

Full Length Research Paper

The financial performance and sustainability of microfinance institutions during the current financial crisis: The case of Amhara Credit and Saving Institution (ACSI) in Ethiopia

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Abstract

The purpose of this study is to assess the financial performance of Ethiopian MFIs during the current financial crisis with particular reference to Amhara Credit and Saving Institution (ACSI), the largest MFI in the country. The global financial crisis has been spreading quickly in emerging markets, but little is known about its impact on the microfinance sector. It is in this vacuum that this study is being carried out especially within Ethiopia. The study employed a descriptive research design. The data is quantitative and obtained from the MIX market website. For data analysis, descriptive statistics such as percentages and graph are used. The result of the study indicates that there was a negative shift in the performance indicators particularly in the year 2009. The gross loan portfolio has declined by 15.73% in the year 2009. As a result a decline in ROA and ROE had occurred due to lost financial revenue. The portfolio at risk rose during 2008 and 2009 indicating deterioration of portfolio quality. The number of active borrowers (outreach) declined in the year 2009 by 4.37%. However, there was an increase in number of staff members by 5.48% in the same year. Thus, the firm's productivity was poor during 2009.

Keywords: Microfinance Institutions, Global financial crisis, Financial performance, Ethiopia.

JEL Classification: G21

INTRODUCTION

Ethiopia has an estimated population of about 83 million (CSA, 2010). Agriculture is the backbone of the economy. A significant proportion of the population in Ethiopia lives below poverty line. According to an appeal made by the government of Ethiopia at the mid of the year 2011, the estimated drought affected people requiring food aid were about 4.5 million. After the change made on Ethiopia's economic policy towards market economy, with the objective of economic growth and poverty alleviation, the establishment and expansion of microfinance institutions has been seen as a way of development. Interventions through the delivery of microfinance services have been considered as one of the policy instruments of the government to enable rural and urban poor increase output and productivity, technology adoption, improve input supply, increase income, reduce poverty and attain food security. The establishment of sustainable microfinance institution 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 (Amha, 2000). For sustainable poverty alleviation, the microfinance institutions themselves should be profitable and sustainable. However, no research effort has been done to address the financial performance and sustainability of microfinance institutions during the current financial crisis.

The general objective of the paper is to assess the financial performance and sustainability of microfinance institutions during the current financial crisis with particular reference to Amhara credit and saving institution which is the largest microfinance institution in the country. More specifically, the study assesses the profitability and sustainability, portfolio quality, productivity, deposit mobilization and outreach of ACSI during the current financial crisis. The remaining part of the paper is organized in four chapters. First a review of the related literature is made, and then followed by a description of the data and methodology and result and discussions. Finally, the last chapter presents conclusion and recommendation.

LITERATURE REVIEW

Robinson (2001) cited in Ejigu, (2009) defined microfinance as small scale financial services – primarily credit and saving provided to people who farm or fish or herd; who operate small enterprises or micro enterprises where goods are produced, recycled, repaired, or sold, who provide services, who work for wages or commissions; who gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and groups at the local levels of developing countries, both rural and urban.

Microfinance is an effective tool to fight poverty by providing financial services to those who do not have access to or are neglected by the commercial banks and other financial institutions. The poor, having no or very little income, cannot offer any collateral which banks require, have no credit history, banks are too far away to verify and observe their behavior (there is little information) and the loans are generally far too small compared to transaction costs (Dokulilova et al, 2009).

The Asian financial crisis (in the second half of 1990's) could offer a number of potential implications for microfinance. Economic recession resulted in fewer job opportunities. At the same time the profitability of MFIs' clients fell caused by reduced demand for their output. Resources for government development programs, often supporting MFIs, decreased. Obviously the crisis had an impact on MFIs. However, the crisis has lesser impact on MFIs than commercial banks (Ibid). Financial crisis can put MFIs in a vicious circle. The financial problems of MFIs could cause the loss of confidence that MFIs could provide other loans. In this situation the debtors could lose incentives to repay their already existing debts. This could deteriorate the MFIs' loans portfolio quality and worsen the financial problem of MFIs.

According to Claessens et al (2010), the causes of the current global financial crisis are multiple, with a mixture of elements common to previous year's financial crises and some new elements. The current financial crisis had four features in common with other crises. These are asset price increases that turned out to be unsustainable, credit booms that led to excessive debt burdens, build-up of marginal loans and systemic risk, and the failure of regulation and supervision to keep up with and get ahead of the crisis when it erupted. On the other hand, four key aspects were new for current financial crisis. These are the widespread use of complex and opaque financial instruments; the increased interconnectedness among financial markets, nationally and internationally, with the U.S. at the core; the high degree of leverage of financial institutions; and the central role of the household sector.

According to a study in Ethiopia by Kereta (2007), the industry's outreach rose in the period from 2003 to 2007 on average by 22.9 percent. He identified that while MFIs reach the very poor; their reach to the disadvantaged particularly to women is limited (38.4%). From financial sustainability angle,

he found that MFIs are operationally self sustainable measured by return on asset and return on equity. His study found no evidence of trade-off between outreach and financial sustainability. The study also found that PAR is at 3.2% for the period 2005 to 2007 which is, according to him, in comfort zone. By 2007, the worldwide MFIs had received (estimated) USD 5 billion of foreign investment from developed countries. As a result, present microfinance system is connected to global markets by an unprecedented degree. The global trade of year 2009 is projected to contract. Both GDP growth of developing countries and private capital flows to developing countries are projected to fall roughly by half compared to their 2007 levels (Watson 2009, cited in Dokulilova, 2009).

In March 2009, CGAP surveyed over 400 MFI managers from all regions to identify present impacts of crisis. MFIs (65%) have reported that their gross loan portfolios were either flat or had decreased and 69% of the respondents reported deterioration of loan portfolio quality (CGAP, 2009). According to CGAP, the full effect of the global crisis and its triple shocks- economic contraction, currency depreciation and scarcity of credit, will fully show its power in emerging countries in the second half of the year 2009. The CGAP survey also indicated that MFIs in Latin America and the Caribbean faced a decrease in repayment rate and portfolios quality. The study has also revealed that although SSA region is the developing region and it is least integrated in to global economy, growth is supposed to fall from 5.5 % in 2008 to 1.7% in 2009. The study indicated that many of the poor were already hit by recent increases in food prices and sharp declines in remittances to the region from abroad.

Balkenhol (2009) indicated that the impact of the current crisis on microfinance depends largely on the way MFIs raise their resources. MFIs that work primarily with locally mobilized resources especially retail deposits are fairly isolated from the contagion.

Empirical studies aimed at assessing the impact of the current financial crisis on the sustainability of microfinance institutions in Ethiopia is missing. Therefore, this study is important not only because it fills the gap, but also it arouses researchers' curiosity to undertake a research in similar areas.

METHODOLOGY

The study is descriptive type and it is based on quantitative data. The researcher has collected and analyzed annual reports and other documents of the last six years (2004-2009) using descriptive statistics and carried out time series analysis. The data was obtained from the MIX market website. To assess profitability and sustainability of MFIs, the study used return on asset (ROA) and return on equity (ROE) ratios. Portfolio quality indicators included are Portfolio At Risk>30 (PAR+30) and Portfolio At Risk>90 (PAR+90). Number of borrowers per personnel is used to assess productivity of MFIs. In this study two important ratios (deposit to loan ratio and deposit to total

asset ratio) are also used to assess the deposit mobilization of MFIs during the current financial crisis. Finally, numbers of active borrowers were considered in determining the outreach of MFIs during the current financial crisis.

FINDINGS

Profitability and Sustainability of ACSI

[Figure 1]

Figure 1 shows not only that ACSI is operationally self sufficient, but also that ACSI's profitability (or operational sustainability) is improving from year to year, particularly from 2005 onwards except the year 2009. When the ROA and ROE for 2008, the year of financial crisis, is considered, one could notice that ACSI's performance is still improving. CGAP(2009) indicated that the impact of the current financial crisis on emerging countries will fully show its power in the year 2009. Thus, to assess the impact of the crisis on ACSI's performance, the ROA and ROE for 2009 was considered. When we consider ROA and ROE ratios for the year 2009, it can be noticed that ACSI is still operationally sustainable. However, we can see that its profitability has declined in the year 2009 compared to 2008. This was due to the decline in gross loan portfolio and therefore lost financial revenue. The gross loan portfolio has declined by 15.73 percent. Whereas the financial revenue as a percentage of average total asset has declined by 2.51 percent in absolute terms.

The portfolio Quality of ACSI: The most important measurement tool used to assess portfolio Quality in this research is the Portfolio at Risk (PAR).

$$PAR (\times Days) = \frac{\text{Outstanding principle loan balance of all loans past due more than } \times \frac{\text{Day + Re negotiated portfolio}}{\text{Gross loan portfolio}}}$$

In this study, the Portfolio at Risk (PAR+30) and PAR + 90 are chosen to see the portfolio quality of ACSI during the current financial crisis.

[Figure 2]

As shown in figure 2, the PAR +30 has decreased to 1.55% in 2006 from 1.9% in 2005. Again, the PAR + 30 have declined from 1.55% in 2006 to 1.27% in 2007. It was an excellent performance and shows that ACSI's portfolio quality was good during those periods. However, ACSI's PAR+30 during 2008 and 2009 were 1.35% and 3.8% respectively. So it was rising. This shows that the portfolio quality of ACSI has deteriorated during 2008 and 2009. It should be noted that, despite deterioration of portfolio quality, ACSI's portfolio quality is still in comfort zone.

[Figure 3]

Look at the trend of Portfolio at Risk (PAR+90) from year 2004 through 2008. The Portfolio at risk greater than 90 days is declining from time to time indicating that the Portfolio quality of ACSI is improving. However, the Portfolio at Risk (PAR +90) as well as the Portfolio at Risk (PAR+30) revealed that the Portfolio quality of ACSI has deteriorated in the year 2009.

Productivity of ACSI

Number of borrowers per personnel: This ratio is measured by dividing number of active borrowers by the number of personnel.

[Figure 4]

Figure 4 shows that the increasing trend for number of active borrowers per personnel is a positive signal of the productivity of ACSI's personnel. An exception to this trend was the ratio for the year 2007 and 2009. The 2007 and 2009 ratios were somewhat lower than the preceding year ratios. This is due to smaller increase in the number of active borrowers but larger increase in the number of personnel particularly in the year 2007. There was a decrease in the number of active borrowers, in the year 2009 to 679,518 from 710,576 in 2008 while number of staff members increased by 5.48% in 2009. The result is a decline in number of active borrowers per personnel which shows that ACSI's productivity has declined during 2009.

Deposit mobilization

[Figure 5]

Note figure 5 that the deposit as percentage of the loan outstanding for ACSI is on average 55.14%. This shows that ACSI has managed to cover about 55.14% of its loan outstanding from savings. This indicates that the experience of ACSI is encouraging. The deposit to total asset ratio is also significant, which is about 41.73% on average. This also shows that ACSI is doing well in terms of deposit mobilization. ACSI has mobilized a significant amount of savings from poor households. Saving mobilization in Ethiopia has become an integral part of a viable micro- credit delivery system. Therefore, the lesson is that the poor in Ethiopia are indeed worth banking on. However, note that during the year 2009, deposit to loan ratios has increased to 59.64% from 53.56% in 2008. This is due to a 15.73% decline in gross loan portfolio, which is the denominator. The nominator, total deposits, has also declined but only by 6.16% from the previous year (2008). The average amount of deposits per depositor has also declined from \$87 in 2007 to \$77 in 2008, then to \$55 in 2009. This shows that MFIs' clients were less willing to maintain large amount of deposits partly because of the need to meet their transaction needs since food prices were skyrocketed during those periods.

Outreach of ACSI

Almost all microfinance institutions aim ultimately at expanding the number of clients being served. One measure of outreach is the number of active clients served. The number of active client includes borrowers, depositors and other clients who are currently accessing any financial service (Rosenberg, 2009). However, in this study, because of unavailability of data, the number of active borrowers is used as a measure of outreach.

[Figure 6]

From figure 6, it can be seen that ACSI's outreach is increasing from year to year. In the year 2004, ACSI was able to serve about 350,000 borrowers. In four years time (2004 to 2008), the number of borrowers served increased to more than double. This shows that ACSI has shown a remarkable growth in terms of outreach, particularly in the number of active borrowers. However, note that the number of active borrowers declined in the year 2009 by 4.37 percent from the preceding year (2008). The non-earning liquid assets as a percentage of total assets increased from 7.43% in 2008 to 18.29% in 2009. It seems that there was a change in loan provision direction of ACSI from increasing number of outreach to quality to reduce the risk of default.

CONCLUSION AND RECOMMENDATION

In this paper an attempt is made to assess the financial performance of MFIs during the current financial crisis with particular reference to Amhara Credit and Saving Institution. It is found out that ACSI is not only operationally self-sufficient but also its profitability is improving from year to year during the period under review particularly from 2005 through 2008. However, the profitability of ACSI during the current financial crisis has declined. A decline in ROA and ROE was noted in the year 2009. Although, ACSI's portfolio quality was good during the period under consideration, its PAR>30 rose during 2008 and 2009. This shows that ACSI's portfolio quality has deteriorated in those periods due to clients' hardship to pay timely. It should also be noted that despite deterioration of portfolio quality in the year 2009, ACSI's portfolio quality is still in comport zone since the PAR+30 is less than 4 percent during the period under review. The study also revealed that the number of active borrowers per personnel was increasing from year to year except the year 2007 and 2009 where the ratio was lower than that for their preceding year. The decline in this ratio particularly in the year 2009 was probably due to change in loan provision direction of ACSI from increasing number of outreach to quality to reduce the risk of default. A 10.86% increase in non-earning liquid assets as a percentage of total assets was noted in 2009.

Another finding in this study is that ACSI has mobilized a significant amount of saving from poor households. The deposit as percentage of the loan outstanding was on average 55.14%. ACSI has managed to cover about 55% of its loan outstanding from saving reflecting that ACSI is doing well in

terms of deposit mobilization. The deposit to total asset ratio is also significant, which is about 41.73% on average. However, note that during the year 2009, deposit to loan ratios has increased to 59.64% from 53.56% in 2008. This was due to a significant decline in gross loan portfolio, which is the denominator. Finally, it was found out that the number of active borrowers served more than doubled in four years time (2004 to 2008). Thus, ACSI has shown a remarkable growth in terms of outreach particularly in the number of active borrowers. However, the number of active borrowers has declined in the year 2009 by 4.37 percent from the preceding year (2008).

In this research Amhara Credit and Saving Institution's performance was found to be improving from time to time except during the current financial crisis. However, a comparative study of performance should be carried out to determine whether ACSI is performing better than other microfinance institutions. Amhara Credit and Saving Institution has mobilized significant amount of savings from poor households. This is encouraging. However, much remains to be done to attract more deposits. In this regard ACSI should diversify its financial product by introducing new deposit accounts among other things that can attract more savers. Negative shift in the performance indicators may be due to other factors other than the financial crisis and hence additional study be made to assess whether the financial crisis is the proximate cause for the negative change. Finally, the author recommends additional research be made on a large scale in the future. Since data on other MFIs was not available the study considered Amhara credit and Saving Institute only.

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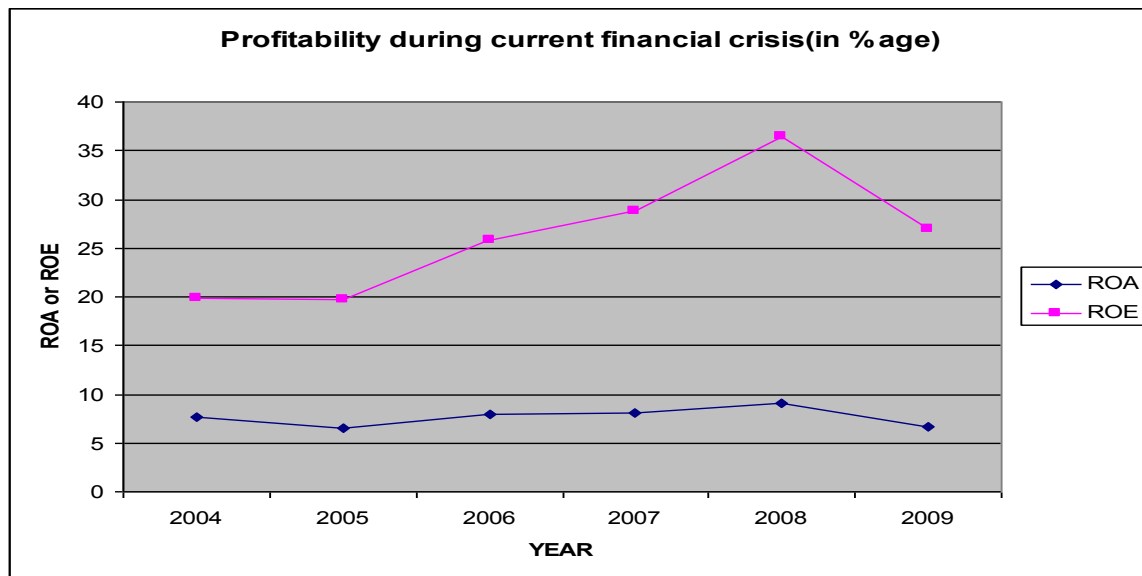
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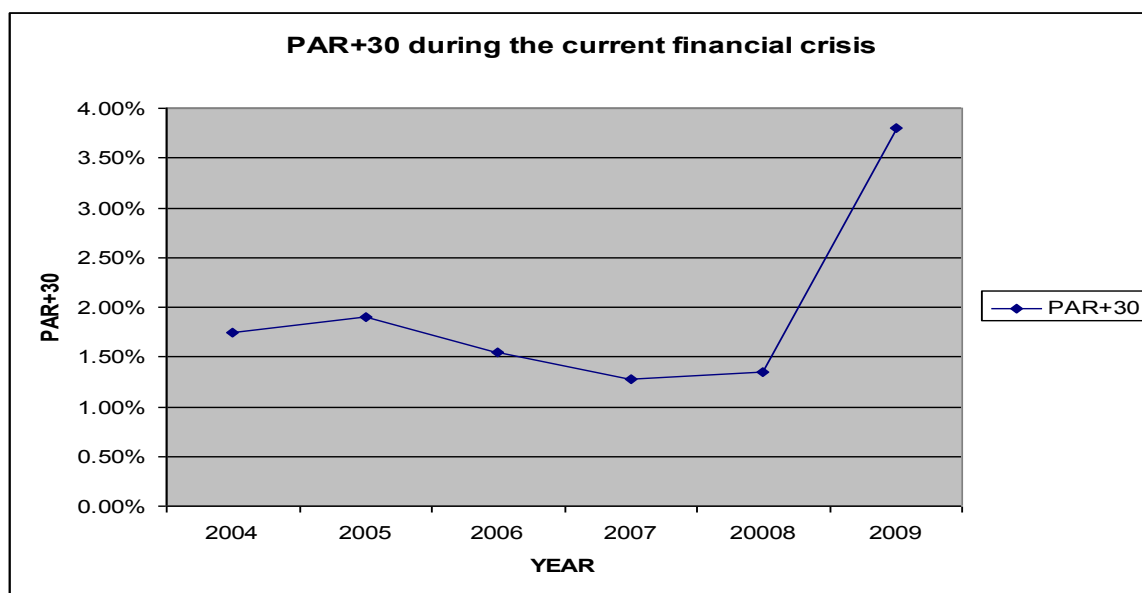
APPENDICES

Figure 1



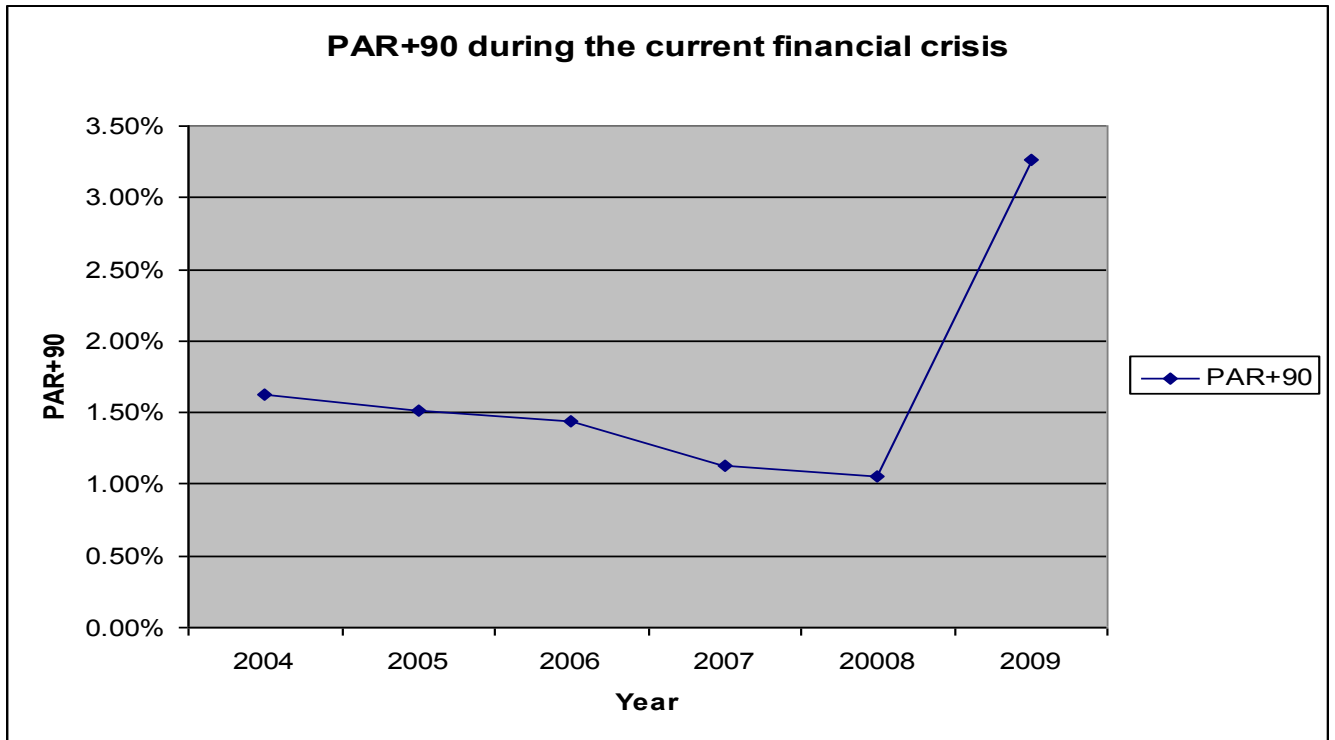
Source: Based on data from MIXMARKET website (www.mixmarket.org)

Figure 2



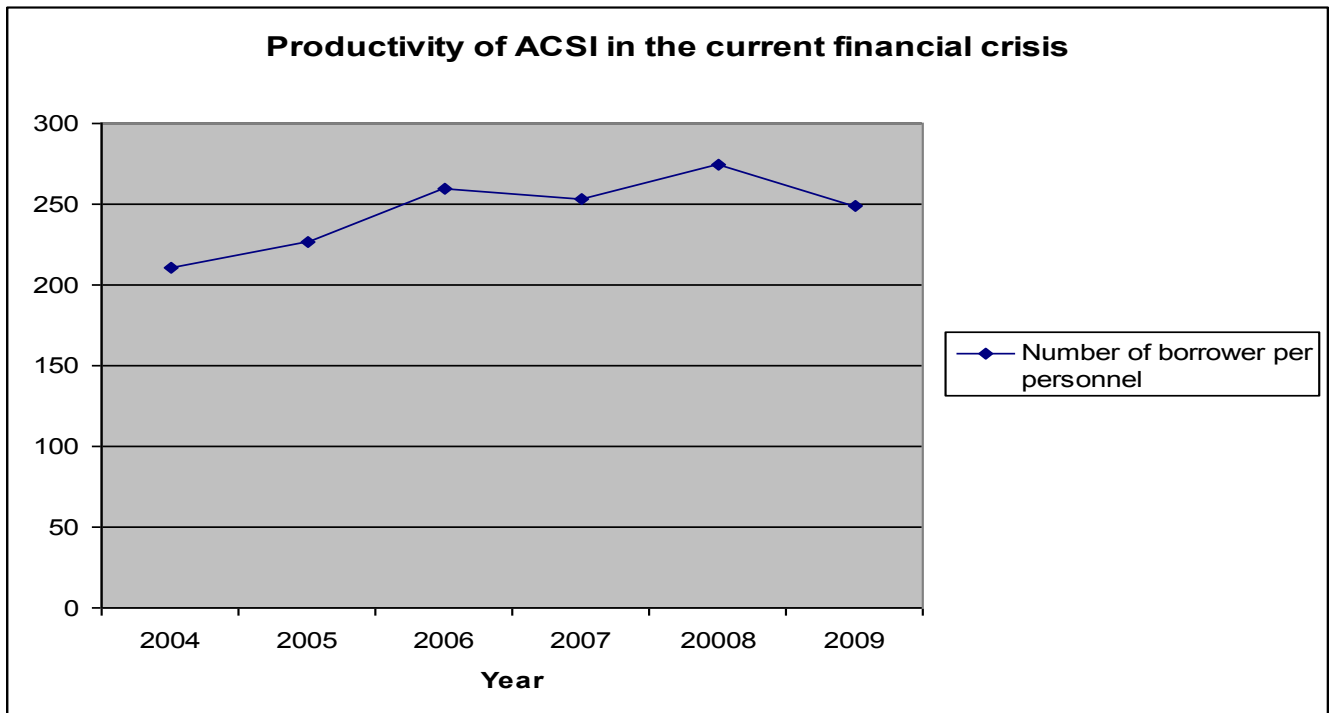
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Figure 3

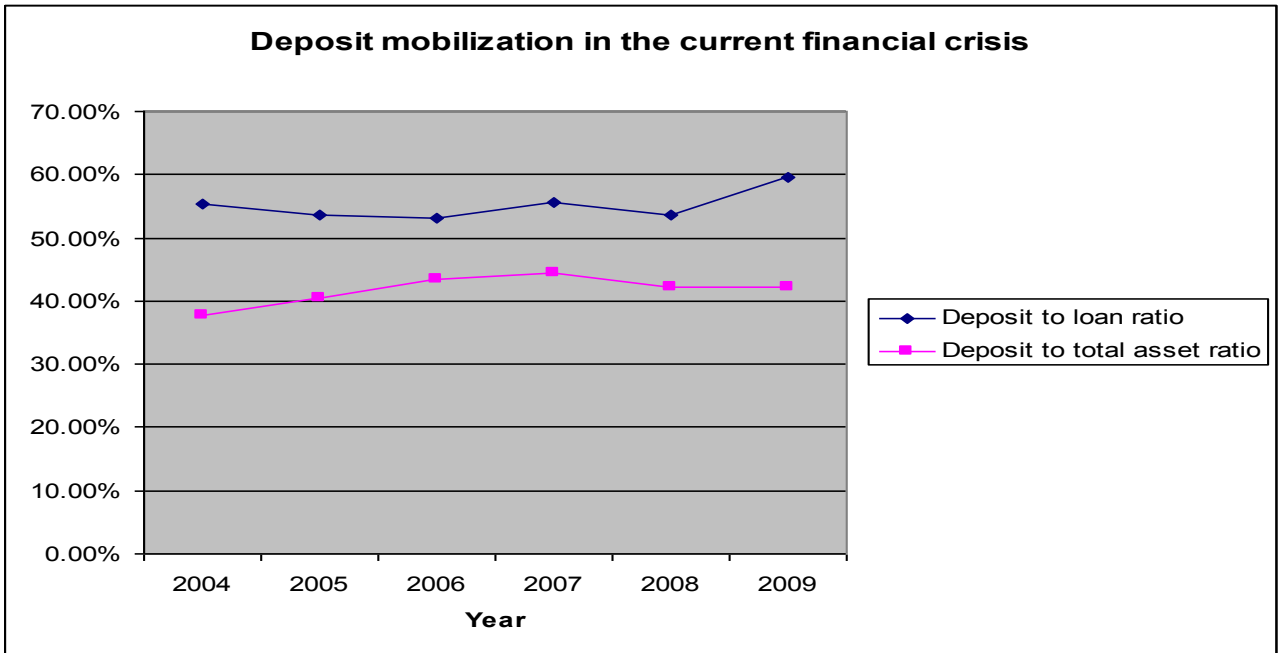


Source: Based on data from MIXMARKET website

Figure 4

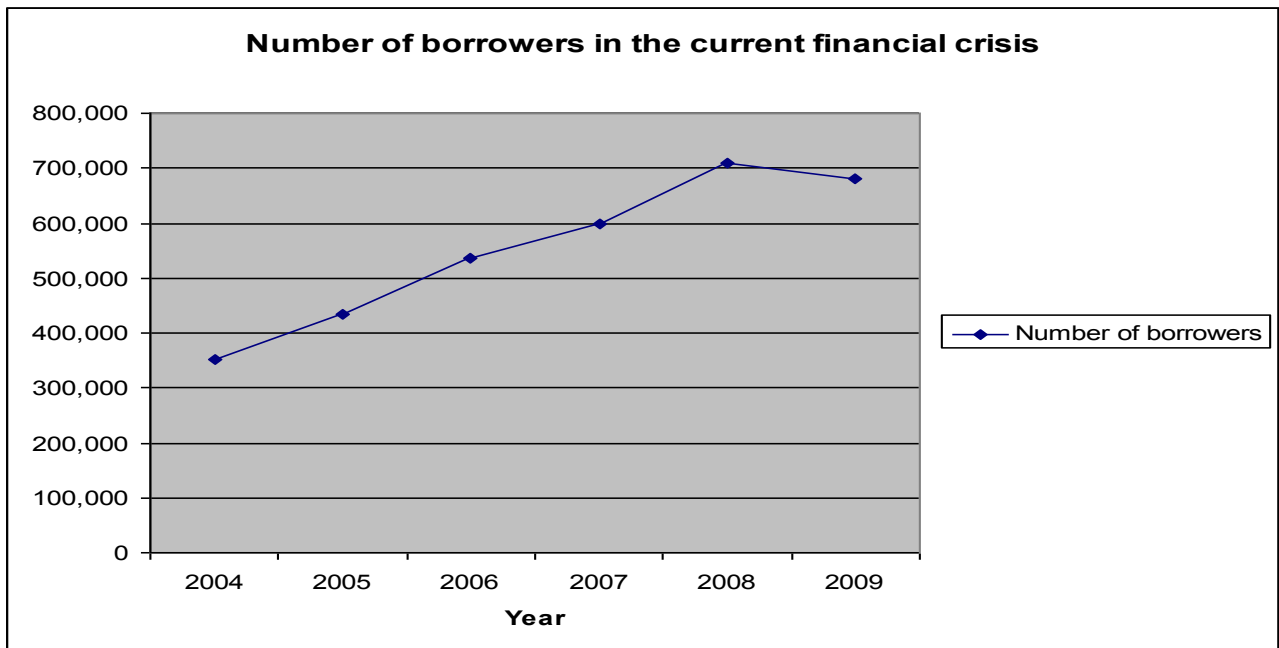


Source: Based on data from MIXMARKET website



Source: Based on data from MIXMARKET website

Figure 6



Source: Based on data from MIXMARKET website