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AN OVERVIEW ON TRIUMPHS AND IMPEDIMENTS OF ETHIOPIA'S INFORMAL FINANCIAL ACTORS

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ABSTRACT

The article assess the roles that have played by Informal financial Institutions (also known as ''Microfinance Institutions'') to improve the life condition of the poor in Ethiopia so far, and to identify the obstacles that hinder these intuitions. These institutions are thought to be best possible alternatives for those people who can't get an access to the other alternative in the financial market, mainly Banks and Insurance companies. In most cases, Banks, Insurances and other formal financial institutions failed to address the financial needs of the poor. Furthermore, these institutions are crucial to combat poverty, diminish idleness, and empower females and other disadvantaged segments of the public. Despite successful stories, these institutions are suffering from challenges like lack of sufficient skilled man power, unable to equip with updated technologies, limited service provision, structural, policy and regulatory challenges, and limited geographical coverage. The study concludes that notwithstanding numerous hindrances, Ethiopia's informal financial sector is playing significant role in the financial market, and improve the life conditions of hundreds of thousands of poor. And, these institutions have the potential to lead the financial market of the country if they expand their service areas and geographical coverage, equip with updated technologies and skilled man power.

Keywords: Financial Market, Financial needs, Formal financial institution, Microfinance, Empowering.

INTRODUCTION

Informal financial actors are supplementary agents to the existing formal financial institutions to bring about overall societal progress and fighting poverty and improve financial accessibility for the poor element of a given society, in most cases in the developing countries (Al-Bagdadi and Brüntrup, 2002). They serve as the best financial option for the disadvantaged, ignored and financially weak segment of a society. This section of a society don't have (sufficient) access to the other possible financial alternative in the financial market (mostly are banks and Insurance companies). Thus, these institutions are vital means by which societal social and economic evils of the poor would be alleviated (Ramanaiah and Gowri, 2011). Even in the 21st century where financial institutions are reaching almost every corner of the world, formal financial institutions mainly Banks failed to access or/ and satisfy the financial demands of the poor. The problem is more rampant, and microfinances emerged as the best possible financial actors to fill the gap (Seibel, 2007). In doing so, these institutions help society in general, and the poor in particular to reduce poverty (Muiruri, 2014). In addition, microfinances are also vital to empower women socially and economically (Luyirika, 2010).

Formal financial actors including Banks and Insurance companies failed to fully satisfy the financial demands of the poor and rich sections of the society. Formal financial actors are the main actors in the financial market, highly competitive and primarily profit oriented institutions. Besides, these institutions and their services are mostly limited to urban areas (Deribie et al, 2013). In such condition, we need other actor who can take risks and reach the poor mostly in rural areas. The best actors are, therefore, microfinances. Unlike banks, microfinances have welfare impact motives (not primarily profit oriented), less bureaucratic and poor centered financial (Bamlaku, 2006).

In Ethiopia, despite there are a number of microfinance institutions, still a large of section of the society have no/ or little access to these institutions (Hurissa, 2011). Even on the areas where microfinance institutions exist, the poor is not still benefiting exhaustively mainly due to the high interest rates that the poor cannot afford to pay and lack of sufficient knowledge from the side of the society on how to utilize the loans they get from the institutions (Bamlaku, 2006). Generally, in this paper issues like the connotation of microfinancing, the roles that the informal financial actors are playing in Ethiopia and the challenges they are facing are addressed. Besides, based on the findings, further reformations and exit strategies are provided.

DEFINING MICROFINANCE

Micro-financing is popular almost in every corner of the world. Some used to define microfinance using substitute terms such as microcredit, credit NGOs, group finance or Grameen banking (Seibel, 2007). While Alemayehu (2010 as cited on Hurissa, 2011), defined It as the financial services provided by informal financial actors/institutions to the poor who is denied financial access into the profit leaning institutions. While Adams and Graham (1984), defined these institutions as the financial institutions that provide primarily financial services in the areas, and to the clients that banks fail to do so. But, unlike formal financial institutions, these institutions have limited finance, provide limited services and operate in a limited geographical area (Mutengezanwa et al, 2011).

THE ROLE OF MICROFINANCE INSTITUTIONS

The idea and the practice of microfinancing is not something newfangled. It has been there with various societies having different names. For instance, Iqub and Idir in Ethiopia, Susu in Ghana, the Chit funds in India, Tandas associations in Mexico and so on (Refera, 2014). This indicates, these institutions have been playing a paramount role to create and strengthen social bonds and interactions among members of a given community and improve their economic capabilities. In this regard, microfinances are unsurpassed tools to alleviating poverty through providing loans to the poor so that they can open and run their own businesses, and clients can improve their saving habits (Gebru and Paul, 2011).

In Ethiopia, there are more than 20 microfinance institutions functioning throughout the country. All of which are established after the mid-1990s (Wiedmaier-Pfister, et al, 2008). The most common names are: Amhara Credit and Saving Association (ACSA), operating in Amhara regional state, *Dedebit* Credit and Saving Association (DCSA), from Tigray regional state, *Omo* Microfinance in the Southern Nations, Nationalities and People's regional state, Oromia Credit and Saving Association (OCSA), in Oromia regional state, *Addis* Credit and Saving Association (ADCSA) in Addis Ababa, *Dire* Credit and saving Association (DCSA) in Dire Dawa and so on. These institutions are providing credits in billions of Birrs to help the poor take part in the socio-economic development of the country, and share from the fruits of the country. Relatively, the number of women clients benefiting from these institutions is growing from time to time. For instance, in the year 2007, from the total number of beneficiaries across the country, 39% are female (Wiedmaier-Pfister, et al, 2008).

Microfinances are more comfortable and suitable financial institutions to the poor. Unlike formal financial institutions, microfinances provide loans and other financial services, mainly to the rural poor, with less bureaucratic financial procedures in limited days. Thus, they serve as engines of growth, tools of societal changes/improvements, and means of financial security (Mutengezanwa et al, 2011).

In Ethiopia, up to the year 2008, by 14 microfinance institutions alone provide 4.2 billion Ethiopian Birrs of credit to their clients (Ramanaiah and Gowri, 2011). *Dedebit* Credit and Saving Institution (DCSI), a microfinance running mainly in Tigray and Addis Ababa, Ethiopia, known for its effort to improve the lives of the worn torn region of 17 years of civil war between 1974/75-1990/91, and later by the Ethio-Eritrean war (1997/98-1999/2000). Originally, this institution was established with the aim of rehabilitating the region under the control of the ruling party called ‘‘TPLF/EPRDF.’’ Its clients are largely farmers for a long period of time, and latter from the mid-2000s additional clients mainly from micro and small enterprises’ owners are benefiting a lot (Asmelash, 2003).

Above all, it is a fact that formal financial institutions are increasing and expanding from time to time. But, largely limited in the urban areas. And, microfinances are filling the financial gap that the formal sector failed to address/fill (Refera, 2014). There is a biggest opportunity for Ethiopia’s microfinance institutions .i.e. the poor is a big market for these institutions. In other words, the demand is increasing from time to time. This results in rapid growth of micro financial institutions throughout the country. According to Ebisa et al (2013), Ethiopia’s microfinance institutions are known for the service they provide is mainly poor oriented, provide financial services in a larger geographical areas of the country, the institutions are not autonomous (not free from government influence), the most dominant microfinance institutions are politically affiliated and backed by the ruling EPRDF (Ibid). Besides, microfinancing results in increasing in the average loan size per individual in recent years. For example, according to Wiedmaier-Pfister et al (2008), in 2006, the average loan size per individual was about Birr 1427 (US$159). This figure increases by 20% comparing to the average loan size per individual in the years 2001-2005.

In general, the objective of microfinances is beyond providing loan to the poor. Rather, they have mission of serving the needy (mostly the poor) with full capacity both in times of stable financial situations and at times of crisis so that they become number one choice of the poor. And, this has been a reality in last 2 decades in Ethiopia. The institutions able to accumulate a large amount of capital from the services they provide to their clients. So, both the clients (poor) and the institutions are benefiting from each other (Ibid).

CHALLENGES OF MICROFINANCING IN ETHIOPIA

Despite a successful stories experienced by microfinances, there are challenging factors that hinder the overall success of the institutions. Among others, Mutengezanwa et al (2011), identified two broad categories of challenges that Ethiopia’s microfinance institutions are facing. These are: structural challenges, and policy and regulatory challenges. Structural challenges refers to the condition that the services provide microfinance institutions are not in line with the demands of the rural poor while policy and regulatory challenges meant informal financial sectors are suffering from the absence of conducive policy and work setting.

Microfinancing is allowed merely to Ethiopian nationals. Foreigner and their financial institutions are prohibited from working in the financial sector of the country. This have its own impact on the overall growth of these institutions for the fact that allowing foreign financial institutions enter the market would results in competition among these institutions and would increase their loaning and lending capacity (Ebisa et al, 2013). This is one of the challenges to the sector. Besides, lack of adequate skillful man power in the sector, inefficient administration, failed to provide variety of services by the institutions, lack of (sufficient) loan in the market, lack of clear and periodic follow ups on the legality of the services delivered by these institutions, poor infrastructure in rural areas, poor community awareness on how to properly utilize the loans, and failure to update the institutions with the existing technologies are some of the other challenges not provide smooth and continuous service to their clients (Ibid).

CONCLUSION AND RECOMMENDATIONS

A number of Microfinance Institutions (MFIs) in Ethiopia are providing various financial services to the poor who didn’t have an access to formal financial institutions mainly banks. As a result of which significant number of clients have experienced changes in their income, and their live is improved accordingly.

Despite many success stories, MF institutions are suffering from various challenges in Ethiopia. Among others: structural challenges, policy and regulatory challenges, non-accessibility to all parts of the country, failure to equip the institutions with the necessary technology and skilled man power. Plus, clients are not well informed in using the debts to the intended goals, clients’ failure to repay their debts on time and so on. So, the author recommends the following points to help the institutions manage the challenges and clients get benefited better than ever before:

a. The government should encourage domestic entrepreneurs, and allow foreign investors enter in to the sector;
b. MFIs shall extend their service areas and variety of services they provide;
c. MFIs need to equip themselves with current updated technologies and skilled man power as much as possible;
d. MFIs, the government and any other concerned bodies need to work hand in hand to improve the financial market and financial transparency of the country; and
e. MFIs need to work hard to create awareness on the side of the community, mainly rural poor about the institutions and their services, and how to effectively use the loans provided to their clients.

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