Livelihoods Through Micro-enterprise Services? Assessing Supply and Demand Constraints for Microfinance in Ethiopia (With Particular Reference to the Amhara Region)

By

Getaneh Gobezie
(getanehg2002@yahoo.com)

Paper Presented at the 3rd International Conference on the Ethiopian Economy,

Organized by the Ethiopian Economic Association June 2-4, 2005, Addis Ababa, Ethiopia.

Nov. 2005
Bahir-Dar

"Most of the people in the world are poor; so if we knew the economics of being poor we would know much of the economics that really matters."

(Theodore W. Shultz, on accepting the Nobel Prize, in Economics, 1979)

ACCRONYMS

ACSI: Amhara Credit and Saving Institution

AIMS: Assessing Impact of Microenterprise Services

BDS: Business Development Services

DECSI: Dedebit Credit & Saving Institution

GGLM: Group Guarantee Lending Model

HHEP: Household Economic Portfolio Model

IFAD: International Fund for Agricultural Development

MFIs: Microfinance Institutions

MGD: Millennium Development Goals

NBE: National Bank of Ethiopia

NGOs: Non Governmental Organizations

PWR: Participatory Wealth Ranking

REMSEDA: Regional Micro and Small Enterprises Development

SACCOs: Saving and Credit Cooperatives

SIDA: Sweden International Development Agency

WDR: World Development Report

OUTLINE

1. BACKGROUND

- **The Poverty Situation and Microfinance as an Anti-poverty Strategy**
- **The "Modern" Microfinance Service Provision**

2. GAPS IN RURAL FINANCIAL INTERMEDIATION: A FRAMEWORK FOR ANALYSIS

- **The Inefficiency Gap**
- **The Insufficiency Gap**
- **The Feasibility gap**

3. ASSESSING THE GAP IN THE REGION

a) Microfinance Policies, Organizational Behaviours, and the Incentive Problem

- ***Policy, Regulation, Supervision Issues***
- ***Organizational Behaviours in Service Delivery***
- ***The Incentives Problem***

b) Institutional capacity for innovative service delivery

- ***Lending Methodology: From Replicating to Customizing Models?***
- ***Micro-Saving: Reducing Donor Dependence***
- ***The Human Resource Factor***
- ***Computerizing Management Information System***

c) Constraints for "Legitimate" Demand

- ***Distance***
- ***Client Business' Absorptive Capacity***
- ***The Culture Problem***
- ***The Women Issue***

4. CONCLUSION & RECOMMENDATIONS

BIBILIOGRAGHY
ANNEXES

SUMMARY

Rural financial intermediation currently constitutes a key development intervention in many poor countries. Yet, the success achieved particularly in countries who implemented such programmes a couple of decades ago notwithstanding, there remain many constraints limiting both the supply and demand in very poor countries like Ethiopia. Experience from over ten years of financial intermediation reveals that good intentions for expansion of supply are having difficulties due to poorly designed regulations and policies, organizational behaviours, the incentive problem, as well as weak capacity of institutions implementing it. Where poverty alleviation constitutes the main development agenda, rural financial regulations and policies tend to have an in-built rationing mechanism, targeting primarily the poorest and the disadvantaged, thus often missing others who might also have the demand for it. While more efforts are still needed to rectify the restrictive effects of some regulations and policies on pricing and competition, in a situation where there is no strict supervision and monitoring of the effective implementation of the well-intended ones, there are organizations, working without any hard budget constraints and mixing microfinance business with charity, thus crowding out the operations of more sustainable rural financial intermediaries. For those who are intent on implementing the rules of strict financial intermediation, their methodologies are largely replications of those implemented elsewhere, primarily under Grameen, with little capacity to customize it to local realities. No less challenges also remain on the demand side. For the majority poor, the communication system in rural areas, particularly the road network, bars them from accessing the service. Where the access is granted, clients low skill achievement in business development dictates their business' absorptive capacity to remain weak. Many are risk averse, or don't like (for cultural reasons) to venture into non-traditional activities, while others have a very low income perspective and simply don't have the demand for such income-improving services. Such problems manifest themselves more profoundly on women, whose very access and benefit from the service is further limited because of problems emanating from a male-dominated patriarchal societal system prevailing in the country. Closing the supply and demand gap is a daunting task, but not impossible, and should involve microfinance practitioners, government, non-government organizations, donors, etc., -- for failure to do so would stifle efforts aimed at poverty alleviation and development at large.

1. BACKGROUND[1]

The Poverty Situation and Microfinance as an Anti-poverty Strategy

By most indicators, poverty and ill-being in Ethiopia are abysmal. The Amhara region in particular, has been prone to much suffering in the past, and was one of the hardest hit areas in the 1973, 1984 and more recent famines of Ethiopia[2]. A study undertaken jointly by the Ministry of Finance & Economic Development and the Central Statistical Authority (CSA) indicates that more than 42% of the 17 million people of this region cannot afford the minimum consumption for survival (the 2200 calories, recommended by the World Health Organisation)[3].

The Government has undertaken series of economic reform programmes aimed at re-orienting the economy from command to market economy, rationalizing the role of the state and creating legal, institutional and policy environment to enhance private sector investment. More recently, the Government's "***Sustainable Development and Poverty Reduction Programme (***2002) has more clearly articulated the objectives in revitalizing development in the country. Given that poverty reduction will continue to be the core of the agenda of the country's development, the strategy is built on **four pillars** (building blocks). These are: Agricultural Development Led Industrialization (ADLI), Justice system and civil service reform, decentralization and empowerment, and capacity building in public and private sectors. Such a four-pronged approach is believed to be effective in a fight against poverty and ensure sustainable development[4].

Of all the four "pillars", the ADLI strategy emphasizes rural finance. The Ethiopia's existing realities reveal that there is an acute shortage of capital. In contrast, the country is endowed with a large number of working age population and a potentially cultivable land although land is still relatively scarce in some part of the country, particularly the northern and central highlands. It is believed that faster growth and hence economic development could be realized if the country adopts a strategy that helps raise the

---

[1] The author is currently working at the Amhara Credit & Saving Institution (ACSI). The views expressed are those of the author and not necessarily those of the Institution. Feedbacks are very welcome at e-mail: getanehg2002@yahoo.com.

[2] For a more extensive description of this, particularly relating to the area in the Northern part of Ethiopia where ACSI is operating, see Devereux and Sharp (2003).

[3] This minimum consumption is estimated in Ethiopia to cost only about $10 per month/adult. One should therefore note that the poverty rate would be even higher if one considers the $30 poverty line (in other words, the 'dollar a day' convention) set by the World Bank.

[4] For example, making the judicial transparent and accountable will greatly improve the enforcement of contracts and property right, and thereby reduce non-commercial risks. Civil service reform will render far better the implementation of policies and regulations as well as delivery of services, which translates into reduction of transaction costs and removal of distortions of resource allocation. These are all important for the development of the private sector. Decentralization and empowerment will increase the decision power of district administration in developmental projects and allow interaction with the rural population. Apart from making felt needs better reflected, it will give rural communities valuable experience about development and how it can be brought about through their actions. (See FDRE, 2002).

employability of labour resources and enhance productivity of land resources aimed at capital accumulation.

In turn, for agriculture to continue serving as an engine of growth in the coming years, through the domestic economy and international trade, there has to be progress in terms of commercialization, with more intensive farming, increasing proportion of marketable output and correspondingly decreasing ratios of production for own consumption. Aside from deepening technological progress, it will mean greater market interaction on the part of the farmer, more research and extension, application of inputs, irrigation, production of tools and equipment, etc. Extension of credit to the small farmer has to gain importance with commercialization of agriculture and give impetus to the establishment of rural banks (FDRE, 2002).

Thus, overall, financial sector development is viewed as an important underlying element in overall economic growth and development for three reasons (See also Inter-American Development Bank 2001). First, financial sector development unleashes the economic potential of increasingly greater proportions of the population and accelerates ***economic growth*** through efficient intermediation and risk management. Countries with more developed financial markets and greater *financial depth* (as measured by the ratio of M2[5] to Gross Domestic Product, or the 2% of population threshold (Honohan 2004)) have grown faster, other things equal, than countries with less articulated financial markets. A significant proportion of people both in urban as well as rural area is believed to be bankable but underserved. This untapped market represents both a substantial social and private economic loss. Second, the lack of adequate financial services and deep financial markets hinders the formation of new enterprises and the expansion and modernization of existing ones and contributes to ***income inequality***. Those fortunate enough to have access to credit and deposit services can increase their income faster than those that do not.

Third, improved rural financial intermediation could directly ***reduce vulnerability*** and alleviate ***poverty*.** Indeed, in many otherwise very poor countries, microfinance is proving its clear impact on poverty by positively affecting the household economic portfolio (See the HHEP model in the Annex): expanding *opportunities* for income generation for the poor, improving *capabilities*, reducing *vulnerability,* and enhancing *empowerment*. Expansion of opportunities may include greater improvements on household income, assets, sources of income, housing tenure, enterprise growth, and employment generation through which people can obtain their material requirements. Improved capabilities implies improving human capital that enables people to maintain/raise living standard. Reducing vulnerability refers to improving the capacity of an individual/household to deal with a risky event. Likewise, the main items in empowerment dimension refers to control over resources and income, savings, self-esteem, respect from others, and future orientation by an individual, especially women.

---

[5]M1= Transferable Deposit + Currency Outside Bank; M2= M1 + Time Saving + Foreign Currency Deposits (See UNOSCAL (2000)

For these to be realized, a number of constraints on both the demand and supplied side of rural finance (to be discussed below) need to be resolved.

The "Modern" Microfinance Service Provision

In Ethiopia, the rural financial landscape essentially remains dominantly informal. *Supply* of formal services is still very weak or inexistent - very few banks operate, there is little lending activity and virtually no savings mobilization, mainly because of the high transaction costs involved. For a number of reasons – for instance lack of accessibility or cultural specificities- *demand* for these financial services also remains constrained. Hence, a good portion of the financial transactions that take place are concluded informally, at the village level[6]. Money is borrowed or lent by individuals and households, hoarded or saved at home, in Rotating Savings and Credit Associations (the *Equb* system), social insurance systems (such as *Iddirs*), etc[7].

Equb is the local version of Rotating Saving and Credit Association, whereby group members meet regularly to collect contributions of equal amounts from the members and to allocate the amount. This allocation is based on a lottery system, as a loan to one member. *Equb* has an important cultural and economic significance in the traditions of Ethiopian population. A study conducted on the establishment of the Rural Development Bank in Ethiopia (1995) estimated that the volume of money revolving within *Equb* is in the range of 8-10 % of the GDP (IFAD, 2001). This system is somewhat equivalent to the *Esusu* in Nigeria, Liberia and Sierra Leon; the *Tontines* in Senegal, Burkina Faso, Ivory Cost, Niger; and *Sanduk* in Sudan. On the other hand, *Iddir* is a local insurance mechanism whereby members regularly contribute to a pool from which they are entitled to a lump-sum to meet expenditures mainly related to burial ceremonies in the case of death of a family member. Rural communities in the southern part of Ethiopia also have a local version of Accumulating Saving and Credit Associations (ASCAs).

These informal sources, however, do not generate enough and affordable finance for business to stimulate economic development. In particular, the individual money lender (the *Arata Abedari*) is extremely expensive, and is only resorted to in the absence of any alternative. In this case borrowers are required to provide guarantors and the interest rate is excessively high. Until recently the annual interest rates that the money lenders charged was estimated to range from 60% to 120%; in a more recent study, IFAD (2001) found that these rates can go as high as 400% per annum.

Thus, the first step in the Government's ***Sustainable Development and Poverty Reduction Programme*** (2002) is to encourage the further spread of modern financial services in the country. In fact, formal microfinance in Ethiopia started in 1994/5. In particular, the Licensing and Supervision of Microfinance Institution Proclamation No.

[6] According to an earlier study on rural Ethiopia, less than 1% of the population has access to microfinance (see Chao-Beroff *et.al.*, 2000 and Meles, 2000). This is believed to have changed to some extent with the proliferation of MFIs in all regions of the country.

[7] For an excellent narration of informal financial systems in Ethiopia, see Aredo (1993). For an overall review, see Kropp, M. *et. al.* (1989).

40/1996 encouraged the spread of Microfinance Institutions (MFIs) in both rural and urban areas as it authorized them to, among other things, legally accept deposits from the general public (hence diversify sources of funds), draw and accept drafts, and manage funds for the micro financing business (Article 3).

With a view to further stimulate economic activities and provide opportunities for the poor to escape poverty through availing more and appropriate financial services to the majority, the Government has been refining the ***regulatory framework*** for the microfinance operations. The regulation that put a ceiling on the interest rate that micro-financial institutions could charge from their credit clients no longer exists and a new liberal system is in operation (Directive No. MFI/92/98) whereby MFIs could decide the level of interest rate they charge as long as they can remain in the competitive market, thus opening up a new opportunity in the effort to ensure both operational and financial sustainability for MFIs. More over, the National Bank directives with regard to lending methodologies, terms and conditions are relaxed (pursuant to the Federal Rural Development Strategy) in a way encouraging MFIs to diversify their client base.

The ***macro-economic context*** also has a lot of enabling situations for the microfinance industry. Historically, Ethiopia has one of a stable price structure, and the economy has never faced any serious threat from *inflationary problem*. Ethiopia in fact belongs to the group of Africa countries with relatively low rates of inflation, suggesting that there is less of a threat from inflation on the effective interest rate charged. Like-wise, the relatively stable political and economic climate has been providing good working environment.

Yet, microfinance outreach is still so low in Amhara region or elsewhere in Ethiopia. For example, in terms of outreach[8] by ACSI (the largest MFI in the country), a total of over 698,000 poor people have been reached so far with regular credit. Currently, there are over 385,000 credit clients (with over 34% of them being poor women[9]) and another 151,000 individual voluntary savers. But, given the number of economically active people outside of the reach of the conventional financial service, estimated at over 2.9 Mill, ACSI and other smaller MFIs and Saving and Credit Cooperatives (SACCOs) in the region only manage to reach between 10 and 12% of the demand. There are many economically active poor people still un-reached.

---

[8] Outreach here refers only to *Breadth*. But it can also include wider aspects like: *Worth of outreach to clients* (value to clients that commands their willingness to pay); *Cost of Outreach to clients:* price costs and transaction costs; *Depth of Outreach:* level of relative poverty of clients; *Length of Outreach:* sustainability of the service; and *Scope of Outreach:* diversity of services provided.

[9] About 40% of households in Ethiopia are headed (*de jure* and *de-facto*) by women (IFAD 2001). As employment and traditional livelihood strategies for men disappear, poor women have had to make their ways into the informal sector in increasing numbers, primarily in low paying and often menial work - piece work, vending, petty trading, agricultural labour, collecting garbage, cleaning toilets, and factory employment. In almost every country covered under a World Bank study, both men and women reported women's greater ability to accommodate, ***bury their pride*** *and do whatever job was available* to earn the money to feed the family. This sometimes include prostitution. (World Bank Group, p.50)

2. GAPS IN RURAL FINANCIAL INTERMEDIATION: A FRAMEWORK FOR ANALYSIS

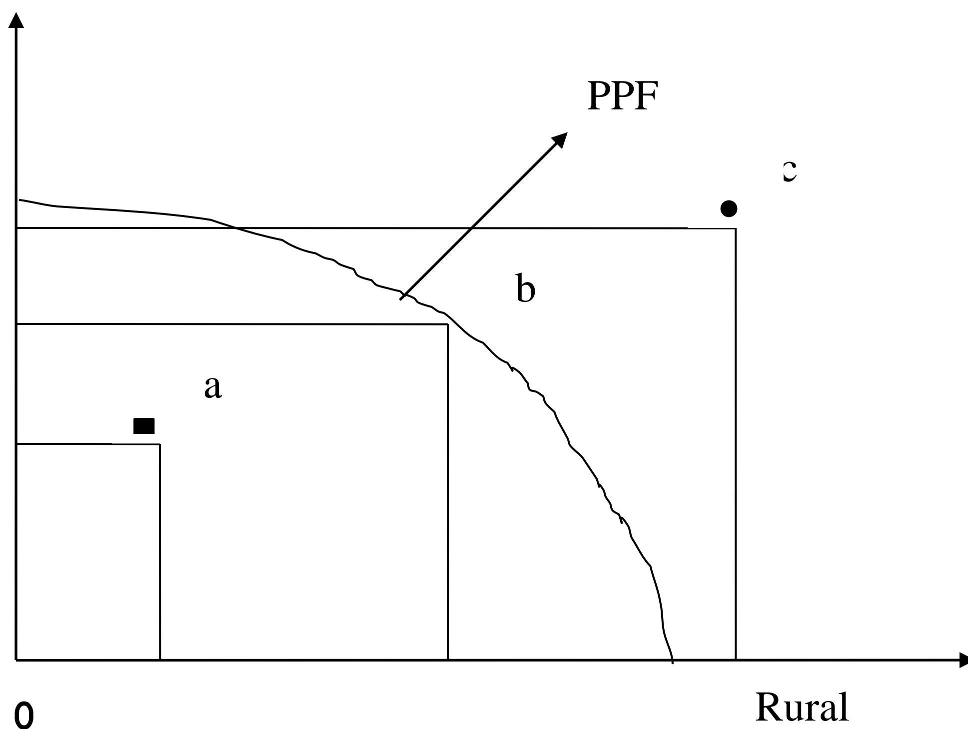
According to Claudio Gonzalez-Vega (2003), successful acceleration of the process of rural financial deepening will require the closing of three different gaps: **inefficiency gap, insufficiency gap, feasibility gap.**

The Inefficiency Gap

The inefficiency gap separates current achievements in rural financial deepening from the *potential supply*. Current achievements differ from potential supply because all available resources for the production of various types of financial services are not being used efficiently. Any country and region has a potential supply of various types of financial services. This potential supply reflects the country's endowment of various factors of production (*e.g.*, physical and human capital), its institutional infrastructure (*e.g.*, a framework for property rights and contract enforcement), and its knowledge about financial technologies and potential clients (*e.g.*, information capital). Available resources (*e.g.*, loan officers) can be allocated to the production of one or another type of financial service (*e.g.*, urban or rural credit). When the limits that define the frontier are finally reached, greater production of one type of financial service (using available funds, loan officers, and managerial systems) would require less production of another financial service. At any point in time, therefore, potential supply can be represented by a **frontier of production possibilities** of financial services (PPF).

For simplicity, the frontier shown in Graph 1 represents potential combinations in the production of two types of financial services –urban and rural. Amounts of urban financial services are shown on the vertical axis and amounts of rural financial services are shown on the horizontal axis. Combinations "a" and "b" of these two types of services are feasible, while combination "c" is not feasible, under current circumstances. Moreover, combination "b", which is right on the frontier, indicates the achievement of **technical efficiency**. Given this combination, it is no longer possible to produce more rural financial services without reducing the amount of urban financial services produced. Below the frontier, it would still be possible to produce more of both types of services.

Urban



Graph 1: Production Possibilities Frontier for Financial Services

The existence of an inefficiency gap is represented by a current combination of urban and rural financial services produced at a point such as “a”, which is below –inside– the frontier in Graph 1.

Gonzalez-Vega (2003) identifies three key sources of inefficiency. First, the lack of efficiency and the resulting waste may reflect distorted resource uses in rural financial markets as a consequence of incorrect government **policies**, such as those adopted during the protectionist-repression period. Second, inefficiency and waste may reflect the channeling of public resources and funds through weak and unsustainable rural financial **organizations**, which cannot productively use them. Third, inefficiency and waste may frequently reflect the absence of appropriate structures of **incentives** within rural financial organizations. These incentives are needed to induce decision-makers to seek efficiency.

Policies matter for efficiency. To close the gap, repressive and distorting financial policies must be abandoned. Further, the framework of **prudential**[10] regulation and

[10] Regulation is “prudential” when it is aimed specifically at protecting the financial system as a whole as well as protecting the safety of small deposits in individual institutions. When a deposit-taking institution becomes insolvent, it cannot repay its depositors, and – if it is a large institution – its failure could

supervision influences the types of financial organizations that are authorized to operate. Different types of organizations have different inclinations and abilities for the achievement of technical efficiency. Moreover, in order to encourage the development of robust and efficient organizations, international agencies and donors must channel their funds through organizations that seek efficiency and sustainability.

Apart from the "wasteful" use of scarce resources, by allowing weak organizations to compete in the same market segments as other intermediaries, without **hard budget constraints** or without the discipline of operating on market terms, this –unfair– behavior crowds out the operations of other, potentially more sustainable, rural financial intermediaries. This behavior of governments and donors and the resulting negative externalities further discourage any **investments** in the research and development of new financial technologies that would expand the supply of services in these particular market segments. This behavior further contributes to the destruction of **social capital** –shared social norms that facilitate transactions– as these government and donor programs weaken the *culture of repayment* and send signals about loans as political handouts rather than as financial contracts.

Reaching the frontier of the country's potential supply also requires that, in making decisions and in performing their tasks, the suppliers of rural financial services face incentives that are **compatible** with efficiency and sustainability. Ultimately, the performance of rural financial organizations depends on the decisions of their owners, managers, staff, clients and regulators. Given the particular objective function of each one of these stakeholders, their actions will respond to the existing structure of **incentives**, and these actions will in turn determine the performance of the organization. Reaching the frontier requires structures of incentives compatible with technical efficiency.

The Insufficiency Gap

---

undermine public confidence enough so that the banking system suffers a run on deposits. Therefore, prudential regulation involves the government in overseeing the financial soundness of the regulated institutions: such regulation aims at ensuring that licensed institutions remain solvent or stop collecting deposits if they become insolvent. This concept is emphasized because great confusion results when regulation is discussed without distinguishing between prudential and non-prudential issues. …Prudential regulation is generally much more complex, difficult, and expensive than most types of non-prudential regulation. Prudential regulation (for instance, capital adequacy norms or reserves and liquidity requirements) almost always require a specialized financial authority for their implementation, whereas non-prudential regulation (for instance, disclosure of effective interest rates or of the individual controlling the company, financial crimes, fraud…) may often be largely self-executed and can often be dealt with by other than the financial authorities. … Thus an important general principle is to avoid using burdensome prudential regulation for non-prudential purposes – that is, purposes other than protecting depositors' safety and the soundness of the financial sector as a whole. For instance, if the concern is only to keep persons with bad records from owning or controlling MFIs, the central bank does not have to take on the task of monitoring and protecting the financial soundness of MFIs. It would be sufficient to require registration and disclosure of the individuals owning or controlling them, and to submit proposed individuals to a "fit and proper" screening. Some non-prudential regulation can be accomplished ubder general commercial laws, and administered by whatever organs of government implement those laws, depending on the relative capacity of those agencies. (See Christen, Robert, Timothy R. Lyman and Richard Rosenberg, 2003).

The insufficiency gap separates the potential supply of rural financial services from legitimate demand. Legitimate demand reflects the *willingness and ability* of the rural population to demand different types of financial services at the prices and terms and conditions at which they are offered or could be offered under competitive conditions. An application to take a loan is not sufficient evidence of demand. In a loan, an amount of current purchasing power that is certain is exchanged for an uncertain promise to repay in the future. Many people would "demand" loans that they do not plan to repay or that they do not expect that will be collected. This would be a spurious demand. This possibility creates the need to define ***legitimate demand*** as the existence of a ***true willingness and ability to repay*** the loan, given the terms and conditions included in the "price" vector of the transaction.

In any case, these excess demands could not be eliminated through increases in interest rates, in view of possibilities for **adverse selection** and **moral hazard** that increase the risk profiles of loan portfolios when interest rates rise. Given these threats of increased risk, credit **rationing** typically takes place, excess demands are not removed, and the market for credit does not clear[11]. The insufficiency gap can only be reduced through outward shifts of the PPF.

The insufficiency gap is closed when there are outward shifts of the frontier. Three different processes can cause a biased expansion of the frontier that favors rural financial deepening: (a) **innovations** in financial technologies that overcome typical obstacles to rural financial transactions and the design of new financial products that respond to the characteristics of rural household-firms, (b) development of the physical and institutional **infrastructure** that facilitates adoption of the new financial technologies, and (c) **human capital** formation that facilitates adoption and implementation of the new technologies.

The Feasibility gap

The feasibility gap separates a legitimate demand for rural financial services from political promises and **expectations** about portfolio levels, dimensions of outreach, and loan prices. Frequently, this gap reflects lack of recognition of the feasible rhythm of expansion of the PPF. Not all rural firm-households possess legitimate demands for financial services. Usually, demands for payments services and deposit facilities are quite widespread. Legitimate demands for credit are not as broadly based, given the debt service burdens that accompany loans. The feasibility gap can only be closed with political maturity and fiscal responsibility. Rural financial market interventions should assess what is feasible. **Cost-benefit** analysis should be used to determine when an

[11] This gap reflects two sets of circumstances. First, because of market failure, due to adverse selection and moral hazard, even in equilibrium, financial markets may not clear. That is, any resulting degree of credit rationing implies that demand exceeds supply even at equilibrium interest rate. Second, even if the market cleared, given the obstacles discussed, it might clear at very high interest rate, which would leave many attractive opportunities unexploited. In particular, some unexploited opportunities may have marginal rates of return higher than those of actual projects financed elsewhere in the economy. The credit constraints would prevent the exploitation of socially-valuable opportunities for income expansion which, thereby, generate unsatisfied legitimate demand for loans. (See Gonzalez-Vega, 1998.)

expansion of the supply of rural financial services is socially desirable. After all, the opportunity cost of resources spent in promoting rural financial deepening are the education, health, nutrition, and other public services that could have been funded otherwise. Given a political decision to promote an expansion of the frontier in a particular dimension, optimum intervention rules must be followed in the choice and implementation of the strategy.

3. ASSESSING THE GAP

Using the above framework, one can assess the gap in financial services in the region and draw conclusions and potential recommendation for enhancing the service. The discussion will focus on inefficiency gap and insufficiency gap. Thus, on the supply side, the discussion will focus first on existing policies, organizational behaviour and the incentive problem with-in organizations, and second on Institutional capacity for innovative service delivery. On the demand side, attention will be on distance, clients' business absorptive capacity, culture as well as on specific situation of women.

a) Microfinance Policies, Organizational Behaviours, and the Incentive Problem

A number of problems can be listed in this regard. But the following only highlights on some of the points that are more relevant to the present discussion.

Policy, Regulation, Supervision Issues

Setting Regulations on Microfinance as an anti-poverty strategy

In line with the government overall focus on poverty and food in-security issues, originally, microfinance policies and regulation were directed towards the poorest. Indeed, the Microcredit Summit also suggests that MFIs should have as clients those belonging to the bottom 50% of those living below the poverty line. This makes a lot of sense in the Amhara region setting. Indeed, not only is the prevalence of poverty high, but so is the depth (or intensity) of poverty. This means that the average income of the poor is not only lower than the pre-determined poverty line, but also very far below it. In other words, the gap between the average income of the poor and the poverty line income level that would enable one to maintain at least the minimum requirement for mere survival is very high. Eliminating this gap would not only help reduce the poverty head-count, but, at the same time, it would reduce the depth of poverty, which is often taken as a more appropriate indicator of life condition in certain localities than the poverty rate. Indeed, the most accepted axioms in the measurement of poverty (the Foster-Greer-Thorbecke measures of poverty (Foster *et al.,* 1984) and their subsequent refinements) highlight the depth of poverty[12].

[12] In the microfinance discussion, the 'double bottom line' of institutional sustainability (financial returns to MFIs) and depth of outreach (social returns) constitutes the central issue. More recent arguments on the contribution of microfinance on enhancing social welfare, based on the traditional economists' tool of 'cost-benefit analysis', focuses the discussion on the net increase in total social welfare over and above the

Thus, if we are to make advances on the reduction of both the rate and depth of poverty, thereby positively contributing to meeting the poverty reduction targets stated in the PRSP and the MDGs, we need to help the very poor come out of poverty. Assuming direct correlation between income level and the loan size demanded (i.e., those with better income level demand higher loan size) this implies that, we need to adequately respond to the demands of clients who require very low loan sizes, i.e., the very poor.

Thus, at policy and regulation level, the ***loan size*** has been limited (until recently) to a maximum of Br. 5000, with a view to limiting it to the requirements of the poor. But, whereas the priority given to the poor (using the "ox" targeting, See Annex) has a clear and logical justification, targeting the poorest in the business world faces a lot of difficulty, for many of the poor are not natural entrepreneurs and the opportunities for productive use of loans are often limited. On the otherhand some, having been clients to MFIs and having developed business skill, require loan size beyond this limit set up by the National Bank.

Thus, in the areas where MFIs are operating, there are many who are not getting the access because of the exclusive focus on the poorest of the poor. Some would suggest that the secondary income and employment effects of providing services to the vulnerable non-poor and the "***missing middle***" helps the poorer (usually risk adverse and non-entrepreneurial) people more effectively than requiring all to become business people. Mosley (1999) in his study of Latine American MFIs for the World Development Report 2000/1 suggested that secondary income and employment effects were beginning to come through. Certainly there is evidence that the poorest can enjoy higher daily wage labour rates in the villages of Bangladesh as a result of MFI activities[13].

Likewise the ***loan term*** also used to be limited to a maximum of one year. This has been one of the main obstacles limiting the efficacy of the microfinance service on the poor who are largely engaged in agriculture and live-stock sector which need more time than one year to produce any result. Moreover, for those who would like to undertake relatively large projects, with higher investment cost, and returns coming after some years, this has not been an attractive modality.

---

benefit to (private) customer that result from consumption of financial services. The net social benefit is determined by the depth, breadth, and length of outreach. Depth of outreach matters because society places greater value on helping the poor people than the better-off. Breadth of outreach matters because society values helping more people than fewer people. Finally, length of outreach of outreach matters, because society cares about the poor both now and in the future. *Ceteris paribus*, the greater the depth, breadth, and length of outreach, the greater the net social benefit (see Woller and Schreiner, 2004).

[13] Progress for some families in a microbank can mean progress for others who are not in the bank. Several years a go, two visitors sat with a group of women at a microbank meeting in South Asia. "What impact has your microbank had on the husbands of non-borrowers?" the visitor asked. The women of the microbank spoke softly together and then one of them answered. "Before we joined the bank," the borrower explained, "our husbands were daily labourers, working whenever they could find work on other people's land. When we took our first loan, our husbands stopped being daily labourers and joined us in our business – growing garlic on leased land, husking rice, driving a bicycle rickshaw. There become a shortage of day-labourers in this area. This caused the wage to go up for the husbands of women who were not with our bank. That was the impact of this microbank on the husbands of the non-borrowers." (See Microcredit ***Microcreditsummit Report 2002*** ….)

The Revised Regulatory Framework

As indicated above, with a view to stimulate economic activities and provide opportunities for the poor to escape poverty through availing appropriate financial services to the majority, the Government is refining the ***regulatory framework*** for the microfinance operations. For example, the regulation that put a ceiling on the interest rate that micro-financial institutions like ACSI could charge from their clients no longer exists and a new liberal system is in operation (Directive No. MFI/92/98) whereby MFIs could decide the level of interest rate they charge as long as they can remain in the competitive market, thus opening up a new opportunity in the effort to ensure both operational and financial sustainability for the Institution.

More over, the National Bank directives with regard to lending methodologies, terms and conditions are recently relaxed (pursuant to the Federal Rural Development Strategy) in a way encouraging MFIs to diversify their client base. Indeed, with the growth of the microfinance industry in the country, the NBE is trying to make its policies fully respondent to the needs of the clients the industry is helping in their effort to come out of poverty. Most important amongst them are:

- Alternative lending methodologies other than the "group lending" can be explored, etc.
- Repayment period for the loan taken from MFIs is revised from 1 to 2 years,
- MFIs can lend a loan size more than the Br. 5000 limit, on the condition that total disbursement for such loans would not exceed 20% of preceding year disbursement, and the maximum loan size would be 0.5% of MFI's capital, etc.
- And repayment period for these kind of loans can go up to 5 years,
- etc.

Such a change of policies at the national level away from exclusive focus on the poor (and the poorest of the poor first of all) emanates from the firm believe that the poor can also be well served by providing the access to capital to the relatively well-off people who might open enterprise employment for the poorest section. By way of diversifying, this would provide Microfinance Institutions an opportunity to enjoy the benefit of economies of scale. Thus, MFIs can diversify their client base, reaching out to broader clientele not just the poorest of the poor. However, it seems that although the regulatory framework provides for such new opportunities, many MFIs are slow in fully implementing it due either to strong attachment to the old operational modality (of working primarily with the poorest) or to the limitations on capacity (financial, human, technical, etc). This will be discussed further latter.

Ceiling on Interest

As indicated above, interest rate ceilings on loans charged by MFIs were lifted by Directive No. MFI/11/98, which reads, "the interest rate to be charged on loans and advances extended by a microfinancing institution shall be determined by the Board of

Directors of each microfinancing institution." This has helped many to set a lending interest rate high enough to cover their operating costs. On the other hand, a minimum is set for the interest that can be paid to depositors. The relevant directive in this regard (Directive No. MFI/13/2002) reads: "The minimum interest rate that shall be paid per annum by microfinancing institutions on saving and time deposits shall be 3%".

This discourages saving mobilization in remote, difficult to reach areas. The administrative cost associated with mobilizing small deposits in poor areas such as the Amhara Region in Ethiopia is so high because of the high ratio of transactions to deposited amount; and small savings are indeed no less expensive than bank loans. On the other hand, there is enough evidence that, as in the case of credit, the poor are more interested in "access" to safe saving services rather than the income from it, and there is increasing evidence in many poor areas where the poor actually "pay" (directly or indirectly) for efficient saving services. Indeed, we do the poor a great disservice if we remove modern saving options, and let the poor continue to use riskier saving options, because cash kept in the house can be stolen, livestock can die of disease or be un-salable when cash is needed, and so on[14].

Foreign Involvement in microfinance ?

Currently most types of non-financial foreign direct investment are encouraged by the Ethiopian government, while financial foreign investment, including the banking business in whatever form, is prohibited. Specifically, the proclamation 84/1994 precludes a foreign national from undertaking banking business in Ethiopia, and no person is permitted to own more than 20% of a banking company's shares. Accordingly, MFIs in Ethiopia should be established as share companies, the capital thereof owned fully by Ethiopian Nationals and/or organizations wholly owned and registered under the laws with a head office in Ethiopia.

The challenges or problems that constrain the government from permitting foreign banks' entry include many interrelated factors. Perhaps most importantly, foreign bank competition with infant domestic banks may be detrimental to the domestic banks rather than making them efficient. Moreover, foreign banks will focus on private returns rather than social (e.g., serving the poor), and given their easy access to funds in the international financial market, they may not be interested in mobilizing domestic savings. There is also the possibility of a sudden outflow of capital in response to changes in investor sentiment which would bring instability in the domestic banking system. Finally, given the current capacity within the NBE, there will not be any mechanism to effectively supervise and monitor that these foreign banks are operating within the law.

[14] Some even argue that saving facilities for the poor serve very important social objective. According to the "Security Theory" children in developing countries are produced partly to provide informal social security. In situations with overcrowding and in cases in which parents do not take into account the negative externalities imposed by their children (through congestion, and environmental degradation, for instance), social welfare may be enhanced by shifting to alternative social security programmes. For example, establishing secure, convenient savings programmes may allow households to reduce the number of children they have without undermining their ability to cope with less income in old age and can provide a second round of benefits to the community through reductions in negative population-related externalities. (See: Jonathan Morduch (1999).

On the other hand, however, if foreign banks penetrated the Ethiopian financial system (through subsidiaries, branches, joint ventures, etc…) and brought "packages" of services with them, the domestic financial system may benefit in terms of: higher levels of efficiency in service provision due to increased competition, more advanced technologies in the provision of financial services; higher quality and quantity of services; better training in financial management; and proper risk assessment and evaluation, leading to improved loan portfolio quality; enhanced access to international capital, either directly or indirectly through parent banks; and potentially increased lobbying for a proper regulatory regime for the entire banking sector, etc.

Organizational Behaviours in Service Delivery

Although the regulatory framework is put in place, effective supervision of its implementation is still lacking. Thus **NGO**s involved in micro-finance delivery without a license are becoming real dangers to the growth of the industry. Often, their system of lending involves some irregularities including subsidized interest rate, mixing business with charity and not following strict business discipline in the treatment of delinquency etc, which would make clients dependent on such operations and would potentially endanger the healthy operation of the whole micro finance industry.

This in large part emanates from the firm believe maintained by some donors', NGOs, "outside experts" etc, that the way out of poverty for the poor is only through extending charity handouts. The reality is that the poor people do not necessarily lack business skills and are not looking only for charity hand-outs, as is often assumed. They are not passive recipients of money transferred from other segments of the economy in a top-down approach. Rather, they need to be empowered to create their own jobs and enhance private income and, in fact, they are too proud to look for charity! They only lack the opportunity for income generation and employment.

Such charity-oriented operations is a real threat to the industry. In Amhara Region, the total amount of disbursement under such circumstances reached more than Br.100,000,000 in the last one-two year (1995, 1996 E.C) period alone. This amounts to about 40% of ACSI annual disbursement. In fact, if such NGOs do not follow strict business discipline and price their services properly, the "subsidized" fund pumped in the economy will affect the economy as a whole. Such ***market segmentation*** and lack of competition results in inefficiency. Clients with identical loan demand and risk profiles can receive different terms and conditions depending on source of funding (Inter-American Development Bank, 2001). Thus, for example, a producer that has access to subsidized credit can price her/his product lower than the one who borrowed at market interest rate, and thus the latter will be placed at a disadvantaged position[15]. The

[15] Moreover, since repayment is linked t the profitability of the activity being financed, borrowers who expect to have to repay their loans tend to be more careful in their choice of micro-projects than those who do not expect to repay. Low repayment, like low interest rate, may lead to capital mis-allocation, since

cumulative effect of this and similar distortion will have a disastrous effect on the whole free market system.

The Incentives Problem

Mcrofinance institutions currently face problems from different incentive structures that impacts upon their performance. For example, whereas foreign ownership of MFIs is “officially” restricted in the country, lack of transparency in capital ownership poses a real threat to the health of the industry. It is clear that in some MFIs equity structures are sponsored by foreign donors who have contributed the initial capital required for registration. In these cases, the real owners are *not* listed as shareholders. "Nominal" shareholders act as "fronts" for the real owners. These shareholders are precluded from selling or transferring their shares and "voluntarily forsake" their claim on dividends, if any, declared by the MFI. Such shareholders do not have a *real stake* in the organization and would be unlikely to lend it support at a time of financial crisis (See IFAD, 2001).

Within the microfinance institutions, the incentive system, the career structure, the promotion, salary and other benefits system are not such as to *incite* staff to perform with high achievements in mind. Often, the *career advancement scheme* whereby staff could expect higher-level position/salary after some years of experience, or after some level of education/training, etc, is not established, and there are no mutually developed and agreed upon performance evaluation criteria.

b) Institutional capacity for innovative service delivery

The *insufficiency gap* separates the potential supply or rural financial services from “legitimate demand” that reflects the willingness and ability of the rural population to demand services at the price and terms and conditions at which they are offered. There is a big gap in this regard too, related mainly to institutional inability to develop sufficient financial technology. Some of the reasons are given below.

Lending Methodology: From Replicating to Customizing Models?

One of the unique features of the Ethiopian microfinance industry is perhaps the fact that it largely finances “agriculture” which is little served by modern technology and for the most part dependant on unreliable climate, facing very poor infrastructure (particularly the rood network), small and fragile market, with people earning very precarious income inflows, etc. In fact, some argue that microfinance systems and methodologies are more appropriate for non-agricultural activities[16].

---

borrowers can make money even from socially unprofitable projects. (See Inter-American Development Bank, 2001, World Bank 2003).

[16] See, for example, Jennefer Sebstad (2002): *Short Study on Microfinance in Ethiopia*, Addis Ababa.

Moreover, particularly at the beginning, the service delivery methodology and the products of ACSI and other MFIs happen to be mainly *supply driven*. All MFIs usually start by *copying/replicating* the microfinance methodologies and products from other MFIs. Clients are then forced to fit to procedures, terms and conditions of the MFIs. Little regard has been accorded to the importance of "market research" to understand the financial needs and preferences of clients (and potential clients), how borrowing and saving fits into their money management strategies to meet day-to-day needs, manage risk, and take advantages of opportunities, etc.

The *Group Guarantee Lending Model (GGLM)* is the dominant methodology. Given the solidarity structure of real community life, particularly in rural Ethiopia, the methodology has a lot of conducive atmosphere to be effectively implemented. It has been a great opportunity for the majority poor as it removes the main entry barrier for those with no collateral, limited literacy, weak technical knowledge and narrow prior money management experience. For the very poor, the groups serves as the very forum where they can share valuable information about business, market, technology, politics, etc, etc. It has advantages for MFIs in terms of screening those who are not credit worthy[17].

Yet, the methodology has not been without problems. The advantages of peer monitoring over traditional practices lies in its social connectedness, as local knowledge about others' assets, capabilities, and characters is used to sort and self select. In theory, the dynamic of joint liability implies that groups screen and self-select their own members to form relatively homogeneous groups; i.e. the members share very similar probability of defaulting a loan. It is assumed that social solidarity will ensure that the successful members cover for the defaulters.[18]

There are, however, evidences that it tends to exclude the poorest but economically active people for various reasons: by the group members themselves, since a partially formed peer group looking for reliable members with whom to share risk is more likely to reject candidates they consider most risky; and by the "*Credit and Saving Committee*" who are not sure of guaranteeing repayment from the very poor, or for reasons related to seeking personal advantages from the less poor. Appropriate adjustments had to be made to make the group methodology relevant to the needs of the poor in local areas.

Specifically, field level experience has signaled the need to review the purpose and structure of "Centers" (group of groups). Centers were originally considered as one more platform to organize people for loan guarantee mechanism. Center formation (about 70-

---

[17] Research on Grameen Bank reveals how the GGLM plays its critical role: "Women who are really disorganized and cannot "manage" their households, women who are considered foolish or lacking in common sense, women who are "belligrant" and cannot get along with others, women with many small children, with husbands who are "lazy" and gamble and waste money or are "bad", are generally considered "high risk". It is felt that these women will be unable to use loans "wisely"; they would be unable to save and invest and increase incomes. These women, even if provided with membership, would drop out and would have negative influence on others." (See Syed M. Hashemi (1997); p.115)

[18] In terms of ensuring repayments, ***group lending*** can have both positive and negative effects. It increases loan repayment because successful borrowers may help repay loans of less successful borrowers unable to repay. Group lending may also reduce the repayment rate if the "entire" group defaults (i.e when some borrowers who would have paid default because other group members have done so). (See Khandker, Shahidure 1998:p.15).

105 clients or more) and holding individual members responsible for default of any one member in the center, though may be applicable in the originators of MFIs (especially those of Grameen, and replicators in Bangladesh, other Asian countries and elsewhere in the world) where there is less of *information asymmetry* by virtue of their proximate or densely populated living style, it proved not feasible for our local circumstances, where rural villages are situated very much isolated among themselves, and the information gap among people living there is very much. Most successful early starter MFIs like Bank Rakyat Indonesia (BRI) and Grameen Bank operate in countries like Indonesia and Bangladesh where the population density averages between 700-900 people per square kilo-meter, which sharply contrasts with Sub-Saharan Africa and Latin American case which is fewer than 10 people per square kilo-meter. (CGAP 2004, b). These conditions also increases the cost of moving cash and conducting loan analysis, and make client monitoring more difficult. Thus center formation (and hence mobilizing center saving) was subsequently stopped, focus being on group members (5-7) where the problem of information asymmetry is less sever.

Even lending in groups of 5-7 has sometimes been rendered problematic due to the geographically "isolated" nature of living style in rural Ethiopia. Under such circumstances, the information asymmetry among group members become very serious. And this is more so among women, who have little opportunity for information about their immediate neighbour-hood due to their day to day full engagement in house-hold chores. In order to suit the methodology for the needs of poor women, the minimum group-size has in some instances been reduced to 4-5.

Moreover, the standard practice until recently was to collect compulsory (up-front and on-going) savings from credit clients, which was returned *only* when the client left the organization. Access to these deposits was otherwise limited, which curtailed a potentially important source for smoothing consumption. This was identified as exacerbating client dropout. Currently, any client whose group members has made full repayment of their loan can withdraw any amount of his/her compulsory saving, and yet continue to getting the next loan. This has been very much appreciated by clients who were intent on dropping out in order to access their compulsory savings.

On the other hand, despite the rhetoric often heard about the ***social capital*** generated in solidarity groups, the endless weekly meetings are typically not popular among some borrowers: poor (and non-poor) people have better things to do with their time. There are also people who have the ability to offer collateral, but cannot do so simply because the collateral don't have legal title. The key to spurring development is enabling millions poor entrepreneurs to become part of the system rather than excluded from it. It is clear that the main problem (of lending to many) is not that the poor actually lack capital, but that many lack the legal title to assets they already hold. …"They have houses but not titles; land but not titles; crops, but not deeds; business but not statutes of incorporation; etc…" (de Soto, 2003). Giving them the legal title will unleash the "dead capital" so that it can be used as collateral for loans to fund new business or expand existing ones. The next step involves transforming property into collateral, collateral into credit, and credit into higher incomes.

For example, the ***warehouse receipts system***, also known as inventory credits, can facilitate credit for inventory or products held in storage. These receipts, sometimes known as warrants, when backed by legal provisions that guarantee quality, provide a secure system whereby stored agricultural commodities can serve as collateral, be sold, traded or used for delivery against financial instruments including futures contracts. These receipts are documents that state the ownership of specific quantity of products with specific characteristics and stored in a specific warehouse[19].

Such modalities have never been tested on the ground and the warehouse infrastructure is currently very much underdeveloped throughout the region.

Experience with warehouse receipts from farmers in Ghana

Since 1989, the NGO TechnoServe has worked closely with the Department of Co-operatives and the Agricultural Development Bank (ADB) in Ghana in encouraging small-scale farmers to form cooperatives and use warehouse receipts to store their crops for sale in the lean season. ADB provides loans against the members' grain, at 75-80% of current market price, and the grain is stored in co-operatively owned warehouses. The scheme is concentrated in the Brong-Ahafo "maize triangle" of Ghana—the major area of agricultural surplus, where annual price fluctuations are high.... From 1992 to 1996, participating farmers in this region were able to increase their profits on grain sales by an average of 94% per year, even despite the high interest rate of 42% charged on the short-term loans used. By 1997/98. more than 130 farmers groups were being assisted and for over 8 years, the loan repayments have been an impressive 100%. ...Although this system still relies on NGO support, it contrasts with commercial grain storage that is still under parastatal control and not as vibrant. Some of the benefits resulting from the scheme include: increased food production; better food security for farming families previously forced to accept low prices when selling at the same time (harvest); reduced post-harvest losses and higher rural investment.

(See Giovannucci, et., al (1999)

The ***titles to land*** are currently non-existent, and therefore land cannot be used as collateral. The tenure security must be formalized, and governed by legal rules. This affords certificate holders indisputable proof of right to land. In this way land can also be a base for mortgage system for provision of credit facility.

On the other hand, ***leasing*** is a financing tool that overcomes this constraint, and provides a very good opportunity for those who cannot easily form groups. The ***youth,*** who have no land or any other physical asset has been marginalized from the microcredit opportunity in many rural areas. In leasing, the provider (lessor) owns the equipment and

[19] Such a warehouse receipts system has the benefits of: mobilizing credit to agriculture by creating secure collateral for the farmer, processor, and trader, smoothing market prices by facilitating sales throughout the year rather than just after harvests, reducing risk in the agricultural markets, improving food security and credit access in rural areas, increasing market power of small holders by enabling them to choose at what point in the price cycle to sell their crops, helping to upgrade the standards and transparency of the storage industry since it requires better regulation and inspection, helping to create commodity markets which enhance competition, market information and international trade, providing a way to gradually reduce the role of government in agricultural commercialization, contributing to lower post harvest losses due to better storage conditions (i.e. induces farmers to store in more appropriate warehouses), lowering transaction costs by guaranteeing quantity and quality, increasing quality awareness (assuring the quality deposited is the same as quality withdrawn) (See Giovannucci, et., al (1999).

permits the client (lessee) to use the equipment in exchange for periodic lease payments. For most rural enterprises, leases are also a means of acquiring equipment (and not just its use) and ownership is transferred to the leasee at the end of the lease period. Leasing offers several advantages over loans, both to the lessee and to the lessor. For lessees, the most important benefit is access to a source of finance. From the lessor's perspective, the lessor has a stronger security position compared to that of the lender. In a lease, the lessor owns the equipment. In contrast, in a secured loan transaction, the borrower owns the equipment, the lender only has a charge on the collateral. In the case of default, repossessing a leased asset is much easier than repossessing a collateral. In many countries, creditor rights are weak and a lender is forced to be involved in lengthy court proceedings in order to take possession of collateral, while the lessor, as the owner of the asset, can repossess a leased asset without going to court.

Micro-Saving Mobilization: Reducing Donor Dependence

Microfinance can also play a big role in reducing vulnerability of the poor by availing suitable *saving products*, and enhancing self-insurance. ACSI puts high priority on the issue of ***moving away from dependence on donor*** funding and to focus on high level of saving mobilization and its own profitability as its source of fund. Thus, saving mobilized from clients and non-clients could finance progressively higher portion (normally between 50-70%) of outstanding loan. The ratio of the total value of voluntary savings to total loan portfolio has been increasing steadily.

The need to save in cash for the poor is indeed very high for spending requirements related not just for *emergencies* but also to: *life cycle needs*, and economic *opportunities.* Thus, poor people, living in straw hut in a village or in an urban slum, run into problems with money management, and finding a safe place to store savings. The physical risks are the least of the problem. Much tougher is keeping the cash safe from the many claims on it - claims by relatives who have fallen on hard times, by importunate neighbors, by hungry or sick children or alcoholic husbands, and by creditors and beggars. Finally, even when one does have a little cash left over at the day's end, if one doesn't have somewhere safe to put it he/she will most probably spend it in some trivial way[20].

Indeed, the poor *can* save, *do* save, and *want* to save money. Only those so poor that they have left the cash economy altogether - the elderly, the disabled…, for example, who live by begging food from neighbours - cannot save money. The recent ACSI survey of 600 potential credit/saving clients indicates that some 79.2% actually have some kind of savings, which they hold either in cash (57.9%) or in kind. Often, it is when saving "in

---

[20] Details are very well narrated in Stuart Rutherford (1999): *The Poor and Their Money*, Institute of Development Policy & Management, University of Manchester. For the different kinds of savings: "Saving Up", "Saving Down", and "Saving Through", see in Stuart Rutherford (2002?): *The Economics of Poverty: How Poor People Manage Their Money*, *Safe*Save, Bangladesh.

cash" is not convenient that the poor resort to saving in real asset[21]. The achievements in saving mobilization, however, leaves much to be desired, given the potential in the region. So far the number of voluntary savers is not more than 151,000. This is a very small achievement in a region with over 17 Mill population, about 3 Mill. households (over 90% living in rural areas with very little access to formal bank). Problems are multi-dimensional, yet the absence of aggressive *promotional work* is believed to be the key.

The Human Resource Factor

Human resource is the key factor in the success or failure of microfinance operations. Thanks to the strict selection procedure that ACSI and similar MFIs follow it can be said that the staff both management, administrative and program staff have high degree of commitment to the vision of the Institutions and willingness to work in a learning environment where uncertainty is likely, flexibility required and experimentation necessary. The recruitment criterion is such that only those who have reasonable knowledge of the area, its culture, custom, language, etc., and who acquired a mix of business and social development skills are selected.

Efforts are always going on to make the staff policy, salaries and incentive scheme very comparable to other similar NGOs and government offices. We can say that ACSI and similar MFIs are to an extent employer of choice, not necessarily because they pay higher salaries, but because their vision for poverty alleviation can be easily shared by many who are really concerned about the poverty level in the poor areas. The very principle and strategies employed of creating “opportunities” for the poor for transformation from a recipient of relief to self-employment and development attracts many professionals.

On the other hand, one should also notice that unlike the “conventional” kind of employers, which tend to emphasize academic achievements, such MFIs give value to social attachments, knowledge of local culture, custom, norm, language etc, which tend to be ignored by others. Thus, indeed, for many with such very valuable credentials which are very essential for effectively discharging demanding tasks like microfinance and other more “participatory” development works, in remote poor areas, but with relatively low academic achievements, competition from the “conventional” employers has so far been relatively low.

---

[21] The form of holding wealth or *capital formation* which a rural economic unit chooses depends on the return, the risk, the convenience and the flexibility or liquidity of the alternative investment opportunities. When saving "in cash" is not convenient, the poor resort to saving in real asset (crops put into storage, a house constructed, a pig fattened -- hence the idea of "piggy bank" -- a tree planted, or children raised (and educated) as an investment in human capital, helping one's neighbours and putting on a feast to raise claim for future assistance (social capital). But the return on such investments are not always very large since investments are made in order to save, and not vice versa, when other saving opportunities are unavailable (Schimidt and Kropp, 1987: 26). … The assumptions in the new paradigm in *micro-saving* is based on: massive demand exists for institutional voluntary savings among the poor; the poor do not need to be *taught* to save - they already save in a variety of forms. Moreover, in a stable economy with adequate infrastructure, other forms of savings will often be inferior to financial savings. (See Jonathan Morduch and Barbara Haley (2002): *Analysis of the Effects of Microfinance on Poverty Reduction*, NYU Wagner Working Paper No. 1014, p.65)

Yet, the need for developing suitable financial products that satisfy the growing and diversified need of clients, introducing reasonable flexibility in the terms and conditions of existing financial products, as well as providing services expected of a micro-bank, requires more adequately qualified and ***trained manpower*** at Head Office, at Branch as well as at S/Branch level than is currently available. However, the current capacity, in terms of the size as well as the quality of manpower, is not such as to effectively discharge such increased responsibility in the industry. The majority are 12 grade graduates or below. Only some have diplomas and degrees, particularly at the head office. While few have some exposure, the majority have gained their training in-house, and acquired skills from practice.

Computerizing Management Information System

Many microfinance institutions, including ACSI so far have no well-developed efficient computerised *Management Information System* (MIS) to capture relevant data and to generate desired management reports. Thus the data transferred from branch and sub branch to the head office are not so suitable to ascertain the *asset position* of the Institution and to establish *performance indicators*. As a result, information on loan portfolio, financial accounting and others has never been evaluated fully, by branch and Sub Branch and accurate, timely and comprehensive *reports* have not been produced and provided to the different levels of users such as management, staff, board, others. This exacerbated the liquidity management problems, thus also constraining the development of new financial products the are in real demand from the poor.

Working Facilities have a significant contribution to staff performance. One of ACSI's serious operational problems, for example, is that many branches and S/Branches suffer from serious logistical problems of all sorts (inadequate/old buildings, shortage of transportation, low supply of office furniture, etc). Given the geographical set up of the region, and the poor physical infrastructure (particularly the rood network), the inadequate supply of transportation facilities is so serious that operation in the region as a whole, and particularly in rural areas, has proved to be a very problematic task. This is more so for those involved on a daily financial transactions. Microfinancing activities as undertaken by institutions like ACSI are such that not only does one need to identify and disburse loans to the right client in isolated remote areas, but one also needs to ensure full repayment through daily monitoring and follow up of each client, with very low loan sizes. Very small savings have to be encouraged and mobilised from these same poor people. Live cash has to be transported from one location to the other. And such activities often involve a door-to-door service. Given the current number of credit and saving clients, one ACSI S/Branch officer is expected to attend about 400 clients. With poor infrastructure, and with inadequate transportation facility, attending the given number of microfinance client has been a challenge.

c) Constraints for "Legitimate" Demand

The demand for rural financial services is constrained by a number of factors. Some of the most common problems in poor areas such as the Amhara region are identified below.

Distance

As indicated above, **distance** is one of the most important determinants of transaction costs. Geography, ethnicity, culture, and social class create distance between borrowers and lenders. Distance hinders communications. Transaction costs are high in rural areas for borrowers and for depositors due to deficiencies of the transportation and communications infrastructure. The reduction of transaction costs needed to increase the demand for financial services critically depends, therefore, on the provision of some of the most basic **public goods** and physical infrastructure: roads, telephones, mail services, literacy, electricity.

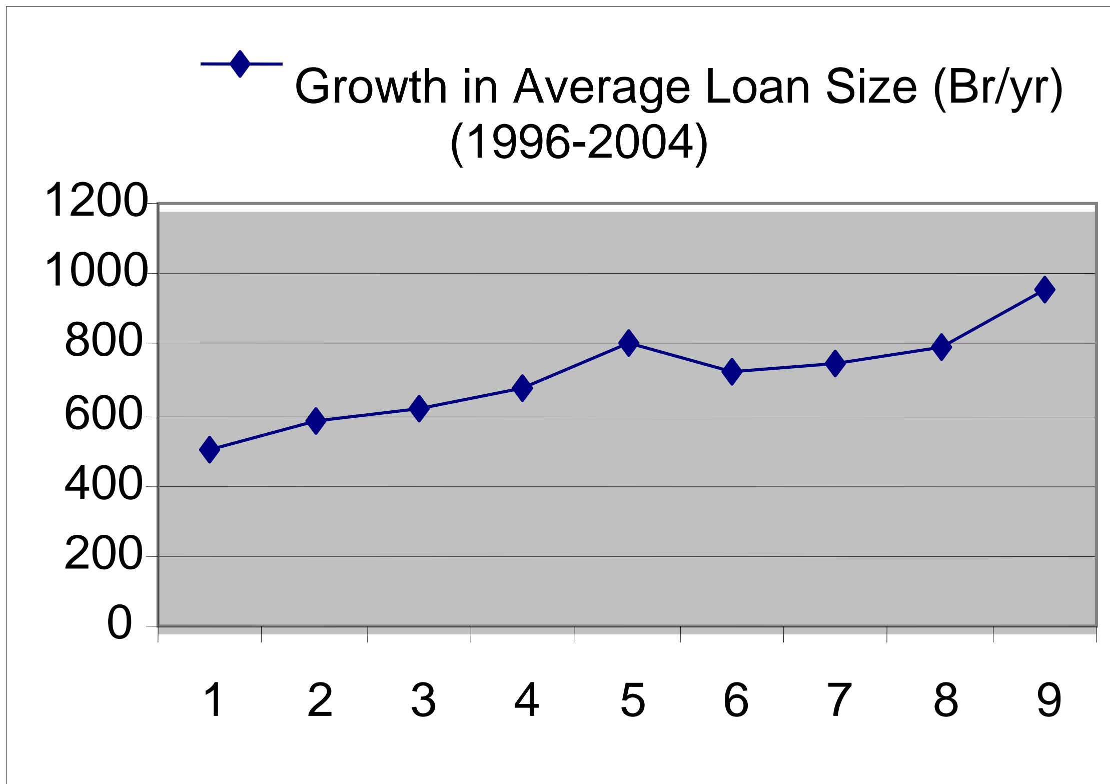
Access to the nearest other market is blocked due to the very poor infrastructure, particularly the *road network*. Many of the rural areas are inaccessible in the rainy season, making development of internal markets very difficult. Only a fraction of the Region's population is located with-in a 10 kilo meter range of an all weather road. For instance, results of the recent socio-economic survey indicate that only 57% of farmers are within a 2 hours walk distance to any all weather road. Inefficient transport undermine the price received by producers, making the price spread (the difference between price received by producer and price paid by the consumer) very wide. (See: Amhara National Regional State (2004). Moreover, the *market infrastructure* is generally poor. The income level, and therefore the purchasing power in rural areas is very low. Production does not always cater specifically to what this small market demands. The business and marketing skill is non-existent on the part of the client. Due to underdeveloped market information services (through Cooperatives….) production usually focus on traditional few activities. Covariant as well as idiosyncratic risks therefore abound, both for the institution as well as for the clients themselves. Similar products are offered on the small market, which easily saturates. The provision of these public goods also increases the repayment capacity of potential borrowers, by facilitating access to markets for inputs and for outputs.

Client Business' Absorptive Capacity

On the clients end, the most practical problem faced by MFIs is the very *low absorptive capacity* of the majority poor in rural areas, greatly constraining the potential positive impacts of access to microfinance programmes. Many rightly argue that credit alone, without the necessary infrastructure to enhance the skill capacity of the potential borrower, would often end up without achieving the intended goal of enabling the poor get out of poverty. This might sound more true given the objective reality in the rural areas of the region. In the case of very poor economies with poor infrastructural facilities of all kinds, two relevant issues emerge:

a) Credit <u>alone</u> tends to be used to increase the *scale* of existing activities rather than to move into new, more sophisticated or higher value added areas. It was unusual for credit to trigger a continuous increase in technical sophistication, output or employment: it was much commoner for each of these variables to reach a plateau after one or two loans and

remain in a *steady state*[22]. Having been in operation for the last 9-10 years, and with a clear policy allowing for a loan size progression of individual enterprise (+100%, 75%, 50%, 25% additions from the 2nd loan cycle onwards), the average loan size still stagnates at about Br. 1000 (See Graph).



b) One of the principal reasons for the lack of innovation and sustained growth among the clients of minimalist (credit-only) credit schemes is that producers are often poorly represented among them. Commonly, lenders' portfolios are dominated by those involved in trade and in simple food-production and -processing activities, where the scope for innovation and qualitative improvements in techniques is limited. Over 58% and 35% of ACSI portfolio are invested in ***small-holder*** agriculture (mainly operating very small land, purchase of oxen, traditional sheep rearing and other livestock) and petty trade, respectively. Average land holding is already constrained, and cannot be expanded.

The ***agricultural extension*** scheme, cover only a small portion of the total farmers in the region. Thus, despite all the efforts, the area applied with fertilizer is just 33% of cultivated land, while the area under irrigation and improved seed is just 1.7% and 2.72%

---

[22] Jonatan Dawson with Andy Jeans (1997): Looking Beyond Credit: Business development services and the promotion of innovation among small producers, Intermediate Technology [p: Summary]

respectively. (See Amhara National Regional State, 2004). The recent effort to utilize water harvesting technologies as well as other animal packages to enhance food security at house-hold level are very welcome, but again the implementation requires strict monitoring and follow-up to effectively integrate the activities of the sectors. There is apparently almost no institution giving such ***BDS services*** to a sufficient scale that can respond to all the demands of the poor. New institutions destined to address such demands as Regional Micro and Small Enterprise Development Agency (REMSEDA), etc are just getting established. The supply side arrangement is not so strong so far.

On the demand side, many clients, as can be expected, are very much *risk-averse* that even with the availability of credit and BDS service, they do not like to venture into activities other than those inherited from their fathers or for-fathers. In a recent interview of about 300 clients, over 78% responded that they only want to be engaged in activities that they know something about previously. Similar responses have been obtained from micro-finance clients in Tigray region, Adigudom (See Fiona, 2001).

The Culture Problem

There is also the problem of *cultural bias* towards some activities. The tendency (and the attendant competition for resources) is often to get on with such activities as agriculture, trade, etc, which are somehow free from cultural taboos. Some non-traditional activities which could provide alternative employment opportunities (like blacksmithing, weaving, tannery, pottery, embroidery, other handicrafts, etc…) are rather frowned at, and not easily taken up by clients. Experience suggests that they offer many advantages: they employ indigenous technology/local input, they are not land-based and are environmentally friendly. They enjoy less competition and are otherwise much more rewarding -- the data indicates that there is a statistically significant difference in profitability between these activities than traditional ones like agriculture. Yet, as indicated above, the total loan that went to finance such activities is less than 5%.

Demand for financial services also remains constrained for some cultural specificities. In some localities, for example, Muslims do not take credit or save in banks or microfinance institutions because paying or receiving "interest" is forbidden by religion. According to Muslim scholars, if someone indulges in trading (undertakes risk), the profit earned on it will be permissible. But earning money by the act of loaning is *haram*[23] (in discord with

[23] Thus, most Islamic banking strategies have tried to remove all forms of fixed nominal interest rates. But the abolishment of fixed interest rate does not mean that no remuneration is paid on capital. Profit making is acceptable in Islamic society as long as these profits are not unrestricted or driven by the activities of a monopoly or cartel. Islam deems profit, rather than interest, to be closer to its sense of morality and equity because earning profits inherently involves sharing risks and rewards. Profit-making addresses the Islamic ideals of social justice because both the entrepreneur and the lender bear the risk of the investment…... But for some, although Islamic financial practices are founded on the core belief that money is not an earning asset in and of itself, there is more to the system's underlying tenets. Islamic religious law – that is, sharia – emphasizes ethical, moral, social, and religious factors to promote equality and fairness for the good of society as a whole which derives from the wider context of Islamic attitudes towards ethics, wealth distribution, social and economic justice, and the role of the state. Principles encouraging risk sharing, individual rights and duties, property rights, and the sanctity of contracts are all parts of the Islamic code underlying the banking system. In this light, many elements of microfinance could be considered consistent

the Islamic code) (See Dhulmale and Sapcanin, 1999). This is more so particularly in the Muslim dominated areas of Oromia Zone in Amhara region, as well as in parts of south Wollo.

A related and more problematic issue is also the ***low income perspective***[24] that prevail among most dwellers in many rural areas. Thus, after getting the additional ox that has been set as a target, most would stop asking for more loan or only take a small amount.

The Women Issue

The role microfinance plays in-terms of empowering individuals with respect to increasing control over resources, increasing saving, self-esteem, orientation towards the future, etc. leaves much to be desired. Generally, empowerment as a development strategy approach for women involves two levels: *intrinsic* and *extrinsic*. The extrinsic level refers to gaining greater *access* and *control* over resources. On the other hand, the intrinsic level involves changes from within, such as the rise in *self-confidence*, *consciousness* and *motivation*. It recognizes women's triple roles (i.e., as wife, mother as well as businesswoman) and seeks to meet strategic gender needs through bottom-up participation on resources and development issues that concern the life of women.

Credit and saving programmes in particular are geared towards the promotion of off-farm activities by rural women. These programmes are implicitly or explicitly based on the assumption that rural women are conversant with non-farm income generating activities, have sufficient time and labour to expand traditional, or start new, income generating activities. As suggested above, one of the important issues relevant for gender-focused policy interventions is the question of how rural women manage to actively engage in off-farm activities *on top of* their demanding roles in agricultural production and domestic labour. Here in lies the appropriate channel to identify the potentials and constraints rural women face regarding gender-focused rural intervention, especially those relating to saving and credit schemes. There are practical problems in this regard.

We can discuss some important issues related to *shortage of time* women face. Generally, most domestic tasks such as grinding grain and food processing, water and fuel wood collection are known to be highly arduous, labour-intensive and time-consuming. And this applies to many women in developing countries in general. The burden of women in Ethiopia is compounded by the fact that labour saving "appropriate" technology is largely unknown even by the standards of developing countries. Access to clean water, grain mills, roads, energy saving devices, etc., is extremely limited. Some Ethiopian authors take the issue a bit further to argue the burden on women as relating to some cultural factors. Dejene (2000), for one, noted that Ethiopian rural women face significantly

---

with the broader goals of Islamic Banking. Both systems advocate entrepreneurship and risk sharing and believe that the poor should take part in such activities. At a very basic level, the disbursement of collateral-free loans is an example of how Islamic banking and microfinance share common aims. (See Dhulmale and Sapcanin, 1999).

[24] See also the Federal Democratic Republic of Ethiopia (2002): *Rural Development Strategies, Policies and Instruments* paper.

higher domestic labour burden (especially in the areas of food processing and cooking) than their counter parts in most of sub-Saharan Africa[25].

As we have outlined above, there is also a serious problem of *marketable skill* in rural areas. There are no institutions providing such opportunities of skill development for the needy. Those that exist tend to concentrate in semi-urban areas, and often such opportunities are snatched by men. Thus, when it comes to skill acquisition, women are more ill-equipped than their male counterparts. The survey indicated that women generally took smaller loans, and their profit margin is much lower. Women have to go a long way to be able to be good business managers themselves.

Yet, not all loan destined to women is utilized by themselves. To encourage more women participation in business, ACSI has a target of delivering at least 50% of the credit service to women, which seems to have been attained. However, whether they are actually making use of the loan themselves, thereby improving their business skill and their *breakdown position*[26] is an issue requiring closer scrutiny. In fact, an additional area of concern, in terms of the impact of loans of the poorest, concerns *men's usurpation of loans* targeted specifically to women[27]. In a recent survey, the above issue has been directly posed to married women respondents. It is interesting to note that only less than 40% said that they themselves manage the loan, the rest either used it "jointly" with or totally hand it over to their male counterparts.[28] Yet, it seems that the mere fact that they are the sources of the credit access have improved their empowerment at least at the household level.

4. CONCLUSION & RECOMMENDATIONS

[25] Dejene hypothesizes that this is partly due to the sophisticated and labour intensive nature of domestic production arising from Ethiopian Highland *culinary culture*. For example, *teff* (the favorite food grain in Northern highlands) is not only labour intensive in its cultivation but also the preparation of *injera* out of *teff* is an equally labour and energy (fuel) intensive process. The preparation of home made spices (e.g., red pepper) is similarly a labour intensive task.

[26]Women's relative well-being depends on the relative bargaining power of the spouses. The bargaining power, in turn depends on the individual's *breakdown position,* which represents the welfare level which individuals (husband or wife) would have to face if this cooperation, or marriage, eventually breakdown (See Lutfun N. Khan Osmani 1998: p.32)

[27] As such increased income may come at the cost of depletion of other valued resources such as time, health and general well-being. Moreover, accepting that there may be many positive impacts of increased incidence of earnings among women, such as more autonomy and personal power, not to mention reduced poverty, this does not necessarily apply where women's wages remain low, or they are pressurized into surrendering their earnings to fathers, husbands, or other relatives. In turn, the market value of women's work may not be particularly important to women themselves compared with other aspects of their employment which, in a given social and cultural context, may be strongly valued at a personal level, such as modesty, respect, acceptability to husbands and kin, job fulfillment and/or the ability to reconcile paid work with childcare. (See in Sylvia Chant (2003)

[28] Similar impact study of credit programmes on women carried out on four credit programmes in Bangladesh: the Grameen Bank, BRAK, a large government scheme (the Rural Poor Programme RD-12), and a small NGO (Thangemare Mahila Senbuj Sengstha) by Goetz and Sen Gupt (1995) suggest that women retained significant control over the use to which the loan was put in 37% of cases; 63% fell into the category of "partial", limited or no control over loan use. Furthermore, women were found to have greater control over small loans made for purposes which did not challenge the *existing gender division* of labour (See Johnson & Rogaley (1997), p.13

Some broad conclusions and policy recommendations can be drawn from the above discussion. At policy and regulatory level, the Ethiopian government has established a good framework early-on that has helped to lay out the roadmap for the development of the industry. Subsequent improvements remove some of the key regulatory problems faced by the industry. But more needs to be done to enhance supply, including capacity improvement by those actually delivering the service. Equally important measures are needed to awaken "legitimate" demand.

- ***Charity-oriented NGOs involved in micro-finance*** The NBE has removed a number of obstacles in its directives for smooth operation of rural financial intermediation. Effective supervision and monitoring of the smooth implementation of those rules is a must. Thus, Charity-oriented NGOs involved in micro-finance, and without a license are damaging the industry. Often, their system of lending involves some irregularities including subsidized interest rate, mixing business with charity and not following strict business discipline in the treatment of delinquency etc, which would make clients dependent on such operations and would potentially endanger the healthy operation of the industry.

- While the ***interest rate ceiling*** on credit has been removed, a minimum on interest to be paid for savings persists, hampering savings mobilization in remote rural areas. Given the risky situation of life in rural areas, the demand for saving services is indeed high. Saving mobilization in these areas should be encouraged very much, with no restriction like setting a ceiling on interest, not only to generate capital for investment, but also to help the poor the mechanism to smooth consumption and improve the vulnerability condition.

- ***Diversifying the lending methodology*** away from the current "group methodology" into others like village banking and possibly to individual lending may help, for the group lending on the one hand tends to ignore the very poor, and on the other hand, have no room for those who can borrow on individual bases.

- ***Trained Manpower***: The need for developing suitable financial products that satisfy the growing and diversified need of clients, introducing reasonable flexibility in the terms and conditions of existing products, as well as providing services expected of a micro-bank, requires more adequately qualified and *trained manpower* at all level than is currently available. However, the current capacity, in terms of the size as well as the quality of manpower, is not such as to effectively discharge such increased responsibility in the industry. This needs an immediate action, alongside with establishing a clear *incentive system* for staff.

- ***Rural infrastructure***, particularly the road net-work needs special attention by government and others for a healthy microfinance operations. Given that the poor are largely involved in few enterprises, the risk is indeed high if similar products cater only for the small market nearby, which easily saturates, diminishing potential profitability. Relevant *market information* and networks are also vital.

- ***Expand BDS service***: Credit must, above all, be accompanied by some kind of marketable skill development, which the poor seriously lack. Credit alone can only increase the "*scale*" of existing activities rather than enabling the poor to move into new or higher value activities. Some kind of *cultural transformation* may also be called for at this particular juncture in order to change the attitudes of some otherwise poor people who are reluctant, for cultural reasons (including religion), to engage themselves in non-traditional activities which are much more rewarding indeed.

- ***Women*** are "allocated" some portion of the credit, but a good portion of it is destined to their male counterparts, violating the institutional objective. This partly has to do with the fact that women are still highly handicapped with lack of any business skill, much more than their male counterparts. On the other hand, however, this may have also to do with the "wrong assumptions" that planners of micro-finance services had on the *available time* that women have. Planners forget that women are fully engaged in domestic works through out the day, and have little to afford for such business activities. Appropriate *labour saving technologies* is largely unknown even by the standards of developing countries. For microfinance to have its intended positive impact on the lives of poor women, these infrastructural problems need to get enough attention.

- ***Credit With Education*** The delivery of credit and saving services alone cannot be sure way out of poverty for the majority poor. Thus, initiating strategic alliance between, among others, the mutually supportive but operationally separate activities of micro-finance and health education (family planning…) services would allow each to do what it does best, yet benefit from each other activities.

BIBILIOGRAGHY

AEMFI: Review of Microfinance Industry in Ethiopia: *Regulatory Framework and Performance*, Occasional Paper No.2, Aug. 2000

ACSI (2001): *Institutional Profile, Current Status and Future Strategy,* May 2004, Bahir-Dar .

Amha, Wolday (2003): *Microfinance in Ethiopia: Performance, Challenges and Role in Poverty Reduction*, AEMFI Occasional Paper No. 7.

Amhara National Regional State (2004): *Agricultural Marketing Study*, Bahir-Dar, Ethiopia.

Bigsten, A., B. Kebede, A. Shimeles and M. Tadesse (2003) '*Growth and Poverty Reduction in Ethiopia: Evidence from Household Panel Surveys' World Development* 31(1): 87-106.

CGAP (2004)(a): *Financial Institutions with a "Double Bottom Line": Implications for the Future of Microfinance*, Occasional Paper, No. 8.

--------- (2004)(b): *Scaling Up Poverty Reduction: Case Studies in Microfinance*, Washington, DC.

--------- (2005): *Managing Risks and Designing Products for Agricultural Microfinance: Features of an Emerging Model* (Ocasional Paper No. 11).

Chant, Sylvia (2003): *New Contributions to the analysis of poverty: methodological and conceptual challenges to understanding poverty from a gender perspective*, United Nations, Women and Development Unit, Santiago, Chile)

Chao-Beroff, Renee; Woldy Amha, Tesfaye Mengesha, Yohanes Sefere and Kurunde Tesgera (2000): *Enhancing Rural Financial Intermediation in Ethiopia,* IFAD/World Bank.

Chen, Marta and Elizabeth Dunn (1996): *The Household Economic Portfolio* (AIMS) USAID.

Christen, Robert, Timothy R. Lyman and Richard Rosenberg, (2003): *Guiding Principles on Regulation and Supervision of Microfinance,* Microfinance Consensus Guidelines, CGAP, 2003.

Dawson, Jonatan Dawson with Andy Jeans (1997): *Looking Beyond Credit: Business development services and the promotion of innovation among small producers*, Intermediate Technology.

Dejene Aredo (1993): *The Informal and Semi-formal financial sectors in Ethiopia: A Study of **Iqub**, **Iddir**, and Saving and Credit Cooperatives*. African Economic Research Consortium, Nairobi, Kenya.

De Soto, Hernando (2003): *Hearing the Dogs Bark*, Finance & Development, People in Economics, December 2003.

Devereux, S. and K. Sharp (2003) '*Is Poverty Really Falling in Rural Ethiopia?*' *Paper presented at the Conference 'Staying Poor: Chronic Poverty and Development Policy'* at the University of Manchester.

Dhumale, Rahul and Amela Sapcanin (1999): *An Application of Islamic Banking Principles to Microfinance, Technical Note,* A Study by the Regional Bureau of Arab States, UNDP, in Cooperation with the Middle East and North Africa Region, World Bank.

Dunn, Elizabeth (1997): *Diversification in the Household Economic Portfolio*, AIMS, USAID.

ECI-Africa (2005): *Amhara Credit & Saving Institution*; USAID AMAP Financial Service Knowledge Generation – State Owned Retail Banks.

Federal Democratic Republic of Ethiopia (2002?): *Rural Development Strategies, Policies and Instruments*, Addis Ababa, Ministry of Information.

------------------------ (Aug. 2001) *Food Security Strategy,* Addis Ababa.

------------------------ (Nov. 2000): *Interim Poverty Reduction Strategy Paper (2000/1-2002/03)*, Addis Ababa.

------------------------ (July 2002): *Ethiopia: Sustainable Development and Poverty Reduction Programme*, Addis Ababa, Ministry of Finance and Economic Development.

Getaneh Gobezie (2004) *Microfinance Development: Can Impact on Poverty and Food Insecurity be Improved Upon?*' Paper presented at the 'International Conference on Microfinance Development in Ethiopia' organized by AEMFI, Awassa, Ethiopia

----------------------(1999): *Measurements and Determinants of Rural Poverty: A Comparative Analysis of Three Villages*, Unpublished M.Sc Thesis, Addis Ababa University, Addis Ababa.

Giovannucci, Daniele; Panos Varangis and Don Larson (1999): *Warehouse Receipts: Facilitating Credit and Commodity Markets*, World Bank.

Gonzalez-Vega, Claudio (2003): *Deepening Rural Financial Markets: Macroeconomic Policy and Political Dimensions*, Ohio State University

---------------------------------- (1998): *Microfinance: Broader Achievements and New Challenges*.

Hashemi, Syed (1997): *Building up Capacity for Banking with the Poor: The Grameen Bank in Bangladesh*, in Hartmut Schneider (eds): Microfinance for the Poor? OECD/IFAD.

Honohan, Patrick (2004): *Financial Sector Policy and the Poor: Selected Findings and Issues*, World Bank Working Paper No.43.

IFAD (2001): *Ethiopia: Rural Financial Intermediation Programme (RUFIP) -- Formulation Report*, Working Paper 1: The Micro-finance Sub-sector, Annex XII: Rural Women and Financial Intermediation: Background Paper for Rural Financial Intermediation Programme (RUFIP)

Institute of Development Studies (2003): *Microfinance, Poverty and Social Performance*, IDS Bulletin, Vol. 34, No 4.

--- (1998): *Microcredit: Impact, Targeting and Sustainability*, IDS Bulletin, Vol. 29, No 4.

Inter-American Development Bank (2001): *Rural Finance Strategy*, Sustainable Development Sector Strategy and Policy Paper Series, Washington, D.C

------------------------- (2001): *Lessons Learned in Rural Finance: The Experience of The Inter-American Development Bank*, Sustainable Development Sector Strategy and Policy Paper Series, Washington, D.C

Johnson and Rogaly (1997): *Microfinance and Poverty Reduction*, (??)

Kabeer, Naila (1997): *Tactics and Trade-Offs: Revisiting the Links Between Gender and Poverty,* IDS Bulletin Volume 28, No. 3, July

Khandker, Shahidure 1998: *Microcredit Programme Evaluation: A Critical Review*; in IDS Bulletin: Micro-credit: Impact, Targeting and Sustainability; Vol.29, No.4, Oct. 1998.

Lipton M. and Ravallion M. (1993); "*Poverty and Policy*", World Bank Working Paper, No.1130, The World Bank, Washington DC.

Mehan, Fiona (2001): *Usage and Impacts of Micro-credit Provision: A Case Study Based on the credit Operations of the Dedebit Credit and Saving Institutions (DECSI*), Tigray. Mekelle University.

Morduch, Jonathan (1999): *Between the State and the Market: Can Informal Insurance Patch the Safety Net?* The World Bank Research Observer, Volume 14, No. 2.

Morduch, Jonathan, Barbara Haley (2002): *Analysis of the Effects of Microfinance on Poverty Reduction*; NYU Wagner Working Paper No. 1014.

Nagaranjan, Geetha and Richard L. Meyer (2005): *Rural Finance: Recent Advances and Emerging Lessons, Debates, and Opportunities*. Reformatted version of Working Paper AEDE-WP-0041-05, Department of Agricultural, Environmental, and Development Economics, The Ohio State University (Columbus, Ohio USA).

OECD/IFAD (1997): *Microfinance for the Poor*? Paris

Osmani, Lutfun N. Khan (1998) *Impact of Credit on the Relative Well-Being of Women: Evidence from the Grameen Bank*, in IDS Bulletine: Micro-credit: Impact, Targeting and Sustainability; Vol.29, No.4, Oct. 1998

Ravallion, Martin (1992); *Poverty Comparisons, A Guide to Concepts and Methods*; World Bank, LSMS Working Paper 88.

Rutherford, Stuart (1999): *The Poor and Their Money*, Institute of Development Policy & Management University of Manchester.

________________ (2002?): *The Economics of Poverty: How Poor People Manage Their Money*. *Safe*Save Bangladesh.

Sebstad, Jannefer (2002): *A Short Study on Microfinance in Ethiopia* (Study prepared for SIDA), Addis Ababa.

Sebstad, Jennefer and Monique Cohen (2000): *Microfinance, Risk Management, and Poverty:* Synthesis Study Based on Field Studies Conducted by Ronald T. Chua, Paul Mosley, Graham A. N. Wright, Hassan Zaman.

Schmidt, R.H and Erhard Kropp; 1987: *Rural Finance: Guiding Principles,* Eschborn, Germany.

Snodgrass, Donald R. and Jennefer Sebstad (2002): *Client in Context: The Impacts of Microfinance in Three Countries Synthesis Report*. (AIMS).

UNHCR (2002): *A Human Rights Approach to Poverty Reduction Strategies – Draft Guidelines*, Geneva, Switzerland.

UNOSCAL (2000): *Microfinance in Africa: Combining the Best Practices of Traditional and Modern Microfince Approaches Towards Poverty Erradication*

World Bank (2003): *Rural Finance Services: Implementing The Bank's Strategy To Reach The Rural Poor*, Agriculture & Rural Development Department, Rural Private Sector, Markets, Finance and Infrastructure Thematic Group, Washington, D.C.

----------------(2001): *World Development Report 2000/2001-Attacking Poverty*, Oxford University Press.

World Bank Group (2001): Fourth edition; p: 42 *Poverty Trends and Voices of the Poor*: Poverty Reduction and Economic Management, Human Development, Development Economics.

Wright, Graham A.N., Deborah Kasente, Germina Ssemogerere and Leonard Mutesasira (1999): *Vulnerability, Risks, Assets and Empowerment -- The*

Impact of Microfinance on Poverty Alleviation; Contribution to World Development Report 2001.

Zeller, Manfred (2004): *Review of Poverty Assessment Tools,* Report Submitted to IRIS and USAID as part of the Developing Poverty Assessment Tools Project.

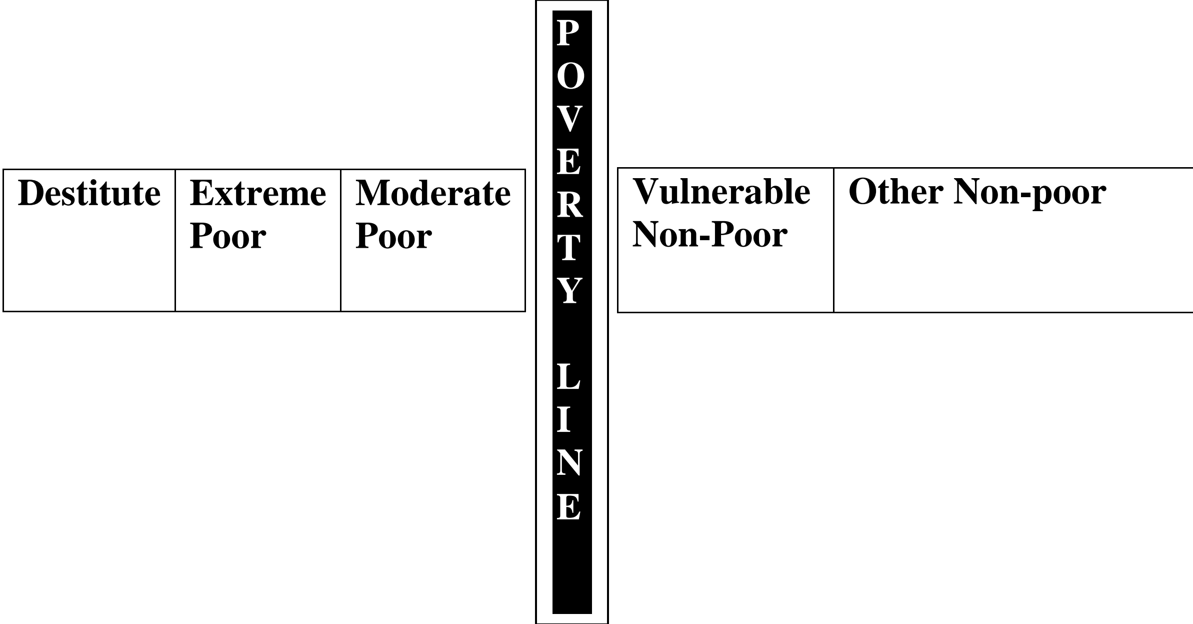
ANNEXES

Checklist of Sustainability Potentials in Microfinance Interventions	
Traditional Approach (Low Potential)	**Modern Approach (High Potential)**
1. Project Approach and Design/Household Level	

-Overemphasis on credit -No demand assessment for Financial Services -Dependence on external assistance and subsidy -High external technical assistance -Top down approach without market orientation -Without involvement of "beneficiaries" -Projected long-term hypothetical incremental income -High recurrent cost and low or no viability -Insincer support and low risk aversion -Complex external technology -Operating under complex alien norms -Without or against legitimate leadership -Complex project orientation -Legal insecurity	-Mobilization of indigenous financial resources -Professional demand assessment for Financial Services -Viability of project interventions at all levels -High indigeneous human resource mobilization -Demand, market and customer orientation -Village-based genuine co-operative approach -Planned short-term secure incremental income -Cost-effectiveness and high viability -Professional support and high risk aversion -Improved local and appropriate technology -Operating under transparent legitimate norms -Under legitimate leadership -Simple and transparent project orientation -Legal security -Disinct project M&E, control and audit
2. Participating Financial Institutions	
-Subsidised, directed and limited services -Overburdening of Participating financial institutions through project credit -Government controlled institutions -High transaction cost (operation & risk) -Low productivity and low motivation -Low financial performance (CAMEL) -Lack of cost effective retailers/intermediaries -Credit based on project models -Inadequate management information and control -Erratic and unprofessional audit	-Viable and customer-oriented services -Capacity adequate participation of Financial Institutions -Private sector institutions -Low transaction costs (operation & risks) -High productivity and high motivation -High financial performance (CAMEL) -Involvement of cost-effective intermediaries -Credit based on character and capacities -Adequate management information and control -Regular and professional audit
3. Macro-Policy Environment	
-Inefficient political commitment/responsibility -Centrally planned economy -Low subsidiarity/centralized decision making -Negative and subsidized interst rates -Ineffective regulation and supervision of financial institutions -Limited government/project accountability	-Firm political commitment/responsibility -Pluralist and market oriented policies -High subsidiarity/deligated political authority -Positive and cost-covering interst rates -Effective regulation and supervision of financial institutions -Clear government/project accountability
Source: Rauno Zander (1997): ***Integrating the Poor into the Rural Financial Mainstream: Issues and Options*** **in: Micro-finance for the Poor? OECD/IFAD.**	

Figure

Defining Poverty



ONE OX

The Household Economic Portfolio Model