Country Survey:

ETHIOPIA

Key Facts : Microfinance in ETHIOPIA				
By CGAP[i]	No. of MFIs	No. of Borrowers	Borrowers Population[1]	Borrowers/Poor[2]
	22	1,420,000	2%	5%
By MIX[ii]	No. of MFIs reporting (2009)	No. of Active Borrowers	Gross Loan Portfolio (USD)	Average Balance per Borrower (USD)
	22	2.3 million	409.4 million	140
By MFT[3]	No. of MFIs (2011)	No. of Active Borrowers	Gross Loan Portfolio (ETB)	% Products with a Flat Interest Rate
	31	2,470,641	6.9 billion	70%

Country Overview

Situated in the Horn of Africa, the Federal Democratic Republic of Ethiopia is Africa's oldest independent country. Bordered by Eritrea to the North, Sudan and South Sudan to the West, Djibouti and Somalia to the East and Kenya to the South, Ethiopia is a landlocked country of 82 million people – the second most populous country in Africa.

Ethiopia has a land area of 1.1 million square kilometers. It has a diversity of climate, wildlife and geographic topographies, ranging from mountains in the north to rift valley lakes in the south. Ethiopia's population is also highly diverse. It consists of around 80 ethnic groups with the Amhara, Oromo and Tigrinya ethnic groups making up two third of the country's population[iii]. The country is rich in cultural and traditional heritage. More than 70 languages are spoken in Ethiopia. The official language of the country is primarily Amharic although regional states use their own languages in dealing with internal affairs. English remains a widely spoken foreign language and taught in all secondary schools and higher education institutions.

The majority of Ethiopia's population (83%) lives in rural areas, concentrated mainly in the highlands of the country. Due to recent economic changes, demographic factors and incidences of drought in some regions, migration among the working age groups to the major cities is on the rise. The average life expectancy at birth in Ethiopia is 56 years, and approximately half of Ethiopia's population is under 18 years old[iv].

[1] MFI borrowers as a percentage of the country's overall population

[2] MFI borrowers as a percentage of the poor population based on national poverty rates

[3] This row of the table is populated with data from MF*Transparency*'s *Transparent Pricing Initiative in Ethiopia*

Political Overview

Ethiopia has a multi-party democracy, and is today regarded one of Africa's most stable countries. The Marxist, pro-peasant movement, The Ethiopian People's Revolutionary Democratic Front (EPRDF), took power in 1991 from the previous dictator, focusing its efforts on ethnic federalism and socioeconomic development in an effort to consolidate its support base. After the country ratified its new constitution in 1994, the political system decentralized by restructuring and devolving mandates to nine ethnic based regional states and two city administrations including the capital, Addis Ababa. Every five years Ethiopians cast their vote in national and local elections. However, most of the elections remain controversial and even bloody, such as the 2005 election. The EPRDF is the leading political party in the country, hanging on to power since 1991. There are currently no strong opposition parties in the country. The government recently made moves to restrict civil society, and in 2009 approved a law prohibiting non-governmental organizations (NGOs) that have more than 10% foreign funding from engaging in any activities concerning democracy, justice or human rights in Ethiopia.[v]

Macroeconomic Overview

Since the fall of the socialist government in 1991 Ethiopia has been subject to major economic reforms. These have included the liberalization of the financial sector, a relaxing of foreign exchange controls and the removal of the previous interest rate regime. There has also been the creation of a new regulatory framework for banks, insurance companies, cooperatives and microfinance institutions[vi]. Ethiopia's economy is one of the fastest growing in sub-Saharan Africa, with economic performance over the past five years showing particularly impressive results. From 2006 to 2010 the country's Gross Domestic product grew with an average yearly rate of 11%[vii]. During this period the agriculture sector, the mainstay of Ethiopia's economy, grew by an average rate of 8%. The industry and service sector registered an average growth rate of 10% and 14.6% respectively. Over recent years the service sector has expanded significantly enough to overtake the traditional agriculture sector in terms of the biggest contributor to GDP[viii].

GDP and Inflation

Year	GDP (PPP)*	GDP Real Growth	Inflation	GDP Per Capita (USD)
2007	62.0	11.5	44.4	249
2008	70.2	10.8	44.4	330
2009	77.1	8.8	8.5	386

*Billion USD, 2009 figures, Source: World Bank[1]

The government of Ethiopia has outlined its growth targets for the next five years in its Growth and Transformation Plan (GTP 2011-2015). According to this strategy document, the country aims to maintain the average annual economic growth at 11% and hence, meet all millennium development goals by 2015. This government plan also has ambitions to double the country's GDP in 2015 from the level of 2010[ix]. More conservatively, real GDP growth projections by the IMF in 2011 show a figure of 7.5% and give an average projection for the next five years of 7.7% per year.

GDP – composition by sector:	
Agriculture	42.9%
Industry	13.7%
Services	34.4%
Annual Trade:	
Imports	$7.5 billion
Exports	$1.7 billion

Source: 2009 figures World Bank[1]

Rising inflation especially food prices pose a persistent challenge to the development efforts of the country. General year on year inflation in consumer price for the months of October and November 2011 as compared to the same period in the previous year shows increase of 29.1% and 39.2% respectively[x]. IMF data on inflation on consumer prices for Ethiopia over the years 2009, 2010 and 2011 showed inflation rates of 36.4%, 2.1% and 18.1% respectively. The IMF also projected that inflation will rise again to the level of 2009 in the coming year, 2012. Tackling this unhealthy inflation in the economy, especially the rising food prices, is a primary challenge for Ethiopian government.

As at September 30, 2011, the top five major foreign exchange earning export items for Ethiopia were coffee, sesame seeds, fresh chat, semi-processed gold and roses. Over the same period, the country imported petroleum oil, edible palm oil, durum wheat and other industrial chemicals and machineries. The economy's dependency on agricultural items for export and petroleum for import make it highly vulnerable to price volatility in international commodity markets. Rising population is also likely to be one of Ethiopia's economic development challenges in the coming years. Moreover, the country still suffers from draught and food shortage in its different regions. Ethiopia works closely with international donors such as the UN, EU, DFID, USAID etc in areas of economic development, good governance and humanitarian relief through finance and technical assistance. It is also one of the chief recipients of foreign aid from sub-Saharan countries.

Poverty in Ethiopia

Ethiopia is one of the poorest countries in the world. Plans to reduce poverty are central to the government's development agenda, and many policies, goals and objectives are focused on targeting the most disadvantaged households. Microfinance is considered by the government to be one of the important tools in fighting poverty.

Key Poverty Figures	
HDI value	0.328
HDI Rank	157
GINI	29.8
Pop. below $ 1.25 a day (%)	39%
Source: Human Development Report 2010	

In 2010, the Human Development Report listed Ethiopia as the 11th fastest improver in terms of its human development[xi]. Enrolment in primary school has increased from 33% in 1991 to 95% in 2007, however more than half the population lives in a household where nobody has completed primary school.[xii] Ethiopia's GNI per capita in PPI terms is $971 which, although is one of the fastest growing falls below average for sub-Saharan Africa. The income gap between the financially wealthy and the poor is also high with the inequality adjusted HDI index standing at 0.247 as of 2010[xiii].

Traditional Financial Sector

Ethiopia's financial sector consists of commercial banks, insurance companies, microfinance institutions, saving and credit associations, multipurpose cooperatives and money lenders. The financial sector is categorized into three sub-sectors - formal, semi-formal and informal. The formal financial system, as of September 2010 comprised of 15 commercial banks, 13 insurance companies and 30 microfinance institutions[xiv]. Over the same period, the total capitalization of the banking sector stood at ETB 13.2 billion. The capital of the sector is highly dominated by the state owned Commercial Bank of Ethiopia, accounting for 41.8% of capital. The total number of bank branches in the sector stood at 712, with a high concentration of 38.6% located in the capital city, Addis Ababa.

According to the Access Capital report of 2010, the Ethiopian banking sector is booming. Financial results for the fiscal year 2010 shows relatively high growth in profits and dividends, and all key areas of banking operations - collecting deposits, providing loans and foreign exchange dealings had grown by more than 20%. Overall banking sector profits were up 45%[xv]. The outlook for the banking industry remains positive and the industry is waiting for six potential new entrant private commercial banks, currently undergoing the licensing process. The insurance sector of the country consists of 13 private and state owned insurance companies with a total capital of ETB 847 million, as at September 2010.[xvi]

The microfinance sector is comparatively large, with its collective loan balance nearly 10% of the volume of the banking sector. As of September 2010, the microfinance industry had mobilized ETB 2.8 billion, growing from previous period although with significantly lower growth than the banking sector. The microfinance sector is dominated by five large microfinance institutions – Amhara, Dedebit, Oromia, Omo and Addis Credit and Savings Institutions. When combined they account for 87.4% of total capital, 93.5% of deposit mobilization, 90.4% of credit provision and 90.8% of total asset of the industry.[xvii]

Since 2009 commercial banks are not required to have a separate license to offer microfinance services, however at present most do not offer the service. The limited rural branch distribution of the banking sector has prevented direct service delivery to rural and low income clients, and the risk perceptions towards the same group have also limited indirect involvement through loans to microfinance institutions (MFIs). Government regulations require formal banks to demand full collateral for their loans, a condition with MFIs are often unable to meet.

The semi-formal sector consists of prudentially unregulated financial institutions including SACCOs, multi-purpose cooperatives and funeral funds. Tied to the growth of the microfinance sector in Ethiopia, the semi-formal sector is experiencing growth in recent years. The informal financial sector in Ethiopia consists of unregistered traditional institutions such as Iqub, Idir and money lenders.

Financial Inclusion in Ethiopia

A significant portion of Ethiopia's population lives without access to basic, affordable and sustainable financial services. This is largely due to the perception by commercial banks of the unattractive risk-return outlook of serving the low income urban and rural population. This, together with the high demand for bank loans in the mainstream economic sectors of the country, has created a comfort zone for the existing commercial banks, leading Ethiopia to be one of the least banked countries in the world. Data from the National Bank of Ethiopia suggests that the country has a ratio of total population per bank branch of 112 thousand[xviii].

As a result of these factors, more than two third of the population of Ethiopia has resorted to traditional, informal and expensive financial services such as money lenders, keeping cash at home, funeral funds etc. Although these mechanisms may prove instrumental to the financial needs of poor families, they come at a cost of high risk of failure, lack of sustainability, legal challenge and the difficulty building long standing trust among stakeholders.

The situation however is changing in terms of creating access to financial services for poor families. Firstly, the recent expansion of the banking sector and significant number of new entrants in the industry has created the motivation amongst the banks to downscale. Secondly, following policy prescriptions by the government of Ethiopia and various NGO initiatives more than a decade ago, microfinance institutions have come into the picture, filling the gap in access to credit. These institutions are also slowly moving towards solving issues of access to sustainable and affordable saving, and access to insurance and remittance services at the bottom end of the market. Importantly, microfinance institutions, with the support of NGOs and other stakeholders, are working at various levels to provide financial education and create financial awareness amongst poor households.

Despite its huge potential, Ethiopia has been slow to incorporate mobile technologies in the provision of financial services. Elsewhere, mobile technology has revolutionized the provision of cheap and affordable financial services. Ethiopia's sparse population distribution, together with rising mobile subscribers and the high growth in the demand for financial services has created the incentive to employ mobile technologies, the adoption of which is likely to significantly increase access to finance in future.

Microfinance Industry of Ethiopia

Introduction

The Ethiopian microfinance sector is one of the world's fastest growing microfinance sectors[xix]. Between 1997 and 2009 the total assets of the microfinance sector showed growth of 3084%[xx]. Microfinance was first seen in Ethiopia in the late 1980s, offered by mostly by NGO relief and development programs. The year 1996 saw the formalization of the industry with the government issued "Proclamation for licensing and supervision of microfinance institutions Nr 40/1996". This Directorate officially bought MFIs under Ethiopia's monetary and financial framework. It enabled all MFIs to accept deposits and stressed the need for sound commercial principles in the sector.

The Ethiopian microfinance sector is characterized by its rapid growth, an aggressive drive to achieve scale, a broad geographic coverage, a dominance of government backed MFIs, an emphasis on rural households, the promotion of both credit and savings products, a strong focus on sustainability and by the fact that the sector is Ethiopian owned and driven[xxi]. The industry has a strong focus on loans to the very poor, as indicated by the relatively small loans when compared to neighboring countries. Sector outreach is impressive and the financial performance of the sector is considered good, although the operational margins and profitability are low. MFIs have also mobilized a significant amount of savings, thereby improving financial as well as operational sustainability. Compared with other African countries the sector is relatively transparent.

The government is heavily involved in the sector, and has prioritized the development of sustainable financial institutions and a nationally owned industry. The industry has strong social aims, and the government has written into statute the requirement for the industry to serve rural subsistence farmers. Most MFIs take this poverty-targeting mandate very seriously.

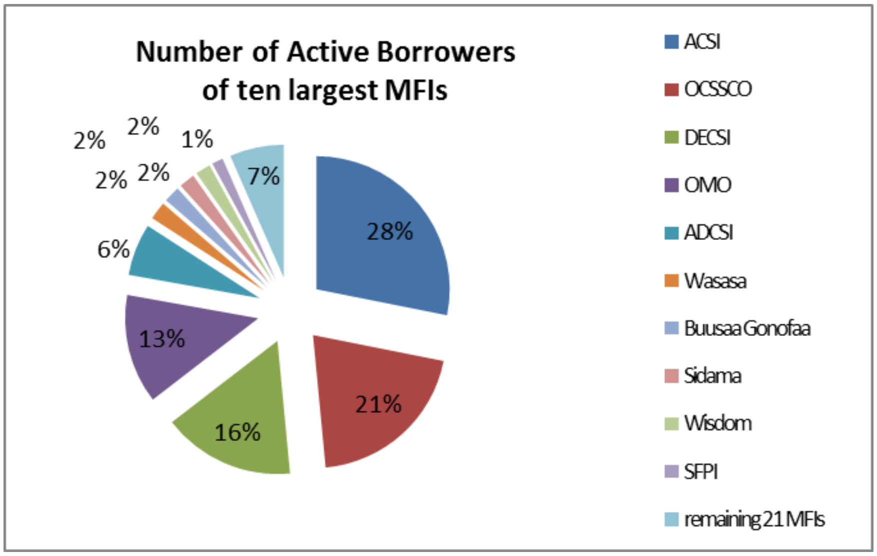
Microfinance Institutions

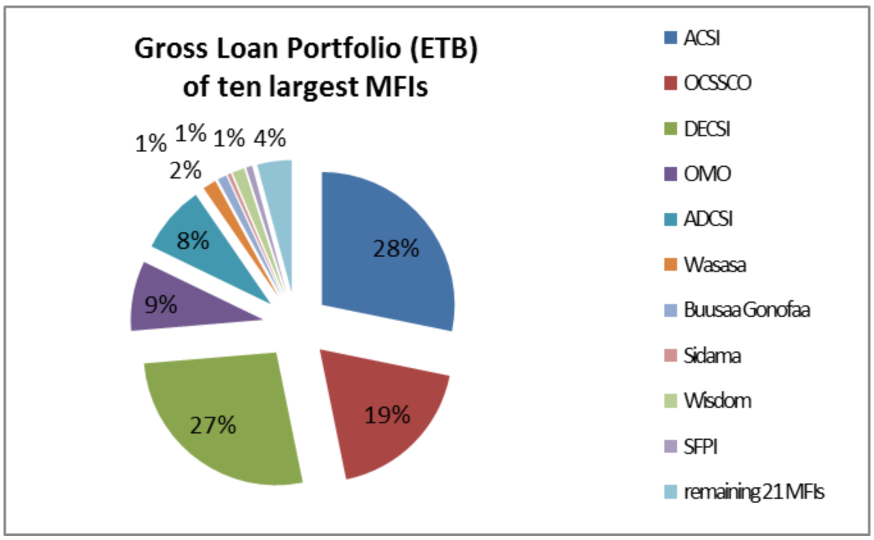
The microfinance sector of Ethiopia, as at 2009, recorded 2.3 million borrowers[xxii]. There are currently 31 MFIs registered with the National Bank of Ethiopia serving clients through 433 branches and 598 sub-branches[xxiii]. Studies estimate that this figure serves between 10-25% of the total microfinance demand in the country[xxiv].

The Ethiopian microfinance market is dominated by a few large players, all of which are closely linked to regional government ownership. The three largest institutions account for 65% of the market share in terms of borrowers, and 74% by gross loan portfolio[xxv]. These are Amhara (ACSI), Dedebit (DECSI) and Oromia (OCSSCO) Credit and Savings Institutions. In contrast to many other African countries, MFIs in Ethiopia reach relatively large numbers of clients, with ACSI reaching over 650,000 borrowers. Most institutions have over 20,000 clients. The average loan per borrower for the 11 Ethiopian MFIs reporting to the Mix Market as of June 2010 stood at 140 USD, below half of the country's GDP per capita.

Source: MF*Transparency Transparent Pricing Initiative 2011*

Microfinance Institution	Number of Active Borrowers	Gross Loan Portfolio (ETB)	Reports to MIX (2009)	Participated in MF*Transparency Pricing Initiative*
Addis Credit and Savings Inst (ADCSI)	156148	566826000	Y	y
Africa Village Financial Services (AVFS)	17359	14974452	Y	
Aggar Microfinance	5854	19130224		
Amhara Credit and Saving Inst (ACSI)	694993	1940827401	y	y
Benishangul Gumuz Microfinance	28874	51762087	y	
Buusaa Gonofaa Microfinance	48908	76548872	y	y
Dedebit Credit and Savings Inst (DECSI)	396648	1849942011	y	y
Digaf Microfinance	1270	1334920	y	y
Diredawa Microfinance	5923	16285631		y
Dynamic Microfinance Inst	261	2224932		
Eshet Microfinance	24116	40588029	y	y
Gambela Microfinance	880	1173831		
Gasha Microfinance	6991	14736312	y	
Ghion Microfinance	233	286268		
Harar Microfinance	2706	7101769		
Harbu Microfinance	17984	23808751	y	y
Lefayeda Credit and Savings	303	623441		
Letta Microfinance	925	4790020	y	
Meket Microfinance	2959	2329562		
Meklit Microfinance	14224	23029053		y
Metemamen Microfinance	10218	8720938	y	y
OMO Microfinance	327888	585102740	y	y
Oromia Credit and Savings (OCSSCO)	503000	1280000000	y	y
PEACE Microfinance Inst	17206	45507171	y	y
Shashimene eddir yelimat Agar (SEYAMFI)	4144	10959365		
Sidama Microfinance	47810	28334552		y
Somali Microfinance	new	new		
Specialized Financial & Promotional Inst (SFPI)	33342	50807161	y	y
Tesfa Microfinance	162	203576		
Wasasa Microfinance	53981	113970892	y	y
Wisdom Microfinance	45331	101205955		





Source: MF*Transparency Transparent Pricing Initiative 2011*

Cooperatives

Ethiopia's cooperative sector has been increasing in size, doubling every few years, since the regime change in 1991. Data for June 2006 showed that there were 5,437 savings and credit cooperatives, representing a membership of 381,312, and 1,166 rural SACCOs with a membership of 64,665[xxvi]. These are regionally concentrated with most of the Rusaccos located in Addis Ababa and Oromia. Along with Community Based Organizations, Rusaccos are seen as potential outlets for microfinance activities. MFIs have been exploring ways to work with SACCOs so that they operate as agents for the MFIs, extending microfinance into more rural areas.

Regulated under the Proclamation No. 147/98, cooperatives are owned and controlled by their members. In contrast to MFIs they are unable to take savings from non-members, typically provide loans for a term of less than a year, and offer interest rates lower than those of MFIs and moneylenders. Ethiopia has no structures in place to monitoring the performance or to supervise the operations of SACCOs.

Non-governmental organizations

It was the poor performance of NGO credit programs that led the government to overhaul the sector and to introduce microfinance regulation. The provision of microfinance services by non-regulated institutions is now forbidden under the laws of Ethiopia. Despite this, some international NGOs continue to include credit schemes in their development programs. This is considered to negatively impact the work of MFIs by undermining the market. The persisting practice of microfinance by the NGOs has been criticized both by the MFIs and at a political level.

Informal finance

Informal finance is often the only option available for those who require financial services but who are unable to access the formal financial sector. It is also attractive to some due to the limited questioning about loan purpose and the speed of loan processing. More than two thirds of the population has access to an informal finance provider, whether it is from money lenders, friends/relatives, or from one of the three popular Ethiopian-specific systems of informal finance. These are Iddir (financial assistance during mourning periods), Iqqub (cash savings organizations), and Meskel Aksiyon (group collaborations to purchase meat for the Meskel festival). Interest rates vary widely, from 0% from relatives, to an average of 10.5% per month from moneylenders[xxvii].

Microfinance Networks in Ethiopia: The Association of Ethiopian Microfinance Institutions (AEMFI)

Since its inception in 1999, AEMFI has been the network of all registered MFIs in Ethiopia. Its membership has expanded from 4 MFIs in 1999 to 31 in 2011. AEMFI is well regarded both nationally and internationally as one of the strongest microfinance networks in Africa. It has a strong focus on the social performance of microfinance institutions in Ethiopia. The objectives of AEMFI are threefold. It aims to provide a forum through which MFIs can exchange information, enhance capacity through the provision of training and funding negotiations, and to strengthen the sector by providing research, advocacy, promotion and engagement to positively influence policies and practice. AEMFI has close links to the government and is playing a key role in the development of the industry and in shaping the policy environment.

Funders and Donors

Lack of access to affordable capital to finance growth is a major challenge faced by Ethiopian MFIs. It is thought that most MFIs have the capacity to at least double their outreach and portfolios in the foreseeable future; however lack of access to capital is preventing this. As decreed by microfinance law, the main source of funding for MFIs in Ethiopia is savings mobilization. There is a prohibition against foreign direct investments into the financial sector, under the Ethiopian Foreign Direct Investment Laws - this includes the microfinance sector. This legislation urges MFIs to reposition themselves away from dependence on donor subsidized funds and towards commercial sources of funds; however the extent to which this has occurred is not certain.

International donor agencies, particularly independent and private ones, have been very supportive of the sector, however due to the growth of the MFI's needs for loan capital; many donors have reached the limits of their ability to help. The government supported MFIs are reinforced by equity finance from regional governments. Some multilateral donors, including KfW and AFD have designed loan guarantee schemes that allow MFIs access to capital without contravening FDI laws.

The social mission of MFIs presses them to direct most of their resources into their loan portfolios, leaving them poorly equipped with regard to management information systems. This results in a lack of apparent professionalism, which has deterred investors from the sector. Specialized microfinance funds have little investment into the Ethiopian market due their high return-on-investment expectations. This lack of capacity is being tackled via the Rural Financial Intermediation Program (RUFIP), which is a major initiative supported by IFAD, AfDB and the World Bank. RUFIP is an US80 million program to provide capacity building support for MFIs, low-cost capital provision, and capacity building support to the National Bank of Ethiopia (NBE). The second tranche of funding under this program is due in the coming months.

Microfinance Regulation

A prudential regulatory framework governing the microfinance sector was introduced by the National Bank of Ethiopia in 1996, and a revised version was released in 2009. This was a single legal framework for regulating and supervision of the sector, known as the Proclamation Nr 40/1996 for Licensing and Supervision of Microfinance Institutions. The objective of the regulation is to protect small depositors, ensure the integrity and stability of the microfinance sector, and to promote efficient performance of the institutions. This law, enabling the establishment of deposit-taking MFIs, or "share companies" has supported the development of MFIs for over a decade. As well as facilitating growth in the sector, the law prohibits NGOs and any other institution from offering financial services. There are currently 31 registered institutions regulated by NBE, including regional government supported institutions, local NGO affiliated institutions, and privately owned microfinance institutions.

The Proclamation No. 626/2009 terms microfinance business as "the provision of financial services like accepting savings, extending credit, drawing and accepting drafts payable, providing money transfer services and others specified in the Article 3(2) of the proclamation"[xxviii] .Notably, this definition does not restrict microfinance to credit services, rather it is the provision of a wide range of financial services, including savings, insurance, transfer facilities etc. As microfinance was defined as a business this new legislation allows banks that are licensed by the NBE to engage in microfinance business without a separate microfinance business license.

Due to the government enforced restrictions on the provision of banking services by foreign nationals, all MFIs in Ethiopia are wholly owned by Ethiopian Nationals or by organizations that are wholly owned and registered in Ethiopia, with a head office in-country. Regulation requires MFIs to incorporate as for-profit share companies, although as most shareholders are either public or civil society institutions, in practice most MFIs are structured as not-for-profit hybrids. When the regulations came into play all existing microfinance providers had to cease activity and apply for a license to operate. The first MFIs to register were part owned by regional governments, for example, Dedebit, Amhara, Oromia Savings and Credit Institutions, with the local governments owning between 25% and 97% of shares. NGOs took longer to convert to MFIs, the first being Specialized Financial and Promotional Institution (SFPI) and Gasha.

The government and the National Bank of Ethiopia have been gradually improving the regulatory framework over time, issuing a series of amending Directives. Research has shown that the regulations have bought many benefits to the sector, including creating an enabling environment, promoting standardization and encouraging transparency[xxix].

Capitalization levels for new entrants to the MFI market are set at a low and non-prohibitive figure of ETB 200,000. This is thought to be the lowest minimum capital requirement for MFIs in the world[xxx] . MFIs are able to collect savings from the public, which helps buoy their loan portfolios. If these savings exceed ETB 1,000,000 the MFIs are required to reregister with the NBE. This re-registering will subject the MFI to further inspection of capital adequacy ratios, liquidity and heightened reporting requirements; however it releases the MFI from maximum loan sizes and amortization terms[xxxi]. The capital adequacy ratio for re-registered MFIs is 12% (risk weighted assets to total capital ratio), and at least 20% of total savings must be kept in the form of liquid assets.

The 1996 statute dictated that loans should to be delivered to clients using the group loan methodology, without the requirement for property collateral. The 2009 statute opened this up, allowing the loan methodology used by the MFIs to be selected at their discretion. The maximum loan size for MFIs whose savings fall under the ETB 1,000,000 mark is ETB 5,000. For those whose savings portfolio exceeds ETB 1,000,000 the maximum loan size is unrestricted, however loans over ETB 5,000 should not surpass 20% of total loans[xxxii]. Loans to individuals are not able to exceed 1% of the MFIs total capital or 4% of total capital when lending to groups. Directive MFI/17/2002 sets the maximum loan period to 24 months for loans of up to ETB 5,000 and 60 months for loans surpassing this amount[xxxiii]. The NBE has imposed these loan limits in an attempt to dissuade MFIs from drifting from their poverty alleviation missions.

Historically, few MFIs have recorded profits, so the issue of taxation is unclear. The Ministry of Finance is consulting with AEMFI to clarify this area. Article 23 instructs that if profits are distributed to shareholders then the MFI shall pay profit tax, but if they are fully ploughed back into the institution then profit tax shall not be paid[xxxiv]. The number of branches an MFI may operate is unrestricted. The closure of branches is more carefully supervised, requiring formal approval from the NBE and at least 3 months' notice. Non-compliance with the regulatory Directives set by the NBE incurs penalty fees, the potential removal of the Chief Executive and the withdrawal of an institution's license to operate.

Cost of Borrowing - Interest Rates, Fees and Charges

Until 1996 interest rates were set by the National Bank of Ethiopia (NBE). This figure was capped at 12.5% per year; however there was no clarification as to whether this referred to a flat or declining balance rate. Since 1996, the cap has been removed and Directives state that interest rates should be determined by each MFI's board of directors.[xxxv] The minimum interest rate paid on savings deposit is however regulated. This has fluctuated over the years, and is currently set at 5%.[xxxvi] It has been set in an attempt to encourage savers to deposit at MFIs and so strengthen the financial intermediation process. Interest rates charged on loans are typically low, leading to low portfolio yields and low rates of return. These have remained low for various reasons, but it is largely due to the source of funds for MFIs arising mainly from regional governments and NGOs. Both actors are the main source of loanable funds and in-kind assistance to MFIs, leading to low cost of capital which is passed to the client.

Reporting and Supervision

By law, MFIs must report quarterly to the NBE their income statements, balance sheet, status of impaired loans, and loan provision. MFIs with deposits of over ETB 1,000,000 must also provide quarterly liquidity and capital adequacy reports. In practice, MFIs have struggled to implement this, hindered by the geographical spread of their client base, their concentration on rural communities, and their weak information management systems[xxxvii]. The Proclamation requires MFIs to submit externally audited reports each year by auditors acceptable to the NBE.

Prior to October 2001 the supervision of MFIs was carried out under the bank supervision division of the NBE. Since then, the sector has been supervised under a separate microfinance division, which was upgraded to Department level in 2004 and then Directorate level in 2009. The number of staff has grown from six in 2004 to 15 in 2010. The Directorate assesses MFIs through both off-site surveillance (analysis of the quarterly reporting) and on-site examination. However the Directorate has a limited capacity to makes on-site visits to MFIs and their inspection teams have encountered problems due to lack of appropriate information management systems in MFIs. It has been suggested that the industry is largely self-regulated by AEMFI and shareholder intervention.

Loan Products

Whilst the group lending methodology traditionally predominated in the Ethiopian microfinance market, data from microfinance institutions participating in the MF*Transparency's Pricing Initiative* has revealed a shift in the focus of lending methodology to individual lending. The dataset shows group lending constitutes 35% of methodologies, with individual lending methodology is cited in 65% of cases. This is quite a shift considering the heightened risks perceived with individual loans. It also might suggest that the institutions are adapting to better understand the client as individual rather than a group and adapting their product offerings accordingly.

In terms of sector composition, agriculture is the main focus of loans, however loans aimed at micro and small enterprises also feature, as well as housing loans, consumption loans and equipment loans. Savings consist of compulsory savings, voluntary savings and term deposits. Compulsory savings is a key feature of loans. MFIs are also allowed to accept demand and time deposits. Other products such as insurance (e.g. for crops, health and home) are offered by some MFIs, particularly the government sponsored programs, as well as money transfers and pension administration.

Financial Performance

The majority of Ethiopia's MFIs have achieved both financial self-sufficiency and operational self-sufficiency – an impressive achievement considering the youth of the sector. Each year AEMFI produces performance analysis reports from voluntary member institutions that submit financial and operational data. According to 2010 report, 74% of the 22 microfinance institutions included in the analysis were operationally self-sufficient, i.e. they were able to cover all their operating costs with the profit generated from their core microfinance operations[xxxviii]. The analysis for financial self sufficiency taking in to account adjustments for subsidies and inflation found that, on average, the same institutions were able to cover around 48% of their financial obligations[xxxix].

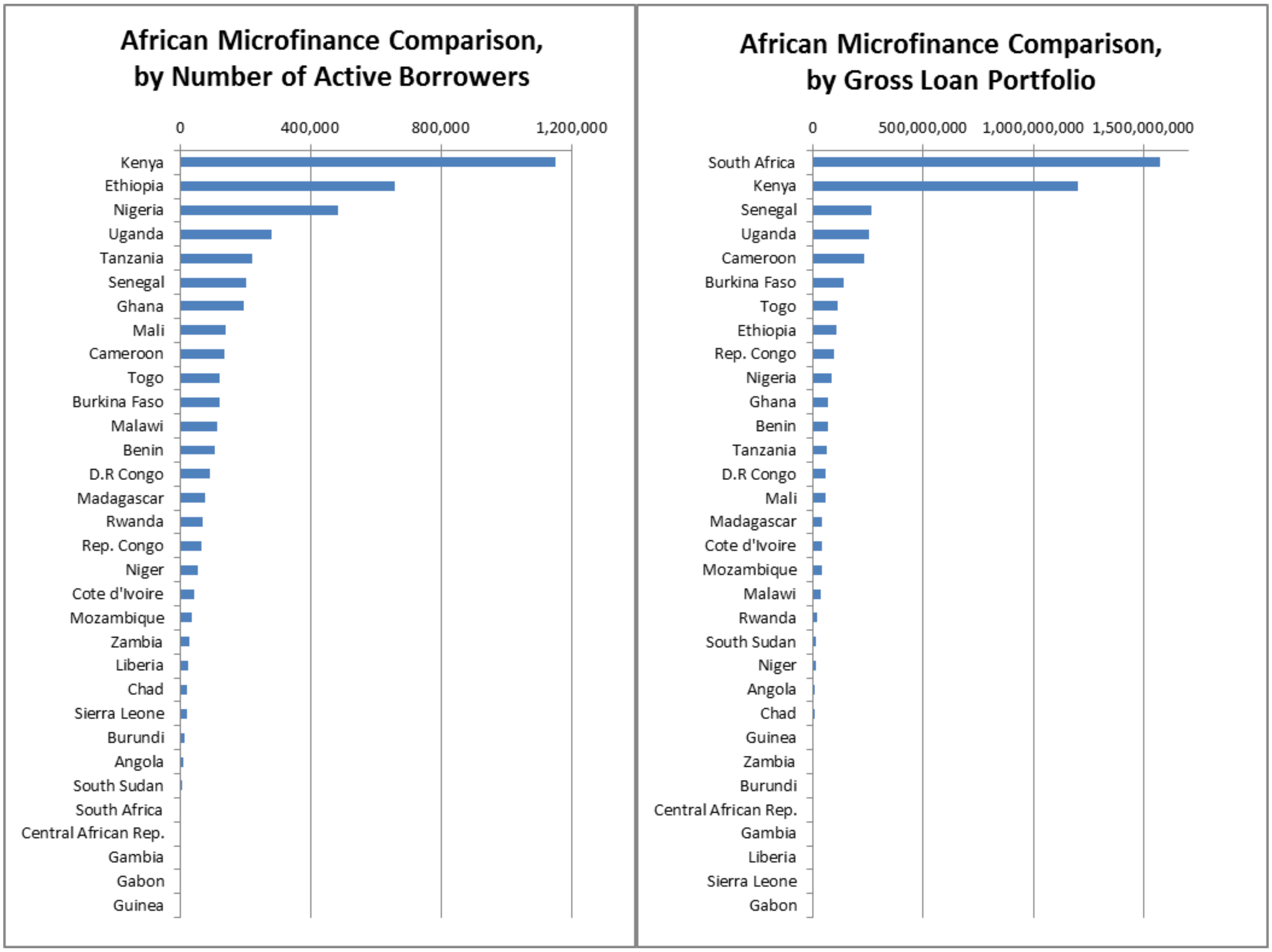
In general, the industry's ability to maintain self-sufficiency has been achieved through large scale, low cost operations with low portfolio yield, low interest rates and low costs. Margins are small and only sustainable due to the low cost of capital.[xl] Operating costs have been kept low, and at an average of 10% of assets operating costs are amongst the lowest in the industry. The AEMFI 2010 report details that the main challenge for Ethiopian microfinance institutions in achieving and maintaining financial self-sufficiency is the high inflation that predominates in the country, a concern that is shared by many of the MFIs.

Consumer Protection

In 2010 the existing Trade Practice Proclamation was modified to include issues of consumer protection. The new law proposed the establishment of the Trade Practice and Consumer Protection Agency, accountable to the Ministry of Trade and Industry. The new bill protects the rights of consumers to get satisfaction, accurate information on the type of goods and services offered, and compensation for damages suffered due to misleading transactions. AEMFI has also become active in this field in the area of microfinance, and has been working with several initiatives, including the Smart Campaign, the Social Performance Task Force and MF*Transparency* to improve consumer protection within the microfinance sector.

Ethiopia and Microfinance in Africa

The scale of outreach of Ethiopian microfinance institutions as compared to other African countries is sizeable. Ethiopia is home to several of the largest MFIs on the African continent. In absolute terms, the Ethiopian microfinance market is the ranked the second highest in terms of total number of active borrowers and eighth largest market in gross loan portfolio.



Source: Mix Market 2010

MFI Ratings & Reporting

The majority of Ethiopian microfinance institutions reported financial and operational performance data to MIX market as of 2009, showing the sector's adherence to international reporting standards. Several of these institutions have also underdone thorough ratings checks of their financial and operational performance. Social performance ratings are still relatively rare in Ethiopia but all three of the major rating agencies in the microfinance industry have worked in the Ethiopian microfinance market, covering five Ethiopian MFIs so far. The following table lists the MFIs with their respective rating score.

MFI	Rating	Rating Agency	Reporting Date
Financial / Operational Ratings			
ACSI	α	MicroRate	7-Sep
Buusaa Gonofaa	B-	PlanetRating	11-Oct
Benishangul Gumuz	B-	MicroRate	6-Jan
Metemamen	D	PlanetRating	8-Apr
PEACE	C++	PlanetRating	8-Aug
SFPI	Institutional diagnostic	Microfinanza	10-Apr
SEYAMFI	Institutional diagnostic	Microfinanza	11-Apr
Wasasa	Institutional diagnostic	Microfinanza	9-Jul
Wisdom	B-	MicroRate	8-Sep
Social Ratings			
Buusaa Gonofaa	x	PlanetRating	7-Jul
SFPI	x	PlanetRating	7-Aug
AVFS	x	PlanetRating	7-Aug
PEACE	x	PlanetRating	10-Aug
Wasasa	x	PlanetRating	8-Apr

Challenges for the Ethiopian Microfinance Industry

Although it is a well-supported sector, the Ethiopian microfinance industry faces several important challenges. One of the most significant challenges for Ethiopia's microfinance institutions has been the lack of access to foreign capital and donor funding for MFIs to finance their loans. Not only has this hampered the ability for MFIs to scale up, but it has resulted in some MFIs having to make some products dormant whilst they seek new funding streams. This lack of capital has also hindered MFIs from investing in their own development. One of the major constraints to MFIs in Ethiopia is the poor management information systems (MIS) and the lack of technical capacity within the institution. Efficiency gains could also be gained by linking branches more effectively with headquarters. With increasing borrower numbers MFIs require reliable integration of loan tracking and accounting software, all of which comes at an often prohibitive expense.

The industry also faces the challenges of limited outreach (particularly to women), uneven coverage over parts of the country and limited financial products. With the introduction of more flexible Directives regarding group lending, MFIs are now able to bring new products to market and expand their product offerings. However, they need to balance their requirement to address rural client needs with the problem of how to advertise agricultural products and bring them to market. Improved telecommunications and electricity infrastructure are developing in rural areas, and MFIs are increasingly looking at ways to work with community based organizations to improve outreach.

The issue of human resources is a familiar problem for the sector - staff turnover is high, particularly in rural areas where living conditions may be unattractive to staff and in urban areas staff where the private sector offers more attractive remuneration and alternative benefits such as shareholdings. In Ethiopia there is the additional challenge of the stringent personnel requirements for senior staff of the MFIs. The chief executive officer must have a minimum of a first degree in social sciences plus three years senior management experience in a financial institution. Board members must all have completed high school. These requirements are often detailed as prohibitive as the lack of skilled personnel in the sector has impaired the fulfilling of this requirement[xli]

Although the government is supportive of the sector and there is a clear legal framework, the NBE has a limited capacity to supervise and provide technical support. Concerns have been expressed by some over the about the risk of market distortion by regional government support of microfinance, as well as the dangers associated with over-regulation and the potential politicizing of microfinance in Ethiopia. There are also deep concerns within the sector about the growing issue of inflation on the profitability of MFIs, and the ability to maintain low interest rates. The absence of an efficient legal and court system to help protect both customers and MFIs means that contracts cannot be enforced and there is no foreclosure law.[xlii] On the regulatory side, Ethiopia also lacks a common regulatory framework for SACCOs.

There is a growing interest in microfinance from Ethiopian commercial banks, social investors and the private sector. In the past these have viewed microfinance as high risk with high transaction costs. However the commercial banks have the management expertise and systems infrastructure in place to impact the sector significantly. Despite this growth in competition there is a huge unmet potential market demand.

Along with many other microfinance markets in Africa, the Ethiopian microfinance sector has a need for greater training assistance, social performance assistance and business development assistance. Ethiopia lacks specialized consulting firms, a local rating agency, and a microfinance training institution that would be able to provide this support. AEMFI however is considered one of the strongest national networks in Africa, and if sufficiently resourced, would be able to provide much of the support that the sector is currently lacking. Internationally recognized initiatives, such as MF*Transparency*, are also working to help strengthen the sector and improve responsible microfinance in Ethiopia.

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