

Successes in Expanding Microfinance Opportunities in Rural Ethiopia – Where There is Little Entrepreneurship?

By

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“Most of the people in the world are poor; so if we knew the economics of being poor, we would know much of the economics that really matters.” (Theodore W. Shultz, on accepting the Nobel Prize in Economics, 1979)

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Abstract

Expanding micro-enterprise services like microfinance is currently receiving perhaps the highest attention ever as a key tool to achieving many development goals in poor countries. Indeed, prospects for a more inclusive financial services are expanding in poor countries like Ethiopia, with Government's development strategies increasingly giving strong emphasis for sectors that support 'self-employment', thus further improving the enabling environment for financial intermediation.

Thus the microfinance service has been expanding over the last one decade or so in Amhara Region of Ethiopia, by organizations like the Amhara Credit & Saving Institution, notwithstanding the fact that it still dominantly use a single methodology of Group Guarantee Lending Model (GGLM). Institutional efforts to 'customize' such models to the local socioeconomic situation where agriculture is the dominant activity are indeed paying – adjusting the size and functions of the group; integrating with and effective use of endogenous community knowledge for client screening and follow-up; and de-linking repayment schedule from the actual cash flow of the agricultural activity to which loan is taken; offering convenient saving mechanism to clients which provides 'self-insurance' and help smooth income flow from seasonal and risk-prone agricultural activities; etc.

Yet, enhancing the efficacy and impact of the services are becoming challenging task since such agricultural and related activities are little supported by new technology, BDS, marketing, good infrastructure, etc. Low BDS support accompanied by poor entrepreneurship culture, which, to an extent, has been aggravated by the generous relief and safety-net supply has been an impediment for micro-enterprise growth. Indeed, this also is a challenge for national development at large.

Background

The Amhara region of Ethiopia covers an area of 172,752 square kilometre, and has a population of about 18 million people (about a quarter of the national population) with some 85% of the population residing in the rural parts of the region. The topography, combined with limited road and other communication networks, mean that many communities are difficult to access. Agriculture is the dominant economic sector, accounting for 48.6% of the regions GDP while the industrial sector comprises 27.8% and the service sector 23.5% respectively. The annual per-capita GDP is Br. 732 (about US\$ 82) which is even below the national average.

Level of poverty and ill-being in Ethiopia is apparently very high. The Amhara region in particular, has been prone to much suffering in the past, and was one of the hardest hit areas in the 1973, 1984 and more recent famines of Ethiopia. Over all, 52 out of the 113 districts in Amhara region are catagorized as chronically food in-secure. Currently, more than 30.1% of the regional population earns an income below the (locally driven) poverty line income level. This minimum consumption is estimated in Ethiopia to cost only about \$10/month/adult (Dercon, et, al, 2006). One should therefore note that the poverty rate would even be higher if one considers the \$30 poverty line (the dollar-a-day convention) set by the World Bank. Many factors have accounted for such high level of poverty, among which low level capital and of monetization is one. According to an earlier study on rural Ethiopia, less than 1% of the population has access to finance from formal sources (IFAD 2001).

The EPRDF-led Government of Ethiopia, which has taken power after the fall of the *Dergue* regime in 1991, has undertaken series of economic reform programmes aimed at re-orienting the economy from command to market economy, rationalizing the role of the state and creating legal, institutional and policy environment to enhance private sector investment. The Government's "*Sustainable Development and Poverty Reduction Programme* (2002) (Ethiopia's version of PRSP), which is based on the earlier rural, industrial and other development strategies, has more clearly articulated the objectives in revitalizing development in the country, with emphasis on effective rural financial intermediation, among others. The more recent "*Plan for Accelerated and Sustainable Development to End Poverty*" (*PASDEP*) (2005-2010), Ethiopia's current guiding strategic framework document, also provides an even more strengthened emphasis to micro-enterprise and self-employment supportive intervention based on key principles such as: (a) enabling people, communities, businesses – not crowding out personal responsibilities, (b) achieving the objectives through decentralization, private sector promotion and liberalizing market controls while recognizing market failure and (c) targeting services to vulnerable groups.

Thus, formal microfinance in Ethiopia started in 1994/5. In particular, the Licensing and Supervision of Microfinance Institution Proclamation No. 40/1996 encouraged the spread of Microfinance Institutions as it authorized them to, among other things, legally accept deposits from the general public (hence diversify sources of funds), draw and accept drafts, and manage funds for the micro financing business. Perhaps, Ethiopia is one of the few countries which introduced regulated microfinance early on, which, unlike in other cases, also allows MFIs to mobilize public savings.

Moreover, with a view to further stimulate economic activities and provide opportunities for the poor to escape poverty through availing more and appropriate financial services to the majority, the Government has been refining the *regulatory framework* for the microfinance operations. Currently, there are 27 MFIs operating in Ethiopia, providing microcredit service for 1.5 million clients, of which Amhara Credit & Saving Institution (ACSI) is the largest.

Managing Growth of Agricultural microfinance in poorer areas of Amhara Region: From Replicating to Customizing Models?

The operation of ACSI, the main rural financial intermediary in Amhara Region, is traced back to 1995 when it was initially initiated by the Organization for the Rehabilitation and Development in Amhara (ORDA), an indigenous NGO engaged in development activities in the Amhara region. ACSI had undertaken its pilot activities in 1996, and was licensed as a microfinance share company in April 1997. As of June 2007, ACSI is operating in all *Woredas* (districts) of the region, and has covered 2690 *Kebeles* (about 80% of the total rural villages of about 1000 households each, representing the lowest Government administrative unit). In terms of *outreach*, currently there are over 553,000 poor clients, with an active credit balance, and another 320,000 voluntary savers, and operational and financial sustainabilities have already been achieved. Such an achievement in outreach in a period of just one decade or so can be considered quite impressive, particularly given the very poor infrastructure and communication, poor economic activity, etc. Some of the factors that account to this are detailed below.

Customizing the Group Guarantee Lending Model

The Group Guarantee Lending Model (GGLM) is the dominant methodology. Thus, potential clients are required to exercise a peer group self-selection and organize groups for the purpose of sharing a mutual loan repayment guarantee. The methodology involves credit delivery through very small, affinity-based groups of 5-7 members each, with about 10-15 groups getting together at one 'Center' (group of groups) meeting monthly for the purpose of discussion, settling repayments, saving, etc. Priority is given to the poorest, especially women. As a rapid assessment (RA) method, possession of one ox (or equivalent) serves as the local 'poverty line'. A sort of 'Participatory Wealth Ranking' (PWR) is also carried out whereby representatives from the community (the 'Credit and Saving Committee') exercise further rankings of those who should be first beneficiaries of the service.

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

Some authors, however, advise that the methodology might as well distract and *crowd-out* existing traditional mutual support networks particularly in times of repayment problems. They contend that in majority of poor communities, the rural

poor have much less information on the behaviour of their immediate neighbours when it comes to “financial” matters. Ana Marr (2002) in her comprehensive study of microfinance clients in Peru, found that only 4% of all participants have prior relationships based on issues of borrowing and lending, i.e., they are members of common Rotating Saving and Credit Associations (ROSCAs). And this is more so among women, who have little opportunity for information about their immediate neighbourhood due to their day to day full engagement in house-hold chores. All this means that the vast majority of participants are unfamiliar with financial issues when they first join the programme. When these group members are then confronted with an alien way of relating to one another – in this particular case, monitoring colleagues’ loans, investments, returns, risks, and so on -- they tend to react very strongly and may resort to acts of intimidation, threats and even physical abuse in order to repress information about their financial affairs.

Such problems have been faced in practice, and adjustments taken. Specifically, field level experience has signalled the need to review the purpose and structure especially of “Centers” (group of groups). Centers were originally considered as one more platform to organize people for loan guarantee mechanism. Center formation (about 70-150 clients) and holding individual members responsible for default of any one member in the center proved not feasible for the local circumstances, though it may be applicable in the originators of MFIs (especially those of Grameen, and replicators in Bangladesh, other Asian countries and elsewhere in the world) where there is less of *information asymmetry* by virtue of their proximate or densely populated living style. Most successful early starter MFIs like Bank Rakyat Indonesia (BRI) and Grameen Bank operate in countries like Indonesia and Bangladesh where the population density averages between 700-900 people per square kilo-meter, which sharply contrasts with Sub-Saharan Africa and Latin American case which is fewer than 10 people per square kilo-meter (CGAP 2004).

Thus center formation (and hence holding individual members responsible for the default of any one member in the center of 70-150 clients) was subsequently stopped, focus being on group members (5-7) where the problem of information asymmetry is less severe. The group threat imposition of ‘social sanction’ to prevent loan default. The group members also have their own ‘*by-laws*’ (in lieu of the formal court procedures) and signs documents authorising the group to seize goods (land, equipment, etc) in the event of loan default. Such adjustments have facilitated the smooth operation of groups, while reducing risks to individual clients, thus attracting more poor people to join the microfinance service.

The Decentralization Effort

Given the geography, the scattered living style of the population, and the poor physical infrastructure, particularly the road-network, where 80% is inaccessible during the rainy season, operations in the region as a whole, and predominantly in rural areas, have proved to be a very problematic task. Microfinancing activities as undertaken by institutions like ACSI are such that not only does one need to identify and disburse loans to the right client in isolated remote areas, but one also needs to ensure full repayment through daily monitoring and follow up of each client, with very low loan sizes. Very small savings (as small as \$1 or even less) have to be encouraged and mobilized from these same poor people. Live cash has to be

transported from one location to the other. And such activities often involve a door-to-door service.

ACSI has thus developed a 'decentralized structure', involving 10 branch and 185 sub-branch field office network distributed throughout the region. Each sub-branch office is a 'profit-center' and an incentive system is established based on sub-branch performance. Decentralized operations favour a reliable, opportune loan appraisal and loan processing and effective loan administration by field staff. Such operation therefore requires that field staff working in rural areas have a solid background in agriculture, work experience in rural areas and a right attitude towards the poor (Cambers, 1993). Thanks to the strict selection procedure that ACSI follows, it can be said that the staff both management, administrative and program staff have high degree of commitment to the vision of the Institution and willingness to work in a learning environment where uncertainty is likely, flexibility required and experimentation necessary. Unlike the "conventional" kind of employers, which tend to emphasize academic achievements, value is given to social attachments, and the recruitment criterion is such that only those who have reasonable knowledge of the area, its culture, custom, language, etc., and who acquired a mix of business and social development skills are selected.

Not only is staff recruited mainly from local areas, but also the active involvement of local organizations and communities is highly sought, which help reduce the time and the costs of client screening, loan appraisal and loan monitoring. Given the problem of information asymmetry on the part of the client, giving rise to 'moral hazard' and 'adverse selection' problem, ACSI draws on the support of the local community (the Credit and Saving Committee) to screen out those who should get the service first (based on their poverty level) as well as creditworthiness, and to further facilitate follow up and monitoring.

Moreover, the effort to generate the loan-able fund from within the local areas in form of 'micro-saving' has served to create loan clients' sense of ownership and prompt repayment by inculcating the feeling that what is in their hand in the form of credit is a saving mobilized from their neighbours ("warm money").

Dealing with Agricultural Seasonality

One of the unique features of the Ethiopian microfinance industry is perhaps the fact that it largely finances "agriculture". In fact, some argue that microfinance systems and methodologies are more appropriate for non-agricultural activities (Sebstad, 2002). Microfinance operation under such circumstances require closer understanding of the 'household economic portfolio' (Chen and Dunn, 1996) of the target clients. Thus, the institution treat rural clients like the sophisticated financial managers they are, and work to build a complete financial relationship with them. Specifically, it 'de-links' loan uses from repayment sources and instead treats the entire farming household as a single economic unit, with multiple income sources and multiple financing needs. Even if a loan is supposed to be used to produce a specific crop, the borrower's entire household income is considered when judging repayment capacity.

Indeed, many farming households diversify their sources of income by engaging in a variety of farm and non-farm activities. Such non-farm activities are important

sources of income in the programme areas (about 40%). Household members may also travel to other parts of the region for seasonal employment on farms or employment in cities, typically migration to coffee growing areas of Southern Ethiopia. Different family members perform these activities and contribute all or part of their income to the family's income pool.

Moreover, contrary to earlier perceptions, field level experience has shown that even small farmers save. In fact, their savings are an integral part of farm household livelihood strategies. Savings are crucial to straddle the period between two successive harvests and to meet contingency expenditures and debt repayment. Household savings can be used for a variety of production, investment and deferred consumption purposes, thus providing 'self-insurance'. These include cash hidden in some ways or saved at the MFI, conserving seeds, storing of crop produce for deferred consumption and/or selling off later in the season at more lucrative market prices, etc. Such efforts are facilitated by providing appropriate Institutional saving services.

Thus, by di-linking loan use and repayment, the institution stress that repayment must be made regardless of the success or failure of a particular productive activity to which loan is taken, which resulted in higher repayment rates over the years.

Less Dynamic Rural Economy and Individual Entrepreneurship Undermines Enterprise Growth

Apparently, efficacy and impact of the microfinance programme has to be seen in the context in which it is being implemented.

Poor Infrastructure and Enterprise Support

Making financial services accessible to the poor, especially those living in rural areas, is a real challenge indeed. Where the access is granted, clients' low skill achievement in business development dictates their individual enterprises absorptive capacity to remain weak. ACSI portfolio are largely invested in small-holder agriculture (mainly operating very small land, purchase of oxen, traditional sheep rearing and other livestock) and petty trade, and the most practical problem faced by the MFI is the very low absorptive capacity of the business of the majority poor in rural areas. Many rightly argue that credit alone, without the necessary infrastructure to enhance the skill capacity of the potential borrower, would often end up without achieving the intended goal of enabling the poor get out of poverty. Indeed, it was unusual for credit to trigger a continuous increase in technical sophistication, output or employment: it was much commoner for each of these variables to reach a plateau after one or two loans and remain in a *steady state*.

For example, the agricultural extension scheme cover only a small portion of the total farmers in the region. Thus, despite all the efforts, the area applied with fertilizer is just 33% of cultivated land, while the area under irrigation and improved seed is just 1.7% and 2.72% respectively (ANRS, 2004 (a)). There is apparently almost no institution giving non-agricultural BDS services to a sufficient scale that can respond to all the demands of the poor. New institutions destined to address such demands as

Regional Micro and Small Enterprise Development Agency (REMSEDA), etc are just getting established.

Access to the nearest other market is blocked due to the very poor infrastructure, particularly the *road network*. Many of the rural areas are inaccessible in the rainy season, making development of internal markets very difficult. Only a fraction of the Region's population is located with-in a 10 kilo meter range of an all weather road. For instance, results of the recent socio-economic survey indicate that only 57% of farmers are within a 2 hours walk distance to any all weather road (ANRS, 2004 (a)). Inefficient transport undermine price received by producers, making the price spread wide. Similar products are offered to nearby market, which easily saturate, thus undermining enterprise profitability and growth, and thereby limiting the potential demand for higher loan size. Institutional historical data indicates that having been in operation for the last 10 years, the average loan size taken by individual client still stagnates at about Br. 1000 (~US\$110) (See Fig. 1 in Annex).

Thus, the rural economic system in Ethiopia in general is still much less dynamic system, making any transformation effort a very slow process. As Pickettes (1991) once noted, the peasant still uses very little capital – sickles, hoes, wooden ploughs, and machetes – and virtually no skills that result from systematic training. Power comes from humans and scrawny draught animals. Agriculture is weather dependent, production increases when there is good weather and declines when the weather condition deteriorates.

The Entrepreneurship Challenge

On the other hand, demand for credit is highly constrained due, mainly, to low entrepreneurship. Many clients, as can be expected, are very much risk-averse that even with the availability of credit and BDS service, many do not like to venture into activities other than those inherited from their fathers or for-fathers. In a recent interview of about 300 clients, over 78% responded that they only want to be engaged in activities that they know something about previously.

A related and more problematic issue is also the '*low income perspective*' or '*aspiration failure*' that prevail among most dwellers in many rural areas, who, after getting the additional ox or the "subsistence" level of income that has been set as a target (construction of a residential house of local standard, for example) most would stop asking for more loan or only take a small amount. In a much detailed study, CHF (2007) reported a much more convincing findings of aspiration failure from a detailed qualitative and quantitative survey conducted in the five biggest regions of Ethiopia (Tigray, Amhara, Oromia, South, and Afar) covering nine *Woredas* (districts), involving 144 households from each of the nine *Woredas*. The study strongly argues that due to 'satisfaction' (or 'hapiness') with one's circumstances, and absence of "role models" in the localities, there is a widespread occurrence of aspiration failure.

'Aspiration failure' occur when individuals are unwilling to make pro-active investments to better their own lives. A question was asked to respondents: "...A banker came to you and offered to lend any amount of money you ask: How much would you ask for if the loan was payable in one year, 5 year and 10 year?..." The response clearly come out that the amount that would be borrowed remain relatively

small, even for a 10-year repayment period. Moreover, Table 1 (see Annex) indicates that the average loan amounts demanded are linked to the respondents' "relative" level of aspiration. The results are rather clear, showing that one would borrow significantly more if he/she feel in control of his/her life. In other words, differences between low aspiration and high aspiration individuals are significant, the latter being significantly more willing to take a loan for all maturity periods. Controlling for factors that may compete in explaining one's investment behaviour (including the lack of complementary assets, the exposure to income shocks, lack of information, identity traits, missing markets and limited local investment opportunities) overall, the results give fairly strong support to the existence of aspiration failures.

It is also interesting to note that even at that very low level of demand for credit, there is also the problem of *cultural bias* towards some micro-enterprise activities with otherwise very good potential for the localities. The tendency (and the attendant competition for resources) is often to get on with such activities as agriculture, trade, etc, which are somehow free from 'cultural taboos'. Some non-traditional activities which could provide alternative employment opportunities (like blacksmithing, weaving, tannery, pottery, embroidery, other handicrafts, etc...) are rather frowned at -- they are considered to be jobs traditionally given for citizens of the lower class -- and not easily taken up by clients. Experience suggests that they offer many advantages: they employ indigenous technology/local input, they are not land-based and are environmentally friendly, they enjoy less competition and are otherwise much more rewarding -- the data indicates that there is a statistically significant difference in profitability between these activities than traditional ones like agriculture. Yet, the total institutional loan that went to finance such activities is less than 5%.

One can also argue that the problem has been compounded by the fact that many of the rural residents have had an easy *access to relief* for many decades as there were enough flows of food-aid in the form of safety net from the generous tax payers in the western world, and there are experts, professionals, officials, NGOs, etc who advocate for it as their own livelihoods also depend on 'distributing' it. The majority have sustained life in this way for decades.

Gender Issues

About 40% of households in Ethiopia are headed (*de jure* and *de-facto*) by women (IFAD 2001). Credit and saving programmes in particular are therefore geared towards the promotion of off-farm activities by rural women. These programmes are implicitly or explicitly based on the assumption that rural women are conversant with non-farm income generating activities, have sufficient time and labour to expand traditional, or start new, income generating activities. One of the important issues relevant for gender-focused policy interventions is the question of how rural women manage to actively engage in off-farm activities *on top of* their demanding roles in agricultural production and domestic labour. There are practical problems in this regard. Generally, most domestic tasks such as grinding grain and food processing, water and fuel wood collection are known to be highly arduous, labour-intensive and time-consuming. And this applies to many women in developing countries in general. The burden of women in Ethiopia is compounded by the fact that labour saving "appropriate" technology is largely unknown even by the standards of developing countries. Access to clean water, grain mills, roads, energy saving devices, etc., is

extremely limited. For example, it is estimated that rural women in Ethiopia travel on average half a day to fetch water for household consumption.

Some Ethiopian authors take the issue a bit further to argue the burden on women as relating to some cultural factors. Dejene (IFAD 2001), for one, noted that Ethiopian rural women face significantly higher domestic labour burden (especially in the areas of food processing and cooking) than their counterparts in most of sub-Saharan Africa. Dejene hypothesizes that this is partly due to the sophisticated and labour intensive nature of domestic production arising from Ethiopian Highland *culinary culture*. For example, *Teff* (the favorite food grain in Northern highlands) is not only labour intensive in its cultivation but also the preparation of *Injera* (Ethiopian staple food) out of *Teff* is an equally labour and energy (fuel) intensive process. The preparation of home made spices (e.g., red pepper) is similarly a labour intensive task.

As we have outlined above, there is also a serious problem of *marketable skill* in rural areas. There are no institutions providing such opportunities of skill development for the needy. Those that exist tend to concentrate in semi-urban areas, and often such opportunities are snatched by men. Thus, when it comes to skill acquisition, women are more ill-equipped than their male counterparts. Thus, women generally took smaller loans (on average 22% lower than those taken by men), and their profit margin is much lower.

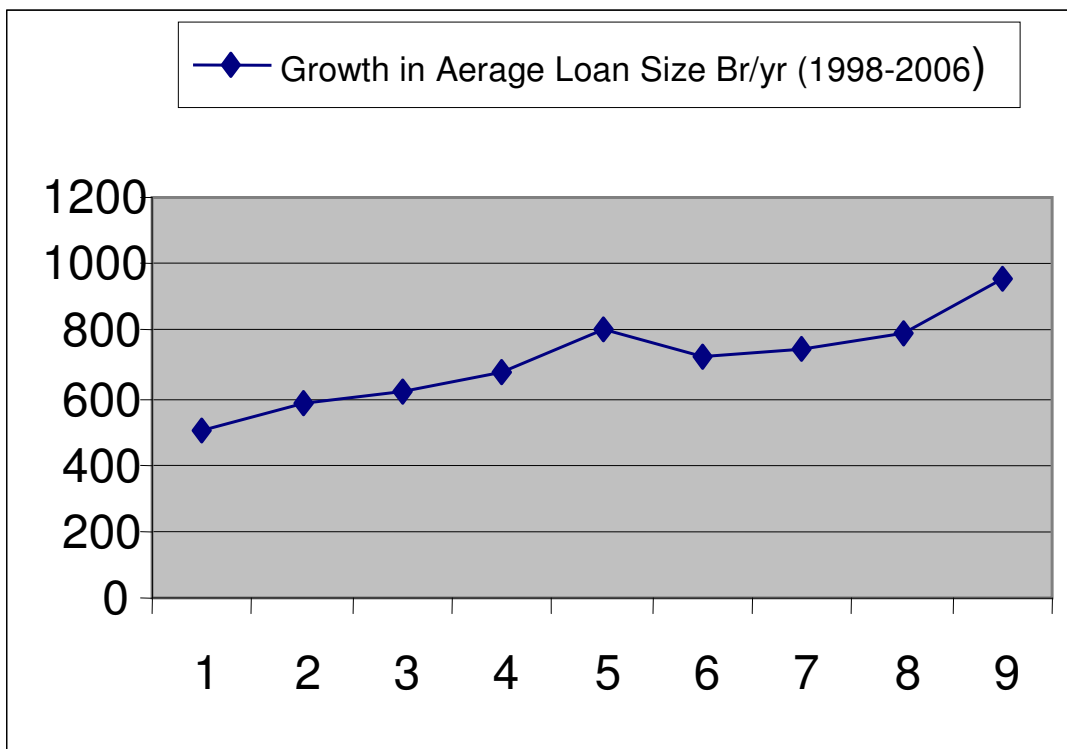
Yet, not all loan destined to women is utilized by themselves. Indeed, to encourage more women participation in business, MFIs generally have a target of delivering at least 50% of the credit service to women, which seems to have been attained. However, whether they are actually making use of the loan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

Conclusion

Microfinance holds a good promise as one key sector to poverty alleviation and microenterprise development. In particular, where appropriate financial products and methodologies suited to local circumstances are available, considerable achievements can be registered. For this to be more effective, however, such complements have to be there, particularly those related to enterprise development, including: appropriate agricultural technology and extension, Business Development Services, marketing, entrepreneurship development, rural infrastructure, etc. Given the high proportion of people in this particular sector of the economy, a collaborative effort is required to remove all challenges that are facing the industry, as this would have a strong repercussion on the entire micro-enterprise growth as well as to the national development at large.

Annexes

Fig. 1: Growth in Average Loan Size



Source: Own Computation, using Institutional Data

Table 1: Aspiration Failures

	“Each person is primarily responsible for his/her success or failures in life” (Eth Br.)*	“One’s success or failure in life is a matter of his/her destiny”	% difference	t-test: p-value
Amount borrowed for one year	1988	1647	20.64	0.0003
Amount borrowed for 5 years	3188	2717	17.29	0.0001
Amount borrowed for 10 years	4073	3463	17.61	0.000`
Number of observations	1466	723		

*US\$1~Eth.Br. 9.5

Source: CHF, Partners in Development (2007)

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