



**THE NEED FOR TRANSITION: MICRO CREDIT TO MICRO
FINANCIAL INSTITUTIONS - A CASE STUDY OF AMHARA SAVING
& CREDIT INSTITUTION (ACSI), ETHIOPIA**

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ABSTRACT

Fighting poverty is one of the core objectives of the Millennium Development Goals (MDG). Micro Finance is the best way to eradicate poverty and to empower people. Micro finance is the newly emerging financial industry. It has the target market of more than 1.8 billion people in the whole world. The emphasis of this study is to analyze the prospects of micro financial institution in Amhara regional state. This research stresses the need of the diverse micro financial services in order to make the micro finance banks sustainable and profitable while serving the diverse needs of the poor. Micro Finance Institutions (MFI's) should be distinguished from the NGOs as they are not just charity organizations. The diverse products would mitigate the risk and at the same time gives a variety of services and choices to the clients. Today the reason of the loss of the most of the micro finance institutions is that they offer very few products dominantly micro credit.

The study has reviewed the success factors of Amhara saving & credit institution. Successful ACSI in Amhara region and has developed its recommendations on the basis of this analysis that can be implemented on the other MFI's. There is a demand for diverse micro financial services

in Amhara region and just by meeting a very small group. So, if there are more innovations in the product development, this sector can become sustainable. Future of micro finance is bright in Ethiopia. The objectives of microfinance in ACSI can only be achieved by focusing on the financial systems approach which can cover the diversified needs of the clients in the different trades of the society.

The researcher discussed that the poverty lending approach is supply driven in nature where as financial system approach is demand driven and hence more reasonable to adopt by MFIs (i.e. by Amhara saving & credit institution) to be sustainable and profitable. . There was a time when micro credit was the times need but with the time and development of the society the needs have also developed and people demand other products like insurance services and other long term loans.

Key words: micro financial institution, micro credit & micro bank.

1.1. INTRODUCTION

A number of saving & credit institution & micro Bank's emerged in the market providing micro financial services in different cities of Ethiopia.

Despite the acknowledgement of the government regarding the vitality of these institutions for the uplift of poor segments of the society, the financial status of these institutions remain far from satisfactory. There are a number of reasons why these institutions could not incorporate within them a fast track toward economic prosperity and profitability. The chief cause behind the slow growth of microfinance institutions in Ethiopia is that most of them look ahead towards governmental agencies and domestic/international donors in order to maintain their operating efficiency. The main shareholders of Amhara saving & credit institution(ACSI) are the regional government (25%), ORDA(Organization for Rehabilitation & Development in Amhara) (35%), ADA(Amhara development association) (20%), AWDA(Amhara Women's Development Association) (10%) and Endeavour (10%). Major donors and supporters include: SIDA, IFAD, USAID, Packard Foundation, etc. (ACSI, Institutional Profile, Current Status and Future Strategy, 2004)

Such economic dependency is detrimental for the growth of the microfinance sector since the basic motivation behind the creation of microfinance institutions was to generate income

opportunities for members of low income classes residing either in rural or urban areas. MFI's advanced these loans for capacity building of the masses on reasonable interest rates. Majority of such microfinance schemes are supported mainly by the government. But despite the pampering received through different sources, these microfinance institutions are plagued with the inability to cater to their operating expenses incurred during their operating activities. One of the main reasons for this is that these microfinance institutions have not devised a mechanism to support their existence and survival. Since the micro finance institutions offer loans to people of the deprived class at reasonable rates, apart from this the default share of these loans is also high. Resultantly these MFI's are faced with the dilemma as to how to survive independently. The days of the present era demand from these MFI's to adopt a major shift in their traditional way of operating especially when catering to a target market whose economic status is vulnerable. In this scenario these MFI's need to incorporate a wide variety of products to their portfolio for e.g. long term loan & insurance services. By the addition of more products these MFI's would be able not only to generate profits through prudent investment endeavours which would eventually aid these MFI's to meet their operational expenses but will also contribute towards enhancing the financial literacy of the members of the deprived class.

Considering the importance of microfinance to the development the country's economic growth and poverty reduction, the Ethiopian government has paved a way to establish micro finance institutions. The formal microfinance industry began in Ethiopia in 1994/1995 with the government's "the Licensing and Supervision of Microfinance Institution Proclamation" designed to encourage Microfinance Institutions(MFIs) to extend credit to both the rural and urban poor of the country.

1.1.1 WHAT IS SUSTAINABILITY?

Here by sustainability we mean organizational sustainability which is explained by (Balazs Sator, 2006) as,

- Sustainability is a capacity, potential, ability rather than a given fact.
- The capacity of an organization to fulfil its mission and reach its vision.
- More than survival: growth, development, impact.
- A perceived indicator of success of an organization.

According to Balazs Sator in his report on organizational development and organizational sustainability the elements which responsible for NGO's sustainability are:

- **INSTITUTIONAL SUSTAINABILITY:** Capacity to provide for the strategic framework, effective leadership and efficient organizational background for the NGO.
- **PROGRAM SUSTAINABILITY:** The capacity to provide for the best possible services and programs making and impact, improve the lives of beneficiaries with the resources available.
- **FINANCIAL SUSTAINABILITY:** Capacity to generate the resources necessary to achieve institutional and program sustainability.

1.2. CONCEPTS OF MICROFINANCE:

Micro Finance is defined as formal scheme designed to improve the well being of poor through better access to saving and services loans (Schreiner, 2000).

Micro finance is the tool that can bring the positive change in the life of the poor people of Ethiopia. Micro finance is more than simply credit.

Asian Development Bank (ADB's) micro finance development strategy defines microfinance as providing a broad range of financial services, such as;

- *Deposits*
- *loans*
- *Payment services*
- *Money transfers*
- *Insurance to poor and low income households and their micro-enterprises.*

ADB's definition of micro finance is not restricted to the poor; it includes low income households (ADB, 2008).

According to Robinson, Marguerite (2001), "microfinance refers to small-scale financial services primarily credit and savings provided to people who farm or fish or herd; who operate small enterprises or micro enterprises where goods are produced, recycled, repaired, or sold; who provide services; who work for wages or commissions; who gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and groups at the local levels of developing countries, both rural and urban. Many such households have multiple sources of income".

According to the definition on "Microfinance Gateway" an MFI is the organization that offers financial services to the low-income people (Microfinance gateway, 2008).

There are MFI's that can be considered in the business of micro finance. These institutions are the community based financial intermediaries such as credit union; cooperative housing societies and some other are owned and managed by the local entrepreneur and municipalities. This type of institution is varying from country to country (Rehman, 2007).

LEADING VIEWS ON MICROFINANCE:

According to Marguerite (2001), there are two leading approaches to microfinance:

- **Poverty lending approach.**
- **Financial systems approach.**

Both these approaches tend to provide the availability of financial services for the poor, despite having consonance in their goals, each approach tends to adopt different methods of working for the achievement of their desired aim. The researcher looks at how these two approaches tend to operate:

POVERTY LENDING APPROACH:

According to Robinson & Marguerite (2001), the basis focus of the poverty lending approach is the reduction of poverty through institutions which receive funds from donors or governmental authorities. The basic aim of the poverty lending approach is to reach the poorest of the poor. In poverty lending approach to microfinance saving is only limited to a trivial status i.e. only as a compulsion for receiving credit. Institutions adopting the poverty lending approach are not sustainable, the reason being that the interest rate on their loans is too low for the recovery of even their costs. These institutions also do not cater to the demand for micro saving services among the poor. The focus of poverty lending approach is upon micro-credit not microfinance.

FINANCIAL SYSTEMS APPROACH:

According to Robinson, Marguerite (2001), the financial systems approach focuses on financial intermediation between the poor borrowers and savers on commercial basis. This approach lays its emphasis on the institutional self-sufficiency. The world has witnessed the emergence of many commercial microfinance intermediaries in the past decades. These commercial microfinance intermediaries provide credit and saving services to the economically active poor. The loans of these institutions are financed by savings, commercial debts and through profitable investments. The financial systems approach represents a more globally acceptable model of microfinance.

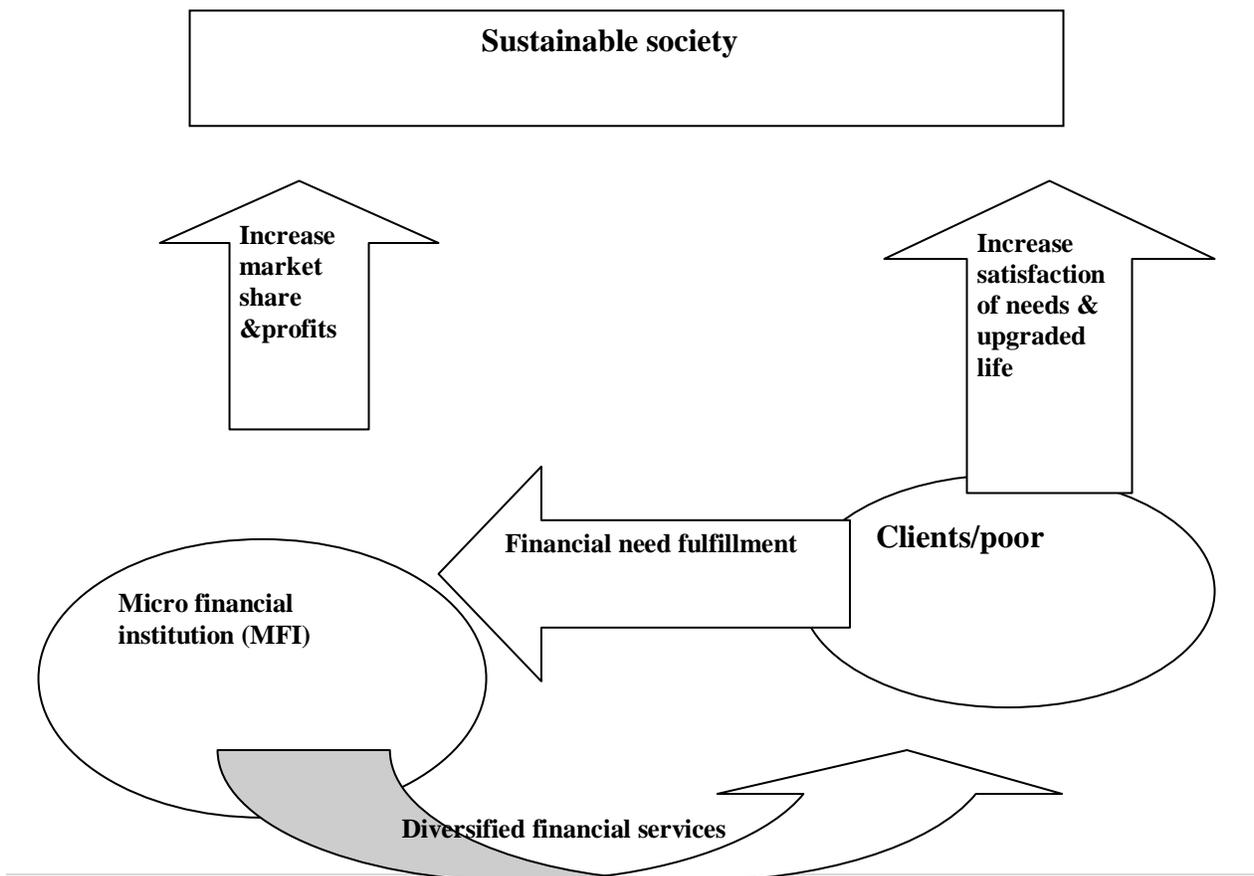
1.3 OBJECTIVES OF THE STUDY:

The objectives of this study is to analyze the profitable of micro financial institution the case of Amhara saving & credit institution(ACSI), Ethiopia This study tends to probe an approach (financial systems approach) and the ways that how Amhara credit & saving institution can be transformed to a profitable microfinance industry(i.e. Amhara micro bank)

What is the importance of Diversified Micro financial Services for making ACSI sustainable while fulfilling the Poor's needs?

The Figure 1.1 below depicts that diversified micro financial services are of great significant for both i.e. micro financial institutions and the clients (poor). By diversified financial services, the micro financial institutions and the clients (poor) simultaneously for the fulfilment of their financial needs. On one hand the micro financial institutions benefit i.e. in the form of increased market share and profits. On the other hand the clients (poor) benefit i.e. through their increased satisfaction of their needs and up gradation of their life style. Resultantly economy triggers up and the society starts to transform towards a state of sustainability.

Figure 1.1



This research is a journey from saving & credit to the micro finance institutions. Hence, ASCI transform to Amhara micro bank. The current growing Micro Finance industry of ACSI is not sustainable or profitable. The industry is running mainly with its core product i.e. Micro credit and hence is not sustainable. The above figure is the objective of this research that ACSI (Amhara saving & credit institution) can become sustainable by offering diversified products while serving the unprivileged people (target market). This would reduce their operating expenses and finally they can become profitable.

1.4 RESEARCH APPROACH:

The objective of this study is ACSI adopt financial system approach and provide diverse micro financial services while expanding their portfolios. According to (Ghauri, 2005, page.3) “Research is a process of planning, executing and investigating in order to find answers to specific questions. In order to get reliable answers to questions, researchers need to do this investigation in a systematic manner, so that it is easier for others to understand the logic of and believe in this report”

There are three approaches, which can be used in any research inductive, deductive and the combination of the two.

“By deduction mean that the researcher draws conclusions through logical reasoning. In this case, it need not be true in reality, but it is logical. The researcher in this type builds/deduces hypothesis from the existing knowledge (literature), which can be subject to the empirical scrutiny (testing) and thus can be accepted or rejected.”(Ghauri, 2005, page 15)

Deductive approach important in a context that it uses the existing data and knowledge which is already been tested and hypothesized. In this study the researcher analyze different school of thoughts. The researcher study different variables associated to the problem and also relation between them. “This not only helps the researcher to better formulate and understand the research problem, but also broaden the base from which scientific conclusion can be drawn. In other words, the verification process is more rapid and the reliability of the information and conclusion is greatly enhanced.” (Ghauri, 2005, page95)

As primary data is not available, so this research would be secondary in nature and hence deductive approach would be applied here. The researcher relying on the published data, papers and discussed the current programs of the ASCI. In this way the researcher can access a large amount of data in a short span of time. The researcher chooses among different schools of thoughts. The researcher can accept and reject the theories on the basis of different ideologies.

1.5 FINDING & CONCLUSIONS

Micro finance should be treated as newly emerging part of Ethiopia financial institution. It should give a variety of more financial services to low income people. Micro financial institution is at good manner in Ethiopia, in order to become profitable it has to follow financial systems approach. In this way the microfinance industry can justify its existence of being a profitable institution.

In this paper, the researcher have tried to evaluate the importance of Diversified Micro financial Services for making ACSI sustainable while fulfilling the Poor's needs. Analysis of the information and a case shows that the idea is successful in terms of sustainability of ASCI's as well as fulfilling Poor's needs. In this study above the researcher discussed the poverty lending approach and financial systems approach and their benefits. The researcher discussed that the poverty lending approach is supply driven in nature where as financial system approach is demand driven and hence more reasonable to adopt by ASCI to be sustainable and profitable. A transition from poverty lending approach towards a financial systems approach is needed to achieve the purpose, i.e., Making ASCI sustainable while fulfilling the Poor's needs, because this approach motivates introduction of diversified financial products and services, where as the former just stresses on the reducing the poverty by giving loans irrespective of the clients potential to make use of it in a better manner.

Furthermore target market that is Amhara region and the characteristics of the society were reviewed because this is the main market of concern for my research. What are the needs and what kind of products would be suitable for this segment. The objectives of microfinance in ACSI can only be achieved by focusing on the financial systems approach which can cover the diversified needs of the clients in the different trades of the society. There is a demand for innovation in the product line as the clients demand more. There was a time when micro credit was the times need but with the time and development of the society the needs have also developed and people demand other products like insurance service and other long term loans. The insufficiency of the diversified product lines is also a reason that the loans meant for income generation purposes are spent on other things and hence clients default when unable to produce income.

Examples were taken from Amhara saving & credit institution (ACSI) and other MFIs working successfully and which show that these institutions are moving forward into providing diverse financial services and their experiences help other institutions to improve and to be more

efficient and more effective on the way to achieving the lofty goal of providing affordable, high quality services to the poor. Sustainability and profitability are difficult objectives to reach. ACSI must try innovative ways of reaching the market when it comes to specially designed products. Their successes provide lessons, as do their mistakes. So, their flexibility to continue adjusting as they learn new lessons is an important one. A not very detailed comparison of MFIs in Ethiopia was done so a broader study or a synthesis of several regional or country activities from other regions and other types of institutional and delivery mechanisms would be helpful.

It is an effort to recommend that in a country like Ethiopia financial systems approach must be applied by the ACSI to be sustainable. This is only possible by introducing new product lines to the portfolio of the products and services offered by ACSI in Ethiopia. The needs of the target market must be considered in this regards and since there is always a continuous evolution in the needs of the clients the products and services must be reviewed after some regular intervals and changes be made or new products be developed accordingly.

The success of MFIs in other countries gives some important lessons for ACSI in Ethiopia. It shows that poor people have diverse credit needs. ACSI have to provide different and flexible products to help poor get out of poverty. A good institutional set-up and carefully designed product that is flexible enhances the capabilities of ACSI. It is recommended that the product design and development by the ACSI be done after understanding the existing financial service behaviour and the attributes of the poor. The innovations made to the products must be dynamic in nature that can adopt to the changes in their needs and time. It must also be content specific.

During the last twenty years, there have been significant changes in both the understanding of the needs of the poor for financial services and of the provision of financial services for them. The microfinance revolution showed that the poor are bankable and now there is a time to show that these poor people are not just the people who need only credit to fulfil their living needs but they have a need for a set of financial services which can be offered by the ACSI that meet the complex livelihood needs of the poor.

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