Outreach and Sustainability of the Amhara Credit and Saving Institution (ACSI), Ethiopia

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Outreach and Sustainability of the Amhara Credit and Saving Institution (ACSI), Ethiopia

A Masters Thesis

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Ås, Norway
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DECLARATION

I do declare that this thesis is my original work. It has not previously been submitted for any academic degree to any academic institution. Any source of information is duly acknowledged.

Adeno Kidane
14th of May 2007

Ås, Norway
DEDICATION

Dedicated to microfinance clients and my ex-colleagues at the Amhara Credit and Saving Institution with whom I enjoyed and shared the challenges and opportunities at work. I especially dedicate to all those working against poverty and injustice.

_Dreams are renewable. No matter what our age or condition, there are still untapped possibilities within us and new beauty waiting to be born._

Dr. Dale Turner
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ABBREVIATIONS

ACSI- Amhara Credit and Saving Institution
AEMFI- Association of Ethiopian Microfinance Institutions
BOFED- Bureau of Finance and Economic Development
CASHPOR Credit and Savings for the Hard-core Poor
CGAP- Consultative Group to Assist the Poorest
CSA- Central Statistics Agency
DPPA- Disaster Prevention and Preparedness Agency
ER0- Ethiopian Relief Organization
FSS- Financial Self-sufficiency
MFIs- Microfinance Institutions
MIX- Microfinance Information eXchange
MOFED- Ministry of Finance and Economic Development
NBE- National Bank of Ethiopia
ORDA- Organization for Relief and Development in the Amhara Region
OSS- Operational Self-sufficiency
PAR- Portfolio at Risk
PWR- Participatory Wealth Ranking
ROA- Return on Assets
ROE- Return on Equity
SPSS-Statistical Package for the Social Sciences
TLU- Tropical Livestock Unit
ABSTRACT

The two empirical questions of outreach and institutional sustainability were the themes of this paper taking ACSI as a case. The study employed both primary and secondary data. Evaluations of outreach, operational and financial self-sufficiencies were made using the operational and the audited financial reports for the period 2001 to 2005. The field survey was conducted with a sample size of 118 clients selected randomly from two sub branch offices and the descriptive statistics was analysed using SPSS.

ACSI has covered 77% of the Amhara region in its operation by the end of 2005. It served more than half a million clients. Over 1.6 million loans had been disbursed worth Birr 1.5 billion. The expansion was not only in loan portfolio but also accompanied with aggressive savings mobilization as a perennial source of loanable fund. ACSI financed more than half of its portfolio from savings in 2005. By the end of 2005, the institution was operationally and financially self-sufficient at 119.9% and 115.3% respectively. ACSI is among a few microfinance institutions which are able to achieve the highest efficiency at the lowest cost per borrower. The operating cost per Birr lent was as low as five cents in 2005. Such lowest operational costs did contribute to the attainment of operational and financial self-sufficiencies. ACSI has a high portfolio quality. Loans infected with delinquency virus account only 1.9% of the portfolio in 2005. The repayment rate was at average 98.8% over the five year period. Based on the level of income and expenditure, asset ownership in the form of livestock and land, and housing conditions the clients of ACSI are the poorest of the poor. ACSI is working with and for the poor and poorest sections of the society. Such a remarkable performance shows the attainment of the twin targets of institutional sustainability and serving the poor who are excluded from banking services.
CHAPTER I. INTRODUCTION

Microfinance is a recent flourishing development phenomenon. It is prescribed as an effective input to alleviate poverty through provision of financial services to those marginalized parts of the society. Nevertheless it cannot be a panacea in itself. The emergence of pro-poor microfinance practitioners nullified the thought that the poor are not bankable. However, in line with today’s neo-liberal orthodoxy, there is a paradigm shift in microfinance to make it a profitable venture to attract external funding through private investment. This seems to be a compromise of the very mission of fighting poverty by reaching and serving the ‘poorest of the poor’ with the objective of maximizing profits.

Microfinance is a better intervention as a development strategy for Ethiopia, which is addicted to aid and identified with a brand of deep-rooted poverty. It is one way to shift from aid dependency to self-reliance. Having recognized the positive contributions of microfinance, legislations were adapted to license and supervise service providers in 1996. The Amhara Credit and Saving Institution (ACSI) is the pioneer to work as a licensed microfinance in the country. It is operating in the Amhara Regional State of Ethiopia.

At present institutional sustainability is becoming the guiding principle for microfinance service providers. Even if it has deserved the greatest attention of practitioners to continue as a going concern so far many are subsidy dependent. It is estimated that only five percent of programs would be able to go up on the ladder of financial sustainability whereas the rest either will wither out or rely on subsidies. A few microfinance institutions (MFIs) are becoming sustainable with a record of remarkable profit returns. However there are positions that such sustainability is achieved at the exclusion of the ‘poorest of the poor’ (Morduch, 1999). This goes against the basic principle of targeting the disadvantaged that erodes the commitment to serve the very poor.

Leakage, a fact in which better-off clients expel very poor clients, is a common problem in the sector (Woller and Woodworth, 2001). It is obvious that serving the poor is costly and risky. This may compel to focus on the ‘non-poor’ or better offs so as to minimize the risk of default. Another factor is donors’ demand on MFIs to record highest repayment rates as a condition for
further funding. Besides, the methodologies of many MFIs do not fit with the interests of the very poor and they remain excluded as a result. Most MFIs lack precise ways of identifying target clients (Greeley, 2005). Furthermore, the limited supply and drainage of donor funds makes MFIs to focus on mobilizing savings as a perennial source of loan fund that highly needs to ensure sustainability to win trust of depositors. Issues of reaching the poor and ensuring sustainability are among areas of ongoing debate in the microfinance field. The contestation is on looking at outreach and sustainability in isolation and a matter of priority between the two. Still it is a great challenge to build MFIs that reach the poor and simultaneously achieve sustainability (Otero, 1999). As to Morduch (1999:1571) “the greatest promise of microfinance is so far unmet, and the boldest claims do not withstand close scrutiny” Morduch (1999:1571). Currently, building sustainability is given more focus than outreach. However, both are the twin targets of microfinance if to impact on poverty alleviation.

In sum, this paper is intended to address some of the problems MFIs have had to date taking the experience of ACSI as empirical evidence. The two most important empirical questions of sustainability and outreach are the themes of the study. This research is expected to contribute and considered as part of the ongoing effort to fill the gap between theory and practice in microfinance. The paper consists of five chapters. The remaining parts of this chapter deals about the objectives of the research, research questions, and methodology of data collection and analysis. In the second chapter literatures on institutional sustainability, financial self-sufficiency, outreach, pros and cons of subsidy, measures of poverty targeting and the conceptual framework for analysis of the study are incorporated. Institutional profile of ACSI and overview of the microfinance industry in Ethiopia is presented in the third chapter. Chapter four is devoted to the results and discussions of the study. Performances of ACSI in terms of outreach, credit and saving delivery methodologies, the socio-economic condition of clients, and clients’ feedback on the services of ACSI are discussed in detail. The remaining section of chapter four deals with institutional sustainability of ACSI where standard measurements are applied and results displayed on financial and operational self-sufficiency, productivity and efficiency, profitability, and portfolio quality. The last chapter is dedicated to conclusion.
Objectives

The objectives of the study are to:

- Evaluate outreach performance of the institution
- Assess clients’ perception on the services of the institution
- Determine the financial and operational sustainability of ACSI

In order to realize the above objectives of assessing whether ACSI is able to achieve the twin targets of ensuring sustainability and serving the poorest of the poor at the best interest of its clients, the following questions are employed as guidance.

Research questions:

1. Who are the clients of ACSI in their socio-economic condition compared to the national poverty line? Who should be considered a poor client?
2. How is its outreach in terms of breadth and depth? How well does ACSI reach the poor?
3. How do clients feel about the services of ACSI?
4. What do the sustainability indicators of operational and financial self-sufficiency disclose? Is ACSI sustainable based on sustainability ratio calculations?
5. What is the condition of the portfolio quality?

Methodology

The study with the aims of assessing outreach and sustainability of ACSI employed the following methods of data collection and analysis. Both primary and secondary data were collected. Financial and operational sustainability of the institution was determined based on the audited financial reports of balance sheet and profit and loss from 2001 to 2005. Evaluation of outreach was done using the operational reports for the same period stated. Both time series and industry comparisons were done where data were available.
Data Collection

Two sub branches, Meshenti and Tis-Abay, operating under the Bahir Dar branch were selected which far almost 35kms from the regional capital of Bahir Dar. The selection of sites took into account access to transport and limited time given to conduct the research. These sub branches operate in districts where they are believed to be surplus producers or at least food self-sufficient. The questionnaire was used as a tool for the primary data collection. It was designed to include nominal, ordinal, ratio and interval data. A mix of open-ended and close-ended questions was included. The questionnaire was designed in a way to translate the research objectives into specific questions. The answers to those questions provided adequate answers for the research questions outlined. Background information about the socio-economic status of clients, income and expenditure, housing and utilities condition, asset ownerships and clients’ feedback on services provision was collected (See the English translated Questionnaire in Appendix 1). They also helped to assess the depth of outreach of ACSI. A pre-testing of the questionnaire was done at Tis-Abay sub branch taking five clients. The pre-test helped to refine and adjust the questionnaire before the survey was carried at full-scale. The research was conducted in the second half of October till the end of November 2006.

The field survey was conducted with a sample size of 118 clients selected randomly from a list of clients. Equal numbers of clients (118) from two sub-branch offices of Meshenti(centres 45 and 47 with 20 groups) and Tis-Abay(centres 10,18,19 and 35 with 29 groups) were taken with equal composition of gender. Lists of clients from pre-numbered collection sheets for savings have been used. The centres were selected on simple random basis drawing a lottery in each of the two sub branches. Once centres have been picked randomly clients were selected in a systematic random sampling basis. The sampling frame was determined by taking the total respondents expected from each sub branch and the total number of members in the selected centres. The sampling interval is determined for each centre by dividing total member of the centre by the cases required in that centre. Once the first case was selected, every n\textsuperscript{th} case was taken for the sample.
The list of respondents was prepared at sub branch offices before going to the field. The interviews were conducted on the same date with centre meetings days for savings collection. Hence, respondents once selected from collection lists at sub branch offices were contacted on the same date when centre meetings were held with no need to come for the purpose of the interview alone. All the interviews were held going to the field with field officers at centre meetings sites. The questionnaire was prepared and conducted in the local and official language of Amharic. The respondents were first asked for their consent and briefed about the purpose of the study that it was intended for academic purposes only. They were told that it was anonymous and any information revealed would be kept confidential. As much as possible care had been taken to be sensitive for ethical issues and let them feel free to respond. The interviewees gave their full consent and support at heart. The help of employees at all levels of the head-office, branch and sub-branches was appreciated. I took first a letter from Noragric to the managing director of the institution requesting cooperation towards the intended research. The managing director wrote to the branch office and then the branch office informed the sub branches to extend their support related to the study. I got utmost cooperation at all offices of the institution. Hence, access to the required data was not a problem for me.

Secondary data from various literatures and company resources were employed. Operational and audited financial reports for the five year period from 2001 to 2005 were extensively used. Those data from portfolio and savings reports, balance sheet and income statement were manipulated to answer the research questions related to scale of outreach and institutional sustainability in terms of financial and operational self-sufficiency (attached in Appendix 2). Formulas designed to make ratio and percentage calculations and averages were used as presented by Joanna Ledgerwood which is attached in Appendix 3 (Ledgerwood, 1999). Previous institutional ratings by independent rating agencies like MicroRate and the Microfinance Information eXchange (MIX) were used for industry comparisons with African microfinance institutions. The survey results conducted by the Ministry of Finance and Economic Development (MOFED) and the Regional Bureau of Finance and Economic Development (BOFED) were also used for comparisons in some of the results found in this study.
Data Analysis

The data collected using the questionnaire was entered, organized, summarized, and categorically analyzed using SPSS. The output was discussed using tabulation and cross tabulation of variables with averages and percentage values in descriptive statistics. The operational and financial data were manipulated using performance standard formulas used for MFIs (Ledgerwood, 1999). Readily non-quantifiable data are discussed through qualitative description.

Limitations

Some of the limitations while conducting this research are presented below. The impact of financial and other services provided by the institution were not taken into account. The impact study itself is another topic of research. Savings operation was not widely covered unlike the credit operation. The study gave less focus on the feelings of clients on savings. In this research, non-clients and drop-out clients were not included. All the respondents were active clients during the survey. Respondents sometimes did not give direct and specific answers to the questions related to age, income and expenditures. There were difficulties in getting respondents’ income disclosed in monetary terms directly and there was a need to convert their agricultural produce in financial amounts. Responses were limited to only the questions in the questionnaire. No interviews were conducted with the management and field officers at branch and sub branch level. Mostly clients were reserved when comes to complaints but praised the services of ACSI. No financial or material reward was given to the respondents. The meeting days were once in a month and it needed to finish the questionnaire with in that time that forced to complete under pressure.
CHAPTER II. LITERATURE REVIEW

2.1 Institutional Sustainability

Institutional sustainability can be defined as the continuous service provision to clients profitably as a going concern without relying on subsidies (Ledgerwood, 1999). The four dimensions of sustainability are continued benefit flows, longevity or survival, ability to meet recurrent costs, and institutional capacity and performance. There are no precisely set and universally acceptable indicators of institutional sustainability. Sustainability is beyond “calculating sustainability rates”. It is about ensuring effectiveness, building and maintaining capacity, and realizing that capacity into tangible results (Brown, 1998:61-62). Sustainability is of two types: operational and financial. Operational sustainability is the ability of the firm to cover operational costs from revenue earned from major lines of business. Financial sustainability is the entity’s ability to operate without subsidies. Even if all MFIs promote financial sustainability as a guiding principle nearly all of them are subsidy dependent. Subsidies seem a fact of life for microfinance firms (Morduch, 1999).

In the case of microfinance, performance parameters to measure financial sustainability are well developed (Zeller and Meyer, 2002). The basic measures of sustainability are operational self-sufficiency (OSS), financial self-sufficiency (FSS), and profitability (Natalson and Bruett, 2001). Operational self-sufficiency measures the capacity of MFIs to cover operating expenses, financing costs, and allowance for bad debts from operating revenues. Financial self-sufficiency measures the ability of MFIs to cover all direct and indirect costs without subsidies taking adjustments to operating income and expenses (Barres, 2002; Ledgerwood, 1999; Fisher and Sriram, 2002). Profitability is achieved when profits net of taxes and subsidies are at least equal to the opportunity cost of capital and risk taking. Operational efficiency is the ability of an institution to offer a particular service at the lowest cost. Empirical evidences show that internal inefficiencies worry microfinance organizations whether they are subsidy dependent or not. Window dressing in financial reporting is a way to hide institutional inefficiencies from period to period. Many of the MFIs experience management inefficiency, high running costs, persistent
subsidy dependence, inclination to social service than business approaches, non-performing loans, lofty default rates, small number of clients and targeting failure of the very poor. Those MFIs that secured self-sufficiency are through extending credit to marginally poor rather than the poorest. Hence, many of the MFIs are unable to keep their promise of “including the excluded” (Woller and Woodworth, 2001:272; Bhatt and Tang, 2001; Zeller and Meyer, 2002; Brau and Woller, 2004).

At present FSS is the paradigm that compels the microfinance industry. The perception of FSS as a measure of success is related to cost-effectiveness, breadth of outreach, increasing productivity of field workers, and charging high interest rates (Woller, 2002). On the other hand focusing on financial sustainability is “disrupting the social fabric of communities, creating more poverty, and excluding the poorest and most vulnerable from any given group”. Hence, institutional sustainability, defined in terms of FSS, overshadows the prime objective of poverty reduction. Financial sustainability and poverty alleviation seem paradoxical objectives (Marr, 2003:7; 18-19). Nevertheless the issue of actual existence of a trade-off between financial sustainability and reaching the poorest is questionable (Gulli, 1998).

2.2 Financial Self-Sufficiency

Financial self-sufficiency shows cost recovery regardless of size of operation and gives a quick synopsis of the general performance of the institution. It gives a clue on the sustainability of the institution considering the impact of subsidies into account. MFIs are said to be sustainable and financially self-sufficient when their FSS ratio is above 100%. To continue in the industry as a going concern, “MFIs should be-or strive to become financially self-sufficient”. As to Barres, “having a positive FSS ratio alone is not sufficient”. Because FSS can be achieved either from internal strength of the institution through strict cost control or charging higher interest rates to hide management inefficiencies. Hence, it is not only the plus or minus of the FSS calculations but it is detrimental to deeply analyze its components (Barres, 2006:21). Progressive lending at a larger scale and efficient operation helps to achieve FSS while working with the poorest. Internal efficiency and organizational strengths, rather than the clientele served, determines the potential for FSS (Gibbons and Meehan, 1999). Moreover, the limit to the FSS level that MFIs should
target depends on the expected rate of return and “the desire to share the benefits with their clients” (Barres, 2006:22). The level of FSS hinges on being sustainable and accrual of benefits to clients.

Ensuring FSS is necessary to serve large numbers of the poorest to impact on poverty but not at the sacrifice of the aim of poverty reduction. The issue is “how best to go about it (FSS) without losing sight of our overriding concern for poverty reduction (Gibbons and Meehan, 1999:135). Ensuring scale of outreach permanently is a “function of financial viability”. Clients negative perceptions on the future survival of the institution and reliance on external financing rather than internally-generated resources “creates incentives to default” (Paxton and Fruman, 1997:14).

Poverty alleviation through microfinance requires reaching the poor lacking productive capital through building viable institutions (Otero, 1999). In fact, microfinance is “not a panacea for the Third World poor” (Woller and Woodworth, 2001:268). Mosley and Rock (2004) argue that poverty reduction may be effective by granting loans to the non-poor, not to the poorest, which can create employment opportunities to the latter. The availability of credit alone could not be a solution to the problems of the ultra poor. Microcredit to impact on the life of the poorest should be delivered with non-financial services, which is a big hurdle to attain sustainability. Microfinance institutions should not be blamed for not reaching the poorest. It is the poor who “often ‘self-select’ themselves out of credit programs in recognition of their inability to ‘use’ the loan profitably” (Bhatt and Tang, 2001:327). The poor may lack the self-confidence to take credit and are excluded from solidarity groups as risky borrowers (Woller and Woodworth, 2001; Halder and Mosley, 2004; Greeley, 2005). Still reaching the poor and sustainability are unresolved controversies in the microfinance industry.
2.3 The Schools of Thought on Microfinance Service Delivery

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 and Tang, 2001; Brau and Woller, 2004; Woller and Woodworth, 2001). The institutionalist approach centres 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. 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 and Woodworth, 2001:276). 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, 2002:596).

The “microfinance schism” between advocates of “institutionalist” and “welfarist”, even if there are some crossovers among them, leads to various types of policy settings (Morduch, 2000:617; Bhatt and Tang, 2001). The two divisions of 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 and 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 (Bhatt and Tang, 2001). Subsidies, for institutionalists, are start-up fuels and finance new innovations in an effort to enhance efficiency to be sustainable (Morduch, 1999; Schreiner, 2002). Welfarists blame that MFIs are urged to divert from their mission of serving the poorest of the poor (Brau and Woller, 2004).
The poverty approach aims at serving the poorest section of the society that is highly costly to serve. The loss from higher expenses will be financed from subsidies (Gulli, 1998). The self-sustainability approach focuses on the less-poor clients on the outer edge of the conventional banking system. Minimalists focus only on financial services. In fact, most MFIs are minimalist in design and delivery (Woller and Woodworth, 2001; Bhatt and Tang, 2001). For minimalist, non-financial services delivery weakens the sustainability and is not a basic condition for quality microfinance provision. Integrative programs include the belief that the poor are constrained with many factors beyond finance. The integrated programs combine financial products with other services to impact. The integrated service delivery approach incorporates the provision of non-financial services related to health, nutrition, education, and business development trainings. Cost of service delivery is the key issue of debate between minimalist and integrative programs (Woller and Woodworth, 2001). This leads to think about whether there exist tradeoffs between sustainability and poverty alleviation missions of MFIs. I have not sided on either of the groups but believe that it is possible to achieve sustainability by serving the poorest of the poor over time.

2.4 Outreach of Microfinance

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, 1999: 52). Outreach is “a social benefit of microfinance” aiming at improving the well being of the poor. The six features of outreach are worth, cost, depth, breadth, length, and scope. Worth or quality of outreach hinges on contractual terms related to amount of loan, credit period, amortization of debt, interest rate, safety and unlimited withdrawal of savings that fit with the demands of clients (Schreiner, 2002:591). The type of products and services offered and the number of people served measures the breadth of outreach. The depth of outreach is measured by loan size and the portfolio allocated according to gender. Smaller amounts or shorter times indicate better depth. Accordingly, it is believed that poorest clients are served if the majorities are female and the average loan size is smaller (Bhatt and Tang, 2001). It is costly and difficult to measure the poverty level of an individual. Even if it is arguable, some take loan size as a proxy indicator to
poverty. Loan size may be affected by institutional policies, client demand, or supervisory agency restriction (Helms, 2006).

Extent or breadth of outreach refers to the number of clients served. Depth of outreach indicates the ability of the institution in reaching clients “deep in the pool of the under-served”. This can be confirmed using the depth of outreach index that encompasses the poor, women, rural inhabitants, and the uneducated as believed to be the attributes of those excluded from conventional banks and the very poor. These indicators are related to financial services exclusion and are simple to measure (Paxton and Fruman, 1997:10-11). Depth of outreach refers to “how poor are the clients” (Gulli: 1998:5). It is not simple to measure depth of outreach based on income level but some proxies are used for depth. These are “sex (women are preferred), location (rural is preferred), education (less is preferred), ethnicity (minorities are preferred), housing (small, flimsy houses are preferred), and access to public services (lack of access is preferred). Breadth of outreach counts the number of clients served by a microfinance institute. Length of outreach is the provision of microfinance services for indefinite period of time in the future. Scope of outreach implies the types of products and services offered to clients. Cost refers to how expensive the products and services of MFI s are to clients considering both price costs and transaction costs. Price costs are cash expenses of interest and fees that are major income sources for the microfinance organization. Transaction costs refer to non-price costs assumed by the clients but not incomes to the institution (Schreiner, 2002; Gonzalez-Vega, 1998). In sum, serving a broader range of clients including the vulnerable poor and those excluded from conventional banks helps to diversify risk while reaching the very poor in a sustainable way (Helms, 2006).

2.5 Outreach versus Sustainability

Institutional sustainability is attached to “full cost recovery or profit making “with the aim of building institutions “that can last into the future without continued reliance on government subsidies or donor funds”. It is only sustainable MFI s that are “able to preserve the value of their equity base” (Conning, 1999:52, 75). Sustainable institutions reach the wider spectrum of clients and can contribute to the development process (Paxton and Fruman, 1997). Financial
Sustainability is vital to serve clients permanently and “the only way to make an impact far beyond what donor agencies and most governments can fund” but is “not an end in itself” (Helms, 2006:47-56). Outreach and financial sustainability are “the two core drivers” in the industry while “the latter has come to dominate the agenda” menacing the social mission of working with the poor (Greeley, 2005:22).

Serving the very poor and attaining sustainability is a challenge to the microfinance industry. There is a common assumption in microfinance operations that tradeoffs exist between outreach and sustainability. It is not possible to conclude precisely on outreach and sustainability as mutually exclusive goals. It is difficult to presume that deeper outreach is a constraint to sustainability and vice versa (Paxton and Fruman, 1997). There are differences and debates on “tradeoffs between outreach, impact, and sustainability” in microfinance operations and “what to do about them” (Conning, 1999: 52). Reaching the very poor and becoming profitable is a debate among MFIs (Helms, 2006). Based on an overview of industry experience, the poorest can use financial services for improving their economic and social well-being without endangering institutional sustainability of the service provider (Greeley, 2005). There exists “no necessary tradeoffs between serving large numbers of the poorest households and the attainment of institutional financial self-sufficiency (IFS) by an MFI” (Gibbons and Meehan, 1999:131). Yet the evidence on mission drift seems mixed which makes generalizations as to the existence of tradeoffs between profitability and serving the poor difficult. In fact, it takes longer to make a profit and become financially sustainable while working with the poor but not unattainable goal. The tradeoffs between achieving the two goals are “less acute than originally thought”. Provision of better quality services to the very poor is possible while covering full cost. The cross-cutting challenges of the industry are increasing the numbers of clients and reaching the poorest sections of the society at the lowest cost possible (Helms, 2006:47-56).
2.6 The Pros and Cons of Subsidy

The aim of raising such an issue is neither to condemn the flow of subsidies to MFIs nor to deny its role to the current statute of the industry but to look at literatures on the pros and cons of subsidy. Up to the present, subsidies, whether local or international, have contributed “in jump-starting and strengthening microfinance”. Subsidies have been injected so as “to fuel the development and growth of microfinance”. Subsidies served in portfolio funding and capacity building of the institutions in expectation to decline as the industry matures. Donor funds have been used for institutions that started the financial services to the poor which were unthinkable for the private sector due to high risk and minimal returns. Still the role of donors in supporting the industry through financing research and development is vital. (Helms, 2006:93-97).

Provision of financial services at subsidized rates leads MFIs to depend on grants to sustain their operations due to insufficient operating revenues to cover full costs which impede their sustainability in the long run. Viability of MFIs is still questionable except the interest in the sector and lots of subsidies channelled to the industry. Subsidies to MFIs seem inevitable due to high cost of information, high-risk clients, and low returns on investment but require justification on “social equity, public benefit, cost effectiveness, or other grounds”. The three different modes MFIs operate are “survival, sustainability, or self-sufficiency”. Organizations under survival condition do not have bright future as they are eroding their capital base over time and steps to liquidation. Most institutions “seem to operate between survival and sustainability” extending their survival using pills of subsidy together with their lowest operational income. Self-sufficient institutions “can survive and add to their asset base wholly on the basis of income derived from their lending and related operations”. Targeting wider segments of the market adds to self-sufficiency but also requires due care not to undermine institutional mission. Self-sufficiency is taken as a key indicator of sustainability because resources are scarce and subsidies are limited to satisfy the prevailing demand. Additionally, self-sufficiency can lead to increased efficiency, cost reduction, and enhances leverage (Pollinger et al, 2007:26, 36).
Even if subsidies do have contributions that range from access to start-up fuels as loan fund to capacity building its cons should be considered. Microfinance has been able to attract the interest of governments. But this keen interest has its opportunities and challenges. Governments can play a positive role in policy formulation and levelling the field towards the creation of sustainable institutions. Others consider the sector as donating money to poor people ignoring the wide array of financial services required by the poor. It goes to the extreme of setting political criteria rather than proper credit discipline and guidelines on selection of clients and operational locations. Government “moratoriums on loan repayment and other meddling” can erode and wither best-designed and successful institutional achievements. Reliance on subsidies can lower the inducement to mobilize savings. Subsidies should leave the way to private funding sources (Helms, 2006:127). Dependence on subsidies “might alter a firm’s incentive structure” reducing the chance of a positive event. Subsidies may deter the incentive of firms to analyze their true costs to set appropriate prices and operate efficiently. Microfinance institutions should be required to practically show that they are efficient ways for delivering subsidies to serve the market if subsidies are required (Pollinger et al, 2007:37). Public funds channelled through microfinance should make a difference in the lives of poor people.

Sustainable MFIs that serve poorer clients “must charge higher interest rates, have higher staff cost per dollar loaned, and are less leveraged” as it costs higher than serving other segments of the market. It is difficult to institutions working towards achieving deeper outreach to be leveraged. As to Conning, “the institutionalists are correct that microfinance will never amount to more than a drop in the bucket of poverty alleviation efforts unless large sums of money can be mobilized from private sources” (Conning, 1999: 51-75). Clients should pay the full cost for the services they got but “should not be asked to bear the burden of incompetent MFIs management and inefficient operations” which makes attainment of FSS “a cost issue rather than a pricing issue”. MFIs should serve the largest number of clients possible with their resources at least cost because cost is the means to FSS (Gibbons and Meehan, 1999:145).
2.7 Measures of Poverty Targeting in Microfinance

The catchphrase in the mission of the microfinance is ‘alleviating poverty by reaching the very poor’. The extent to which MFIs are able to reach the poorest of the poor with their services is still an open debate. Careful targeting measurements are necessary (Woller and Schreiner, 2004). The poorest are those people belonging to the bottom fifty percent of the group of people living below a country’s nationally defined poverty line. As there is no consensus on the definition of the ultra poor it is not simple to identify them. Aspects such as quality of life, health, women’s roles, and empowerment are difficult to quantify (Darley-harris, 2005). But most of the attributes are related to lack of access and control to assets and limited source of income. The meaning of the ultra poor needs to be seen multi-dimensionally. Various indicators should be considered like income, job, housing, geographical location, and household features (Halder and Mosley, 2004:390). The destitute also includes the poorest or the hard core poor who lack access to land, widows, women-led families, families with disabled adult male members, with no or very irregular income sources (Halder and Mosley, 2004; Darley-Harris, 2005).

There is no consensus on determining who the target clients should be. Some argue that it is more important to have a wider geographical impact on a permanent basis through microfinance institutions (outreach approach) although there may be a compromise between sustainability and reaching the poorest of the poor. Others argue that microfinance services should reach the poorest of the poor i.e., in depth targeting (Woller, 2003; Brau and Woller, 2004). For the poorest, access to credit is a human right as a security against economic exclusion (Yunus and Jolis, 1999). Addressing challenges of “defining, targeting, and reaching very poor households” makes the industry consistent with its mission of poverty alleviation. Three approaches are employed to identify who the poor is using information on calorie consumption (direct method), data on income/expenditure (indirect method), and the perception of the respondents (qualitative method) (Halder and Mosley, 2004: 389). Different MFIs have set their own techniques of reaching the poor. The basic essence of these methods is on how to attract the poorest and discourage the better offs. Among those practically employed methods are the CASHPOR (Credit and Savings for the Hard-core Poor) housing index, participatory wealth ranking (PWR),

The CASHPOR housing index is based on looking at the quality and condition of a house. It takes into account the size, physical condition, and building materials of the house. People living in houses constructed from mud bricks, with poor quality roofing, small windows and in a general state of poor condition tend to be selected as the poorest. In the participatory wealth ranking (PWR) community members rank themselves according to their understanding of poverty. Geographical distribution of poverty serves to identify area of intervention for the microfinance service providers. Moreover, limiting the size of credit to be given is also another technique that discourages the non-poor from joining microfinance. Another way of identifying the very poor is house visits of potential clients. This lets credit officers to get first hand observation on the living condition of the poorest. It also helps to exchange information about income and expenditures of the family. In general, the microfinance industry demands globally recognized measures of poverty outreach to evaluate its contribution in the fight against poverty (Hatch and Frederick, 1998).

The failure of microfinance in the financial market is described as a move “from market failure to marketing failure”. Customers of MFIs are bunched around the poverty line, almost ‘moderately poor’ (top 50th percentile of households below the poverty line) or ‘vulnerable non-poor’ (households above the poverty line but vulnerable to slipping back into poverty). As experienced in most MFIs, lack of explicitly stated and effective targeting strategy leads to the “shallow depth of outreach” (Woller, 2002:305-308). Understanding the desires and needs of the very poor and offering products and services that satisfy them ensure deep outreach (Woller, 2002). Exclusion of the poor has been a “recurrent criticism of microfinance since its takeoff in the early 1990s” (Halder and Mosley, 2004:403).
2.8 Conceptual Framework for Analysis

The framework takes sustainability and wide outreach to the poor as a linking bridge between the MFIs and clients (see Figure 1). Sustainability and outreach are incentives for clients to save and repay loans for future access. They are foundations for building trust between clients and the institution. It is based on the new paradigm in rural finance that considers rural populations as bankable through effective institutions. To contribute to sustainable poverty reduction through increasing outreach, MFIs themselves must be viable, sustainable, and growing. Only viable institutions can continually increase their outreach to the poor.

![Figure 1. Outreach and Sustainability Bonding Clients and MFIs](image)

Clients are reasons for the MFIs to come into existence and to continue as a business. Microfinance firms serve clients, not program beneficiaries, of financial services. Microfinance is not charity but doing business with the poor. The majority excluded from conventional banking services need to get services and need reliable, dependable and sustainable service providers. The service provider to fulfil the demands of the clients and win trust of them should
ensure that it will exist as a service provider and being able to reach those in need of its service. When the institution is first established it is assumed as a going concern or continuity of existence with no proof unless there is a special circumstance to assume as a program with a limited life span. Microfinance businesses should demonstrate that they will survive in the financial market rather than to wither as donors impede their handouts. Institutional sustainability adds value to company resources. To reach the majority in the long-run requires being self-reliant and sustainable by securing revenues through expanding its outreach and increasing its volume of service. Both outreach and sustainability are affecting and affected by clients and the company.

Outreach and sustainability are the twin objectives of MFIs. Increasing the depth of outreach and financial sustainability are compatible objectives in the sense that increasing scale of operations will also increase the absolute number of poor people among clients. Outreach is expanding service delivery to the poor. Building of lasting, permanent financial institutions requires that they become financially sustainable through value maximization beyond covering costs. The third policy objective relates to the impact of financial systems development, particularly on poverty reduction, which is outside the scope of this study. There are potential synergies among these objectives of microfinance policy. Firstly, financial sustainability is likely to be perceived by potential clients as a critical indicator of institutional performance in the long run to become and stay as clients. Thus, greater financial sustainability can positively influence outreach. This synergy is even important for savers who must have faith in the permanence of the institution to which they entrust their savings. No one will save with an institution that is considered to be only temporary. Secondly, striving for financial sustainability forces institutions to be sensitive to client demand and induces them to improve products, operations, and increase outreach. Better financial products, in turn, generate greater economic benefits for clients and thus greater impact and enhance income to the firm. Serving up to the expectations of clients is to mean marketing services beyond and by far from disbursing money to them. Efficient and effective service delivery is decisive to success. The clients should not be forced to assume costs arising from institutional failures and inefficiencies. Having a vision of achieving sustainability and working towards that goal helps in building financially self-sufficient, subsidy free, locally managed and free of donor strands business (Ledgerwood, 1999).
Performance standards help to determine how well MFIs are doing financially and operationally. Financial statements of balance sheet and income statement as well as operational reports are required to construct ratios (Ledgerwood, 1999). These standards are ratio analyses and calculations expressed in terms of percentages and averages with their interpretations employed both as part of the company’s management information system and for external users. The management of the firm, supervisory agencies, financiers and other stakeholders use ratio analyses. These standards are helpful to make industry comparisons, variance and trend analyses. Ratio analyses help to evaluate profitability, investment utilization, liquidity, stability, and growth of a firm. They also facilitate operational and financial decisions. They are a key step in assessing the performance and financial position of a firm. These performance standards, which are mainly quantitative, should also be augmented with other information related to clients’ characteristics. Even if ratio analyses are based on historical data, obviously they do have also predictive value. However, users should take into account that ratio analyses do have limitations. Ratio analyses are subject to qualitative factors and being quantitative only. They are also affected by the effect of inflation, industry trends, external factors, ratio definitions, differing accounting policies, changes in accounting policies, and time frame of analysis. They are constructed from historical data. Despite these limitations, proper use of financial ratios and interpretations can provide invaluable insight for interested users. The six major areas outlined to measure performance of MFIs are outreach (breadth and depth), sustainability (viability), profitability, productivity and efficiency, capital structure and portfolio quality (Ledgerwood, 1999).

Ratios give a look at the financial results of the credit and saving operations of the institution. Profitability and sustainability ratios show the ability to go on operating and future growth prospects of the institution. Operational self-sufficiency (OSS), financial self-sufficiency (FSS), return on equity (ROE) and return on assets (ROA) are the basic components of the sustainability and profitability ratios. OSS is the most basic measurement of sustainability showing the extent at which operating revenues are enough to finance operational expenses (Barres et al, 2005). IFS refers to the ability of the institution to finance operating expenses and cost of funds adjusted for inflation and subsidies from operational income. Inflation adjustments take into account the
effect of inflation on assets. Subsidy adjustments consider donations and cheap loans below the market rate. These adjustments help to evaluate the commercial viability and FSS (Gibbons and Meehan, 1999). Unlike OSS, FSS measures the institutions ability to cover not only operating costs but also value maximization and expansion and growth with no dependence on subsidies. In other words, OSS measures survival where as FSS indicates ability to grow. In calculating FSS, there is a need to adjust for inflation and cost of funds. Cost of funds is determined using market interest rate applied on average funding liabilities, deposits, and cheap borrowings. Institutions should strive to achieve FSS of greater than 100 percent (Barres et al, 2005; CGAP, 2003 and Ledgerwood, 1999).

ROA measures how well assets are utilized to maximize profits. ROA is higher for institutions that are able to keep a higher ratio of portfolio to assets. ROE indicates the institutions competency to maximize the wealth of owners, increasing its accumulated earnings, and raising more equity investment. ROE discloses the institutions ability to use retained earnings and donor funds in its efforts to become sustainable (Barres et al, 2005). Efficiency and productivity indicators show “how well an MFI uses its resources, particularly its assets and personnel”. Operating expense ratio, cost per loan, borrower per loan officer, clients per staff member and average loan size are some of the ratios used to assess efficiency and productivity (Barres et al, 2005:77). Efficiency is “to maximize output from a set amount of inputs”. Average number of active loan clients and average loan portfolio per loan officer are the two basic measures commonly used to monitor efficiency of the field staff (Gibbons and Meehan, 1999:145,151). Capital structure ratios include computations of percentages and averages using balance sheet accounts related to resources and sources to these resources like debt-to-equity and debt-to-assets ratios. These ratios are important mainly to investors and lenders to determine how leveraged the firm and to assess its capital adequacy to absorb losses before creditors are at risk. Portfolio quality indicators help to assess the over all health of the portfolio, customer satisfaction, and practice of staff monitoring and follow-up. The portfolio-at-risk (PAR), repayment rates, and loan loss ratios are indicators for portfolio quality. PAR is “the most widely accepted measure of loan performance in the microfinance industry” (Barres et al, 2005: 75). PAR is the best measure of loan portfolio quality unlike the repayment rate commonly used in conventional banks (CGAP, 2003; Gibbons and Meehan: 1999 and Ledgerwood, 1999).
CHAPTER III. INSTITUTIONAL PROFILE OF ACSI

In this part of the paper an attempt is made to give a highlight on microfinance industry at national level in general and ACSI in particular. A brief coverage is given on its establishment, vision, mission and objectives, ownership and governance, and financial services landscape in the rural Amhara Region.

3.1 Industry Overview

As the level of poverty is deep rooted in our nation it requires diverse measures. Access to financial services to the poor is taken as an alternative to enhance the employment and income generation opportunities through asset-base creation. Hence to reduce the poverty rate microfinance is taken as a strategy and the Ethiopian government issued proclamation No. 40/1996 on 5 July 1996. Microfinance business means an activity of extending credit, in cash or in kind, to rural and urban communities, the loan size of which shall be fixed by the National Bank of Ethiopia (NBE). Microfinance institution means a company licensed under this proclamation to engage in microfinance business in rural and urban areas. The major purposes of MFIs are granting of credit and accepting of saving deposits. MFIs must obtain a license from the Bank and be formed as a share company with a minimum paid-up capital of Birr 200,000. As to the regulation MFIs shall device and execute a policy whereby the low-income sections of society, especially in rural areas, get access to credit. The institutions shall use social collateral to solve the problem of securing usable property guarantee from potential poor clients (Federal Negarit Gazeta, 1996:246-251).

Currently there are 27 MFIs operating with the other two in the pipeline to join the industry. Still the market is largely untapped given that half of the institutions are working in Addis Ababa. Even if MFIs operate both in urban and semi-urban areas, clients in rural areas do have a limited choice among alternative service providers. It is estimated that Ethiopia needs at least 300 MFIs to satisfy the growing demand for microfinance services (Berihu, 2005). As of September 2006,
According to the information from the Association of Ethiopian Microfinance Institutions (AEMFI), a network of Ethiopian Microfinance Companies, there had 1.48 million active clients with an outstanding portfolio of Birr 2.04 billion. On the same date, MFIs were able to mobilize savings of Birr 754.6 million with 2.71 billion and 818 million assets and net worth respectively. These institutions owe 1.89 billion Birr. In fact, the big five of government affiliated MFIs, the Amhara, Addis, Dedebit, Oromia, and Omo, operating in five of the regional states account for almost 80% of loans outstanding and total assets of the industry. These five institutions have served and accounted for more than 80% of total active clients and capital in the industry. Hence, those big fives are the leading in microfinance business. The position of ACSI in the industry seems dominant that it accounted for 35% of active clients in the industry with 30% of loans outstanding, 44.4% of client savings, 29.4% of total assets and 25.6% of capital of the industry as of Sept. 30, 2006 (AEMFI, 2006). The growth in the number of service providers in the country is encouraging with a market requiring more to join.

### 3.2 Establishment, Ownership and Governance

ACSI is operational in the Amhara National Regional State located in the north-western part of the country headquartered at the Regional capital of Bahir Dar city. The genesis of ACSI dates back to the 1995 as a semi-autonomous department of the then Ethiopian Relief Organization (ERO), the current Organization for the Rehabilitation and Development in the Amhara (ORDA). The institution recognized as a licensed micro financing company in April 1997.

Shares of ownership are allocated as the regional government (25%), ORDA (35%), Amhara Development Association (20%), Amhara Women’s Development Association (10%) and Endeavour, an umbrella foundation for party-associated business enterprises (10%) (ACSI, 2004). The board of directors having eight members sets the policy directions of ACSI. The board consists of three committees of audit, compensation and incentives, and risk management. The managing director appointed by the board runs management of operations. ACSI has designed and implemented functional based organizational structure having departments of finance and logistics, credit, savings, internal audit, human resource and administration, and promotion and
documentation. It has a three tier organizational structure of head office, branch, and sub branch offices (see figure 2). The head office and the branch offices provide administrative guidance and supervision tasks. The operational tasks of financial product and service delivery are done at sub branch office. The institution secures utmost support from the state government. Even if interest rate ceilings have been already waived by the NBE still ACSI is charging the lowest interest rate MicroRate has experienced. Monthly reports are prepared at head office, branch, and sub branch offices. ACSI is required to report to the NBE every quarter (MicroRate, 2005).

3.3 Vision, Mission and Objectives

ACSI has set a vision to see a poverty free capable society. It operates with a mission of providing financial services to low income productive poor in the Amhara region to improve their economic condition and well-being. It aims at ensuring cost-effectiveness in operations and integrating its activities with other stakeholders working in the Region. The basic objectives of the institution are assisting diversified economic activities of households with greater outreach to impact and achieve institutional sustainability. To realize its objectives it has crafted strategies of community participation, women’s empowerment and savings mobilization as a means.

ACSI offers services and products of credit, saving, money transfer and pension administration. Credit is given only for income generating activities based on formation of solidarity groups. It does not extend consumption loans. Its portfolio is highly dominated by agricultural credit. ACSI encourages the public to save both loan clients (compulsory) and others. Pensioners in the Region have got their monthly stipends from the institution through its regional network. It charges the Pension and Social Security Authority a fee for this service. Its local money transfer service is limited to organizations only. The major financial sources of ACSI are capital contributions by shareholders, donations, income from operational and non-operational activities, and savings mobilized (ACSI, 2004).
Figure 2. Organizational Structure of ACSI
3.4 Financial Services Scene in the Rural Amhara Region

ACSI is operational in the Amhara National Regional State located in the north-western part of the country headquartered at the Regional capital of Bahir Dar city (see figure 3). The Region has an estimated total population of more than 20 million (CSA, 2006). More than 85% of the population in the Region lives in rural areas leading a miserable life of hand-to-mouth based on subsistence agriculture. The Region covers an estimated area of 159,174 square kilometres, almost half of Norway. According to the Bureau of Finance and Economic Development (BOFED), 42% of the population lives in absolute poverty. The GDP per capita is Birr 795.00 and life expectancy at birth is 50 years. The literacy rate is below 18% (BOFED, 2003 in BOFED, 2004: 2). The average family size is five persons. Land ownership, the key asset for rural households’ survival, is less than a hectare. The farmers practice traditional farming tiling with oxen and traditional tools. Lack of well-functioning and sustainable financial institutions has its own contribution for the existence of abduct poverty in the Region (BOFED 2004: 3-1).

The demand for financial services by the rural households is untapped compared to the availability of such services in the Region. According to the survey conducted by the BOFED there is a high demand for credit services in the Region. It is estimated that 58% of the households require getting financial services for various purposes. Yet the rural households having access to credit in the Region are below 30%. The source of borrowing for the majority poor is the informal financiers. The lion’s share (57%) of credit financing for the rural poor is channelled from informal sources like local money lenders, friends and relatives, churches, and merry-go-round associations where as the rest is covered by semi-formal financial institutions like ACSI and co-operatives. The loans are taken for consumption smoothing (41%) and financing production activities (59%). The reasons for borrowing are for the purchase of agricultural inputs (25%), trade (6%), household consumption (41%), purchase of farm animals (23%) and handicrafts (0.8%). Most of the credit from informal sources is used for consumption smoothing unlike credit from semi-formal sources that is mainly for the purpose of income generating activities. Credit from local moneylenders or usury is very exorbitant that the interest rate on average is 100% per year. The demand in free labour and other preconditions by the local
moneypanders make the credit from such sources highly unaffordable for the poor; in fact next to none for those having no option. ACSI has provided larger loans compared to co-operatives and others. According to the survey of the BOFED, “male-headed households have been highly accessible to credit than female-headed households”. It is believed that MFIs can bridge between commercial banks and farmers cooperatives to reach rural households. Nevertheless the study claims that these institutions “should be independent and the government should create an enabling environment for proper functioning of the institutions”. Capacity limitation and poor credit modalities of service providers are constraints to households’ access to the financial services from the existing semi-formal financial institutions (BOFED, 2004: 3, 7, 19, 20, 23, and 36).

Keeping savings for various purposes seems poor in the Region that only 16% of the respondents do have savings. Moreover, it is practiced in a traditional way that more than 67% of the rural households save mainly in non-financial assets like domestic animals and grain rather than cash. Only 33% of the households keep their savings in financial forms. The level of saving is minimal and the experience of keeping savings in financial institutions in the region is very poor. Depositing savings in financial institutions is limited at only 3% out of which 79% used ACSI and 19% in the Commercial Bank of Ethiopia. Low savings are attributed to low level of income, discouraging facilities and incentives. Access to credit in the survey area where this study has been conducted is 30.1% where the purposes of borrowing are agricultural activities(73%), trade(8.9%), consumption(22.6%), handicrafts(0.9%) and others(1.4%)(BOFED:2004,16,33,37).

Figure 3. The Strategic Positioning of ACSI

CHAPTER IV. RESULTS AND DISCUSSION

This section of the paper is constructed on the three objectives of evaluating the outreach, service delivery, and sustainability of ACSI. Breakdowns are made according to the research questions outlined to answer those objectives. The detailed analysis of the performance of ACSI supported with survey data and financial and operational reports is presented. Firstly, outreach performance in terms of scale and outreach is presented. The feedback of the clients on service delivery follows next. Finally the sustainability and portfolio quality measures are presented with ratio calculations and their interpretations. Where it is possible both trend analysis over the five year operational period from 2001 to 2005 as well as benchmarking or comparisons with peers in the industry are given. The sustainability position of ACSI is determined based on operational and financial self-sufficiency ratios presented. Portfolio quality tests are the closing discussions.

4.1 Outreach Performance of the Institution

This section covers credit and saving service delivery briefly and outreach performance in terms of breadth and depth.

4.1.1 Overview of Methodologies of Credit and Saving Provision

ACSI strongly stresses that the business approach in its operation is a guiding principle and the way to ensure institutional sustainability. It clearly stipulated that in business nothing is for free. ACSI gives its financial services on fee basis. Interest is collected on credit extended and paid for savings accepted. Fees are charged for other services like local money transfer and pension administration. To get credit from ACSI clients are required to pass through rigorous screenings and evaluations (ACSI, 2006). An overview of the methodologies followed in credit and saving services are given in this section of the chapter extracted from operational manual of the institution.
4.1.1.1 Client Selection and Credit Modalities

Effective and profitable financial service delivery requires identifying who the potential clients are and differentiating the market base on credit demand. The microfinance business is characterized by the existence of different market niches (Paxton and Fruman, 1997). MFIs know that very poor clients are among the potential market niches beyond the social perspective (Helms, 2006). In the case of ACSI the productive active poor with the demand for such services are the target clientele. Hence, as much as possible, even if it is hard to set clear-cut criteria to identify the poor, the institution has established some selection strategies. Potential clients are those economically productive urban and rural poor lacking access to conventional banking services. Loan applicants are expected to be those in need of working capital and able to utilize the loan in productive ventures. Focusing on the poor, they should have a know-how on the type of activity to do; those who are able to make profit using the credit they get and benefit themselves and their families, improve their living condition and able to repay their loan timely. ACSI takes into account age, gender, personal characteristics, and wealth condition in selecting clients. Some of the criteria used in selecting a potential client are:

- aged 18 to 60
- permanent resident in the community
- low annual income (unable cover their annual expenditures)
- own one ox or none no previous debt from any source
- free of any mental illness or other illnesses that prohibits from working, and
- free of socially unacceptable behaviours like theft, drunk, and prostitution

Civil servants with an annual income of not greater than Birr 1,100.00 with a productive household member can qualify as a client. Priority is given to women clients keeping all the above criteria (ACSI, 2006). Targeting women is necessary to impact on poverty because women use their income for the well-being of the household and empowers women in making economic decisions (Greeley, 2005).
New clients are selected based on community participation. There is a credit and saving committee at county level organized for the purpose of screening viable clients. This helps to reduce transaction costs and minimize information asymmetry. It is believed that the committee adequately knows qualified potential clients according to the criteria of the institution. Starting from the second loan, credit decisions are made by the sub branch office (ACSI, 2006). Acquiring information about potential clients has a contribution in reducing risk and lowering costs. Collecting information concerning the characteristics and credit worthiness of borrowers is costly. A solution to information asymmetry problems in microcredit has been “relation-based financing” (Pollinger et al, 2007:23). Well-informed clients about the performance of the financial institution will also be benefited in making choices among alternative service providers. Clients particularly depositors trust and become confident on those institutions that fully disclose financial performance and interest rates (Helms, 2006).

Group lending methodologies are still the possible way outs for reaching the poorest that lack physical collateral. ACSI follows group lending methodology that a group is taken as a social security to guarantee for a loan in case a member defaults. Each group member guarantees for the rest of group members. Each member is accountable not only for his or her loan but also for the rest of group members’ loans. Only group members are liable for unpaid or overdue loans within a group. Before lending credit, clients are expected to form groups by themselves with no external pressure or interventions that contravene their interest and willingness (ACSI, 2006).

Group members should have no family ties. It is preferable if members in a group have more or less similar economic capacity or living status, live in the same county and almost take relatively equal loan amounts. Group members range from 5 to 7 and 10 to 15 groups form a centre. While in group formation, the required trainings on credit and saving management will be given for not less than 3 to 5 days. They will also be trained on group formation, group liability, institutional rules and regulations and drafting of group and centre bylaws. These group members will prepare and sign centre bylaws. Members will choose their group and centre leaders. The tenure for group and centre leaders will be for only one year. This is to make all members experience leadership skills. Group leaders will work in consultation with other group members and represent their group while dealing with field officers. The group leaders submit loan
applications of members, monitor and follow-up loans given to members and timely repayments, assist credit and saving officers in saving and repayment collections. They also serve as a witness in collection of cash whether it has been done properly (ACSI, 2006).

The centre chairperson is the centre leader and representative. He/she is next to the credit and saving officer in coordinating the credit activities and procedures. While collecting cash the centre leader controls discipline, checks whether all the members have paid any balance due, and records those failed to pay. He/she checks for proper accounting of amounts and balances on collection sheets and clients’ passbooks. This is facilitated by every member giving his passbook and the amount of money to be paid to the centre chief and then to the credit and saving officer intact (ACSI, 2006).

4.1.1.2 Organization of Credit and Saving Committee

The credit and saving committee is to be organized from regional level to the lower county level. Number of members from district to regional level can be from 3 to 5. Members of the credit and saving committee include chairman of district administration, public relations officer, ACSI officer, representatives of district public associations, district information officer, administration and security officer. At county level, the credit and saving committee will have 5 to 7 members. This includes county chairperson or vice chairperson, county public relations officer, public associations’ officers or leaders (associations like women, farmers, and youth), ACSI credit and saving officer, and administration and security officer. In the absence of associations, one man and one woman nominated by the community will be members. The credit and saving committee organized at community level has contributed in minimizing information asymmetry problems about the creditworthiness of clients. The committee also assists in loan monitoring and follow-up as well as putting pressure on timely collection of loans. Much of the burden on initial client selection rests on the committee.
4.1.1.3 Credit Appraisal, Loan Disbursement and Repayment Terms

ACSI advances credit only to income generating activities. No consumption loan is granted. The institution finances activities like farming, husbandry and animal fattening, petty trade, agribusiness, handicrafts, and service businesses. The loan size the clients requested is to be decided considering various factors. These include the type of activity the client engaged in, borrower’s capacity, rough budget of expenditures, credit history, institutional capacity and regulations of the supervising agency. As per the regulation of the NBE the maximum loan to be given to a single borrower is Birr 5,000.00. The minimum loan amount is Birr 300.00 as set by ACSI. The institution has set a limit on average loan size not to exceed Birr 1,500.00 in a given year. This seems taking into account loan size as a proxy indicator of the level of poverty of clients and discouraging better-offs from joining. Clients should get consent of their group members to get a loan. The customer should understand and be aware of the credit terms of repayment period, interest rate, and activity to be financed with the loan. Before granting the loan all the necessary procedures should be completed like completion of forms and spouse signature. Getting signature of the spouse is vital in enforcement of repayments, mutual accountability, and proper credit utilization. Sometimes credit granted without knowledge of the spouse leads to conflict in the household and even to the extent of divorce. For instance taking a loan without consulting the spouse and later bankruptcy either due to business failure or misuse may lead to divorce when the institution claims repayment later.

ACSI follows progressive lending technique in determining loan sizes. New clients are assumed to have less understanding and awareness about institutional procedures and loan utilization resulting high credit risk. The loan given in the first round ranges from Birr 300.00 to 1600.00; for animal fattening and petty trade it will be 2,000.00. The second loan will not be more than twice the first time loan amount. The third round loan will not be more than 75% of the second loan taken. If the client’s financial management capacity is improved step by step the fourth loan will be the third loan plus half of it. The fifth and above round loans will be given up to Birr 5,000.00 taking into account clients’ business plan (ACSI, 2006). A higher risk and return is attached with the increase in amount of loan.
Commonly there are two loan products and credit repayment conditions followed in ACSI. These are the instalment and term loans. The instalment term is highly appreciated and encouraged from institutional perspective to minimize risk of losses due to default. It is also helpful to the debtor as the burden of debt amortized step by step. Loans given to petty trade, handicrafts and service businesses are amortized monthly over a year with equal instalment. Other clients regardless of activity in which they are engaged in are encouraged to settle their debts on instalment basis rather than waiting till the last due date. Term loan refers to a contract to settle the total maturity value on the maturity date. Hence the client will enter into a contract to pay the principal plus interest on the specified date. This term of credit assumes the flow of income for clients to be once. However, for some activities some may pay monthly and others on quarterly or semi annual basis rather than waiting for the last minute of repayment. It may be possible to arrange repayment terms for every 3 or 6 months time for customers engaged in beekeeping and animal fattening. Repayment arrangements fit with clients’ income flows. However, beyond the expected cash flows from the financed project, analysis should be made by de-linking repayments from loan use taking actual cash flows of the household today (Helms, 2006). Special attention should be given to term loans compared to instalment loans on the feasibility of the activity and appraisal of the loan. Most of the time term loan clients are engaged in agricultural activities. Term loans account for the lion’s share of credit granted to clients accounting for 70% of the portfolio as of June 2005 (MicroRate 2005:4).

The interest rate on loans is 18% per annum or 1.5% per month or 0.05% per day. Interest is calculated on declining balance method for instalment loans; not on flat rate basis. Interest rate for efficient microcredit to the poor varies between 35% and 51% of their average loans outstanding taking into account terms of credit and portfolio quality (Gibbons and Meehan, 1999:131). The interest rate charged by ACSI on loans is the lowest compared to Gibbons and Meehan’s findings. A penalty of 2% is charged for on past due balances. The penalty is calculated on the principal amount past due. If there is no hope of securing a repayment of a loan after all efforts has been made, the credit will be written-off once the case is taken to court and the client’s inability is decided by jurisdiction (ACSI, 2006).
4.1.1.4 Provision of Saving Services

The other side of the coin of microfinance service delivery is savings. Savings are the major part of sustainable financial service delivery to the poor. Acceptance of saving deposits may “represent the more valued financial service in many instances”. Savings as an internal source of funding portfolio can contribute to better institutional cost consciousness (Paxton, 1996:22). Saving facilities benefit the poorest better than credit as “loans harm rather than help” (Greeley, 2005:23). ACSI accepts savings from all sectors of the society. Savings are collected from loan clients as well as the public including institutions and organizations. Saving products of ACSI are classified as voluntary and compulsory savings. Voluntary savings further divided into passbook savings, time deposits, and non-interest bearing accounts. The minimum initial deposit to open a passbook saving account is Birr 2.00 which is affordable to the poor compared to Birr 50.00 required to open a saving account in conventional banks. Clients having a saving account can deposit starting from Birr 1.00 (ACSI, 2006).

ACSI serves a joint account saving in which two or more persons run the account jointly. Another type of savings product is minor’s saving account offered to children below 18 years that mentors or parents open on behalf of them. Compulsory savings is required from those clients in need of credit. Credit clients are required to save 3-5% of the loan amount they requested to take before receiving credits. After taking credit it is mandatory to save 1% of the loan taken monthly. Compulsory savings are tied as a security till all group members settle their debt. The interest on savings accounts is 4% that is better than the 3% interest payable at conventional banks. Fixed or time deposit is made with a special agreement entered between the depositor and ACSI to keep the money for a fixed period of time and getting a better interest in return (ACSI, 2006). Currently ACSI is not offering a current account.
4.1.2 Socio-Economic Condition of Clients

The survey conducted for this study incorporated some of the major characteristics of the clients and their socio-economic condition. The common attributes of the poor were lack of basic literacy and numeric skills, livelihood dependent on subsistence agriculture, small land ownership, large family size, and low per capita income.

4.1.2.1 Socio-Demographic Characteristics of Clients

Almost all clients were in the productive age group with a range from 19 to 66 but an average age of 35.19. All clients were engaged in agriculture except one who provided service of selling local drink. The majority (95%) were married, 3.4% were either divorced or widowed and 1.7% single status. Regarding the literacy level of clients, those who were not able to read and write a single statement are 76.3%, with basic literacy were 16.9%, grades one to six level were 5.8%, and those completed grade nine were only 0.8%. The average family size was 5.48 where half of the sample clients fall in the range of 4 to 6 members. Households having at least one family member aged below 15 were 90.7% of the total sample with overall average of 2.5. The average household size as to the survey conducted in 1999/00 was 4.6 and 4.9 for the Amhara region and at country level in rural households (MOFED, 2002). The survey conducted recently by the BOFED of the Region revealed that the average family size per household was five persons (BOFED, 2004). However, the clients of ACSI have larger family size compared to the two averages both at regional and national level. This implies that ACSI clients have many family members, which may demand policy revision of incorporating family size when selecting clients beyond the criterion of possession of one or no ox. The dependency ratio for ACSI clients was lower compared to the national level. It may be possible to say that clients with more productive family members do need and take credit as a result of having more labour to employ. The number of female-headed households from the sample was less than 5%. However, female-headed households account for 23% at national level in rural areas (MOFED, 2002). Hence, ACSI should work towards attracting and serving female household heads mainly those of widowed and divorced due to the burden they are assuming as a family head.
4.1.2.2. Housing and Utilities Conditions

The number of rooms for dwelling ranges from single to three rooms. Of the respondents, 47% lived in a single room, 45% has two rooms the rest of them own 3 rooms. The mean number of rooms was 1.64. The average number of rooms per household for ACSI clients seems better than those of regional and national averages. But comparing the mean number of rooms per household member for each of the three levels of comparison, ACSI clients have the lowest ratio of rooms per a family member. The wall was made of wood and mud for all clients of ACSI. The roofing quality was better for ACSI clients made of iron sheets (59.3%) compared to the lower percentages of 21.3% and 14.8% at regional and national level. It was only 40.7% of ACSI clients whose house roofing made of grass. No access to electric lighting for more than 97% of ACSI clients which was also similar at regional and national level. People mostly used kerosene lamps as a lighting source in rural areas. ACSI clients seem better to use toilets even if it was below 20% compared to 2% and 9% at regional and national level for rural households respectively (MOFED, 2002). Firewood and dung were almost the only source of cooking fuel for ACSI clients as well as rural households in the region and at national level.

Given the poor access to safe drinking water in rural areas at regional and national level, clients of ACSI did not have any way out of the problem exceptionally. Hence, more than 80% of ACSI clients alike their counterparts in the region and country level depend on unsafe water fetched from rivers, ponds, streams and open access common wells. The major sources of drinking water were streams, rivers, and ponds (67%). Those having access to common well were 25% and only 8% do have access to public pipe water.

4.1.2.2 Food Consumption and Asset Ownership of Clients

The majority of the respondents (70%) did not take meat, egg, and milk in their dishes. Those who took these stuffs one to two days in a week were 23% and only 7% of them took 3 to 4 days in a week. It was only 9% who can afford three meals a day and the rest were able to have only two meals a day. The majority (93%) did not face food shortages even for a single day within the last 30 days. Similarly those who did not encounter food shortage at least once in a month during last year account for 92% of the respondents. It was only 5% of the respondents who miss dinner
in a month and went bed with empty stomach. Almost 95% took their dinner in a month’s time. The average number of meals was 14.64 per week.

The ownership of assets mainly livestock before joining ACSI has been assessed. The tropical livestock unit was used to convert different livestock to a similar unit (Sharp, 2003). As indicated on Table 1, the ownership of livestock in terms of Tropical Livestock Unit for Ethiopia (TLU) was 2.9 per household before joining ACSI. This figure has declined after joining ACSI which was coming down to 2.4 TLU. The reasons for the decline in ownership of livestock after joining ACSI need further investigation through conducting researches related to impact. The average cattle ownership was lower for ACSI clients which were 2.4 per household compared to 3.6 and 4.1 for the region and the country rural households (MOFED, 2002). Of the total respondents 56% had none or one ox; those who owned two oxen account for 35% and 9% had three oxen. The average ox ownership was 1.43. Almost more than 97% of ACSI clients and rural households at regional and national level own land. It was only 2.5% of clients who did not have land. The average land holding was 1.26 ha. More than half of the respondents (66%) owned 1 ha of farmland, 26% had 2 ha of land, and 5% owned 3 to 4 ha of land. Those who practiced farming on rented or leased farmland were only 37% making the average as low as 0.26 ha. Only 32% of the respondents had shoes. Radio and tape recorders, which are considered as a luxury in rural Ethiopia, were owned by only 29% of the households.

Table 1. Livestock and Ox Ownership Before and After Joining ACSI

<table>
<thead>
<tr>
<th>Ownership of Livestock (%)</th>
<th>Ownership of Ox (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tropical Livestock Unit (TLU)</strong></td>
<td><strong>Before</strong></td>
</tr>
<tr>
<td>Below 1.00</td>
<td>9.3</td>
</tr>
<tr>
<td>1.00-1.99</td>
<td>28</td>
</tr>
<tr>
<td>2.00-3.00</td>
<td>23.7</td>
</tr>
<tr>
<td>More than 3</td>
<td>39</td>
</tr>
<tr>
<td><strong>Mean</strong></td>
<td>2.9</td>
</tr>
</tbody>
</table>

Source: Survey data (2006)
4.1.2.3 Income and Expenditures

The mainstay of the clients was agriculture that the annual income comes from farming and related activities. A few clients earned a very limited amount of income from off-farm and non-farm activities. Income from off-farm and non-farm activities was on average Birr 116.45 per annum. The mean income for all the respondents was Birr 3,136.88 per household per annum. However, the mean annual income per household member (per capita income) was Birr 572.00. This implies that the daily per capita income is below Birr 2.00. Clients whose per capita income was below Birr 572.00 per year account for 60%. Almost all clients (99%) earned income below USD $1 per day (which is equivalent to Birr 8.8 at the exchange rate during the survey).

Food was the major expenditure item of the total budget (60%). Non-food expenditures account for 40% of the mean expenditure. The mean expenditure for the sample respondents was Birr 2984.89 per household. The Mean annual expenditure per household member (per capita expenditure) was Birr 544.00 that the daily per capita expenditure was below Birr 2.00. More than 60% of the clients earned below the mean per capita expenditure of Birr 544.00. The average food expenditure was lower for ACSI clients compared to the Regional and National level. The per capita expenditure was very small for ACSI clients, even without deflating for price indexes to the prices of 1999/2000, compared to the regional and national level of real per capita consumption expenditure. With no price adjustment, the level of expenditure used as absolute poverty indices set at national level by the MOFED was Birr 1075.00 for 1999/2000(MOFED, 2002). This is higher than the average found for ACSI clients in the survey. Almost 91% of the clients’ per capita expenditure was below the absolute poverty indices. This shows that the clients of ACSI are absolutely poor. Moreover, this finding requires further investigation and should be supported with rigorous study.
4.1.3 Scale and Depth of outreach

Scale or breadth refers to the number of clients served where as depth of outreach indicates the type of clients and their level of poverty. Outreach indicators are both qualitative and quantitative. In fact, it is difficult to set a precise measure for depth of outreach unlike scale of outreach. Outreach is assessed in terms of number of staff and clients. Operational area coverage, amount of portfolio disbursed, and savings mobilized also indicate outreach in terms of breadth. The difficulty in outreach is when examining the depth of outreach to know how poor the clients are as per the mission and targeting strategies of the institution. Some proxy indicators have been used to say how poor the clients of ACSI are. Average loan size may be taken as a proxy measure for depth of outreach. The rural inhabitants, women, the poor, and the uneducated are among the disadvantaged sections of the society who lack access to financial services and taken as proxy indicators of depth (Paxton and Fruman, 1997). The illiterate do face clear problems of getting financial services that involve a bulk of paper works. ACSI has coped with such obstacles through techniques of like oral training and screening, social collateral, and the use of thumbprint signatures.

As of the end of 2005, shown on Table 2, ACSI has given an employment opportunity to more than 1900 staff that more than 60% were credit officers. It has been able to cover 2358 counties of the region, which was more than 70% of the whole region. As of the same date ACSI has active loan clients of 434,814 organized in 88,767 groups and 5507 centres in which female clients account for 37%. Since its establishment, it has been able to serve 791,232 credit clients, disbursing over 1.6 million loans and more than Birr 1.5 billion. There is an increase both in terms of number of loans and average loan size disbursed from year to year. For instance the average loan has increased from Birr 751 in 2001 to 1,126 in 2005. The number of loans has more than doubled between 2001 and 2005. Compared to the potential demand for financial services of almost three million people in the region, the institution, in cooperation with other institutions and credit and saving cooperatives, is able to satisfy only less than 15 % (Getaneh: 2004).
The number of active clients has grown by far when comparing 2001 to 2005. It has increased by 185%. Similarly the number of clients served in 2005 was three fold compared to 2001. The cumulative number of loans, value of loans disbursed and portfolio outstanding have increased by 240%, 330%, and 271% respectively in 2005 compared to the balances reported in 2001. The average loan size per client has increased over the five year period. It was almost Birr 1000.00 in 2005 but less than Birr 800.00 in 2001. This might be attributed to disbursement of larger loans to old clients who have demonstrated their debt paying capacity and credit management experiences. ACSI has mobilized net savings of Birr 239.4 million in 2005 compared to 31.8 million in 2001. The institution financed 54% of its loan portfolio from savings in 2005. In fact, this shows an encouraging achievement on savings mobilization as well as a need to do more so as to cover all loan funds from savings.

There was a dramatic trend of change in savings mobilization. Both the number of savers and monetary amount of savings has increased over the five years. The number of savers grown more than twice in 2005 compared to 2001. Total savings mobilized increased almost eight-fold in 2005 compared to 2001. However, the deposit to loan ratio declined from 89% in 2001 to 54% in 2005. This could be attributed to a higher pace of loan disbursement under aggressive mobilization of savings. Hence, the growth of loan portfolio was higher than the increase in savings. Moreover, it can disclose institutional ability to deploy savings mobilized to loan portfolio, which is diversion of cost bearing liabilities of savings to earning portfolio from period to period. This also indicated the financial management capability and progress of ACSI in properly managing savings money keeping its liquidity optimal. When compared with other African MFIs, The average outstanding loan portfolio per borrower and average savings balances per client of ACSI was the lowest than other African and East African amounts. The average loan and savings balances were Birr 2,702.00 and 1,206.00 for Africa and Birr 1,540.00 and 1,082.00 for East African firms respectively. ACSI had the lowest average loan and savings balances of Birr 1014.00 and 344.00 respectively in 2005(Lafourcade et al., 2006:7-8).
Table 2. Outreach in Operations for the Period 2001 to 2005

<table>
<thead>
<tr>
<th>Indicators</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit Outreach</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Number of Staff</td>
<td>1176</td>
<td>1308</td>
<td>1479</td>
<td>1670</td>
<td>1915</td>
</tr>
<tr>
<td>Total Number of Credit Officers</td>
<td>676</td>
<td>805</td>
<td>891</td>
<td>1049</td>
<td>1169</td>
</tr>
<tr>
<td>Credit officers to total staff ratio</td>
<td>57</td>
<td>62</td>
<td>60</td>
<td>63</td>
<td>61</td>
</tr>
<tr>
<td>No. of Active Clients(Loan)</td>
<td>152565</td>
<td>215970</td>
<td>288681</td>
<td>351163</td>
<td>434814</td>
</tr>
<tr>
<td>No. of Clients Served</td>
<td>262880</td>
<td>363681</td>
<td>482083</td>
<td>628909</td>
<td>791232</td>
</tr>
<tr>
<td>% of Women(Loan Clients)</td>
<td>38</td>
<td>33</td>
<td>30</td>
<td>29</td>
<td>37</td>
</tr>
<tr>
<td>Portfolio outstanding for the period</td>
<td>118665161</td>
<td>155211378</td>
<td>204569376</td>
<td>308046418</td>
<td>440874511</td>
</tr>
<tr>
<td>Loans Disbursed Cumulative</td>
<td>352296755</td>
<td>516420983</td>
<td>749214624</td>
<td>1082109670</td>
<td>1515660762</td>
</tr>
<tr>
<td>Loans Disbursed per year</td>
<td>116040897</td>
<td>164124228</td>
<td>232793641</td>
<td>332895046</td>
<td>426629658</td>
</tr>
<tr>
<td>No. of Loans Disbursed Cumulative</td>
<td>485007</td>
<td>691500</td>
<td>933672</td>
<td>1240358</td>
<td>1649292</td>
</tr>
<tr>
<td>No. of Loans Disbursed per year</td>
<td>154439</td>
<td>206493</td>
<td>242172</td>
<td>306686</td>
<td>378934</td>
</tr>
<tr>
<td>Average Loan Size per Client</td>
<td>777.8</td>
<td>718.67</td>
<td>708.63</td>
<td>877.22</td>
<td>1013.94</td>
</tr>
<tr>
<td>Average Loan Size per year</td>
<td>751.37</td>
<td>794.82</td>
<td>961.27</td>
<td>1085.46</td>
<td>1125.87</td>
</tr>
<tr>
<td>Savings Outreach</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Individual Voluntary savers</td>
<td>51199</td>
<td>64333</td>
<td>101027</td>
<td>121005</td>
<td>184976</td>
</tr>
<tr>
<td>No. of Total Depositors</td>
<td>58808</td>
<td>69910</td>
<td>110724</td>
<td>134013</td>
<td>199486</td>
</tr>
<tr>
<td>Total No. of Active Savers</td>
<td>315879</td>
<td>416841</td>
<td>443365</td>
<td>541416</td>
<td>696021</td>
</tr>
<tr>
<td>Net Savings</td>
<td>31800085</td>
<td>98856347</td>
<td>128649146</td>
<td>172797439</td>
<td>239410576</td>
</tr>
<tr>
<td>Average Savings</td>
<td>100.67</td>
<td>237.16</td>
<td>290.17</td>
<td>319.16</td>
<td>343.97</td>
</tr>
<tr>
<td>Deposit to Loan Ratio</td>
<td>0.27</td>
<td>0.64</td>
<td>0.63</td>
<td>0.56</td>
<td>0.54</td>
</tr>
<tr>
<td>% of Counties in the Region covered</td>
<td>51</td>
<td>57</td>
<td>65</td>
<td>66</td>
<td>77</td>
</tr>
</tbody>
</table>


ACSI follows a targeted credit delivery mechanism of serving the productive active poor with a special focus to women clients. Priority is given to those having one or no ox in the rural areas. Yet it is arguable, even if simple the ranking method is, to take this wealth measurement as a criterion in selecting clients. As poverty is manifested in diverse ways with differing intensities even among the poor additional physical and non-physical assets measurement should be incorporated. Taking the single most criteria of ACSI, average oxen ownership was 1.43 where 56% of clients had one or no ox. Level of income and expenditure for clients discloses the depth of outreach of the institution. The per capita income and expenditure for clients was by far below the national and regional poverty lines. Taking a total sum of other poverty indicators of level of literacy, food consumption, family size and housing and utility conditions it seems possible to conclude that the ACSI is working with and for the poor and poorest sections of the society. The
livelihood of all the respondents is dependent on subsistence agriculture having larger family size of more than five members per family. Most are illiterate living in small number of rooms with poor quality dwellings lacking access to basic utilities. Almost all have been served two meals a day facing food shortages at least once in a month time over a year. The ownership of livestock in terms of tropical livestock unit for Ethiopia (TLU) is 2.4. Shoes, radio and tape recorders are not common to almost 70% of the clients. The average land holding is 1.26 hectares with the majority (66%) owning one hectare per household where mean land ownership becomes minimal given the larger family size of clients. Food expenditure accounts for the lion’s share of their total budget as is common in poor households. Another proxy indicator of depth is average loan size that the average loan amount for clients is below Birr 1,000.00 for the respondents. It increased to almost Birr 1,000.00 at institution level as of the end of 2005. To make stronger, conducting a poverty audit using tools of the Consultative Group to Assist the Poor (CGAP) that requires taking at least 500 respondents both from clients and non-clients in a community is essential (Henry, C. et al., 2003).

4.2 Client’s Feedback on the Services of ACSI

The feedback of credit clients on loan delivery, training, and customer handling of employees has been assessed and presented in this part of the study.

4.2.1. Loan Delivery and Utilization

Informal lenders were the major sources of credit before ACSI has started its services. As shown on Table 3 below, the main sources of credit before ACSI were credit from friends and relatives (45%) followed by local moneylenders (31%). The church, merry-go-round, cooperatives and others are also alternative sources but at a limited level (8%). The clients with no credit experience before ACSI account for 14%. The majority of the respondents (68%) stayed one year and less, 23% stayed from 2 to 5 years, and 9% for 6 to 8 years as members of ACSI. The loan size for the majority (70%) of clients was in the range from Birr 350.00 to 1,200.00. Of the respondents, 68% took a loan once, 22% took 2 to 4 times and the rest from 5 to 8 times. The average number of loans for the sample was 2.2. The maximum amount of loan taken since a
client joined the institution amounts Birr 11,000.00. The average loan size was Birr 930.00 (total loans to number of loans taken). Almost all the respondents shared the loan taken with family members mainly with their spouse.

Table 3. Source of Credit before ACSI

<table>
<thead>
<tr>
<th>Source</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Friends and Relatives</td>
<td>45</td>
</tr>
<tr>
<td>Local Money Lenders</td>
<td>31</td>
</tr>
<tr>
<td>No Credit Before</td>
<td>14</td>
</tr>
<tr>
<td>Church</td>
<td>4</td>
</tr>
<tr>
<td>Merry-go-round</td>
<td>3</td>
</tr>
<tr>
<td>Cooperatives</td>
<td>2</td>
</tr>
<tr>
<td>Traders</td>
<td>1</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Loan Amount</th>
<th>Range</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>350-1200</td>
<td>70</td>
</tr>
<tr>
<td></td>
<td>1201-3000</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>3001-6000</td>
<td>17</td>
</tr>
<tr>
<td></td>
<td>6001-9000</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>Over 9000</td>
<td>3</td>
</tr>
</tbody>
</table>

Source: Survey data (2006)

All the loan advances were on term basis in which the repayment period was one year except for one percent of the respondents that the credit period was two years. All the respondents took the loans for agricultural projects. More than half (55%) of the clients took for the purchase of ploughing ox followed by goat and sheep rearing (26%), animal fattening and dairy (11%), and the rest for agricultural inputs and sugar cane farming using irrigation (8%). The loans requested were mostly to finance agricultural activities posing a challenge to diversify the portfolio. It was only a small number of respondents who did not utilize the loan amount fully (7%). Some gave the reason that the loan size was small to utilize in time as intended. The loan size was sufficient for 59% of the respondents and 41% complained that the amount was not sufficient for the intended purpose applied for. Hence, loan approvals should take into account client needs and capacity. Sometimes clients may shift to another purpose when the loan approved is below the requested amount. In fact, it is common that some clients request larger loan amounts beyond their capacity at their first request. The input of the group and the credit and saving committee is vital in this instance. Especially as first time loans are litmus tests as to the capacity, discipline and debt paying ability of the client.
It took two weeks for more than half of the respondents (51%), one week for 28%, and three weeks for 21% of the clients to get credit. The average time taken to get credit was 2.08 weeks. Delivery of credit was timely for 88% of the respondents but late for the rest. At least the time to get credit should be speeded up during peak periods for seasonal activities and businesses like agricultural inputs and commodities related to a specific period. In fact, possible advantages of reaping market opportunities versus challenges of market saturation when disbursing loans at the same time to all clients should be taken into account.

4.2.2 Service Delivery and Customers Handling of Employees

Clients’ treatment and handling by the employees of the institution was very satisfactory for half of the respondents. It was satisfactory for almost 41% of them and fair for the rest. More than half of the respondents very agree on client selection procedures followed by employees of ACSI. The rest agreed on it except 3% of them who feel as fair. The groups (96%) consisted of 5 to 7 group members and only 4% did have members in the range of 8 to 11. The average member of groups was 6 clients. The average group size seems manageable. Yet, there were still groups with members of more than seven clients that have a positive effect of spreading risk but impact on proper monitoring, follow-up, conflict, and communication gap. Arrears rise as group size increases (Paxton, 1996:15). When the number of members is high there results diversity rather than homogeneity in status. Moreover, clients would be required to wait too long to get another credit until all clients settle their debt in larger groups.

Almost 71% of the clients travel 5 to 15 kms from their residence or villages to sub branch offices, which is fair compared to accessibility of other public services and economic infrastructure in the rural Amhara Region. Additionally, employees of ACSI and clients are expected to travel half of the distance each. Except loan disbursements, credit repayment and saving collections are made in the field going the cashier and security guards there at the centre meeting place, maybe around churches or other centre places selected by both clients and employees. Ease of access to the sub branches reduces transaction costs to the poor particularly during harvesting seasons.
The interest rate seems fair for the majority (70%), high for 14%, very high for 9%, low for 6%, and very low almost for 1% of the respondents. Of the improvements in the future proposed still 44% wants reduction in interest rate, 19% for product alternatives, 25% efficient service delivery, 5% for non-financial services and 16% for other improvements. More than half of the respondents (58%) preferred individual lending methodology than group lending. This demands further investigation to found out the reasons of choosing solidarity groups and vice versa. Hence, there is still a need to introduce new product options that fit to the interests of those clients who prefer individual lending. It was almost credit and saving products that respondents were benefiting except 2% of them who got their pension fund through ACSI as well. Staff promotion efforts were credited (53%) in introducing products and services to potential clients. Others learn from friends and relatives (43%), county administration briefings (2%) and radio ads (2%). The promotion was limited to the staff and the community networks. This way of promotion is acceptable as there is high demand for the services and poor communication media in the rural Amhara Region at the moment.

4.2.3 Trainings

All the trainings given were on credit and saving issues. It was only 10% of the respondents who disclosed that they have got training on reproductive health. The training time took 3-5 days (40%), 6-15 days (48%), and over 15 days for 12% of the respondents. The average training time was 10 days. The training was on introducing the institution, its services and products, group and centre formation, duties and responsibilities as a group member, importance of savings, thriftiness and others. The training smoothes the information gap between clients and the institution. There is a high opportunity to utilize the social network created by ACSI for other beneficial programs through integrating with other stakeholders. Particularly those involved on health like HIV/AIDS and literacy trainings can utilize groups of the institution. Most of the meetings are monthly (64%) and biweekly (36%).
4.3 Institutional Sustainability of ACSI

Currently ensuring sustainability to continue as a going concern in the financial market is a stiff hurdle to the microfinance industry. Institutional Sustainability position of ACSI factored into operational and financial self-sufficiencies has been examined in this section of the paper.

4.3.1 Operational and Financial Self-Sufficiency

Institutional sustainability, also called financial viability, is the ability of an entity to cover its costs with revenue generated from operations with no dependence on subsidy. There are two indicators for assessing financial viability or sustainability. These are measures of operational and financial self-sufficiency. For microfinance companies that are not financially self-sufficient subsidy-dependence index can be calculated to estimate the extent to which the existing interest rate should be raised to operate subsidy free at least at break-even. OSS refers to the firm’s ability to generate sufficient revenue from operations to cover operating expenses, financing costs, and loan losses. All direct costs are included in determining OSS. Being unable to reach OSS results in erosion of the net worth of a company over time and waiting for donor funds to keep on operating. To achieve OSS, the company should increase its revenue from operations and reduce its operating, financing, and loan loss expenses. FSS measures the firm’s ability to generate revenue sufficient to cover both direct (operating, financing, and loan losses) and indirect (cost of capital) expenses of doing business. The cost of capital is adjusted for inflation, expected rate of return by owners, and cost of debt adjusted at market rate. Measure of FSS below 100% indicates dependency on donor funds or subsidies. MFIs aim at first to achieve OSS followed by FSS. As the institution matures, there is an expectation that there will be an increase in financing costs due to more debt in the asset structure to finance the huge portfolio and decrease in operating and loan loss expenses due to efficient management of loan portfolio and reducing operational costs to the lowest possible. Setting adequate interest rate on loans, achieving highest collection rates, aggressive mobilization of savings, and cost-effectiveness and efficiency in operations are policy considerations to achieve sustainability (Ledgerwood, 1999).
Table 4. Sustainability Measures

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operational self-sufficiency</td>
<td>94.64</td>
<td>128.74</td>
<td>178.43</td>
<td>225.94</td>
<td>199.95</td>
<td>165.54</td>
</tr>
<tr>
<td>Financial self-sufficiency</td>
<td>73.29</td>
<td>121.07</td>
<td>88.33</td>
<td>113.4</td>
<td>115.31</td>
<td>102.28</td>
</tr>
</tbody>
</table>


As shown on Table 4, ACSI is going up the ladder of both operational and financial sustainability since 2002. The exception was a decline in FSS below 100% once in 2003. This decrease was due to an increase in total expenses by 90% and cost of capital adjustments which surpassed the growth in operating income by 40%. Since 2002 ACSI has started reaping operational income adequate to cover its operating costs. During the last two years of 2003 and 2004, incomes earned doubled expenses incurred. As indicated on Table 4, the FSS is lower compared to OSS as the former is expected to assume cost of capital adjustments for inflation on financial assets and market interest rate on funding liabilities. The cost of capital adjustments were calculated based on inflation and lending interest rates taken from the NBE over the years (NBE, 2006). Except for the years of 2001 and 2003, when the FSS measure was below 100% implying that there is a subsidy gap, the remaining years demonstrated that ACSI was financially self-sufficient. The institution covered not only operating costs, loan losses, and interest on savings and bank loans but also cost of capital on loans on concession and absorbed inflation impacts on its financial assets. On average ACSI is operationally and financially self-sufficient at around 166% and 102% respectively over the five year period. At the end of 2005, ACSI achieved 1999.9% and 115.3% operational and financial self-sufficiency respectively.

4.3.2 Productivity and Efficiency

These indicators help to assess the capability of MFIs to generate revenue and resource use ability to wealth maximization. Provision of financial services and products at the minimum cost possible is the maxim of efficient service delivery. Productivity consists of both outreach and efficiency. Productive firms utilize human, financial and other resources effectively and
efficiently. Productivity refers to the conversion of an input into output using a given resource. Efficiency refers to achieving the intended objective at the least resource use possible. Efficiency is the measure of the cost per unit of output. The productivity ratio in the case of MFIs focuses on the capacity of credit officers to serve as many clients as possible. These ratios include number of active borrowers and savers, average portfolio, and total amount disbursed per credit officer or field officer or staff. The efficiency ratios measure the operational costs of service delivery. Operating efficiency ratio measures the ratio or percentage of operating expenses relative to the portfolio. The lower operating expense ratio indicates the lower expense relative to portfolio outstanding. Usually costs of credit disbursement are higher than costs of accepting saving deposits. The efficiency ratios include operating costs ratio, cost per unit of currency lent, and cost per loan made. Operating cost ratios of 13% to 21% is a good indicator for successful MFIs (Ledgerwood, 1999).

As indicated on Table 5, productivity of the staff and credit officers has increased from year to year. Number of active borrowers per staff has grown from 130 in 2001 to 227 in 2005. Similarly, the borrowers to credit officer ratio has increased from 226 in 2001 to 372 in 2005. The value of outstanding portfolio per credit officer has increased from Birr 176 thousand in 2001 to 377 thousand in 2005. The capacity of loan officer in managing loan disbursements per year has improved from around Birr 172 thousand in 2001 to 365 thousand in 2005. As shown on Table 5, the operating expense ratio of ACSI as of Dec.2005 was 6%. This rate is very low compared to other African and Latin American firms in the industry, which is 44% and 25% respectively. ACSI is “extremely efficient” which is “unprecedented and surpass anything MicroRate has seen in Africa or Latin America” (MicroRate, 2005). These achievements can be factored into, as to MicroRate, effective management and low operating costs resulting from cost-effectiveness and low salary scheme prevalent in the country. The lowest cost per borrower is a measure of high efficiency achieved by ACSI compared to other African financial service providers in the same industry. This low cost of service delivery is achieved due to support from the Regional government and the credit and saving committee (MicroRate, 2005).
Making groups responsible for some of the activities in screening, monitoring and enforcing loan repayments reduced the risk and operational costs. Effectiveness and efficiency highly depends on the proper and cost-effective identification of poor clients (Gibbons and Meehan, 1999). The benefit of the credit and saving committee lays on utilizing locally available information at no cost and using informal monitoring, follow-up and enforcement mechanisms. The credit and saving committee assumes many of the screening, monitoring and enforcement functions that are too difficult or too costly to be executed by the employees of ACSI alone. Particularly for first time clients of credit the burden on evaluating their character and capacity rests on the credit and saving committee. The group members also have a say on the loan requested by their member because they assume responsibility in case of defaults. This has a positive contribution towards cost reduction and smoothing information asymmetry as the community knows more about their member than a new ACSI staff to that village.

**Table 5. Productivity and Efficiency Measures**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of Active Borrowers per Staff</td>
<td>129.7</td>
<td>165.1</td>
<td>195.2</td>
<td>210.3</td>
<td>227.1</td>
</tr>
<tr>
<td>No. of Active Borrowers per Credit Officer</td>
<td>225.6</td>
<td>268.2</td>
<td>324</td>
<td>334.8</td>
<td>372</td>
</tr>
<tr>
<td>Average Portfolio Outstanding per Credit Officer</td>
<td>175508.2</td>
<td>192717.3</td>
<td>229597.6</td>
<td>293692.5</td>
<td>377182.7</td>
</tr>
<tr>
<td>Amount Disbursed Per period per Credit Officer</td>
<td>171626.9</td>
<td>203783.9</td>
<td>261275</td>
<td>317383.3</td>
<td>364995.8</td>
</tr>
<tr>
<td>Operating Cost Ratio</td>
<td>0.08</td>
<td>0.09</td>
<td>0.08</td>
<td>0.06</td>
<td>0.06</td>
</tr>
<tr>
<td>Cost per Unit of Currency Lent</td>
<td>0.08</td>
<td>0.08</td>
<td>0.06</td>
<td>0.05</td>
<td>0.05</td>
</tr>
<tr>
<td>Cost per Loan</td>
<td>61.1</td>
<td>61.3</td>
<td>57.4</td>
<td>52.6</td>
<td>61.6</td>
</tr>
</tbody>
</table>


As shown on Table 5, the operating cost has decreased from eight cents to six cents per Birr in outstanding portfolio between 2001 and 2005. The cost per Birr lent was eight cents in 2001 coming down to only five cents in 2005. The cost per loan has increased from Birr 52.60 in 2004 to Birr 61.60 in 2005. The operating cost ratio has reduced from 9% in 2002 to 6% in 2004 and 2005. Attention should be given to track reasons for the change in cost per loan, which was unfavourably increased to Birr 61.60 in 2005. The increase in efficiency greatly contributes to profitability and then to sustainability. Additionally clients are benefited whenever there is
reduction in cost of service delivery if the institution is to set a limit on its target level of financial self-sufficiency and willing to transfer part of its gain to clients like by revising interest rates. The average cost per borrower for African and East African MFIs is Birr 634.00 and Birr 510.00 respectively. For ACSI the cost per borrower is below Birr 100. Field officers usually consist of up to 80% of the total staff. Based on best practice for MFIs worldwide, average number of clients per loan officer ranges from 300 to 500 whatever the type of lending methodology employed (Gibbons and Meehan, 1999:150-151). ACSI is by far the most productive in terms of its human resources compared to African and East African firms. ACSI has been able to serve 227 clients per staff and 372 clients per credit officer. African and East African firms have been able to serve only 143 per staff and 132 borrowers per credit officer (Lafourcade et al., 2006:13). Hence it is possible to say that ACSI is more efficient than other African MFIs in the industry. In sum, there is an increase in productivity of employees accompanied by reduction in costs of disbursing loans which is favourable to institutional sustainability.

ACSI is highly applauded for its reliance on internally mobilized savings to finance its portfolio and efficient service delivery at the lowest cost possible compared to others in the industry. ACSI has been rated two times by MicroRate in 2003 and 2005 and ranked as α- by MicroRate standards. This gave ACSI a label stated as a microfinance institution “striving to balance a clear and rational relationship among the social, financial, and operational considerations of sound microfinance practice as compared to an international set of similar companies and emerging standards of the microfinance industry”. ACSI achieved good efficiency and effectiveness with low risk having better future prospects (MicroRate, 2005: Annex A-1).

4.3.3 Profitability

Profitability indicators measure financial performance of a firm over a period of time. It is useful for both internal management and external stakeholders to assess profitability of the business. In these ratios net income is stated as return on assets and return on capital. Return on assets (ROA) measures the average net income earned on a single currency owned and indicates the kind of return the assets are generating. Analysis of ROA helps in policy settings to improve revenue
generating capabilities, better delinquency management, and the introduction of new products to clients. High return implies good utilization of assets. It is a measure of the return from a single Birr of loans outstanding. ROE refers to the maximum return available to shareholders. The ROE gives the rate of return earned on net worth or equity invested. Higher return implies pleased shareholders or owners. Investors may decide to invest or divest by referring to the ROE of the firm. The return on portfolio ratio indicates the productivity of the credit operation. Portfolio yield measures the percentage of net income earned for every Birr in portfolio. Yield measures ultimate profitability. The higher the ratio, the more profitable each currency lent (Ledgerwood, 1999 and Barres, 2006). Investors, financiers, and clients would determine their future ties with the institution by examining its profitability.

The highest income source for MFIs is their portfolio where as the major source of expenses are administrative and personnel expenses. Personnel expenses account for the largest portion of MFI expenses between 50% and 70% of operational costs (Gibbons and Meehan, 1999:150). ACSI earns financial revenues from loans and other financial services in the form of interest income, penalties, and commissions. Financial revenue also includes income from other financial assets, such as investment income. Its financial activities also generate costs of doing business. These include general operating expenses, financing charges, and loan losses due to default. Profitable institutions generate greater revenue that exceeds total expenses. From the very nature of the line of business, interest income is the major source of income for ACSI. As presented on Table 6, more than 90% of the total income derives from interest earned on loan portfolio. On the contrary, operating expenses take more than 60% of total expenses of ACSI. High operating costs may be attributed to weak infrastructure like roads and communication, low average population density combined with higher personnel costs. ACSI has been enjoying profits after six years of operation. Since 2002, it has been earning profits with the highest record in 2004 of Birr 32 million. These results are attributed to higher efficiency and best portfolio quality.

As depicted on Table 6 below, the highest return on assets and equity registered in 2004. A Birr in assets earned around eight cents in 2004 but declined to six cents in 2005. A Birr invested in equity has generated around 20 cents in 2004 and 2005. Return on portfolio increased over the years except a decline in 2005. The highest yield on portfolio was around 19 cents per Birr in
portfolio in 2003 but declined to 17 cents in 2005. A Birr lent earned an interest income of around 17 cents in 2005. The average ROA and ROE over the five year were 4.5% and 13% respectively. ACSI has moved from reducing its resources due to loss to adding value on its assets from profits. From 2002 on, ACSI registered positive returns on total assets. ACSI is more profitable than other African MFIs as its ROA is around 6.5% compared to 2% for the latter in 2005 (Lafourcade et al., 2006:13).

Table 6. Profitability Measures

<table>
<thead>
<tr>
<th>Indicators</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>-0.5</td>
<td>2.76</td>
<td>6.13</td>
<td>7.65</td>
<td>6.49</td>
</tr>
<tr>
<td>ROE</td>
<td>-1.89</td>
<td>11.46</td>
<td>16.4</td>
<td>19.37</td>
<td>19.22</td>
</tr>
<tr>
<td>Yield on Portfolio</td>
<td>11.82</td>
<td>16.68</td>
<td>18.66</td>
<td>18.4</td>
<td>17.36</td>
</tr>
<tr>
<td>Interest Income to Total Income</td>
<td>85.32</td>
<td>89.01</td>
<td>93.51</td>
<td>91.91</td>
<td>95.39</td>
</tr>
<tr>
<td>Operating Expense to Total Expense</td>
<td>57.66</td>
<td>63.47</td>
<td>69.12</td>
<td>70.97</td>
<td>68.52</td>
</tr>
</tbody>
</table>


4.3.4 Financing or Capital Structure

MFIs finance their activities with funds from various sources, both debt (deposits from clients and borrowings from banks and other financial institutions) and net worth. Measures of financial structure describe these various fund sources and compare them with assets purchased with those funds. Financing structure ratios, also termed as stability ratios, include leverage and capital adequacy measures. Leverage is the extent in which debt financing is employed compared to equity financing. Leverage ratio is calculated by dividing debt to equity. It shows the amount of debt per a Birr invested in capital i.e., the number of times of debt for every Birr of equity. The lower the ratio the safer is the firm. Commercial loans and clients’ savings serve as a base for leverage. Leverage impacts on profitability positively. Total debt to total assets ratio shows the percentage of debt in financing the business. Too high debt to equity ratio indicates highly leveraged situation that implies too much debt or too small equity base in the financing structure.
On the other hand, too low debt to equity ratio indicates inefficient use of equity. Hence it is advisable to maintain optimal level of debt to equity ratio (CGAP, 2003 and Ledgerwood, 1999).

Adequate capital is an incentive for both lending institutions and savers to build confidence in the MFIs in meeting its obligations in the future. Capital is a pillar for expansion, source of security, flexibility, stability, buffer against risk and losses, and a base for borrowing. Capital adequacy is the amount of capital compared to the overall financial position of the firm. It refers the optimal level of capital required to take up losses incurred with out damaging the institutional sustainability. Capital adequacy measures the stability and solvency of the firm in line with the level of leverage. The desired trend is that the higher the safer. Too low ratio indicates too much debt in the firm’s financial structure. Too high ratio is on the other hand an indicator of under-leveraged there by reducing return on equity. As debt financing is cheaper than equity it is advisable to maintain optimal use of debt as much as possible (CGAP, 2003 and Ledgerwood, 1999).

The sources of funding for ACSI are shareholders equity, retained earnings, donated equity, commercial borrowings, subsidized liabilities, and savings. As indicated on Table 7, ACSI funds 32.36 % of assets with equity. Savings are the main source of liabilities. Deposits account for 60% of total liabilities. Borrowings represent only a small proportion of funding for ACSI. This contributes to low leverage implying poor utilization of commercial borrowings to finance the portfolio.

**Table 7. Financial Structure Indicators**

<table>
<thead>
<tr>
<th>Financial Structure</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity-to-Assets Ratio</td>
<td>24.21</td>
<td>23.81</td>
<td>46.75</td>
<td>33.52</td>
<td>32.36</td>
</tr>
<tr>
<td>Debt-to-Equity Ratio</td>
<td>313.14</td>
<td>319.93</td>
<td>113.92</td>
<td>198.4</td>
<td>209.03</td>
</tr>
<tr>
<td>Debt-to-Assets Ratio</td>
<td>75.79</td>
<td>76.19</td>
<td>53.25</td>
<td>56.48</td>
<td>67.64</td>
</tr>
<tr>
<td>Loans to total assets ratio</td>
<td>62.25</td>
<td>69.19</td>
<td>70.43</td>
<td>67.36</td>
<td>74.43</td>
</tr>
<tr>
<td>Net Savings to total assets ratio</td>
<td>44.53</td>
<td>44.15</td>
<td>44.29</td>
<td>37.78</td>
<td>40.42</td>
</tr>
<tr>
<td>Net Savings to Loans</td>
<td>71.52</td>
<td>63.81</td>
<td>62.89</td>
<td>56.09</td>
<td>54.3</td>
</tr>
</tbody>
</table>

There was an increase in the share of equity from total assets in 2005 compared to 2001. The highest equity-to-asset ratio was 46.75% in 2003 due to higher donated equity. Having higher equity to asset ratio shows increase in stability of the institution. The debt-to-equity or leverage ratio declined in 2003(113.92%) but doubled in 2005(209.03%). For the years 2001 and 2002, the total debt was more than three times equity and over 70% of total assets were financed with debt. For a Birr in equity (net worth) there was two Birr in liability in 2005. Almost 68% of total assets were financed through debt in 2005. In other words, from one Birr in assets 68 cents was a liability. Based on the rule of thumb in debt-to-assets ratio of 1:1 there is still a room for ACSI to use debt financing so as to maintain optimal leverage and use of advantages of debt financing. There is an increase in deployment of assets to the earning asset of loan portfolio from year to year. It was 62% of total assets in loan portfolio that increased to 74% in 2005. This shows effective utilization of assets to generate interest income. On the other hand deposits finance more than 40% total assets for the first three years. But this trend has declined in 2004 and 2005. This is attributed to the increases in total assets higher than the increase in savings. The share of net savings in financing the loan portfolio was at its peak in 2001 but declined in latter years. This is due to an increase in the loan portfolio that outweighs the increase in savings collected. Yet still more than 50% of the portfolio is financed through deposits mobilized. ACSI should make every effort at its best level to cover much of the loan fund from savings collected. African MFIs fund only 25% of assets with equity which implies that they are highly leveraged compared to ACSI (32.36%) in 2005. deposits account for 72% of liabilities for African firms but only 60% in the case of ACSI(Lafourcade et al., 2006:9). Overall, ACSI’s capital adequacy is relatively high for an MFI. However, given the portfolio’s concentration in agricultural loans, and given the lack of insurance against adverse climatic conditions, a conservative capital structure would be advised (MicroRate, 2005:11).
4.3.5 Portfolio Quality

The major productive asset of ACSI, as it is common in other MFIs, is its loan portfolio. Thus, portfolio quality refers to the health of this productive asset and the risks attached to it; mainly delinquency as a “beast” to its loan portfolio. The portfolio quality is detrimental to the institutions current performance as well as future prospect in generating higher revenues and better outreach to the poor. Repayment rates, loan loss, and portfolio quality ratios are indicators used to assess the portfolio quality. The repayment rate indicates the recovery rate of loans due in time. It measures loan repayments collected compared to the total expected amount to be collected over a given period of time. It is important in cash flow projections and monitoring loan repayments. It is hardly possible to evaluate current condition of the portfolio based on repayment rate but has a predictive value based on past experience. This measurement may be misleading in fast growing, long term portfolio conditions (CGAP, 2003; Gibbons and Meehan, 1999 and Ledgerwood, 1999).

The second portfolio quality measurement is portfolio quality ratios. This indicator comprises of three different ratios of the arrears rate, the portfolio at risk (PAR), and the ratio of delinquent borrowers. The arrears rate shows the risk that a loan will not be collected in the future. Arrears are loan amounts overdue from the originally set repayment time and date. In principle a loan late even hours is termed as in arrears. It shows how much of the loan is uncollected on the due date. Some argue that arrears rate does not show the overall risk the total portfolio is exposed of as it indicates only the amount overdue. In fact, it is not the overdue amount only which is at menace but the outstanding amount in total is at risk of loss when its part is overdue. A better indicator or measure of risk associated with the portfolio is then assumed to be the portfolio at risk ratio that includes any remaining balance of loans infected with arrears including the arrears balance itself. In other terms the calculation takes into account outstanding balance of loan amounts that have past due amounts. It is prudent compared to the arrears rate by considering the total poisoned loan which is in doubt of collection including the past due amount. The PAR helps to see the real picture of the risk of delinquency particularly in credit terms with small loan payments over a long credit period. It should be noted that the definition of the policy of
delinquent loans matters the calculations of portfolio quality measures (CGAP, 2003; Gibbons and Meehan, 1999 and Ledgerwood, 1999).

Another indicator is based on loan losses. Loan losses are part of the costs of doing business. Ratios can be calculated based on an estimated amount used in businesses as loan loss reserves and an actual amount of loans written off during the period. Loan loss reserves are estimated based on experience over time that the reserve ratio can be an indicator to evaluate the delinquency management over time. The ratio is expected to decrease over time if accompanied with better delinquency management practices. Loan loss reserve ratio rarely exceeds 5% for successful microfinancing institutions (Ledgerwood, 1999). The loan loss ratio measures the amount of loans written-off or cancelled from accounting records as uncollectible during a given accounting period when the loans do have little hope of collection in the future. The trend analysis for the loan loss ratio can be made to evaluate the changes over time. As a general indicator, loan losses of above two percent annually show a delinquency problem (Ledgerwood, 1999).

MFIs with a vision to stay in the market as a going concern should display to their clients that they will stay in the business for indefinite period of time. Showing sustainability and stability in the business is a decisive factor for clients to repay today in expectation of getting services in the future. The reason behind failure of short-sighted credit service interventions is that clients default in expectation of no pressure to settle their debt from a project to phase-out. They compare the cost and benefit of defaulting vis-à-vis repaying the loans. The first challenge when ACSI started its services was to show clients that it would still continue serving them as a going concern. It was a must to attest rural clients that no excuse or write-off for those who default and group members were liable for any loan unpaid. What the clients did was to keep the money at hand and stayed at home rather than coming to centre meetings in the field for repayment of loans. It was a must to go home-to-home with group and centre leaders to collect the repayments with penalties. What was surprising was that they did have the money but they were checking whether the institution would request them to repay or keep silent as those previous credit interventions by other programs. Later, the information was reached to the remaining clients to be alert and come in time to repay the maturity amount. Hence, the first step to stay in the market
is to show the dedication and determination of the institution to serve them in the future and will stay in the areas with better outreach and service alternatives to the poor rural clients.

Portfolio quality of ACSI was, in the words of MicroRate, “excellent” and “one of the best MicroRate has seen in Africa”. The Rating agency was further surprised by the Portfolio at Risk (PAR) ratio of below 2% in 2005 while doing business with poor subsistence farmers. However, the credit terms that were mostly term loans have contributed to such outstanding performance when repayments were to be made once. Such a remarkable performance should be further supported with adequate insurance schemes from unexpected perils that may harm the portfolio quality (MicroRate, 2005:6). As indicated on Table 8, ACSI was able to maintain high portfolio quality with PAR as low as 1.7 in 2004 and 1.9 in 2005.

**Table 8. Portfolio Quality Indicators**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Repayment Rates</td>
<td>98.9</td>
<td>98.4</td>
<td>98.8</td>
<td>NA</td>
<td>99.19</td>
</tr>
<tr>
<td>Arrears Rate</td>
<td>1.1</td>
<td>1.6</td>
<td>1.2</td>
<td>NA</td>
<td>0.81</td>
</tr>
<tr>
<td>Portfolio at Risk &gt; 30 Days Ratio*</td>
<td>2.5</td>
<td>3.5</td>
<td>3.1</td>
<td>1.7</td>
<td>1.9</td>
</tr>
<tr>
<td>Loan Loss Reserve Ratio</td>
<td>NA</td>
<td>2.75</td>
<td>2.83</td>
<td>1.55</td>
<td>1.38</td>
</tr>
<tr>
<td>Loan Loss Ratio</td>
<td>2.18</td>
<td>1.43</td>
<td>1.06</td>
<td>0.00</td>
<td>0.35</td>
</tr>
</tbody>
</table>

* PAR ratios are taken from MicroRate (2005) and MIXMarket(2006)


Portfolio quality of ACSI based on its PAR ratio of below 2% was at its best compared to the global average, African and East African PAR values of 5.2%, 4%, and 4.8% respectively as of 2005((LaFourcade et al., 2006:14). The loan loss and loan loss reserve have become reduced which shows the reduction in non-performing loans. However, the loan loss reserve was below the PAR ratio that the risk and the buffer for the risk in expectation of defaults seem mismatched. To be prudent enough, it was wise to have an allowance for loan losses at least that equates with the ratio of portfolio at risk. Writing off loans went even to the extent of nil in 2004 and 0.35% of outstanding portfolio in 2005 which required scrutiny as a financial institution dealing with
credits in millions with hundred thousands of poor clients. From 2001 to 2005 ACSI has been able to maintain an excellent repayment rate at an average of 98.8%. The arrears were below 2% of its loan portfolio. Such a remarkable performance is hard to achieve even in conventional banks backed by huge collaterals having a few credit clients but a bulk of credit balances. This performance might be attached to proper client selection, follow-up and monitoring both by the staff and credit and saving committee, credit discipline and profitability of clients.
CHAPTER V. CONCLUSIONS

The study on outreach and sustainability of microfinance institutions taking ACSI of Ethiopia as a case was aimed at assessing its outreach, feedback of clients on its service delivery and institutional sustainability in terms of operational and financial self-sufficiency. These objectives were accomplished in line with the guiding research questions related to the socio-economic condition of clients, outreach of the institution in terms of breadth or scale and depth, clients’ feedbacks on services they got, operational and financial self-sufficiency, productivity and efficiency and profitability, and the health of its portfolio.

Most of the clients of ACSI lack basic literacy and numeric skills practicing subsistence agriculture on small land holdings having larger family size. All were in the productive age group. All were married except a few. Female-headed household clients were a few. The housing quality was poor with one to two rooms. No access to utilities like electricity, safe drinking water, and toilet facilities. Even if food shortage did not seem a critical problem, the number of meals served was two times a day. ACSI clients’ livestock ownership was lower than regional and national averages. The simplest but basic client selection criterion of ownership of one or no ox showed on average 1.43. Almost all except a few have land, lifeblood to the rural poor in the region. The majority own not more than one hectare. Two-third of the clients did not have shoes. Almost all clients earn below USD $1 a day. Food was the major expenditure item accounting more than half of the total household budget. Based on the level of income and expenditure, asset ownership in the form of livestock and land the clients of ACSI are the poorest of the poor. Nonetheless this should be augmented with further poverty audits.

ACSI has covered 77% of the Amhara region in its operation by the end of 2005. The institution showed a tremendous change in terms of outreach. It served more than half a million clients. Over 1.6 million loans had been disbursed worth Birr 1.5 billion with an increase in average loan size. The expansion was not only in loan portfolio but also accompanied with aggressive savings mobilization as a perennial source of loanable fund. ACSI financed more than half of its
portfolio from savings in 2005. However, the deposit to loan ratio declined from 89% in 2001 to 54% in 2005 showing a gap to cover loanable fund from savings.

Informal sources mainly friends, relatives and local money lenders were the major sources of credit before the intervention of ACSI. All loans were for agricultural projects on term basis of one year credit period. This shows highest portfolio concentration on a single sector vulnerable to natural disasters and calamities. For some of the clients the loan size was not sufficient for the intended purpose. It took two weeks to get credit. Sub branch offices were nearly located to rural villages compared to other economic and public infrastructures. Employees of the institution went to the rural villages as well. The respondents were pleased with employees’ customer treatment and handling with a few exceptions. The average number of members in a group was six clients that seem manageable. Almost all the trainings were on credit and saving services of the institution which took on average 10 days. The majority (88%) got credit timely. The interest rate was fair for 70% of the clients except complains as high from 10% of clients. More than half of the respondents preferred individual lending than solidarity groups which highlight a way to new product development and to find out the reasons for such desire. Products and services promotion was highly dependent on the staff efforts and community networks which were acceptable compared to the high demand for financial services and poor communication media in the rural areas.

Institutional sustainability, also called financial viability of ACSI has been measured in terms of operational and financial self-sufficiencies achieved. In 2002, ACSI reported operating income after six years of operation. Interest income was the major source of income. Operating expenses account for more than half of the total expenses. ACSI started adding value to its assets and equity since 2002 due to positive returns on resources deployed. ACSI has achieved operational self-sufficiency since 2002. It has started enjoying financial self-sufficiency since 2004. By the end of 2005, the institution was operational and financially self-sufficient at 119.9% and 115.3% respectively. ACSI was among a few MFIs which were able to achieve the highest efficiency at the lowest cost per borrower. ACSI operated at the lowest operating expense ratio compared to other African and Latin American firms in the industry. Such lowest operational costs did
contribute to the attainment of operational and financial self-sufficiencies. The role of support from the Amhara Regional state and the credit and saving committee should also be underscored.

Productivity per staff and per credit officer has grown over the years. There was also an increasing trend on portfolio. The operating cost per Birr lent was as low as five cents in 2005. ACSI was the most productive in its human resource and operates at the lowest cost per borrower compared to other African and East African MFIs. Savings were the main source of liabilities. ACSI was lowly leveraged due to poor utilization of commercial borrowings. It had high level of capital adequacy resulting low leverage. This high capital adequacy could be utilized to attract more debt financing.

ACSI has a high portfolio quality. PAR as an excellent measure of portfolio quality indicated that the ratio was below 2% for ACSI. Loans infected with delinquency virus accounted only 1.9% of the portfolio in 2005. The loan loss and loan loss reserve ratios declined over the years showing reduction in non-performing loans. However, there existed mismatch between PAR value and the risk coverage ratio of loan loss reserve which was not wise as a financial institution for ACSI. The repayment rate was at average 98.8% over the five year period. Such a remarkable performance in portfolio quality is hard to achieve even in commercial banks that work with a few clients backed by huge usable collateral. In sum, based on the experience of ACSI, it is possible to conclude that institutional sustainability could be achieved while reaching to the poorest sections of the society.
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Appendix 1. Survey Questionnaire

Questionnaire on the Socio-Economic Condition of Clients and Services of ACSI

This questionnaire aims at assessing the outreach and sustainability of the Amhara Credit and Saving Institution (ACSI). It is intended for academic purpose to do a masters thesis. Your first hand information has a paramount value in this research. The respondent’s answers and opinions are confidential and no harm to him/her.

With may thanks for sharing your experience and ideas as well as your time in advance.

Branch……………… Sub-branch……………Centre………. Group………Case No. ………

I. SOCIO-DEMOGRAPHIC CHARACTERISTICS OF CLIENTS

1. Sex

   1. Male □  2.Female □

2. Age:………..

3. Occupation:

    7. Service  8. Others………………

4. Marital status


5. Educational level:………………

   1. Illiterate  3. Primary  5. Secondary
   2. Basic literacy  4. Junior  6. College or tertiary

6. Family size:………………
### II. WEALTH CONDITION

1. **Source of income**
   - **Monthly income (Birr)**
   - **Annual income**
     - a. Farming
     - b. Off-farm activities
     - c. Non-farm activities

2. **Expenditures**
   - **Monthly expenditure**
   - **Annual expenditure**
     - a. Food
     - b. Non-food
     - c. Clothing
     - d. Health
     - e. Education or school fees
     - f. Fixed assets
     - g. Labour
     - h. Others

3. How many rooms does the dwelling have?

4. What type of roofing material is used in main house?
   - 1. Grass  
   - 2. Iron sheets  
   - 3. Tarpaulin, plastic sheets, or branches and twigs  
   - 4. Stone or slate  
   - 5. brick tiles  
   - 6. Concrete

5. What type of exterior walls does the dwelling have?
   - 1. Mud walls  
   - 2. Timber  
   - 3. Brick or stone with mud  
   - 4. Iron sheets  
   - 5. Brick or stone with cement plaster

6. What type of flooring does the dwelling have?
   - 1. Dirt  
   - 2. Wood  
   - 3. Cement  
   - 4. Cement with additional covering

7. What is the electricity supply?
   - 1. No connection  
   - 2. Shared connection  
   - 3. Own connection

8. What type of cooking fuel source primarily is used?
   - 1. Firewood  
   - 2. Dung  
   - 3. Charcoal  
   - 4. Kerosene  
   - 5. Gas  
   - 6. Electricity

9. What is the source of drinking water?
   - 1. Rainwater, dam, pond, or river  
   - 2. Spring  
   - 3. Public well-open  
   - 4. Public well-sealed with pump  
   - 5. Well in residence yard  
   - 6. Piped public water  
   - 7. Bore hole in residence
10. What type of toilet facility is available?

1. Bush, field, or no facility
2. Shared pit toilet
3. Own pit toilet
4. Shared, ventilated, improved pit latrine
5. Own improved latrine
6. Flush toilet, own or shared

11. Do you have shoes?  Yes □  No □

12. Do you have radio or tape recorder?  Yes □  No □

13. How many times do you eat meat and egg in a week?..............

14. How many meals were served to the household members during the last week?..............

15. During the last 30 days, for how many days did your household not have enough to eat every day?..............

16. During the last 12 months, for how many months did your household have at least one day without enough to eat?..............

17. Have you ever experienced going to bed with no food in a month’s time?  Yes □  No □

18. How many cattle and poultry did/do you have?

<table>
<thead>
<tr>
<th></th>
<th>Before joining ACSI</th>
<th>After joining ACSI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cows</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oxen</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adult Sheep and Goat</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Donkey</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mule/horse</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

19. Land ownership in hectares:

<table>
<thead>
<tr>
<th></th>
<th>Agricultural</th>
<th>Non Agricultural</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owned</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Leased (rented)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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III. CREDIT

1. Where did you get credit before becoming a member of ACSI?
   1. Friends and relatives  2. Local money lenders (usury)  3. Banks
   4. Cooperatives  5. Rotating credit and saving schemes  6. NGOs
   6. Churches  8. Others……

2. Did you have access to bank loans before?
   1. Yes ☐  2. No ☐

3. For how long have you been a member of ACSI?
   1. Less than three months  2. 3-6 months  3. 6-9 months  4. 9-12 months
   5. Above one year

4. How many loans (number of loans) have you taken from ACSI?
   1. Not yet taken  2. One  3. Two  4. Three  5. Four
   6. More than four loans

5. How much loan you have borrowed from ACSI including any outstanding balance owed currently?..............................

6. For what purpose have you taken the loan?
   1. Consumption  2. Agricultural inputs (fertilizer and seeds)  3. Animal fattening
   4. Petty trade  5. Handicraft  6. Purchase of fixed assets or equipments
   11. Others (specify)……………………………

7. Did you use the loan entirely for the intended purpose (as stated on the loan application)?
   1. Yes ☐  2. No ☐
   If not, how did you spend the remaining amount?..............................

8. Is the loan amount sufficient for the intended purpose?
   1. Yes ☐  2. No ☐

9. Have you shared the loan with other members of the family?

10. How long is the credit period?.........................
11. Is the loan term loan or instalment basis?

1. Term loan  
2. Instalment

**IV. SERVICE DELIVERY**

1. How long it takes to get a loan?

1. One week  
2. Two weeks  
3. Three weeks  
4. Over three weeks

2. How far is the sub-branch office from your village?

1. Below 5 km  
2. 5-10 km  
3. 11-15 km  
4. 16-20 km  
5. Above 20 km

3. Are employees’ customer handling and treatment satisfactory?

1. Very disappointing  
2. Disappointing  
3. So-so  
4. Satisfactory  
5. Very satisfactory

4. Is there a proper selection of clients by field workers?

1. Very disappointing  
2. Disappointing  
3. So-so  
4. Agree  
5. Very agree

5. Is there proper and timely follow-up of credit given by fieldworkers?

1. Very disappointing  
2. Disappointing  
3. So-so  
4. Agree  
5. Very agree

6. What is the total number of group members in your group?  

7. What trainings did you get from ACSI?

1. Credit and saving  
2. Business development  
3. Marketing  
4. Literacy/education  
5. Reproductive health  
6. Others

8. How long is the training time on average?

1. One week  
2. Two weeks  
3. Three weeks  
4. One month  
5. More than a month

9. When and how frequent you held meetings?

10. Did you get the loan amount as you requested?

1. Reduced  
2. As requested  
3. Large to manage

11. Did you get loans timely?

1. Strongly disagree  
2. Disagree  
3. So-so  
4. Agree  
5. Strongly agree
12. Is the interest rate on loans fair and just?


13. What improvement do you expect from or suggest to ACSI?

1. Interest rate reduction  2. Offering variety products
3. Provision of non-financial services (trainings, literacy)
4. Efficient service delivery  5. Others

14. Do you prefer group lending or individual loans?  1. Individual  2. Group

15. Which services you use in ACSI?

1. Savings  2. Credit  3. Overdraft facilities  4. Insurance  5. money transfer

16. How did you learn about ACSI?

1. Learning from friends and relatives  2. Ads on TV, radio, and newspapers
3. Introductions or briefings given by employees of ACSI  4. Others
## Appendix 2. Financial Data, Inflation, Lending Interest and Foreign Exchange Rates

<table>
<thead>
<tr>
<th>Balance Sheet Accounts (in Birr)</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Assets</td>
<td>190621155</td>
<td>224335116</td>
<td>290470897</td>
<td>457326547</td>
<td>592355831</td>
</tr>
<tr>
<td>Loans</td>
<td>118665161</td>
<td>155211378</td>
<td>204569376</td>
<td>308046418</td>
<td>440874511</td>
</tr>
<tr>
<td>Net Worth</td>
<td>46139915</td>
<td>53422233</td>
<td>135782210</td>
<td>153280827</td>
<td>191680862</td>
</tr>
<tr>
<td>Total Liabilities</td>
<td>144481240</td>
<td>170912883</td>
<td>154688688</td>
<td>304045720</td>
<td>400674970</td>
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<tr>
<td>Average Funding Liabilities</td>
<td>109969732</td>
<td>124967211</td>
<td>133133725</td>
<td>208765614</td>
<td>324609691</td>
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<tr>
<td>savings</td>
<td>84874800</td>
<td>99045737</td>
<td>128649146</td>
<td>172797599</td>
<td>239410576</td>
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<table>
<thead>
<tr>
<th>Income Statement Accounts (in Birr)</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Income</td>
<td>13214447</td>
<td>22842521</td>
<td>33561821</td>
<td>47162697</td>
<td>65008732</td>
</tr>
<tr>
<td>Total Income</td>
<td>15488205</td>
<td>26127896</td>
<td>38593064</td>
<td>54928899</td>
<td>74125560</td>
</tr>
<tr>
<td>Interest Expense</td>
<td>4496221</td>
<td>5319279</td>
<td>4299999</td>
<td>6592586</td>
<td>9411654</td>
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<tr>
<td>Loan Loss Provision</td>
<td>2432336</td>
<td>1963280</td>
<td>1911647</td>
<td>0</td>
<td>1318785</td>
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<tr>
<td>Operating Expense</td>
<td>9436910</td>
<td>12651240</td>
<td>13902782</td>
<td>16119823</td>
<td>23353937</td>
</tr>
<tr>
<td>Total Expenses</td>
<td>16365467</td>
<td>19933799</td>
<td>20114428</td>
<td>22712409</td>
<td>34084376</td>
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<tr>
<td>Net profit</td>
<td>-877262</td>
<td>6194097</td>
<td>18478636</td>
<td>32216489</td>
<td>40041184</td>
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</table>

<table>
<thead>
<tr>
<th>Inflation, Lending Interest and Foreign Exchange Rates*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inflation Rate</td>
</tr>
<tr>
<td>Lending Interest Rate</td>
</tr>
<tr>
<td>Foreign Exchange Rate (per USD)</td>
</tr>
</tbody>
</table>

## Appendix 3. Formula for Calculating Performance Ratios

<table>
<thead>
<tr>
<th>No.</th>
<th>Indicator</th>
<th>Formula</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Repayment Rate</td>
<td>( \frac{\text{Amount Received}}{\text{Amount Due}} )</td>
</tr>
<tr>
<td>2.</td>
<td>Arrears Rate</td>
<td>( \frac{\text{Amount in Arrears}}{\text{Portfolio Outstanding}} ) or ( 1 - \text{Repayment Rate} )</td>
</tr>
<tr>
<td>3.</td>
<td>Portfolio at Risk (PAR)</td>
<td>( \frac{\text{Outstanding Balance of Loans with Payments Past Due}}{\text{Portfolio Outstanding (including amounts past due)}} )</td>
</tr>
<tr>
<td>4.</td>
<td>Ratio of Delinquent Borrowers</td>
<td>( \frac{\text{Number of Delinquent Borrowers}}{\text{Total Number of Active Borrowers}} )</td>
</tr>
<tr>
<td>5.</td>
<td>Loan Loss Reserve Ratio</td>
<td>( \frac{\text{Loan Loss Reserve for the Period}}{\text{Portfolio Outstanding for the Period}} )</td>
</tr>
<tr>
<td>6.</td>
<td>Loan Loss Ratio</td>
<td>( \frac{\text{Amount Written-off in the Period}}{\text{Average Portfolio Outstanding for the Period}} )</td>
</tr>
<tr>
<td>7.</td>
<td>No. Of Active Borrowers per Credit Officer</td>
<td>( \frac{\text{Total Number of Active Borrowers}}{\text{Total Number of Credit Officers}} )</td>
</tr>
<tr>
<td>8.</td>
<td>Average Portfolio Outstanding per Credit Officer</td>
<td>( \frac{\text{Portfolio Outstanding}}{\text{Number of Credit Officers}} )</td>
</tr>
<tr>
<td>9.</td>
<td>Amount Disbursed per Period per Credit Officer</td>
<td>( \frac{\text{Amount Disbursed in a Period}}{\text{Number of Credit Officers}} )</td>
</tr>
<tr>
<td>10.</td>
<td>Operating Cost Ratio</td>
<td>( \frac{\text{Operating Costs}}{\text{Average Portfolio Outstanding}} )</td>
</tr>
<tr>
<td>11.</td>
<td>Cost per Unit of Currency Lent</td>
<td>( \frac{\text{Operating Costs for the Period}}{\text{Total Amount Disbursed in the Period}} )</td>
</tr>
<tr>
<td>12.</td>
<td>Cost per Loan</td>
<td>( \frac{\text{Operating Costs for the Period}}{\text{Total Number of Loans Made in the Period}} )</td>
</tr>
</tbody>
</table>
## Appendix 3 Formula for Calculating Performance Ratios

<table>
<thead>
<tr>
<th>No.</th>
<th>Indicator</th>
<th>Formula</th>
</tr>
</thead>
<tbody>
<tr>
<td>13.</td>
<td>Operational Self-Sufficiency =</td>
<td>Operating Income &lt;br&gt; Operating Expenses Financing Costs Provision for &lt;br&gt;Loan Losses</td>
</tr>
<tr>
<td>14.</td>
<td>Financial Self-Sufficiency =</td>
<td>Operating Income &lt;br&gt; Operating Expenses Financing Costs Provision for &lt;br&gt;Loan Losses Cost of Capital</td>
</tr>
<tr>
<td>15.</td>
<td>Cost of Capital =</td>
<td>((Inflation Rate*(Average Equity-Average Fixed Assets)) &lt;br&gt; + (Average Funding Liabilities * Market Rate of Debt- Actual Financing Costs)</td>
</tr>
<tr>
<td>16.</td>
<td>Return on Asset(ROA) =</td>
<td>Net Income &lt;br&gt; Average Assets</td>
</tr>
<tr>
<td>17.</td>
<td>Return on Equity =</td>
<td>Net Income &lt;br&gt; Average Equity</td>
</tr>
</tbody>
</table>

Source: Ledgerwood (1999)