

THE ROLE OF MICROFINANCE INSTITUTIONS ON POVERTY ALLEVIATION IN ETHIOPIA

(A Case Study with Special Reference to Dedebit Credit & Savings Institution Mekelle Branch)

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ABSTRACT

Microfinance can be a critical element of an effective poverty reduction strategy mostly for developing countries. Particularly in Ethiopia there is lack of improved access and efficient provision of savings, credit, and insurance facilities to develop their businesses, enhance their income earning capacity, and enjoy an improved quality of life. The objectives of this paper are to assess the role of MFI (DECSI) on poverty reduction, to evaluate how the MFI (DECSI) helps to change their (poor) economy and to point out the significance of the provision of MF service to break grinding cycle of poverty. In this study both secondary and primary data via self-administered questionnaires and interviews were used. Following the information collected from both MFI's managers and their clients, it was revealed that MFI have changed the life of poor people in a positive way. Despite these achievements it was further observed that some conditions like high interest rates, loan application process & approval, collateral, service delivery and lack of close relationship between institution management and the borrowers have been limiting factors for poor people to access the MFI services.

Keywords: *Microfinance Institution, Savings Institution, Poverty Alleviation, Income.*

Introduction:

Microfinance can be a critical element of an effective poverty reduction strategy. Improved access and efficient provision of savings, credit, and insurance facilities in particular can enable the poor to their consumption, manage their risks better, gradually build their asset base, develop their businesses, enhance their income earning capacity, and enjoy an improved quality of life. Researchers argue that the Microfinance Institutions are useful as they

- ✓ reduce poverty through increased income and standards of living;
- ✓ empower women;
- ✓ develop the business sector through growth potentials, and
- ✓ develop a parallel financial sector. (Hulme and Mosley, 1996a; Hashemiet al, 1996; and Buckley, 1997).

It is generally accepted that without permanent access to institutional microfinance, most poor households would continue to rely on meager self-finance or informal sources of microfinance, this limits their ability to actively participate and benefit from development opportunities.

The proponents of credit approach argue that people who live in developing countries might improve their living standards by becoming micro entrepreneurs and that financial institutions should support their initiatives with small loans. This is true because well established and sustainable micro and small enterprises in many societies contribute to the growth of national income, more employment opportunities, better standard of living and hence to the reduction of poverty. However, according to the International Finance Corporation (IFC, 1994), 60 per cent to 69 per cent of the population in many African countries has no access to conventional financial institutions.

Ethiopia, a country of more than 70 million is grappling with all sorts of problems that range from lack of food (to feed its expanding millions) to poor governance. Its people derive their livelihood mainly from traditional, subsistence agriculture and suffer from lack of access to the essentials for human existence. In terms of the recommended calorie intake, which is 2,200 per adult per day, Ethiopia is by far behind many least developed countries. Considering food baskets and non-food items, an estimate by MoFED (2002) shows that 44 per cent of the population is below the poverty line. The problem is highly pronounced in rural

areas more than it does in urban centers with coverage of 47 and 33 per cent of the respective population. As far as Human Development Index is concerned (which is 0.244 as per the report of UNDP 1998), Ethiopia is positioned 170 out of 174 countries in the year 2000/1 (World Bank, 2001).

The above-mentioned facts and figures indicate that the government's promises are not realized. Even at worse, Ethiopia is still fraught with recurring famines, low literacy, widespread poverty and lack of good governance. Other challenges include stemming HIV/AIDS, reducing discrimination against women, building infrastructure and creating jobs. The country also remains highly dependent on foreign aid (though some of the donor communities indicated to withhold direct budgetary support following disputed elections of May 15, 2005).

Ethiopia is one of the 70 countries that developed a poverty reduction strategy paper (PRSP). This PRSP is becoming the operational framework to translate the global Millennium Development Goals (MDG) targets into national actions. This document is serving as a practical building block to address the country's challenges. As per the UN declarations, by the year 2015, the poverty situation of the country should decrease by half from its level in 1999. The most important strategies through which this goal is to be achieved include capacity building, improvement in the legal system, civil service reform, devolution and empowerment. More importantly, the PRSP document emphasized that the economy of the country should grow by 5.7 per cent per year to get its Millennium Goal achieved. In the PRSP document, institutions and the political economy of society are considered key in influencing economic growth and its impact on poverty. It also indicates that reform of the legal system, enforcing contracts, ensuring property rights, reducing conflicts (internal/external), and improving the efficiency of the bureaucracy can generate a growth pattern that ensures faster reduction of poverty and the achievement of the Millennium Development Goals in the country (MoFED, 2002).

The major concern of the Ethiopian government in its PRSP is to give due emphasis to the country's all and basic industry-agriculture through its strategy called ADLI. In the document, microfinance is indicated among the specific means that is given greater emphasis and is expected to play essential role for reducing poverty in rural areas of the country where the bulk of its populace dwell. Thus, most of the microfinance services providing institutes have articulated creating a small and easily accessible loan to the poor as their primary objective with the expectation of fostering pro-poor growth.

There are still potential possibilities for the microfinance industry and other sectors of the economy to play their level best in pushing the country's economy forward to achieve some of the goals specified.

According to the research conducted on the socio-economic status in certain sample woredas of Tigray Regional State in 1993, the absence of financial

institutions which can provide financial services to the poor was one of the obstacles that hindered the undertaking of rehabilitation and development activities. The research commissioned by the Relief Society of Tigray /REST/ revealed the significance of establishing this institution so that a full pledged financial services can be provided to the poor households. Hence, Rural Credit Scheme of Tigray, as one development wing of REST, was established in 1994. This was later called as Dedit Credit and Saving Institution (DECSI).

After three years of its operation, Dedit Credit and Saving Institution (DECSI) were reregistered in the form of a Share holding Company as a legal entity in 1997 following the proclamation of the National Bank of Ethiopia. With such commitment, DECSI has been working widely in rural and urban Tigray for the last 15 years.

Review of Literature:

When one goes through the bulk of literature on the impact of microfinance, one can find quite different results, which are generally inconclusive. In some cases, microfinance is said to have brought positive impacts on the life of the clients. A growing database of empirical studies shows that microfinance has positive impacts to boost the ability of poor people to improve the conditions in which they live. Research works indicate that the poor have taken advantage of increased earnings to improve consumption levels, send their children to school, and build assets.

In some other instances, microfinance is said to play insignificant role towards mitigating the problem of the poor. But looking at the positive impacts, several studies indicate that microfinance allows poor people to increase their incomes by starting new enterprises or expanding existing ones. The argument is that through diversified sources of income, the people could be able to shield themselves against external shocks. Savings and micro insurance services could also allow poor individuals to plan for future expenses, cope with stochastic crises and cover unanticipated expenses. Studies of microfinance programs and their clients indicate the following impacts on poverty and hunger. In Zimbabwe, extremely poor clients of Zambuko Trust, a local MFI, increased their consumption of high protein foods at a time when food expenditures across the country as a whole were decreasing (Barnes, 2001). In Tanzania/Zanzibar, the income and assets values of borrowers are almost twice that of non-borrowers (REPOA, 2005). In India, in addition to increased economic wellbeing, SHARE clients have shown a striking shift from irregular, low-paid daily labour to more diversified sources of income, with a strong reliance on small businesses (Simanowitz and Walters, 2002). Studies of two separate microfinance institutions in Bangladesh documented a similar shift from informal labour to self-employment among MFI clients. As a result, overall wage rates in the villages served by the microfinance programs also increased. (Zaman, 2000 and Khandkher, 1998).

Pitt and Khandker (1998) also indicated that microfinance has brought positive marginal impacts on consumption in Bangladesh. They showed that microfinance has become a promising strategy to shield the poor from vulnerability through consumption smoothing as well as building assets.

Using the assumption of perfect targeting, Khandker (1998) estimated that for every 100 taka lent to a woman and a man, household consumption increased by 18 taka and 11 taka respectively. He indicated that moderate poverty and ultra-poverty were reduced by 15 per cent and 25 per cent respectively for households in BRAC. The rate was even lower for old borrowers than new ones. This is to mean that number of loans was found to be important in impacting the life of clients positively. Strengthening this assertion, Montgomery *et al* (1996, cited in Zaman, 2001) pointed out that third time borrowers were found to get higher incomes and register growth in their enterprises. Mustafa *et al* (cited in Zaman, 2001) also found out that older borrowers were found to have greater asset values and household expenditures on average than new borrowers.

Using the same data as Khandker did, Morduch (1998) did not find the same result. Morduch noted that Khandker's eligibility threshold was flawed. Thus, he used an alternative approach and corrected for the selectivity biases. Eventually, he did not find an evidence to suggest that microfinance can reduce poverty *per se*. Using the difference-in-difference strategy, he found out that microfinance has proved to be a viable tool towards reducing vulnerability showing that consumption variability was 47 per cent, 54 per cent and 51 per cent lower for eligible Grameen, BRAC and BRDB households respectively. However, he indicated the difficulty he faced to show whether microfinance could increase consumption levels or schooling as compared to control groups in contrast to what Khandker indicated.

It is well known that the majority of microfinance programs specifically target women clients and provide them with direct control over resources because access to microfinance services is believed to open up greater livelihood opportunities for women and thereby allow for their increased participation in the economy. As a result, many MFIs consciously design their programs to empower women, with the goal of increasing their voice in decisions (family, economic, social, and political) that affect their lives. The following studies could substantiate this.

After joining Freedom from Hunger affiliates in their respective countries, women clients in Ghana were found to play a more active role in community life (MkNelly and Dunford, 1998) and those in Bolivia (Ibid, 1999) were found to be actively involved in local government. On the other hand, a survey of 1300 women in Bangladesh showed that MFI clients were significantly more empowered than non-clients in terms of physical mobility, asset ownership, and control of productive assets, decision making, and political and legal awareness (Hashemi, Schuler, and Riley, 1996).

A gender impact study of four microfinance programs in Bangladesh concluded that women clients experienced positive change at a personal level, in the form of increased

self-worth, as well as the household level, in the form of decreased violence and increased affection resulting from their contribution of resources (Kabeer, 1998).

Apart from the above-mentioned positive impacts of microfinance, access to financial services whether credit, savings, or insurance enable many poor people to access better health care services. A study of client households of CRECER, an MFI in Bolivia showed higher rates of breast-feeding, and DPT immunizations among children, as compared to non-client households (MkNelly and Dunford, 1999). A similar study in Ghana showed higher rates of breast-feeding among MFI clients and better health outcomes among their year-old children, as compared to non-clients (MkNelly and Dunford, 1998). In Uganda, clients of FOCCAS demonstrated better health-care practices: 95 percent used improved nutritional techniques for their children and 32 percent tried at least one AIDS prevention technique. Respective rates for non-clients were 72 percent and 16 percent (Barnes, Morris, G. and Gaile, G. 1998).

Another study indicated that a 10 percent increase in credit to women MFI clients was associated with a 6.3 percent increase in mid-arm circumference of daughters a common measure used to identify malnourished children (Pitt and Khandker, 20003). Two other studies in Bangladesh show that contraceptive use was significantly higher among Grameen clients (59 per cent) than among non-clients (43 per cent) (Hashemi, Schuler, and Riley, 1996).

Statement of The Problem:

MF is emerged as the provision of financial service to financial resources for low income and active group of people living in both urban and rural area in general. Although microfinance programmes and institutions have become increasingly important safety nets of the poor, knowledge about the achievements of these strategies remains only partial and controversial. Several studies indicate that microfinance has positive impacts in reducing poverty (Holcombe, 1995; Hossain, 1988; Remenyi, 1991; Schuler, Hashemi and Riley, 1996; Hulme and Mosley, 1996; Pitt & Khandker, 2003 and Khandker, 2003). On the other hand, there are studies that indicate pessimistic kind of result on the impacts of microfinance programme initiatives towards reducing poverty (Buckley, 1997; Montgomery, 1996; Rogaly, 1996; Wood and Shariff, 1997). There are also quite a number of research works that have been done on microfinance-poverty linkages in Ethiopia. However, so far there was no study made on the role of microfinance institutions on poverty alleviation especially in Dedebit Credit & Savings Institution (DECSI) at Mekelle Branch. Therefore, this study is designed to fill this gap.

Objectives of the Study:

The objectives of the study were as follows:

- i. To asses the role of MFI (DECSI) on poverty reduction.

Table 1: Profile of Respondents

Particulars	No. of Respondents	%
Sex		
Male	84	40.00
Female	126	60.00
Total	210	100.00
Age		
20-40 year	132	62.86
41-49 year	48	22.86
50 and above	30	14.28
Total	210	100.00
Marital Status		
Married	141	67.14
Unmarried	69	32.86
Total	210	100.00
Occupation		
Farmer	94	44.76
Trader	63	30.00
Office worker	21	10.00
Students	18	8.57
House wife	14	6.67
Total	210	100.00

Source: Questionnaire

Table-2: How often Clients have Taken the Loan

No	Particulars	No. of Respondents	%
1	1 – 2 times	111	52.86
2	3 – 4 times	63	30.00
3	Above 5	36	17.14
	Total	210	100.00

Source: Questionnaire

Table- 3: Satisfaction of The Clients About Loan Amount And Period

Item	Yes		No		Total	
	No. of Respondents	%	No. of Respondents	%	No. of Respondents	%
Do you satisfy the loan amount and loan period by the institution?	50	23.81	160	76.19	210	100.00

Source: Questionnaire

Table-4 Attitudes of the Respondents

Item	Yes		No		Total	
	No. of Respondents	%	No. of Respondents	%	No. of Respondents	%
1. Do you have awareness of using credit and saving?	189	90	21	10	210	100.00
2. Do you have the habit of saving?	189	90	21	10	210	100.00
3. Do you know the benefit of credit and saving institution on poverty reduction?	147	70	63	30	210	100.00

Source: Questionnaire

- ii. To evaluate how the MFI (DECSI) helps to change their (poor) economy.
- iii. To point out the significance of the provision of MF service to brake grinding cycle of poverty.

Methodology:

In order to achieve the aforementioned objectives, the researcher collected and revived relevant documents and reports from both secondary and primary data sources. A survey research method was the basic research design. The

primary data were collected through self-administered questionnaires as well as personal interviews. The self-administered questionnaire was developed through a review of literature as well as through interviews and pretests with managers of the MFI for the purpose of collecting the first hand information from the clients (loan takers). In addition to this method, interviews were conducted with management of the institution as well as with clients who have taken the loan more than three times

Table- 5 Life Improvement After Loan Taking

Item	Living standard		Income		Expanding Business		Total	
	No. of Respondents	%	No. of Respondents	%	No. of Respondents	%	No. of Respondents	%
What improvement does the credit and saving institution brings you?	105	50	42	20	63	30	210	100.00

Source: Questionnaire

Table-6 Income Change After Taking The Loan

Item	Yes		No		Total	
	No. of Respondents	%	No. of Respondents	%	No. of Respondents	%
1. There is any additional asset on your household?	132	62.86	78	37.14	210	100.00
2. Did you shift the source of energy after the use of credit?	111	52.86	99	47.14	210	100.00
3. Is there any additional no. of children used to go to school after credit?	147	70.00	63	30.00	210	100.00

Source: Questionnaire

from the institution in order to gather relevant additional information.

A convenience sampling method was used in order to select the sample elements, 210 of the population were taken as sample size and the researcher has distributed 210 questionnaires to clients and all questionnaires were collected. The questionnaires were administered only in the Tigray Region, Mekelle city. Tigray region is one of the victims of bad weather (drought) when it compares with other regions of Ethiopia. As a result of this the extent of poverty is higher in this region. Thus, it is crucial to study the MFIs services on poverty alleviation taking this region. Mekelle which is the largest city (capital city) in the Tigray Region, northern part of Ethiopia and also the branch head office of MFI is located in Mekelle city. Furthermore, the reason behind why the researcher selected the case study of Mekelle branch is so far there was no study made on the role of MFI on poverty alleviation especially in DECSI at Mekelle branch.

The study also used secondary data, and the main sources were various official documents and reports of DECSI (MFI). The collected data was analyzed using tables and percentages.

Data Analysis And Interpretation:

This section covers the profile of clients (age, sex, marital status, and occupation), how often clients have taken loan, satisfaction of the clients about loan amount & period, and clients attitude towards loan. It also presents clients awareness about the institution role on poverty alleviation, life improvement and income change after loan taken. Furthermore, the major problems were raised by clients and managers response on the overall activities of the institution. This section concludes by giving the summary and implication of the results.

The profile of respondents is presented in table one. The table indicates that 40 per cent of the respondents are male and 60 per cent are female. This indicates that the women participation is high.

As the table shows that the clients (loan takers) of the institute are classified into three major categories on the basis of their age. From the total sample of respondents 132 (62.86 per cent) of them are in the age group between 20 – 40 years, 48 (22.86 per cent) are in the age 41 – 49 and only 30 (14.28) are above 50 year. This indicates that most of the respondents are in the age group between 20 – 40 years called productive stage and who have the ability to being change their living standard by loan.

Table-1 shows that 67.14 per cent of the clients are married and 32.86 per cent are unmarried. This indicates that married clients are more than unmarried so the institution gives service for family than single person.

The table further reveals that 44.76 per cent of the respondents are formers, 30 per cent are traders, and 10 per cent are office workers, but only 8.57 per cent and 6.67 per cent are students and house wives respectively. This indicates that formers and traders are more beneficiaries from the institution.

Table two shows that 52.86 per cent, 30 per cent and 17.14 per cent of the respondents have taken the loan 1- 2, 3 -4 and above five times respectively. This indicates most of the clients have taken loan 1-2 times. This may be because of the clients changed their living standard step by step and the institution is giving the opportunity for the new clients in order to get the loan or existing clients are not satisfied by the loan and other conditions.

Table three reveals that only 23.81 per cent of the respondents are satisfied by the loan amount and the loan period while 76.19 per cent are not satisfied. This indicates

that most of the clients are not satisfied by the amount of the loan and the loan period by offering the institution.

It can be seen from the table four that most of the respondents i.e. 90 per cent have the awareness of using credit and saving whereas 10 per cent of the respondent have no the awareness. 90 per cent of the respondents have the habit of saving while 10 per cent have not habit of saving.

It can be further observed from the table that the majority of respondents (70 per cent) knew the benefit of the credit and saving institution on poverty reduction. It concludes most of the clients have good awareness about credit and saving and the benefit of the institution on poverty reduction.

Table five indicates that 50 per cent of the total respondents said the credit and saving institution improves their living standard; while 20 per cent and 30 per cent indicated the institution improves their income and expanding business by providing credit respectively. This indicates that the credit and saving institution have a great role in the process of improving the living standard of the society than others.

As it can be observed from table six, 62.86 per cent of the respondents have got additional household asset, while 37.14 per cent were not in a position to hold any additional household asset. 52.86 per cent of respondents said that they shifted their energy source after credit while 47.14 per cent responded that there is no change in their source of energy they used after credit, whereas 70 per cent of the respondents replied that they had sent additional children to the school after credit; while 30 per cent only said 'no'. From this we conclude that the institution has a great role in changing the living standard of the society. In general, it was found that the poor have undoubtedly benefited from the institution in several ways.

Major Problems Raised By Clients About The Institution And Credit:

The researcher has conducted an interview with the clients who have taken a loan from the institution at least more than three times about the institution and credit.

Although the institution is established to help different people in order to facilitate their business or increase their life standard, the institution may fall in some problems that almost 75 per cent of the respondents have complained what they encountered the problems concerning the institution and the credit they used.

The following are the major problems raised by the clients:

High Interest Rates:

This was indicated by the clients of DECSI (Mekelle Branch) saying that the available funds were too expensive, as well as the interest rates that the borrower has to pay the lender, there are other direct and indirect costs incurred by the clients. These costs include registration fees, weekly compulsory savings and the loan

application fee. All these add to the cost of obtaining the loan.

Loan Application Process And Approval:

When new client is approached to get loan it takes too much of time due to the lack of tainted staff workers and the process of application for loans starts with small amount and after repayment the client can apply for next higher amount. This process was observed to be a limited factor for those customers who needed a large amount right from the beginning. This is true because it takes an unnecessarily long time for those seeking a large loan to obtain enough funds to meet their needs. In addition to the time taken to receive large loans, the clients also raised concerns about the time frame from the receipt of the loan to the time of starting repayment, which is just one week after the disbursement of funds in most cases.

Problem of Collateral:

The beneficiaries of MFI are poor people who engage themselves in micro or small scale business and farmers. Most of them have low value assets thus limiting their access to credit in formal financial institutions such as commercial banks, which require them to pledge collateral. These conditions for borrowing under individual lending mechanism are strict for majority of poor people.

- ✓ Pre-lending training programme did not bring up any changes.
- ✓ Borrowers were not agreed with the existing institution policy.
- ✓ There was no close relationship between institution management and the borrowers.
- ✓ There was no proper service delivery.

Manager's Response On The Institution Concerning To The Overall Activities:

The researcher tried to collect information from managers through interviews about the role of the institution of poverty reduction as general.

As the managers said that the main role of the institution is

- ✓ To improve food securities at household level both in the rural and urban areas of the region.
- ✓ To create job opportunities to the unemployed parts of the population through promoting micro, small and medium enterprises in the region.
- ✓ To stimulate the local economy through offering adequate and efficient financial services and builds financially sound and sustainable institution.
- ✓ To give training or orientation for their target groups before giving loan about the entire credit process and the benefit of saving.

Conclusion:

To a large extent Dedit Credit and Savings Institution (DECSI) role in Mekelle Branch has brought about positive changes in the standard of living of people who

access their services. Although some of the clients have not benefited, most of the clients have benefited positively. Despite the achievements of DECSI clients, most of them complained that, the interest rates charged by DECSI were very high.

The findings reveal that the process of application for loans starts with small amount and after repayment the client can apply for next higher amount. This process was observed to be a limiting factor for those customers who needed a large amount right from the beginning. This is true because it takes an unnecessarily long time for those seeking a large loan to obtain enough funds to meet their needs. In addition to the time taken to receive large loans, the clients also raised concerns about the time frame from the receipt of the loan to the time of starting repayment, which is just one week after the disbursement of funds in most cases.

The surveyed DECSI conducted a pre-lending training programme, but it was further observed that, the training was provided by loan officers who were not experts or practitioners in the area of small business. The training concentrated more on familiarizing the clients with loan terms and conditions rather than providing small business skills. This practice may build up the spirit of loan repayment but does not influence business growth. Furthermore, the clients had raised those problems concerning the collateral. Borrowers did not agree with the existing institution policy and there was no close relationship between institution management and the borrowers.

Recommendations:

The following recommendations are put forward in order to improve the role of MFI (Dedebit Credit and Savings Institution Mekelle Branch) on poverty alleviation.

- The interest rate should be lowered to a level that would cover MFI operating expenses and at the same time facilitate the growth of their clients' business.
- The institution must overcome the problem regarding to the loan application process and approval.
- Regarding the issue of small base loans, the MFI should be flexible by raising the minimum base to reflect changes in the value of money over time.
- The institution should ask for collateral by considering the poor society.
- MFI should restructure their training contents to include improving their clients' business skills. They should organize regular business training for their clients and qualified training people should conduct this.
- The institution must give continuous orientation to client and make them familiar with the policy of the institution.
- The institution has to create close, mutual relationship with borrowers to improve defaults.
- The institution must avoid service delivery problem.

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