REVIEW OF MICROFINANCE INDUSTRY IN ETHIOPIA: REGULATORY FRAMEWORK AND PERFORMANCE

Occasional Paper No. 2

Wolday Amha (Dr.)
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I. Introduction

Ethiopia has an estimated population of 60 million. Agriculture is the mainstay of the economy and approximately 85% of the country's population live in the rural areas. Ethiopia is ranked 169 of 174 countries on the human development index. About 45% of the population in Ethiopia are reported to live below poverty line (Getahun Tafesse, 2000).

Poverty and food insecurity are the main challenges and fundamental issues of economic development in Ethiopia. According to an appeal made by the Government of Ethiopia at the beginning of the year 2000, the estimated drought-affected people requiring food aid were about 8 million. The major causes of low economic growth and high incidence of poverty in Ethiopia include lack of income, assets, employment opportunities, skills, education, health and infrastructure. These problems have been aggravated by soil degradation, deforestation, recurrent drought, civil war, and inappropriate policies.

To address the issues of development and food insecurity, the Federal Government of Ethiopia has implemented development programs such as the New Extension Program to increase agricultural production and productivity and the Federal and Regional Food Security Strategies designed to increase food and agricultural production, improve food entitlement and strengthen the capacity to manage food crises. Other sectoral development policies such as health, education, population, natural resources, monetary and fiscal policies have the objectives of addressing problems of food insecurity and poverty alleviation.

Development of microfinance in Ethiopia should be viewed as (a) an identification of considerable levels of unrealized demand and potential market growth for financial services and (b) a shift by the NGO sector and government from relief assistance to sustainable development which intersects at the point of institutionalization of microfinance provision (Fiona, 1999). Interventions through the delivery of microfinance services have also been considered as one of the policy instruments of the
Government and Non Government Organizations (NGOs) to enable rural and urban poor increase output and productivity, induce technology adoption, improve input supply, increase income, reduce poverty and attain food security. The establishment of sustainable microfinance institutions that reach a large number of rural and urban poor who are not served by the conventional financial institutions, such as the Commercial Banks, has been a prime component of the new development strategy of Ethiopia.

Although the development of microfinance institutions in Ethiopia started very recently, the industry has shown a remarkable growth in terms of outreach particularly in number of clients. Since the issuance of Proclamation 40/1996, which provides the establishment of microfinance institutions, sixteen microfinance institutions (MFIs) have been legally registered by the National Bank of Ethiopia (NBE) and started delivering services, and two more applications by new MFIs are currently being processed.

1 Microfinance institutions are institutions that provide suitable financial and other services using innovative methodologies and systems at low cost to meet the need of low-income sections of the population and act as financial intermediaries in a genuine sense.
According to the Microstart Project document of UNDP (1999), the economically active poor in Ethiopia who can potentially access financial services are about 6 million. Out of this, about 8.3% of the active poor have gained access to the licensed microfinance institutions. Despite the obvious disadvantages of the microfinance industry in Ethiopia such as poor communication and infrastructure, weak legal systems, banking sector and technical capacity when compared with other Sub-Saharan countries, the sector has been growing at a significant rate. The main objectives of this paper are to:

i) review the development of the microfinance industry in Ethiopia;

ii) assess the regulatory frameworks of the industry;

iii) analyze the performance of MFIs in Ethiopia; and

iv) identify problems and recommend interventions by the government and NGOs to improve access to financial resources by the poor.

The information on the performance section was generated through questionnaire distributed to MFIs. The rest of the data were collected through field visits and from secondary sources.
II. The Regulatory Framework for the Microfinance Industry and Micro and Small Enterprises

The delivery of efficient and effective microfinance services to the poor required conducive macro economic policies and the establishment and enforcement of legal and regulatory frameworks of a country. An effective financial system provides the foundation for a successful poverty alleviation program. Prudential financial regulation, according to Chaves and Gonzalez -Vega (1994), refers to general principles, or legal rules that aim to contribute to stable and efficient performance of financial institutions and markets and ensure the safety and soundness of the system. However, regulations in the microfinance industry does not only mean government regulations; it also involves self-regulations and code of conducts introduced by networks or associations.

Regulatory frameworks governing the microfinance industry should ensure that the MFI has a sound portfolio performance; low delinquency or default rate;

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1 Prudential financial regulation according to Chaves and Gonzaliz - Vega (1994) has three major objectives (i) ensure the solvency and financial soundness of all intermediates; in order to project the stability of the country's payment system (ii) provide consumer (for example depositor) protection against undue risks that may arise from failure, fraud, or opportunities behavior on the part of the suppliers of financial services and (iii) promote the efficient performance of institutions and markets and the proper working of competitive market forces.
high diversification to reduce the risk of specializing in the
delivery of oneloan product; ensurethesafetyof
deposits through equity capital; ensure lower levels of liquidity risk; provide regular and high quality financial information and reduce the risk arising from dependence on subsidy and influence of donor.

There are numerous policies, laws and directives which affect the development of microfinance industry and micro and small enterprise development in Ethiopia. An attempt is made here to review only the most relevant and recent policies affecting the industry. The Monetary and Banking Proclamation No. 83/1994 empowered the National Bank of Ethiopia (NBE) to license, supervise and regulate financial institutions such as banks, insurance companies, microfinance institutions and savings and credit cooperatives. The Licensing and Supervision of Banking Business Proclamation No. 84/1994 allowed for the first time the establishment of private financial institutions, thus breaking the state monopoly. To date, six private banks and eight private insurance companies have been established.

Since micro-credit delivery and savings mobilization in Ethiopia were performed by NGOs, government departments, cooperatives and others in a fragmented
and inconsistent way, the government took the initiative to establish the regulatory framework in order to facilitate sound development of the microfinance industry. Proclamation No. 40/1996 which aims to provide for the licensing and supervision of the business of microfinancing clearly indicates the requirements for licensing microfinance institutions by empowering the National Bank of Ethiopia to license and supervise them (see Annex 1 for details). According to the Proclamation, any institution that needs to engage in microfinance activity should fulfill the following:

i) obtain license from the National Bank of Ethiopia;

ii) form as a company governed by the commercial code of 1960 (a share company owned fully by Ethiopian nationals and having its head office in Ethiopia); and

iii) deposit the minimum capital required, i.e., 200,000 Birr in a bank.

The National Bank of Ethiopia has also issued 12 directives, which have been consistent with Proclamation No. 40/1996. These included setting a loan ceiling of 5,000 Birr and a loan duration of one year. The interest rate has been waived and MFIs are now free to set their own interest rates ceiling. There is also a requirement for re-registration once an MFI mobilizes deposits greater than one million Birr.

The regulatory framework has affected the welfare-oriented NGOs in Ethiopia which focus on welfare programs by providing free or subsidized micro-credit services. They tend to provide
credit services at very low interest rate (below market interest rate) focusing on the poorest of the poor (based on humanitarian reasons) rather than on sound credit management principles. As a result, many of the NGOs, providing micro-credit services in Ethiopia, are in a transition from highly subsidized credit programs to a finance based system. Although the initial reactions of the NGOs in Ethiopia to the implementation of the regulatory framework (Proclamation No. 40/96) were negative, they have now realized that the regulatory framework has institutionalized and unified microfinance services in the country.

The required minimum paid-up capital payment for MFI in Ethiopia (about 25,000 US Dollars) is low and affordable. The recent full liberalization of lending interest rates is also a positive development towards implementing an operationally sustainable strategy for MFIs. This assists to adequately price small-scale and risky loans and microfinance operations.

The government has recognized the importance of micro-enterprise development to the overall economic growth of the country and poverty alleviation. It has established the Micro and Small Enterprise Development Agency to co-ordinate and support this sector. According to Proclamation No. 33/1998, the Agency shall be involved in designing policies and strategies for the development and expansion of the micro and small enterprise; study the demand for training and conduct training; establish skill upgrading, technical and demonstration centers in different regions of the country; and disseminate information to the entrepreneurs. However, these enterprises require adequate flow of institutional credit to finance both short-term operating expenses and long-term investment needs.
In addition to addressing poverty and food security issues, micro-enterprises teach the poor new skills and help them generate greater savings for investment and promote inter-sectoral linkages. According to a survey by the Central Statistical Authority (CSA) in 48 towns in 1997, there were 584,813 micro-enterprises and 2,731 small-scale enterprises in Ethiopia employing over 739,898 workers.

The main constraints of micro and small enterprises include lack of finance, business information, business premises, skills and managerial expertise, access to appropriate technology, lack of adequate infrastructure and in some instances discriminatory regulatory practices (Ministry of Trade and Industry, 1997). In the Ethiopian context, and in terms of partially solving the problem of financial resources, the agency has to integrate its activities with the microfinance industry.

The Federal Government of Ethiopia has produced the Micro and Small Enterprises Development Strategy to address the above problems and create an enabling environment for the growth of these enterprises. It has identified criteria and prioritized the target beneficiaries of the support program. The support program will consider those micro and small enterprises using local raw materials and/or labor intensive technologies, having greater inter-and intra-sectoral linkages; potentially competitive and have objective of exporting their products; and those engaged in facilitating and promoting tourism. The support program focuses on creating an enabling legal framework; streamlining existing regulatory conditions; facilitating access to finance; training in entrepreneurship, technical and management skills; facilitating access to market, raw materials and fostering partnership; and facilitating the availability and access to adequate infrastructure.
Proclamation No. 83/1995 provides for the establishment of primary and secondary agricultural cooperatives on voluntary basis and democratic principles. One of the objectives of the new Proclamation 147/1998, (Co-operatives Societies Proclamation) is to develop and promote saving and credit services for members to participate actively in the free market economic system. There were about 670 savings and credit co-operatives in June 1998 with outstanding loans totaling 155 million Birr and 167 million Birr of savings from 150,468 members.

III. Implementing, Monitoring and Evaluating the Regulatory Framework of the Microfinance Industry

The process of policy formulation, implementation, monitoring and evaluation is, by and large, the same whether it refers to the policy formulated at macro or micro levels. It applies equally to policies formulated by the government, a particular private firm or by an NGO. Just as in a project, the formulation, implementation and monitoring process of financial policy, or any development policy, should follow a defined path. The process starts with the identification of financial policy constraints impending the achievement of the stated objectives. This is then followed by the analysis of the constraints, formulation of alternative financial policy options or remedial measures, appraisal and approval, implementation and finally monitoring and evaluation of the effects and impacts of the financial policies of the regulatory framework of the microfinance industry. We can call this the financial policy cycle instead of the project cycle.

The search for appropriate change in the regulatory framework and identifying the problems starts when the stated government objectives and targets fail or are failing. The need for financial
policy reform or change could also start when concerned
government
departments (such as the National Bank of Ethiopia) or
stakeholders realize that existing regulatory frameworks are
having unanticipated negative consequences. The identification
of a financial policy reform for the microfinance industry and
designing appropriate policy options could start when one of the
following situations or a combination of these occur.

i) When the Ethiopian government itself, the National Bank
of Ethiopia or the Prime Minister’s Office believes that
the envisaged financial policy objectives and targets are
not met or realized.

ii) When the government, with an external pressure e.g.,
from the IMF or World Bank, considers that current
financial policies are not sustainable in the long term.

iii) When existing regulatory frameworks result in negative
consequences that were not envisaged or the effect has
been underestimated at the time of their conception.

iv) When the government realizes that there are better
financial policy options to bring about an accelerated
development in the microfinance industry.

v) When stakeholders such as the practitioners in the
microfinance industry demand a change in the current
policies or regulatory framework.

Thus, the possible identification of a change in the regulatory
framework of the microfinance industry could originate from (a)
government line departments; (b) multilateral and bilateral
donors; (c) organized and unorganized stakeholders such as the
practitioners in the microfinance industry; and (d) research
institutes acting as think tanks for policy analysis, financial
policy monitoring and evaluation.
In Ethiopia, there is no government department which follows up the overall development of the microfinance industry. Currently, there are no research institutes involved in microfinance development and policy research which recommend a change in the regulatory framework. There are attempts, however, by the Prime Minister's Office and the Ethiopian Economic Association to establish an Economic Policy Research Institute. In the Ethiopian context, multilateral and bilateral organizations do not have the mandate and responsibility of identifying and changing government policies through direct or indirect pressure. The last option to the microfinance industry is to use the network which is established with the objective of creating a forum to discuss policy issues and problems of the industry and share experiences. The Association of Ethiopian Microfinance Institutions (AEMFI) has created a forum to discuss and review the performance of the regulatory framework and monitor its impact.

The entry point for policy analysis in the financial sector in general and microfinance industry in particular is the review of existing policies with the view to understanding shortfalls and to assess the extent of overhauling or complete changes required. The analysis involves both quantitative and qualitative approaches.

The progress made in the implementation of the various activities related to policy reforms in light of the reform targets and schedule of achievements should be monitored regularly. Once the implementation of the financial policy is launched, the National Bank of Ethiopia, or stakeholder organizations such as AEMFI should review the progress of the implementation. The impact monitoring aspect involves measuring the qualitative and quantitative changes brought about as a result of the implementation of the regulatory framework of the microfinance industry. This should be compared against the objectives and
targets set for the industry. The National Bank of Ethiopia with full participation of the stakeholders should undertake such impact evaluation or policy monitoring regularly. This involves highlighting the progress so far registered, problems encountered, measures taken, recommendations made for remedial measures, resources required etc. The author believes that the network (AEMFI) will facilitate a holistic, transparent, participatory and inclusive approach to policy implementation, monitoring and evaluation in the microfinance industry.

Moreover, as indicated earlier, regulation in the microfinance industry refers to a set of enforceable laws and rules. These rules could be enforced by government departments or associations of practitioners such as AEMFI, which, in the later case of the latter, is self-regulation. According to Stefan Staschen (1999), self-regulation by networks or associations can be useful if there is lack of interest, insufficient capabilities of government or inadequate knowledge of government authorities about the microfinance sector. In the Ethiopian case, there is already an established government regulatory and supervisory department under the National Bank of Ethiopia. What is suggested is to combine implementation of self-regulation by networks and government regulations, as the two approaches to regulate the microfinance industry are not mutually exclusive. Here self-regulation mainly involves drafting the code of conduct for the industry and developing performance indicators or self-rating system.
IV. Governance

Governance of MFI is a system that links the shareholders to the board, the management, the staff, clients, and the community at large (CGAP, 1997). A sound governance is fundamental in creating efficient and sustainable microfinance institutions.

The success of microfinance activities in Ethiopia is particularly affected by the availability of income of clients which directly depends mainly on crop harvest and the high risk due to drought. The fluctuations of product prices which are difficult to predict also affect the performance of MFI. Given the above circumstances, sound governance will play a vital role in the sustainability of MFIs. As a result of the above problems and the limited experiences of MFIs (where most of them are in transition from NGO-supported micro-credit activities to commercial financial services), the boards of MFIs who manage the managers have huge responsibilities.

As indicated in Table 1, the ownership of MFIs includes regional governments, local NGOs and individuals. Although many of the MFIs in Ethiopia are established as private share companies, the dividends are not distributed to shareholders. The entire resources (dividends) are to be utilized for the benefit of the target group i.e. the poor. Shareholders of Ethiopian MFIs are not investors in the sense of earning dividends. That is, there hardly exists private capital investment in the microfinance industry in Ethiopia. This implies that the microfinance industry is an unattractive investment opportunity. Getahun Nana (1999) indicated that the nominal shareholders may not have sufficient interest to control and guide the management of MFIs. Yet again, they may not be unwilling to provide capital quickly whenever the MFIs are in crisis due to
loose governance structure; this fact is the real challenge to MFIs in Ethiopia.
Table 1: Year of Establishment and Ownership Structure of Microfinance Institutions in Ethiopia

<table>
<thead>
<tr>
<th>Microfinance Institutions</th>
<th>Year of Establishment</th>
<th>Regional Government</th>
<th>Associations and NGOs</th>
<th>Individuals</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amhara Credit &amp; Savings Institutions</td>
<td>1995</td>
<td>25</td>
<td>25</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Dedebit Credit &amp; Savings Institutions</td>
<td>1994</td>
<td>75</td>
<td>75</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Oromia Credit &amp; Savings Institutions</td>
<td>1997</td>
<td>50</td>
<td>50</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Omo Microfinance Institution</td>
<td>1997</td>
<td>25</td>
<td>25</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Specialized Financial &amp; Promotional Institutions</td>
<td>1997</td>
<td>20</td>
<td>20</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Gasha Micro-Financing S.C</td>
<td>1998</td>
<td>62</td>
<td>62</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Wisdom Micro-Financing Institutions C.</td>
<td>1998</td>
<td>10</td>
<td>10</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Addis Micro-Financing Institutions C.</td>
<td>1998</td>
<td>97</td>
<td>97</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Africa Village Financial Services C.</td>
<td>1998</td>
<td>15</td>
<td>15</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Addis Credit and Savings Institutions C.</td>
<td>1999</td>
<td>10</td>
<td>10</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Meeket Microfinance Institutions C.</td>
<td>2000</td>
<td>16</td>
<td>16</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Addis Credit and Savings Institutions C.</td>
<td>2000</td>
<td>15</td>
<td>15</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Meeket Microfinance Institutions C.</td>
<td>2000</td>
<td>15</td>
<td>15</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Addis Credit and Savings Institutions C.</td>
<td>2000</td>
<td>15</td>
<td>15</td>
<td>-</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: National Bank of Ethiopia, 1999
There is a clear difference between the first four MFIs that have relatively strong support from regional governments and the rest which are mainly supported by international NGOs. Such types of governance of MFIs and governance structures are unique in Africa and need to be studied in detail. In our assessment, all MFIs in Ethiopia do have government support and all depend on donor support as one of the major sources of funds for loans. There is no basic difference in terms of the structures, process of control and the content of governance between the two groups. The actual difference between the two categories of MFIs lies in the support the MFIs obtain from the grassroots government administrative organizations. One hardly observes any conflict of interest and use of the MFIs in meeting specific political agenda. Some argue that the support from the government has assisted these MFIs to have relatively higher repayment rate and lower transaction cost. In some of the international NGO-supported MFIs, the parent NGOs influence the board and also affect the activities of the MFIs. This indicates that the relationship between the parent NGO and the MFI is not clear.
The major elements of sound governance are transparency, accountability, board members' qualification and experiences, dedication and commitment of members to the mission and activities of the institution, policies and procedures that the board follow and the skills of the chairperson (skills in leadership, vision in thinking and management). Moreover, members of the board should have a clear understanding of the institution's client base. The objective here is to assess whether the governance of MFIs in Ethiopia is effective in directing the institution to achieve its mission.

In some of the MFIs, there is no regular board meeting. The competency of some board members in terms of diversified skills and effectiveness in guiding the managers of MFIs is questionable. Some other board members are very busy to spare time for MFI development. These MFIs will require restructuring and training for their board members. Regular assessment and evaluation of the board and annual auditing by independent auditors are also important for effective governance.
Although there hardly exists an accepted formula on the mix of board members, selection criteria, etc., the MFIs in Ethiopia need to adjust their own criteria, rules and procedures in order to fit to the dynamic growth of the microfinance industry. Since the board members are not the owners of the invested capital, positive incentives for them should be designed. The author would also suggest the need for a specific and detailed study to be carried out on governance of microfinance in Ethiopia.

In addition to strong governance, the sustainability of MFI depends on other factors such as efficient systems, capable human resource, appropriate legal frameworks and products and investment capital. The MFIs should also have sufficient strength to absorb shocks and losses which arise due to unforeseen circumstances. A good example is the effect of Eritrean aggression on Dedebit Credit and Saving Institution S.C (DECSI) and its clients. In spite of the serious difficulties as a result of the war, DECSI has absorbed the shocks, which clearly indicates its strength and comparative advantage of working with the poor at grassroots level.
V. The Performance of MFIs in Ethiopia

For the purposes of this study, the criteria of evaluation for the performance of the MFIs are mainly sustainability and outreach. The sustainability of MFI is measured in terms of generating enough revenues (excluding subsidies) to cover the cost of all factors of production and loanable funds whereas outreach is a hybrid measure that assesses the extent to which an MFI has succeeded in reaching its target clientele and the degree to which the MFI has met the clientele's demand for financial services (Yaron, 1994). Alternatively, outreach is the provision of a wide array of quality financial services to a large number of poor people (Lariviere and Martin, 1999). It is measured in terms of the number of clients, loan size, percentage of loans to clientele below the poverty line, percentage of female clients, range of financial and non-financial services offered to the poor, the level of transaction costs levied on the poor and the extent of client satisfaction with respect to financial services. However, on top of the criteria of sustainability and outreach, one has to include developmental effects (income and empowerment) on the target group as core performance criteria.
### Table 2: Outreach Indicators of MFIs in Ethiopia, March 2000

<table>
<thead>
<tr>
<th>No.</th>
<th>Microfinancial Institutions</th>
<th>No. of borrowers</th>
<th>Portfolio* (Birr)</th>
<th>Loan Outstanding (Birr)</th>
<th>Average Loan Size (Birr)</th>
<th>Total Women Borrowers (%)</th>
<th>No. of Savers</th>
<th>Saving (Birr)</th>
<th>Saving from outstanding (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Amhara Credit and Saving Institution S.C</td>
<td>156,398</td>
<td>111,721,776</td>
<td>146,000,000</td>
<td>1,000</td>
<td>49.5</td>
<td>41,942</td>
<td>41,000,000</td>
<td>60.5%</td>
</tr>
<tr>
<td>2</td>
<td>Dedebit Credit and Saving Institution S.C</td>
<td>218,000</td>
<td>346,642,270</td>
<td>146,000,000</td>
<td>1,450</td>
<td>43.0</td>
<td>202,000</td>
<td>76,000,000</td>
<td>52.1%</td>
</tr>
<tr>
<td>3</td>
<td>Oromia Credit and Saving Institution S.C</td>
<td>250,000</td>
<td>275,294,844</td>
<td>250,000,000</td>
<td>1,000</td>
<td>20.4</td>
<td>90,000</td>
<td>90,000,000</td>
<td>20.0%</td>
</tr>
<tr>
<td>4</td>
<td>Omo Microfinance Institution S.C</td>
<td>38,624</td>
<td>30,600,000</td>
<td>146,000,000</td>
<td>1,000</td>
<td>33.0</td>
<td>8,840,000</td>
<td>8,840,000</td>
<td>44.8%</td>
</tr>
<tr>
<td>5</td>
<td>Specialized Financial &amp; Promotional Institution S.C</td>
<td>2,000</td>
<td>3,000,000</td>
<td>1,069,097</td>
<td>1,000</td>
<td>78.0</td>
<td>2,500</td>
<td>483,119</td>
<td>45.2%</td>
</tr>
<tr>
<td>6</td>
<td>Global Microfinancing S.C</td>
<td>1,928</td>
<td>1,700,000</td>
<td>908,547</td>
<td>2,650</td>
<td>75.0</td>
<td>2,802</td>
<td>384,161</td>
<td>42.2%</td>
</tr>
<tr>
<td>7</td>
<td>Wisdom Microfinancing S.C</td>
<td>6,728</td>
<td>17,000,000</td>
<td>5,087,000</td>
<td>865</td>
<td>33.0</td>
<td>6,500</td>
<td>1,006,846</td>
<td>21.0%</td>
</tr>
<tr>
<td>8</td>
<td>Sanaa Microfinancing S.C</td>
<td>13,124</td>
<td>56,100,000</td>
<td>7,900,000</td>
<td>1,400</td>
<td>66.5</td>
<td>9,750</td>
<td>889,988</td>
<td>11.3%</td>
</tr>
<tr>
<td>9</td>
<td>Asse Microfinancing S.C</td>
<td>2,318</td>
<td>1,000,000</td>
<td>600,000</td>
<td>600</td>
<td>100.0</td>
<td>2,318</td>
<td>60,000</td>
<td>10.0%</td>
</tr>
<tr>
<td>10</td>
<td>Africa Village Financial Services S.C</td>
<td>185</td>
<td>978,000</td>
<td>12,138</td>
<td>500</td>
<td>53.0</td>
<td>16</td>
<td>19,872</td>
<td>16.4%</td>
</tr>
<tr>
<td>11</td>
<td>Bussaamba Microfinance S.C</td>
<td>501</td>
<td>181,300</td>
<td>181,300</td>
<td>360</td>
<td>77.8</td>
<td>501</td>
<td>14,234</td>
<td>7.8%</td>
</tr>
<tr>
<td>12</td>
<td>Mekket Microfinance Institution S.C</td>
<td>1,661</td>
<td>259,420</td>
<td>259,420</td>
<td>225</td>
<td>85.3</td>
<td>1,385</td>
<td>64,294</td>
<td>24.3%</td>
</tr>
<tr>
<td>TOTAL</td>
<td>471,966</td>
<td>525,803,937</td>
<td>273,331,198</td>
<td>44.0</td>
<td>129,444,000</td>
<td>47.4%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: 1 US$ = 8.15 Birr

β) as of June 1999
Table 3: Sustainability Indicators of MFIs in Ethiopia, March 2000

<table>
<thead>
<tr>
<th>No</th>
<th>Microfinance Institutions</th>
<th>Repayment Rate (%)</th>
<th>Staff</th>
<th>No. of Loan /Staff</th>
<th>Loan/Staff (Birr)</th>
<th>No. of Savers/Staff</th>
<th>On Lending Interest Rate (%)</th>
<th>Deposit Interest Rate (%)</th>
</tr>
</thead>
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<td>Amhara Credit and Saving Institutions S.C</td>
<td>97.5</td>
<td>1106</td>
<td>284</td>
<td>200,814</td>
<td>206</td>
<td>12.5</td>
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<td>Dedebit Credit and Saving Institutions S.C</td>
<td>97</td>
<td>729</td>
<td>417</td>
<td>276,515</td>
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<td>Oromia Credit and Saving Institutions S.C</td>
<td>98</td>
<td>128</td>
<td>273</td>
<td>193,000</td>
<td>300</td>
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<td>Omo Microfinance Institution S.C</td>
<td>99</td>
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<td>200,814</td>
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<td>Specialized Financial Promotional Institution S.C</td>
<td>97</td>
<td>27</td>
<td>200,814</td>
<td>12.5</td>
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<td>6</td>
<td>Gasha Microfinancing S.C</td>
<td>34***</td>
<td>57</td>
<td>26,734</td>
<td>12.5</td>
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<td>7</td>
<td>Wisdom Microfinancing Institutions S.C</td>
<td>98</td>
<td>40</td>
<td>238,386</td>
<td>12.5</td>
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<td>8</td>
<td>Sidama Microfinancing S.C</td>
<td>94</td>
<td>123</td>
<td>262</td>
<td>158,000</td>
<td>195</td>
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<td>Asser Microfinancing S.C</td>
<td>16</td>
<td>36</td>
<td>36</td>
<td>24</td>
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<td>10</td>
<td>Africa Village Financial Services S.C</td>
<td>100</td>
<td>14</td>
<td>151</td>
<td>12</td>
<td>12</td>
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<td>11</td>
<td>Buusa Gonfa Microfinance S.C</td>
<td>12</td>
<td>56</td>
<td>37</td>
<td>36</td>
<td>24</td>
<td>8</td>
<td></td>
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<tr>
<td>12</td>
<td>Mekket Microfinance Institutions S.C</td>
<td>100</td>
<td>16</td>
<td>191</td>
<td>28,824</td>
<td>154</td>
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</table>

β) Per loan officer; and

** Loan officers only

Note: 1 US $ = 8.15 Birr
Over a brief period of time, MFIs in Ethiopia have reached more than 471,966 clients, delivered about 526 million Birr (about 64.5 million US dollars) to these clients. They have 273 million Birr (about 33.5 million US dollars) of loan outstanding and mobilized about 129 million Birr (about 15.8 million US dollars) of savings (Table 2). In addition, the first four government-supported MFIs in Table 1 disbursed 239 million Birr (about 29.3 million US dollars) of input credit to farmers to purchase fertilizer and improved seeds for 786,239 clients. The clientele served by the MFIs in Ethiopia are mainly the rural poor. About 44 percent of the clients of MFIs in Ethiopia are female. These figures indicate the relatively higher outreach of MFIs by all standards of measurement. The very low average loan size of the MFIs in Ethiopia that varies between Birr 223 (about 27.4 US dollars) in Meekit Microfinance Institution S.C to Birr 5,000 (about 614 US dollars) in Sidama Microfinancing Institutions S.C reveals that the microfinance industry in Ethiopia focuses entirely on the poor.

The lending interest rates of MFIs in Ethiopia (Table 3) are again relatively lower than interest rates in other Sub-Saharan countries. In fact, the lending interest rates of all the MFIs do not allow them to cover their operation costs. However, the financial reports of some branches and sub-branches of the MFIs reveal that they are operationally efficient. These branches and sub-branches even question why they should subsidize unprofitable branches and sub-branches of the MFI. It is worth noting that MFIs in Ethiopia could increase interest rates and still become operationally efficient although all MFIs believe that the activities of the poor are not profitable to cover higher interest rates. Thus, they argue that microfinance institutions which focus on the alleviation of poverty targeting the rural poor do have high cost of operation which reduces their profit margin. This issue has emerged as one of the challenges
of the microfinance industry in Ethiopia. It must be clear that the financial sustainability of MFIs complements the social objectives of MFIs.

The gross savings as percentage of the loan outstanding, which is about 47%, indicates that the experience of the MFIs in Ethiopia is encouraging. The two government supported MFIs (ACSI and DECSI), which account for 80% of total clients in the industry, have managed to cover about 55% of their loan outstanding from savings. Another indicator of good performance of the MFIs in Ethiopia is the high repayment rate which varies from 94 to 100 percent. There is reasonable client or loan size to field staff ratios although this varies from one MFI to another.
## Table 4: Financial Performance and Portfolio Quality of Selected MFIs

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<tr>
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<tbody>
<tr>
<td>A</td>
<td>Profitability (%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Return on Asset</td>
<td>-9%</td>
<td>-11%</td>
<td>-21%</td>
<td>-1.89%</td>
<td>-3%</td>
<td>-1%</td>
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<tr>
<td>2</td>
<td>Return on Equity</td>
<td>-11%</td>
<td>-15%</td>
<td>-69%</td>
<td>-3.15%</td>
<td>-9.70</td>
<td>-2%</td>
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</tr>
<tr>
<td>3</td>
<td>Opera. Self. Suff.</td>
<td>44%</td>
<td>45%</td>
<td>25%</td>
<td>101%</td>
<td>87%</td>
<td>119%</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Capital Adequacy</td>
<td>97%</td>
<td>66%</td>
<td>13%</td>
<td>49%</td>
<td>28%</td>
<td>62%</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Velocity ratio</td>
<td>4.4:1</td>
<td>6.6:1</td>
<td>1.4:1</td>
<td>8.3:1</td>
<td>7.8:1</td>
<td>4.8:1</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Debit Equity (Ratio)</td>
<td>0.1:1</td>
<td>0.5:1</td>
<td>6.6:1</td>
<td>1:1</td>
<td>2.6:1</td>
<td>0.6:1</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Liquidity (Ratio)</td>
<td>8.2:1</td>
<td>2.9:1</td>
<td>1:1</td>
<td>4.5:1</td>
<td>1.4:1</td>
<td>2.6:1</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Finan. Self-Suff.</td>
<td>32%</td>
<td>38%</td>
<td>25%</td>
<td>87%</td>
<td>34%</td>
<td>86%</td>
<td></td>
</tr>
<tr>
<td>B</td>
<td>Efficiency</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Administrative Efficiency</td>
<td>52%</td>
<td>48%</td>
<td>52%</td>
<td>13%</td>
<td>12%</td>
<td>12%</td>
<td></td>
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<tr>
<td>10</td>
<td>Operational efficiency</td>
<td>40%</td>
<td>42%</td>
<td>54%</td>
<td>17%</td>
<td>16%</td>
<td>13%</td>
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<tr>
<td>11</td>
<td>No. of active loan officer</td>
<td>211</td>
<td>227</td>
<td>-</td>
<td>205</td>
<td>372</td>
<td>282</td>
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<tr>
<td>12</td>
<td>Outstanding loan per officer</td>
<td>96,106</td>
<td>113,455</td>
<td>-</td>
<td>179,649</td>
<td>277,138</td>
<td>128,537</td>
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<tr>
<td>C</td>
<td>Portfolio quality</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>13</td>
<td>Delinquency (%)</td>
<td>0.75%</td>
<td>2.46%</td>
<td>12%</td>
<td>2.66%</td>
<td>0.76%</td>
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<tr>
<td>14</td>
<td>Loan loss provision</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
<td></td>
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</table>

Source: Renee Choa-Beroff and et., al., IFAD & World Bank sponsored study, August 2000.

* Nine Months
The study of Renee Chao-Beroff et.al (2000) is the only study which attempts to provide valuable information on portfolio quality, efficiency and profitability of microfinance industry in Ethiopia. Although the repayment rates of MFIs in Ethiopia is relatively better, it does not give the true picture of efficiency and financial health of MFIs. The limited data on ageing, loan write-off, loan loss reserve, and adjusted cost of subsidy affects the portfolio quality estimation procedures.

However, in spite of the data constraint, this study has provided useful information on the financial performance and portfolio quality of the MFIs in Ethiopia. Table 4 indicates that MFIs such as SFPI, WMFI, ACSI and OMFI have delinquency rates of 0.75%, 2.46%, 2.66% and 0.76% respectively. This is a relative indicator of good portfolio quality of MFIs in Ethiopia.

As of December 1999, administrative efficiency varies from 52% in WMFI to 12% in OMFI and OCCSSCO. The operational efficiency varies between 54% in WMFI, to 13%, 16% and 17% in OMFI, ACSI and OCCSSCO respectively. By international standards, OMFI, ACSI, and OCCSSCO are considered to be operationally efficient reaching the level of better practices. The active loan clients to loan officer ratios are also encouraging, in some cases exceeding what same practitioners call best practices. Since 95% of the loan of MFIs in Ethiopia is agricultural loan, we believe that this performance is relatively better.

The study of Renee Chao-Beroff et.al (2000) also reveals that three MFIs have surpassed the 100% operational self-sufficiency ratio, with the maximum one being 133 percent and the worst 25 percent operationally self-sufficient. Taking financial self-sufficiency, the worst one was 25 percent and the best one 87 percent. The overall
conclusion of the study is that MFIs in Ethiopia are efficient but unprofitable due to low interest rates.

It is not only the sustainability of the microfinance institution that is important, but also the sustainability of clients which could be measured by estimating the quantitative and qualitative impact. There have been very limited studies which assessed the impact of microfinance activities on poverty alleviation. The very few case studies conducted in Dedebit Credit and Savings Institution S.C (Fiona, 1999) revealed that overall, credit provision had a significant impact on increasing agricultural production through build-up of production assets, particularly draught oxen, and increasing the amount of land farmed by clients who were able to retrieve land previously rented out and farm it themselves, and clients who were able to get more land through rent. Trading activities also engaged in by clients increased in scale. Female clients were particularly able to take on trading activities which had previously been inaccessible to them through lack of capital. The increased income generated by the credit input had a positive impact primarily on household food supply, and on educational provision for children as well as clothing and other basic necessities. However, the positive impact reported was dependent on continued access to credit on regular basis. An impact study made of the Amhara Savings and Credit Institutions S.C (Zegeye Bentie, et al. 1999) revealed similar results as that of the study of DECSI.

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VI. Strength and Problems Encountered

Strength of MFIs in Ethiopia

a) The delivery of microfinance services to the rural poor in Ethiopia is one of the effective instruments to promote food production and food security. All MFIs in Ethiopia have a shared vision of poverty alleviation. Moreover, Ethiopia has a favorable macro policy environment and regulatory framework to promote sustainable microfinance activities.

b) The MFIs have demonstrated good repayment rates. The high repayment rate in the government supported MFIs is partly explained by the support from grassroots level government institutions.
c) Because of the emphasis on financial sustainability, MFIs have been concentrated on accessible regions, urban areas where there are bank services and on micro and small enterprise development. However, the region-based and government-supported MFIs have addressed the problem of microfinance delivery to agriculture and remote areas. The establishment of these MFIs has also contributed to the relatively fair distribution of microfinance activities in the country.

d) The MFIs have mobilized significant amounts of savings from poor households. Savings mobilization in Ethiopia is becoming an integral part of a viable micro-credit delivery system, such that the link between savings and credit has promoted food production and food security. The experience of MFIs in Ethiopia reveals that the poor are indeed worth banking on.

e) There is a growing demand for input credit, particularly for fertilizer and improved seeds, as a result of the implementation of the new extension program to increase production and productivity in agriculture. There were attempts to use MFIs, the regional governments (at all levels), and Ministry of Agriculture offices to supply input credit to farmers who needed it. However, this approach was not sustainable. Presently, the government is using the co-operatives as an option to deliver input credit to farmers. Today, these co-operatives are regaining their importance as mediators between the semi-formal and formal sectors in an environment that is free from ideology.

**Major Problems Encountered**
In spite of the success of microfinance activities in Ethiopia in a short period of time, there are problems which need to be addressed. These include:

1. problems related with the regulatory framework in the microfinance industry are:

   a) allowing a short period of loan, that is, a maximum of 12 months;

   b) permitting only group guarantee as collateral and entertaining no modalities that do not fit into the group model;

   c) limited loan size of MFIs, that is only 5000 Birr. Although the loan size was not a serious problem to the MFIs, this is affecting the development of micro and small enterprise, delivery of credit for low-cost housing and co-operatives;

   d) prohibiting the participation of international NGOs as shareholders in the MFIs; and

   e) failure in considering how co-operatives can benefit from the MFIs.

   a) Limited support to micro and small enterprise development. The conventional banks provide support to the business community with relatively high income. The MFIs in Ethiopia focus on the rural poor. As a result, there is a gap or absence of links between the above two groups. This will require the promotion of micro and small enterprises by applying individual lending, larger loan size and longer loan period. The micro and small enterprises have different characteristics contrasting with the minimalist approaches of the MFIs. The Ethiopian Micro and Small Enterprise
Agency should provide training to those who are in the business and start-ups. It should co-ordinate its activities with the MFIs which provide funds and training on how to manage loans and post-loan support focusing on loan repayment. This will need some changes in the regulatory framework.

3. Some NGOs still insist on providing credit as a grant. Such supply of donor-subsidized and very soft loans is retarding the development towards sustainable MFIs. NGOs can be involved in capacity-building of the MFIs by participating in training, supplying hardware and other facilities that reduce their overhead cost and providing capital for MFIs.

4. The line departments of the federal government such as the tax authorities hardly understand the role and objectives of MFIs. They have insisted that MFIs should pay all types of taxes. In fact, some regional governments understand better and appreciate microfinance activities than the Federal Government and the National Bank of Ethiopia (NBE).

5. Absence of solid linkages between MFIs and Commercial Banks. These untapped conventional banks should serve as alternative financial sources for MFIs. There is a need for developing a strategy to link and integrate microfinance industry into the wider financial markets. Ultimately, this will open up vast resources accumulated by the banks for lending to the microfinance industry.

6. A well functioning and efficient legal system is a very important factor in order to enhance the performance of the MFIs. Clear property right law is critical to implement availing collateral support and asset-based lending. The
7. Relatively low interest rates in the microfinance industry affecting the financial health and viability of MFIs. The interest rates of MFIs in Ethiopia are extremely low to cover operating costs, protect funds from inflation and allow adequate margins, including the provision for bad debts and other institution-building costs.

8. Limited capacity of the National Bank of Ethiopia to supervise MFIs and absence of a government department or other institution to support microfinance development in the industry.

9. Lack of fund for loans and an institution to establish microfinance fund and access to soft loans from NGOs.

9. The products provided by the MFIs lack diversification.

10. The poor infrastructure in Ethiopia affects outreach and sustainability of MFIs. This increases the transaction cost and affects the profitability of the MFIs.

11. There is very limited research and innovation in the microfinance industry.

12. Inadequate management information systems (MIS).


14. Absence of insurance schemes for clients.
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ANNEX - I
PROCLAMATION No.40/1996

A PROCLAMATION TO PROVIDE FOR THE LICENSING
AND SUPERVISION OF THE BUSINESS OF
MICROFINANCING
INSTITUTIONS

WHEREAS, it needs to provide for a legal regime that brings the
activities of Microfinancing Institutions within Ethiopia's monetary
and financial policies;

WHEREAS, the monetary and banking laws in force do not provide
for microfinancing institutions catering for the credit needs of
peasant farmers and others engaged in small-scale production and
service activities;

WHEREAS, it has become necessary to legislate on the licensing
and supervision of the business of microfinancing institutions;

NOW, THEREFORE, in accordance with Article 55 (1) of the
Constitution of the Federal Democratic Republic of Ethiopia, it is
hereby proclaimed as follows.
1. **Short Title**

This Proclamation may be cited as the "Licensing and Supervision of MicroFinancing Institutions Proclamation No. 40/1996".

2. **Definitions**

In this Proclamation, unless the context otherwise requires:

1) "Bank" means the National Bank of Ethiopia;

2) "Company" means a share company, as defined under Article 304 of the Commercial Code, the capital thereof owned fully by Ethiopian nationals and/or organizations wholly owned by Ethiopian Nationals and registered under the laws of, and having its head office in Ethiopia.

3) "Microfinancing business" means an activity of extending credit, in cash or kind, to peasant farmers or urban small entrepreneurs, the loan size of which shall be fixed by the Bank;

4) "Microfinancing institution" means a company licensed under this Proclamation to engage in microfinancing business in rural and urban areas;
5) "Members" means the shareholders of a microfinancing institution or signatories to any type of membership arrangement created by such institutions;

6) "Group guarantee" means a guarantee mechanism whereby a group of borrowers undertake to be liable jointly or severally to defaulted loan of any one of them;

7) "Savings" means non-withdrawable mandatory or regular savings of members of microfinancing institutions;

8) "Deposits" means any regular or irregular savings which may be withdrawn partially or totally at any time by the account holder;

9) "Directors" means members of the board of a microfinancing institution.

3. Purpose and Duty

a) The purpose of microfinancing is granting credit, in cash or in kind, the maximum amount of which shall be determined by the bank.

b) Subject to conditions set under this Proclamation, a microfinancing institution may carry out some or all of the following activities:

c) accepting savings as well as demand and time deposits;
d) drawing and accepting drafts payable within Ethiopia

e) borrowing money for its business purposes against the security of its assets or otherwise;

f) purchasing such income generating financial instruments as treasury bills;

g) acquiring, maintaining and transferring of any movable and immovable property including premises for carrying out its business;

h) providing counseling service to its clients;

i) encouraging income generating projects for urban and rural micro operators;

j) rendering managerial, marketing, technical and administrative advice to borrowers and assisting them to obtain services in those fields;

k) managing funds for micro financing business; and

l) engaging in other activities customarily undertaken by micro financing institutions.
PART TWO

Licensing of Microfinancing Institutions

1. Conditions Required to Engage in Micro-Financing Business

To carry out microfinancing business, the following conditions shall be fulfilled:

a) obtain a license from the bank;

b) be formed as a company

c) deposit with a bank the minimum initial capital required by the Bank; and

d) that the directors and other officers meet requirements set by the Bank

e) The Council of Ministers may, upon recommendation by the Bank, exempt an applicant from the requirements of any of the provisions of sub-Article (1) of this Article in order that other innovative financial intermediaries engage in micro-financing business and for other causes consistent with the objective of this Proclamation.

2) Prescribing Additional Conditions

a) The Bank may issue directives at any time and prescribe additional conditions to be complied with before a license is issued.

b) Where the Bank intends to change or vary the terms and conditions attached to a license, it shall notify the concerned microfinancing institutions of such intentions forty-five (45) days before the date it propose to carry the same into effect.
3) **Application for License**

a) An application for license to carry out micro financing business shall contain the following:

   a) the prospective place of operation (indicating that of the head office and branches);
   b) the name, occupation, residence and nationality of the founders;
   c) form of organization of the undertaking;
   d) memorandum of association of the undertaking;
   e) proposed name of the undertaking;
   f) biographical data on each of the founder, proposed directors and officers;
   g) the proportion of contribution in cash and in kind and the manner of valuation of contribution in kind;
   h) the proposed transactions and operations of the undertaking as well as the manner for carrying out the same; and
   i) such other relevant information as the bank may require.

a) an investigation fee, prescribed by the bank, shall be paid at the time of submitting the application for license.

b) an applicant issued with a license shall commence operations within 12 (twelve) months from the date thereof.

c) No microfinancing institution shall, without prior consent of the bank, operate outside the area for which it has been issued with a license.

d) every microfinancing institution shall pay such annual license renewal fee as the Bank may prescribe.

4) **Authorization of Commencement of Operation**

Any microfinancing institution may, before commencing operations, be required to meet certain conditions prescribed in a directive to be issued by the Bank.
5) **Recovery of Monies and Securities Received by Unlicensed Undertakings**

Where any unlicensed person undertakes activities carried out pursuant to this Proclamation, and holds monies or property obtained through such act, the Bank may apply to the Federal High Court for orders in respect of the disposition of the same; the High Court shall give orders for the speedy and efficient return of such monies or property to the depositors or owners thereof.

6) **Revocation of License**

The license of a microfinancing institution may be revoked by the Bank for any of the following reasons:

a) where it fails to commence operations within a period of 12 (twelve) months following the issuance of license;

b) where it ceases to carry on its activity;

c) where it is declared bankrupt or decided that it be liquidated;

d) where it is amalgamated with another micro-financing institution or bank without prior written authorization of the Bank; or

e) where it is confirmed that its registration was effected on the basis of false information.

7) **Application for Re-registration**

a) where the savings mobilized by a micro-financing institution equals Birr 1,000,000 (One Million Birr) it shall apply for re-registration.

b) where application is made under sub-Article (1) of this Article, it may be required that additional conditions prescribed by directives issued by the Bank be met.
8. **Assistance**

a) Where it deems it appropriate, the Bank shall extend technical assistance requested by a microfinancing institution while being organized or in the course of operations.

b) Microfinancing institutions may obtain line of concessional credit of any assistance from foreign sources for the purpose of on-lending or capitalization.

c) Any credit or assistance to be obtained under sub-Article (2) of this Article shall require the prior approval of the Ministry of Finance.
PART THREE
Financial Requirements and Limitations

1) Minimum Capital Requirement and Powers and Responsibilities of the Bank

a) The minimum paid-up capital required to obtain license for microfinancing business shall be determined by directives to be issued by the Bank.
b) The Bank may issue directives governing the limits on the maximum credit extended by microfinancing institutions to any individual or group;
c) the loan period and procedures;
d) periodic reporting of the accounting system and the keeping of books of accounts;
e) periodic surveys of loan and audits;
f) standards regarding accountability, structure, savings system and financial performance;
g) setting of special interest rate applicable to microfinancing institutions;
h) the bank shall have the responsibility to:
i) encourage banks and other financial institutions to engage in microfinancing business or to expand their activities in the same;
j) offer or facilitate training for the personnel of microfinancing institutions;
k) promote and develop traditional savings institutions such as Iqub in order that the low-income section of society benefit most from them; and
l) promote investment in microfinancing business, especially in rural Ethiopia, pursuant to powers vested in it under the law.

2) Consolidation and Merger

Consolidation and merger of microfinancing institutions operating in adjacent areas shall be encouraged and such incentives as the bank deems appropriate shall be granted to them.
3) **Opening of Branches**
   
a) Every microfinancing institution shall notify its opening of a branch office within fifteen (15) days of the commencement of operation of such a branch.

b) The Bank may set general guidelines on donations of opening and operating branch offices by microfinancing institutions.

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**PART FOUR**

**General Conditions**

1) **Extending of Loan Services**

Microfinancing institutions may extend loan to members as well as to non-members. However, such credit schemes as operating under group guarantee shall exert themselves to bring borrowers into membership of the institutions.
2) **Minimum Operational Prudence**

The minimum prudential framework of operation in respect of all microfinancing institutions shall be in the manner and form to be prescribed by the Bank.

3) **Prohibitions**

Without the prior approval of the Bank, no micro-financing institutions may:

a) enter into any arrangement or agreement for the sale of disposal, by amalgamation or otherwise, of its business or effect self restructuring;

b) transfer or otherwise dispose of the whole or any part of its property, whether inside or outside Ethiopia, other than in the ordinary course of its business;

c) effect reduction of its capital; or

d) amend its memorandum of association or alter the name under which it is licensed.

4) **Circumstances Requiring Approval for Managerial Responsibility**

The following shall not be allowed to manage microfinancing institutions without the prior written approval of the Bank:

a) persons declared bankrupt or who have made a compromise with their creditors, whether in Ethiopia or elsewhere; and

b) persons convicted of offenses of breach of trust or fraud, whether in Ethiopia or elsewhere.

5) **Tax Exemption**
The Ministry of Finance is hereby empowered to determine the period, manner and condition of exemption of micro-financing institutions from income tax.

6) **Special Responsibility**

Every microfinancing institution shall devise and execute a policy whereby the low-income section of society, especially in rural areas, get access to credit and to this end it shall implement such means of substituting group guarantee for property collateral requirement.

**PART FIVE**  
*Miscellaneous Provisions*

1) **Duty to Cooperate**

Where so requested by the Bank, all concerned bodies shall have the duty to cooperate in the implementation of this Proclamation.

2) **Audit**

Accounts of microfinancing institutions shall be audited annually by an independent auditor acceptable to the Bank prior to the payment of dividends to shareholders.
3) **Inapplicable Laws**

Any law inconsistent with the provisions of this Proclamation shall not apply to matters provided for under this Proclamation.

4) **Other Applicable Law**

With respect to matters not covered under this Proclamation, the Licensing and Supervision of Banking Business Proclamation No. 84/1994 shall apply, mutatis mutandis.

5) **Power to Issue Directives**

The Bank may issue directives necessary for the proper implementation of this Proclamation.

6) **Transitory Provisions**

a) Undertaking engagement in microfinancing business, prior to the coming into force of this Proclamation, may continue in their previous form until reorganized in compliance with the provisions of this Proclamation.

b) The conditions and time limit of non-applicability of this Proclamation to such undertakings shall be determined in directives to be issued by the Bank.

7) **Date of Effect**

This Proclamation shall come into force as of the 5th day of July, 1996.
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