Outreach and Sustainability of Microfinance Institutions of Ethiopia: A Case Study on Specialized Financial and Promotional Institution (SFPI)

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Abstract
Ethiopia has an estimated population of more than 90 million. Agriculture is the mainstay of the economy and approximately 83.2% of the country's population live in the rural areas. Ethiopia is one of the least developed countries. The per capita income of the country is only USD 550 during the current period. Poverty and food insecurity are the main challenges and fundamental issues of economic development in Ethiopia. To address the issues of development and food insecurity, several microfinance institutions (MFIs) have established and have been operating towards resolving the credit access problem of the poor. The establishment of sustainable MFI that reach a large number of rural and urban poor who are not served by the conventional financial institutions, such as the commercial banks, has been a prime component of the new development strategy of Ethiopia. Healthy financial and operating performance of microfinance institutions is very important for their well-functioning and to serve their clients properly. The motivating philosophy of this paper is that unless MFIs become viable and sustainable financial institutions, they can never fully realize their objective of reaching a greater number of poor people. In light of this, this paper has attempted to look at the Financial and Operating Performance of Specialized Financial and Promotional Institution (SFPI) at firm level and compare against the Industry Average (I.A) from Sustainability, Profitability and Outreach level perspectives. The major theme of this study is to examine the institutional-level financial and operating performance of SFPI. Data for the study were from secondary sources and various ratios and indicators were used to measure the performance of SFPI. Fifteen years data from 2000 to 2014 were used to see the trend in its performance and revealed through tables, figures and ratios. The major finding of the study indicates that, the percent of women borrowers of SFPI is higher than the percent of women borrowers of the Industry Average. The Financial Sustainability and Profitability of SFPI is going down the ladder of Sustainability and Profitability measures during the periods of the study. On average SFPI is operationally self-sufficient at around 111.44% over the sixteen years period.
Keywords: Outreach, Profitability and Financial Sustainability

1. Introduction

Ethiopia has an estimated population of more than 90 million. Agriculture is the mainstay of the economy and approximately 83.2% of the country's population live in the rural areas. Ethiopia is one of the least developed countries. The per capita income of the country, though it showed improvement in recent years, is only USD 550 during the current period. Most of the poor, which mainly argued to be constrained by absences of credit access, participate in some kind of informal sector ranging from small petty trading to medium scale enterprises. (Befekadu B.Kereta, 2007).

Poverty and food insecurity are the main challenges and fundamental issues of economic development in Ethiopia. At the same time, famine, disease, civil strife, unwise policies were part of its history. Almost all indicators identify Ethiopia as one of the poorest countries on earth. The major causes of low economic growth and high incidence of poverty in Ethiopia include lack of income, assets, employment opportunities, skills, education, health and infrastructure. (Wolday Amha 2000). Following the political changes in 1991 the Federal Government of Ethiopia has made subsequent policy changes towards a free market economy and agriculture focused development programs such as the New Extension Program to increase agricultural production and productivity, the Federal and Regional Food Security Strategies designed to increase food and agricultural production and Growth and Transformation Plan.

To meet those objectives the development of financial sectors in the country is important. The financial sector is a component of a nation's economy created by the ebb and flow of capital in the financial industry.

Institutions like banks, insurance companies, investment firms, Microfinance's and so forth are all part of the financial sector. (www.wisegeek.com).

Microfinance is the provision of financial services for the poor people with very small business or business project. Microfinance is the provision of a broad range of financial services such as – deposits, loans, pension services, payment services, money transfers and insurance products – to the poor and low-income households.[4] 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. (Robinson M, 2001) i.e. Microfinance stands for financial services addressed to the poor as targeted clients with different motives to use such services.

The success of an enterprise to a great extent depends upon its financial and operational performance. Careful and well planned financial management is needed for raising and efficient utilization of resources. In addition, healthy financial and operating performance of microfinance institutions is very important for the achievement of development goals (the purpose for which these institutions are established for) and for the well-functioning of the country's financial system as a whole. Hence, it is highly essential to evaluate the financial and operating performance of microfinance institutions.

Performance evaluation of a company is usually related to how well a company can use its assets, shareholder equity and liability, revenue and expenses. Financial ratio analysis is one of the best tools of performance evaluation of any company. In order to determine the financial position of the MFIs and to make a judgment on how well the MFIs efficiency, its operation and management and how well the industry has been able to utilize its assets and earn profit.

Performance of an institution shall be measured from the objectives of the organization angle. Microfinance's goal is to eradicate poverty. In the early days when MFIs started, they were financed by donor funds that have a poverty eradication goal. Hence the performance of the MFI was measured on how much MFI reach to the poor (outreach) and impact (how far the lives of those who get financial services are changing as compared to those who don't get these services). But as the MF industry grows in size, the need for increased financing coupled with unpredictability of donor funds activate the issue of building a sustainable MFIs that stand on their own feet. That is; MFIs shall start covering their own cost of operation from their program revenues. Sustainability is loosely defined as the ability of a MFI to cover its operating and other costs from generated revenue and provide for profit. It is an indicator which shows how the MFI can run independent (free) of subsidies. This change in emphasis has created a different perspective on the analysis of performance of the MFIs. (Letenah Ejigu, 2009). Today many key players in the industry use sustainability as one core criteria to evaluate the performance of MFIs in addition to the outreach and impact measures described earlier. For a country like Ethiopia, poverty and food insecurity remains to be one of the biggest policy concerns. Amongst various measures to eradicate it, Microfinance, has provided a ray of hope.

In Ethiopia, several MFIs have established and have been operating towards resolving the credit access problem of the poor particularly to those who participates in the petty business. (*Befekadu B. Kereta*, 2007). Of those microfinance institutions which are working in Ethiopia, Specialized Financial and Promotional Institutions is one. Specialized Financial and Promotional Institution S.C. was established in 1997 with an authorized capital of Birr 800,000. Out of which Birr 200,000 was subscribed and fully paid. The company is registered as Microfinance institution by the National Bank of Ethiopia as March 1997 under the certificate No.MFI/0034/97. (www.mixmarket.org). Currently SFPI is providing financial services through 15 branch offices. Up to now, the institution has given total loan amounting to Birr 179 million, and has over 46,000 active clients being served by a total of around 237 employees. (sfpi, 2015 annual report)

The objectives of SFPI in brief are to provide loan in cash or in kind to target group with meager income, to accept from its clients savings in the form of savings at the expire of fixed period or without limit of time, to provide clients technical advice and to loaners with work methods and market, technical and management advice, creating job opportunity and stimulating the local community. In order to meet the felt needs of the target market, SFPI strongly committed itself to develop a variety of financial products. Currently it has five loan products (Group loan, individual loan, youth loan, MSE and WEDP loan products) and five saving products (compulsory saving, ordinary saving, fixed time deposit, housing fund saving and box saving products). On top of these financial products, SFPI designed credit life insurance product which has been endorsed by the BoDs and expected to be implemented in the 2016 fiscal year. To achieve these objectives the institution should be financially feasible and sustainable.

1.1. Statement of the Problem

The Ethiopian economy has been state controlled through a series of industrial development plans since the Imperial Government of Haile Selassie. Under state socialism (1974-91), popularly referred to in Ethiopia as the 'Derg regime', Financial institutions were directed to finance some public projects that may not have passed proper financial appraisal.(Yesuf Legas, 2010) Following the down fall of the Derg regime a new policy have been

proposed and implemented to promote the development of the country.

Now, Ethiopia strives to grow and to become under the category of the countries which have middle income societies. Thus; now is the time for Ethiopia to escape from poverty. So, to achieve such an objective, the financial sector especially the microfinance institutions play an important role by helping the poor who have no access to other financial institutions. In consideration of this, the federal government of Ethiopia has adopted a strategy to support them in their expansion.

The establishment of sustainable MFI that reach a large number of rural and urban poor who are not served by the conventional financial institutions, such as the commercial banks, has been a prime component of the new development Strategy of Ethiopia. (Wolday Amha, 2000)

Financial and operating performance of a company being one of the major characteristics indicates competitiveness, potentials of the business, economic interest of the company's management and reliability of present and future contractors. Therefore, identification of the MFIs weaknesses and strengths through financial and operating performance indicators has great contribution to the management, shareholders, the public, (customers of the microfinance institutions), the regulators (the government bodies) and the economy as a whole. The objective of almost all of the microfinance institutions in Ethiopia is poverty alleviation. To achieve this objective microfinance institutions should be financially viable and sustainable.

Regardless of the increasing trust on microfinance to reduce poverty in Ethiopia there has been amazingly some work undertaken to evaluate their performance. There is also a fear among interested parties in the industry that MFIs could not stay in the market to serve the poor without the immense support of government, donors and others. (Alemayehu Yirsaw, 2008)

A number of studies have been conducted on microfinance institutions. Most of the prior studies focus on assessment of the impact of MFIs on poverty alleviation, impact of MFIs on women's empowerment, the role of microfinance on agricultural productivity, and impact of microfinance institutions on children's education. There are also some studies carried out even on this issue but, the area of Financial and Operating Performance of MFIs in Ethiopia specifically SFPI is not thoroughly researched.

Thus, this paper will attempt to look at the Financial and Operating Performance of SFPI as a whole and compare against the Industry Average (I.A) [1] based on the following parameters of measuring financial performance:

1. Outreach level
2. Sustainability and Profitability

The financial performance indicators are usually ratios extracted from the financial reports (Balance Sheet, Income Statement and Portfolio Report).

Microfinance has been viewed as one way of dealing with poverty by expanding services to the poor and low income persons that do not have access to the formal financial institutions.

Microfinance offers poor people access to basic financial services such as loans, savings, money transfer and micro insurance services. People living in poverty, like everyone else, need a diverse range of financial services to run their businesses, build assets, smooth consumption, and manage risks.

Microfinance is the chance to the poor never had. The typical microfinance clients are low income persons that do not have access to the formal financial institutions. Generally, the contribution of microfinance institutions for the development of the country's economy is viewed as multidimensional: such as, poverty eradication, women's empowerment, creating job opportunity, finance mobilization and so forth. Thus, the motivating philosophy of this paper is that unless MFIs become viable and sustainable financial institutions, they can never fully realize their objective of reaching a greater number of poor people. It is therefore, important to assess the institutional-level financial and operating performance of SFPI and compare to the Industry Average.

1.2. Research Questions

The purpose of this project was to analyze the performance of SFPI at firm level. So far, most research tried to assess the impact of microfinance on poverty, women empowerment, income generation, agricultural productivity, etc. But this paper was trying to assess whether Specialized Financial and Promotional Institution is financially and operationally sound or not by addressing the following questions:

✓ What is the extent of SFPI outreach level?
✓ Can SFPI provide microfinance services sustainably?

1.3. Objectives of the study

The general objective of the study was to assess financial and operational performance of SFPI. In line with the, the study addressed the following specific objectives:

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[1] For the purposes of this paper, Industry Average (I.A) were defined as the summation of DECSI, ACSI, OCCSSI, OMO and SFPI then divided by five:

- To assess the outreach level of SFPI and compare with the Industry Average.
- To find out whether the institution provides its microfinance services sustainably in comparison with the Industry Average.

2. Literature Review

This section provides theoretical and empirical literature review. The first subsection the theoretical review provides an overview of microfinance concept and performance evaluation tools which lays foundation for the study.

2.1. Microfinance – An Overview

The emergence of the global micro finance has a history of about three decades, yet has gone through stages of historical development. The micro finance industry is said to be in revolution: the service that was initiated in small scale and small village of South East Asia "Chintanga", Bangladesh now turned to be international agenda and an issue addressing one of the main problems i.e. poverty in developing countries of the world.

As commonly understood, the term micro finance refers to the activities of financial and social intermediation services directed to low income population group. The financial intermediation refers to loans, savings, insurance, transfer services and other financial products targeted at low income population group. The social intermediation, however, refers to group formation, development of self-confidence, training in financial skills, and arrangement capabilities among the poor section of the society. This idea is supported by (Robinson, 2001) that microfinance industry strives to provide services that help the low –income poor reduce financial risk, improve their management skills, increase their productivity and therefore their income, collect higher returns on investments, provide financial and emotional security, and improve the overall quality of life for their families.

2.1.1 What are Microfinance Institutions?

Microfinance (MF) is seen as one of the most efficient instruments to promote economic development and to fight poverty in poorer countries. Numerous microfinance institutions (MFIs) all over the world have proven that financial services can be offered on a sustainable basis with high outreach.

Microfinance institutions (MFIs) provide a range of financial services to poor households. Their worldwide growth in numbers has had a positive impact by providing the poor with loans, savings products, fund transfers and insurance facilities. This has helped create an encouraging socio-economic environment for many of these developing countries households. (Mamiza Haq, Michael skully, Shams Pathan ,2009).

Microfinance refers to the provision of financial services primarily savings and credit to the poor and low income households that don't have access to commercial banks (Arsyad L. 2005). (Legerwood 1999) defines it as the provision of financial services (generally saving and credit) to low income clients.

Microfinance is the provision of financial services for the poor people with very small business or business project. Microfinance is the provision of a broad range of financial services such as – deposits, loans, pension services, payment services, money transfers and insurance products – to the poor andlow-income households.(www.bsp.gov.ph/regulations/attachments/2001/circ272) 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. (Robinson M,2001) Microfinance institutions (MFIs) are relatively small financial institutions that have traditionally provided small loans (micro credit) to low income citizens with the objective of helping them to engage in productive activities (micro enterprise). The nature of these institutions is quite different from traditional financial institutions (such as commercial banks). MFIs are significantly smaller in size, limit their services towards poor households and often provide small collateral or free group loans.(Mamiza Haq, Michael skully, Shams Pathan ,2009).

Thus, MFIs are different from traditional financial institutions because they only provide services to low income customers and often provide loans without collateral.

According to Woller et al. 1999; Murdoch 2000 MFIs are different from commercial banks in their two main operational objectives. First, they act as financial intermediaries to poor households. This is known as the 'institutionist paradigm'. This means MFIs should generate enough revenue to meet their operating and financing costs. Second, they have a social goal. This is known as the 'welfarists paradigm' which includes a focus on poverty alleviation and depth of outreach along with achieving financial sustainability. (M.kabir Hassen Benito, 2009) In broader understanding, Alemayehu conceived that services given by microfinance institutions include loans, savings, insurance and pensions; however, some microfinance institutions also provide credit cards, payments services and money transfer services**.** (Alemayehu Yirsaw, 2008)

2.1.2 Evolution of Microfinance

Traditional banking sector cannot reach millions of poor for whom small loans could make huge differences. There are several reasons for this. Most of the poor are rural, and they are much dispersed. They have low education levels, if at all. As a result, administrative cost of supplying loans to the poor population is extremely high. Another issue that makes it difficult to serve these customers through traditional banking is that the poor does not have any

assets to use as collateral. As a result, the poor had access to loans only through local moneylenders at exorbitantly high interest rates. (www.sesric.org).

Micro-credit financing starts with the assumption that the poor is willing to pay high interest rates to have access to finance. In general, the system uses the social trust as the collateral. Although there are different micro-credit financing models, the borrowers in the pioneering models are usually members of small groups. Loans are given to individuals, but an entire group is responsible for the repayment. Hence, the borrower who does not fulfill his commitment to repay back will lose his/her social capital. Micro-credit institutions report that their repayment rates are above the commercial repayment rates, sometimes as high as 97%. Today, there are millions of poor people around the world who turn to be entrepreneurs through the micro-credit sector. (Alemayehu Yirsaw, 2008).

The year 1974 is a landmark in the history of microfinance development. It was by then that Professor Muhammad Yunus, a Bangladeshi economist introduced the idea of providing the poor with small loans. While he was on a field trip to an impoverished village with his students, he met a woman and interviewed her. She was making a living from the sale of stool (prepared from bamboo). From the interview he understood that the woman was making only a penny margin of profit for each stool. Then he reasoned that the woman would raise herself above subsistence level if she were given the loan with a more advantageous rate: then, he did it from his own pocket. In 1983 he formally established the Grameen Bank (meaning "village bank)**.** (www.globalenvision.org).

Thus, the limitations of financial institutions in providing the poor with credit have become the driving forces behind the emergence of MFIs. Nowadays, microfinance institutions are growing to provide the poor with financial as well as technical assistance. The accomplishment of MFIs is, therefore, a manifestation of a paradigm shift that defeated the old notion that the poor are not "creditworthy." (Bamlaku Alamirew, 2006)

Generally, the field of microfinance was pioneered by specialized non-governmental organizations (NGOs) and banks. They challenged the conventional wisdom of the 1970s and discovered that with new lending methods, the rural poor repaid loans on time. These new methods included providing very small loans without collateral at full-cost interest rates that were repayable in frequent installments. They demonstrated that the poor majority, who are generally excluded from the formal financial sector, can, in fact, be a market niche for innovative banking services that are commercially sustainable. As a result, current microfinance has made a major shift from subsidized microfinance projects of the past, which ended up serving few people, to the development of sustainable financial institutions specialized in serving the low-income market. Today there are a growing number of successful microfinance institutions (MFIs) worldwide. These are primarily local institutions that are reaching a significant number of poor people and that are becoming commercially viable. (www.undp.org).

Over the past 10 years or so, microfinance has rapidly evolved and expanded from the relatively narrow field of microenterprise credit to the more comprehensive concept of microfinance (which includes a range of financial services for poor people, including savings, money transfers, and insurance) to the enormous challenge of building inclusive financial systems.

The ideas and aspirations behind microfinance are not new. Small, informal savings and credit groups have operated for centuries across the world, from Ghana to Mexico to India and beyond. In Europe, as early as the 15th century, the Catholic Church founded pawn shops as an alternative to usurious moneylenders.

These pawn shops spread throughout the urban areas in Europe throughout the 15th century. Formal credit and savings institutions for the poor have also been around for generations, offering financial services for customers who were traditionally neglected by commercial banks. The Irish Loan Fund system, started in the early 1700s, is an early (and long-lived) example. By the 1840s, this system had about 300 funds throughout Ireland.

In the 1800s, Europe saw the emergence of larger and more formal savings and credit institutions that focused primarily on the rural and urban poor. The financial cooperative was developed in Germany. It aimed to help the rural population break from their dependence on moneylenders and to improve their welfare. The movement emerged in France in 1865 and Quebec in 1900.

Many of today's financial cooperatives in Africa, Latin America, and Asia find their roots in this European movement. Another early example is the Indonesian People's Credit Banks (BPRs) that opened in 1895 and became the largest microfinance system in Indonesia, with close to 9,000 branches.

In the early 1900s, variations on the savings and credit theme began to appear in rural Latin America and elsewhere. These rural finance interventions aimed to modernize the agricultural sector, mobilize "idle" savings, increase investment through credit, and reduce oppressive feudal relations that were enforced through indebtedness. In most cases, these new banks for the poor were not owned by the poor themselves, as they had been in Europe, but by government agencies or private banks. Over the years, these institutions became inefficient and, at times, corrupt.

Between the 1950s and 1970s, governments and donors focused on providing agricultural credit to small and marginalized farmers in hopes of raising productivity and incomes. These efforts to expand access to agricultural credit used state-owned development finance institutions, or farmers' cooperatives in some cases, to make loans to customers at below-market interest rates. These subsidized schemes were rarely successful. Rural development banks were unable to cover their costs with subsidized interest rates. Customers had poor repayment

discipline, because they saw their loans as gifts from the government.

2.1.3 History of Microfinance in Ethiopia

The Ethiopian economy has been state controlled through a series of industrial development plans since the Imperial Government of Haile Selassie. Under state socialism (1974-91), popularly referred to in Ethiopia as the 'Derg regime', Financial institutions were directed to finance some public projects that may not have passed proper financial appraisal. (Yesuf Legas 2010).

Following the political changes in 1991 a subsequent policy changes has been made towards a free market economy, agriculture focused development and to liberalize the financial sector. To this effect, Proclamation No. 84/94 was issued, which allows private domestic investors to participate in banking and insurance activities, which were previously monopolized by the government. However, the issuance of this proclamation alone did not totally solve the financial problem of the economically active poor people in rural and urban areas**.** (Seifu A., 2002)

Another Proclamation, No. 40/96 was issued to solve the problem of the delivery of financial services to the poor. Following the issuance of this proclamation different NGOs have shifted themselves into microfinance institutions raising the number of MFIs in Ethiopia to 35 in 2015. Consequently, the microfinance industry of Ethiopia showed a remarkable growth in terms of outreach and sustainability. Furthermore, the National Bank of Ethiopia issued a new directive on May 2002 to improve the regulation limits on loan size (Br. 5000), repayment period (one year), and lending methodology (social collateral). (Bamlaku Alamirew, 2006)

Thus, formal Microfinance industry in Ethiopia was started in 1994/5. In particular, the Licensing and Supervision of Microfinance Institution Proclamation of the government encouraged the spread of Microfinance Institutions (MFIs) in both rural and urban areas as it authorized them among other things, to legally accept deposits from the general public (hence diversify sources of funds), to draw and accept drafts, and to manage funds for the micro financing business**.** (Getaneh G. 2005) Currently there are 35 microfinance institutions in Ethiopia, licensed and registered by NBE, following the issuance of proclamation No. 40/96.

The proliferation of microfinance institutions could indicate the emphasis given to the strategy to fight against poverty in the country. Microfinance initiatives are policy instruments (prime components of the new development strategy). They can create an enabling environment for the poor to increase output and productivity by inducing technology adoption, improving input supply, and increasing income, reducing hunger and thereby reducing poverty**.** (Wolday A, 2001).

2.1.4.   The Schools of Thought on Microfinance institutions (MFIs)

The Schools of thought on how to deliver financial services to the poor are the minimalist, institutionalist, self-sustainability, the integrated service delivery, welfarist and poverty approaches. (Bhatt N & Tang S, 2001).

The institutionalist approach centers on "financial deepening" of building sustainability to serve those excluded from services of conventional banks. Achieving FSS and the number of clients served (in other terms breadth of outreach) are at the heart of the institutionalist approach. Institutionalists do not agree on directly targeting the very poor. Targeting the very poor is costly that hinder FSS. On the other hand, welfarists argue that it is possible to realize breadth and depth of outreach with poverty targeted services. (Adeno K, 2007) For welfarists, the net social benefits derived from serving a limited number of very poor clients are better than serving large numbers of not-so-poor clients. (woller G & Woodworth w.,2001) To have the same effect on social welfare, the self-sustainable lender must have 15 to 125 times the breadth of the poverty lender.(Schreiner M,2002). The institutionalist and welfarist approaches have practical inferences on differences in the devise for service delivery, institutional structures and financing, and segregation of the potential clients to be served. (Woller & Woodworth, 2001) Their basic difference lies at focusing on the institutional sustainability on the part of institutionalists but social benefits of welfarists. Hence, institutionalists give main concern to the business; welfarists focus on clients. As to welfarists change in the life of clients would be brought trough provision of both financial and non-financial services with the aid of subsidies.

2.1.5.   Can Microfinance be Profitable?

It is true that in order to provide efficient financial services MFIs should operate at a profit. Now days, most MFIs offer loans to the poor and SMEs from funds obtained from foreign donor organizations. However, this trend should not be continued, and MFIs should mobilize funds from the public or else they should be owned by private owners. Therefore, for their continued existence and viability these institutions should be free from any impositions by the government and be profitable.

Data from the Micro-Banking Bulletin reports that 63 of the world's top MFIs had an average rate of return, after adjusting for inflation and after taking out subsidies programs might have received, of about 2.5% of total assets. This compares favorably with returns in the commercial banking sector and gives credence to the hope of many that microfinance can be sufficiently attractive to mainstream into the retail banking sector. Many feel that once microfinance becomes mainstreamed, massive growth in the numbers of clients can be achieved (CGAP, 2003).

Others worry that an excessive concern about profit in microfinance will lead MFIs up-market, to serve

better off clients who can absorb larger loan amounts. This is the "crowding out" effect. This may happen; after all, there are a great number of very poor, poor, and vulnerable non-poor who are not reached by the banking sector. It is interesting to note that while the programs that reach out to the poorest clients perform less well as a group than those who reach out to a somewhat better-off client segment, their performance is improving rapidly and at the same pace as the programs serving a broad-based client group did some years ago. More and more MFI managers have come to understand that sustainability is a precursor to reaching exponentially greater numbers of clients. Given this, managers of leading MFIs are seeking ways to dramatically increase operational efficiency (Robinson, 2001). In short, we have every reason to expect that programs that reach out to the very poorest micro-clients can be sustainable once they have matured, and if they commit to that path. The evidence supports this position.

2.1.6. Key Principles of Microfinance

When Microfinance institutions were emerged before 38 years ago, they have the overriding concerns of eradicating poverty and helping the poor by providing them different financial services. Thus, unlike the mainstream banks, they have the social objectives of helping the poor who do not have any means to access any form of loans. Here under are the basic principles of MFIs. These principles were developed and endorsed by CGAP1 and its 31 member donors, and further endorsed by the Group of Eight leaders at the G8 Summit on 10 June 2004.

- ❖ *The poor need a variety of financial services, not just loans*. Just like everyone else, poor people need a wide range of financial services that are convenient, flexible, and reasonably priced. Depending on their circumstances, poor people need not only credit, but also savings, cash transfers, and insurance.

- ❖ *Microfinance is a powerful instrument against poverty*. Access to sustainable financial services enables the poor to increase incomes, build assets, and reduce their vulnerability to external shocks. Microfinance allows poor households to move from everyday survival to planning for the future, investing in better nutrition, improved living conditions, and children's health and education.

- ❖ *Microfinance means building financial systems that serve the poor*. Poor people constitute the vast majority of the population in most developing countries. Yet, an overwhelming number of the poor continue to lack access to basic financial services. In many countries, microfinance continues to be seen as a marginal sector and primarily a development concern for donors, governments, and socially-responsible investors. In order to achieve its full potential of reaching a large number of the poor, microfinance should become an integral part of the financial sector.

- ❖ *Financial sustainability is necessary to reach significant numbers of poor people.* Most poor people are not able to access financial services because of the lack of strong retail financial intermediaries. Building financially sustainable institutions is not an end in itself. It is the only way to reach significant scale and impact far beyond what donor agencies can fund. Sustainability is the ability of a microfinance provider to cover all of its costs. It allows the continued operation of the microfinance provider and the ongoing provision of financial services to the poor. Achieving financial sustainability means reducing transaction costs, offering better products and services that meet client needs, and finding new ways to reach the unranked poor.

- ❖ *Microfinance is about building permanent local financial institutions*. Building financial systems for the poor means building sound domestic financial intermediaries that can provide financial services to poor people on a permanent basis. Such institutions should be able to mobilize and recycle domestic savings, extend credit, and provide a range of services. Dependence on funding from donors and governments—including government-financed development banks—will gradually diminish as local financial institutions and private capital markets mature.

- ❖ *Microcredit is not always the answer*. **Microcredit is not appropriate for everyone or every situation.** The destitute and hungry who have no income or means of repayment need other forms of support before they can make use of loans. In many cases, small grants, infrastructure improvements, employment and training programs, and other non-financial services may be more appropriate tools for poverty alleviation. Wherever possible, such non-financial services should be coupled with building savings.

- ❖ *Microfinance can pay for itself, and must do so if it is to reach very large numbers of poor people*. Most poor people cannot get good financial services that meet their needs because there are not enough strong institutions that provide such services. Strong institutions need to charge enough to cover their costs. Cost recovery is not an end in itself. Rather, it is the only way to reach scale and impact beyond the limited levels that donors can fund. A financially sustainable institution can continue and expand its services over the long term. Achieving sustainability means lowering transaction costs, offering services that are more useful to the clients, and finding new ways to reach more of the unbanked poor.

- ❖ *The key bottleneck is the shortage of strong institutions and managers*. Microfinance is a specialized field that combines banking with social goals. Skills and systems need to be built at all levels: managers and information systems of microfinance institutions, central banks that regulate microfinance, other government agencies, and donors. Public and private investments in microfinance should focus on building this capacity,

not just moving money.

❖ *Microfinance works best when it measures—and discloses—its Performance*. Accurate, standardized performance information is imperative, both financial information (e.g., interest rates, loan repayment, and cost recovery) and social information (e.g., number of clients reached and their poverty level). Donors, investors, banking supervisors, and customers need this information to judge their cost, risk, and return.

❖ *Interest rate ceilings can damage poor people's access to financial* **services**. It costs much more to make many small loans than a few large loans. Unless micro lenders can charge interest rates that are well above average bank loan rates, they cannot cover their costs, and their growth and sustainability will be limited by the scarce and uncertain supply of subsidized funding. When governments regulate interest rates, they usually set them at levels too low to permit sustainable microcredit. At the same time, micro lenders should not pass on operational inefficiencies to clients in the form of prices (interest rates and other fees) that are far higher than they need to be.

❖ *The government's role is as an enabler, not as a direct provider of financial services.* National governments play an important role in setting a supportive policy environment that stimulates the development of financial services while protecting poor people's savings. The key things that a government can do for microfinance are to maintain macroeconomic stability, avoid interest-rate caps, and refrain from distorting the market with unsustainable subsidized, high-delinquency loan programs. Governments can also support financial services for the poor by improving the business environment for entrepreneurs, clamping down on corruption, and improving access to markets and infrastructure. In special situations, government funding for sound and independent microfinance institutions may be warranted when other funds are lacking.

❖ *Donor subsidies should complement, not compete with private sector capital.* Donors should use appropriate grant, loan, and equity instruments on a temporary basis to build the institutional capacity of financial providers, develop supporting infrastructure (like rating agencies, credit bureaus, audit capacity, etc.), and support experimental services and products.

o In some cases, longer-term donor subsidies may be required to reach sparsely populated and otherwise difficult-to-reach populations. To be effective, donor funding must seek to integrate financial services for the poor into local financial markets; apply specialist expertise to the design and implementation of projects; require that financial institutions and other partners meet minimum performance standards as a condition for continued support; and plan for exit from the outset.

❖ *The lack of institutional and human capacity is the key constraint*. Microfinance is a specialized field that combines banking with social goals, and capacity needs to be built at all levels, from financial institutions through the regulatory and supervisory bodies and information systems, to government development entities and donor agencies. Most investments in the sector, both public and private, should focus on this capacity building.

2.1.7. Performance Measurements in Microfinance

The achievements of MFIs are examined through the lenses of standard industry performance metrics over a series of variables: Outreach (breadth and depth), financial structure, financial performance, efficiency and productivity, and portfolio quality (Lafourcade, et.al, April 2005, p. 6). The performance of Microfinance institution is also best evaluated in light of the institution's context and stage of development. Note where the MFI's key strategic moves may have adverse short-term financial consequences but positive long-term effects. MFIs' achievement can be evaluated in terms of social performance and financial performance.

2.1.7.1. Financial Performance of MFIs

MFIs earn financial revenue from loans and other financial services in the form of interest fees, penalties, and commissions. Financial revenue also includes income from other financial assets, such as investment income. An MFI's financial activities also generate various expenses, from general operating expenses and the cost of borrowing for provisioning to the potential loss from defaulted loans. Profitable institutions earn a positive net income (i. e. operating income exceeds total expenses).

    o Average portfolio outstanding
    o Liquidity ratio
    o Delinquency and loan ageing reports
    o Ratio of losses to average portfolio outstanding

2.1.7.1.1. Sustainability and Profitability

Financial sustainability (profitability)—refers to whether the MFI is profitable enough to maintain and expand its services without continued injections of subsidies. (www.undp.org).

      The financial sustainability of MFIs is important as the poor benefit most if they have access to financial services over time rather than receive, for example, just one loan but denied future loans because the MFI has disappeared, or is illiquid because repayment rates are low, or funds promised by donors or governments have not materialized. Two levels of financial sustainability can be measured. One is a lower level of achievement in which the MFI reaches operational self-sustainability (OSS) meaning that operating income is sufficient to cover

operating costs, including salaries and wages, supplies, loan losses, and other administrative costs. Financial self-sustainability (FSS) is a higher standard because it means that the MFI can also cover the costs of funds and other forms of subsidies received when they are valued at market rates. Achieving this level is important because it means the MFI would still break even if all subsidies would be withdrawn. However, this does not always assure long-term institutional sustainability. In addition, the MFI must earn enough income to build capital reserves required for growth and as protection against future shocks. Measuring financial sustainability requires that MFIs maintain good financial accounts and follow recognized accounting practices that provide full transparency for income, expenses, loan recovery, and potential losses. Many MFIs cannot meet this standard. (Yesuf Legas, 2010) Most widely indicators of Sustainability and Profitability include: Adjusted return on equity, adjusted return on assets, Operational self-sufficiency & Financial self-sufficiency. (Seifu A., 2002).

2.1.7.1.2.   Portfolio Quality

Portfolio quality is a crucial area of analysis, since the largest source of risk for any financial institution resides in its loan portfolio. The loan portfolio is by far the MFI's largest asset and, in addition, the quality of that asset and therefore, the risk it poses for the institution can be quite difficult to measure. For microfinance institutions, whose loans are typically not backed by bankable collateral, the quality of the portfolio is absolutely crucial. Fortunately, many microfinance institutions have learned how to maintain loan portfolios of very high quality. In fact, leading microfinance institutions typically better at maintaining a higher portfolio quality than their commercial bank peers in many countries. The most widely used measure of portfolio quality in the microfinance industry is Portfolio at Risk (PaR), which measures the portion of the loan portfolio "contaminated" by arrears as a percentage of the total portfolio. Although various other measures are regularly used, PaR has emerged as the indicator of choice. It is easily understandable, does not understate risk, and is comparable across institutions. A microenterprise loan is typically considered to be at risk if a payment on it is more than 30 days late. In addition to the Portfolio at Risk indicator, there are other indicators related to portfolio quality and associated risks: Write-Offs and Risk Coverage.(Tor Janssen ,2003)

2.1.7.1.3.   Efficiency and Productivity

Efficiency and productivity indicators are performance measures that show how well the institution is streamlining its operations. Productivity indicators reflect the amount of output per unit of input. These indicators reflect how efficiently the MFI is using its resources, particularly its assets and its Personnel. (Alemayehu Yirsaw ,2008)

Efficiency indicators also take into account the cost of the inputs and/or the price of outputs. Since these indicators are not easily manipulated by management decisions, they are more readily comparable across institutions than the profitability indicators such as return on equity and return on assets. On the other hand, productivity and efficiency measures are less comprehensive indicators of performance than those of profitability. Microfinance institutions have much lower rates of efficiency than commercial banks because on a dollar per dollar basis microcredit is highly labor intensive: a hundred-dollar loan requires about as much administrative effort as a loan a thousand times larger. In an MFI, administrative costs may be $15, $20, or even $30 for each $100 in the loan portfolio, so the efficiency ratio is 15%, 20% or 30%, whereas in commercial bank efficiency ratios of 1.5%, 2% or 3% are common. Economies of scale have much less impact on efficiency in MFIs than is usually believed because of the high variable costs of the microcredit technology. If the loan portfolio of an MFI exceeds $2 to $3 million, growth does not seem to bring significant efficiency gains and small MFIs can often be more efficient than their much larger peers. (Tor Jansson ,2003) This paper includes the following indicators of measuring productivity and efficiency: Operating Expenses, Cost per Borrower, Personnel Productivity, Loan Officer Productivity, average outstanding loan size, and other expense ratios.

2.1.7.2. Social Performance of MFIs

2.1.7.2.1. Outreach level

Outreach refer to financial services provision to a large portion of the society, termed breadth of outreach, and to the poorest of the poor, also called depth of outreach. (Conning J, 1999) Outreach at glance means the number of client's served by the microfinance institutions. (Befikadu B, Kereta ,2007)

The best measurement of outreach is straightforward. That is the number of clients or accounts that are active at a given point in time. The number of active clients includes borrowers, depositors, and other clients who are currently accessing any financial services. However, Meyer (2002) described as outreach is multidimensional concept. In order to measure outreach we need to look in to different dimensions. The first is simply the number of persons now served that were previously denied access to formal financial services. Usually these persons will be the poor because they cannot provide the collateral required for accessing formal loans, are perceived as being too risky to serve, and impose high transaction costs on financial institutions because of the small size of their financial activities and transactions. Women often face greater problems than men in accessing financial services so number of women served is often measured as another criterion.... Although difficult to measure, depth of poverty is a concern because the poorest of the poor face the greatest access problem. Some measure of depth of outreach is needed to evaluate how well MFIs reach the very poor. Finally, the variety of financial services provided is the criterion because it has been shown that the poor demand and their welfare will be improved if

efficient and secure savings, insurance, remittance transfer and other services are provided in addition to the loans that are the predominant concern of policy makers. (Mayer, R.L 2002). Navajas et al. (2000), cited on Befekadu B. Kereta similarly, indicated that there are six aspects of measuring outreach: depth, worth of users, cost to users, breadth, length and scope. Where, depth of outreach refers to "the value the society attaches to the net gain from the use of the micro credit by a given borrower. This measure is to identify the poor clients. And, worth of outreach to users refers to "how much a borrower is willing to pay for a loan." Similarly, cost of outreach to user refers to "cost of a loan to a borrower." These costs to users might consists of prices like interest rates and various payments that they have to pay, which could be revenue to the lender, and other loan related transaction costs like expenses on documents, transport, food, taxes, etc. Finally, "breadth of outreach is the number of users...length of outreach is the time frame in which a microfinance organization produces loans," and "Scope of outreach is the number of type of financial contracts offered by a microfinance organization."

It is argued that length of a loan matter, because if the microfinance institutions support the poor only in the short run it will hamper the social welfare of the society in the long run. In the case that when the client of the microfinance institution knows that he/she will not receive additional loan in the future they would have no incentive to borrowers to repay their loan. (Navajas Rodriguez meza, 2000).

Efforts to extend Microfinance services to the people who are underserved by financial institutions are classified as outreach. Outreach can be measured in terms of breadth – number of clients served and volume of services (i. e. total savings on deposit and total outstanding portfolio) – or depth – the socio economic level of clients that MFIs reach (Lafourcade, et.al, April 2005, p. 6). In general indicators of outreach include:

- o The value and number of loans and savings accounts;
- o Types of financial services offered;
- o Number of branches established;
- o Percentage of target population served;
- o Annual growth rate of assets;
- o Participation of women.

All thriving microfinance institutions did well in at least 2 of these areas (CGAP, 2003). Furthermore, the social performance of MFIs can be measured in terms of changes in the social and economic lives of clients and their households.

2.2. Empirical Literature Review

The involvement of MFIs as a financial intermediary to service the financial needs of un-served or underserved group of society in both rural and urban areas of the community everywhere in the globe is increasing from time to time. So

Below are a summary of prior empirical studies on financial and operating performance of microfinance institutions in the context of different countries.

Crombrugghe, Tenikue and Sureda (2007) have carried out performance analysis for a sample of microfinance institutions in India. The methodology used for the study was regression analysis. They investigated three aspects of sustainability: cost coverage by revenue, repayment of loans and cost-control. Their results suggests that the challenges of covering costs on small and partly unsecured loans can indeed be met, without necessarily increasing the size of the loans or raising the monitoring costs. Their analysis also suggests that to improve their financial results, like a better targeting of the interest rate policy or increasing the number of borrower's periled officers especially in collective delivery models.

Study conducted by Manos and Yaron (2009) on the key issues in assessing the performance of MFIs, they identified that there is a trade-off between outreach and sustainability in the short run. The researchers' analysis was based on Production Possibility Frontier (PPF). According to the researchers'findings, in the short run whenever the MFIs are on the production frontier there is enviably a trade-off between increasing financial sustainability and extending outreach. However in the long – run it ispossible to improve both outreach and financial sustainability by utilizing scale of economies, improving operational modes, and introducing innovations.

The study conducted by Lafourcade et al. (2005) concerning the outreach and financial performance of MFIs in Africa shows that, unlike MFIs in the rest of the global regions, African MFIs have a higher number of savers than other regions of the world. In contrast to this outreach breadth in terms of borrowers in Africa is far behind their counterparts in South Asia, East Asia and the Pacific. Even, outreach in Africa varies by region. East Africa region dominates the outreach results with 52 percent of all African savers and 45percent of all African borrowers. This dominance is the result of the presence of two very large borrowing institutions in Ethiopia Amhara Credit and Saving Institution (ACSI) and Dedebit Credit and Saving Institution (DCSI) and the largest saving institution in Kenya (Kenya Post Office Saving Bank KPOSB). The depth of outreach measured by a percentage of women borrowers sub Saharan Africa has 61 percent women borrowers which is the lowest compared to 86 percent in south Asia, 80 percent in MENA, 76 percent in East Asia and pacific. With regard to

financial performance, compared with other global regions MFIs in sub- Saharan Africa report the lowest Average ROA of 2 percent whereas MENA region reported 2-5 percent, Latin America and the pacific region reported 5-8 percent and Asia reported 8-10 percent.

Across African region MFIs in East Africa are the most profitable (ROA of 3.4 percent), and those in West Africa also generate positive returns (ROA of 1.7 percent). Whereas MFIs in the Central Africa (ROA of - 0.6 percent), South Africa (ROA of -9.7 percent) and Indian Ocean (ROA of -3.3 percent), generate negative returns.

Qayyum and Ahmad (not dated) conducted study on efficiency and sustainability of microfinance institutions in South Asia by using non parametric Data Envelopment Analysis (DEA). While conducting DEA analysis using single country data at a time, they found that eight MFIs from Pakistan, six MFIs from Bangladesh and five MFIs from India were at the efficient frontier under variable returns to scale. They considered both inputs oriented and output oriented methods by assuming constant returns to scale (CRS) and variable returns to scale (VRS) technologies. The combined DEA analysis for the three countries, however, resulted in only two MFIs being efficient under CRS and five MFIs under VRS assumptions.

Their analysis further reveals that the inefficiencies of MFIs in Pakistan, India and Bangladesh are mainly of technical nature. The results have an important policy implication that in order to improve the efficiency of the MFIs there is need to enhance the managerial skills and improve technology. This could be done by imparting training.

Alemayehu Yirsaw (2008) has made study on the performance of six Micro Finance Institutions in Ethiopia. From profitability and sustainability point of view, the study found that most of the microfinance institutions were doing well in terms of operational self-sufficiency and financial self-sufficiency. According to the result of the study as the size of MFIs decreases in terms of gross loan portfolio, operational self-sufficiency and financial self-sufficiency decreases as well. From asset and liability management angle, the study found that most microfinance institutions used the highest portion of the assets to their primary activity (making loans to micro entrepreneurs). A low cost of funds results from an MFI gaining access to deposits and /or borrowings at a reasonable cost. In this respect all MFIs were successful in obtaining funds at an average interest rate below commercial banks lending rate (7%). The study further noted that, medium and large MFIs performed well in obtaining funds as compared to their small counter parts. In the year under the studies investigation, medium and large MFIs had below 50% liquidity ratio represented by current asset over current liability. From efficiency and productivity point of view the study found that, large MFIs have the lowest operating expense ratio (more efficient) and small MFIs the highest operating expense ratio represented by operating expense over average gross loan portfolio. According to the result of the study as the size of MFIs increases the operating expense ratio decreases as well. That is; Large MFIs spends the least (or are efficient) in personnel and administrative expenses to serve a single borrower. Small MFIs seem to reach poorer clients since the average loan size is the smallest. Generally the study noted that large microfinance institutions were more efficient and productive but Small MFIs seem to reach poorer clients better.

Befikadu B. Kereta (2007) has made study on outreach and sustainability of microfinance institutions in Ethiopia. The paper examines the performance of MFIs in relation to outreach and financial sustainability. The study reviews literatures on core performance indicators of MFIs. The studies literatures noted that MFIs could be examined through three main pillars: outreach to the poor, financial sustainability and welfare impact. However; the welfare impact assessment is not covered in his paper due to time and money limitations. Both secondary and primary data (obtained from questionnaire distributed to representative sample of MFIs) has been employed in his study. In the analysis process, the study has adopted simple correlation and descriptive analysis techniques.

From the outreach angle, he found that individual MFI's outreach has shown increment over the period of the study with different rates of growth, leading the industry's outreach to rise in the period from 2003 to 2007 on average by 22.9 percent. It is also identified that while MFIs reach the very poor, their reach to the disadvantaged particularly to women is limited (38.4 Percent).

From financial sustainability angle, the study found that MFIs in Ethiopia are hopeful. They are operationally sustainable as measured by return on asset and return on equity and the industry's profit performance is also improving over time. While, dependency ratio measured by the ratio of donated equity to total capital declined, ratio of retained earnings to total capital is raising letting the industry to be financially self-sufficient. Using Nonperforming Loan (NPLs) to loan outstanding ratio indicator, his study found that MFI financial sustainability is in a comfort zone with average NPLs ratio of 3.2 percent for the period from 2005 to 2007.

Arega (2007) the study conducted on three Ethiopian microfinance institutions (Aggar, Harbue and SFPI) shows that ROA and ROE for Aggar microfinance was negative with ROA ratios of -6.66% and -7.11% during the years of 2005 and 2006 respectively. Aggars ROE for the same years was -9.04% and -13.05%. As per the researchers finding the negative results were due to the huge net loss reported by the firm during the years of 2005 and 2006. ROA for SFPI during 2005 and 2006 was 0.49% and 0.60% respectively. SFPI's ROE ratio was 0.97% and 1.14% for the same periods. But Harbue's ROA during 2005 and 2006 was 0.28% and -2.58% respectively.

The firms also have ROE of 0.97% and -3.40 during 2005 and 2006 respectively.

Adeno Kidane (2007) made a study on one of the largest MFIs in Ethiopia Amhara Credit and Saving Institution (ACSI). His result shows that ACSI has served more than half a million clients. Over 1.6 million loans have been disbursed worth Birr 1.5 billion. By 2005, the institution was operationally and financially self-sufficient at 119.9 and 115.3% respectively. ACSI is among a few MFIs that are able to achieve the highest efficiency at the lowest cost per borrower. The operating cost was as low as five cents in 2005. ACSI also has a high portfolio quality, as delinquency rates are around 1.9%.

Bamlaku Alamirew Alemu (2006) made a study on micro financing and poverty reduction in Ethiopia the paper examines the impact of Ahmara credit and saving Institute (ACSI) in Ethiopia taking a sample of 500 households from five different zones in Amhara region using both descriptive statistics and econometric tools were employed (such as chi- square, paired T-test and ANOVA) and econometric analysis (Logistic regression), so as to investigate the impact of credit on improving the life of the clients . The study has found out the poor has smoothed their income in the study area. However there is a problem of fungibility in the sense that clients manipulate the loan for their immediate needs which forces the poor to offset long term befits due to the urgent need for daily survival of lack of business skills to engage into a productive business. Therefore, generally the study noted that the current service of ACSI need to focus on business training skills apart from loan provision to create sustainable micro enterprise and other economic activities to help the poor move beyond day to day survival and plan for their future.

Kassa Teshager (2008) has made a research on microfinance as a strategy for poverty reduction. The paper examines empirical evidence in Ethiopia to check if microfinance is good poverty reduction strategy for this purpose the two cases (ACSI and Wisdom) were analyzed based on Design, outreach, financial performance, sustainability and impact framework. The study found that Microfinance is indeed a strategy for poverty reduction in Ethiopia. However, the contribution of cases depends on their approach. ACSI is efficient, profitable, and sustainable MFI and best reflects the business approach. However, it is less effective in achieving its development mission and reaching the poorest clients in the region. Although Wisdom is financially less efficient, productive and sustainable, its strong link with World Vision Ethiopia helps to work relatively better in its development objectives. The study result shows pressure should have motivated MFI's to serve more poor people with better quality products and conclude that any clients benefited from the two program(ACSI & Wisdom) but they exclude the poorest segment of the population especially women and youth besides to this the studies shows both case have positive impact on their clients especially in income diversification, health and nutrition, housing and empowerment of the poor and finally addressed that microfinance is not a miracle solution. It is not for everyone and is not solely responsible for poverty reduction. It must also be integrated with other social programs like public works, safety nets and/or community development programs that are flexible to meet the diverse needs of destitute families. Microfinance loans need to be reviewed and adjusted to the contextual needs of the poor, since the poor are not a homogenous group.

Letenah Ejigu (2009) has made a research on performance analysis of sample microfinance institutions of Ethiopia. The paper appraises the performance of Ethiopian MFIs in terms of various criteria by comparing with the Micro banking Bulletin (MBB) benchmark and for some relative ratios comparison among themselves. The MF industry as a whole is challenged by the need to reach the poorest customers and at the same time being financially self-sufficient. Although the industry as a whole is growing at a faster pace still the two critical questions of reaching the poor and building a financially sustainable MF industry that walk on their own leg freely are empirical questions. Data for the research were purely secondary taken from the MIX Market website and used one sample t test, one way ANOVA with Scheffe Post Hoc Comparison tests, Kruskal-Wallis test and Pearson correlation coefficients. The result of the study indicates that Ethiopian MFIs in general are poor performers on depth of outreach. They are not reaching the poorest of the poor. They are also poor in terms of the ratio of GLP to assets, allocating a lower proportion of their total assets in to loans. They are also not using their debt capacity properly. The large and smaller MFIs are allocating more loan loss provision expense than the industry average and the related PAR is high for these MFIs. All the MFIs are good at breath of outreach, cost management, efficiency and productivity. They also charge low interest rates. The profitability and sustainability of the MFI depend on their size. From a simple correlation analysis it is found that there is a tradeoff between serving the poor and being operationally self-sufficient. MF age correlates positively with efficiency, productivity, the use debt financing (commercialization) and OSS. It is also found that the use of debt financing makes firms more efficient and productive.

The study undertaken by Cull et al. (2006) on the financial performance and outreach of leading Micro banks using data on 124 MFIs from 49 developing countries identified points such as: in terms of financial viability indicators, average financial self-sufficiency of 1.035 which implies MFIs are financially self-sufficient since the minimum requirement for MFIs to breakeven is 1 or 100 percent, the average operating self-sufficiency of MFIs was 1.165 which means the MFIs are covering their cost through operating revenues. The mean adjusted ROA of -0.027 indicates MFIs are not earning positive return on their investment. They further identified Average loan

size to GNP per capita which is outreach depth indicator of 0.676, percentage of women borrowers of 64.9 percent. Finally their findings indicated the mean GLP to asset ratio of 68.9 percent, average real gross portfolio yield (average interest rate) 34.8 percent and personnel expense to total asset ratio of 18.55 percent for MFIs embraced in the study.

Giovanni Ferro (2006) has made a research on measuring the performance of microfinance institutions. The paper examines the financial sustainability of an MFI only gives one feature of its performance. As many MFIs primarily exist in order to help the poorest people, one also has to include aspects of outreach in their performance. Hence, MFIs' performance can be termed multidimensional. The study noted that how some statistical tools can offer new insights in the context of MFIs' performance evaluation. Factor analysis is used in a first step to construct performance indices based on several possible associations of variables without posing too many a priori restrictions and also can help construct some synthetic indices of both *outreach* and *self-sustainability* One advantage of factor analysis is that no arbitrary weight needs to be ascribed to each variable, as the "data speak for themselves", in that the weights are computed from the correlation matrix of the chosen variables. One drawback of this technique is that it does not provide information of the absolute level of performance. Cluster analysis was mainly used to better grasp the possibility that some MFIs would form groups across the two scores. The clusters were not very compact and quite unstable across the years, probably also because MFIs come from different countries and are possibly influenced by institutional or macroeconomic factors specific to their countries.

Nawaz (2009), conducted a study on ―Efficiency and Productivity of Microfinance: Incorporating the role of subsidies‖ on 204 Microfinance Institutions in 54 countries using Data Envelopment Analysis and Malmquist index as analysis tool. His findings have revealed an average 1% increase in total factor productivity including subsidy and an average 0.8% decrease in total factor productivity excluding subsidies.

A research conduct on the Outreach and Financial Performance of Microfinance Institutions in Africa by the MIX market taking 163 MFI in Africa had indicated that MFIs in East Africa are the most profitable as compared to other regions of the continent. The study has indicted that from this region the largest portion is cover by the largest MFIs of Ethiopia. MFIs in West Africa also generate positive returns, whereas MFIs in the Central Africa, Southern Africa, and Indian Ocean regions generate negative returns.

With regard to efficiency, East African MFIs are highly efficient in absolute terms because they spend only 58 USD per borrower. In contrast, MFIs in the Indian Ocean region spend the most, at more than 240 USD (83 percent of GNI per capital) to maintain each loan client more than half the average loan amount of 468 USD (161 percent of GNI per capita). In general, the finding of the study underline that Ethiopian microfinance (ASCI and DESCI) are performing well in terms of the outreach and profitability as compared to the other microfinance institution, especially the western Africans.

A case study by Mubarek (2006) on sustainability of microfinance institutions in Ethiopia which has taken Addis credit and saving institution (AdCSI), Omo Microfinance Institutions (OMFI) and Sidam Micro finance institution (SMFI) indicates that the two of them (AdCSI and OMFI) have achieved operational sustainability of 103 percent and 106 percent in the year 2004 respectively, which is almost equal to average for Ethiopian MFIs, 104 percent and below average for African MFIs, 111.1 percent. The revenue they generated from operations fully covers their operating costs. However, all sample MFIs under study are not achieving the level of financial sustainability.

3.   Research Methodology
3.1. Sampling Method
Sampling is the part of statistical practice concerned with the selection of an unbiased or random subset of individual observations within a population of individuals intended to yield some knowledge about the population of concern, especially for the purposes of making predictions based on statistical inference. Or sampling is the process of selecting a few or sample from the large group or sampling population in order to estimate about the prevalence of unknown piece of idea in the study population. However; the issue of sampling in this paper will have little/no significance, as the purpose of the study will be to assess Financial and Operating performance of SFPI in comparison with the Industry Average. Thus; the researcher will select the microfinance institutions based on different criterion: i.e. geographical distributions (to include at least major regions of Addis Ababa, Amhara, Tigray, Oromia, Southern Nations, Nationalities and Peoples) and year of establishment (microfinance institutions which were established during the year of 1997 G.C) to determine the Industry Average (I.A). This criterion is included to overcome the impact of age difference on performance. As a result; SFPI, ACSI, OMO, OCCSSI and DECSI are the microfinance institutions which will be included in this paper. Therefore, these institutions will be the sample units for the study. Hence; in selecting the sample elements judgmental sampling technique will be employed.

3.2. Methods of Data Collection

The study with the aims of assessing Financial and Operating performance of SFPI, will be purely based on secondary data from the annual financial reports of the institutions such as income statement, portfolio report and the balance sheet of the selected MFIs, data from books, journals, news papers, magazines, reports of various governmental and nongovernmental organizations such as AEMFI (Association of Ethiopian Micro Finance Institutions) for literature review and data from National Bank of Ethiopia and the Mix Market[1] web sites were used.

To increase the reliability of data the researcher will be used more recent and fifteen years audited annual financial reports for the selected microfinance institutions for the period covering from 2000 to 2014 as a source of secondary data in order to assess and close to the fact of the institutional-level financial and operating performance of SFPI and compare against the Industry Average.

3.3 Methods of Data Analysis and Interpretation

Once the data is collected from secondary sources, it will be analyzed through various techniques.

First, the collected data will be arranged in the manner that it will become easy for analysis.

Secondly, the arranged data will be analyzed and interpreted using different statistical tools like, tables, charts, graphs and percentages.

In addition to, these statistical tools and techniques of financial analysis such as trend analysis (time series analysis), Industry Average Analysis and ratio analysis will be used. To reveal performance of MFIs very well, fifteen years data from 2000 to 2014 will be used to see the trend in financial and operating performance of SFPI and compare against the Industry Average (I.A).

4. Results and Discussions

As it was indicated in the first section, the findings stated below are based on secondary sources. In this section the paper presents findings of the study on Financial and Operating Performance of SFPI and comparison with the Industry Average.

4.1. Outreach/Coverage

Table 1. Number of active borrowers

Indicator /Year	Number of Active Borrowers		Growth Rate of Active Borrowers	
	SFPI	**Industry Average**	**SFPI**	**Industry Average**
1999	5,520.00	73,932.80	NA	NA
2000	5,942.00	83,741.40	7.64%	13.27%
2001	6,526.00	94,593.60	9.83%	12.96%
2002	7,728.00	125,470.60	18.42%	32.64%
2003	9,552.00	136,363.40	23.60%	8.68%
2004	11,430.00	180,109.40	19.66%	32.08%
2005	14,345.00	226,402.80	25.50%	25.70%
2006	19,169.00	265,727.20	33.63%	17.37%
2007	25,294.00	323,729.00	31.95%	21.83%
2008	26,459.00	356,163.80	4.61%	10.02%
2009	29,044.00	387,295.60	9.77%	8.74%
2010	30,240.00	395,254.20	4.12%	2.05%
2011	32,645.00	421,283.80	7.95%	6.59%
2012	34,494.00	440,206.00	5.66%	4.49%
2013	35,943.00	451,353.40	4.20%	2.53%
2014	37,060.00	465,182.20	3.11%	3.06%
Average	20,711.94	276,675.58	2.07	1.99

Source: - Researcher's own computation from MIX Market Inc. website (www.themixmarket.com).

Numbers of active borrowers are the number of individuals who currently have an outstanding loan balance with the microfinance or individuals who are responsible for repaying any portion of the gross loan portfolio. Number of active borrowers of SFPI and the Industry Average is increasing from time to time as can be observed from table 1 above and Figure 1 below. SFPI's outreach in terms of number of active borrowers has shown increment over the period of the study with different rates of growth.

SFPI has shown a gradual progress in terms of outreach since its establishment. The table given above

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[1] MIX Market Inc. website (www.themixmarket.com) is a not-for profit initiative that works in for the dissemination of information among the MFIs institutions**.**

would illustrate this best. However all over the period of the study the absolute number of active borrowers of SFPI is less than the number of active borrowers of the Industry Average. But comparing the size might not be meaningful in this context so, when we compare the growth of active borrowers of SFPI with growth of Industry average especially starting from the year 2009 up to 2014(the recent data) we can find that SFPI is better than industry average. The average growth of SFPI over the sixteen years period is 2.07 which is better than the industry average of 1.99. Therefore; SFPI is performing well as compared to the industry average.

Figure 1. Numbers of Active Borrowers by Growth rate
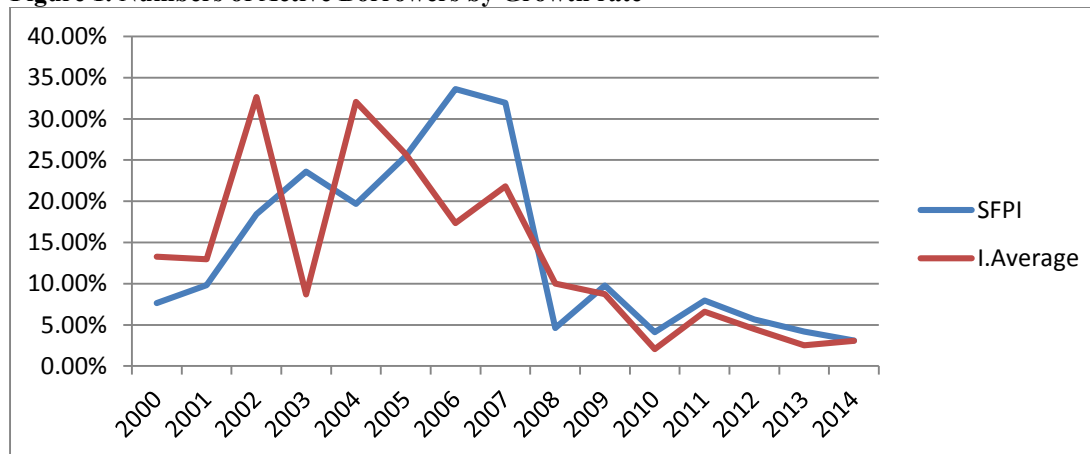
Source: - Researcher's own computation from MIX Market Inc. website (www.themixmarket.com).

Table 2. Percent of women borrowers

Indicator/Year	No. of Active Borrowers		Percent of Women Borrowers	
	SFPI	**Industry Average**	**SFPI**	**Industry Average**
1999	**5,520.00**	**73,932.80**	**56.00%**	**35.40%**
2000	**5,942.00**	**83,741.40**	68.21%	**38.46%**
2001	**6,526.00**	**94,593.60**	71.99%	**34.90%**
2002	**7,728.00**	**125,470.60**	69.99%	**35.17%**
2003	**9,552.00**	**136,363.40**	69.00%	**36.08%**
2004	**11,430.00**	**180,109.40**	60.00%	**33.60%**
2005	**14,345.00**	**226,402.80**	54.51%	**33.70%**
2006	**19,169.00**	**265,727.20**	66.84%	**37.60%**
2007	**25,294.00**	**323,729.00**	50.01%	**41.60%**
2008	**26,459.00**	**356,163.80**	55.00%	**44.06%**
2009	**29,044.00**	**387,295.60**	55.76%	**44.37%**
2010	**30,240.00**	**395,254.20**	56.94%	**45.97%**
2011	**32,645.00**	**421,283.80**	56.00%	**46.90%**
2012	**34,494.00**	**440,206.00**	55.81%	**46.42%**
2013	**35,943.00**	**451,353.40**	53.50%	**45.09%**
2014	**37,060.00**	**465,182.20**	55.57%	**46.66%**
Average	**20,711.94**	**276,675.58**	**59.70%**	**40.38%**

Source: researcher's own computation from MIX Market Inc. website (www.themixmarket.com)

       With respect to the total population in the region and the coverage SFPI currently has managed to address, one could argue that it still needs to go further. The percent of women borrowers for SFPI was showing a remarkable progress from year to year as we can observe from the above table 2 and Figure 2 below. So all over the period of the study the percentage of women borrowers of SFPI is more than the percentage of women borrowers of the Industry average. Therefore SFPI is performing well in terms of balancing the gender aspect of its clients compared to the industry average. Besides to this all over the years of the study, women are represented by far more than men. Table 5.2 above and Figure 5.2 below exhibit the percent of women borrowers from the total number of active borrowers of SFPI and Industry Average. The result shows that the percent of women borrowers of SFPI is higher than the percent of women borrowers of the Industry Average all over the periods covered by the study. One of the disadvantaged groups from economic empowerments point of view are women. The study found that even if credit access to women is still limited in the industry but SFPI is registered remarkable performance in this aspect. At the industry level women credit access share is only 40.38 percent on an average while at the SFPI the percent of women borrowers is 59.70 percent on an average which is by far better than the

industry average. Therefore, SFPI has shown a remarkable progress in terms of emphasizing more number of women borrowers in order to balance the gender aspect of its clients and to support the disadvantaged group of the economy. So the industry is required to adjust its policy that increases the percent/the number of women borrowers like SFPI. Since empowering women and serving the active poor are the primary objectives of any microfinance institutions.

Figure 2. Percent of women borrowers
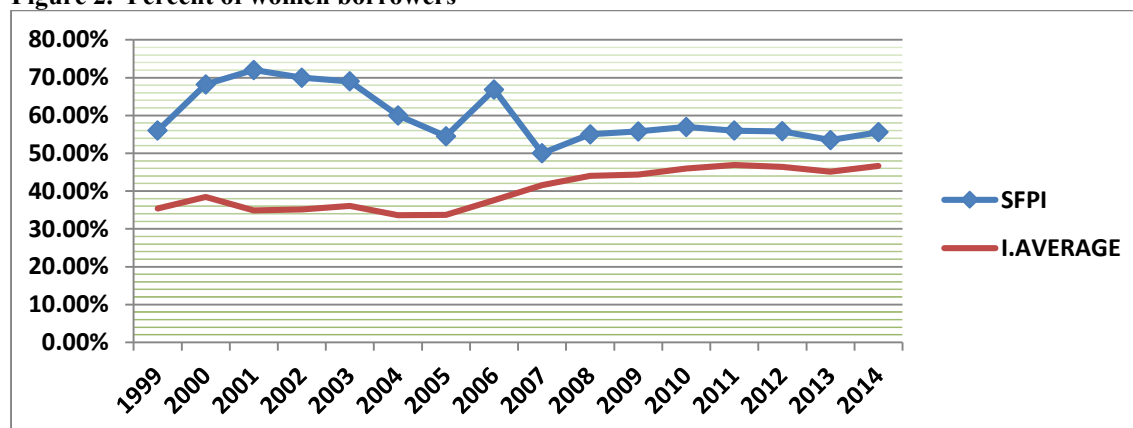
Source: - Researcher's own computation from MIX Market Inc. website (www.themixmarket.com)

4.2 Financial Sustainability and Profitability
Table 3: Sustainability and Profitability Measures

Indicator /Year	ROA		ROE		OSS		Yield on Gross portfolio	
	SFPI	I. Average	SFPI	I. Average	SFPI	I. Average	SFPI	I. Average
1999	1.45%	0.02%	24.35%	3.32%	70.00%	104.34%	12.66%	11.01%
2000	1.29%	0.34%	31.99%	7.75%	53.79%	108.47%	15.05%	12.15%
2001	1.16%	1.65%	23.86%	7.53%	55.36%	111.09%	12.98%	11.81%
2002	0.97%	1.86%	-8.72%	5.49%	70.71%	117.69%	15.33%	13.33%
2003	1.87%	3.61%	1.64%	6.87%	106.06%	140.58%	21.32%	15.48%
2004	1.49%	4.03%	0.97%	9.16%	106.06%	160.84%	19.55%	14.62%
2005	1.60%	3.83%	1.13%	11.80%	104.39%	158.97%	19.06%	14.49%
2006	3.13%	4.67%	5.84%	15.44%	126.69%	171.65%	18.35%	13.86%
2007	1.36%	3.19%	2.80%	12.34%	111.27%	170.02%	16.40%	13.19%
2008	2.96%	3.42%	6.48%	12.52%	119.33%	155.28%	23.42%	15.61%
2009	3.61%	3.38%	15.00%	13.42%	121.32%	147.83%	24.21%	15.48%
2010	4.75%	3.73%	15.07%	12.83%	127.26%	147.00%	11.78%	12.81%
2011	5.80%	4.62%	14.35%	13.91%	149.15%	162.11%	22.08%	15.81%
2012	5.57%	4.13%	17.75%	14.57%	152.17%	163.56%	22.33%	15.64%
2013	6.72%	4.46%	21.00%	15.04%	155.18%	188.79%	22.83%	15.28%
2014	6.58%	4.48%	18.10%	14.76%	156.60%	174.67%	24.73%	16.67%
Average	**3.14%**	**3.21%**	**11.98%**	**11.05%**	**111.44%**	**148.93%**	**18.88%**	**14.20%**

Source: Researcher's own computation from MIX Market Inc. website (www.themixmarket.com).

As depicted on Table 3 above, the highest return on assets of SFPI was registered in 2013. A Birr in assets earned around seven cents in 2013 but previously it was declined continuously and reached around one cents in 2002. On an average SFPI had ROA of 3.14% which is lower than the average ROA of the Industry Average, i.e., 3.21%. A Birr invested in equity has generated the highest return on the year 1999, 2000, 2001 and 2013 around 24 cents, 32 cents 24 cents and 21 cents respectively. Yield on gross portfolio of SFPI was swing from year to year as we can observe from the above table and Figure 6 below. The highest yield on portfolio of SFPI was around 25 cents per Birr in portfolio in 2009 and 2014 but declined to 12 cents in 2010. The highest extreme of SFPI (i.e. 25 cents) is higher than the highest extremes of the Industry Average (i.e. 17 cents) and the lowest extreme of SFPI (i.e. 12 cents) is higher than the lowest extremes of the Industry Average (i.e.11 cents). From this it can be concluded that SFPI has better asset management (better utilization of assets in generating revenue) and better management of portfolio as compared to the industry average during the years under the study.

Generally; as shown on Table 3 above and Figure 3, 4, 5 and 6 below SFPI is going down the ladder of

Sustainability and Profitability measures during the periods of the study. On average SFPI is operationally self-sufficient at around 111.44% over the sixteen years period but it is less than the Industry Average i.e. around 148.98%. At the end of 2014, SFPI achieved 6.58%, 18.10% and 24.73% of ROA, ROE and yield on gross portfolio respectively higher than the industry Average.

SFPI had high ROE and (YGP) Yield on gross portfolio as compared to the Industry Average over the sixteen years likewise SFPI's OSS was lower than the Industry Average all over the period covered by the study. The above table showed that average operational Self-Sufficiency (OSS) for SFPI is 111.44% where as average financial self-sufficiency still below the threshold level (148.93%). From this it can be concluded that SFPI is in a position to generate sufficient revenue to cover operating costs and at the same time their ability to operate and expand without subsidies is possible for these institutions. Better efficiency, high productivity, more leverage, and more MFIs age (experience) all leads to good OSS.
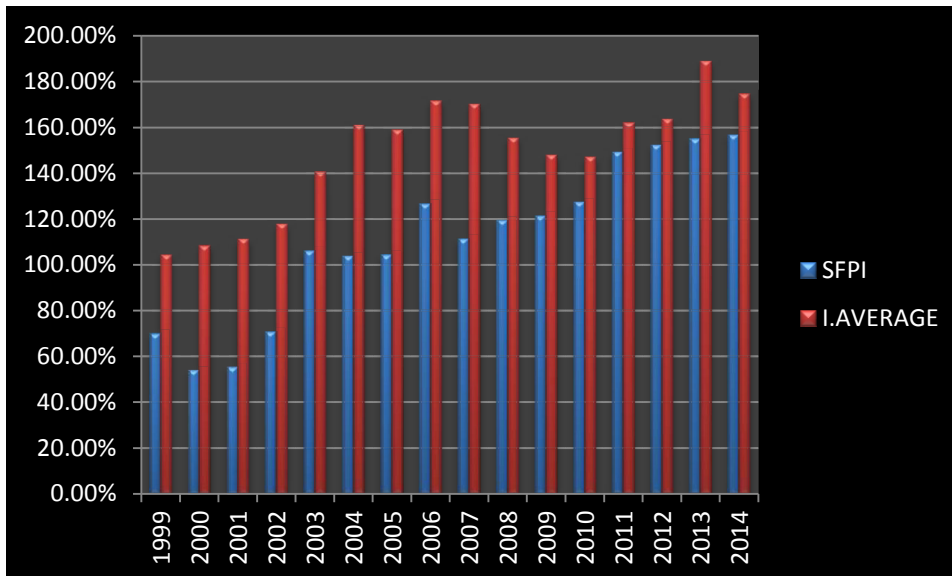
Figure 3. Returns on Asset (ROA)
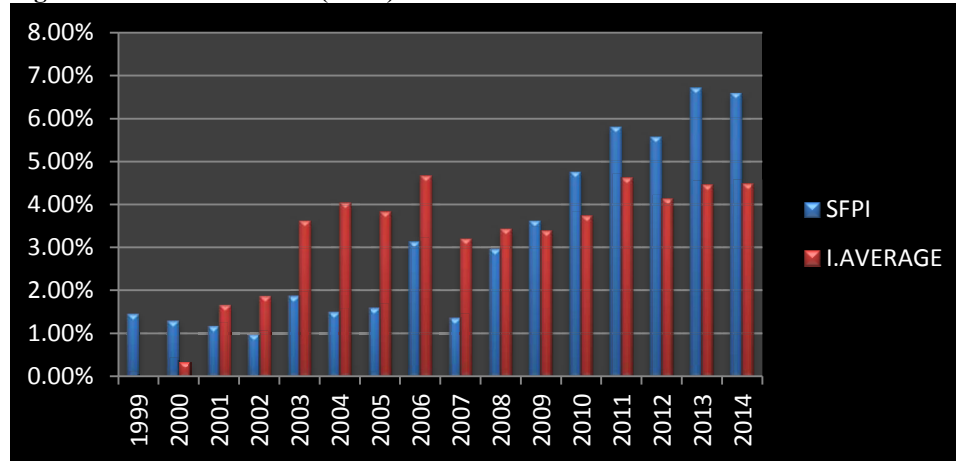
Source: - Researcher's own computation from MIX Market Inc. website (www.themixmarket.com)

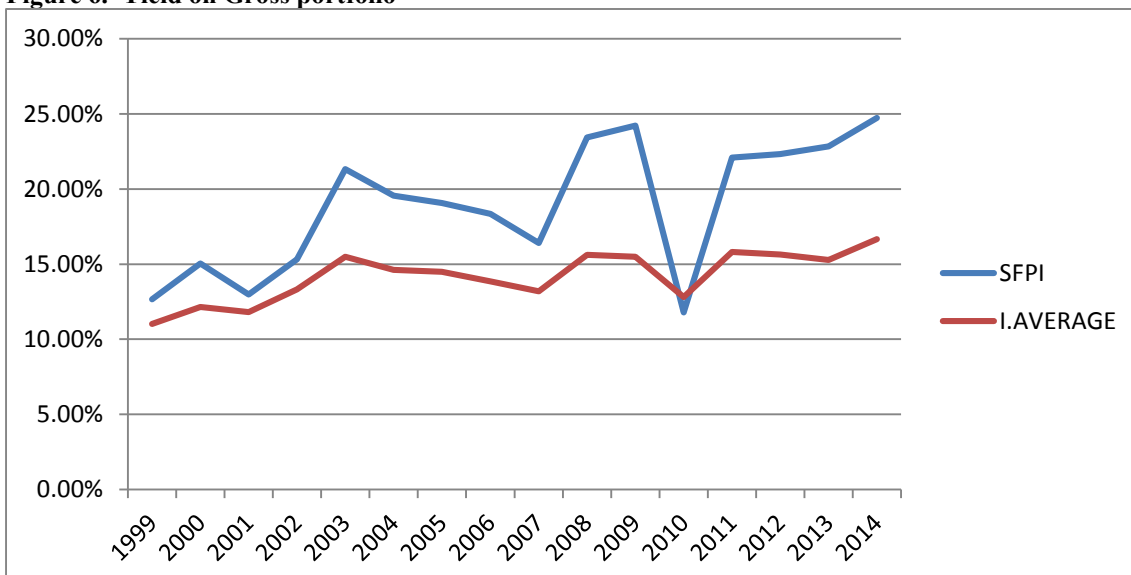**Figure 4. Returns on Equity (ROE)**
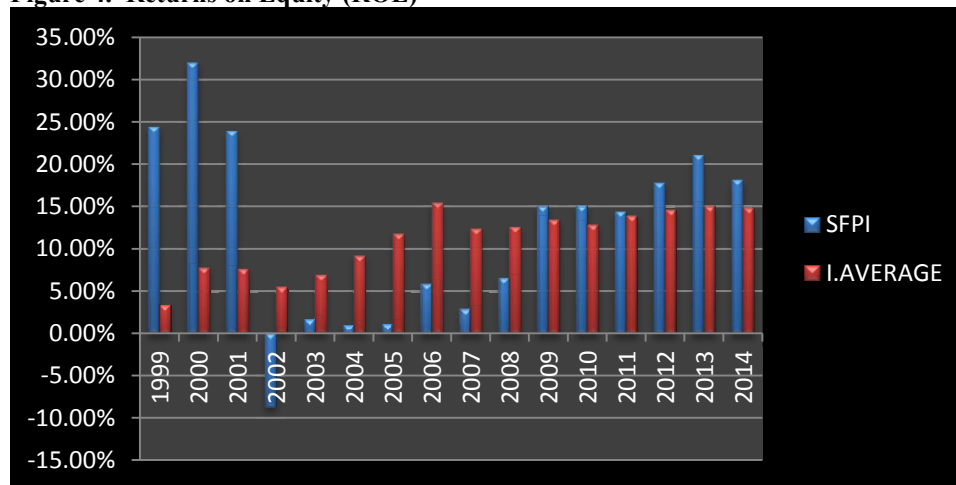
Source: - Researcher's own computation from MIX Market Inc. website (www.themixmarket.com)

Figure 5. Operating Self- Sufficiency (OSS)

Source: - Researcher's own computation from MIX Market Inc. website (www.themixmarket.com)

Figure 6. Yield on Gross portfolio

Source: - Researcher's own computation from MIX Market Inc. website (www.themixmarket.com)

5.   Conclusion and Recommendation

In above section, the actual performance of SFPI in comparison with the Industry Average has been made. Hence; this chapter presents the conclusions and recommendations that were drawn from the previous chapter of this study.

5.1 Conclusion

This study aims to evaluate the financial and operating performance of SFPI and compare with the industry average. The comparison of SFPI with the Industry Averages financial performance was made from Sustainability and Profitability; Portfolio Quality; Efficiency and Productivity and Outreach level perspectives. Data for the study was from secondary sources and various ratios and indicators were used to measure the performance of SFPI. The financial performance indicators are usually ratios extracted from the financial reports (Balance Sheet, Income Statement and Portfolio Report). In addition, various theoretical aspects and related studies made on the performance analysis of Microfinance Institution in various countries were also reviewed. Thus, based on such analysis on the secondary data, the following conclusions are drawn:

The outreach of SFPI's has shown increment over the period of the study with different rates of growth. However, all over the period of the study the absolute number of active borrowers of SFPI is less than the number of active borrowers of the Industry Average. But comparing the size might not be meaningful in this context so,

when we compare the growth of active borrowers of SFPI with growth of Industry average especially starting from the year 2009 up to 2014(i.e. the recent data) we can find that SFPI is better than industry average. The average growth of SFPI over the sixteen years period is 2.07 which is better than the industry average of 1.99. Therefore; SFPI is performing well as compared to the industry average. Besides to this; the percent of women borrowers of SFPI is higher than the percent of women borrowers of the Industry Average all over the periods of the study. From this it can be concluded that SFPI has shown a remarkable progress in terms of emphasizing more number of women borrowers in order to balance the gender aspect of its clients and to support the disadvantaged group of the economy. So the industry is required to adjust its policy that increases the percent/the number of women borrowers like SFPI. Since empowering women and serving the active poor are the primary objectives of any microfinance institutions.

The Financial Sustainability and Profitability of SFPI is going down the ladder of Sustainability and Profitability measures during the periods of the study. On average SFPI is operationally self-sufficient at around 111.44% over the sixteen years period. SFPI had high ROE but less ROA as compared to the Industry Average during the years under the study. Likewise SFPI's OSS was less than the Industry Average during the years under the study. From this it can inferred that even though SFPI's Sustainability and Profitability was on waning trend but on average SFPI was performing better as compared to the industry average from ROE and Yield on gross portfolio (YGP) measures. But SFPI was performing less in comparison of the industry average from ROA and OSS measures of Sustainability and Profitability. From this it can be concluded that SFPI has better asset management (asset utilization) and better management of portfolio as compared to the industry average during the years under the study.

5.2 Recommendation

This study attempted to evaluate the financial and operating performance of SFPI and tried to compare with the industry average by using financial ratios. Based on the findings and conclusions reached above, the following recommendations are made by the researcher:

❖ Even if Specialized Financial and Promotional Institution share company (SFPI) as a Microfinance Institution (MFIs) its depth of outreach shows better than the industry average over the periods of the study that measured by number of active borrowers by growth it needs further effort to increase its performance taking into consideration the total population in the region, the status of our country as well as age of the institution. So SFPI should have to work hard to get more motivated borrowers and savers by applying a known key microfinance principles that indicated in the literature review section. Because outreach refers to the central purpose of successful MFI.

❖ Since SFPI's sustainability and profitability was declining continuously during the study period of years (1999-2014) as compared to Industry Average, SFPI should have to work on it in order to increase the ROA, ROE and OSS and YGP parameters of measuring profitability and sustainability because these are the means to guarantee its survival in the market and makes to stand on its own leg. i.e. without the massive support of the government and donors. For this to happen, higher saving mobilization, product expansion (efficient loan administration) and better resource management should be sighted in depth by SFPI to achieve sustainability and profitability and rural infrastructure predominantly, the road net-work, and telephone net-work needs special attention by government and others for healthy microfinance operations and clients profitability since the success of the microfinance institutions depends on the success (profitability) of their clients.

5.3 Scope for Further Research

❖ Finally, the financial and operating performance indicators, i.e. financial ratios, independently are not enough to measure the performance of microfinance institutions and also the researcher has not made adjustments for inflation, in-kind subsidies, cost of funds, and varying accounting practices across institutions. Thus, alternative financial measures such as Data Envelopment Analysis (DEA), Stochastic Frontier Approach (SFA) and adjustment of the financial statement of the microfinance shall be considered by further researchers.

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