AMHARA CREDIT AND SAVINGS INSTITUTIONS: ETHIOPIA

USAID AMAP FINANCIAL SERVICES KNOWLEDGE GENERATION – STATE OWNED RETAIL BANKS

microREPORT #58

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This publication was produced for review by the United States Agency for International Development. It was prepared by Neil Brislin and Phetsile Dlamini of ECI*Africa* Consulting (PTY) LTD and Development Alternatives, Inc.

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PREFACE

This case study of Amhara Credit and Savings Institute was written by Phetsile Dlamini and Neil Brislin, under the USAID-funded AMAP SORBS project. Phetsile Dlamini, a Specialist at ECI*Africa,* managed the team contribution in developing the census of state banks in Africa and the case study on ACSI. Neil Brislin, who had previously conducted a rating of ACSI while with MicroRate, is a senior specialist at ECI*Africa*. Input was also provided by Robin Young of DAI and Dr. Gerhard Coetzee of ECI*Africa.*

Special thanks go to ACSI and its management for providing additional information and answering questions, as well as to MicroRate Africa, specifically Patrick Kerr and Craig Kirkwood, who provided up-to-date financial and operational information as well as other insights following their August 2005 rating review of ACSI.

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LIST OF ACRONYMS

ACSI	Amhara Credit and Savings Institution
ADA	Amhara Development Association
ADLI	Agricultural Development Led Industrialization
ALCO	Asset and Liability Committee
AWA	Amhara Women's Association
ANRS	Amhara National Regional State
CBE	Commercial Bank of Ethiopia
GDP	Gross Domestic Product
IFAD	International Fund for Agricultural Development
MFI	Micro Finance Institution
MIS	Management Information Systems
NBE	National Bank of Ethiopia
NGO	Non-governmental Organization
ORDA	The Organization for the Rehabilitation and Development of Amhara
SIDA	Swedish International Development Cooperation Agency
USAID	United States Agency for International Development

EXECUTIVE SUMMARY

The purpose of this case study is to highlight how the Amhara Credit and Savings Institution (ACSI) has been successful in terms of delivering financial services to poor, rural and remotely located communities in Ethiopia. ACSI was selected for this series of case studies on state owned financial intermediaries based on its growth (both in loan portfolio and savings mobilized), service diversification, efficiency and sustainability - remarkable achievements given the challenging environment in which it operates. Relatively little has been documented or disseminated about ACSI, a financial intermediary partially owned by the state of Amhara in Ethiopia, apart from a 2003 MicroRate rating.[1]

ABOUT ACSI

ACSI began operations in 1995 as a department of the organization for the Rehabilitation and Development of Amhara (ORDA), a local non-government organization, and was licensed as a separate micro finance share company in April 1997. Its primary mission is to improve the economic situation of the low income, productive poor in the Amhara region – primarily through increased access to lending and savings services. ACSI seeks to maintain cost effectiveness in service delivery and integrates its activities with government and NGOs working towards achieving food security and poverty alleviation[2].

Summary Stats	USD 000s except as indicated				
	Dec-01	Dec-02	Dec-03	Dec-04	Jun-05*
Net Operating Income	(148.6)	541.3	1,494.2	2,829.9	1,681.9
Gross Loan Portfolio	13,868.7	18,121.8	24,403.2	36,206.4	44,488.9
Savings	9,919.6	11,564.1	14,924.5	19,999.7	21,186.4
Cash & Equivalent	6,284.3	4,430.1	6,834.4	12,372.6	12,166.0
Portfolio at Risk 30 days (%)	2.5	3.5	3.1	1.7	1.3
Operating Expense Ratio (%)	8.3	9.2	7.8	6.2	6.0
Average outstanding loan size (USD)	90.9	83.9	84.5	103.1	112.8
Portfolio Yield (%)	13.3	17.8	18.5	18.0	17.8
ROE (%)	(1.9)	11.2	16.6	24.4	29.9
Debt / Equity (:1)	3.1	3.2	1.1	2.0	2.0
Total Capital / Risk Weighted Assets (%)	33.5	28.7	58.1	50.1	52.4
Cash and Liquid Assets / Total Deposits (%)	63.4	38.3	45.8	61.9	57.4

* Represents a six month period. Relevant ratios have been annualized. Source: MicroRate Africa.

[1] The MicroRate team was accompanied by USAID and SIDA representatives and a management information systems specialist. This case study is based primarily on the information gathered and reports generated from that visit and has been updated with additional information that ACSI's management provided, as well as discussions with MicroRate subsequent to their August 2005 ACSI rating update.

[2] ACSI Institutional Profile, Current Status and Future strategy

From the outset, ACSI has had a strong link with government, with the state government holding 25 percent of ACSI's shares. ACSI could be described as an anomaly when compared to the conventional wisdom on MFI performance and efficiency.

During its first decade of operations, ACSI has grown its loan portfolio to US$44.5 million, with deposits totaling US$21.1 million. Portfolio quality has consistently been excellent (even though the majority of the portfolio is agricultural in nature), and operational efficiency has tended to improve every year – even though efficiency levels are already high. The key measure of operating efficiency, the operating expense ratio[3], has dropped to 6.0 percent, which is amongst the lowest in the world for a micro finance institution. High levels of efficiency have in the past typically been associated with MFIs operating in urban areas and targeting the upper end of the typical MFI market.

However, ACSI operates in a very tough environment with the majority of its clients being the rural poor. ACSI's average loan size has been below US$100 up until December, 2003 before increasing to just above US$100 in 2004 and 2005, is heavily state influenced, and has poverty alleviation as its ultimate goal. In many other settings, this would lead to political patronage and financial disaster, yet ACSI has managed to achieve high levels of sustainability and financial independence. The rest of this case study looks at how they have done this, and what lessons can be learned.

ENVIRONMENT

Ethiopia is a country of over seventy one million people with a GDP per capita of USD 112.7. Amhara National Regional State, where ACSI operates, has a population of eighteen million, of whom most live in rural areas, and has the highest poverty levels in the country. The topography (quite mountainous), combined with limited roads and transport networks makes it very inaccessible. As a result, delivery of financial and other services is very difficult.

Legislation (proclamation and directives), which allows for the establishment of deposit taking micro finance institutions, has supported the development of the micro finance sector. Enacted in 1996 and revised in 2002, the legislation allows for MFIs to be established with a minimum capital requirement of Birr 200,000 (Approximately USD 23,000) and allows them to grant credit as well as mobilize deposits from the public. It also allows alternative lending methodologies, longer repayment periods of up to 5 years, and a loan size limit of 0.5 percent of MFI capital, with a condition that the total sum of advances for this kind of lending does not exceed 20 percent of the preceding year's disbursements. The interest rate ceiling on loans was also lifted, allowing MFIs to price to cover costs, but a minimum on interest to be paid for savings is still in place which hampers savings mobilization in rural areas. The legislation restricts foreign ownership in the sector. Putting in place appropriate legislation, the liberalization of financial markets and the removal of a number of existing controls in the economy created an environment conducive to the development of ACSI. Notwithstanding the favorable legislative context, the financial sector is still not well developed and a gap in the market exists in terms of the delivery of financial services throughout the country.

The government of Ethiopia has over the years adopted economic reform measures to address the issue of poverty. These measures include creating an environment conducive to a free market economy, employment creation which includes the promotion of policies that will encourage domestic savings and private investment, increasing income earning opportunities and promotion of small-scale industries in the informal sector among others. Credit is therefore also one of the means that is aimed at increasing smallholder production and activities in the informal sector.

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[3] Defined as operating expenses for the period divided by the average outstanding portfolio for the period.

The changes in government policy away from a socialist orientation towards more free market principles helped to influence the establishment of MFIs by focusing on creating opportunities for self-employment and income generation for the poor to escape poverty. Micro finance and micro enterprise support to the poor in countries like Bangladesh proved to play a vital role against poverty and this has had a significant influence on the development of micro finance in Ethiopia.

The transition of NGO activities in Ethiopia initially involved in the provision of relief and humanitarian support that then extended their services to the provision of credit to micro enterprises, rural and urban poor was another factor that contributed to the growth of micro finance in Ethiopia.

TARGET MARKET

In line with government policies, ACSI's target focus is the low income, rural based, productive poor, with a special emphasis on women. Women are mostly marginalized and cannot easily access financial services. Priority is given to those areas that are more food insecure, and a combination of poverty assessment and targeting methods is used to identify prospective clients. The organization is committed to providing innovative and diversified products to its clients, including a variety of savings and credit products. ACSI disburses pension funds for the government in Amhara State, and currently provides money transfer facilities for businesses. They are exploring the provision of money transfers for individuals, micro insurance and credit services to water point construction groups for re-building or maintenance of their water points.

ACSI has remained focused on its target market; with the average outstanding loan size just above US$100 in 2004 and 2005. To date, almost 70 percent of the Kebele's[4] in Amhara have been penetrated. However, the number of people serviced–very high by any standard at 394 374 clients at the end of June 2005–is only about 10 percent of poor people in the state–leaving considerable scope for continued growth, particularly if ACSI also introduced a vertical growth strategy to include more than just the poorest of the poor.

PRODUCT OFFERING

ACSI has become increasingly client focused and has developed a number of financial products to serve their clientele. At present ACSI offers three types of credit products (installment, term and asset loans), savings accounts (both pass book and term/time deposits), money transfers (limited to institutions at present) and pension fund payments on behalf of the government. ACSI also is developing a micro insurance product that should be launched by the end of 2005.

ORGANIZATIONAL STRUCTURE

Largely reflecting the rugged environment in which ACSI operates and its manual management information systems (MIS), both of which cause delays in information reaching head office management, ACSI has decentralized operations to the sub-branches, the only client facing part of the operation. In turn, the sub-branches report to branch offices, which then forward consolidated information to head office. This manual process takes around a month to produce consolidated information at head office. While this system is effective, it is time consuming and costly in terms of the number of staff required to capture data. As a result, it is open to errors and fraud and an

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[4] A Kebele is a local level government administrative unit, comprising approximately 1000 households, who elect a Kebele Committee.

automated system would be more efficient. ACSI has recognized this and recently appointed an MIS consultant to help implement a computerized MIS.

While operations are decentralized, subject to the strict implementation of policies and procedures, strategic decision-making is centralized at the head office, with a strong tier of management and senior staff.

Staff are recruited at entry level, and offered growth prospects through a clear and well-understood career path from field office to branch office level, although historically very few, staff incentives include tertiary education opportunities for long serving, high performing staff members. The lack of a computerized MIS has made it difficult to implement individually based performance incentive schemes, and current incentives are based on branch and sub-branch performance, and are limited to annual salary increments with no bonuses being paid to staff.

CRITICAL SUCCESS FACTORS

ACSI's accomplishments are the product of a number of factors. Although its results to date lay a strong foundation for future success, real challenges remain. The following is a summary of key lessons from ACSI that may serve others developing rural and state owned financial intermediaries.

Operational efficiency. ACSI is operationally highly efficient, and has been so since inception, reaching scale quite quickly. In large part, the ability to intermediate savings and government support more directly in the earlier years, helped the institution scale up its operations. A number of factors impact on the operational efficiency described. These include the decentralization of operations and the accompanying standardization of processes across the organization, a stable and committed workforce, very low staff costs and the involvement of the communities being served on a volunteer basis in the screening of loan applications.

Financial Independence. Good management has translated operational success and efficiency into financial success. By capitalizing its profits as retained earnings, ACSI has built up its reserves and a strong balance sheet, further fuelling the institution's ability to grow. Importantly, this has led to financial independence. As ACSI is not dependent on government or other outside funding, it is largely insulated from negative political influence on its operations, which has allowed ACSI to chart its own course and stay true to its vision and mission.

Community Involvement. A key factor behind ACSI's success is that they draw on the support of the local community (the Credit and Savings Committee) to priorities service delivery according to poverty levels and to screen all loan applications. Interestingly, these screenings are conducted in open forums, and the whole community can have a say. The committees also facilitate follow-up and monitoring. These committees are an effective way of using local knowledge to assess creditworthiness, and reflect in ACSI's portfolio quality. Committee members are representatives of the community and there is no financial or material benefit derived from their involvement other than the respect and recognition for being transparent, fair and displaying a wealth of local knowledge and wisdom. This minimizes the threat of collusion and any distortion by the committees.

Portfolio Quality. Portfolio quality is also very good reflecting the community involvement and customized products. The peer group pressure is still effective and plays a key role in ensuring that all loans are repaid. In addition to this, clients are encouraged to settle their debts whenever they have the money, and close follow-up and monitoring of groups is undertaken by staff.

Product Development. Another key factor that must be taken into account is ACSI's ability to successfully replicate products, in a way that adapts and designs products to fit into the existing environment and community structures and making optimal use of what is already in place on the ground.

Staff Commitment. Underlying all of this, however, is the dedication and commitment of ACSI's staff. Faced with a very challenging and physically demanding work environment, they are committed to what they are doing, and by and large share the institutional vision and mission. However, the difficult working conditions lead to staff turnover, with trained staff from the sub-branch and branch levels finding employment in government departments where the salaries are the same but working conditions much easier.

Relationship with Government. While the risks of a close relationship with government for financial institutions are well documented, this specific relationship does work to ACSI's advantage. Clearly the risks remain, , but, as pointed out already, ACSI's financial independence strengthens its position as does the presence of a strong management team.

Competition. There are 23 licensed MFIs in Ethiopia and just over 900,000 credit clients. The majority of these MFIs' operations are located in urban and semi-urban areas with little or no competition for clients in rural areas. ACSI, therefore, is a leader in financial services provision in Amhara. Although the threat of competition always exists, ACSI is well ahead of its peers, and is by far the largest MFI in Amhara.

REMAINING CHALLENGES

Infrastructure. ACSI operates in an environment that is characterized by low levels of infrastructure. This poses many operational challenges. One of its biggest challenges is the implementation of a computerized MIS, a process which they recently commenced.

Information flow. Probably a result of the manual systems, ACSI has in the past perfected the upwards flow of information in the organization, but needs to improve the amount and regularity of feedback provided to branch and sub-branch level – it is somewhat disempowering to not have access to the information you need to make decisions.

Ownership and Investment. With no foreign financial investment permitted in Ethiopia, the regional government and local NGOs own ACSI. MFIs are established as share companies and the capital should be owned fully by Ethiopian Nationals and/or organizations. This restriction limits inflows of capital into Ethiopia and forces MFIs to focus only on local sources. Only 2.5 percent of ACSI's equity base is made up of paid-in equity. If ACSI is unable to attract local investments the restriction of foreign financial investment is a potential barrier to ACSI's growth and development prospects. Although ACSI has significant local funding lines open that have not been drawn on, the potential positive influence of external shareholders on good governance and limiting undue interference should not be underestimated.

Risk Management. Without a comprehensive risk management framework in place ACSI is not well equipped to identify, quantify and manage the risks that it is exposed to. While it is not uncommon amongst small MFIs to have no risk management policies in place, it is more of concern for ACSI because of the millions of dollars in client savings in their custody. ACSI would benefit from assistance channeled towards undertaking a comprehensive risk assessment exercise that will result in a detailed review of risks facing the institution and developing strategies aimed at mitigating those risks.

Diversification. ACSI has made some headway in terms of increasing its array of products offered. It however needs to further diversify its product range to be able to reduce the risk exposure of its current portfolio which is concentrated in agriculture. The poverty alleviation mission of ACSI is noble, but to sustain its growth ACSI would benefit from a more diversified portfolio.

State Control and Influence. Despite its financial independence, 2 out of 8 of ACSI's Board Directors are government officials. Their influence has been witnessed in their ability to keep interest rates low despite the obvious high costs associated with lending to this target market. Government is believed to be behind keeping interest rates charged by MFIs very low, although the ceiling on rates was lifted some time ago.

INTRODUCTION

The Amhara Credit & Saving Institution (ACSI) started operations in 1995 as a department of a local NGO, the Organization for the Rehabilitation and Development of Amhara (ORDA), and has grown to become one of the largest micro finance institutions (MFIs) in Ethiopia. It had a gross outstanding loan portfolio of over US $44 million at the end of June 2005, and 394,374 active borrowers. The institution makes predominantly agricultural loans using group-lending methodology through a regional network of 10 branches and 174 sub-branches. ACSI changed into a company limited by shares in 1997, and is effectively controlled, through direct and indirect ownership, by the Amhara National Regional State, one of Ethiopia's 9 federal states with a population of 18 million. ACSI's main source of loan funding has been client savings (June 2005: $21 million), with the balance coming from donors, loans from the state owned Commercial Bank of Ethiopia (CBE) and retained earnings.

In many ways, ACSI is an anomaly when compared to the conventional wisdom on MFI performance and efficiency. ACSI operates in a very tough environment, with the vast majority of its clients being the rural poor. Its average loan size was just over US$100 in 2004-2005; it operates on a manual system; is controlled by the state and yet it is highly efficient when compared to other MFIs, generating healthy profits and mobilizing significant savings. The following table summarizes ACSI's performance to date.

Vision: ACSI aspires to see a society in which people are free from the grips of abject poverty, with all the power determining their future in their own hands.

Mission: Given the level of poverty in the region, ACSI's primary mission is to improve the economic situation of low income, productive poor people in the Amhara region primarily through increased access to lending and saving services. It will maintain cost effectiveness in service delivery, and integrate its activities with government and NGOs working towards achieving food security and poverty alleviation in the region.

TABLE 1: SUMMARY STATISTICS

(USD 000s except as noted)	Dec-01	Dec-02	Dec-03	Dec-04	Jun-05*
Net Operating Income	(148.6)	541.3	1,494.2	2,829.9	1,681.9
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Cash and Liquid Assets / Total Deposits (%)	63.4	38.3	45.8	61.9	57.4

* Represents a six-month period. Relevant ratios have been annualized. Source: MicroRate Africa.

This case study explores ACSI within its environment in an attempt to identify and understand the factors behind its success, as well as any risks that should be noted. Finally, it considers the critical success factors and what lessons could be drawn from ACSI's experience.

OVERVIEW OF THE ENVIRONMENT

SOCIO-ECONOMIC PROFILE OF ETHIOPIA AND AMHARA REGION

Ethiopia is the third most populous country in Africa. The country has a long political history, recurring droughts and a majority of its population living in absolute poverty. On the other hand, it is a country that has reasonably good resource potential for development of agriculture, biodiversity, water resources and minerals.

The table below provides socio-economic data of Ethiopia and the Amhara National Regional State[5].

TABLE 2: SOCIO-ECONOMIC FACTORS

	Ethiopia, 2003/2004	Amhara, 2003/2004
Total Population	71.1 million	18.15 million
Rural Population	84 percent (or 59.9million)	88.75 percent
Population Density	62.4:1 sq.km	1119:1 sq.km
Annual Growth	2.9 percent	2.67 percent
Life expectancy at birth	53-55 years	50.8 years
Fertility rate	6 births per woman	5 births per woman
Infant mortality	96.8 per 1000 live births	112 per 1000 live births
Children under 15 years		43 percent
GDP (in million Birr)	69,195.7	16,167
GDP per capita	USD 112.7	USD 103.50
GDP growth rate	11.6%	3.56%
Inflation rate (annual - 2004)	6.4%	17.3%
Exchange rate (average - 2004)	Approx 9 Birr to 1 USD	Approx 9 Birr to USD

ACSI is based in and operates within the Amhara region, located in the northern part of Ethiopia. Amhara covers an area of 170,752 square kilometers, and has a population of about 18 million people (about a quarter of the national population). Some 85 percent of the population resides in rural parts of the state, although it is more densely populated than other states in Ethiopia.

The topography, combined with limited road and other transport networks, means that many communities are difficult to access. This not only creates a problem for delivery of financial services but also for the promotion of enterprise development and the provision of other necessary services such as health, education and telecommunications.

Poverty levels within the Amhara State are the highest in the country as reported in 1999/2000. The proportion of people in Amhara who is absolutely poor[6] was 42 percent and overall 52 out of 113 districts[7] in Amhara are categorized as chronically food insecure[8] with variations between the urban and rural areas.

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5 Bureau of Finance and Economic Development

6 Refers to people whose total consumption expenditure was less than the total poverty line of Br 1075 (please provide US$ equivalent 119) for a basket providing 2200 kilocalories per adult per day, using the F.G.T. poverty model.

7 A region in Ethiopia is divided into zones, districts (woredas) and localities (kebeles). In the Amhara State there are 11 zones, 113 woredas and 3232 kebeles.

Within Amhara, agriculture is the dominant economic sector, accounting for 51 percent of the state's GDP. The industrial sector comprises 32 percent and the service sector 17 percent of GDP respectively. The annual per capita GDP is 795 Birr (USD 88), which is below the national average of USD 112.7, and 96 percent of households have household income that is below 1050 Birr (USD116) per annum. Expenditure on food accounts for 55 percent of household expenditure.

The majority of the people in Amhara State reside in rural areas where conditions are difficult. As most of them are heavily dependent on agriculture, they are faced with climatic adversities. They also have poor telecommunications and transport infrastructure, and health services are insufficient and not easily accessible. The series of challenges that face a typical Ethiopian rural household are extreme and have the potential to undermine the development efforts geared towards bringing about an economic turnaround and improving household income levels.

The situation of HIV and AIDS in the Amhara State is one of the worst in the country with persistently high prevalence rates. The prevalence rate increased from 13.0 percent in 1992/1993 to 20.8 percent in 1999/2000 and further to 23.4 percent in 2001.[9]

EVOLUTION OF GOVERNMENT POLICIES IN ETHIOPIA

With a socialist government in power, the 1970s in Ethiopia saw the government extending its control over the whole economy, nationalizing all large corporations (including all financial institutions). During this period, up until the early nineties, the country's economy weakened as a result of, amongst others, the loss of productive capacity and competitiveness within state institutions as well as recurring drought, conflict and war draining the resources.

In the 1990s the Transitional Government of Ethiopia initiated a broad spectrum of reform measures to improve the economy and address the development challenges within the country. These reforms were aimed at reorienting the economy from a command to a market economy, rationalizing the role of the state and creating a legal, institutional and policy environment to enhance private sector investment.

In 2002, the Federal Democratic Republic of Ethiopia introduced the Sustainable Development and Poverty Reduction Programme which is built on four pillars: agricultural development led industrialization (ADLI); justice system and civil service reform; decentralization; and empowerment and capacity building in public and private sectors.

These above-mentioned strategies and policies are explicit in making poverty reduction their core objective and, as such, there is a strong focus on rural and agricultural development. This is because agriculture is the source of livelihood for 85 percent of the population, the majority of which is poor and lives in the rural areas.

The government seeks to make extensive use of the labor and intensive use of the cultivable land resources in order to considerably increase the contribution that these resources make to economic growth. The provision of appropriate financial services has a fundamental role to play in terms of ensuring that government meets these objectives. ACSI is amongst the many vehicles that government supports and endorses as part of its sustainable development and poverty reduction efforts.

To ensure responsive service delivery, the federal system adopted by government seeks to deepen and strengthen the decentralization of government functions. Power is devolved to the regional government

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8 Source: The Aids Resource Centre, Addis Ababa, Ethiopia. (www.etharc.org) Source :BoFED Bureau of finance and Economic Development, 2002

9 Amhara HIV/AIDs Prevention and Control Secretariat

so that decision-making and the implementation of economic policies and development programmes take place at regional level. The federal system of government also allows some revenue collection by the regions and provides budgetary subvention to the regions and grants the regions full autonomy in budgetary expenditures.

Given ACSI's alignment with the government's objectives of poverty reduction, as well as the important role played by ACSI in the delivery of financial services (and other services described later), the organization's operations are supported by the government, from state to local level. In the past, direct assistance was provided in the form of free or very cheap office space for ACSI's outlets. However, such direct assistance is largely not provided anymore as ACSI has moved quite deliberately to establish itself as an independent financial institution.

The economic policies followed by Government since the late nineties are significant developments that empowered the regional states to tackle the development agenda within their respective regions. The Amhara region also has a potential for natural resource based development.

Amhara State has the potential to increase its agricultural production. In Amhara, about 85 percent of the people are believed to be involved in agriculture, and the State is believed to be one of the major staple food producing areas in the country. Crops that are produced included in large quantities are barley, wheat, oil seeds, sorghum, maize, wheat, oats, beans and peas. Cash crops such as cotton, sesame, sunflower and sugarcane are grown in the vast and virgin tract of the region's low land. The water resources from Lake Tana and all the rivers found within the State provide immense potential for irrigation development, and there are already programmes working in this area.

LEGAL AND REGULATORY FRAMEWORK

A proclamation known as the Licensing and Supervision of Micro-financing Institutions Proclamation No.40/1996[10], came into effect in 1996 shortly after ACSI was established as a programme of ORDA. Prior to the proclamation, a number of NGOs and donor organizations provided small-scale credit at concessionary rates to the rural and urban poor and micro enterprises on a limited scale in Ethiopia.[11]

The proclamation allowed for the establishment of formal financial institutions as profit-oriented share companies owned by Ethiopian nationals and/or organizations. The proclamation also laid out a regulatory framework for the operations of such companies which fall under the supervision of the National Bank of Ethiopia (NBE). In the proclamation the micro finance business is defined as "an activity of extending credit, in cash or in kind to peasant farmers or urban small entrepreneurs". The NBE is empowered to license, supervise and regulate the delivery of financial services to the rural and urban poor through MFIs. MFIs are allowed to accept savings and time deposits, borrow money for business purposes, take security, provide counseling services and manage funds for micro financing business. All MFIs under the proclamation are expected to devise and execute a policy whereby the low-income section of society, especially in rural areas, gets access to credit. To this end, they are required to implement property collateral substitutes, such as group guarantees.

The Proclamation No. 84/1994[12] precludes a foreign national from undertaking banking business in Ethiopia and no person is permitted to own more than 20 percent of a banking company's shares. Accordingly, MFIs in Ethiopia are established as share companies, the capital thereof fully owned by

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[10] Gobezie, G, 2005

[11] Shiferaw and Amha, 2001

[12] Gobezie, G, 2005

Ethiopian Nationals and/or organizations wholly owned and registered under the laws with a head office in Ethiopia.

Most credit operations that operated prior to the proclamation were influenced by humanitarian principles, and therefore did not aim to achieve operational or financial sustainability. The preoccupation was largely towards the delivery of financial services and in the recovery of the capital loan amount, with little or no regard for cost recovery or profit margins.[13]

Most NGOs provided soft loans in areas affected by drought and famines. The majority of their lending programmes required compulsory savings. They targeted women and offered loan sizes between 100 birr and 10,000 birr ($11.1 to $1,111 USD). These programmes played a role in terms of relieving stress and temporary shocks when rural calamities struck. However, they were typically short-term interventions with humanitarian objectives.

Over the longer term these interventions would not be sustainable because they were not so designed, and did not adopt business practices that would ensure that they recovered costs associated with lending activities. The focus on recovering only the principal outstanding amount to maintain a revolving fund meant that over time the funds would diminish because of inflation and loan losses. This compromised the overall growth and outreach of these credit operations.

The NBE directive with regard to lending methodologies, terms and conditions was recently relaxed. The most important changes include encouraging alternative lending methodologies other than the “group lending”, extending the maximum repayment periods for loans from one to two years, and removing the interest rate ceiling on credit, although a minimum interest rate to be paid on savings is still in effect. In addition, MFIs were allowed to extend loans larger than the Br 5000 limit, on the condition that total disbursement for such loans would not exceed 20 percent of the preceding year’s disbursements, and the maximum loan size would be 0.5 percent of the MFI’s capital. The repayment period of such loans can go up to five years.

The regulatory framework has helped to lay out the roadmap for the development of the micro finance sector and the amendments have addressed some of the problems that MFIs had been facing. However, the restriction in terms of foreign ownership confines new insights and learning that could be derived and potentially reduces competition in the industry.

As of April 2005, 23 MFIs are licensed under the NBE. The number of MFIs has grown at a slow pace, with a majority of the MFIs operating in urban and semi-urban areas. This means competition for clients in rural areas is almost non-existent and the rural poor still have few choices for financial services. Of the total of 23 MFIs, only a handful have a clientele of over 100,000, with the majority of MFIs having a client base of some 10,000 or less.

There are also a number of NGOs involved in micro finance delivery without a license. As mentioned earlier, their system leans more towards subsidized interest rates and charitable or humanitarian values. The extent of potential damage that can be caused by such practices is a concern, as they could distort market systems and undermine clients of licensed MFIs.

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[13] Shiferaw and Amha, 2001

FINANCIAL SECTOR

HISTORY OF BANKING SECTOR

Following the declaration of socialism in 1974 the government extended its control over the whole economy, and all large corporations, including banks, were nationalized. All institutions with similar functions were merged. The financial sector that was left behind by the socialist government constituted only 3 banks, namely the National Bank of Ethiopia, the Commercial Bank of Ethiopia and the Agricultural and Industrial Development Bank.[14] During the socialist era, the Office of the National Committee for Central Planning (ONCCP) outlined all development strategies and plans for all major economic sectors. During this time, the Central Bank of Ethiopia provided credit facilities to the central government and public enterprises.[15]

In 1994, following the changes in economic policy and financial sector reforms, the Monetary and Banking Proclamation of 1994 established the National Bank of Ethiopia as a judicial entity, which made it the central bank, and it ceased all commercial banking operations. This was to assist the country to foster monetary stability, a sound financial system and such other credit and exchange conditions conducive to the balanced growth of the country's economy.

THE CURRENT STATUS OF THE BANKING SECTOR

The number of commercial banks had grown to nine at the close of 2004, of which three were government and six privately owned. The number of insurance companies has also grown to nine, one state owned and eight privately owned. There were also 23 micro finance institutions and several savings and credit cooperatives operating as financial institutions. Foreign investment in the financial sector is not allowed[16].

At the end of 2004, the number of bank branches totaled 359, twenty more than a year earlier, with most of them in the big cities. Of the total bank branches, 172 (47.9 percent) belonged to the Commercial Bank of Ethiopia. Ethiopia remains one of the most under-banked countries - even compared to other Sub-Saharan African countries (the bank branch to population ratio was 1: 198,050 during 2003/04[17)] and the formal financial sector in Ethiopia displays disparities similar to other developing countries. The formal banking sector is not targeting the rural, remotely located or poorer communities in Ethiopia, and micro finance in Ethiopia has developed as a result of the obvious gap in the provision of financial services.

LENDING

Until 1994 the Development Bank of Ethiopia (DBE) was the only supplier of agricultural input loans to small farmers. In 1997 the DBE terminated the provision of agricultural input loans and started specializing in medium term credit.

The Commercial Bank of Ethiopia only started getting involved in providing agricultural input loans in 1994, but did not continue to do so for long. CBE provided input loans through intermediary

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[14] The Agricultural and Industrial Bank was restructured further and renamed Construction and Business Bank of Ethiopia (CBBE) and Development Bank of Ethiopia (DBE)

[15] The National Bank of Ethiopia, 2001.

[16] The National Bank of Ethiopia, 2001

[17] The National Bank of Ethiopia, 2001

organizations such as service cooperatives, peasant associations and farmers' groups. The development and extension agents of the Ministry of Agriculture, working at grass root levels, were used to assist in processing the credit applications and in the subsequent correct application of inputs. Over time, high default rates threatened the financial health of the banks involved in agricultural credit to the point where banks decided to provide input credit to farmers only after the state government guaranteed the loans. The CBE was not involved in collecting the loan repayments from the small farmers - instead the regional government paid CBE and recovered all loans directly from the farmers. The impact and outreach of these initiatives remained limited.

These guarantees were being provided to support the commercialization of agriculture, particularly in the rural areas. The guarantees are being withdrawn by government and therefore no longer available. The guarantee scheme is one of the initiatives that marked state government's involvement in the delivery of financial services to districts and localities.

SAVINGS AND CREDIT CO-OPERATIVES SOCIETIES

Savings and Credit Cooperatives Societies in Ethiopia started in the mid-1960s as Savings and Credit Associations (SCAs). By 1996, a total of 578 SCAs with a membership of 129 216 members were formed nationwide, holding a total of 124 million Birr in savings. New legislation was promulgated in 1998 which sought to reorganize the SCAs into Savings and Credit Cooperative Societies (SCCSs). The original national development office for cooperatives was dissolved and regional governments were given the responsibility of promoting and supporting the formation of SCCSs. The exact number of SCCSs cannot be traced but estimates indicate that total members in SCCSs are about 6,300 in Amhara region.

THE STORY OF ACSI

HISTORY AND CREATION OF ACSI

OWNERSHIP

ACSI was formed by the Organization for the Rehabilitation and Development in Amhara (ORDA), an indigenous, local NGO engaged in development activities in the Amhara region. ORDA was established in 1991 to provide relief to people affected by drought and the war against the previous Dergue regime. In a move to depart from the more usual direct provision of relief, the NGO created a department to supply small amounts of credit to rural people on a pilot basis. That department grew into a separate institution and ACSI was licensed as a micro finance share company in April 1997 with the primary mission of improving the economic situation of low income productive poor people in the Amhara region through increased access to lending and savings services. ORDA is still involved in relief activities as well as development projects such as conservation, forestry and small-scale irrigation in the Amhara region.

The other shareholders of ACSI are the Amhara State Government (25 percent), Amhara Development Association (ADA) 20 percent, Amhara Women's Association (AWA) 10 percent and Endeavour 10 percent.

ADA is a non-profit NGO established in 1992 and engaged in primary health and basic education, skills training and other development activities in the Amhara region. ORDA is a local NGO established before 1991 to provide relief to people affected by drought and the war, while Endeavour is a local NGO engaged in the development of agro-industries that facilitates agricultural production and processing. AWA is a member owned, donor-funded association engaged mainly in promoting and mainstreaming women's issues in development.

STRUCTURE AND OPERATIONS OF ACSI

ACSI has grown from only 6 branches (in 1996) to 10 branches and 174 sub-branches in 2005, and from a two layered organizational setup (where there was only a head-office and branches) to a three-layered one (where there is the head-office, branches and sub-branches). ACSI now has three departments (finance, operation, and planning); three services (audit, administration and promotion) and two units (MIS, legal). It has about 1680 employees (some 17 percent women). The vast majority of staff (about 91 percent) are employed at sub-branch level with most of them dealing directly with clients. Few have college degrees and diplomas, and the majority are 12th grade graduates[18], some of who are studying towards a diploma.

In its operations, ACSI has managed to gain support from many of its stakeholders, the government, the local NGOs and community organizations operating in the rural areas. ACSI draws on the support of the local community (through participation in the Credit and Savings Committee) to screen potential clients in order to assess creditworthiness and to priorities those who should receive loans first (based on their poverty level, those households that have one oxen because possession of one oxen serves as a local poverty line) and to further facilitate follow up and monitoring.

[18] Institutional Profile, Current Status and Future Strategy, ACSI, 2004

Recognizing that financial services alone cannot alleviate poverty and in an attempt to ensure that poverty is tackled in a holistic manner, ACSI has initiated a strategic alliance with the Amhara Development Association (ADA). This union aims at being mutually supportive although operationally separate, with ACSI providing micro finance activities and ADA providing health and skills education. The coordinated delivery of these vital services attempts to give a broader integrated offering, especially to women, who are a priority focus to both organizations.

ACSI's growth and development is to an extent dependent on the relationships it builds and establishes with the relevant stakeholders, because the provision of financial services it undertakes cannot single-handedly achieve the goal of improving the economic situation of the low income, productive poor people in Amhara.

MARKET

ACSI's focus has always been on the poorest of the poor, and particularly on women. This is mainly because women are believed to have the highest impact on poverty and food security within the household. ACSI has a target of delivering at least 50 per cent of the credit service to women. This target has been reached in the past (1998), but over the years it has dropped. As of August 2005, 38 percent of clients were women. Many reasons account for this decrease. As outreach expands to the very remote and peripheral areas, the challenge of attracting additional women increases, and a lot of promotion is needed to attract them. Further, in the most remote areas, women are more risk averse. Moreover, ACSI has recently made some modifications in operations with a view to limiting risks in cash transactions. Specifically, loan repayment and savings collections and withdrawals have to be conducted at office level in the presence of all essential sub-branch officers instead of at any point in the field. This requires clients to physically appear at ACSI sub-branches for such transactions. The further the sub-branch is located from the field point the larger the chances that poor women will miss out on the service because they cannot travel such long distances from their homesteads.

In terms of area targeting, priority is given to those areas that are most food insecure. At a household level, a combination of poverty assessment and targeting methods is used to identify prospective clients. At an individual level, ACSI targets people who are engaged in productive activities - those that if appropriately assisted could by themselves create activities that could enable them to get out of poverty (the entrepreneurial poor). Prospective clients of ACSI are also expected to be persons who are free from other debts (e.g. governments and cooperatives), and a permanent resident in the locality.

ACSI's target market is largely involved in agriculture. Over 58 percent of ACSI's portfolio is invested in agricultural activities; mainly the purchase of oxen, traditional sheep rearing and other livestock, cultivating of teff[19], maize, wheat and barley. 35 percent of the portfolio is invested in trade activities, and the remaining 7 percent is invested in handicrafts, weaving, pottery, beekeeping, etc.

ACSI's operations currently cover most of Amhara State, reported as over 65 percent of the rural villages. Through its 10 branches and 174 sub-branch field offices it has reached all districts in the State and operates in over 2221 of the 3240 kebeles (almost 70 percent if the total). By June 2005, ACSI had an outreach of over 394,000 active credit clients with a loan portfolio of US$44.5 million. In

Governmental Structure in Amhara State

Ethiopia is a Federal Republic, with each of its 9 states being governed by a sister political party of the main party. Amhara State is broken down into 11 Zones; 114 Woredas (district level government administrative units); and 3,240 Kebeles (local level government administrative units). Kebeles are comprised of approximately 1000 households, who elect a Kebele Committee.

[19] An African cereal.

addition, ACSI had over 600,000 savings clients, with total savings of US$21.1 million mobilized.

Although its expansion to the rural part of the state is quite impressive, estimates show that ACSI has reached only 8–10 percent of the poor people in Amhara. As most MFIs operate in urban and semi-urban areas, the number of MFIs serving the rural areas is low, which means competition for clients is weak and the rural poor have no or little choice in terms of financial service providers. For most people in Amhara, ACSI is the only service provider.

Taking into account the remote location of ACSI's clients and the poor infrastructure in Amhara, it is clear that delivery of financial services to this target market remains a serious challenge. The risks involved in transporting cash, the follow-up and daily monitoring of clients to ensure full repayment of loans, the time taken to report on and communicate within the organization on operations, and the delays experienced during the rainy season when branches and sub-branches are inaccessible, are critical issues that impact on ACSI's operations. These are also the factors that deter or minimize competition in the delivery of financial services within Amhara. There is no policy or legislation that prohibits other MFIs from setting up and operating within the same region as ACSI – and in fact some have, but are relatively small in size.

PRODUCTS AND SERVICES

ACSI currently provides four types of financial products; credit, saving, money transfer and pension fund management. They plan to launch a micro insurance product within the year on a pilot basis.

CREDIT

Credit is provided for income generation and related purposes. The credit products consist of installment, term and asset loans. The asset loans are being offered on a pilot basis, particularly for the housing construction sector. The installment loan is aimed at traders, manufacturers and handicrafts producers. Term loans are mainly made in the agriculture sector, with balloon repayments made at the end of the term (coinciding with the harvest).

TABLE 3: DESCRIPTION OF LOAN PRODUCTS					
Loan Type	**End-Term**	**Installment**	**Food Security**	**Asset**	**Business loan**
Methodology	Group	Group	Group/Individual	Individual	Individual
Interest Rate	18%	15/18%	12.5%	18%	10-12.5%
Interest Rate Type	Declining Balance	Declining Balance	Declining Balance	Declining Balance	Declining Balance
Other Fees	Nil	Nil	Nil	Nil	Nil
Term	9-24 Months	6-24 Months	24 months (with rescheduling)	1-3 Years	1-5years
Repayment Schedule	Semi-annually or end of term	Monthly	Semi-annually or end of term	Monthly	Monthly/Term
Savings Collateral as % of Loan Value	5% Upfront, 1% monthly	3% Upfront, 1% monthly	Nil	20% Upfront	Nil
Minimum Size	$17	$17	$17	$116	$580
Maximum Size	$580	$580	$580	$1,744	$11,627
Predominant Loan Uses	Agriculture	Processing; manufacturing; trade & service	Agriculture	Housing construction & equipment	Trade, small enterprises, agro-industries, commercial agriculture
% of Portfolio	76.7%	15.2%	4.7%	2.1%	1.3%
Ave. Outstanding Balance	$91	$166	$152	$357	$ 5776

Credit is extended to groups, but recently ACSI started issuing loans to individuals. With the group methodology, the collateral substitute is the group guarantee and candidates are required to exercise peer group self-selection and organize themselves for the purpose of sharing a mutual loan guarantee. Individual lending has started on a limited scale, with collateral for these loans in the form of fixed assets like houses (where available and if the house is registered with the municipality) and individual guarantees from salaried people or those who have fixed assets

Interest charged on loans ranges between 12 to 18 percent per annum, and is calculated on a declining balance basis. No additional fees are charged on loans. The maximum loan period for group loans is two years and the majority of the loans are to groups that are residing in the rural areas. The proportion of lending to urban areas is limited.

The ceiling on interest rates that is charged on loans was lifted by the National Bank of Ethiopia some time ago, with no formal restrictions in terms of interest rates MFIs charge their clients. This means that ACSI can freely price its loans to cover administrative expenses, loan losses, and cost of funds, capitalization rate and a profit margin. However, there appears to be pressure from the Government to keep interest rates low.

In addition to the normal interest rates and loan charges, ACSI also implements penalty charges for loans in arrears as follows:

TABLE 4: DAYS IN ARREARS	
Days in Arrears	**Penalty**
1-30 days	No penalty
31-90 days	1% of outstanding
91-180 days	2% of outstanding
181-270 days	3% of outstanding
271-360 days	4% of outstanding
>360 days	5% of outstanding

SAVINGS

ACSI mobilizes savings from loan clients (both compulsory and voluntary savings) as well as from other members of the public (voluntary savings).

Voluntary savings mainly comprise savings deposits/pass book and time deposit. Clients receive a record book where their deposits and withdrawals are entered, so they can keep track of their transactions. Time deposits allow clients to lock into an interest rate for a specified period of time.

Compulsory savings are forced savings, whereby all loan clients save various obligatory or compulsory amounts regularly in addition to their voluntary individual savings throughout their membership of ACSI. These are intended to encourage savings at a personal level and at the same time to create an investment reserve for on-lending.

PENSION FUND MANAGEMENT

ACSI serves as a local agent of the pension and social security authority to disburse pensions in areas where ACSI has sub-branches. Because they have branches at all district levels they are able to extend this service adequately. In reality, ACSI is nearer to the pensioner than the government offices, which are generally situated in towns. Pensioners are not required to have savings accounts with ACSI. ACSI is paid a commission for all the pensions they pay out. At this point in time ACSI has not developed any appropriate financial products targeted at this market but sees an excellent opportunity for that. .

MONEY TRANSFERS

ACSI is involved in the business of money transfers, currently only for institutions. The feasibility of providing money transfers at the individual level is being investigated.

OTHER PLANNED PRODUCTS

ACSI states that it is committed to product and client diversification to ensure that they continue to provide financial services that are valuable to clients whilst maintaining institutional stability.

Currently, ACSI is focusing on developing procedures for the delivery of credit services for water point construction to groups organized under the water and sanitation cooperatives. This is a community loan product, targeted at users of water points[20].The users regularly contribute a certain

[20] Planned locations where communities can consistently access water for basic human needs.

amount as a water fee/charge. Part of this fee is used to finance expenditures like the guard's salary and the other part goes into a maintenance fund for the water points. Such a token contribution in cash and labor and other local materials is presumed to enhance the sense of ownership of the community. Whenever these funds are not sufficient for the maintenance, repair or re-building of the water point, credit is requested from ACSI. The maximum loan amount based on the construction of a water point is Br 15,000. The terms and conditions of the loan are negotiable.

ACSI is currently exploring through a detailed investigation the feasibility of developing a village banking model. This would involve lending through community based organizations or cooperatives which would further on-lend to their members. ACSI is concerned, however, about the capacity of the community based organization and cooperative to be able to serve this function.

PRODUCT DEVELOPMENT AT ACSI

ACSI is moving away from a supply driven methodology towards being more client focused. It has now become a standard practice for ACSI to be more client responsive; they conduct ad-hoc studies of client satisfaction, and impact assessments of the various financial services being offered.

They also use group meetings as a forum with all clients to discuss amongst other matters the suitability of financial products and services being offered. This information is submitted to head office as feedback from the field for analysis and possible action. Head office staff also carries out quarterly supervision visits to its branches and sub-branches, and the supervision programme also includes direct contact with a sample of clients.

Client feedback has, in the past, led to revision of the financial delivery process. Originally centres, where groups of clients meet for their regular meeting, were considered as a possible mechanism to organize people for loan guarantees. This would mean members of a centre would be responsible for default of any one member in the centre, a concept taken from the Grameen model. However, because the rural villages are isolated from each other, there is a significant information gap amongst people organized under one centre. To counter this, smaller groups of five to seven people from the same village (where the problem of information asymmetry is significantly lower) now guarantee each others loans as a collateral substitute.

> An example of how poor infrastructure impacts on ACSI's operating efficiencies is reflected by the fact that it takes one full day of travel by mule (the only viable transport) for ACSI regional staff to reach a number of the sub-branches – which have no electricity, communication or reliable transport connecting them to other areas. This is something the internal audit staff has to do quite regularly. When one of them was asked what ACSI could do to improve the working conditions, the answer was a surprising "Give us company sleeping bags for when we undertake these trips".

SYSTEMS

As a result of its extremely challenging environment, around half of ACSI's sub-branches have no electricity or communication and some operate in villages that lack communication facilities. This presents significant challenges to the running of the organization and, in particular, complicates the design/selection and implementation of a suitable computerized MIS. As a result, ACSI still operates a manual MIS system.

Under this system, information on loan disbursements and repayments, savings and pension payments is collected and recorded at each sub-branch. The sub-branch then submits to the branch hand written summary operational and financial reports on a monthly basis. The branch office then manually consolidates the sub-branch information, and submits a consolidated report for the branch to head office.

While the system is effective in that it seems to produce reliable information, it is clearly not efficient as it is a tedious process requiring lots of manual report writing and cross checking. Information takes much longer to reach management, at all levels, than would be the case with a computerized system. Under the current manual system, it takes about a one month for consolidated information to be available to management. Further inefficiencies include the sheer number of staff involved solely in capturing and generating data, which typically never gets analyzed at source due to time constraints.

While ACSI had previously attempted to computerize their MIS, with donor funding paying for the local development of a software solution, this was not a success. However, ACSI has recently (with donor backing) appointed an MIS consultant to implement a computerized MIS solution, which is likely to entail quite significant business process re-engineering to be truly successful and result in efficiency gains. Retraining of staff whose positions may become redundant will also be required, as will general computer literacy training for most sub-branch and even branch staff.

Given ACSI's relatively large size – this is a considerable challenge, but one that must be met. As ACSI grows, and in particular as it becomes more sophisticated in terms of product offering, the need for a computerized system becomes critical to the maintenance of internal control. A large part of the success to date using the manual system can probably be attributed to the standardized product offering and loan process. Internal auditors pay a lot of attention to verifying compliance with policies and procedures, a lot of which can be automated with a computerized MIS. As a result, there is a sense that they do not always have sufficient time to be able to analyze data and trends and identify and focus on key risk areas – leaving ACSI somewhat exposed to potential fraudulent activities.

STAFF AND INCENTIVE POLICIES

ACSI generally recruits at the bottom, with staff first working as sub-branch field workers after receiving internal training on micro finance and ACSI's products and procedures. After spending about two years in this position, staff can then move into other positions (cashier, accountant, co-ordinator, junior branch accountant etc.), also for an average of two years. It takes about 8 years to progress from fieldworker at the sub-branch to the branch level.

This career path, which is understood by staff members, represents the main financial incentive for good performance. In the past, there has not been a performance based incentive scheme (PBIS) targeting field workers. From 2001 to 2003, the performance incentives were based on a ranking of branches and sub-branches, with the top 50 sub-branch coordinators and top 4 branch managers receiving salary increments that were slightly higher than the overall annual salary increments.

The lack of a computerized MIS no doubt makes it difficult to implement an individually based PBIS, but this is essential for ACSI (or any other organization) to maintain and improve current levels of efficiency, as well as retain staff in the medium to long-term. While ACSI has recognized the need for such a scheme, it is only likely to be feasible once the MIS is computerized.

Another "incentive" for ACSI staff is the training that is provided – particularly the long-term training offered to employees with a good performance record and quite lengthy service history (offered to sub-branch and branch level employees). This training is provided through higher training institutions such as the Ethiopian Management Institute, Mekelle Business University, Addis Ababa University or Bahir Dar's university/college. Staff members that get study opportunities are granted paid study leave and are placed in appropriate positions upon their return.

While staff generally share ACSI's vision and mission and are committed to the goal of poverty alleviation, the difficult working conditions are seen as a major factor impacting on increased levels of staff turnover – possibly facilitated by the training that ACSI provides. The impact of HIV/AIDS cannot be ignored either, although it is not clear to what extent staff are being directly impacted by the disease. It is noted, however, that staff have access to life insurance and an HIV/AIDS treatment program.

Organizational culture is difficult for an outsider to assess, and especially while this report is largely based on secondary information sources. However, based on the author's previous interaction with ACSI management and staff, as well as the organizational structure, it would be fair to say that, although most operational functions are decentralized, strategic decision-making is centralized. Decentralized functions are, however, subject to very strict implementation of prescribed policies and procedures, e.g. sub-branch and branch accounting, hiring of staff and loan approval.

The flow of information also reflects the above, with the upward flow of information from sub-branch level through branch level to head office having been perfected. However, there is seemingly very little feedback of information from head office to branch and sub-branch level on a regular basis. This is probably somewhat disempowering for branch and sub-branch management, in that you cannot make good decisions if you do not know, or cannot readily access, all the relevant information.

RISK MANAGEMENT POLICIES AND PROCEDURES

In the past ACSI has not had a comprehensive and systematic risk management framework in place and, as such, was not identifying, quantifying and managing all the risks to which it is exposed. As an example, ACSI only took out insurance for cash in transit and cash held in safes. No fidelity insurance is in place – a common feature in organizations handling other people's assets (in this case cash). However, the board has recently been re-organized to incorporate the necessary skills and risk management has become more formalized with a risk management framework put in place, including the creation of a risk management board sub-committee, along with remuneration and audit sub-committees.

Another obvious, and significant, exposure for ACSI relates to the agricultural nature of the majority of the loan portfolio. In the absence of protection or insurance against crop losses, ACSI's exposure to such events is a significant constraint to credit quality and could deter potential investors. We should, however, note that despite this being such a risk, the portfolio quality of ACSI is good and non-repayment from crop failures does not seem to be a current threat to operations.

Each branch is staffed with an internal auditor, who performs internal audit functions and supervises as well as trains the sub-branch internal auditors. The sub-branch auditor verifies the completion and accuracy of financial and operational information.

ACSI has continuously been improving its internal control environment. One particular area that has received attention is the segregation of duties at sub-branch level. This was done in conjunction with the construction of new offices. Internal control had been compromised by the fact that every sub-branch employee, apart from the guard and the sub-ledger accountant (there is one at every sub-branch and ACSI recognizes this person as an internal auditor), managed a portfolio of clients. Furthermore, staff often needed to step in for other staff members when they were not in the office.

Another area that is receiving attention relates to education and prevention strategies and initiatives surrounding HIV/AIDS, which is becoming a problem amongst clients. ACSI is linking with other social services to be able to refer clients that need assistance and is introducing life insurance for its clients. These measures should serve to protect ACSI's clients and, hence, its portfolio quality going forward. Given the high prevalence rate in their area of operation this is a very timely initiative.

SIGNIFICANCE OF OWNERSHIP AND CAPITALIZATION IN ACSI STRUCTURE

ACSI, as a financial institution is not reliant on its shareholders or donors for funding, with the majority of funding being generated by retained earnings, mobilization of savings, donated equity, subsidized loan funds and other short-term liabilities. This funding structure, as well as the fact the ACSI is quite profitable, gives the institution financial independence, which in turn minimizes political influence as there is little possibility of funding being tied to specific objectives.

An examination of ACSI's equity base at the end of December 2004 shows that 71.9 percent of equity consists of retained earnings, and 25.7 percent of donated equity (from donors to provide funding for loan portfolio growth). Less than 2.5 percent of equity consists of paid-in capital. ACSI is either unable to attract additional investors or has not intensified efforts to secure local equity investment. The absence of local investment has the potential to constrain its ability to grow the loan and savings portfolio as quickly as the unmet demand for loans would allow. In addition, the restricting of foreign ownership and investment in Ethiopian companies is effectively blocking ACSI's ability to attract equity investments from specific foreign funds set up to invest in MFIs. This does not necessarily impact on ACSI's ability to raise funds, but it does mean that significant retained earnings have to be generated and re-capitalized in order to meet minimum capital adequacy requirements.

The Amhara National Regional State, which has a direct holding of 25 percent, is believed to have a very strong influence over ACSI when it comes to strategic and/or sensitive decisions, such as raising interest rates. This influence is reflected in the composition of the Board of Directors, with 2 of 8 Directors holding positions in the State Government or bureaus.

ACSI is aware of the potential risks of such strong Government links, and has worked to establish ACSI's independence. A major change in the past few years is that ACSI has moved away from the utilization of government office space to operate from separate premises to create a physical separation in the eyes of clients.

Looking more broadly at capitalization, total equity comprises 18 percent of total assets, with the balance of ACSI's funding comprising voluntary savings (24 percent), compulsory savings (14 percent), subsidized loans (16 percent), other short-term liabilities (23 percent) and long-term liabilities (5 percent). Clearly, the mobilization of savings has been a critical factor in ACSI's ability to grow its loan portfolio, and will continue to be so into the future. Furthermore, as with most MFIs, ACSI still seems to struggle to secure long-term funding that can be used to fund growth and also facilitate a better matching of assets and liabilities.

ACSI's ownership structure, as well as the institutional vision and mission, helps define ACSI as an institution that is committed to poverty reduction and improving the livelihoods of its clients. Its vision and mission also are influenced by government's current policies that focus on sustainable development and poverty reduction.

However, two areas have had potential negative impact on ACSI's performance. One is the pressure to keep interest rates low. ACSI has responded by becoming very efficient to ensure that costs fall within their revenues – but it always remains a risk when there is any doubt as to whether prices will always be able to fully cover costs. The other area of negative influence is that ACSI has, in the past, been forced by the State Government, whose responsibility it is to ensure the growth of agricultural output, to make agricultural input loans. The funds for these loans were provided by the Commercial Bank of Ethiopia (CBE) and are guaranteed by the State Government, so there is no direct repayment risk to ACSI. Of the 9.5 percent interest charge (set by the State Government), ACSI received 4.5 percent (the CBE gets 5 percent), which, given the small loan sizes, did not cover the costs of making the loans. In essence, ACSI was an involuntary agent of the government when it came to the disbursement of these loans. The operational risk to ACSI of providing these loans is a result of clients, while not going through the regular ACSI channels, not distinguishing between these special loans and ACSI's regular loans. This could result in a deterioration of ACSI's portfolio quality if clients have the impression that all loans from ACSI are guaranteed.

GOVERNANCE

ACSI defines its governance structure as having the following components:

- The General Assembly of Shareholders,
- Board of Directors,
- External Auditors, and
- The General Manager.

The Board of Directors, representative of the shareholders, is entrusted with the responsibilities of providing overall guidance and policy directives while the General Manager is responsible for the day-to-day management of the activities of ACSI. The board has recently been restructured to incorporate the necessary skills and three board sub-committees have been formed – remuneration, risk management and audit.

While government is not involved in managing the day-to-day operations of ACSI, there is a strong link, particularly as ACSI integrates its activities with government and NGOs working towards achieving food security and poverty alleviation in the region. Furthermore, the link is strengthened by ACSI acting as an agent for the government with regard to disbursing pension payments, and also certain agricultural input loans in the past.

ACSI has established firewalls to protect itself from negative political influence. Firstly, ACSI is profitable, and not reliant on the government for funding (possibly the most important factor). Secondly, the level of community involvement in the loan application screening process helps deflect any pressure on ACSI to disburse loans that it otherwise may not have disbursed. Lastly, the very small loan sizes offered by ACSI are definitely less attractive for political figures and manipulating the system to get a loan inappropriately does not result in much benefit. The ultimate gain for a client is to remain within the system graduating to larger loans and gradually accumulating wealth over a period of time rather than receiving large, once-off loans.

The involvement of the communities has been a key factor behind ACSI's success. ACSI draws on the support of the local community (the Credit and Saving Committee) to select those who should get the service first (based on their poverty level) and to further facilitate follow up and monitoring. Clients also are required to organize into groups to encourage monitoring among themselves. This community involvement in screening loan applications helps mitigate the problem of information asymmetry on the part of the client in an efficient and cost effective manner. This community involvement is on a voluntary basis and their contribution is valuable and has served as an excellent screening mechanism. It is probable that ACSI's government connection has assisted in getting the local leaders on board with the process. Community involvement is another mechanism that empowers locals in allowing them to actively participate in their development and be involved in empowering other members of the community who would otherwise be dependent on relief services and hand-outs.

ACSI also is seeking to further promote their clients' sense of ownership by emphasizing the generation of the loan funds from savings mobilized within the local areas. This has reportedly served to create a sense of ownership for loan clients and prompt repayment by inculcating the feeling that what is in their hand in the form of credit is savings mobilized from their neighbors (warm money). A future strategy ACSI will consider to further enhance this sense of ownership and stakeholding will be making clients shareholders, so that they become fully affiliated with the institution.

TRANSPARENCY AND DISCLOSURE

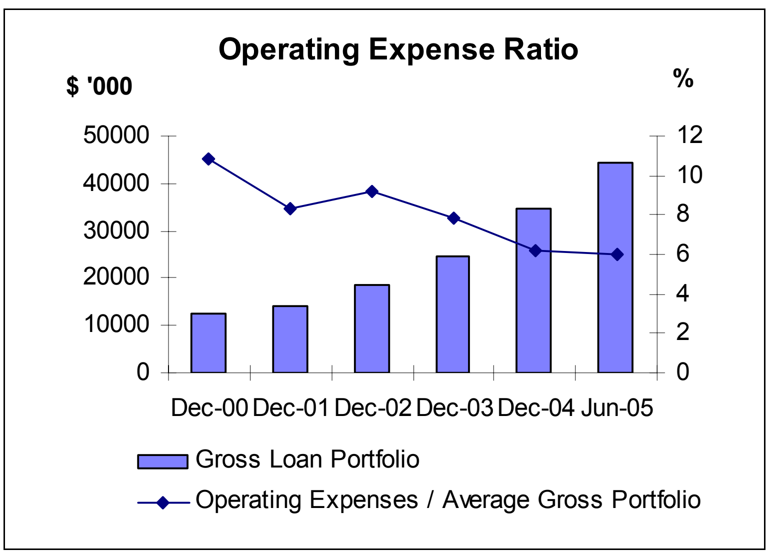
ACSI is certainly very transparent in its loan disbursement process, with the screening of applicants involving the community and being done in open forums in the villages. It has benefited ACSI in that known "bad risks" are largely excluded and contributes to the "social collateral" underpinning the loans made.

Possibly less transparent, certainly to non-senior staff members and the public at large, is the overall performance of the institution. To a degree, this is due to the lack of a computerized MIS, but probably also reflects the organizational structure, with management centralized at head office. ACSI to advise further on the current position in this regard

PERFORMANCE INDICATORS[21]

An analysis of the financial statements shows that ACSI has a healthy financial position, with significant increases in profitability recorded since its last recorded loss in 2001. For 2004, audited accounts show a net profit of US$3.7 million (excluding grant income), and retained earnings of US$6 million. The key measure of operating efficiency, the operating expense ratio[22], already at incredibly low levels, reduced even further in 2004, reaching 6.2 percent, which is amongst the lowest in the world, see Figure 1.

FIGURE 1: OPERATING EXPENSE RATIO



The loan portfolio has continued to grow, reaching US$36.2 million at the end of 2004, and to almost US$44.5 million by the end of June 2005. Loan officer productivity has continued to increase, despite the challenging environment, see Figure 2.

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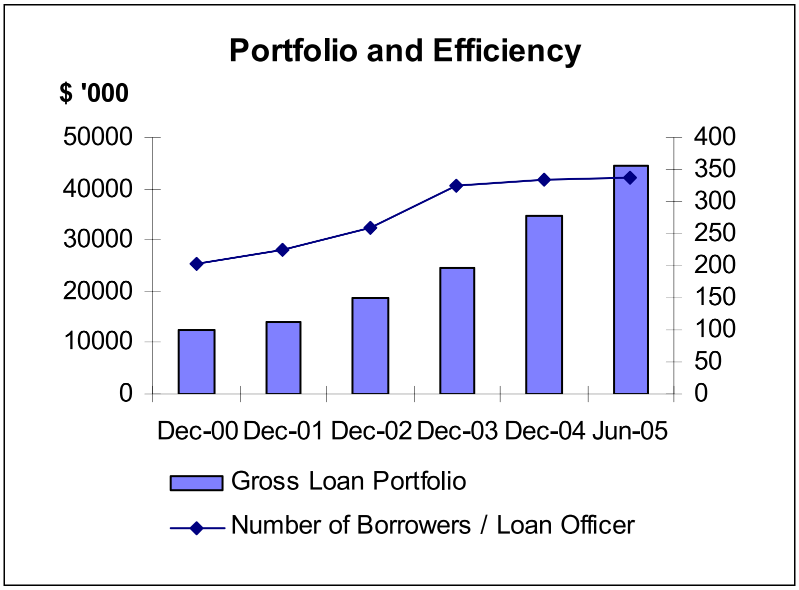
[21] In the absence of an on-site visit, the authors have chosen to rely on the financial and operational data provided in an earlier MicroRate rating report, augmented by up to date information from ACSI and MicroRate following a rating review conducted in August 2005. The summary financial statements and performance ratios, sourced from MicroRate, are shown in Annex A.

[22] Calculated as operating expenses divided by the average outstanding gross loan portfolio.

FIGURE 2: PORTFOLIO AND EFFICIENCY



At the end of 2004, ACSI had cash and short-term investments totaling US$12.3 million, while savings mobilized totaled a significant US$20 million, of which US$12.3 million was voluntary. Savings equated to 55 percent of the outstanding gross loan portfolio. Portfolio at risk (1.7 percent at the end of December 2004) has consistently compared very well to industry norms.

To summarize ACSI's performance, one could say the following:

- High profitability driven by increasing staff productivity and very low (while still improving) operating costs relative to the size of the portfolio – leading to a very low cost per borrower of under US$10 p.a.
- Consistently strong portfolio growth and maintenance of a good portfolio quality, with write-offs and non-payment problems generally being minor.
- High levels of liquidity and capitalization, giving rise to a strong balance sheet.
- Good ability to mobilize savings, which is a vital source of loan funding for the institution.

Table 5 shows a comparison of key ratios between ACSI and the peer group average (African Large Financial Intermediaries), as per the MicroBanking Bulletin for the period ended December 2003. As evidenced, ACSI compares favorably to its peers, particularly when the average loan size is considered – with ACSI being at under US$100[23], and the average at almost US$500.

[23] As at December 2003.

TABLE 5: COMPARATIVE RATIO ANALYSIS–12/2003

		ACSI[24]	Africa Large FI - Average
Portfolio			
Gross Loan Portfolio	USD	25,410,925	20,881,815
Portfolio at Risk > 30 days Ratio	%	3.3%	10.7%
Write-off Ratio	%	0.0%	3.0%
Efficiency			
Borrowers per Staff member	Number	195	205
Cost per Borrower	USD	6	121
Operating Expense / Loan Portfolio	%	7.4%	18.4%
Profitability			
Return on Equity	%	19.1%	(7.0)%
Return on Assets	%	6.0%	0.0%
Profit margin	%	43.6%	2.6%
Financial			
Total assets	USD	35,088,884	36,075,937
Savings	USD	10,862,281	20,751,055
Total Equity	USD	16,402,491	n/a
Debt to Equity Ratio	Times	1.1	4.4
Other			
Number of Active Borrowers	Number	288,681	98,710
Number of Savers	Number	110,724	154,995
Average Loan Balance per Borrower	USD	88	488
Average Savings Balance per Saver	USD	98	196
Women Borrowers	%	29.4%	40.9%

Source: MicroBanking Bulletin: 2003 Benchmarks (www.mixmbb.org)

[24] Note that there are some differences between statistics shown in this table –as reported by the MicroBanking Bulletin and those reported by MicroRate (Table 1 and Annex A). The differences are mainly due to the MBB showing adjusted numbers and ratios, whereas the MicroRate numbers are unadjusted.

WHY ACSI HAS SUCCEEDED

CRITICAL SUCCESS FACTORS

The report tells the story of ACSI, an institution that has grown over almost a decade to become one of the largest micro finance institutions in Ethiopia. Since inception the loan portfolio has grown to US$44m, with US$21.1m mobilized in deposits. Operating from 10 branches and 174 sub-branches, ACSI has 394,374 active loan clients, and 625,645 savings clients. In 2004, its return on equity was 24.4 percent, and portfolio at risk remained low at 1.3 percent with the operating expense ratio improving further to 6.2 percent. ACSI is dedicated to serving the rural poor in the Amhara State and operates in a very tough environment, with tough terrain, inaccessible and poor physical infrastructure and has grown its portfolio largely from retained earnings.

From the information and insights we have gathered into the operations of ACSI we make inferences about what the underlying success factors are.

PROFITABILITY

Our first point in terms of ACSI's success is that is remains operational and profitable, when many micro finance institutions struggle to provide services to rural, remotely located and poor populations in developing countries. Their profitability stems from the low cost per client, efficient operations and the fact that most staff is client facing. ACSI has succeeded where others have failed in terms of delivering much needed financial services to remotely based poor communities.

FINANCIAL INDEPENDENCE

ACSI has attained a level of financial independence (thanks to healthy profits that can be reinvested in the operations) that affords them the leeway to dictate and map out their own path, without heavy reliance on external funding sources.

ACSI is largely a self-funding institution, with savings deposits being an important component of ACSI's total funding. Savings mobilized equaled 44 percent of total assets and 61 percent of outstanding loans. The ratio of liquid assets to total deposits is 46 percent, which is well above the 20 percent minimum requirement of the National Bank of Ethiopia. Managing the liquidity position of ACSI is another challenge which they are working on in order to ensure that their potential profitability is not compromised by over liquidity.

OPERATIONAL EFFICIENCY

The operational efficiency ratios of ACSI are, at first glance, unbelievable, particularly in the context of the infrastructure deficits described in the report. While already low at 7.5 percent in 2003, the operating expense ratio dropped further to 6.2 percent in 2004, which is one of the lowest in the world for micro credit operations. In addition to the infrastructure constraints, ACSI operates a manual MIS, which is more time consuming and laborious, yet ACSI still manages to outperform most of its peers in terms of its operational efficiency levels.

A key reason behind this would appear to be the staffing of the organization. With over 90 percent of staff employed at sub-branch level, and with most of them carrying client loads, ACSI has a very high staff productivity ratio, and a low level of overhead or staff cost.

DECENTRALIZATION/STANDARDIZATION

The management of wide spread activities across the state by ACSI is achieved through decentralization of activities and operations to sub-branch level, giving the sub-branch the autonomy to operate and conduct business with little central office involvement. The flip side to this is that most sub-branch activities are pre-determined and designed at central office; this enables the sub-branches to undertake and manage these fairly standardized operations with central office controlling the overall design of these activities and operations. ACSI has simplified and standardized its processes in such a way that they can be implemented uniformly across sub-branches and that central office, through the branch offices, can supervise activities and ensure that the operations are being undertaken as planned and stipulated.

STAFF

ACSI has, in the past, been able to maintain a stable and productive workforce. Their staff costs are incredibly low (4.4 percent of the average outstanding gross loan portfolio in 2004). Staff commitment is high and long-term service is recognized and rewarded through long-term study and training opportunities that benefit individual staff members in their own career development as much as in their increased value and contribution to the organization. However, the difficult working conditions do lead to staff turnover, as mentioned previously.

CLIENT MOBILITY

Of notable significance, although not substantiated, is the assumed low mobility of clients that are served by ACSI. There appears to be a very low incidence of clients that take up loans and abscond, cannot be traced and therefore default on loans. This reduces the inherent risk of lending to a highly mobile society where the constant threat and occurrence of clients absconding faces the organization. The involvement of local communities also ensures that thorough screening and proper credit assessments are undertaken which minimize the incidence of poor credit decisions. The lack of strong competition from other MFIs providing financial services to some extent helps to limit the propensity of clients defaulting from one MFI and getting assistance from another. In this case clients are only dependent on ACSI as the major MFI and would want to maintain a good credit record with ACSI.

STATE OWNED

ACSI has positioned itself and aligned its mandate to feed into the government policy. By virtue of the fact that is addresses the plight of the rural poor with dedication and commitment, targeting the most disadvantaged, ACSI has become a strategic vehicle for government policies and to some extent this ensures that they receive the required government support, irrespective of the political inclinations of the government of the day. It has made itself into a relevant and much needed instrument that contributes significantly to the Amhara State Government’s drive to reduce poverty levels and grow the economy.

It is also noted that ACSI’s financial strength and independence have contributed greatly to the successful relationship that exists between state and institution. As ACSI is not dependent for funding on the state, it can, to a large degree, withstand political pressure to undertake functions that would be detrimental to the health of the organization.

SUCCESSFUL REPLICATION

ACSI has managed to replicate successful models by adapting them to suit and fit into the local context. ACSI’s success can be attributed to an intimate knowledge and appreciation of what exists within its environment, and being able to adapt the model to work within that environment. Their operating models make use of the existing structures in the most unconventional ways. Working with what exists in new ways, as opposed to imposing new things into the existing environment, appears to be a critical success factor.

A few examples include their use of Woredas[25] to target and identify priority areas and the use of local committees, on a voluntary basis, to screen potential borrowers. Lastly, the proposed way in which they intend using cooperatives in the area, not initially as an intermediary that can provide access to finance for members, but by using the production that members own as part of the cooperative as potential security for individual loans they intend getting from ACSI shows innovative thinking.

INNOVATION

ACSI has been very innovative in the way they have used, adapted and replicated credit models, always ensuring that what is functional and effective in the local context is used and incorporated in their design of products and processes. This is a combination of home grown solutions, an intimate understanding of the context, and maximizing the learning and experiences from other countries. ACSI's client focus has enabled it to develop a range of diversified product ranges that target different economic activities and cycles as well as financial needs of the rural poor.

ALIGNING WITH GOVERNMENT POLICY

Government's policy is explicit in making poverty reduction a core objective. So ACSI's vision and mission makes it a significant vehicle for government support. Government policies have been influential in the creation of ACSI and the policies have contributed in terms of providing an enabling environment for ACSI to operate within.

REGULATION

The regulation framework has created the appropriate road map for the development of MFIs in Ethiopia. Allowing MFIs to mobilize savings from the public has enabled ACSI to finance a substantial portion of its portfolio from these savings. Improvement to regulations, which includes revision of loan size ceiling for individual borrowers, revision of repayment periods and removal of interest rate ceiling, has addressed some of the problems that the MFI sector was facing. To improve the enabling environment, the regulatory framework needs to continuously find ways of helping the MFI sector to become more competitive and efficient in delivering financial services to the rural poor and to continue to protect the savings entrusted to MFIs.

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[25] A Woreda is a district level government administrative unit (114 in the State).

REMAINING CHALLENGES

There exist several challenges that have the potential to undermine and compromise the sustainability of ACSI's success.

- **Risk Management.** There is a need to have solid risk management in place. The need to undertake a comprehensive risk assessment exercise during which all risks faced by the organization are identified, ranked and quantified as best as possible. This would allow ACSI to take such steps as are necessary to protect the organization against the identified risks. These steps could include re-engineering business processes, implementing additional controls/monitoring mechanisms, insurance and other actions.
- **Asset and Liability Management.** In addition to this, ACSI needs to establish a proper asset and liability matching policy and practice. However, it is probably too complex a task in the absence of an integrated, computerized MIS. As such, any MIS solution should include a comprehensive treasury management function, which will facilitate proper asset and liability matching and cash management amongst others.
- **Insurance for Agricultural Risks.** ACSI should investigate possibilities for insuring the agricultural portfolio against adverse climatic conditions. If this were done, ACSI would be protected against potentially catastrophic widespread crop failures due to bad weather. In the absence of such protection, ACSI's exposure to such events is a significant constraint on credit quality, and could deter potential investors. We should note that despite this being such a risk the portfolio quality of ACSI is good and non-repayment from crop failures does not seem to be a current threat to the operations.[26]
- **Information Systems.** Until the manual operations and management information systems are replaced by an efficient, suitable, computerized MIS, ACSI will be challenged when it comes to management reporting and will continue only to receive delayed information on the performance of the various branches and sub-branches. It is noted that a project to computerize the MIS, funded by SIDA, is just beginning.
- **Portfolio Diversification.** Most activities that are being financed by ACSI are to traditional micro enterprise businesses like small-scale livestock and petty trade, with very little diversification into other sectors, with larger businesses or for other types of personal loan products. This is obviously because of limited skills and training in the rural areas. Secondly, non-traditional activities such as blacksmithing, tannery, weaving, pottery, handicrafts etc, which are more profitable, remain a small component of the economy and of the loan portfolio. ACSI is actively addressing this issue as discussed earlier. ACSI also provides other services, such as money transfers and pension payments, further leveraging off of its existing infrastructure.
- **Growth and Development.** As ACSI evolves in its growth and development, it will take on new challenges, including a more diversified product offering and client base. Current strategies include valuing social attachments, knowledge and culture. This may not be appropriate and effective when targeting a broader market outside the rural poor. The shift in focus away from the simple,

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[26] The World Council of Credit Unions, Inc provides concise definitions of crop insurance and index insurance and also examples of how these could be applied in: A Technical Guide to Rural Finance: Exploring Products. WOCCU Technical Guide # 3, December 2003 p15.

standardized operations and diversification calls for a new set of skills and enhanced capabilities and capacities. Without these, ACSI may not be able to sustain the levels of activity or manage the complexities arising from the diversified offering. This may compromise the overall success achieved by ACSI to date. The introduction of a new MIS also offers a series of challenges - the skills requirements, changes in staff roles and responsibilities, including redundancies in certain functions.

- **Political.** ACSI must continue to minimize government influence and control. Although the organization serves a fundamental role, political changes still present the risk of major shifts in policy and philosophy, such as interventions to more socialist and benevolent activities, which could result in a major divergence from ACSI's operating principles. While this seems highly unlikely, if such interventions should occur, it could undermine the success achieved by ACSI.

- **Investment.** ACSI may be constrained in its ability to grow by the inability to attract foreign equity investment as a result of the regulatory environment. This could lead to ACSI having to restrain growth to continue to comply with prudential guidelines.

- **Interest on savings.** A minimum of 3 percent (per annum) has been set by the National Bank of Ethiopia as the interest rate that should be paid to depositors. This could discourage savings mobilization in remote, difficult geographies because the high administrative cost associated with mobilizing small deposits in remote and poor areas. As a result, for ACSI, small savings are indeed no less expensive than bank loans as a source of funds. In as much as MFIs are allowed to charge appropriate interest rates that can cover their operating costs, it would also be logical to allow them to pay depositors interest rates that reflect the costs of mobilizing savings.

LESSONS LEARNED

This section outlines a few lessons that can be learned from ACSI and could possibly be replicated by the broader micro finance sector.

ACSI's **financial independence** has largely been achieved through the ability to mobilize savings and generate a self-funding mechanism. This means that ACSI remains relatively independent and cannot easily be subjected to excessive influence. This enables them to remain uncompromised in their focus on their vision and mission.

ACSI also has managed to successfully **replicate the models** that have been shared globally (suitably adjusted to fit local conditions). Successful replication is challenging and the critical factor is the ability of the replicator to understand the local context in which it operates intimately enough to be able to adopt and adapt to what is appropriate. ACSI's understanding of the local context has translated into the institution's ability to use its existing structures in innovative and unconventional ways.

The **standardization of policies and procedures** in a way that allows for staff across the organization to uniformly implement them, has undoubtedly been a key factor behind ACSI's success in a difficult environment. In fact, with a manual system in place within such a large and growing organization, it is fair to say that such standardization is probably essential for survival, let alone success.

Another key lesson learned, is that ACSI's staff all share the **institutional mission**–there is a sense that they are all working together for the greater good of their communities, and in large part, this explains the commitment and loyalty of the staff under difficult circumstances and in the absence of any real financial incentive programme.

Lastly, ACSI has realized that to fully achieve its mission, it needs to be **client focused** and responsive – notwithstanding that it does have a virtual monopoly on the provision of financial services to its target market. While MFIs in competitive markets have been awakened to the fact that it is essential to be client centric, the fact that ACSI has been moving there despite operating with little to no institutional competition should be noted.

Underlying all of these is the commitment and **strength of the senior management** team at ACSI. They have been the driving force behind the institution's successes and their role cannot be over-emphasized. They are all well qualified, and firmly committed to achieving ACSI's vision and mission. They also keep in-touch with what is happening in the broader microfinance industry and are active participants in the local sector.

ANNEX A: DETAILED FINANCIAL AND OPERATIONAL STATISTICS

The following statistics are sourced from MicroRate Africa, who conducted a rating review of ACSI in August 2005, the second rating exercise that ACSI has been through.

TABLE 6: ACSI INCOME STATEMENTS AND BALANCE SHEETS – DECEMBER 2001 TO JUNE 2005

(All amounts in US$'000 except as noted)

Income Statement for the year ended:	**31-Dec-01**	**31-Dec-02**	**31-Dec-03**	**31-Dec-04**	**30-Jun-05***
Interest and Fee Income	1,764.1	2,868.7	3,824.7	5,458.6	3,347.5
Interest and Fee Expense	(525.5)	(621.1)	(498.8)	(763.0)	(487.2)
Net Interest Income	**1,238.6**	**2,247.6**	**3,325.9**	**4,695.6**	**2,860.3**
Provision for Loan Loss	(284.3)	(229.2)	(221.8)	-	(39.2)
Net Interest Income After Provisions	**954.3**	**2,018.4**	**3,104.1**	**4,695.6**	**2,821.0**
Operating Expense	(1,102.9)	(1,477.1)	(1,610.0)	(1,865.7)	(1,139.1)
Net Operating Income	**(148.6)**	**541.3**	**1,494.2**	**2,829.9**	**1,681.9**
Other Income	46.1	127.7	338.4	898.9	390.8
Other Expenses	-	-	(2.9)	-	-
Extraordinary Items	-	-	-	-	-
Net Income Before Taxes	**(102.5)**	**669.0**	**1,829.6**	**3,728.8**	**2,072.7**
Taxes	-	-	-	-	-
Net Income	**(102.5)**	**669.0**	**1,829.6**	**3,728.8**	**2,072.7**
Balance Sheet as at:	**31-Dec-01**	**31-Dec-02**	**31-Dec-03**	**31-Dec-04**	**30-Jun-05**
Cash and Banks	5,751.6	4,430.1	5,609.5	9,834.0	9,604.9
Temporary Investments	532.7	-	1,225.0	2,538.6	2,561.1
Net Loans	13,868.7	18,121.8	23,731.9	35,653.5	43,957.0
Gross Loans	13,868.7	18,121.8	24,403.2	36,206.4	44,488.9
Performing Loans	13,517.8	13,868.7	23,646.8	35,573.9	43,918.6
Portfolio at Risk	351.0	631.1	756.4	632.5	570.3
Loan Loss Reserve	-	-	671.2	552.9	531.9
Other Current Assets	1,827.9	3,333.0	2,886.7	4,425.0	4,245.7
Current Assets	**21,981.0**	**25,884.9**	**33,453.0**	**52,451.0**	**60,368.6**
Long -term Investments	-	-	-	-	-
Property and Equipment	297.5	307.5	244.3	480.3	547.3
Other Long-term Assets	-	-	-	-	-
Long-term Assets	**297.5**	**307.5**	**244.3**	**480.3**	**547.3**
Total Assets	**22,278.5**	**26,192.4**	**33,697.3**	**52,931.3**	**60,915.9**
Demand Deposits	-	-	10,587.5	12,784.3	12,492.3
Short-term Time Deposits	9,919.6	11,564.1	4,337.0	7,215.4	8,694.1
Short-term Funding Liabilities	4,264.9	3,446.9	1,049.9	9,561.9	-
Other Short Term Short-term Liabilities	2,701.5	4,944.0	1,970.9	2,802.5	13,923.1
Current Liabilities	**16,885.9**	**19,955.0**	**17,945.3**	**32,364.2**	**35,109.5**
Long-term Time Deposits	-	-	-	-	-
Long-term Funding Liabilities	-	-	-	2,826.3	5,809.4
Other Long Term Liabilities	-	-	-	-	-
Long–term Liabilities	**-**	**-**	**-**	**2,826.3**	**5,809.4**
Capital	2,384.5	2,558.1	232.0	231.5	230.9
Retained Earnings	(260.9)	491.8	2,318.3	6,041.7	8,100.4
Other Capital Accounts	3,268.9	3,187.5	13,201.7	11,467.7	11,665.6
Equity	**5,392.5**	**6,237.3**	**15,752.0**	**17,740.8**	**19,997.0**
Total Liabilities & Equity	**22,278.5**	**26,192.4**	**33,697.3**	**52,931.3**	**60,915.9**

* Represents a six-month period.

TABLE 7: ACSI KEY FINANCIAL AND OPERATIONAL RATIOS–DECEMBER 2001 TO JUNE 2005					
Year ended:	**31-Dec-01**	**31-Dec-02**	**31-Dec-03**	**31-Dec-04**	**30-Jun-05***
Asset Quality					
Portfolio at Risk / Gross Loan Portfolio (%)	2.5	3.5	3.1	1.7	1.3
Loan Loss Provision exp. / Ave. Gross Portfolio (%)	2.1	1.4	1.1	0.0	0.2
Loan Loss Reserves / Portfolio at Risk (%)	80.7	81.2	88.7	87.4	93.3
Write-offs / Average gross portfolio (%)	0.0	0.0	0.0	0.0	0.0
Efficiency and Productivity					
Operating Expenses / Ave. Gross Loan Portfolio (%)	8.3	9.2	7.8	6.2	6.0
Cost per borrower ($)	n.a.	8.0	6.4	5.8	11.6
Average outstanding loan size ($)	90.9	83.9	84.5	103.1	112.8
Number of Borrowers per Staff (no.)	144.8	177.6	195.2	210.3	214.1
Number of Borrowers / Credit Officer (no.)	225.7	259.3	324.0	334.8	337.4
Operating Expenses / Net Interest & Other Income (%)	85.9	62.2	43.9	33.3	35.0
Profitability					
Net Income / Ave. Equity (%) (ROE)	(1.9)	11.2	16.6	24.4	29.9
Net Income / Ave. Assets (%) (ROA)	(0.5)	2.8	6.1	8.6	7.9
Portfolio Yield (%)	13.3	17.8	18.5	18.0	17.8
Net Interest Income / Ave. Gross Loan Portfolio (%)	9.4	13.9	16.1	15.5	15.2
Non Interest Income / Total Operating Income (%)	2.5	4.3	8.1	14.1	10.5
Financial Management					
Interest and Fee Expenses / Ave. Gross Portfolio (%)	4.0	3.8	2.4	2.5	2.6
Interest and Fee Expenses / Ave. Funding Liabilities (%)	4.1	4.3	3.2	2.9	3.1
Debt / Equity (:1)	3.1	3.2	1.1	2.0	2.0
Total Capital / Risk Weighted Assets (%)	33.5	28.7	58.1	50.1	52.4
Tier One Capital / Risk Weighted Assets (%)	*33.5*	*28.7*	*58.1*	*43.2*	*40.6*
Tier Two Capital / Risk Weighted Assets (%)	*0.0*	*0.0*	*0.0*	*6.9*	*11.8*
Cash and Liquid Assets / Total Deposits (%)	63.4	38.3	45.8	61.9	57.4
Cash and Liquid Assets / Liabilities to the Public (%)	37.2	22.2	38.1	38.2	34.7
Nominal Growth indicators					
Assets (%)	n/a	17.6	28.7	57.1	15.1
Loan Portfolio (%)	n/a	30.7	34.7	48.4	22.9
Shareholders Equity (%)	n/a	15.7	152.5	12.6	12.7
Deposits (%)	n/a	16.6	29.1	34.0	5.9
Net income (%)	n/a	n.a.	173.5	103.8	11.2

* Represents a six-month period. All relevant ratios have been annualized.

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