventions and in this integrated intervention, government and donor agencies could play a great role.

Relevance to Development Studies

According to International Year of Micro credit 2005, 'Microfinance is one of the practical development strategies and approaches that should be implemented and supported to attain the bold ambition of reducing world poverty by half'. Other development agendas that emphasize microfinance in reducing poverty include the G8 Declarations of 2005; the UN 2005 World Summit, the Commission on Private Sector Development, the Brussels Programme of Action; and the Africa Commission Report. All their documents considered Microfinance as an alternative to achieve Millennium Development Goals by 2015. Therefore, doing a research on microfinance as a strategy for poverty reduction is relevant to development studies.

Keywords

[Microfinance, Poverty, Outreach, Sustainability, Impact, Poverty reduction]

Chapter 1: Introduction

“Sustainable access to microfinance helps alleviate poverty by generating income, creating jobs, allowing children to go to school, enabling families to obtain health care, and empowering people to make the choices that best serve their needs. The stark reality is that most poor people in the world still lack access to sustainable financial services, whether it is savings, credit or insurance. The great challenge before us is to address the constraints that exclude people from full participation in the financial sector.” (Kofi Annan, United Nations Secretary-General, International Year of Microcredit, 2005)

1.1 Background

Ethiopia is one of the poorest and most heavily indebted countries of the world with the population of about 77 million. The agricultural sector, which accounts on the average for about 45 percent of GDP, is a source of livelihood for about 80 percent of the country's population (MoFED 2005). It is a fairly large but landlocked country with a total area of about 1.1 million square kilometres. Its land mass consists of large plateaus in the interior and vast lowlands in the peripheries. Its highlands are home to the lion's share of its population. A substantial portion of the highlands is so deforested and suffering from recurrent droughts, while a semi-arid climate characterizes the greater part of the lowlands. A combination of these facts together with a poorly developed agricultural production system, have exposed a substantial proportion of the population to cyclical drought and a perpetual state of food insecurity and deep rooted poverty.

Following the downfall of the government of Emperor Haile Selassie I in 1974, Ethiopia spent the next 17 years under a heavy-handed Marxist junta (commonly known as the “Derg”). Under Derg rule, the national economy suffered tremendously, due mainly to a rather large number of ill-conceived policy measures designed to steer and control the courses of social, economic and political development in the country. Above all, nationalization of urban and rural land, rental housing, major manufacturing industries, banks, insurance companies, leading business firms, and agricultural enterprises did a great deal of harm to the national economy.

The country has been undergoing market-oriented reforms following takeover by the current government in 1991. Based on its understanding of the implications of the predominantly agrarian nature of the national economy, and guided by the firm belief that surpluses created in the agricultural sector would go a long way to support industrial development in the country; the Ethiopian government has adopted a national economic development policy of Agricultural Development-Led Industrialization (ADLI). Accordingly, poverty reduction has remained the declared core objective in the government's old and new Poverty Reduction Strategic Papers (PRSPs). In those papers, microfinance is indicated among the specific means that is given greater emphasis and is expected to play essential role for reducing poverty in the country.

This research, therefore, seeks to analyse the theme of microfinance and poverty reduction in Ethiopia, in order to check whether microfinance is a good strategy for poverty reduction or not, based on two selected cases (ACSI and Wisdom) in the framework of Institutional design, achievements, impact and the role of actors.

1.2 Problem Statement

World Bank (World Development Report, 2000/2001) shows that , of the world's 6 billion people, almost half (2.8 billion) live on less than \$2 a day, and a fifth (1.2 billion) live on less than \$1 a day. In Africa, more than 40% of its 750 million people live below the internationally recognized poverty line of \$1 a day, and the evidence is even more worrying for Sub-Saharan African countries including Ethiopia.

Poverty is the fundamental problem in Ethiopia. Recent estimates suggest that about 31 million people (44%) live below the locally determined poverty line, which is equivalent to US45 cents or 3 Birr¹ per person a day (MoFED 2005:22). The HDI of Ethiopia for 2005, which takes life expectancy, adult literacy, primary schooling and per capita income, gives the country a rank of 169th out of the 177 countries. Similarly, according to the HPI for 2005, Ethiopia ranks 105th among 108 developing countries for which the index has been calculated (UNDP 2007/2008). The above facts show that poverty is multi dimensional and deep rooted problem of Ethiopia. Faced with this problem, poverty reduction has been identified as the overarching long term goal for the government of Ethiopia. In connection with the growing emphasis on poverty reduction, microfinance has been recognized as the most necessary and “the missing ingredient” which is believed to be effective in reducing poverty (Otero and Rhyne 1994; Khandker 1998).The Ethiopian Government Rural Development Strategy, the Poverty Reduction Strategy Paper (PRSP), including the most recent Plan for Accelerated and Sustainable Development Programme (PASDEP) and other documents emphasise, among other things, microfinance as a good entry point in achieving development objectives as well as curbing the dangerous trend in poverty and meeting the Millennium Development Goals (Gobezie 2008:3). As a result, almost all MFIs, including ACSI and Wisdom, are working based on poverty reduction mission in the country.

Despite such efforts, it is evident that poverty in Ethiopia has persisted (Woldehanna 2004). Although there is no clear evidence from Ethiopia, literature from other countries shows that using microfinance as a strategy to reduce poverty is controversial. According to David Hulme, microfinance has become an increasingly important component of strategies to reduce poverty. However, knowledge about the achievements of such initiatives remains contested. While some researchers argued that microfinance has positive economic and social impact on the poor, others warn of its negative impacts on the poor. Still others in the middle contend that microfinance indeed has a positive impact, but not on the poorest, as is so often claimed (Hulme 2000:79).

This research, therefore, is to analyse and see how microfinance is used as an effective poverty reduction strategy in Ethiopia based on the analysis of institutional design, achievements, impacts on the poor clients, and the role of governments and donors in supporting the program.

¹ Birr is the local currency of Ethiopia (\$1 is approximately equal to 8.65 Ethiopian Birr).

1.3 Relevance and Justification

Microfinance has been viewed as one way of dealing with poverty by expanding services to the poor. It is therefore, important to analyze how microfinance can be used as an effective strategy to poverty reduction and able to realize its intended objectives.

The study will contribute to the debate on microfinance and its impact on the poor and an indication will be made on whether there is a need to come up with other interventions for the different groups, so as to make an impact in terms of fighting poverty.

1.4 Objectives and Research Questions

Objectives

The main objective of this study is to make an analysis on how microfinance can be used as more effective poverty reduction strategy and to see which modality works relatively better in reducing poverty based on two case studies in Ethiopia.

Research questions

The guiding research question is *‘to what extent and in which way microfinance services of the two cases can lead to poverty reduction in Ethiopia?’* Based on this guiding question, it is hoped that the study will answer the following specific questions:

- How MFIs targeting the poor, especially women in their service provision?
- What modalities are used and which modality is more effective in reaching the poor?
- What are the services/products provided and what results have been achieved?
- What impact do the program schemes have on the lives of poor clients?
- What are the roles of the government and donor agencies in financial service provision for the poor?

1.5 Research Methodology

This study depends on desk research using secondary data from different sources. The analysis attempts to appraise the two MFIs (ACSI and Wisdom) in terms of their institutional design, achievements and impact of the programme. This study is comparative analysis to see whether microfinance is a good strategy for poverty reduction. The reason for choosing these two cases is that: ACSI is often seen as one of the efficient, profitable and largest government affiliate MFI in Ethiopia. Wisdom is also the largest private World Vision affiliate MFI in the country. Both have the objective of poverty reduction by focussing on the poor, especially women mainly in rural areas, of which poverty is deep rooted. However, they also serve the urban areas and men clients. There fore, the researcher believes that the analysis of these two cases will be indicative to show financial service provision to rural and urban areas for both women and men poor clients and their impact on poverty reduction.

In this research, both quantitative as well as qualitative data are used. Secondary sources for Literature review are books, articles and journals from ISS Library as well as

through microfinance and poverty related websites, such as microfinance gateway, MicroNed, themix.com, MicroLinkAfrica, the mixmarket.org, microlinks.org, etc. Annual Performance report and strategic plan of AEMFI, ACSI and Wisdom strategic plans, their annual reports, impact assessment reports, working papers about microfinance, and country PRSPs are used for the analysis of this research. Impact of ACSI mainly assessed based on the study conducted by Garber et al (2006)² in IDEAS, and the impact of Wisdom is assessed based on the study conducted by Shannon C. Dooch (2004) in Johns Hopkins University.

1.6 Scope and Limitation

There are many MFIs in Ethiopia. However, this paper limits itself only to ACSI and Wisdom because of the constraints of time, cost and availability of information. The geographical scope of ACSI is only Amhara region. However, Wisdom works in the Northern, Southern and Central Ethiopia (Appendix 6). The study focuses on selected criteria: institutional design (targeting the poor, lending methodology and services/products offered), achievements (outreach, financial performance and sustainability) and impact (income, nutrition and health, housing condition, and empowerment) of services to the poor. Since the paper depend mainly on secondary data, inconsistency and unavailability of relevant up to date information affects the quality of the paper. Moreover, ACSI is partly state owned and has the advantage of government support. But, Wisdom is private MFI. This study didn't control the benefits ACSI gained from the government. Therefore, the analysis will have some limitations in comparing the two programs.

1.7 Organisation of the Study

This study contains five chapters. The first chapter comprise the introduction which includes background of the research, problem statement, objectives and research questions, relevance and justification, research methodology and scope and limitation. The second chapter deals with conceptual and analytical framework about microfinance and poverty reduction. The third chapter presents the two case studies based on background description, institutional design, achievements and impact of the programs. It also presents an overview of poverty and microfinance as a poverty reduction strategy in Ethiopia. The fourth chapter discusses the theoretical reflection of the case studies on how they contribute for poverty reduction based on their design features, their performance and sustainability and impact on the poor. The fifth chapter presents the conclusions and recommendations.

² Carter Garber is the executive director of the Institute for Development , Evaluation, Assistance and Solutions(IDEAS)

Chapter 2: Conceptual and Analytical Framework

This chapter reviews the basic concepts of poverty and microfinance and establishes the analytical framework used in this research. The first part starts with the concept of poverty. The second part deals with the concept, evolution and approaches of microfinance. The third part includes the link between microfinance and poverty reduction. Finally, the analytical framework is discussed based on three major components namely: institutional design, achievements and impact.

2.1 Concept of Poverty

The definition of poverty has become ever controversial. Some would like to argue that poverty, like beauty, is in the eyes of the beholder. According to Amis and Rakodi, there are two main approaches to define poverty: one which emphasizes the absolute nature of poverty, while the other focuses on relative deprivation. In the absolute approach a minimum or basic poverty level is established and individuals below this level are designated to be in conditions of poverty. The relative deprivation approach defines poverty in relation to either average levels or societal norms. This approach attempts to relate the definition of poverty to its potential causes such as economic exploitation and problems of social marginality (Amis and Rakodi 1994).

The above two measures use income or consumption based approach to poverty. Income measure of poverty, however, is criticized because it does not consider peoples' access to basic services such as education, health care, adequate quality housing with basic services etc. A different view on poverty is the entitlement approach. The approach explains deprivation not in terms of an overall lack of resources, but in terms of household's ability to command such resources by means of mechanisms called entitlements (Sen cited in Amis and Rakodi 1994).

The definition of poverty by the World Bank (World Development Report, 2000/2001) also extended the conceptual dimension beyond the conventionally held ideas of income to a more comprehensive notion of lack of opportunities, capabilities, sense of voiceless-ness and vulnerability to external shocks. Thus, poverty reduction strategies aimed not only to create income-earning opportunities, but also must ensure improved capabilities, empowerment of the poor. Gert Van Maanen also quoted Jan Pronk's description of day to day reality of being poor as follows:

Poverty cannot be captured in terms of money and income alone. If poverty is seen as a lack of opportunity to acquire lasting control of resources in order to strengthen one's capacity to acquire the basic necessities of life-water, energy, food, a safe place to eat, rest, sleep, wash, have sex and go to school, basic health services and medicine in case of illness, [...]all that requires more than money, more than an income. It requires assets or entitlements, the value of which cannot be easily estimated in financial terms (Maanen 2004:34)

The poor are heterogeneous group which can be categorized into different levels according to their poverty status (Sebstad and Cohen 2001:4). In consideration of poverty line, people in countries of the world can broadly be divided into two categories: namely, poor and non-poor. The non-poor are living above and the poor are living below the poverty line. The poor may be further divided into destitute, extreme poor and moderate poor (Appendix 3). However, in this research the category of poor and non poor are used.

2.2 The Concept of Microfinance

According to Patrick Meagher, microfinance is defined as 'lending small amounts of money for short periods with frequent repayments' (Meagher 2002:7). However, this definition equates the concept with micro-credit, which is rather a part of microfinance service. For Van Maanen, 'microfinance is banking the unbankables, bringing credit, savings and other essential financial services within the reach of millions of people who are too poor to be served by regular banks, in most cases because they are unable to offer sufficient collateral' (Maanen 2004:17).

In broader understanding, Ledgerwood conceived that financial services generally include savings and credit; however, some MFIs also provide credit cards, payment services, money transfers, and insurance services. Besides, many MFIs undertake social intermediation services such as group formation, development of self-confidence, and training in financial literacy and management capabilities among members of a group. Thus, the concept of microfinance often includes both financial and social intermediations (Ledgerwood 1999: 1).

2.2.1 The Evolution of Microfinance

From the 1950s onwards, governments and international donors have been assisting subsidized credit for small holder farmers in developing countries with the aim to increase agricultural productivity (Beshir 2005:6). Development financial institutions such as agricultural development banks were established to deliver subsidized credit to those farmers. Unfortunately, 'the failure of state implemented credit schemes has been more the rule than the exception' (Sida 2004: 23). In the 1960s and 1970s the supply-led credit approach ended up with failure, despite the middle and upper class farmers benefited in increasing agricultural productivity through intensive use of inputs. Main reasons for state failure of credit provision were rapid disbursement of funds with greater political emphasis, failure to collect loans stemming from lack of proper institutional arrangement and clients' attitude towards loan as grant money (Assefa et al 2005). As Robinson describes in *The Microfinance Revolution*, the 1980s demonstrated that 'microfinance could provide large-scale outreach profitably,' and in the 1990s, 'microfinance began to develop as an industry' (Robinson 2001: 54). In the 2000s, the microfinance industry's objective is to satisfy the unmet demand on a much larger scale, and to play a role in reducing poverty.

2.2.2 Approaches to Microfinance

There are different approaches to microfinance service provision to the poor. They can be categorized in to three: business Vs development approach (Maanen 2004), Minimalist Vs Integrated approach (Hikson 2001), and poverty lending Vs financial systems approach (Gulli and Berger 1999). The following sections discuss the first two approaches whereas the last one is discussed in the section microfinance and poverty reduction.

Business Vs Development Approach

The prime objective of MFIs is the provision of basic financial services to the poor. However, the service provision depends on their approaches. There are two contesting approaches among microfinance supporters: business approach and development

approach. According to Van Maanen (2004:53), business approach primarily focused on organizational achievements such as repayment, cost recovery and profitability. Hence, their concern is 'how to develop the industry' rather than 'how to develop the community'.

On the other hand, development approach emphasises more on break-even, impact on credit and on how the client is doing rather than profitability. Supporters of this approach argue that the clients should participate in awareness and capacity building programs before taking the loans. Looking at these different approaches, Van Maanen in his work concluded that:

[T]he basic difference seems to be whether the MFI should be seen as a business, be it with a development mission, or as a development body, be it with a business character. [...], the answer depends on the type of clients the MFI wants to serve: if the MFI aims at clients deep down the poverty pyramid ..., the approach of the development should prevail. If they look for clients who could eventually "graduate" to the formal sector, the sound business approach is more logical (Maanen 2004:55)

Since the development approach gives emphasis not only to building institutions for sustainable provision of services, but also empowering the poor people to get the most out of the services delivered, this research paper adopts the development approach to analyze the functioning of ACSI and Wisdom MFI in Ethiopia. The next approaches give an indication of financial products/services and their integration with non-financial services.

Minimalist Vs Comprehensive Approach

Poverty reduction focused microfinance service providers are divided into two approaches in terms of their view on microfinance products/services: Minimalist and integrated. According to Sabharwal, Minimalist approach emphasises, often exclusively, on credit access, which it sees as the 'missing piece' for poverty reduction (Sabharwal 2000:15-7). Advocates of this approach restrict their service only to the provision of credit and savings facilities making the client responsible to make the best out of the loan delivered.

In contrast, integrated approach refers to the provision of non-financial services such as training in health, literacy, social action and environmental awareness besides financial services (Hickson 2001:64). The supporters of this approach acknowledges that credit alone may not be enough to ensure stable employment and productivity for the reason that the causes of poverty at the grassroots level are multidimensional ranging from economic and social problems to lack of marketable skills and resource management know how (Amha 2003: 8). This research adopts the integrated approach to see how the cases integrate their financial services with other non financial services in Ethiopia.

2.3 Microfinance and Poverty Reduction

Most governments and donor agencies agree that MFIs can contribute to poverty reduction. However, there is less consensus about the degree to which, how and when poverty can be reduced through microfinance. According to Gulli and Berger, there are two main 'camps' regarding microfinance and poverty reduction: the financial systems approach and the poverty lending approach. The financial system approach states that the overall goal of microfinance is to provide sustainable financial services to low-

income people, but not necessarily to the poorest among them (Gulli and Berger 1999:16).

The Poverty lending approach, on the other hand, claims that the overall goals of microfinance should be poverty reduction and empowerment. According to this approach, MFIs should target the poor, conduct impact assessment studies to prove the poverty-reducing effect of their activities and provide complementary services such as business development services in order to contribute to poverty reduction. As opposed to the financial systems approach, credit is seen as a powerful tool for poverty reduction (Woller et al 1999:1).

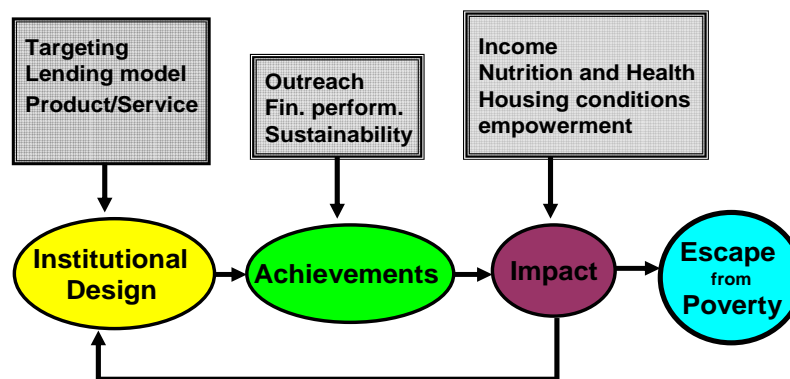
However, to Gulli and Berger, the truth seems to lie somewhere in between the two approaches. Rather than simply asking the question of whether or not microfinance is an important tool for poverty reduction, it is important to analyse how, to what degree and under which conditions microfinance can contribute to poverty reduction (Gulli and Berger 1999:17).

Sadegh Bakhtiari argues that microfinance can be considered as an important element for an effective poverty reduction strategy. It shows that access and efficient provision of microcredit can enable the poor to smooth their consumption, better manage their risks, gradually build their assets, develop their micro enterprises, enhance their income earning capacity, and enjoy an improved quality of life (Bakhtiari 2006). However, we need to understand when and in what form microfinance is appropriate for the poorest. Therefore, the following section establishes the analytical framework with the assumption that the above three approaches can be assessed based on three main categories: Institutional design, achievements and impact.

2.4 Analytical Framework

The Analytical framework of this study assumes that, appropriate institutional design will lead to better achievements in outreach and but may or may not necessarily lead to profitability, efficiency and sustainability because the more the program targets the poorest, the less the cost recovery and profit margin expected. And reasonable achievements of the program will have positive impact on the poor clients and positive impact on the poor will lead to poverty reduction (Figure 1).

Figure 1
Analytical Framework



Source: Combined by the researcher based on the work of Johnson, S. and B. Rogaly (1997:3-4)

2.4.1 Institutional Design for the Poor

According to Johnson and Rogaly, recent microfinance interventions have made use of a range of design features (Johnson and Rogaly 1997:3). Although there are different design features, this research focuses on three design features: targeting, lending methodology and products/services. The following section discusses these three design elements and the ways that they operate.

Targeting the Poor

According to Ledgerwood, targeting the poor clients depends on the objectives of the microfinance service provider and the perceived demand for financial services. These objectives include: to reduce poverty, to empower women or other disadvantaged population groups, to create employment, to help existing business grow or diversify their activities, to encourage the development of new businesses etc (Ledgerwood 1999:34). For Ledgerwood, targeting the poor may be direct or indirect. Direct targeting refers to the allocation of a specific amount of funds to provide credit to a particular sector of the economy or population like poorest of the poor, women, the indigenous population or the economically active poor whereas indirect targeting is when the service is designed to exclude the non poor through relatively high interest rates, small loan sizes, group guarantees and the holding of compulsory regular meetings to qualify for loans and to make repayments (Ibid).

Dunford and Denman argued that the small loan size, high interest rate, short loan duration, the frequent repayments, and dependence on group guarantees and weekly attendance at group meetings are all factors assumed to make the program unattractive to people who have other sources of credit as an indirect method. However, when easier finance options are not available to the not-so-poor, the demand for credit may be so high that even they are willing to tolerate the unattractive features of group-based poverty lending (Dunford and Denman 2000)

According to Ledgerwood, MFIs target women more than men clients because women almost always make up the poorest segments of society and are responsible for child rearing, and they often have fewer economic opportunities than men (Ledgerwood 1999:37). It has been argued that an increase in women's income benefits the household and the community to a greater extent than a commensurate increase in men's income (Ibid: 37-8). Johnson and Rogaly argued that 'microfinance interventions may lead to empowerment for women by increasing their incomes and their control over that income, enhancing their knowledge and skills in production and trade, and increasing their participation in household decision making. As a result social attitudes and perceptions may change and women's status in the household and community may be enhanced (Johnson and Rogaly 1997: 38).

However, the investigation carried out in Bangladesh by Goetz and Gupta (1996), demonstrated that, although women received the loans, gender relations within the household affected how loans were used, and the degree of control the women borrower retained over their use. A study conducted in Malawi and Ethiopia (Pitamber 2003) also shows that there was little empirical evidence on empowering women. Therefore, this study examines how the two cases are targeting women and benefiting them.

Lending Methodologies

MFIs are using different models to provide financial services to the poor. Robert Cull et al, in their global analysis of lending micro banks, found three main categories: Group, Individual, Village Banking Models (Cull et al 2007). According to Johnson and Rogaly, the rationale of group lending is that ‘if a member is having difficulty with repayments, others in the group will put pressure on that member to repay. Further, that if this pressure fails and the member defaults on the loan, the whole group will repay the loan on behalf of the members’ (Johnson and Rogaly 1997:38). While many schemes use groups, Hulme and Mosley (1996) concluded that groups are not always a crucial feature of scheme design. Attending group meetings and monitoring group members can be too costly, especially where houses are not close together. Group formation may exclude some poor people, especially when the group is formed based on religion, ethnicity, sex, etc (Vigenina and Kritikos 2004). As a result, clients may prefer other models like individual and village banking.

Individual lending is defined as ‘the provision of credit to individuals who are not members of a group that is jointly responsible for loan repayment’ (Ledgerwood 1999: 83). It requires frequent and close contact with individual clients to provide credit products tailored to the specific needs of the business. Village banking was designed in the early 80s in Latin America by John Hatch and his associates at the Foundation for International Community Assistance (FINCA) to provide asset building loans to poor women in Bolivia. Village banking³ group is a support group of 10-35 members-usually women-who meet weekly or biweekly to provide themselves with three essential services: small self-employment loans to start or expand their own businesses; an incentive to save, and a means of accumulating savings and a community-based system that provides mutual support and encourages personal empowerment.

Products and Services

According to Ledgerwood (1999:64) there are four broad categories of products/services that may be provided to microfinance clients: namely, (i) *Financial intermediation* or the provision of financial products and services such as savings, credit, insurance, credit cards and payment services, (ii) *Social intermediation* or the process of building the human and social capital required by sustainable financial intermediation for the poor, (iii) *Enterprise development services*, non financial services that assist micro entrepreneurs include business training, marketing and technology services, skills development and subsector analysis; (iv) *Social services or non-financial services* that focus on improving the wellbeing of micro entrepreneurs include health, nutrition, education and literacy training. However, the degree to which an MFI provides each of these services depends on whether it takes a minimalist or integrated approach (Appendix 5).

Many MFIs provide savings and credit services without getting involved in related development activities. However, many scholars argues that integrating financial with non financial services is usually seen as essential in addressing the causes of poverty

³ This definition is from FINCA’s website.

identified in a particular area or by a particular group of people; it is rarely the case that savings and credit activities alone will reduce poverty (Harper 2003, Johnson and Rogaly 1997, Ledgerwood 1999).

2.4.2 Outreach, Financial Performance and Sustainability

This section focuses on the achievements expected from MFIs as a result of products and methodological design. This mainly includes three parts: the outreach, financial performance and sustainability.

Outreach

According to Lafourcade et al, outreach can be measured in terms of breadth (number of clients served and volume of services or depth (the socioeconomic level of clients that MFIs reach) (Lafourcade et al 2005:4). Richard Meyer (2002) also noted that outreach is multidimensional concept. In order to measure outreach, Meyer emphasized on the number of poor clients served that were previously denied access to formal financial services; the number of women served since women face greater problems than men in accessing financial services ; depth of poverty that shows how well MFIs reach the very poor. Finally, the variety of financial services provided because the poor demand and their welfare will be improved if efficient and secure savings, insurance, remittance transfer and other services are provided in addition to loan services (Meyer 2002:4). Therefore, this research adopts the approaches of Meyer and Lafourcade et al to analyse the outreach performance of the two programs.

Financial Performance

MFIs earn financial revenue from loans and other financial services in the form of interest fees, penalties, and commissions etc. Financial revenue also includes income from other financial assets, such as investment income. An MFI's financial activities also generate various expenses, from general operating expenses and the cost of borrowing to provisioning for the potential loss from defaulted loans. Profitable institutions earn a positive net income (operating income exceeds total expenses). To measure the overall financial performance, financial revenue and expense indicators as well as returns can be compared against the institution's equity and assets (Lafourcade et al 2005).

Efficient institutions reach large number of poor people with minimum costs of delivering services (Dunford 2006, Cull et al 2007). The efficiency of an MFI can be calculated in various ways; Lafourcade et al used operating expense ratio, costs per borrower and costs per saver as indicators of efficiency. Productivity often measured in terms of borrowers per staff member and savers per staff members. Productive MFIs maximize services with minimal resources, including staff and funds (Lafourcade et al 2005: 11). The analysis of financial performance in this research is based on Lafourcade et al's approach.

Financial Sustainability

The other indicator of performance of an MFI is its financial sustainability. Meyer (2002) noted that the poor needed to have access to financial service on long-term basis rather than just a one time financial support. Most literature in microfinance industry refers to two levels of financial sustainability: operational self-sufficiency and financial self-sufficiency (Meyer 2002, Ledgerwood 1999). Operational self-sufficiency is

generating enough revenue to cover operating expenses (administrative costs, interest on deposit etc), financing costs (cost of borrowing money) and loan losses (cost of bad debts). Operational self-sufficiency therefore, indicates whether or not enough revenue has been earned to cover the MFIs' operating expenses. Financial self-sufficiency indicates whether or not enough revenue has been generated to cover operating expenses, including financing costs, provision for loan loss, and indirect costs including the adjusted cost of capital (Ledgerwood 1999:217).

There are some disputes on the link between financial sustainability and outreach to the poor. According to some (Christen et al. 1995; Otero and Rhyne 1994), cited in Meyer (2002), outreach and financial sustainability are complimentary; this is because as the number of clients increases MFIs enjoys economies of scale and hence reduce costs which help them to financially sustainable. On the other hand, Hulme and Mosely (1996) argued that there is inverse relationship between outreach and financial sustainability. This research considers both operational and financial sustainability in the analysis. The research also analyses the trend of outreach in relation to sustainability to support one of the above two contesting arguments.

2.4.3 Impact of Microfinance on Poverty

In the year 2000, the United Nations drew up a list of Millennium Goals⁴ which aim to spur development and eradicate extreme poverty. In 2002, Murdoch and Haley were authorized to determine the impact that microfinance has on the realization of the seven Millennium Goals. In an extensive work, Murdoch and Haley concluded that 'there is ample evidence to support the positive impact of microfinance on poverty reduction as it relates to the first six of the seven Millennium Goals' (Murdoch and Haley 2002:5). According to their study clients who participate in microfinance programs have enjoyed increased household income, better nutrition and health, the opportunity to achieve higher education, a decrease in vulnerability to economic shock, greater empowerment, and in some cases, the ability to completely lift themselves and their families out of poverty.

Other scholars (Wright 2000, Simanowitz and Walter 2002, Cherston and kuhn 2002), also argued that microfinance contributes to increased income, consumption smoothing, better health and nutrition, improvement in school attendance and empowerment. All of these benefits are interconnected; the improvement of one will invariably have a positive effect on the others. The combined enhancement in all areas of life brings a marked increase in living conditions for the poor and a new message of hope for the eventual reduction of poverty. However, according to David Holme (2000:79), although some scholars support that microfinance has positive economic and social impacts on the poor, others argued that microfinance has negative impacts on the poor clients. There are also in between who supports the positive impact but not necessarily for the poorest, as claimed. Therefore, this research contributes on this debate.

⁴ The seven Millennium Goals are as follows: 1) eradicate extreme poverty and hunger, 2) achieve universal primary education, 3) promote gender equality and empower women, 4) reduce child mortality, 5) improve maternal health, 6) combat HIV/AIDS, malaria, and other diseases, and 7) ensure environmental sustainability.

2.4.4 Escaping Poverty

According to Asuman Altay, Microfinance tries to fight global poverty and bring opportunities to the world's poorest people. Although microfinance alone does not offer sufficient solutions to reduce poverty, with tiny loans and financial services, it helps the poor, mostly women, start businesses and escape poverty (Altay 2007). Krishna (2004) in Indian found that, very large numbers of households have escaped from poverty as a result of microfinance services; but a very large number of households have also fallen in to poverty during the same time. According to his findings, diversification of income sources is the most important reason for households escape from poverty whereas poor health, high health expenses, high interest private debt, and large social and customary expenses constitute major reasons for households declining in to poverty; This study will also see how the poor are escaping out of poverty as a result of microfinance.

2.5 Chapter Summary

This chapter reviews the basic concepts of poverty and microfinance and establishes the analytical framework used in this research. According to World Bank (2001) Poverty cannot be captured in terms of money and income alone rather extended to more comprehensive notion of lack of opportunities, capabilities, sense of voicelessness and vulnerability to external shocks. Currently microfinance has been recognized worldwide as a strategy to reduce the multi dimensional nature of poverty. In broader understanding, Ledgerwood conceived that, the concept of microfinance often includes both financial and social intermediations' (Ledgerwood 1999: 1). Modern microfinance emerged in the 1970s and as Robinson described, the 1980s demonstrated that microfinance could provide large-scale outreach profitably, and in the 1990s, microfinance began to develop as an industry. In the 2000s, the microfinance industry's objective is to satisfy the unmet demand on a much larger scale, and to play a role in reducing poverty.

There are different approaches to microfinance. According to Van Maanen (2004:53), business approach primarily focused on organizational achievements such as repayment, cost recovery and profitability. On the other hand, development approach emphasises more on break-even, impact on credit and on how the client is doing rather than profitability. For Hickson, (2001:64) Minimalist approach emphasises on credit access for poverty reduction. In contrast, integrated approach refers to the provision of non-financial services such as training in health, literacy, social action and environmental awareness besides financial services. According to Gulli and Berger (1999), the financial system approach focuses to provide sustainable financial services to low-income people, but not necessarily to the poorest. The Poverty lending approach, on the other hand, claims that the overall goals of microfinance should be poverty reduction and empowerment.

The Analytical framework of this study assumes that, appropriate institutional design lead to better achievements in outreach and but may or may not necessarily lead to profitability, efficiency and sustainability because the more the program targets the poorest, the less the cost recovery and profit margin expected. And reasonable achievements of the program will have positive impact on the poor clients. Positive impact on the poor will lead to poverty reduction.

Chapter 3:

Case Presentation

The first part of this chapter discusses an overview of poverty in Ethiopia. The second part deals with microfinance as anti-poverty strategy in Ethiopia. Thereafter, the two cases are presented based on secondary source in the framework of design, achievements, impact on the poor and the role of actors.

3.1 Poverty in Ethiopia

Ethiopia is one of the poorest African nation states. Poverty in Ethiopia is a pervasive and persistent phenomenon due to the interaction of a number of persistent poverty traps like population pressure, low investment in human capital, low levels of infrastructure, agrarian nature of the economy and other related factors (MicroNed 2007:6-7).

Due to these traps, the country's main objective is to strive to break the vicious cycle of poverty and to reduce the magnitude and extent of poverty. In line with World Bank procedures for developing countries, Ethiopia also produces PRSPs. These papers basically define the national development agenda and set priorities and targets. The first one covered the period 2001-2004 and was named SDPRP. The second one was formulated for the years 2005-2010 under the title PASDEP. In this struggle, as to all poor countries, the binding constraint is capital formation to alleviate poverty and encourage investment by the poor. In this regard, microfinance recently gains more and more acceptance in Ethiopia. The next section discusses microfinance as antipoverty strategy and the reason why the government recognised it.

3.2 Microfinance as Anti- poverty Strategy

Current sources of finance in Ethiopia can be categorised into informal, Quasi-credit (NGO and government projects), and formal institutions such as conventional banks and microfinance institutions. Informal financial institutions are entities operating outside the domain of the National Bank of Ethiopia (NBE). They lend at an interest rate, which is more than 200 per cent per annum (Zewde & Associates 2002:11). Besides the high interest rate, this source of finance has limited ability to produce long-term finance or substantial loans for investment.

Many NGOs have become increasingly involved in savings and credit operations to reduce poverty. However, their outreach in terms of clients and area coverage was very much limited (Ibid 2002:12). Furthermore, after Proclamation 40/1996 was issued, NGOs were prohibited from directly involving themselves in credit and saving activities. The major institutions that presently comprise the financial system are public and private conventional banks. However, the capacity of the conventional banking sectors in Ethiopia has been too weak to serve the needs of the rural poor (Amha 2003).

Because of the non-suitability of commercial banks and informal sources and non-sustainability of NGOs' credit schemes, the government established a legal framework (Proclamation No. 40/96) for the establishment and operation of MFIs and currently, there are 27 licensed MFIs operating in both rural and urban areas in Ethiopia. The objective of almost all of the MFIs is poverty reduction (Gobzie 2008). Micro finance is considered to be a tool to fight poverty and ensure food security and growth in the

country. This is reflected in different policy documents of the government. The following section presents the cases to check how this strategy is effective.

3.3 Cases (ACSI and Wisdom)

This section presents the two selected cases for the research. The first part gives the brief background information about the two MFIs in Ethiopia. The second part presents the institutional design features based on targeting, lending model and products/services to both cases. The third section discusses the achievements of the two institutions based on outreach, financial performance and sustainability. The fourth section is about the impact based on impact assessment studies. Finally, the role of the government and donor agencies are presented.

3.3.1 Background of ACSI

ACSI was formed in 1997 by ORDA, an indigenous local NGO engaged in development activities in the Amhara region. In a move to depart from the more usual direct provision of relief, the NGO created a department to supply small amounts of credit to rural and urban poor people on a pilot basis. That department grew into a separate institution and ACSI was licensed as a micro finance share company (ACSI 2004:4). Its shareholders include the Amhara regional government (25%), ORDA (35%), ADA⁵ (20%), Amhara Women's Association, AWA⁶ (10%) and Endeavor⁷ (10%) (USAID 2006:15).

ACSI's Vision is 'to see a society in which people are free from the grips of abject poverty with all the power determining their future in their own hands and its own capacity as an institution well developed to provide best services for all in need in a sustainable manner'. Its primary mission is then '*to improve the economic situation of low income, productive poor people in the Amhara region through increased access to lending and saving services*' (ACSI 2004). ACSI's ownership structure and its vision and mission are influenced by government's current policies that focus on sustainable development and poverty reduction.

The current objectives of ACSI are promoting agricultural and non-agricultural economic activities; alleviating poverty and stimulating the region's economic growth, giving priority to rural and remote communities, particularly women; significantly increasing clients' income and asset position; and promoting sustainable financial services (ACSI 2004). Sustainability was implicitly indicated in the original objectives of ACSI, but in the current objective it is explicitly justified. ACSI believes that unless it is sustainable, it will fail to meet its primary vision and mission of contributing towards poverty alleviation, ensuring food security and economic growth in the region.

⁵ ADA is a non-profit NGO established in 1992 and engaged in primary health and basic education, skills training and other development activities in the Amhara region.

⁶ AWA is a member owned, donor-funded association engaged mainly in promoting and mainstreaming women's issues in development

⁷ Endeavour is a local NGO engaged in the development of agro-industries that facilitates agricultural production and processing.

3.3.2 Background of Wisdom

Wisdom's evolution is linked with the development of World Vision Ethiopia (WVE). World Vision entered Ethiopia in the 1980s to provide famine relief. Its partner office, WVE, operates in designated Area Development Programs (ADPs) and experimented with a number of microcredit schemes in its ADPs. However, it stopped its microfinance activities in keeping with the government of Ethiopia Proclamation No. 40/1996 on the registration and supervision of MFIs. The proclamation states that microfinance can only be conducted by registered, regulated institutions that are established as share companies. In 1998, WVE facilitated the creation of a separate for-profit entity called Wisdom MFI (USAID 2007:2). The share holders are few private individuals and WVE's senior and middle managers who have committed to return all profits to fund expansion and have agreed to forgo any dividend. These WVE shareholders must also transfer their shares to another WVE employee when they leave the institute (Tsega and Norell 2005, Wisdom 2006).

Wisdom is the largest private MFI next to four government affiliate MFIs operating in the country. Its mission is *'to improve the economic, social and moral wellbeing of the productive poor in the rural and urban setting of Ethiopia by way of promoting the development of economically viable and sustainable microenterprise through quality financial and non-financial services within accepted societal and business ethics'*. Its objectives are to provide competitive and quality financial services in good stewardship and a business like manner, for which clients are willing to pay; to promote increased income and employment for the poor; to provide sustainable access by the poor to financial services with a special focus on women; and to promote generally accepted business ethics among clients and foster self-reliance and empowerment (Wisdom 2001).

3.3.3 Institutional Design

This part discusses the institutional design features based on targeting the poor, especially women, organizational lending model and services/products offered. At the end the differences and similarities in their institutional design feature are presented.

Amhara Credit and Savings Institution

Targeting the Poor

ACSI targets the low income, rural based, productive poor⁸, with special emphasis on women. Targeting in ACSI is area as well as household and gender focused. Targeting the poor is both directly through "means-testing"⁹ and indirectly through product and service designed to attract the poor (ACSI 2004). In terms of area targeting, priority is given to those areas that are most food insecure. At an individual level, ACSI targets people who are engaged in productive activities (USAID 2006:16). As a Rapid Assessment (RA) method, priority is given for those with one or less oxen values, with possession of one ox serving as the local poverty line. A sort of Participatory Wealth

⁸ Productive poor are those that have businesses and the capacity to repay back the loans. They are the richest of the poor just close to the poverty line (Robinson 2001).

⁹ "Means testing" refers to an investigative process undertaken to determine whether or not an individual or household is eligible to services.

Ranking is also carried out, whereby representatives from the community exercise further rankings of those who should be first beneficiaries of the services (ACSI 2004).

Although ACSI stated those targeting techniques in its document, in practice they didn't work. Because productive poor land less women and youth were indirectly excluded from the service by community representatives and group members due to collateral reason and fear of default (Haimanot 2007). Although the loans are restricted to productive purposes, clients were used the loan for their immediate use (Bamilaku 2006). Although Special focus is given to women, ACSI has failed to reach large number of poor women clients because, as outreach expands to the very remote and peripheral areas, the challenge of attracting additional women increases and a lot of promotion is needed to attract them (USAID 2006:16). In addition, ACSI do not have suitable products to attract women (Garber et al 2006).

Lending Methodology

ACSI dominantly follows the group lending model. In principle ACSI clients are required to exercise a peer group self-selection and organize groups for the purpose of sharing a mutual loan repayment guarantee. This involves organizing a voluntary group of 5–7 members from the same socio-economic background, and 10–15 credit groups together form a centre (ACSI 2006). ACSI believes that this methodology removes the main entry barrier for those with no collateral, limited literacy, weak technical knowledge and narrow prior money management experience (Gobezie 2007). There are, however, limitations in practice that it tends to exclude the poorest but economically active people for various reasons: by the group members themselves, since a partially formed peer group looking for reliable members with whom to share risk is more likely to reject candidates they consider most risky; and by the kebele representatives who are not sure of guaranteeing repayment from the very poor, or for reasons related to seeking personal advantages from the less poor (Gobezie 2005). Currently ACSI has adopted individual lending model. But, it has started on a limited scale with collateral for these loans in the form of fixed assets like houses and individual guarantees from salaried people or those who have fixed assets (ACSI 2004).

Products and Services

ACSI currently provides four types of financial products: credit, saving, money transfer, and pension fund management (ACSI 2006). Credit is provided for income generation with the objective of stimulating the economy of the region. The credit products consist of microfinance loans, micro and small enterprise loans, food security loans, asset loans and package and resettlement loans with declining balance of interest rate ranging from 10 to 18 % per annum depending on the type of loan (Appendix 1). ACSI mobilizes savings from loan clients (both compulsory and voluntary savings) as well as from other members of the public (voluntary savings) (ACSI 2006). The objective of saving is to help clients to gradually build up income, improve their asset position and eventually be able to run their business from own sources, with out requiring credit. ACSI has initiated a strategic alliance with ADA for the provision of health and skills education. However, this is limited to selected zones and districts of the region. It also provides money transfer services and pension fund management for government organizations (ACSI 2006).

Wisdom Microfinance Institution

Targeting the Poor

Wisdom like ACSI targets the productive poor, especially women. Its initial focus was to provide microcredit to community groups where WVE undertakes ADPs. However, Wisdom expands its operations beyond rural ADPs into adjacent secondary towns (Tsega and Norell 2005). As it moved into more urban and non-ADP areas its proportion of poor clients served has decreased (USAID 2007). This is because Wisdom believes that the overall impact in rural areas will be greater if it uses urban areas to fuel growth, boost profitability, and raise deposits. According to 2005 assessment report, the Wisdom loan service was exclusively focused on Poverty lending. With the value of loan less than \$300 as a poverty loan, the institution has achieved disbursing its 92% of total clients in this category (Tsega and Norell 2005). This basically shows that the institution was serving poor clients from the lower economic strata, thereby directly addressing poverty reduction. Wisdom also provides consumption loan for the poor and this consumption loan, as one of the targeting method, is to be restricted to less than 10% of the portfolio and loan sizes are deliberately kept small to discourage the non-poor and to make it attractive for the poor who don't have other alternatives (Ibid). Although Wisdom serves men and women clients, special focus is given to women clients more than men counterparts. The number of active women clients keeps growing from time to time (Figure 3).

Lending Methodology

Wisdom uses three models: Village banking, group and individual lending. From the start Wisdom has been using Village banking but due to clients' request, group and individual lending models are used. In Village banking and group lending models potential clients are required to exercise a peer group self-selection and organize groups for the purpose of sharing a mutual loan repayment guarantee. The group model involves credit delivery through very small, affinity-based groups of 5-8 members each, whereas in Village banking 20-50 members can form the group and getting together at one centre monthly for the purpose of discussion, settling repayments, saving, etc (Wisdom 2001). Individual and group lending are usually used for businesses and clients who reside in urban and semi urban settings whereas Village banking is basically used for clients in rural settings. While Wisdom prefers Village banking because it is less expensive, the experience in urban areas is that clients trust one another less than in rural areas and prefer group and individual lending models (Tsega and Norell 2005).

Products and Services

Wisdom provide mainly credit for agricultural activities, micro and small enterprises, asset/housing and consumption purposes (Tsega and Norell 2005). Interest charged on loan ranges between 12 to 15 % per annum, and is calculated on a flat balance basis, of which the effective rate reaches 38.5% (AEMFI 2008). Wisdom promotes compulsory saving that is to be made to the group account with the institution. Unlike ACSI, in Wisdom, the balance for each member is recorded in the individual member's passbook and could be withdrawn in full upon full payment of the outstanding loan. Currently wisdom also mobilizes voluntary savings as a pilot test (Wisdom 2006). Wisdom provides credit with non-financial services mainly basic skill training for the clients in collaboration with WVE. It also provides micro-insurance Services for the clients in case of emergency and clients' death (Tsega and Norell 2005).

Differences and Similarities in Design

Both ACSI and wisdom target the productive poor, especially women. ACSI has targeting techniques in principle (direct and indirect) to identify the productive poor and has gained local government support. However, local government representatives focused on the less poor clients and their direct interference excluded the poorest. In Wisdom, there is no clear targeting technique. Interested poor clients can form the group by their own and the Wisdom staff checks whether the group members fulfil the requirements or not.

ACSI provide mainly financial services like Credit, savings, pension, money transfer etc, whereas Wisdom provides both financial services (credit, savings) and basic skill training (health, education, marketing etc) in collaboration with WVE. Wisdom does not have implicit state government guarantee and subsidies like ACSI. ACSI provides fixed sized loans to all group members but loan size within the group is determined by the decision of the group itself and the repayment capacity of individual business with wisdom. ACSI uses group lending model dominantly while also uses individual lending model in a limited scale for business people in urban and semi urban areas. Wisdom uses Village banking model from the start but due to clients request currently it uses group and individual lending models for business people in urban and semi urban areas.

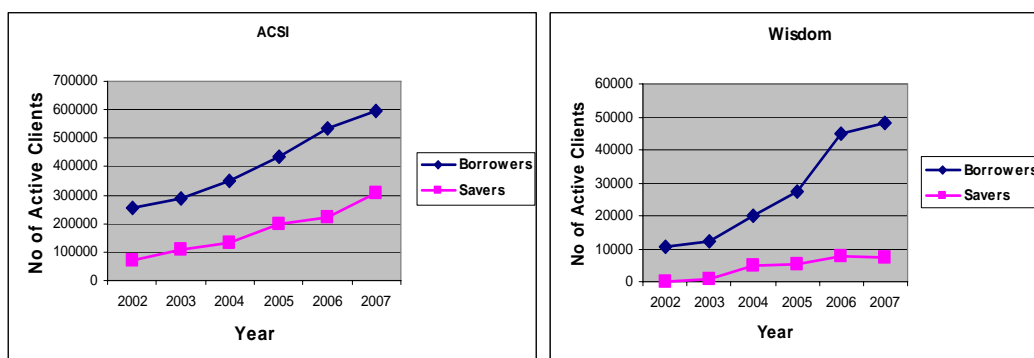
3.3.4 Outreach, Financial Performance and Sustainability

This section discusses the accomplishments of the two MFIs since 2002 to 2007 based on quantitative data from mixmarket.org database. It compares the outreach, financial performance and sustainability of the two cases.

Outreach

ACSI and Wisdom needs to grow in terms of outreach in order to reduce poverty and attain operational and financial sustainability. As indicated in Figure 2, the number of active clients (both borrowers and savers) has shown increment over the period with different rate of growth in both ACSI and Wisdom. The number of active borrowers in ACSI and Wisdom increased on average by 18.8% and 37.7 % respectively from 2002 to 2007.

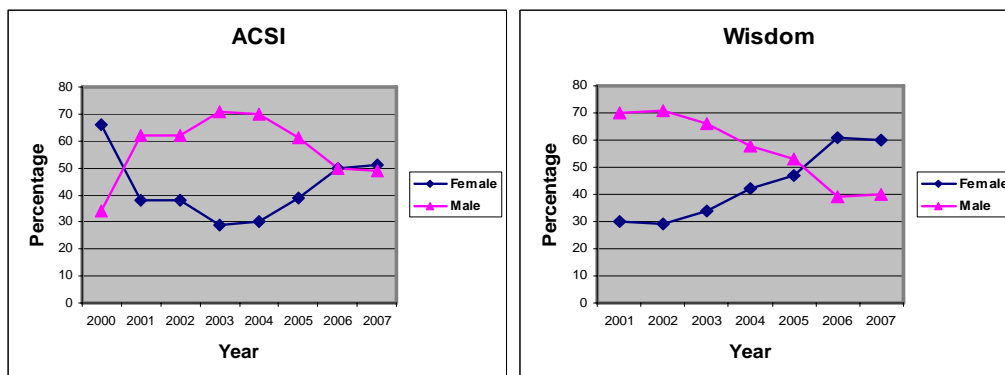
Figure 2
Outreach (No of active borrowers and No of voluntary savers)



Source: Combined from www.mixmarket.org data base (2008)

Even though ACSI and Wisdom target women clients, the data (figure 3) shows that credit access to women is still limited. They were serving more men than women clients against their objective. ACSI shows decreasing trend till 2004 and then increased its coverage to 50% in 2006/07. The reason for this change was awareness creation with local leaders and programs to motivate women entrepreneurs (Garber et al 2006). Bilen Tenna also stated that ACSI provided incentives for loan officers to maximize female clients (Bilen 2005). However, Wisdom shows increasing trend and after 2005 it has more women clients than men.

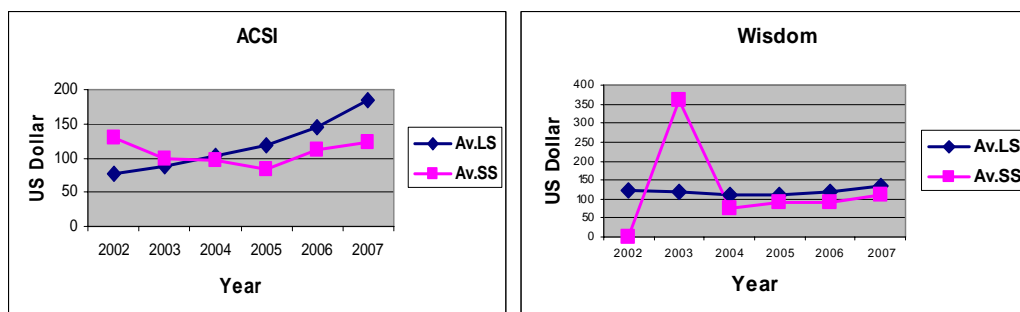
Figure 3
Percentage of Women Clients



Source: Combined from *www.mixmarket.org* data base (2008)

Though it is not precise, loan size is one of the simpler indicators that small loans represent poor clientele (Cull et al. 2007) because the smaller the initial loan, the poorer the client is assumed to be. In this regard, the data (figure 4) shows that ACSI (average loan balance in 2007 is about \$185) serves relatively poor clients using the benchmark that an average outstanding loan balance of \$150 is regarded as a rough indication that clients are very poor¹⁰. While Wisdom (average loan balance in 2007 is about \$136) serves relatively the very poor since it is below the benchmark.

Figure 4
Client Poverty level



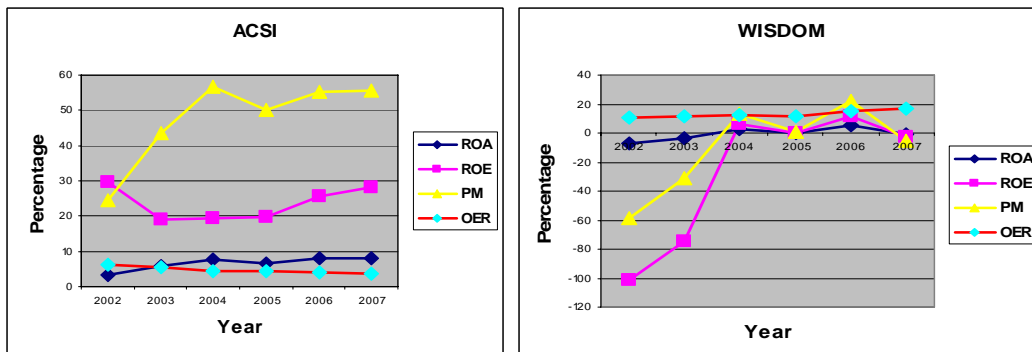
Source: Combined from *www.mixmarket.org* data base (2008)

¹⁰ <http://www.uncdf.org/english/microfinance/uploads/evaluations/Core%20Indicators--UNDP%20version.pdf>

Financial Performance and Sustainability

As shown in Figure 5, ACSI experienced very good financial performance, with significant increase in profitability recorded. The key measure of operating efficiency, the operating expense ratio, is already at incredibly low level. However, wisdom MFI is relatively less efficient and less productive. Its operating expense ratio is relatively high. But the trend shows that even Wisdom's financial performance is encouraging.

Figure 5
Overall financial performance

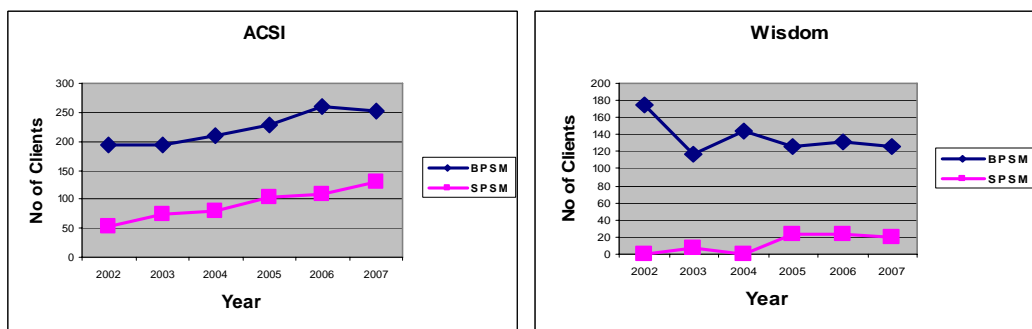


Source: Combined from www.mixmarket.org data base (2008)

The return on assets (ROA) and the profit margin (PM) has shown a significant improvement in the case of ACSI. Although return on assets, return on equity, and profit margin in Wisdom shows positive result from 2004 to 2006, the 2007 results are negative. This shows that Wisdom's financial performance is not sustainable and it is struggling to achieve its financial performance.

As shown in figure 6, ACSI increased its productivity indicators (borrower per staff members (BPSM) from 195 in 2002 to 253 in 2007) and savers per staff members (SPSM) from 53 in 2002 to 131 in 2007 as a result of expansion or increase in outreach. This shows that each loan officer can administer a progressively larger loan portfolio with more clients and, on average, somewhat larger loans, and the same overhead costs can be spread over a larger portfolio. However, in the case of wisdom, SPSM decreased from 175 in 2002 to 126 in 2007 that increases the overhead costs.

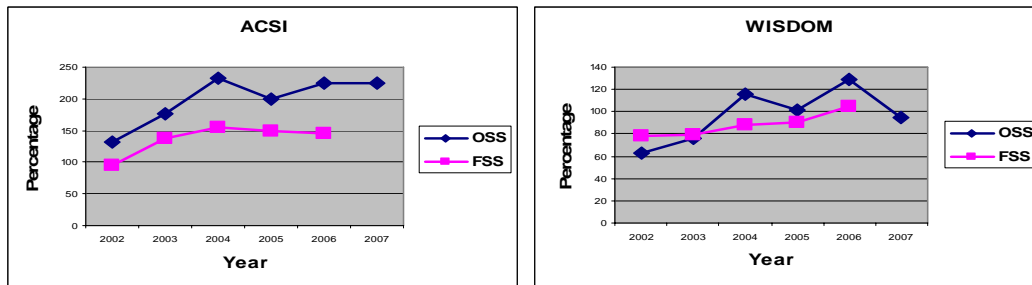
Figure 6
Efficiency and productivity



Source: Combined from www.mixmarket.org data base (2008)

As indicated in figure 7, ACSI has achieved significant progress in terms of operational and financial self-sufficiency as a result of the increase in outreach. Despite good performance in outreach, Wisdom is still on the way to achieve its operational and financial self sufficiency, and the performance is not significant.

Figure 7
Financial Sustainability



Source: Combined from www.mixmarket.org data base (2008)

Differences and Similarities on Performance

Both ACSI and Wisdom have very good accomplishments in outreach. ACSI has been successful in achieving efficiency and profitability, financial and operational sustainability. The reason for this success is the ability to intermediate savings and government support helped the institution scale up its operations. Moreover, very low staff costs and the involvement of the communities being served on a volunteer basis in the screening of loan applications, and lack of competition in the area helps to achieve its financial objective (USAID 2006). However, it is less effective in reaching poorest group especially women.

Given the impressive growth in outreach, Wisdom is relatively less efficient, less financially and operationally sustainable. The reason for this is that Wisdom mobilizes savings in a limited scale, it has competition from government affiliated MFIs including ACSI in all the regions it works. Wisdom provides more on site services, and has fewer guarantee requirements that maximizes the transaction cost and the default rate respectively (Tsega and Norell 2005). But, it is relatively better in reaching poor clients and achieving in poverty reduction objectives.

3.3.5 Impact on the Poor Clients

Impact of ACSI on Clients

The detailed study of Garber et al (2006) assessed the individual, household, enterprise and community level impact of ACSI in Amhara Region. They used 685 (345 mature and 339 incoming clients) for impact survey. According to the qualitative study, the majority of the sample clients reported that their participation in the ACSI program has been a life changing event. They feel much better about themselves and their small successes.

The quantitative part of the same study of Garber et al (2006) showed that the microfinance program of ACSI has resulted in a remarkable impact on its clients. The main quantitative impact of the microfinance program of ACSI includes:

- Average annual income was on an increasing trend for both men and women by 4740 Birr. However, the average annual income for men has significantly increased

(about 11, 500 Birr) more than for women (about 2000 Birr) showing that ACSI benefit the males more than females.

- The number of cattle (ox and cows) of the clients increased significantly after ACSI. On average ACSI clients have owned 5 cattle more than what they had at the time of joining ACSI. It was also found that men owned on average 4 more cattle than women.
- ACSI clients on average, owned 7 livestock (sheep, goats and pigs) more than what they owned before ACSI. But female clients have a significantly higher number of livestock than male clients.
- There was a significant increase in the savings rate (on average 11%) due to ACSI. But women clients have significantly higher savings per unit of loan amount compared to the men clients.
- ACSI Clients on an average had 0.73 more sources of income than what they had before ACSI. However, women had 0.36 sources more compared to men clients.
- The percentage of clients that have assets has grown from 66.67% at the beginning of their relationship with ACSI to 84.21% at the time of study.
- About 60% of ACSI clients have made major improvements to their houses since they joined ACSI.
- Almost 24% of the mature clients received aid from the government before they joined the program and currently there are no clients who receive the aid.
- Fewer clients (13.64%) are facing frequent sickness now than before (22.22%), though the difference is not very significant.
- ACSI did not have significant impact on the total amount of land owned by clients. However, Men have increased land ownership compared to women where the increase is almost stagnant.

Impact of Wisdom on Clients

Shannon Doocy (2004) conducted a study on the impact of Wisdom microfinance services on the poor and vulnerable households in drought and famine affected areas of Ethiopia. A three group (established, incoming and control) cross-sectional survey of 819 households conducted in two predominantly rural sites (Sodo and Adama). The primary objectives of the study were to assess the benefits of participating in microfinance programs on the livelihoods of clients and their households, and to compare the coping capacity and general well being of borrowers and similar non-borrowers and also to assess potential differences in program impact on male and female borrowers. Based on these objectives, the findings on the impacts of the program include:

- Participation in the program had significant results in terms of diversification of household income. On average, clients had 1.39 income sources as compared to 1.23 income sources in incoming clients and 1.18 income sources in community controls.
- Households with primarily non-agricultural incomes had, on average, incomes that were 1.39 times greater than households with agricultural incomes. But, there was no significant difference on the income of established clients, incoming clients and community control, suggesting that Program participation did not result in increased household income.

- Data on household assets does not indicate that participation in microfinance programs is a successful means of increasing household wealth.
- 84.5% of established client households reported owning their homes as compared to 77.2% of incoming clients and 74.6% of community controls. Land ownership was reported by 45.6% of established clients as compared to 30.5% of incoming clients and 41.6% of community controls.
- In Sodo, malnutrition rates in female clients (1.6%) were significantly lower than in community controls (8.3%).
- In Sodo, prevalence of moderate or severe malnutrition in children of established female clients was 11.1% as compared 20.2% in children of established male clients and 20.7% in children of community controls.
- 37.1% of female established clients reported improved dietary quality and quantity in comparison to only 19.6% of male clients and 23.5% of community controls.
- Female clients were significantly less likely than other groups to have received food aid in the past years.
- Significant differences in health status was not observed showing that Wisdom lending program did not have a measurable impact on health status.

Differences and Similarities on Impact

In general, both ACSI and Wisdom have positive impact on their clients. However, in ACSI the impact is more on men than women clients, which is against its objective. This shows that ACSI focuses on less poor clients who have the capacity to generate income, in this case male clients and other few women clients. However, it does not have social programs and specific loans for consumption, education, health etc that enables and empowers poor clients especially women.

Wisdom, microfinance program has positive impact on diversification of income, nutritional status and wellbeing of female clients and their families. Those female clients were significantly less likely to be food aid recipients suggesting that Wisdom is successful in reducing malnutrition and food insecurity problems of its clients. Although the study was conducted two years before ACSI, its impact on increasing income and asset building is relatively less.

3.3.6 The Role of Government and Donor Agencies

Government Support

The various policies and the commitment of the governments at various levels to support microfinance activities have direct impact on outreach and viability of MFIs. Although MFIs need the support of the government, it should not involve directly in the delivery of financial services to the poor. Since 1996, the government of Ethiopia has been supporting and initiating the development of institutionalized microfinance industry. The NBE has taken the lead role in the regulation, supervision and coordination of microfinance in the country. The government has established the Rural Financial Intermediation Program (RUFIP) to provide loan fund and build the capacity of MFIs. Recently the Ethiopian government has created a condition for MFIs to access loan-able fund from the commercial bank (Amha 2008). However, in practice the government support is more on government affiliate MFIs like ACSI than other private and NGO based MFIs like Wisdom.

Donor Support

The support of donors to MFIs in Ethiopia takes mainly four dimensions, namely, provision of loanable capital, building the capacity of MFIs, advisory services, and developing innovative products that meet the needs of poor households (Amha 2007). ACSI has got different support from SIDA, USAID, PACT Ethiopia, Packard foundation and Action Aid since its establishment mainly on capacity building and accessing loanable capital. Similarly, Wisdom has got support from World Vision USA, World Vision Canada, and USAID mainly on capacity building and loanable capital (SIDA 2003). However, there are restrictions on the interventions of donors in the microfinance industry in Ethiopia. For example, donors cannot be shareholders in MFIs, they should be owned by Ethiopians. If MFIs access loans from donors or foreign banks, they are not allowed to pay the interest and the principal in hard currency (Amha 2007). Since these restrictions have direct impact on the growth of MFIs, the government need to revisit the regulatory framework.

3.4 Chapter Summary

This chapter presents the two selected cases for this research based on background information, institutional design features, the achievements, their impact on the clients and the role of the government and donor agencies. ACSI was established by local NGO in 1997 with the primary mission of improving the economic situation of low income, productive poor. Similarly, Wisdom was established by WVE in 1998 with the primary mission of improving the economic, social and moral wellbeing of the productive poor.

Both ACSI and Wisdom target the productive poor especially women. However, what they target is different from what they implement. ACSI provides mainly financial services with group and individual lending models, whereas Wisdom provides financial services by itself and non-financial services mainly basic skill training in collaboration with WVE with village banking, group and individual lending models. ACSI has been successful in achieving efficiency and profitability, financial and operational sustainability. The reason for this success is government support and the ability to intermediate savings. However, Wisdom is relatively less efficient, less financially and operationally sustainable. The reason for this is that Wisdom mobilizes savings in a limited scale, it provides on site services and it has no government support like ACSI. But it is relatively better in reaching poor people.

ACSI and Wisdom have positive impact on their clients. However, in ACSI the impact is more on men than women clients. In Wisdom, microfinance program has positive impact on diversification of income, nutritional status and wellbeing of female clients and their families than men counterparts. The government of Ethiopia has been supporting and initiating the development of institutionalized microfinance industry. However, in practice the government support is more on government affiliate institutions like ACSI than other private institutions like Wisdom. The support of donors in Ethiopia takes mainly provision of loan able capital, building the capacity of MFIs, advisory services, and developing innovative products that meet the needs of poor households. Both ACSI and Wisdom has got different support mainly capacity building from different donors. However, there are restrictions on donors' interventions. Therefore, the government need to revisit the regulatory framework.

Chapter 4:

Theoretical Reflection of the Cases

This chapter is a theoretical reflection on the events of microfinance in Ethiopia. It conceptualises the two case studies presented in chapter three using the theories, concepts and literature of microfinance and poverty reduction. The first section of the chapter attempts to analyse the design feature of the institutions. The second section contains outreach, financial performance and sustainability. Thereafter, the impact on the poor clients, the role of the government and donors, as well as escaping out of poverty are included.

4.1 Institutional Design

This section reflects about the design features of the two cases. As argued by Johnson and Rogaly (1997), the combination of design features will have different outcomes under different circumstances. To see how the two cases are designed, three design features: targeting the poor, diversified products and services and lending methodologies are analysed in terms of theories and literature.

Targeting the Poor

Poverty reduction oriented MFIs target the poor by defining the criteria which users have to meet in order to be eligible for loan (Johnson and Rogaly 1997). Well-designed MFI is likely to have a positive impact on the poor if it specifically seeks to reach them through appropriate product design and targeting (Wright 2000). However, targeting the poor depends on the approach MFIs follow. According to Gulli and Berger, the 'financial system approach' aims to provide sustainable financial services, but not necessarily to the poorest whereas the 'poverty lending approach' aims at poverty reduction and empowerment by targeting the poorest (Gulli and Berger 1999).

ACSI and Wisdom in principle, target the productive poor, mainly in rural and food insecure areas. However, for Robinson the term productive poor refer to those among the poor who have some form of employment as well as the capacity to repay back the loans and who are not severely food deficits or destitute (Robinson 2001). This shows that in principle both MFIs target only a small proportion of the poor close to the poverty line whom they have called productive poor. But, in reality ACSI also serves the non poor (ACSI 2006) and excludes the very poor (Gobezie 2005). There is nothing wrong in serving the non poor but in its mission the target group is the productive poor. Therefore, focusing on the non poor for sustainability and profitability reason will divert the program from its main purpose and affect to achieve its objectives. Although Wisdom still serves the poor in World Vision project areas, there is a tendency to shift from the poorest segment to less poor when it expands the service to urban areas (USAID 2007). This will have impact on achieving its poverty reduction objective.

ACSI uses direct targeting techniques. For example, community representatives' rank the potential clients' based on their property and in principle, the poor who have one ox or less can be the clients of ACSI. However, in practice, this didn't work because ACSI also included clients who have more than one ox, the so called less poor and excluded the very poor especially women and youth to minimize default. In the

case of Wisdom, there is no specific direct targeting technique. However, the eligibility criteria requires that clients should own a business that is in operation for at least 6 months and not produce and/or distribute products that damage societal values and the environment, such as alcoholic beverages, tobacco, charcoal, etc (Wisdom 2001). These criteria could also exclude the poorest from the service. Because on the one hand, the poorest will not have sound business plan, on the other hand, the majority poor women in Ethiopia are living by selling local alcoholic drinks. Therefore, in both cases (more on ACSI) there is a shift from the poor to less poor showing that their approach is changing from poverty lending approach to financial systems approach. They are under pressure to serve the non poor for their financial sustainability and profitability. The danger is that they will miss their development mission and poverty reduction objective. Therefore, there is a need to revise their objective and stick on it so as to contribute for poverty reduction.

Cherston and Kuhn argued that Countries in which women are oppressed or treated as second class citizens are always the ones who suffer the highest rate of poverty, as women make up the majority of poor people. They found that woman's earnings as a result of microfinance go to her family as compared to man, whose earning goes more to leisure (Cherston and Kuhn 2002). Based on this and similar assumptions, many poverty focused MFIs are targeting women as their main clients. The two cases (ACSI and Wisdom) target women and clearly stated in their mission statement. However, the data shows that ACSI allocated some portion of the credit to women, but a good portion of it is destined to their male counterparts and more benefit goes to male clients than women, which is against the objective of the institute. Wisdom relatively increased the percentage of women clients. The benefit was also for more women and their children as compared to men. It is true that targeting women is important in the design of products and services, because women by default have less access to credit and because they face constraints unique to their gender. However, in ACSI and Wisdom, although they target women, there is no special program to encourage and empower them. Women still face considerable disadvantages relative to men because of more limited business networks and opportunities, greater domestic burden, weaker self-confidence, and less education. Therefore, both institutes should take women's needs and assets into account when they design their products.

Lending Methodology

Microfinance lenders use a variety of approaches to provide financial services to the poor. Robert Cull et al (2007), in their global analysis of lending micro banks, used three main categories: Village banking, group and individual lending models. Group lending uses self formed groups of customers that assume joint liability for the repayment of loans given to group members. Village banking is based on larger groups but a similar notion of joint liability with group lending. Individual lending draws on traditional banking practices and involves a standard bilateral relationship between the MFI and customers. According to Jonathan Morduch, in the group lending model, loans are given to individuals but these individuals have to form groups of three to ten persons where all members are held mutually responsible for all credits of the group whereas in the individual lending model, borrowers can take the loan individually but lenders demand collateral for the loan (Morduch 1999).

The experience of ACSI and Wisdom shows the combination of both group lending and individual lending models. Wisdom also uses Village banking model from the start. From its establishment, ACSI lend to groups of five to seven members, who are

jointly liable for a single loan. Getaneh Gobezie found that the group lending methodology undoubtedly opened great opportunity for the majority poor as it removes the main entry barrier for those clients with no collateral, limited literacy, weak technical knowledge and narrow prior money management experience (Gobezie 2007:4). However, there are also problems related to group lending. ACSI offered loans to groups without considering their individual needs. ACSI experience shows that there was a problem of excluding vulnerable groups especially women and youth due to collateral reason and direct interference of community representatives (Gobezie 2005). Some ACSI clients also dislike small size loan when their business grows, group meetings, compulsory savings and joint liability (Garber et al 2006). Similarly in wisdom, both group and village banking helps the poor to share valuable information about business, market, technology and to reduce risks to individual clients. However, there were problems reported. In Wisdom, clients who cannot perform well and cannot meet the repayment deadlines delay the better-off clients from getting further loans. It was also difficult to form 20 to 50 members of the group together (Tsega and Norell 2005).

In response to the above problems, both models adopted individual lending very recently. Both started to provide individual loans on personal guarantee and/or collateral basis. But, the loans are restricted only to large size asset and business loans and they require collateral. Therefore, group lending and individual lending models tend to ignore the very poor who do not have collateral for guarantee. In both cases, there is a need to provide the services with flexible and clients need based lending models.

Products and Services

Jonathan Ledgerwood (1999:64) argued that MFIs provide both financial and non-financial services to poor clients. However, the degree to which an MFI provide these services depends on whether it takes a minimalist or integrated approach. Advocates for the integrated approach argue that MFIs need to focus on poverty reduction as their primary goal and should provide services to the poor that integrate training, basic education, health and nutrition, and microcredit loans. Morduch and Haley also argued that the benefits derived from microfinance, basic education, and primary healths are interconnected, and the impact of each can increase when they are delivered together (Morduch and Haley 2002). The argument for the minimalist approach is that it is necessary to achieve financial sustainability first (through financial services mainly credit and savings) and then, when sufficient profit has been accumulated, the MFI can look into the possibility of providing training and educational services.

ACSI provides mainly financial services and restricts its loan products to income-generating activities. Although credit is delivered to productive purpose, the majority clients are engaged in the traditional businesses of agriculture and petty trade, with low level of education and skill (Gobezie 2007). Business development services that provide opportunities to upgrade skills into other areas are not well developed. Similar products are offered on the small market, which easily saturates. Access to the nearest other market is blocked due to the very poor infrastructure, particularly the road network (ACSI 2004). Although currently ACSI started to make a link with ADA as service provider and Packard foundation for funding to provide education for clients, the service is as a pilot test and the coverage is very limited. Wisdom's main product is loan service and loans are provided for both productive and consumption purposes. But Wisdom has a strong link with WVE for non-financial service provision.

From these evidences, ACSI reflects purely minimalist approach because it focuses mainly on financial services and gives priority for sustainability and profitability. According to one of ACSI officials, ‘ACSI puts high priority on the issue of moving away from dependence on donor funding and to focus on high level of saving mobilization and its own profitability as its source of fund’ (Gobezie 2005:23). Although Wisdom seems minimalist organization, its financial services are integrated with WVE non-financial services. This helps to meet its development mission showing that the combined efforts of effective financial and non-financial programs can be an incredible tool for poverty reduction.

4.2 Outreach, Financial Performance and Sustainability

Christopher Dunford found that ‘...many microfinance programs are reaching large numbers of the very poor while fully covering their costs’ (Dunford 2006:20). Dunford has applied three benchmarks to estimate cases around the world: *Scale* (number of very poor served: at least 10,000), *Sustainability* (number of years at least 10,000 of the very poor are served profitably: at least two consecutive years at Operational Self-Sufficiency greater than 100 percent), *Impact* (evidence of poverty-reducing impacts for very poor clients: at least one credible study showing positive impacts on poverty or one of its correlates) (Ibid : 9). Based on these benchmarks, both ACSI and Wisdom have reached more than 100,000 and 10,000 poor clients respectively for the last 6 years (Figure 2). In terms of operational self- sufficiency, ACSI achieved the benchmark since 2002 while Wisdom has achieved it after 2004 (figure 7). However, wisdoms OSS in 2007 shows 94% which is less than 100%. This could be because of the drought and inflation problems that have been occurred in the country. Although there is some variation, the impact analysis of the two programs shows the positive impact on the income and other social indicators of the clients.

However, MFIs in terms of outreach, financial performance and sustainability may vary depending on their lending models. For example, Robert Cull et al (2007) in their global analysis of leading micro banks, with high-quality financial information on 124 institutions in 49 countries found that Village banks, which focus on the poorest borrowers, face the highest average costs and the highest subsidy levels. By the same token, individual-based lenders earn the highest average profits but do least well on indicators of outreach to the very poor. At the same time, they found examples of institutions that have managed to achieve profitability together with notable outreach to the poor.

Both ACSI and Wisdom showed the combination of the above findings, since they are using diversified lending models. ACSI has reached very large number of clients with sustainable and profitable financial services. According to Forbes magazine report¹¹, ACSI ranks sixth and is one of the Top 50 MFIs in the world. The rank was based on the size of their gross loan portfolio; efficiency, which considers operating expense and the cost per borrowers; risk, which looks at the quality of their loan portfolios; and return, which is measured as a combination of return on equity and

¹¹ http://www.forbes.com/business/2007/12/20/microfinance-philanthropy-credit-biz-cz_ms_1220microfinance_table.html

return on assets. The data in this research also supports this evidence. However, it is relatively poor in reaching the poorest clients especially women because of the interest in profit and sustainability and this could divert ACSI from its poverty reduction objective. Wisdom also reached large number of clients but not as sustainable and profitable as ACSI. However, it is relatively better in outreach indicators like clients' poverty level and women clients' coverage.

As indicated in the literature, Meyer (2002) argued that outreach and financial sustainability are complimentary; this is because as the number of clients increases MFIs enjoys economies of scale and hence reduce costs which help them to financially sustainable. On the other hand, Hulme and Mosely (1996) argued that there is inverse relationship between outreach and financial sustainability. However, the data of the two cases support the argument of Richard Meyer. ACSI performance in outreach helps to achieve its financial as well as operational sustainability. But the outreach is more on the less poor than the poorest. In the case of Wisdom, the progress is increasing as a result of increment in outreach, though the institute is still on the way to achieve its operational and financial self-sufficiency. Therefore, achievement in outreach helps to achieve financial and operational sustainability. But its degree of achievement depends on the poverty level of clients.

From the above evidences, ACSI is the best reflection of business approach. It gives priority for profitability because profit is the ultimate proof of effectiveness, efficiency and sustainability as an economic entity. The assumption is that once profitability is achieved, ACSI will no longer depend on donors (Gobezie 2005). That is true. But without reaching the poorest it fails in its mission and without impact on the very poor, it makes no sense. That implies that all three are equally important and should be kept in the right balance to contribute for poverty reduction. However, Wisdom follows more of development approach and it is more effective in poverty reduction because it is struggling to achieve its sustainability in poverty lending.

4.3 Impact on the Poor

Jonathan Morduch and Barbara Haley found that there is ample evidence to show that overwhelmingly the impacts of microfinance are positive, particularly through increasing income, reducing risk and vulnerability, and empowering women (Morduch and Haley 2002). Christopher Dunford also found that 'microfinance - particularly when provided to relatively poorer women - increases incomes and savings, improves nutrition and health, and empowers women' (Dunford 2006:20). The study by Simanowitz and Walter based on the two case studies (SHARE, group model in India and CRECER, Village banking model in Bolivia) shows that:

SHARE is achieving remarkable levels of impact on the incomes, well-being and business skills of large numbers of very poor clients. SHARE is a minimalist organisation and aims to reduce poverty by providing financial and support services to poor women. [Whereas] CRECER achieves positive impact on both economic and social poverty, of a cross-section of clients, including a large proportion of the very poor. It has a much broader and more explicit social objective than SHARE (Simanowitz and Walter 2002:16).

The case of both ACSI and Wisdom, in general, supported the argument of positive impact on poverty. However, their impact depends on their approach. For the purpose of clarification the following section analyses the impact based on four

categories: income/assets, housing/land ownership, nutrition and health and empowerment.

Income/Assets

Both men and women clients of ACSI showed an increase in the average annual income as well as assets. However, male clients have more income/asset benefit than female clients. Client's source of income was increasing, showing the diversification of income and women clients had more source of income than men clients. Although the result is positive, the focus of ACSI was to reach productive poor especially women. However, the impact is more on men and less poor clients than poor women as planned. In Wisdom an increase in income of clients is not supported by the data. But, established clients had significantly more income source than incoming clients and community controls. This suggests that extended participation in the Wisdom lending program results in diversification of income. In terms of asset there was no significant difference among the three groups.

Although what ACSI plan is different from what it implement, the evidence is in favour of microfinance as a tool to increase household income, to diversify their source of income and smooth consumption. Wisdom also helps to diversify clients' source of income but not significant increase in clients' income. This could be due to the costs incurred in reaching relatively poor people. Therefore, in both cases there is a need to focus on their objective to be viable as a strategy for poverty reduction.

Housing and Land Ownership

Housing improvement is one indicator for impact at the household level, as this is a key target of households with improved income levels. Relatively high proportion (60%) of clients managed to do housing improvement but they didn't have any change in their land ownership since they joined ACSI. However, the study shows that men have increased land ownership compared to women. This means that participating in ACSI didn't facilitate the situation for the poor clients especially women to own land. The data from Wisdom shows that established clients were most likely to own a home or land as compared to non-clients suggesting that the likelihood of home or land ownership might be facilitated and increased with participation in the lending program of Wisdom. Since home is a basic need, both programs should empower their clients to own their own home because microfinance services can contribute to clients' access to and control over improvement in housing due to improved decision making on receiving credit, savings and improved income.

Nutrition and Health

Graham Wright argued that microfinance has substantial effect on the nutrition and health of the poor, especially for children (Wright 2000:31). To Simanowitz and Walter, increased income through participation in microfinance programs invariably will lead to higher nutrition and greater access to health care (Simanowitz and Walter 2002:23). The case study of ACSI shows that it significantly increases the income of clients, which translates into better nutrition and health for households. However, Wisdom has significant impact on nutrition as a result of integrated intervention of WVE. The study shows lower prevalence of malnutrition among children of female clients as compared to male clients. There were lower rates of food aid female clients as compared to male clients, and high proportion of clients report improved quality of diet. Women clients less likely to be food aid recipients suggest that Wisdom is

successful in minimizing food insecurity. This shows that, although their approach is different, both are contributing for better nutrition and health. But the impact is more significant and multi dimensional in Wisdom and directly related to poverty reduction. Therefore, there is a need to integrate ACSI with other social programs in order to create a deep and lasting impact on poverty reduction.

Women's Empowerment

In most Third World communities, men have better income-generating activities, access to wider markets, and enjoy a higher societal status than women (Murdoch and Haley 2002:136). Cherston and Kuhn stated that 70% of people in absolute poverty (living on less than \$1 a day worldwide) are women (Cherston and Kuhn 2002). In order to reduce poverty, women, who suffer the most, must be empowered because poverty reduction strategies that focus on empowering women not only improve the lives of women, but also positively affect entire families and communities. According to Grasmuck and Espinal, women are most apt to use household income to better the nutrition and educational opportunities of their children (Grasmuck and Espinal 2000:240).

Although there is no detail study about women empowerment in Ethiopia, qualitative data from the impact survey shows that women were totally dependent on their husbands before ACSI but some women are responsible for their activities and have access and control of their resources after joining ACSI. Some women clients reported self esteem since joining the program and their interaction in group meetings helped them make good business decisions (Garber et al 2006). However, Although ACSI gives priority to women clients; it has failed to reach large number of poor women and to benefit as well as empower them. The evidence shows that male clients gain more benefit in terms of income, assets, housing improvement and land ownership than female clients which is against its objective. Women still face considerable disadvantages relative to men. Therefore, ACSI should rethink about its policy of reaching and empowering poor women.

In the case of Wisdom, the impact study shows that Wisdom's female clients and their children were better nourished as compared to men and non-clients. The businesses' growth enabled by the loans these women secured helped them to provide their families with protein-rich foods such as meat and eggs. Female clients were also significantly less likely to require food aid, which suggests that Wisdom's programs succeed in reducing vulnerability to prolonged drought and food insecurity. Women and their children benefit more in terms of income, health and nutrition than men and their children. It seems that Wisdom is relatively better in empowering and reaching poor women but still there is a need to have special program for women. However, this part needs further research to understand the role of the two MFIs in women empowerment.

4.4 Escape from Poverty

Shadihur Khandker in Bangladesh found that about 5 percent of microfinance program participants can lift their families out of poverty each year by participating and borrowing from microfinance programs (1998:60). The SHARE program in India was able to lift one third of their clients above the poverty line (Simanowitz and Walter 2002:23). This evidence shows that microfinance can provide diversified sources of

income that enables clients to climb steadily out of poverty, while providing better living conditions and opportunities for their families.

The case of ACSI and Wisdom confirmed that they are contributing in income diversification, health and nutrition, housing and empowerment of the poor. However, the evidence at country level shows that there has not been any significant decline in the overall levels of poverty. Tasew Woldehanna found that, based on qualitative analysis, poverty is increasing while based on quantitative analysis poverty does not change at country level in Ethiopia (Woldehanna 2004:28). The data from Index Mundi website also shows that population below poverty line in 2003 was about 45% and it has increased to 50 % in 2004 and remained the same till 2006. This apparent contradiction could be partially due to the fact that the microfinance programs in Ethiopia have not been very successful in including the poorest. Therefore, microfinance alone could not be a solution for poverty reduction. It must be supported by other development interventions to reach the poorest segment of the population.

4.5 The Role of Government and Donors

The Role of Government

The government has an important role to play in establishing a favourable policy, regulatory and incentive framework for MFIs. Rhyne and Otero argued that ‘Microfinance has flourished in settings where the government did not follow directed credit policies, allowed interest rates to be market-determined, kept credit allocation separate from politics, and was not itself involved in direct lending’ (Rhyne and Otero 2006:19). Microfinance in Ethiopia is considered by the government as its own tool to fight poverty. This is reflected in the poverty reduction program, food security strategy, and rural development program. However, the government seems to be biased towards government affiliate or related MFIs. For example, the study from the two cases shows that ACSI benefited more from government policy and regulation and has gained more support from local government offices and community representatives as compared to Wisdom. Therefore, the government should revise its rules and policies and implement to encourage all MFIs.

The Role of Donors

Elisabeth Rhyne and Maria Otero stated that the role of donors will continue to be essential in the next decade, and an increasing number of private donors becoming very important players in microfinance. They suggested that donors will focus on information dissemination, building the capacity of MFIs, regulators and supervisors; supporting microfinance that reaches very poor clients; innovation in product development and use of technology; overall economic development; and operation in vulnerable states (Rhyne and Otero 2006:50).

According to Wolday Amha, the support of donors to MFIs in Ethiopia takes mainly four dimensions: provision of loanable capital as grant, building the capacity of MFIs, providing advisory services, and developing innovative products that meet the needs of poor clients (Amha 2007:34-5). Donors are supporting ACSI and Wisdom mainly in building their capacity. However, there are restrictions on donors’ intervention on microfinance industry. For example, donors cannot provide credit and cannot be shareholders in an MFI, and if MFIs access loans from donors or foreign banks, they are not allowed to pay the interest and the principal in hard currency (Amha

2007:35). These restrictions will have direct impact on the growth of MFIs because donors can play a positive role in increasing outreach and efficiency of MFIs, they could also assist the poorest through subsidized funds. Moreover, there will be a need to build the capacity of clients, and technical service providers. This will not be achieved without the support of donors, NGOs and other actors in country.

4.6 Chapter Summary

This chapter is a theoretical reflection on the events of microfinance in Ethiopia. In principle, Both ACSI and Wisdom target the productive poor especially women. However, targeting didn't work in ACSI, because on the one hand it includes the non poor, on the other hand it excludes the land less productive poor women and youth. In Wisdom also there is a tendency to shift from the poorest segment to less poor as a result of service expansion to urban areas. ACSI reflects purely minimalist approach because it focuses mainly on financial services and gives priority for sustainability and profitability. Although Wisdom seems minimalist organization, its financial services are integrated with WVE non-financial services. This helps to meet its development mission. The experience of ACSI and Wisdom shows the combination of both group lending and individual lending models. Wisdom also uses Village banking model from the start. Although there were advantages of using these models in both cases, problems were reported that should be taken in to consideration by the two institutions.

ACSI is the best reflection of business approach. It provides financial services for less poor clients and has achieved efficiency, profitability and sustainability. However, it is relatively poor in reaching the poorest clients especially women because of the interest in profit and sustainability and this could divert ACSI from its poverty reduction objective. However, Wisdom follows more of development approach and it is relatively effective in poverty reduction because it is struggling to achieve its sustainability in poverty lending.

ACSI and Wisdom, in general, supported the argument of positive impact on clients. However, their impact depends on their approach. For example, ACSI follows financial systems approach which focuses on financial services but not necessarily for the poorest and the impact is on the less poor. It significantly increases the income of clients, which translates into better nutrition and health, housing improvement etc. However, Wisdom still follows poverty lending and its impact is on the poor as a result of integrated intervention of World Vision Ethiopia.

Although ACSI and Wisdom contributed in income diversification, health and nutrition, housing and empowerment of the poor, the evidence at country level shows that there has not been any significant decline in the overall levels of poverty. This might be due to the failure of MFIs to reach the poorest segment of the population. Therefore, microfinance alone could not be a solution for poverty reduction. It must be supported by other development interventions to include the poorest. This needs the involvement of government, donors and other actors in different interventions. But there are restrictions on donors and NGOs participation and should be revised by the government.

Chapter 5:

Conclusions

Ethiopia has been recognizing microfinance as poverty reduction strategy since 1996, despite the doubts raised in microfinance literature over the success to reduce poverty. Policies and regulations are brought forward to promote microfinance but also MFIs faced pressures to sustain their programs. Those promotion and pressure should have motivated or enforced MFIs to serve more poor people with better quality products. This study has analyzed the microfinance contribution for poverty reduction in Ethiopia and confirmed that microfinance is indeed a strategy of poverty reduction but not in isolation. Looking ahead to the future of microfinance programs as poverty reduction strategy, several conclusions could be drawn.

First, the study shows that many clients benefited from the two programs. However, targeting in the two programs is not necessarily a condition for reaching the poor. While policy documents assume that the poor who do not have access to formal financial services will be targeted by the MFIs in Ethiopia, the two cases are targeting only a small proportion of the poor whom they have called the productive poor. This productive poor are the richest of the poor just close to the poverty line. But, they exclude the poorest segment of the population especially women and youth. This has serious policy implication for the poorest of the poor in order to reduce poverty in the country.

Second, literature shows that targeting women is important in the design of products and services, because women by default have less access to credit and they face constraints unique to their gender. The two cases (ACSI and Wisdom) target women clients. However, the data from ACSI shows that men clients benefited from access to loans to a greater extent than women and more benefit goes to male clients than women, which is against the objective of the institute. This could be due to supply driven financial products which are not tailored to meet the needs of women clients or lack of any business skill and engagement in domestic works much more than their male counterparts. In addition, rural women who do not own land are indirectly excluded from the program. Therefore, ACSI should rethink about its policy of targeting and empowering women.

Third, literature shows that microfinance programs that are integrated with non-financial services are more effective to poverty reduction. However, ACSI reflects purely minimalist approach that focuses mainly on financial services and gives priority for sustainability and profitability. Although Wisdom seems minimalist organization, its financial services are integrated with WVE non-financial programs. This helps to meet its objectives showing that the combined efforts of financial and non-financial programs can be an effective tool for poverty reduction. Therefore, to continue as a poverty reduction strategy by targeting the poor, ACSI financial services need to be integrated with some kind of marketable skill development, some cultural transformation programs, health education, infrastructure, good governance and other development interventions.

Fourth, the analysis shows that both programs are using diversified lending models and this gives opportunity for clients to choose their preferences. However, the lending models are area as well as product focused. For example, in Wisdom, group and individual lending models are used in semi urban areas for asset and business loans

only. There are also implementation problems. In ACSI, group lending tends to exclude the poorest by the group members themselves and by the community representatives who are not sure of guaranteeing repayment from the very poor. Therefore, both ACSI and Wisdom need to revise their model based on clients need and should use flexible lending models in both rural and urban areas. ACSI should also think about the direct interference of community representatives.

Fifth, the two programs were established based on the objective of poverty reduction by targeting the poor. However, their achievements depend on their approach. ACSI is efficient, profitable, and sustainable MFI and best reflects the business model. But it is less effective in achieving its poverty reduction objective and reaching the poorest clients. Wisdom, however, is less efficient, less profitable and less sustainable. But it is relatively better in achieving its poverty reduction objective and in reaching poor people though currently the strategy is also shifting to less poor clients. In both cases, therefore, there is a need to make all efforts to achieve the stated objectives and reach the poor people. This needs to come from understanding demand driven client needs and developing flexible financial and non financial products and services to meet their needs and to change the life of the poorest segment.

Sixth, the review of the impact studies shows that both cases have positive impact on their clients, especially in income diversification, health and nutrition, housing and empowerment of the poor. However, the evidence at country level shows that there has not been any significant decline in the overall levels of poverty. This could be partly due to the fact that the two cases (especially ACSI) have not been very successful in reaching the poorest. Therefore, there is a need to support microfinance programs in Ethiopia so as to reach the poorest segment of the population. Microfinance alone could not reduce poverty. It should be supported by other development interventions.

Seventh, the government has considered microfinance as its own tool to fight poverty and established legal framework to promote MFIs. However, it seems to be biased towards government affiliate or related programs. Therefore, the government should revise its rules and policies and create conducive environment for all MFIs. Although donors are supporting ACSI and Wisdom, mainly in building their capacity, there are restrictions by the government on their intervention. Therefore, the government should revise the regulatory framework to encourage them because donors can play a positive role in increasing outreach and efficiency; they can also assist the poorest through community development programs. Moreover, there is a need to build the skills of clients, and technical service providers. This will not be achieved with out the support of donors and other actors in country.

Finally, microfinance is not a miracle solution. It is not for everyone and is not solely responsible for poverty reduction. It must also be integrated with other social programs like public works, safety nets and/or community development programs that are flexible to meet the diverse needs of destitute families. Microfinance loans need to be reviewed and adjusted to the contextual needs of the poor, since the poor are not a homogenous group.

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- <http://www.cgap.org>

Appendices

Appendix 1

Description of loan products (ACSI)

Loan Type	End- term	Installment	Food security	Asset	Business loan
Methodology	Group	Group	Group/individual	Individual	Individual
Interest rate	18%	15/18%	12.5%	18%	10-12.5%
Interest rate type	Declining	Declining	Declining	Declining	Declining
Other fees	Nil	Nil	Nil	Nil	Nil
Estimated effective rate	18%	15/18%	12.5%	18%	10-12.5%
Term	9-24 months	6-24 months	24 months(with rescheduling)	1-3 years	1-5 years
Repayment schedule	Semi annually or end of term	monthly	Semi annually or end of term	monthly	Monthly/term
Savings collateral as % of loan value	5% upfront, 1% monthly	3% upfront, 1% monthly	Nil	20% upfront	Nil
Minimum size	\$17	\$17	\$17	\$116	\$580
Maximum size	\$580	\$580	\$580	\$1744	\$58,000
Predominant loan uses	Agriculture	Processing; mfring; trade and service	Agriculture	Housing, construction & equipment	Trade, small enterprises, agro-indu, comm. Agri.
% of portfolio	80%	13%	3.2%	2 %	1.8%

Source: USAID 2006, Gobezie &Garber 2007, AEMFI 2006, 2007, 2008

Appendix 2

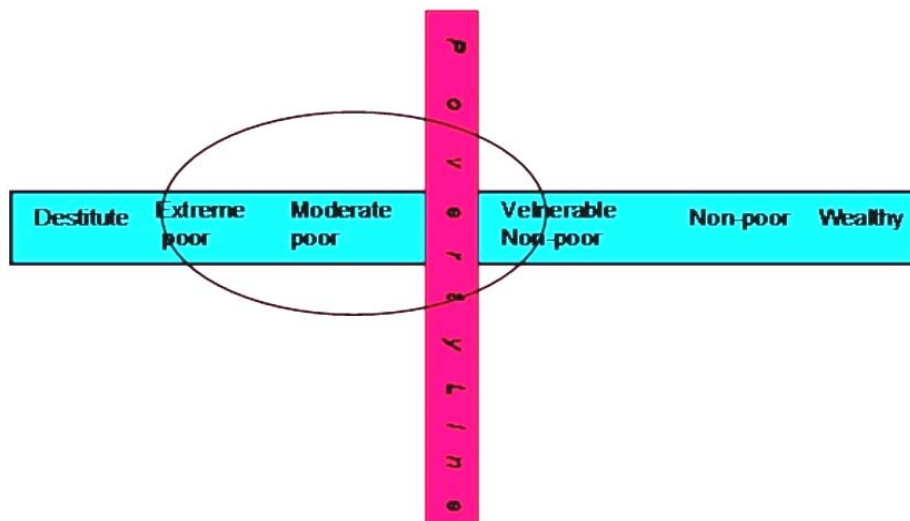
Description of loan products (Wisdom)

Type of Loan	Agricultural	Instalment	Individual	Consumption
Methodology	Village banking	Group lending	individual	consumer
Interest rate	15%	12.5%	12.5%	15%
Interest rate type	Flat	Flat	Flat	Flat
Other fees	2% app. Fee + 2% insurance fee	2% app. Fee + 2% insurance fee	2% app. Fee + 2% insurance fee	2% app. Fee + 2% insurance fee
Estimated effective rate	19.5%	29.8%	38.5%	35%
Term	12 months	12 months	36 months	24 months
Repayment schedule	End of loan term	Weekly/monthly/ev ery two months	Weekly/monthly	monthly
collateral	Group guarantee	Group guarantee	Own/third party asset and/or salaried guarantor	salaried guarantor
Minimum size	\$23	\$87	\$580	\$115
Maximum size	\$230	\$580	\$1160	\$170
Predominant loan uses	Agriculture	Agri-business, business and enterprise loans	Housing, construction & equipment	Consumption
% of portfolio(as 2004 data)	42%	30%	19%	9%

Source: Micro rate 2004, AEMFI 2008

Appendix 3

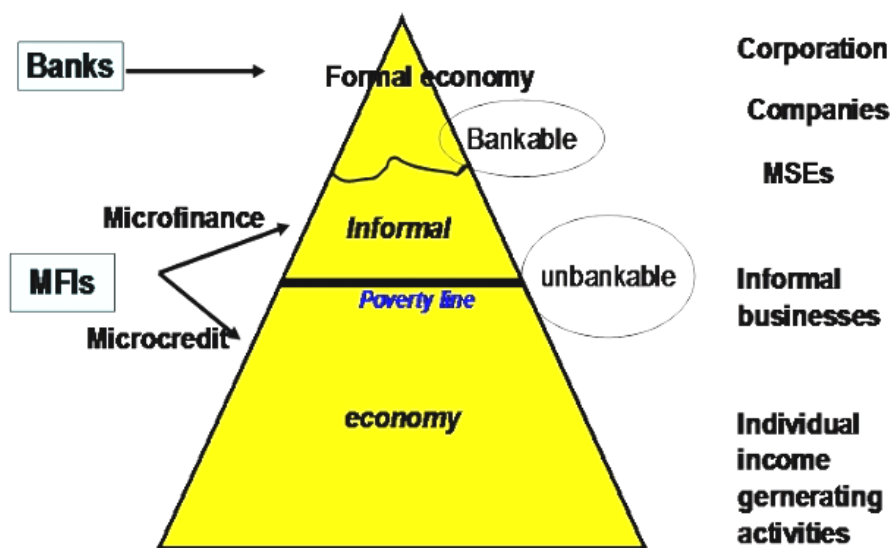
Defining the Poor



Source: Sebstad and Cohen 2001:4

Appendix 4

Clients for Formal Banks Vs MFI

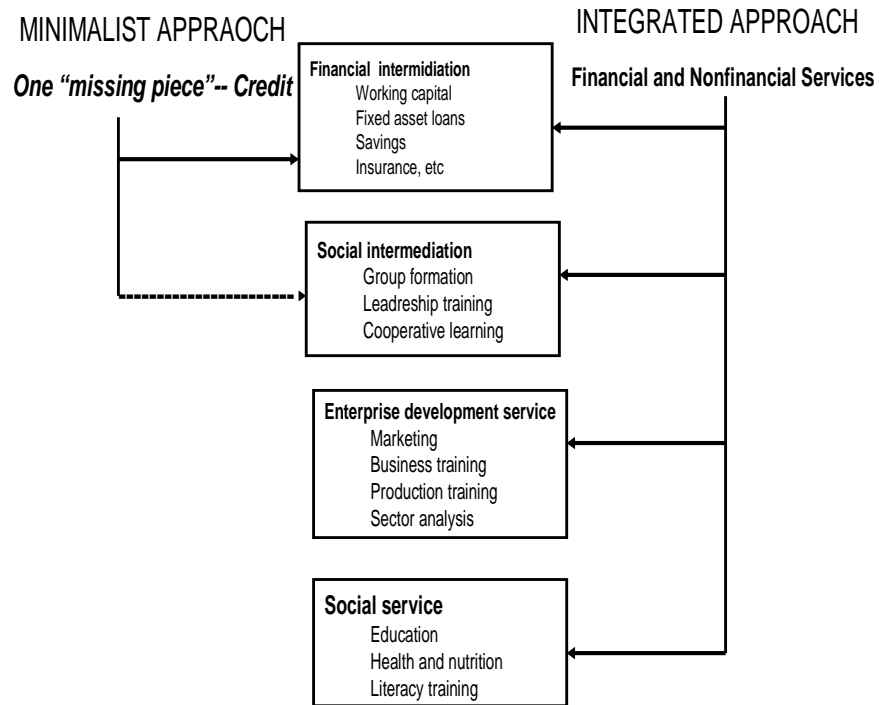


Source: Gert Van Maanen (2004:55)

Appendix 5

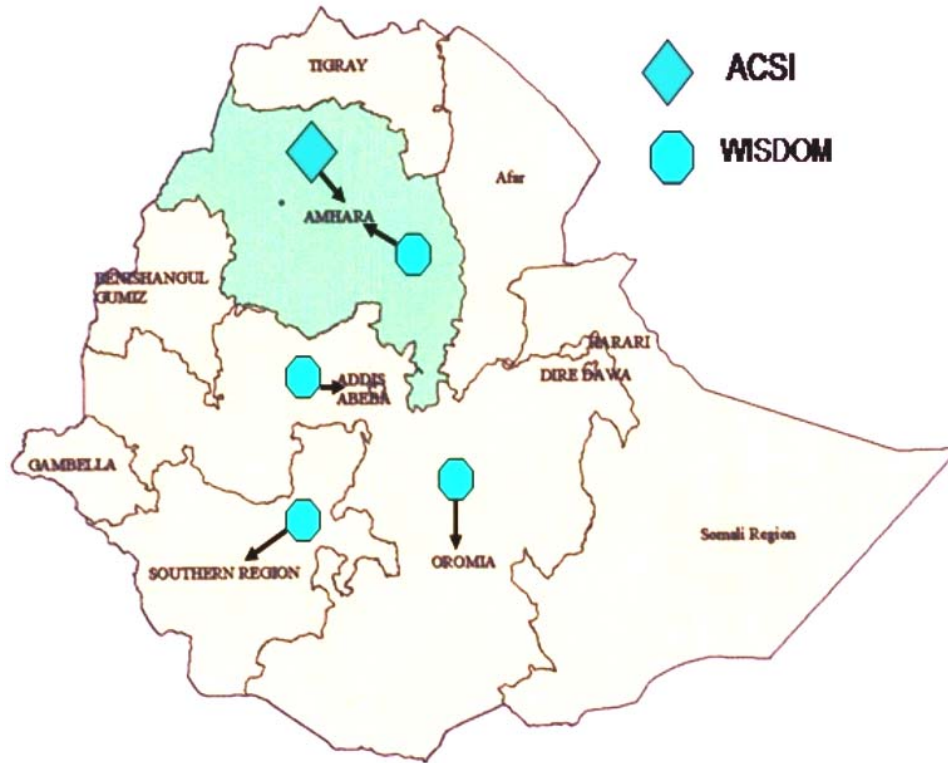
Products and services based on approaches

Minimalist and integrated approaches to microfinance



Source: Ledgerwood (1999:65)

Appendix 6
Map of the case study areas



Appendix 7
Outreach and Financial Performance (ACSI)

Indicators	2002	2003	2004	2005	2006	2007
Outreach						
Number of personnel	1,308	1,479	1670	1,915	2,065	2,363
Number of active borrowers	255,000	288,681	351,163	434,814	536,804	597,723
Average loan balance per borrowers(in US\$)	78	88	104	118	146	185
Women Borrowers(%)	38	29.40	n/a	38.60	50	51
Number of savers	69910	110,724	134,013	199,486	224,571	308,942
Average savings balance per savers(in US\$)	130	98	96	83	111	123
Balance Sheet						
Gross Loan Portfolio (in US\$)	19,887,530	25,410,925	36,414,559	51,237,134	78,235,885	110,606,954
Total Assets (in US\$)	27,909,481	35,088,884	53,235,554	67,902,934	95,873,145	138,820,190
Savings (in US\$)	9,094,995	10,862,281	12,857,776	16,550,336	24,946,692	37,901,184
Total Equity (in US\$)	3,256,416	16,402,491	17,842,808	21,972,761	28,747,168	37,336,582
Financial Structure						
Capital / Asset Ratio(%)	11.67	46.75	33.52	32.36	29.98	26.90
Debt / Equity Ratio(%)	757.06	113.92	198.36	209.03	233.50	271.81
Deposits to Loans(%)	45.73	42.75	35.31	32.30	31.89	34.27
Deposits to Total Assets(%)	32.59	30.96	24.15	24.37	26.02	27.30
Gross Loan Portfolio / Total Assets (%)	71.26	72.42	68.40	75.46	81.60	79.68
Overall Financial Performance						
Return on Assets (%)	3.20	5.96	7.54	6.45	7.91	7.91

Return on Equity (%)	29.74	19.11	19.45	19.62	25.55	28.09
Operational Self-Sufficiency (%)	132.27	177.31	231.79	199.95	223.91	224.93
Revenues						
Financial Revenue Ratio (%)	13.10	13.68	13.26	12.90	14.30	14.24
Profit Margin (%)	24.40	43.60	56.86	49.99	55.34	55.54
Expenses						
Total Expense Ratio (%)	9.90	7.71	5.72	6.45	6.39	6.33
Financial Expense Ratio (%)	2.64	1.65	1.74	1.78	2.06	2.46
Loan Loss Provision Expense Ratio (%)	0.98	0.73	n/a	0.25	0.43	0.25
Operating Expense Ratio (%)	6.28	5.33	4.25	4.42	3.90	3.62
Efficiency						
Operating Expense / Loan Portfolio (%)	9.24	7.42	6.07	6.11	4.93	4.50
Cost per Borrower	7.7	6.2	5.9	6.8	6.6	7.5
Productivity						
Borrowers per Staff member	195	195	210	227	260	253
Savers per Staff member	53	75	80	104	109	131
Risk						
Portfolio at Risk > 30 days Ratio (%)	2.09	3.34	1.75	1.90	1.55	1.27
Loan Loss Reserve Ratio (%)	2.68	2.75	1.53	1.36	1.28	1.04
Risk Coverage Ratio (%)	128.02	82.37	87.42	71.69	82.61	82.04
Write Off Ratio (%)	n/a	0.00	0.00	0.00	0.07	0.10

Source: www.Mixmarket.org

Appendix 8
Outreach and Financial Performance (Wisdom)

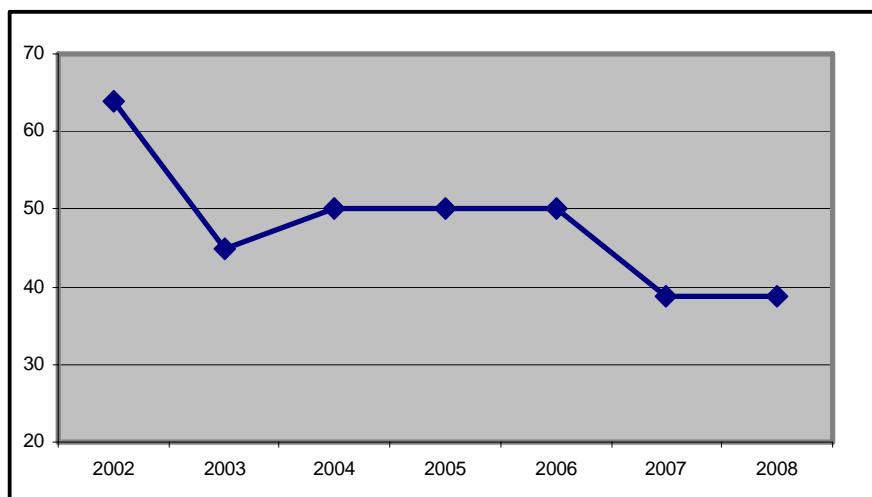
Indicators	2002	2003	2004	2005	2006	2007
Outreach						
Number of personnel	60	103	138	215	344	382
Number of active borrowers	10524	12054	19912	27388	44940	48168
Average loan balance per borrowers(in US\$)	124	117	109	112	118	136
Women Borrowers(%)	28.7	33.7	n/a	46.5	61.3	59.6
Number of savers	0	738	n/a	5242	7743	7320
Average savings balance per savers(in US\$)	0	361	n/a	90	91	111
Balance Sheet						
Gross Loan Portfolio (in US\$)	1,306,066	1,404,463	2,178,024	3,069,951	5,311,433	6,548,812
Total Assets (in US\$)	2,215,809	2,485,619	3,073,654	3,566,973	6,084,063	7,836,678
Savings (in US\$)	0	266,672	380,963	471,440	703,610	808,867
Total Equity (in US\$)	255,294	-20,029	2,196,655	1,433,604	2,871,634	2,831,185
Financial Structure						
Capital / Asset Ratio(%)	11.52	n/a	71.47	40.19	47.20	36.13
Debt / Equity Ratio(%)	767.94	n/a	39.92	148.81	111.87	176.80
Deposits to Loans(%)	0.00	18.99	17.49	15.36	13.25	12.35
Deposits to Total Assets(%)	0.00	10.73	12.39	13.22	11.56	10.32
Gross Loan Portfolio / Total Assets(%)	58.94	56.50	70.86	86.07	87.30	83.57
Overall Financial Performance						
Return on Assets (%)	-6.93	-3.72	2.44	0.17	5.20	-1.11

Return on Equity (%)	-101.08	-74.32	6.24	0.31	11.65	-2.71
Operational Self-Sufficiency (%)	63.07	76.43	115.49	101.10	129.07	94.83
Revenues						
Financial Revenue Ratio (%)	11.83	12.06	18.22	15.69	23.08	20.38
Profit Margin (%)	-58.55	-30.84	13.42	1.09	22.52	-5.45
Expenses						
Total Expense Ratio (%)	18.76	15.78	15.77	15.52	17.88	21.49
Financial Expense Ratio (%)	0.95	0.54	0.48	0.52	1.42	2.00
Loan Loss Provision Expense Ratio (%)	6.71	3.45	2.63	3.49	1.18	2.84
Operating Expense Ratio (%)	11.09	11.79	12.66	11.51	15.29	16.65
Efficiency						
Operating Expense / Loan Portfolio (%)	19.06	20.44	19.65	14.56	17.61	19.54
Cost per Borrower	21.7	24.5	22.0	16.2	20.4	24.9
Productivity						
Borrowers per Staff member	175	117	144	127	131	126
Savers per Staff member	0	7	n/a	24	23	19
Risk						
Portfolio at Risk > 30 days Ratio (%)	2.70	5.32	3.48	3.26	5.46	2.74
Loan Loss Reserve Ratio (%)	1.09	2.46	1.21	2.75	1.67	1.41
Risk Coverage Ratio (%)	40.35	46.31	34.77	84.59	30.56	51.28
Write Off Ratio (%)	13.92	6.75	5.49	2.80	2.18	3.21

Source: www.Mixmarket.org

Appendix 9

Ethiopia - Population below poverty line (%)



Source: <http://indexmundi.com/g/g.aspx?c=et&v=69>