A STUDY ON LINKAGES IN MICROFINANCE SERVICES AND POVERTY REDUCTION IN ETHIOPIA

By

Teklewold, Zelalem Behailu

THESIS

Submitted to
KDI School of Public Policy and Management
in partial fulfillment of the requirements
for the degree of

MASTER OF PUBLIC POLICY

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ABSTRACT

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As it is the same to many of Sub-Saharan countries, poverty in Ethiopia is so acute and widespread. Mentioning that per capita income of the country is second to the lowest in the world, child wasting and stunting is among the top five in the world and the literacy rate is below the average for Sub-Saharan countries is sufficient evidence in this regard.

These disgusting realities signify the pressing need of an array of policy measures to bring about a pronounced impact in the course of wrestling with poverty. Though interrupted by devastating internal and external wars happened at different times, Ethiopia has been implementing integrated development programs, which intend to reduce poverty, for more than 50 years. Most of these endeavors were not successful in eliminating poverty. Various foreign and Ethiopian scholars have identified a number of causes for such disappointing result. As it is not the theme of this thesis, I do not discuss this matter in detail in the coming subtopics.

Since a decade ago the existing regime of the country has clearly set out an Agricultural Development Led Industrialization Strategy as the guiding framework to address the nation’s severe poverty. In it the expansion of micro finance interventions has been spelled out as one of the fundamental instruments to realize the objectives of the strategy.

I have been able to assess in this research whether the micro finance services instituted in the country have been designed and implemented in a way that they actually reach and help the poor come out of poverty. The finding of my research, which is conducted mainly on the basis of secondary data, is so encouraging in that context. That is, as can be seen from the detail of the analysis, I have been able to show by various methods that the micro credit services are so helpful to improving the livelihood of the very poor.

ACKNOWLEDGMENTS

First of all I would like to express my heart felt thanks to Professor Nam, Il-Chong for his willingness to supervise my thesis. I was troubled at the last minute when my first supervisor was in the brink of leaving the school and thus it was a great moment for me when Professor Nam rescued me by accepting my request to supervise this thesis. Moreover, I have to appreciate his kind and greatly useful professional comment and assistance, which helped me very much to complete my thesis successfully and smoothly.

Secondly, I should mention my sister's, Lily Fekade, tireless assistance in typing the first draft. She typed my paper happily like she was doing her own work. Had it not been for her help, given my slow speed in typing, the thesis might not be completed in time.

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ACRONYMS

ACSI – Amhara Credit and Saving Institute

ADLI – Agricultural Development Led Industrialization Strategy

BDS – Business Development Service

CBOs – Community Based Organizations

CMS – Credit Management Services

CSA – Central Statistical Authority

DECSI – Dedebit Credit and Saving Institute

ENB – Ethiopian National Bank

EU – European Union

FINIDA -

FMSEDA – Federal Micro and Small Enterprise Development Agency

GDP – Gross Domestic Product

GMFI – Ghana Micro Finance Institute

HICES – Household Income, Consumption and Expenditure Survey

IFAD – International Fund for Agricultural Development

KWFT – Kenya Women Finance Trust

MFIs – Micro Finance Institutes

MOFED – Ministry of Finance and Economic Development

OCSS.Co. – Oromya Credit and Saving Share Company

RMSEDA – Regional Micro and Small Enterprise Development Agency

SFPI – Specialized Financial Promotion Institute

SMI – Sidama Micro Finance Institute

SNNPR – Southern Nations, Nationalities and Peoples Region

SSA – Sub-Saharan Africa

WB – World Bank

WMS – Welfare Monitoring Survey

ZCMS – Zambian Credit Management Service

CHAPTER ONE

BACKGROUND OF THE THESIS

1.1Introduction

The causes for underdevelopment and poverty in Ethiopia are attributed to a number of factors, which can vary spatially. The commonly understood are the fact that over 80% of the population is dependent on subsistence agriculture, the employment outside agricultural sector is so limited and higher growth rate of population than growth rate of GDP.

There are different specific reasons, which made the country's economy exhibit such kind of disgusting reality. The government in particular and the public at large are applying various solutions envisaged to mitigate most of the identified constraints.

Micro finance is among the specific meanses that are given greater emphasis and expected to play essential role for reducing poverty. Most of the micro finance service providing institutes have articulated creating a small and easily accessible loan to the poor as their primary objective.

I personally think if properly organized and applied micro credit provision to the poor is a right approach to reduce poverty directly and immediately. In this thesis I have assessed the contribution of the small-scale loans in reducing poverty. In the process of looking into that matter, I have also reviewed relevant theoretical explanations and experience of other countries.

The research result is presented in five chapters. In the main part of this paper, chapter four, I have been able to confirm that what I have expected is correct. The micro finance services do help to lower the poverty incidence in short time span. This does not mean that the schemes were free of any limitations. In the last part of my thesis I have pinpointed the major constraints for heightened and sustained contributions of the sector in reducing poverty. My recommendations are also presented along with the limitations.

I would like to mention from the on set that this thesis could have several uses. First, it will serve policy makers, researchers and practitioners of micro credit service to understand the level of the contribution of small loans to reducing poverty and take other necessary supportive measures to strengthen the initiatives. In addition any interested person could use it as a reference for further study on the topic.

1.2 Purpose and Objectives

Since early 1990s a number of micro finance institutions have been set up and have made credit available to finance various small businesses in Ethiopia. They have spelled out in black and white their overriding objective is to reach the very poor and help them get out of poverty track. They have covered overwhelmingly vast parts of the country with such very short time span. The general purpose of this paper is that first it shows the extent of poverty and then describes by using various evidences whether micro credit services put in practice so far have actually attained their objectives – reducing poverty. Specifically, the thesis will have the following five objectives.

- Assessing how far poverty is acute and widespread in Ethiopia.
- Analyzing to what extent micro credit schemes have been designed and implemented in the way to address the nations severe poverty.
- Evaluating the impact of credits provided by some of the major MFIs with regard to upgrading the livelihood of the borrowers.
- Pinpointing the crucial factors, which deterred the heightened impact of MFIs and providing recommendations to tackle them so that micro credit services could be strengthened and bring sustainable improvement in living standard of the very poor.
- To fulfill the partial requirement of Masters Degree in Public policy

1.3Data Collection and Methodology of the Research

I wrote my thesis largely based on secondary data, which I got from published and unpublished papers. To supplement the lacking data I have reviewed the documents of the relevant offices and discussed with officials in charge of micro credit service giving institutes. I could not conduct interview with beneficiary borrowers for one thing it was not indispensable and for another I was unable to do so due to financial, logistical and time constraint. As can be noticed from the subsequent analyses, I can generally say that the information and data I utilized from the secondary sources was so substantial to investigate the topic I chose and address the objectives mentioned above.

The methodology I adopted is descriptive analysis. That is wherever necessary and possible I computed percentages and ratios and used tabular explanations to give a clear picture of the issue I am presenting. Moreover I have tried to make comparison between the practice and performance of Ethiopian MFIs with MFIs operating in other developing countries. In all circumstance, I support my analysis with theoretical backing and other countries experiences wherever possible and appropriate

I did not use econometric regression model because I felt it is not crucial for this thesis. Any one interested or myself can apply appropriate model in the future depending on availability of sufficient time series data and computer software.

1.4Limitation of the Paper

This paper has made conclusion and recommendation that will be applicable to all micro finance institutes working in Ethiopia partially based on data of research results made on some major MFIs. Such generalization might have limitation especially with regard to impact on borrowers livelihood. What I mean is that the stated positive contribution of MFIs in augmenting income may not work for all credit services and could even be exaggerated for the assessed schemes as the reviewed piece meal studies do not cover representative sample in their research.

This, however, does not imply that the data as whole is irrelevant and do not give any suggestion as to the achievement of the micro finance services. After all, those researches are reviewed to provide additional evidence to the main point, which is addressed by the comprehensive data, obtained from annual reports of major micro finance institutes.

1.5 Organization of the Remaining Parts

My thesis has five chapters, each of which is sequentially and logically interrelated and coherent, one another.

As seen from earlier discussions the first chapter contains issues, which highlight the content of the paper, such as general introduction, methodology and data collection procedure, limitations and guiding explanations about how the rest parts of the paper are organized and brief description of what they intend to deal.

In Chapter 2 I have reviewed relevant parts of theoretical explanations about micro finance along with other countries' experiences. The micro credit theories such as the type of lenders of small loans and their common feature are given more emphasis, as these issues are more important to analyzing the thesis objectives stated. In line with what the theory predicts I have reviewed the experience of Ghanaian, Kenyan and Zambian micro credit service provision. These countries are selected because they are more or less at the same level of development with Ethiopia and have ample experience in micro finance area.

Chapters 3 and 4 include analysis of my findings, which is the main body of the thesis. Specifically the intensity, spatial and temporal dimensions of poverty are dealt in chapter three. The consumption and other aspects of poverty situation along with its causes and measures envisaged to reduce it are also discussed in detail in that chapter.

The role micro finance plaid in reducing poverty is presented in chapter four. There I have showed how and why micro finance evolved types of micro finance institutes operating in Ethiopia and to what extent the micro finance services are tailored towards reducing poverty. Broadly, the data analysis that is aided by tabular explanations shows clearly how the objectives mentioned are addressed.

The final chapter is the part where my conclusion and recommendations are presented. More emphasis is given to the recommendation aspect.

CHAPTER TWO

REVIEW OF THEORETICAL FOUNDATION OF MICROCREDIT AND EXPERIENCE OF SOME SUBSAHARAN COUNTRIES

2.1 THEORETICAL UNDERPNINGS OF MICROCREDIT

2.1.1 Sources of Demand for Credit

The demand for credit or capital is usually divide into three parts in most of Development Economics books. First, there is the capital required for new startups or a substantial expansion of existing production lines. The credit market that services these needs is called the market for fixed capital: Capital that is poured into the purchase and organization of fixed inputs such as factories, production processes, machines, or ware houses. The second group is the credit required for ongoing production activity, which occurs because of a substantial lag between the outlays required for normal production and sales receipts. This market is called the market for working capital. Finally, poor individuals who are strapped for cash, either because of a sudden downturn in their production, or a sudden fall in the price of what they sell, or perhaps because of an increase in their consumption needs caused by illness, death, or festivities, such as a wedding. This type of credit is called consumption credit.

Although fixed capital credit is of great importance in determining the overall growth of the economy, working capital and consumption credit are fundamental to understand how an economy supports its poor and disadvantaged. In no sector is this more the case than in agriculture. The seasonality of agricultural production and the low incomes of those who live and work in the rural sector heightens the importance of working capital in production. For instance, at the beginning of the crop cycle, the peasant faces a considerable need for working capital: money to purchase seeds, fertilizers, pesticides, and so on. These expenditures are bunched up front, and the farmer is often without sufficient fund to finance it. Hence, there is a need to borrow, with the loan repaid after the crop is harvested and sold. Similar to the agricultural production, activities in the small-scale non-farm sector do need credit for running the business uninterrupted.

Moreover, there is often a high rate of unemployment in the slack season. Peasants, and landless laborers in particular, who rely on wages as a means of livelihood, find considerable fluctuations in their earnings from month to month. Credit is required for such people to smooth consumption overtime to cover their needs in periods of low income by borrowing against higher expected earnings during times when the going is good. Off course such loans are almost unavailable in most underdeveloped countries like Ethiopia mainly because of unwillingness of lenders to provide the consumption credits. Their reason is the high rate of default.

2.1.2 BASIC FEATURES OF RURAL CREDIT MARKETS

2.1.2.1 Who Provides Small Scale Credit?

Institutional Lenders: The formal or institutional lenders include government banks, commercial banks, credit bureaus, and so on. One or another form of these institutional lenders are setup in many countries around the globe to cater especially to the needs of rural or urban poor.

The main problem with formal lenders is that they often don't have personal knowledge regarding the characteristics and the activities of their clientele. Often, these agencies can not monitor just how the loans are used. The problem is not just production versus consumption: For example, the fear that a loan taken ostensibly for some productive purpose may be squandered to meet the expenses of a wedding. There are other, more subtle reasons for a systematic divergence between what lenders want done with the money and what borrowers want.

Thus institutional credit agencies often insist on collateral before advancing a loan. For a bank that is interested in making money, this is certainly a reasonable thing to do. For poor peasants, however, this usually makes formal credit an infeasible option. It's not that they lack collateral, but that their collateral is often of a very specific kind. A farmer may have a small quantity of land that he is willing to mortgage, but a bank may not find this acceptable collateral, simply because the cost of selling the land in the event of a default is too high. Likewise, a landless labourer may seek funds to cover a sudden illness in the family and pledge his labour as collateral: he will work off the loan. However, no bank will accept labor as collateral.

As discussed above poor encounter serious obstacles for having access to institutional loans. Because of that they are generally referred as unbankable. Realizing this problem many underdeveloped and developing countries have designed a special mechanism - group lending - as a substitute for collateral.

Informal Lenders: The other lenders, which are dominant in reaching many customers, are the informal lenders such as the landlord, the shopkeeper and the trader. In the previous section, we discussed the problem of collateral and that some economic agents offer collateral in forms that are unacceptable to formal lenders. However, the "right" sort of informal moneylender may be willing to accept collateral in these forms. A large landowner who has land adjacent to that of a poor farmer may be interested in the tiny plot as collateral (indeed, perhaps more interested in the plot than in getting the loan back). An employer of rural labor will accept labor as collateral, in case the labor borrower fails to repays.

It is not surprise, therefore, to find that formal banks cannot effectively reach out to poor borrowers, whereas informal moneylenders the landlord, the shopkeeper, the trader to a much better job.

There is another reason for the dominance of informal money lending. Quite apart from the ability to accept collateral in exotic forms, the informal moneylender often has much better information regarding the activities and characteristics of his clientele. A trader who advances loans for working capital often has first claim on the farmer-borrower's output; he can easily arrive at the field on the day of the harvest. A landlord has a better chance of knowing what his tenant is doing with a loan than any commercial bank can hope to have. Thus even in countries where government efforts to extend, rural credit are strong, the informal credit sector flourished. Take the case of India. <The All India Rural Credit Survey, published by the Reserve Bank of India, Reveals that in 1951 only 7.2% of all borrowing was from government sources, banks and cooperatives. By 1981, this number had jumped to 16.2%, thanks mainly to the India government's substantial drive to extend rural credit through official channels. Individual moneylenders by no means vanished; 24.3% of all debt was still owed to them (Bell [1993] as quoted by Debraj, Development Economics, 1992). Debraj in his same book asserts that similar to the case of India, in Thailand, the share of the informal sector in total rural credit declined from a steep 90% in 1975 to a still influential 50% in the late 1980s.

2.1.2.2 Some Common Characteristics of Rural Credit Markets

Information Constraints: The fundamental feature that creates imperfections in credit markets is informational constraints. First, there is lack of information regarding the use to which a loan will be put. Second, there is lack of information regarding the repayment decision. This deficiency includes limited knowledge of the innate characteristics of the borrower that may be relevant in such a decision, as well as limited knowledge of the defaulter's subsequent needs and activities, which place limits on his incentive to default. Most of the important features of credit markets can be interpreted as responses to one or the other of these informational problems.

Segmentation: Another characteristic of the rural credit market is its tendency toward segmentation. Many credit relationships are personalized and take time to buildup. Typically, a rural moneylender serves a fixed clientele, whose members he lends to on a repeated basis; he is extremely reluctant to lend outside this circle. Most often, a moneylender's clients are from within his village or from close by, so that the moneylender has close contact with them and is well informed about their activities and whereabouts. Repeat lending – a phenomenon in which a moneylender lends funds to individuals to whom he has lent before (or has other close interactions with) is very common.

As an example, Debraj (Development Economics, 1992) cites Aleem's (1993) intensive survey of fourteen moneylenders in the chamber region of Pakistan. In that survey the author showed that as many as ten money lenders lent more than 75% of their funds to old clients those with whom they had dealt in the past. Even among the remaining four lenders, the lowest percentage of repeat lending was reported to be 52%. Though it is difficult to get a similar survey done in Africa, the reality is not different.

Inter linkage: A third feature, which may be considered an extension of the second, is the existence of what is described as interlinked credit transactions. Indeed, this a good time to banish from your main the image of a crafty moneylender, whose sole purpose is to lend money at exorbitant rates interest to helpless borrowers. A majority of village moneylenders do not pursue usury as their sole occupation. Most of wealthy landlords tend to give credit mostly to their tenants or farm workers, whereas traders favour lending to clients from whom they also purchase grain. Thus segmentation often takes place along occupational lines, and the complementarity of some production relationship (tenant & landlord or framer and trader) facilitates the credit relationship.

Interest rate variation: Segmentation has a natural corollary: informal interest rates on loans exhibit great variation, and the rates vary by geographical location, the source of funds, and the characteristics of the borrower. Sometimes the rate of interest is extraordinarily high.

However, high interest rates are not necessarily the normal in informal credit transaction. Udry's [1994] study of Nigeria reveals that interest rates on loans among families were low (and depends on the financial circumstances of both borrower and lender). Low or even zero- interest loans from traders are not uncommon (Floro and Yotopoulos [1991]. However, it would be misleading to conclude a loan is zero-interest by looking at the nominal interest rate. Given the interlinked nature of many of these transactions, interest may be hidden in other features of the overall deal such as the lower price at which a trader buys output from the farmer or the forgone wage when a laborer is required to work for lenders.

The disparities in interest rates pose a puzzle: why aren't they smoothed out by people's attempts to make use of the arbitrage opportunities that such variations appear to present? In other words, why don't clever and enterprising agents borrow from lenders who charge comparatively lower rates and lend that money to borrowers who are paying and are prepared to pay much more? The answer has to do with segmentation and (once again) the informational variations that cause it. The personal characteristics of people matter and so does the nature or length of interaction between a borrower and a lender. The lender, before lending to a client, asks himself such questions as: do I know him well? Is he from my village? Is he a good farmer? How much land does he possess? Does he have a pump set to irrigate his land if rainfall is scarce? The lender's decision whether or not to advance a loan and, if he does, what the terms and conditions will be, crucially depend on the answers to these question. Thus, arbitrage opportunities may be only a mirage: the rate at which a landlord lends to client A from village X may not be the same at which he is willing to lend to client B from village Y.

Rationing: Informal credit markets are characterized by widespread rationing, that is, upper limits on how much a borrower receives from a lender. By rationing, it means that at the going rate of interest, the borrower would like to borrow more but cannot. In this sense credit rationing is a puzzle: if the borrower would like to borrow strictly more than what he gets, there is some surplus here that the money lenders can grab by simply raising the rate of interest a little bit more. This process should continue until the price (interest rate) is such that the borrower is borrowing just what he wants at that rate of interest.

Rationing includes the complete exclusion of some potential borrowers from credit transactions with some lenders, i.e. at the going terms offered by the lenders, some borrowers would like to borrow, but the lender doesn't lend to them. In this sense rationing is intimately connected or even can be seen as a special case of segmentation.

Exclusivity: Finally, many informal credit transactions are characterized by exclusive dealings. Moneylenders typically dislike situations in which their borrowers are borrowing from more than a single source. They insist that the borrower deal with them exclusively, that is, approach no other lender for supplementary loans.

Segmentation and exclusivity together paint a picture in which it seems wrong to get an idea of overall competition in informal credit market by simply counting the number of borrowers and lenders who are active. A better description is that despite the overall background of competition, particular dealings are often (though not always) bilateral, and informational, locational, and historical advantages often tends to give lenders the "local monopoly" power, which enable them to excessively exploit the poor borrowers.

2 .2 REVIEW OF EXPERIENCE OF SOME SUBSAHARAN COUNTRIES IN MICROCREDIT

World Bank has made numerous studies on microcredit programs implemented in sub-Saharan countries. Following I have made a brief assessment of the case of Kenya, Zambia and Ghana as they have been intensively engaged in micro financing activities directed to the poor since the mid 19th. The focus of the assessment is their financial performance, target groups, types of activities financed, source of fund and impact on poverty reduction. Doing that (I believe) will provide an insight for gauging performance of a similar initiative made in Ethiopia.

Who Gives Assistance To Credit Institutes?

The respective governments of Kenya, Zambia and Ghana provided support to the sector as a means of sustaining growth and generating employment opportunities. Specifically they have enacted policies in support of the sector and channeled resources to improve infrastructure and facilitate the flow of credit to the sector.

Donors have also showed considerable support to government run as well as private micro credit institutions that proved efficient. The following table summarizes the type of donors and supports the credit institutes obtained.

Table2.1: Type and amount of donor support the reviewed micro-finance institutes.

Name of the micro finance organization	Type of donors	Type of assistance
Kenya Women Finance Trust(KWFT)	Ford Foundation, International Fund for Agricultural Development (IFAD), the Belgian-Survival Fund, and the Netherlands Ministry for Development Cooperation	Provision of seed fund and loanable fund in times of risk of sustainability
Zambian Credit Management Services Limited (CMS)	EU and FINIDA	Provision of loanable fund for specific target beneficiaries
Ghana Micro finance Institution (MFI)	Various foreign NGOs, and Community Based Organizations (CBOs)	Providing seed fund and loanable fund in times of risk of sustainability

Source: WB, Africa Region series country specific microfinance study reports.

The Lending Methodology

All of the lending and saving organizations have adopted a group-based model of intermediation similar to the model used by the Grameen Bank in Bangladesh. The schemes nevertheless have been modified to fit specific conditions and practices. The details of the lending mechanism of that of the Zambian CMS looks the following.

GCMS lends to its target beneficiaries through forming clubs. These clubs are divided into cells of five members. Each cell is requested to mobilize savings from members, based upon which members are given twice the amount they have saved as a loan. The saving is held as security. CMS is able to provide loans of up to about US$ 250. A club can apply for a loan after the initial saving has been accumulated, and members have attended orientation meetings regularly and successfully. Initial orientation and training is a prerequisite to qualify for loans.

Initially, the loan amount is distributed among two members of the cell, chosen by members of the cell without the involvement of the credit officer. This first set of recipients would usually not include the cell leader, who must wait until all other members of the group have been served, before taking her loan.

The loan process is simple. After selection of the recipients, they are presented to the club for endorsement. They then complete loan application forms issued by the credit officer, after which the loans are distributed. Loans are repayable in full, after four months, in a single installment. New loans can thereafter be given to other cell members. Four months after the first two members have received their loans, two other persons are selected using the same process. After a further four months, the last person (leader of the cell) receives her loan.

No detailed loan appraisal process is required. The economic activity assessment and character reference verification conducted by the club and credit officer are adequate for loan approval. The head office management approves applications during field visits, usually undertaken every four months. After loan approval, borrowers sign their individual loan agreements. All members of the cell sign a loan guarantee form jointly with the elected leaders of the club, and then the cash is disbursed without further delay.

The loan procedure ensures that there is peer pressure on the borrowers to repay their loans on time. If the first set of borrowers do not repay, the rest of the group would not be eligible for loans. The group leader, who is usually the most influential person among them, has to wait for the others to borrow and repay before receiving her loan. This minimizes any manipulation of the group by the leader and also sustains pressure for the others to repay.

The responsibility for loan repayment first rests with the individual member of a cell, then the five members of a cell, and eventually the whole group (club). Each cell member is equally responsible for a defaulter or participant who fails to repay. If the cell fails to repay, the club would be required to repay the remaining balance. Eventually, if a loan is not repaid, then the whole group (club), not just the cell, is barred from receiving new loans.

GCMS, as a registered non-bank financial institution, is not permitted by the Banking and Financial Services Act of 1994, to take direct deposits from the public. However, through its lending methodology, which requires the prospective borrowers to save 50 percent of the loan amount, it indirectly mobilizes group savings through the women's clubs. Savers are paid interest, currently at 45 percent per annum. The nominal interest charged by GCMS on loans is 60 percent, which is the same as the market rate. Normally, savers are not allowed to withdraw either the interest or the principal as long as they remain members of the club. Recently, consideration for withdrawal of interest income has been given to clients who have opted to save without borrowing.

Though there are some differences in the details of loan repayment period and application procedure, like Zambia's approach, in order to ensure sustainability and responsiveness to the needs of their clients, Ghana's MFIs use group methodology, peer pressure, responsive disbursement mechanisms, and savings as cash collateral. These strategies have helped to ensure high loan repayments from clients, and have secured the quality of the MFIs' credit portfolios. On the other hand, the rate paid and asked on saving and credit are lower than the respective rates in the Zambian case.

Unique to the other organizations, the Ghana's MFIs offers non-financial services such as training in business development, entrepreneurship development, skill development, and welfare services such as family planning. These services, on top of upgrading the general well-being of the poor, have a dual objectives of capacity building through sustaining small scale entrepreneurial skill as well as improving clients efficiency in loan utilization and timely repayment of loans disbursed.

Financial Performance

In general, the loan portfolios of each of the assessed institutes have performed well in recent years. They have not experienced default and arrears problems. KWFT annual reports place the average loan recovery rate above 97 percent during the end of the 1990s. The same is true with the Zambian CMS. Its innovative approach of deterring the group as a whole from subsequent loan for an individual borrower failure to repay her debt has resulted in high repayment rates of about 98 percent.

Moreover, Credit operations of KWFT, beyond generating enough revenue to cover all its operating costs, have generated a net profit since 1996-1997. As part of this plan, credit operations and accounting functions have been fully decentralized to the branches.

Outreach and Target Groups

The credit organizations of Kenya and Zambia reviewed in this paper are specialized to serve rural poor women. GCMS for instance operates micro-credit schemes for 306 women in the rural areas of Mpo Copperbelt Province in the beginning of its operation. In Luapula Province, CMS has also offered micro-credit service for 423 women borrowers in five locations.

However, some of the MFIs target productive poor regardless of sex bias because doing so has proved to be the most direct means of reducing poverty and increasing the welfare of the family as a whole. Ghana Micro financing Institution (MFI) can be a good example in this regard.

Economic Impact

The Ghana’s micro finance delivery service has helped for over 70% percent poor beneficiary household heads acquire vocational skills for self-employment; access information on support services for improving their business; and earn an income and, thereby, engage in capital accumulation.

Similarly the World Bank report indicate that the loans of GCMS have created a significant impact in terms of employment generation and strengthened businesses. They have had a positive impact on the incomes of clients and have improved their standard of living. Some clients are reported to have diversified their businesses as a result of the loans. One of its clients has expressed for a survey request that she has diversified her business from buying groceries and selling them in her husband’s store, into baking bread and rolls. She has also bought a sewing machine and hired a tailor.

The GCMS clients’ knowledge regarding the benefits of savings is high. This is attributable to training, and the informal savings and credit associations to which the women belong. The program’s compulsory 50 percent savings requirement is not unusual for these women, who are already used to rotating savings and credit arrangements. Individual savings are reported to have increased by as much as 250 percent.

Likewise, by providing women with credit, KWFT has been able to develop entrepreneurship in the coastal towns of Kwale, Kilifi and Malindi. Through a collaborative arrangement with Barclays Bank of Kenya, KWFT also facilitates larger loans to individual women. This empowers women through the creation of additional sources of income and reduces their dependency. By bringing women together in-groups, KWFT has also created some long-lasting relationships that contribute to solving some of the social problems in Kenyan society. Perhaps the most significant non-economic impacts of KWFT are creating credit awareness, developing a business-like attitude and reducing fear of banks and loans among KWFT clients.

Constraints to Current Programs

As it would be true for other similar micro credit schemes in underdeveloped countries, all the three MFIs assessed above in common face operational constraints, which affect their ability to scale up their level of financial service provision. These constraints include a weak capital base; poor credit portfolio management systems; inadequate management information systems; limited loan funds; and lack of logistical support for effective monitoring and follow-up.

CHAPTER THREE

Poverty Incidence, Depth, and Severity in Ethiopia

Before addressing the main objective of my study, showing the role of microfinance to reducing poverty in Ethiopia, I believe it would be appropriate to reveal the level, severity and pattern of poverty in my country. With this view in mind the following subtopics are fully devoted for that purpose.

Recent statistical data on poverty and other indicators of welfare are available from the Welfare Monitoring System, which has been managed by the Ministry of Finance and Economic Development (MOFED). Data on income poverty are available from two national Household Income, Consumption and Expenditure (HICE) surveys carried out by the Central Statistical Authority (CSA) in 1995/96 and again in 1999/2000. Other data are also available from a series of Welfare Monitoring Surveys (WMS) conducted annually (save one year) since 1995/96. Most of the data reported in this chapter are derived from the HICE and the WM surveys.

3.1Trends in Consumption Poverty: Inter-temporal and Spatial Dimensions

Analyzing trends in poverty is extremely useful in determining the effect of policy on poverty reduction. In Ethiopia, the 1995/96 and 1999/2000 HICE surveys provide the opportunity to examine trends in expenditures and income poverty. However, when examining trends, one must recognize that many other factors can affect the level of poverty at any given time, including weather (especially drought), war and external shocks (including changes in commodity prices). Therefore, when comparing the 1999/2000 survey results with that of 1995/96, one must take precaution. That is, it is necessary to keep in mind that agricultural output particularly crop production was affected by weather related factors during the two consecutive years preceding 1999/2000 and sporadic drought incidences were recorded in Somalia, Tigray, and some parts of Oromiya Regional States.

The 1995/96 agricultural seasons, on the other hand, was very good and production of most main products reached record levels. The Ethio-Eritrean border conflict was also at its climax in 1999/2000. One should also not lose sight of the fact that Ethiopia's coffee prices on the international market have been plummeting since 1995/96 and are still on the decline. Thus, the 1999/2000HICE and WM survey results need to be seen against this background.

3.1.1 Trends in Per Capita Real Consumption

Given that Ethiopia is a country with significant agro-ecological and cultural differences, substantial variation would be expected in terms of areas of economic activity, sources of income (subsistence or cash income), patterns of consumption expenditure, distribution of income, incidence, and depth and severity of poverty between regions.

According to the HICE survey results, the mean per capita consumption expenditure of Ethiopia for the year 1999/00 is estimated at 1057 Birr in constant prices of 1995/96. The real per capita consumption expenditure of rural people was 995 Birr and that of urban people 1453 Birr. These levels of real per capita consumption expenditure are equivalent to 139, 131, and 191 USD at national, rural and urban levels respectively, based on the 1999/2000 annual market exchange rates. Poverty incidence was much higher in rural than in urban areas, the poverty head count indices being 45 and 37 percent, respectively, in 1999/2000.

Between 1995/96 and 1999/2000, per capita calorie intake apparently increased in rural areas and declined in urban areas (Table 3.1). The increase in calorie intake in rural areas is not inconsistent with the level of per capita spending on consumption. Rural people spend (use their produce) more on food than on non-food items, in fact a considerable proportion of total consumption is accounted for by own production. The surveys indicate that the food share a typical household consumption bundle in rural areas has increased from 60 percent in 1995/96 to 67 percent in 1999/00 while on the other hand food share in urban areas declined from 56 percent to 53 percent during the same period. However, it must be underlined that an increase in the calorie content of the consumption basket does not necessarily indicate an increase in food quality. A high proportion of the budget being allocated to basic food consumption is still an indication that people in rural areas are food insecure.

It is more difficult to interpret the changes in budget composition in urban areas and more analysis is needed to fully understand these. Some non-food expenses such as transport are more binding in urban than rural areas irrespective of level of poverty of the individual or household. The decline in poverty head count index in rural areas and the modest increase in urban areas, as discussed in subsequent sections is, however, consistent with the trend in calorie intake (rural versus urban) (Table 3.1). It should be noted, however, that the changes in mean consumption per capita in both rural and urban areas are not statistically significant.

Table 3.1: Trends in Real Consumption Expenditure and Calorie-Intake

Items	1995/96			1999/00		
	Rural	Urban	National	Rural	Urban	National
Real Food Expenditure Per Capita	577	790	607	609	631	612
Real Non-Food Expenditure Per Capita	466	625	488	392	830	451
Real Total Expenditure Per Capita	1035	1411	1088	995	1453	1057
Kcal Consumed Per Day Per Adult	1938	2050	1954	2723	1861	2606
Share of Food in total Expenditure	0.60	0.56	0.60	0.67	0.53	0.65
Household Size	5.1	4.7	5.0	4.9	4.6	4.9
Adult Equivalent Household Size	4.2	3.9	4.2	3.9	3.8	3.9
Gini Coefficient	0.27	0.34	0.29	0.26	0.38	0.28

Source: Poverty Profile of Ethiopia, March 2002, MOFED.

Comparisons among urban areas indicate that Addis Ababa has had the highest per capita consumption expenditure closely followed by Afar and Benshangul-Gumuz in 1999/00. Taking each region by its own, Tigray has recorded the lowest per capita consumption expenditure in the country. Compared to the year 1995/1996, the per capita consumption level for 1999/00 has declined in Tigray, Afar, Somalie, Oromiya, Benshangul-Gumuz, Gambella, and Harari. On the other hand, Addis Ababa, Amhara, SNNPR (though marginally), and Dire Dawa have witnessed increases in per capita real expenditure.

Overall, urban areas witnessed an increase in per capita real consumption expenditure between the two survey years, but with considerable variation among regions.

Income distribution in Ethiopia seems to be more evenly distributed in both rural and urban areas compared to other Sub- Saharan Africa (SSA) countries. The overall consumption Gini coefficient for 1999/2000 is found to be 0.28. Income inequality appears to be higher in urban areas (0.38) than in rural areas (0.26). The low level of inequality is consistent with the overall picture of Ethiopia as a very poor country, with a low per capita income. In addition, the egalitarian land holding system might have contributed to a more equal income distribution in rural Ethiopia. While the data from the two surveys suggest that inequality has changed slightly between 1995/96 and 1999/2000, with a small decline in the Gini coefficient in rural areas and a small increase in urban areas, these changes are not statistically significant.

3.1.2Trends in the Level of Consumption Poverty

The food poverty line used in Ethiopia is based on a basket providing 2200 Kilocalorie per adult equivalent per day. In 1995/96 prices, this basket cost Birr 647.8 (USD 85.24) per year. After adjusting for the non-food component, the total poverty line (both food and non-food) was estimated at Birr 1075.0 (USD 141.45) in 1995/96. The same "basket" and poverty line is used in 1999/00 to maintain comparability between the two survey years.

The proportion of people in Ethiopia who are absolutely poor (those whose total consumption expenditure was less than the total poverty line) during the year 1999/00 was 44 percent. The proportions of people who are classified as poor are 37 percent in urban areas and 45 percent in rural areas indicating that rural poverty is higher that urban poverty (Table 3.2).

The moderate changes in consumption levels between 1995/96 and 1999/2000 have translated into small changes in poverty incidence. The data indicate that consumption poverty head count indexes have declined by about 3 percent at national level, by over 4 percent in rural areas and have increased by about 11 percent in urban areas. None of these differences, however, are statistically significant and the continuing high level and depth of poverty in Ethiopia clearly shows the challenge ahead. While little can be said about trends between 1995/96 and 1999/2000, the fact that poverty has not apparently increased, especially in rural areas, despite the considerable worsening of exogenous conditions between the two years does indicate that the Government's development strategy and safety-net program have been effective.

Table 3.2: Trends in Poverty Head Count Indices (Po) by Rural and Urban Areas

Location	1995/96	1999/2000	% Change Over 1995/96
Rural	47.0	45.0	-4.2
Urban	33.3	37.0	11.1
Total	45.5	44.2	-2.9

Source: Poverty Profile of Ethiopia, March 2002, MOFED.

The levels of consumption poverty also show significant variation among rural/urban areas and across regional states. By 1999/00, the highest rural poverty incidence was recorded in Afar followed by Tigray and Benishangul-Gumuz Regional States. The lowest rural poverty incidence was recorded in Harari Regional State followed by Addis Ababa and Dire Dawa City Administrations.

Among the urban areas, the highest poverty was recorded in Tigray followed by SNNPR, Gambella, and Addis Ababa. The lowest poverty incidence (among urban areas) was indicated in Somalie followed by Afar and Benishangul-Gumuz Regional States. In general, consumption poverty is higher in rural than urban areas of the country. While there has been some improvement in the depth and severity of rural and national poverty in 1999/00 compared to 1995/96, it was shown that the incidence of poverty has not improved much between the two survey years.

1999/00 have witnessed a decline in poverty incidence in most of the major towns of Ethiopia. Gonder town (Amhara) had the lowest poverty incidence followed by Bahir Dar town. The highest poverty incidence was observed in Mekele town (Tigray) followed by Jimma town in the same year. Poverty incidence, depth, and severity seem to have substantially declined in Gonder, Dessie, Bahir Dar, and Debre Zeit towns. A modest decline in poverty incidence, depth and severity has been indicated in Mekele and Nazreth towns. On the other hand, Jimma, Harar, Addis Ababa and Dire Dawa are urban areas where poverty incidence, depth and severity were more pronounced by 1999/00.

Although urban areas in general witnessed an increase in poverty head count index, there has not been significant increase in the depth and severity of poverty between the two periods. As is already indicated inequality measured by the Gini coefficient declined for rural areas and increased for urban areas while the per capita consumption of both urban and rural areas have not shown statistically significant increases.

The changes in poverty levels in Addis Ababa are not entirely clear. While there has been an apparent increase in mean total consumption levels, there has also been some apparent increase in the incidence of poverty. If these results represent real changes and are not just due to sampling error, then the implication is that income distribution has become unequal between 1995/96 and 1999/2000. There are some indications that this is the case, but more detailed analysis is needed before more definitive conclusion can be reached.

3.1. 3 Trends in the Level of Food Poverty

Households and the people living in them are defined as food poor if the food expenditure per adult equivalent is less than the food poverty line. Using this definition, the relative position of rural and urban areas in 1999/00 appears to have reversed compared to that of 1995/96. In the earlier period, food poverty was higher in rural areas than in urban areas. The results from the 1999/2000 HICE, however, indicate that the food poverty head count index was found to be lower in rural areas than in urban areas. There are a number of possible explanations for this and more investigation is needed to identify what exactly has happened. One possible explanation could be that spending in rural is weighted more heavily in favour of food items compared to the spending pattern of people in urban areas.

Table 3.3: Trends in Food Poverty Head Count Indices

Location	1995/96 in %	1999/2000 in %	% Change Over 1995/96
Rural	47	41	-12.6
Urban	32	47	43.7
Total	45	42	-6.7

3.1.4.Distribution of National Poverty

In 1995/96, more than 50 percent of people living in consumption poverty resided in Amhara and SNNP Regional States. The influence of these two regions on the national consumption poverty is self-evident given their higher share in total population and agricultural production.

The income/consumption poverty analysis indicates that poverty is still a rural phenomenon as indicated by the contribution of rural areas to the poverty head count index. As indicated in Table 3.4, rural areas altogether contribute about 85 percent to total population while their contribution to total poverty head count index stood at about 88 percent in 1999/00. Urban areas altogether accounted for about 15 percent of total population while its contribution to total poverty head count index was a little over 11 percent in 1999/00. The contribution to total poverty head count index has slightly increased in urban areas (about 1.3 percentage points) while it decreased by the same magnitude (1.3 percentage points) in rural areas in 1995/96.

Table 3.4: Contribution of Rural and Urban Areas to Total Poverty Incidence

	1995/96		1999/00	
	Population Contribution (%)	Contribution to Poverty Head Count Index (%)	Population Contribution (%)	Contribution to Poverty Head Count Index (%)
Rural	85	86.7	85	88
Urban	15	12.3	15	11

Source: Poverty Profile of Ethiopia, March 20002, MOFED.

3. 2 Household Characteristics and Poverty

Poverty incidence shows variation based on the type and nature of a household. Females head 26 percent of the households in the country. This feature, however, is more dominant in urban than in rural areas. According to the 1999/00 HICE & WM survey results, females head 41 and 23 percent of the households in urban and rural areas, respectively. There is no significant difference in income poverty between male and female-headed households in rural areas. In urban areas, however, female-headed households have been found to have higher poverty incidence, depth and severity than their male counterparts (Table 3.5).

Table 3.5: Comparison of Poverty by Gender and Areas of Residence

Survey Year	Poverty Index	Sex of Household Head	National		Rural		Urban	
			Index	SE	Index	SE	Index	SE
1995/96	P_0	Male Headed	0.46	0.01	0.48	0.01	0.33	0.03
		Female Headed	0.42	0.02	0.46	0.02	0.34	0.03
1999/00	P_0	Male Headed	0.44	0.01	0.46	0.01	0.34	0.02
		Female Headed	0.43	0.02	0.45	0.02	0.49	0.01

Source: Poverty Profile of Ethiopia, March 2002, MOFED.

3. 3 Household Vulnerability to Shocks and Vulnerability Dimensions

Ethiopia has suffered from frequent disasters such as drought, famine, epidemics, flood, landslides, earthquakes, civil war and mass displacement, as well as external shocks (for example, rapid declines in commodity prices). The assessment result of vulnerability of individuals based on responses from the 1999/00 WM survey clearly indicates that urban households were more vulnerable than rural households in the survey period. The most probable explanatory factor is the fact that rural households have access to assets such as land and livestock. Nevertheless, this situation might alter from time to time.

3.4 Temporal and Spatial Dimensions of Non-Income Poverty

3.4.1 Nutrition, Health and Literacy

Nutrition (Child Wasting and Stunting): Consistent with the level and severity of poverty, the figure for wasting and stunting in Ethiopia is so high compared to many other Sub-Saharan countries. Despite this general frustrating data, the period between 1999/00 and

1995/96 exhibited a remarkable decline of 47 percent in the proportion of severely wasted children. (Table 3.6).

Table 3.6: Child Wasting as Percent of Children aged 6-59 Months

		1995/96			1999/00			% Change over 1995/96
		Male	Female	Total	Male	Female	Total	
Ethiopia	Wasted	8.9	9.4	9.2	10.2	9.0	9.6	4.3
	Severely Wasted	3.3	3.6	3.4	1.9	1.6	1.8	-47.1
Rural	Wasted	9.3	9.8	9.5	10.5	9.3	9.9	4.2
	Severely Wasted	3.4	3.8	3.6	1.9	1.7	1.8	-50.0
Urban	Wasted	6.5	7.2	6.8	6.5	5.6	6.1	-10.3
	Severely Wasted	2.3	2.4	2.3	2.0	1.0	1.5	-34.8

Source: Dercon, 1997 for 1995/96 and WMS 1999/00 for 1999/2000.

Both stunting and severe stunting in 1999/2000 have witnessed tremendous declines (by 15-34 percent) from the levels observed in the 1995/96 survey, indicating an improvement in the long-run measure of malnutrition (Table 3.7).

Table 3.7: Child Stunting as Percent of Children aged 6-59 Months

		1995/96			1999/00			% Change over 1995/96
		Male	Female	Total	Male	Female	Total	
National	Stunted	68.1	65.1	66.6	58.1	55.5	56.8	-14.7
	Severely Stunted	45.2	42.2	43.7	32.0	30.6	31.3	-28.3
Rural	Stunted	70.0	66.7	68.4	59.4	56.4	57.9	-15.3
	Severely Stunted	47.4	43.8	45.6	32.9	31.6	32.3	-29.2
Urban	Stunted	56.6	55.2	55.9	44.0	45.0	44.5	-20.4
	Severely Stunted	32.1	31.9	32.0	21.5	20.4	21.0	-34.4

Source: Dercon, 1997 for 1995/96; and WMS 1999/2000 for 1999/2000.

Access to Health Services: Besides to having a direct impact on welfare of individuals, their health status has repercussions on their potential productivity. According to WM survey result, a quarter of the population in the country reported being sick in the two months prior to the administration of the Survey questionnaire. In terms of gender, the results indicate that 24 percent of males reported suffering an illness. The figure for females was about 26 percent. While around 27 percent of the rural population reported sickness, only 19 percent of their urban counterparts reported the same.

Over 60 per cent of those reported to have been ill stated that they did not seek any form of medical treatment. This figure is only around 38 per cent in urban areas whereas it is about 62 per cent in rural Ethiopia.

Literacy: the overall literacy rate in Ethiopia for 1999/00 is only 29 percent. The literacy rate has increased slightly from 27 percent in 1995/96 to 29 percent in 1999/00. The marginal increase is more pronounced for males than females (Table 3.8).

Table 3.8: Trends in Literacy Rate (percent)

	1995/96			1997			1998					
	Urban	Rural	All	Urban	Rural	All	Urban	Rural	All	Urban	Rural	All
Male	82.3	29.2	36.5	81.0	25.1	33.4	81.0	28.8	36.3	82.1	33.0	40.0
Female	60.4	9.2	18.1	60.8	7.3	16.5	59.0	8.8	17.1	61.2	11.0	19.5
Total	70.0	19.4	27.3	70.0	16.2	24.8	69.0	18.8	26.6	70.4	21.8	29.4

Source: WMS for 1997, 1998 and 1999/2000; and Dercon, 1997

3.4.2 Asset Ownership and Sources of Livelihood

Housing and Household Durables: About 85 percent of the households in Ethiopia live in low quality houses made of wood and mud and 65 percent of the houses are grass-roofed. Urban houses are relatively better quality than rural houses: 90 percent of house roofs in urban areas are made or corrugated iron sheets. About 15 percent of the houses made use of corrugated iron sheets in their construction in rural Ethiopia. There is a general perception among the rural population that if someone has a house its roof made of corrugated iron sheets, then that person belongs to the strata of rich people.

The average number of rooms per household is 1.6, and is larger for urban than for rural households. Addis Ababa is by far better off than other regions in terms of the number of rooms available for living. The proportion of households possessing a TV set was less than 2 percent, and such households are concentrated in Addis Ababa and Dire Dawa.

Radio has a wider coverage with about 18 percent of the households in the country owning a radio.

Ownership of Farm Assets: The main means of livelihood in rural Ethiopia is agriculture. Thus, land ownership in rural areas becomes an important determinant of welfare. Based on the available information, almost all households in the rural areas of the country hold some amount of land. However, more male-headed households (98.3 percent) hold land than their female-headed counterparts (95.3 percent).

According to the annual agricultural sample surveys conducted by the CSA, about 63 percent of the households in Ethiopia had holding sizes less than 1 hectare in 1995/96. The figure for 1999/2000 had slightly increased to about 64 percent. This indicated to the growing problem of land fragmentation among rural households in Ethiopia.

On the other hand, the WM survey results indicate that about 80 percent of the households in the country own cattle. The share of ownership is skewed against female-headed households. While only 64 percent of female-headed households own cattle, 83 percent of their male counterparts do so. Rural households on average own 4.1 cattle per household. This average ranges between 14.1 for Afar, which is a cattle raising region to 3.6 in Amhara. The average number of cattle owned by the poorest households is only 3.9.

Major Sources of Income: According to HICE 1999/2000, own agricultural enterprises accounted for about 73 percent of total income in rural areas. In urban areas, wages and salaries, and overtime payments and bonuses on the average accounted for over 41 percent of total income. The survey also indicated that well over 63 percent of total income is derived from own agricultural enterprises (Table 3.9).

Table 3.9: Sources of Income for Rural and Urban Households (1999/2000) (percent)

Sources of Income	Rural	Urban	Total
Own Agricultural Enterprise	72.5	4.6	63.3
Household Enterprise Other than Agriculture	5.4	30.3	8.7
Wages and Salaries, Bonus, overtime and allowances	2.9	41.2	8.0
House and other Rents	0.2	0.5	0.3
Dividends and Profit Share as well as Bank Savings	3.9	8.7	4.6
Gift and Remittances	3.5	8.1	4.1
Other Receipts	11.6	6.7	11.0

Source: Poverty Profile of Ethiopia, March 2002, MOFED.

3.5 Determinants of Poverty

The foregoing analysis has provided the detailed poverty profile of Ethiopia based on the 1995/96 and 1999/00 HICE and WM Survey results conducted by the CSA. However, the poverty analysis would be partial unless the underlying causes of poverty are presented. Household based data of national scope, preferably for different point of time, is required to have an adequate exposition of the determinants of poverty. In the absence of such sources of information, I have employed results from small-scale surveys conducted by the Economics Department of Addis Ababa University in collaboration with Oxford University to make the forthcoming analysis on the determinants of poverty in Ethiopia.

The information obtained from the latter refers to the year 1994 although no change in conclusion was observed even when analysis was carried out based on the survey conducted in 1997. The major findings are discussed for rural and urban areas separately below.

Findings for Rural Areas

It has been shown that the probability that a household is classified as poor is related to a number of explanatory variables including size and composition of households, type of crop grown by the household, education of households, assets, occurrence of important infrastructures and institutions, and etc. What has been presented below are the major factors identified.

In terms of the magnitude of its marginal effect, the dependency ratio seems to be extremely important in affecting poverty status in rural areas. Those households with proportionally more number of children under the age of 15 years and older people above the age of 65 seem particularly vulnerable to falling into poverty. This underscores the importance of adult labour in the welfare of rural households. The policy implication of this result points towards the importance of decreasing fertility. Most of the high dependency ratio is explained by a larger number of children under the age of 15; due to low life expectancy, the relative number of people over the age of 65 is small

Besides household composition, as reflected in the dependency ratio, total household size also has an independent effect on the probability of falling into poverty. An additional household member increases the probability of the household being poor by around 3.2 percent at mean values.

Compared to male-headed households, female-headed households face an 8.9 percent higher probability of being poor in rural areas after taking into account other characteristics. In rural areas, the poverty rate among female-headed households is actually lower than for male-headed households. The fact of having a female head only becomes an important factor in determining poverty after allowing for other factors such as age, education, wealth and etc. Targeting, therefore, a household for merely it is female headed might be ineffective, unless these other and more difficult to observe, characteristics could be taken into account.

The crop types included in the study are deliberately chosen to include a staple food that is not much traded (enset), a staple food that is significantly traded in the domestic market (teff), a traditional export crop (coffee), and a 'new' export crop (chat). Teff is one of the main domestically marketed crops in Ethiopia. Generally, rural households produce teff for the market and it is an important source of cash income. Coffee and chat are also important export crops, the first being the most important export item of the country and the importance of the second increased during the recent past. The cultivation of these crops by households has a tendency to decrease the probability of falling into poverty.

Thus encouraging the expansion of exportable crops, particularly non-traditional crops can have a large impact on poverty reduction. This coincides with the overall reform goal of the government - encouraging the production of tradables.

Rural areas relatively nearer to big cities/towns and infrastructures such as road have better access to markets and public services including subsidized credit, and this closeness has a poverty-reducing effect. However, the effect of urban areas on reducing rural poverty is not high owing to the low level of urbanization (only 15 percent).

The last but not least factors in determining the possibility of becoming poor relates to farm assets and off-farm activities. The amount of land cultivated by the household is not correlated to the probability of poverty because almost all families have equal and same quality land.

It seems instead that other farming assets are the more important constraints. As oxen are the most important sources of traction power (the ox-plough complex) in the majority of farms, the addition of one ox in a household holding results in significant decline in the probability of being poor. Initiatives that improve the ox ownership of households either through free provision or on credit basis therefore could have a significant impact on poverty.

Households that are solely engaged in off-farm activities are 11.0 percent more likely to be poor than those that are purely farmer. In the case of rural Ethiopia, off-farm activity seems to be a coping mechanism for poor people rather than a way of accumulating more wealth and enjoying a relatively higher return to labour.

Findings for Urban Areas

Similar to rural areas, a factor that has a strong positive effect on the probability of being poor is the dependency ratio. The adverse effect of the dependency ratio at the household level both in rural and urban areas provides a strong case for often emphasized policy interventions: employment generation and family planning. In a country like Ethiopia where social security is absent, the burden of supporting the old mainly falls on the household or the community.

The other important variables that impact strongly on the probability of falling into poverty are location and level of education. The illiterate and those households residing in the capital city have a 15 percent higher probability of being poor. This somewhat strange result for Addis Ababa dwellers needs more deep analysis to understand the underlying factors.

In summary, from the preceding explanations one can notice that poverty in Ethiopia is a result of various interconnected and standalone factors. The results included above have shown that main causes are large population size, high dependency ratio, limited employment opportunity, low level of education, limited asset ownership (particularly very low ownership of oxen in rural areas), and unavailability of adequate infrastructure that provide access to wider market places and public services.

I think addressing the development policy and strategy of the government next would be greatly useful in making my thesis logically and sequentially consistent. Moreover, it gives insight as to whether microfinance is given due attention as a means to reduce poverty.

3.6 An Overview of Ethiopia's Development Policies and Strategies

The previous section has highlighted the basic features and dimensions of poverty in Ethiopia. In this subtopic I have made a brief review of the countries development policy and strategy focusing on the emphasis given to microcredit aspect.

It is obvious that Ethiopia's economic problems and severity of poverty are complex, intertwined and widespread. That shows that designing and properly implementing a concerted development strategy, which gives priority to the central bottlenecks, is crucial. Recognizing this pressing need, the Ethiopian government has been applying innovative, appropriate for local situation and integrated economic policies and strategies for more than a decade.

It is known by the name Agricultural Development–led–Industrialization policy that serves as guidance to other sectoral development strategies and programs. As the name indicates the ADLI policy gives central place to agriculture as a primary stimulus to generate increased output, employment and income for the people, and as the springboard for the development of the other sectors. Doing that is correct as the lion share of the poor are engaged in it as well as more than 80% of the population is employed in, 45% of the GDP is obtained and 90% of the export receipt is derived from that sector.

It does not mean that the Industrial sector is ignored. Indeed, Industrial development is expected to absorb rural surplus labour, and expand domestic markets for agricultural commodities while the increase in agricultural production, is expected to raise the country's export earnings, to meet domestic demands for food and raw materials and to expand markets for industrial commodities.

The development strategy also places great importance on the provision and improvement of infrastructures such as constructing roads and improving the quality of basic social services, including primary health care, basic education, water supply and sanitation. For that purpose a specific sectoral development strategies and programs are designed and has been implemented for each of them.

On top of that, it has created an enabling environment for community participation, through the devolution and the decentralization of economic management to the regional states. This devolution of responsibilities to the regional states has strengthened the scope for community participation in the development process, emphasizing the role and responsibility of communities in managing their social and economic affairs. Such greater participation for sure will strengthen and hasten the effectiveness of the implementation of the policies. Broadly, objectives of policies and strategies of the government can be summarized by the following six statements.

- Maintenance of stable macroeconomic environment
- Enhancing agricultural growth and strengthening Agriculture – Industry – export linkages
- Private sector development and public sector reform
- Extensive development of economic infrastructure and human resource
- Devolution of power to regional and local governments
- Capacity development for economic management

The government is also well aware of the importance of the finance sector to expanding production in the other sectors. The book published by Ministry of Information (2002) that outlines the rural development policies and strategies of the government has clearly articulated this key role of finance. It states that because the role of rural development finance including MFIs is so crucial in hastening rural development and linking agricultural development with industrial development, the state would give strong assistance to their proliferation as well as growth. In line with this strategy most of the Region based MFIs enjoyed supports such as provision of loanable fund, logistical donation and sharing of their work burden in the form of selecting and training beneficiaries at Woreda - lowest level of administration.

CHAPTR FOUR

TO WHAT EXTENT IS MICROCREDIT SERVICES TAILORED TOWARDES POVERTY REDUCTION IN ETHIOPIA?

Later in this part of my paper, which is the main body of the thesis, I will show using various meanses that microfinancing in my country has greatly targeted the poor and helped them in improving their living standard. First, including some background information about the microfinance industry with regard to how it evolved, where it gets fund, what looks like their lending methodology and the like will make my analysis more informative. With this view in mind the coming few paragraphs are spend to address these issues.

4.1History of Evolution of Micro Finance Institutes in Ethiopia

Many literatures written on this issue including Gebrehiwot's MFIs in Ethiopia (January 2002) confirm that microfinance thought as a means of bringing development started to surface in many forums dealing with development agendas during the end of 1980s. At that time the idea was mainly raised as a response to the failure of targeted subsidized cheap credit programs. "In those subsidized cheap credit programs, benefits mainly went to those with connections and influence rather than the target beneficiaries, large loan losses accumulated, and frequent re-capitalization were required to continue operating, which suggest for new approach." Gebrehiwot’s MFIs in Ethiopia (January 2002).

Governments, donors and NGOs found the new approach – setting up independent profit oriented MFIs persuading in many aspects. This led to establishment of numerous Grameen Bank styled MFIs in early 1990s. Dedebit Credit and Saving Institution, DECSI (1993), Sidama Microfinance Institution, SMI(1994), Amhara Credit and Saving Institution, ACSI(1995) and Oromia Credit and Saving Share Company, OCSS.Co.(1996) are among the major institutes set up after 1993 in order of their establishment period. Currently there are about 20 MFIs, which are registered and operating in accordance with Proclamation No. 40/1996 – a legislative that imposes a requirement all MFIs to be registered private share companies so as to give micro credit services.

4.2 Types of the institutes

The MFIs in Ethiopia can be categorized into that are regionally organized and that are organized based on their specific sponsor NGO’s interest. The former consists of the six region specific micro finance institutes. They operate only in their respective target regions and have wider coverage in terms of area, type of activity and beneficiary household composition. These institutes enjoyed various types of support from Regional States Executive bodies. That is they are provided supports such as provision of loanable fund, logistical donation and sharing of their work burden in the form of selecting and training beneficiaries mainly because they operate in line with the interests of the regional governments.

The latter consists of the fourteen MFIs, which operate only at a specific location and serve only a predetermined activities and sections of the population. They are owned and assisted by various NGOs and individuals. The individual shareholders actually do not receive dividends; as a result, it is difficult to call them shareholders. Such kinds of shareholders happen to exist mainly because the proclamation No. 40/1996 and public notice No. 2/1998 issued by the Ethiopian National Bank (ENB) require MFIs to be legally licensed private share companies. To have the licensed legal persons like the individual shareholders must exist. The following table summarizes the ownership structure and area of coverage of the major MFIs.

Table 4.1: Ownership structure and area coverage of Ethiopian MFIs

Institutes	Operational Place	No. of branches	No. of sub branches	Ownership share in %		
				Regional Governments	Associat-ions or NGOs	Indivi-duals
ACSI	Amhara Region	15	160	25	75	-
DECSI	Tigray Region	12	109	25	75	-
OCSS.CO.	Oromya Region	29	NA	25	75	-
Omo Microfinance Institute	Southern Region	7	49	80	19.5	0.5
Sidama Microfinance S.Co.	Southern Region	9	2	-	70	30
Wisdom MFI		2	12	-	-	100
Specialized Financial Promotional Institute	NA	3	NA	-	80	20
Africa Village Financial Services	NA	NA	NA	-	-	100
Asser Microfinancing	NA	NA	NA	-	97	3
Meket Microfinance Institute	Meket Woreda	1	NA	-	-	100
Addis Credit and Savings Institution	Addis Ababa	3	-	96.7	3.3	-
Gash Microfinance S.Co.	Addis Ababa	2	3	-	61.9	38.1
Peace Microfinancing Institution	NA	NA	NA	-	16	84

Sources: Wolday, Microfinancing in Ethiopia, (2000) and Proceedings of the conference on microfinance development in Ethiopia, Bahirdar (2000).

Other than the contribution made by the shown shareholders, both types of MFIs have enjoyed assistance like provision of loanable fund and logistics from various donors.

4.3 Lending Methodologies

I have discussed in part II that most of the MFIs all over the world, especially those operating in Sub-Saharan countries mimicked the approaches followed by the Grameen Bank of Bangladesh. Likewise all of the MFIs in Ethiopia apply Group-lending mechanism and require prior savings from potential borrowers (up to 2.5% of the amount to be borrowed), which is supposed to continue, even after borrowing, in parallel with the loan repayment. The prior saving requirement is much lower than that is asked by other Countries mainly because of the in ability of the borrowers to do so. For instance, the Zambian credit service requires 50% of the loan amount as prior saving. This procedure is a precondition for membership and access to credit and taken as a substitute to collateral.

The group (and center) formation requirement has a dual purpose. It has an ex ante screening role as well as ex post enforcement and monitoring roles. In the first place applicants with unsettled repayment obligations or perceived as dishonest or lacking the ability to make good use of funds, hence less likely to repay, will be screened out in the process of self-selection-based group/center formation. That is, since group members know each other well, they are likely to know if an applicant has prior commitments or is dishonest or lacks the ability to put borrowed funds into good use.

Secondly, given that group members are jointly liable for the repayment in the event of default and that the entire group will be excluded from future loans if it fails to repay, would be members have an incentive to monitor one another. It provides an incentive to group/center members put pressure on borrowing members to repay. Moreover, the threat of termination of credit in areas of high default (if made public and credible) provides the enforcement mechanism additional strength by creating incentives for the local community in general to put pressure on borrowers to repay. However, there are remote possibilities that the screening out of indebted potential borrowers may not work. This can happen incase most or all members of a group have conspired not to reveal the potential defaulters.

There are some drawbacks of making credit access conditional on settling previous loan obligations although it creates incentive to repay. An automatic exclusion of those indebted may not be consistent with the poverty alleviation objective of MFIs.

Forming groups has its own limitations too. Group formation, which requires several individuals agreeing among other things, to share risk (i.e. repaying defaulted loan) is likely to create access problem. There is some evidence that the 'poorest of the poor' find it difficult to form a group. That is they get excluded solely because others do not want them in their group. This might be against the noble objective of reaching the poor.

The main reason given for the prior saving requirement is that it helps to inculcate the habit of saving and impose financial discipline among their target population. However, to some extent, this approach conflicts with the stated objective of providing credit services to the poor, as it excludes those unable to meet this requirement.

Besides, some MFIs (e.g. SFPI) do not allow withdrawal from the compulsory savings until the group (or center) has fully repaid its loans since they use the amount saved as partial collateral. Its collateral function thus provides another (unstated) rationale for requiring savings prior to borrowing. This fact is not fully consistent with the common claim that MFIs provide non-collateral based loans.

Loans are disbursed to group members either simultaneously or in turns. They also require regular weekly repayments of loans during group meetings. While the regular weekly repayment requirement may have advantages, its rigid application under all circumstances may be inappropriate since ability to pay may not be uniform overtime. For example, for borrowers earning a large proportion of their income from agriculture, repayment capacity typically varies across seasons, suggesting the need for flexibility.

There exist security argument for extending loans to members of a group in turns. That is, it can help to keep a record of credit worthiness of those who borrowed earlier. Such procedure maintains prudent group discipline, as it is a precondition for access by the remaining group members. The practice, however, negatively affects economic activity in at least two ways. First, that one has to wait until group members have repaid in full involves missed opportunity (i.e. one cannot exploit profitable opportunities as and when they arise). Second, lack of continual access to credit for working capital by a member affects existing activities. It should be noted that timeliness of loan disbursement is important.

Currently, MFIs in Ethiopia are subjected to ENB imposed restrictions regarding the maximum amount and term of their loans. Directive No. MFI/05/96 issued by ENB orders the maximum amount and term of their loans to be Br 5,000 and 1-year respectively. A single borrower limit is a standard regulatory measure to guard against imprudent behavior by lending financial institutions in general and to allow them diversify their loan portfolio. It is meant to limit excessive risk taking through excessive exposure to limited number of borrowers, which may result in asset portfolio concentration.

Microfinance schemes in Ethiopia also use small loan size together with frequent regular compulsory meetings for savings and repayment as means to induce the better-off to exclude themselves, who, otherwise, may compete for funds with the poor, especially in the face of very low interest rate.

4.4Impact of the microfinance Industry on Poverty Reduction

In subsequent subtopics by looking at the composition of target groups, spatial dimension of the level of intervention and improvement in the living standard of beneficiaries, I try to show to what extent the micro credit programs waged in the country helped in reducing poverty. Major emphasis is given on the intervention of the two major regional MFIs that are operating in Amhara and Tigray Regional States.

A. Where do the Interventions Concentrate?

In chapter three I have shown that the share of rural poverty in terms of its magnitude and severity greatly exceeds that of urban and needs higher share of any poverty reduction intervention. In line with this reality of severity of the poverty incidence in the country most of the micro credit services are tailored towards the rural areas. This can be observed from the following table, which summarizes beneficiary number and level of loan disbursement going to rural areas by the major MFIs of the country. The share of the beneficiaries and disbursed loan of the following four major MFIs out of the total served and distributed by all 20 operating in the country are 88.34% and 87.96% respectively.

Table 4.2: Share of Micro finance services going to rural areas

Type of MFI	Share of Rural beneficiaries in %	Share of loan going to rural areas
ACSI	100	100
DECSI	100	100
Omo MFI	89	NA
OCSS.Co.	100	100

Source: Compiled from unpublished paper of Wolday Amha(Dr.) entitled Microfinancing in Ethiopia. The data are as of 31 Dec. 2001.

The figures included in the above table give insight as to whether the micro finance services are primarily designed to cater for the needs of the poor or not. Showing that the majority of the service goes to a place where poverty is intense does not fully portray the extent of its contribution to actual poverty reduction. Therefore, the following paragraph addresses the issue who actually got the credit services, which went to rural areas.

B. Composition of Target Beneficiaries and Activities Financed by the Major MFIs

Consistence with theoretical explanation included in chapter two the poor in Ethiopia have little access to credits of both publicly and privately owned commercial banks. In the first place the majority of branches of the commercial banks are concentrated in urban areas. The study of Mulat Demeke and et al (1998) showed that only 21% of the Woredas (lowest level of administrative jurisdiction) have branches of commercial banks. None of private banks have branch at the Woreda capital. Secondly, even in places where such banks exist the poor in general are unable to borrow from them because of higher collateral requirement.

Contrary to the biased operational procedures of the commercial banks against the poor, all of the MFIs intentionally and disproportionately target the poor. All of the MFIs have stated, in their operational manuals, that increasing the productive potential of the poor particularly women headed households as immediate and ultimate objectives.

The practices also confirm to the objective stated on the paper. Most of the credit is allocated to activities done by poor households and for some type of loan women got the lion share. In the table below I have tried to depict these facts.

Table 4.3: Type of activities and beneficiaries financed by micro credit services

Name of institutes	%age share of clients engaged in			%age share of loan offered to	
	Agriculture	Handcrafting	Petty trading	Male	Female
ACSI	56.50	6.03	36.66	53	47
DECSI	61.46	7.77	30.32	59	41
OCSS.Co.	76.80	NA	21.80	88	12
Omo MFI	63.52	6.58	29.74	65	35

Source: Compiled from annual reports of the MFIs, 2001.

It is commonly regarded in Ethiopian context that all the activities mentioned above are businesses, which employ mainly the poor households. Especially more than 95% of those employed in handcrafting and petty trading are really the ultra poor. By allocating more than 99% of loans to these sections of the population the MFIs have proved that their primary targets are the poor.

On top of that, unlike other poverty alleviating programs, women (who are generally considered to be victims of poverty) have better access for microcredit. In deed, their share is slightly less than male beneficiaries. This is expected given the bulk of the beneficiaries are those engaged in agriculture and due to the labour and land constraints females have not been usually major utilizes of loan disbursed for that sector.

The discussions I made earlier shows vividly that the micro credit services instituted in Ethiopia are primarily tailored to reducing poverty. Nevertheless, showing that does not necessarily mean that they have actually helped in reducing poverty. The coming sub topic briefly assesses to what extent the credits disbursed so far have brought positive changes in the livelihoods of the borrowers.

C. Level of improvement in the living standard of beneficiaries

As I have cited now and then at various points in my thesis poverty reduction has been the primary concern of the microfinance industry in Ethiopia. They have been attempting to adopt innovative methodologies so as to reach families below the poverty line or target the very poor.

Although there has not been a comprehensive study, which assessed the impact of microfinance institutions on poverty reduction, the piece meal type of studies carried out at micro level by various scholars indicate that the services offered are bringing positive impact in upgrading the income of the poor. I have summarized below the findings of some of the case studies done desegregating into improvements of entrepreneurial skill and household living standard.

Improvement in Entrepreneurial Skill

All the studies made showed that the credit clients got frequent assistance and training about how to manage their loans so as to enable them upgrade their business management skill maintain profitability. The training’s and assistance’s do actually resulted in improved management of clientele’s business.

A relatively wider investigation of this matter is the one made by a study of Tsehay and Mengistu (2002) which covered five MFIs including OCSS.Co. As can be seen from tables attached in annexe3, all members of the study group randomly selected among the clients of these institutes adopted practice of keeping financial record and analyzing their profitability. Most (over 70%) do not mix business money with cash allocated for household expenditure, which is very important to measure profitability.

In addition to technical skill acquisition, access to credit of OCSS.Co. has also enabled them to modernize their business. The same survey confirmed that about 90.3% of the continuous borrowers have been able to expand their enterprises either by diversifying their product type or increasing the quantity. The fact that about 18.5% of the beneficiaries (both new and regular borrowers) have been able to hire more workers, is a clear indicator of the success of microcredit services of MFIs included in that survey.

For further observation of the gains of the credit services with regard to heightening the entrepreneurial skills, I have attached summary tables of survey results carried out by Tsehay and Mengistu (2002) in annexes 1,2 and 3.

Improvement in the Livelihood of Borrowers

The impact of microcredit intervention at household level can be seen from increase in income, asset and social empowerment perspective. The results of few case studies have clearly indicated that access to finance has led to increased income and that increase in income has been manifested in better food consumption, greater asset holding and higher social acceptance.

Meehan (2001) did a case study on usage and impact of microcredit service of DECSI, which operates in Tigray Regional State. She took randomly selected 64 sample respondents from one sub branch and reviewed the records of the institute to come up with the following result.

The overall conclusion that can be drawn from that survey is that credit provision had a significant impact on increasing production and income. About 94% of the respondents assured that they got a considerable or modest increase in income as a result of getting credit to start up new business or to cover operational expenses at initial phase. However, this significant increase in income has not continued for those who are excluded from subsequent loans.

The impact on loan taken for agricultural production was so pronounced. Such dramatic increase in production and income of agricultural loan was possible mainly because of build-up of production assets, particularly draught oxen, and increasing the amount of land farmed by clients who were able to retrieve land previously rented out and farm it themselves, and clients who were able to get more land through additional rent in.

Clients who took loan for trading activities were also able to increase their business scale. Female clients were particularly able to start new trading activities, which had previously been inaccessible to them due to lack of capital.

As 88% of the respondents confirmed in Meehan's (2001) same study the increased income generated by the greater access to credit input had allowed the household improve the quality and quantity of food consumed. Betterment's mentioned, other than securing better quality and quantity of food, at second and third places include more access to clothing and educational provision for children. However, the positive impact reported was highly dependent on continued access to credit on regular basis. Readers can refer to annex 7 for further scrutiny of the data.

A similar recent study made by Getaneh (2001) revealed that the financial services of ACSI has increased income and improved food security for more than 66% of the respondent clients. Besides to this, 39% of the same study group has told that access to finance in the rural areas has improved access to education and health services. This slightly lower impact is mainly a result of small access or absence of chance for becoming repeat borrower.

The other dimension of the role of the credit service is to be gauged by looking at whether ACSI's loan has actually improved women empowerment. Of course ACSI has been able to attain its target of delivering at least 50% of its loan to women clients. In spite of such impressive achievement the institute still admits that it needs a long way to go to empower the women. Figures such as only 38% of the women reported that they manage the enterprises themselves, about 55% of the respondents revealed that they manage the enterprises jointly with their husband and the remaining 7% reported that their husbands run the activities of the enterprises, indicate that ACSI's admission to work further for meeting its target fits the reality.

ACSI has reported that it has collected more than55million Birr (6.3million USD) saving from the loan clienteles. Given the fact that the majority of ACSI's beneficiaries are the poor, mobilizing such a large sum of saving, which is over 50% of the outstanding loan, from borrowers is an indirect assurance to positive contribution of the credit to livelihood. Figures used in the above analysis and others are obtained from the attached annexes 5 and 6.

Another similar survey, which is carried out by Tsehay and Mengistu (2002) on five MFIs including OCSS.Co., assessed the Impact of those Microfinance Services Among Poor Women. That survey showed that the credit services have brought remarkable positive impact on the income of 84.1% and 62.9% of the rural and urban beneficiary women respectively.

The study also looked into whether the credit has empowered women. In this context, figures included next are nice indicators of actual realization of women empowerment in the family affairs. Over 84 % and 62% of the women borrowers, who took repeated loan in rural and urban areas, respectively, contributed a substantial amount to the household income. In addition, over 46 percent of the women repeat borrowers in rural areas and 38 percent of them in urban areas indicated that they had control over the income generated from their business. Of course few about 3.4 percent of rural and 22.8 percent of urban borrowers who took repeat loans indicated that, though the loan is in their name, the money was actually used by their husbands or sons and they have not benefited much from it.

The increased income has enabled over 85% of the surveyed households own an asset of value at least 500 Birr. Had it not been for the credit service, buying this value of asset would have been unthinkable for poor household. On top of owning asset, over 55% of the respondents were able to cope with temporary difficulties such as eating nutritious food, covering school expenses and repairing houses.

Dr. Wolday Amha in his unpublished paper entitled Microfinancing in Ethiopia has reviewed ITAB's study (2000) on the impact of Gasha Microfinance Institution, which operates in Addis Ababa. Unlike the findings of studies, which I reviewed upper the results of this study are rather disappointing. In the paper it was revealed that only few of the clients, who had used the loan on productive activities, have increased their income to some extent. The combined effects of the war and unfavorable weather conditions during the preceding two consecutive years were cited by the majority as the main factors that contributed to the increasing prices of commodities, particularly food commodities, and as a result eroded both individual and household income of the participant. This implies the need for maintaining macroeconomic stability for the success of microfinance programs.

All in all discussions I made above and other similar small scale impact assessment studies, despite some drawbacks, assure that credit services have generally helped in coming out of poverty. Particularly, they have expanded and in some cases created employment and income opportunities for those who otherwise would be beggars. In my view such kinds of blessed assistances, which encourage an individual to exercise its talent should be strengthened in every possible way. For this to continue the difficulties, which deter the smooth operation of the sector and presented below, should be eliminated.

CHAPTER FIVE

Conclusion and Recommendation

The severity of poverty in Ethiopia seems incomparable with any country in the world. As discussed in chapter two in detail by considering the inter-temporal and spatial dimensions of the level, incidence and type of poverty, no body denies that the problem is so rampant. Showing that real per capita consumption expenditure is below 0.40 USD will be enough to portray this frustrating reality. The fact that poverty head count indices are 45 and 37 percent in rural and urban areas, respectively, depict that poverty incidence is much higher in rural places.

Tackling such a huge and acute problem needs mainly existence of necessary infrastructures, prevalence of adequate trained manpower, well flourished implementing private as well as government institutes and sufficient physical capital. Needless to mention, underdeveloped countries like Ethiopia are deprived of sufficient quantities of all the four crucial factors. However, addressing the existing poverty by making priority list is a question of survival.

In chapter two I have presented a concise review of the type of policies and strategies put in practice to reduce poverty. Microfinance has been given due attention as a direct instrument for poverty reduction. In line with this policy orientation several MFIs have been set up and started to reach more than 400 thousand credit thirsty households all over the nation with in six years.

These institutions have given an overwhelming emphasis on reaching the poor and helping them get out of the poverty situation they are entrenched. I have shown that most of the MFIs particularly region based have made fascinating achievement in this regard by using evidences such as most of the loan fund has been disbursed to rural clients; the lion share of the clients are those who are engaged in activities run by rural poor and women headed households and etc. I have also shown that the loans have actually brought improvement in the living standard of majority of the borrowers. Such kind of remarkable successes of the MFIs in short time period reveal the importance of strengthening the sector. That requires pinpointing the drawbacks and suggesting the appropriate remedies.

Actually the aim of this paper is not making a detail analysis of performance constraints for effective operation of MFIs and suggesting the mitigation measures. Nevertheless, providing recommendations, which help sustain the positive impact of MFIs in augmenting income of the borrowers is so useful for continuing success of the sector.

In spite of the impressive success of microfinance activities in Ethiopia in a short period of time, there are problems, which need to be addressed soon. Some of the main problems and the way in which they could be mitigated include:

- A commonly agreed quantifiable, compatible with local circumstance and objective definition of who are the poor in the microfinance context is absent. This makes targeting the poor cumbersome and could result in lack of consistency in the beneficiary selection procedure. In addition to targeting problem it led to disagreement on the appropriate amount of average loan to be disbursed. “For example, external consultants who visited the industry suggested that the average loan size enough for rising client’s income level and help get out of poverty level in Ethiopian context is 900 – 1000 Birr, which is slightly higher than the per capita income of the country reported by World Bank. ... Some even advise to reduce the average loan size to one fourth of the per capita income, which is 25 USD.” (Wolday Amha, Microfinancing in Ethiopia unpublished Paper,PP.34) However, farmers require loans from MFIs to purchase oxen, cattle, input, etc., the price of that could be higher than the per capita income. It would be difficult for a demand driven MFIs to reject such legitimate requests of poor farmers. Thus, coming up with a nationwide agreed classification of the poor, which enables to immediately and uniformly identify and target them is very important.

- It is true that the provision of financial services to the poor has a crucial role to play in ensuring household food security and alleviating poverty. However, macroeconomic instability, insufficient policy support, poor infrastructural development, low level of government and private sector investments have detrimental effects for successful and effective implementation of the MFIs initiatives. Recognizing this and other role of the increased availability of the mentioned intermediate economic goods and services, the government has to allocate a growing and larger share of its GDP for enhancing those sectors.

- The legislative issued by ENB to monitor micro finance institutes permits only provision of a short term-loan, that is, a maximum of 12 months repayment period. Imposition of such regulation has definitely impaired the MFIs from diversifying their loan portfolio because some activities require more than a year to start to pay. Moreover, following the legislation most MFIs have instituted a weekly, monthly and biannual loan payment procedure. This inconvenient loan repayment mechanism has seriously impeded even the borrowers from becoming innovative and diversifying their business. The law is mainly passed to reduce default and reach as many borrowers as possible. I think it would be preferable to look for other mechanisms to address these problems and lift the upper limit of loan repayment period in order to hasten the process of income improvement as well as make it long lasting.

- The law also fixed a maximum loan size of 5000 Birr. Although the loan size was not a serious problem to activities financed by most of the MFIs so far, it is a major constraint for the development of modern micro and small enterprise. The reason for such limit is basically to reduce risk and based on the requirement of the normally known activities done by the poor. Similar to the imposition of upper limit for loan repayment period, it has impeded borrowers from becoming innovative and diversify their business. Thus this limit too has to be lifted and left to discretionary decision of the respective MFIs based on the type of loan.

- There was also limited support to the development of modern micro and small enterprises. In the first place, there is ambiguity as to which type of enterprises can fall under this classification. The definition of small and micro enterprises can be given either in terms of the number of employee, the capital out lay or/and the level of sophistication of the technology. Depending on the type of criteria taken in the definition there could be various baskets of businesses eligible to be included in the classification and consequently for financing. In my view it should be the capital out lay and employment level in combination that should be used to determine which type of businesses should be included.

- Secondly, there is also a lack of information as to the range of available alternative technologies and where they are found. Once the issue of definition is settled the relevant organizations such as Science and Technology Commission, Federal Micro and Small Enterprise Development Agency and Regional Micro and Small Enterprise Development Agencies (FMSEDA/RMSEDA) should take the task of identifying the proper technologies. In the identification process they should take into account the desirability of the output in local and export market along with checking level of its labour intensity. While I was in South Korea I came across a number of small and medium enterprises which are labour intensive, not complex and less costly. The concerned body can make close contact with South Korean, Taiwanese and Chinese agencies that have ample technology and information of that type.

- Other than the above major obstacles for the expansion of such basic small scale industries, some officials of the existing MFIs do feel that financing those businesses is in conflict with reaching the rural and urban poor. In my perception this understanding has major flaw. First the people who own those enterprises could be the poor organized in-group. What they require is just employing few semi-educated who specially help them in the beginning. After all, the FMSEDA/RMSEDA could provide training to the poor who need to open such business. Second funding similar activities will not be recommended in the face of saturation of the market. That is there will not be sufficient effective demand for accommodating informal activities that are growing at an alarming rate. As a result, MFIs should give greater attention, time and resource to promote micro and small enterprises.

- There is no heightened awareness on the role of microfinance in poverty alleviation among policy makers, experts in the government sector, researchers, and the public. For example, the line departments of the federal government such as the tax authorities hardly understand the role and objectives of MFIs. They have insisted that MFIs should pay all types of taxes. These types of decisions should consider the long-term effect on the profitability of the sector and should give exemption for some of the fees at least at the early stage of operation.

- Lack of loanable fund to expand micro credit services of the institutions is another major constraint for intensifying the impact on as many beneficiaries as possible. In the initial phase the MFIs should be given assistance from government and other kind donors. However, they could not depend for a long time on assistance. They have to look for other meanses such as revenue from sell of share, borrowing from Commercial Banks and increasing the amount of saving mobilized. In order to generate more revenue from sell of share and borrowing from the Commercial Banks, the first thing MFIs should do is increasing their profitability. So far their major concern has been reaching as many poor as possible and as a result gave less attention to profitability. But with out maintaining profitability attaining this objective on sustainable basis would be futile attempt. The primary measure to be taken in this regard is increasing interest rate. Currently the interest rate charged by most of them is about 12.5% per annum, which is below one-eighth of the interest rate charged by informal lenders indicating the availability of ample opportunity in for elevating the rate. Furthermore, it might be useful to develop a strategy to create a link between microfinance institutes and Commercial Banks as well as among one another. Ultimately, this will open up vast resource base for those in need from the reserves of other banks and microfinance industries.

- Corporate Governance is another area of the problems of the microfinance industry. "The core problem of governance of MFIs in Ethiopia is the fact that the board members are not formal share holders with any capital investment to lose. Moreover, the professional mix of the board members does not meet the quality required to guide the MFI" (Bekele and Wolday 2001). Establishing a technical advisory committee that assists the board of MFIs in making sound decisions or reformulating the board in a way that satisfies the requirement could help mitigate this obstacle.

- Absence of Business Development Services (BDS) to clients by responsible organizations also hinders the provision of the MFI services. Although the MFIs exclude these services from their duties as they follow the minimalist approach to reduce cost and attain operational and financial self-sufficiency, NGOs and government could provide BDS services to clients. The service should give much emphasis in introducing the array of small-scale industries identified by Science and Technology Commission, FMSEDA and RMSEDA and their operation.

- The existing limited capacity of the microfinance industry in terms of trained manpower, equipment, transport facilities, offices, Management Information System (MIS), research and innovation also needs to be addressed.

- Last but not least, there was a problem of enforcing loan repayment. Because of group responsibility, the remaining loyal borrowers pay debt of an individual defaulter. This has served as a nice substitute of collateral. It has been seen in many cases that some MFIs do not bother about the individual defaulter after securing their money from the rest group members. Nevertheless, ignoring the individual defaulter once recovering the credit money from other group members is not fair and also creates difficulty to form group for incoming new borrowers. Thus, all MFIs should instigate a system that supports the loyal group members to sue the defaulter and in the end obtain their money.

APPENDICES

Appendix 1 Changes seen in the enterprises run by borrowers of OCSS.Co. and other four MFIs.

Type of change observed	Share of new borrowers in %	Share of repeat borrowers in %
Able to expand their business	77.5	85.3
Able to add new product	28.4	37
Able to improve quality of their product or service	38.7	51.2
Able to hire new workers	18.2	18.8

Appendix 2 Changes seen in the net worth of enterprises run by borrowers of OCSS.Co. and other four MFIs.

Type of change observed	Share of new borrowers in %	Share of repeat borrowers in %
Able to purchase small tools	27.3	37.5
Able to purchase major tools	4.7	12.2
Able to own private transport facility like bicycle and handcart	3.7	9.0
Able to own storage facility	2	8.4

Appendix 3 Changes seen in Business management/Entrepreneurial skill of borrowers of OCSS.Co. and other four MFIs.

Type of change observed	Share of new borrowers in %	Share of repeat borrowers in %
Able to separately record and compute enterprise cash from household spending	75.2	65.9
Improved accountancy skill in computing profitability	25	30

Appendix 4 Changes seen in the livelihood of borrowers of OCSS.Co. and other four MFIs.

Type of change observed	Share of new borrowers in %	Share of repeat borrowers in %
Able to increase overall income	58.4	73.0
Able to purchase assets of value less than 500Birr/USD65	93.8	90.8
Able to purchase assets of value greater than 500Birr/USD65	6.3	8.4

Source: Data included in appendices 1- 4 are obtained from the paper entitled "The Impact of Microfinance Services Among Poor Women in Ethiopia", by Tsehay and Mengistu.

Appendix 5 Changes seen in the livelihood of borrowers of ACSI

Type of change observed	Share of borrowers in %
Overall living standard is improved	89.9
Able to increase quantity and quality of household diet	66.6
Able to improve the house quality	18.18
Able to purchase plough ox	14.81

Appendix 6 Changes seen in the Empowerment of women borrowers of ACSI

Type of change observed	Share of borrowers in %
Greater involvement in household decision making	75
Able to manage the business alone	38.16
Able to manage the business jointly with the husband	55.26

SOURCE: Data included in appendices 5 and 6 are taken from "Some Challenges of Microfinance as Antipoverty Strategy", by Getaneh.

Appendix 7 Changes seen in the livelihood of borrowers of DECSI

Type of change observed	Share of borrowers in %
Overall living standard is improved	94
Able to increase quantity and quality of household diet	88
Able to improve clothing of children	60
Able to make economic investment like purchase plough ox	27

Source: compiled from "Usage and Impact of Microcredit Provision", Meehan

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