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Performance Evaluation of Omo Microfinance Institute in Southern Ethiopia

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Microfinance has been evolved as an economic development approach intended to benefit low income people. Therefore, the objective of this study was to assess the performance of Omo microfinance institute using the core performance indicators and to forward the possible recommendation to strengthen the performance of institute. This study pointed out that there was increment in the number of clients participated in the service delivery across years. The study also found out a negative impact on outreach to the poor and the participation of women clients was small. The results on financial sustainability measured by return on asset (0.02) and return on equity (0.06) showed there was difficulty in the institute profitably to sustain the business and in order to met it objectives in the long run. Under collection performance view, the study found out that a large percentage of PAR (11.78) and ALR (62.28%) which was beyond the threshold of 10 and 5 percent respectively. Therefore, the study concludes that the institute should focus on financial sustainability in order to reduce their subsidy dependence, ensure survival and growth in the future. To the policy makers, the study recommends that poverty alleviation programs need to be accompanied by a targeting strategy and a program structure appropriate to the needs of the poor.

Keywords: Micro-finance, Financial Service, Poverty, performance Indicators

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INTRODUCTION

Like other Sub-Saharan Africa countries, the socio-economic condition of the Ethiopia is Characterized by low growth rate of income, saving, investment, inadequate social services, high population growth and high unemployment rate. Unbalanced growth rate of population with economic growth is both the causes and consequences of poverty in the country (Abebe, 2006).

Lack of access to financial services is also among the causes of poverty . In line with this, there are studies that indicate pessimistic kind of result on the impacts of microfinance program initiatives towards reducing poverty (Buckley, 1997; Montgomery, 1996; Rogaly,1996; Wood and Shariff, 1997). On the other hand, there are studies which implies the positive impact of the services provided by micro finance institutions towards poverty reduction. Provision of financial services is one of the important economic inputs in the effort to reduce poverty and empower economically marginalized segments of the society. These marginalized poor people have limited access to financial services from the formal financial institutions especially in developing countries. Because formal financial system has inadequate geographical outreach, lack of adequate management system, lack of skilled manpower, high risk perception and inadequate collateral, poor people found it difficult to obtain adequate amount of credit and were charged high rates of interest by monopolistic moneylenders [2]. This is supported by several studies (Halcombe, 1995; Hossain, 1988; Remeni, 1991; Hashemi, Schuler and Rilely, 1996; Hulme and Mosley, 1996; Pitt and Khandker, 2003).

In spite of the challenges observed in delivering financial services to the poor (particularly in remote areas), lessons and innovative practices on how to advance the microfinance frontiers in a sustainable ways are emerging. Toward the end of the 1990s, new and innovative approaches of delivering financial services to the poor have been implemented by deposit taking MFIs. Practitioners have identified and implemented the essential requirements needed to establish financial systems and innovative financial products and services that match the needs of the poor (Wolday, 2008).

Moreover, the renewed emphasis of the government of Ethiopia on poverty reduction, rural development and Micro and Small Enterprise (MSE) development in urban areas has also put the poor population back in the spotlight of the country's development agenda. To this end, the macro, meso, micro and sectoral policies and development programs give due focus to the provision of finance to the poor (Wolday, 2008).

The development of microfinance institutions in Ethiopia is a recent phenomenon. The proclamation, which provides for the establishment of microfinance institutions, was issued in July 1996. Since then, various microfinance institutions have legally been registered and started delivering microfinance services (Wolday, 2000). The introduction of microfinance in Ethiopia has been gradual with its initiation attributed to the proclamation in 1996 (Wabekon, 2006).

In doing so, several micro finance institutions have established and have been operating towards resolving the financial service access problem of the poor in Ethiopia based in different regional states of the country. Among these micro finance institutions, Omo microfinance institute is the one, which was established in October 1997 and legally registered by the National Bank of Ethiopia by the accord of Proclamation No.40/1996. It is operating in the Southern Nations and Nationalities Peoples Regional Sate (SNNPRS) through 14 branch offices and 154 sub branch offices in order to render its financial services of credit, saving, insurance, money transfer and micro lease.

MFIs help the poor to increase their income through providing loans for income generation activities and availing saving facilities. Since the demand for financial services is huge, there is high need for financial institutions, which can provide financial services to the poor in sustainable manner especially in low-income countries such as Ethiopia. Sustainability however, for microfinance institution that caters for the poor is not an easy task. Attaining the objective of financial sustainability and the objective of poverty alleviation successfully is the real challenge of microfinance institutions (Mubarek, 2006).

Owing to this reality, it is a quite important task of evaluating the performance Omo Micro Finance Institute from outreach, collection performance and financial sustainability angles using data obtained from primary and secondary sources in order to assert whether the objectives are met or not and for the necessary measures to be taken for the improvement of the Institute.

METHODOLOGY

Methods of Data Collection

The study has used both quantitative and qualitative method to obtain information on outreach and financial performance of the Omo MFI. For outreach indicators, the data were collected on number of clients, loan size, loan term, and percentage of women clients. Data for financial performance were mainly collected from the financial reports. Primary data were collected through semi structured questioners and discussion was held with executive officers of the MFI at head office level. The secondary data was mainly collected from published and unpublished documents.

Methods of Analysis

Basic tools to measure performance of microfinance institutions (MFIs) areas adopted from Richard Rosenberg (2009) were employed for the statistical analyses and it was concentrated on the major three areas of outreach, collection performance and profitability based on the availability of data.

Outreach

Breadth Outreach (number of clients served)

The best measurement of outreach is the number of clients or accounts that are active at a given point in time. The number of active clients includes borrowers, depositors, and other clients who are currently accessing any financial services.

Depth Outreach (client poverty level)

Many, though not all, microfinance projects have poverty reduction as an explicit objective, and are thus expected to reach poor clients. For this study we have used the average outstanding balance as a measure of indicator. outstanding balance includes only loan amounts that clients have not yet repaid, or savings that clients have not withdrawn. This was obtained by the following formula:

$$Average\ Outstanding\ Balance = \frac{Gross\ amount\ of\ loans\ /savings\ outstanding}{numNumber\ of\ active\ clients\ or\ accounts\ ber}$$

Collection performance

In order to evaluate the collection performance ***Portfolio at Risk (PAR), Loans at Risk (LAR), Current Recovery Rate (CRR)*** **and** ***Annual Loan-loss Rate (ALR)*** *were used for the analysis.*

The standard international measure of portfolio quality in banking is ***Portfolio at Risk (PAR)*** beyond a specified number of days:

$$PAR(days) = \frac{outstanding\ principal\ balance\ of\ all\ due\ more\ than\ x\ days}{outstanding\ principal\ balance\ of\ all\ loans}$$

The number of days (***x***) used for this measurement varies. In microfinance, 30 days is a common breakpoint. If the repayment schedule is other than monthly, then one repayment period (week, fortnight, quarter) could be used as an alternative.

Loans at Risk (LAR), a simpler indicator that counts the number of loans instead of their amounts. As long as repayment is roughly the same for large loans and small loans, LAR will not differ much from PAR.

$$LAR(xdays) = \frac{number\ of\ loans\ more\ than\ x\ days}{total\ outstanding\ balance}$$

An alternative measure, the ***Current Recovery Rate (CRR),*** can be computed by most MFIs, and gives a good picture of repayment performance—but only if it is interpreted very carefully.

$$CRR = \frac{cash\ collected\ during\ the\ period\ from\ borroers}{cash\ falling\ due\ for\ the\ first\ time\ during\ the\ period}$$

The CRR indicator should never be used without translating it into an ***Annual Loan-loss Rate (ALR)****.* Here is a simplified formula:

$$ALR = \frac{1 - CRR \times 2}{T}$$

Where T is average loan term expressed in years

Financial sustainability (Profitability)

profitability indicators such as return on equity and assets were used for the profitability analysis of this study. Return on Assets (**ROA**) was calculated by dividing net income (after taxes and excluding any grants or donations) by period average assets and Return on Equity (**ROE**) was calculated by dividing net income (after taxes and excluding any grants or donations) by period average equity. Mathematically presented as:

$$ROA = \frac{After-\ tax\ profits}{Starting\ (or\ over - period\ average)assets}$$

$$ROE = \frac{After-\ tax\ profits}{Starting\ (or\ over - period\ average)\ equity}$$

RESULTS

As indicate above, the findings stated below are from the primary and the secondary sources. In this section the paper presents findings of the study on outreach, collection performance and financial sustainability of Omo MFI in the country in brief.

Outreach

Assessing the number of clients being served by a given MFIs can been seen in its breadth and depth. Microfinance is supposed to be effective strategy to extend financial services to the poor and other disadvantaged groups not reached by formal sector banks. Generally, outreach, according to Webster and Fidler (1996), is evaluated in terms of scale (the number of people reached) and depth of outreach (the extent to which clients are poor and/or underserved by financial institutions.)

Breadth of outreach

As it can be observed from figure 1, the MFI breadth of outreach has shown increment over the period of the study with different rates of growth. The study showed

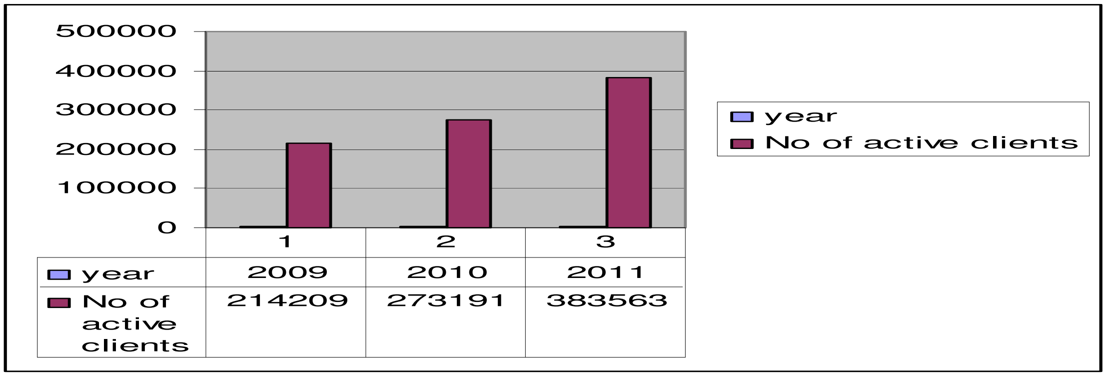

Figure 1: Trend of Outreach

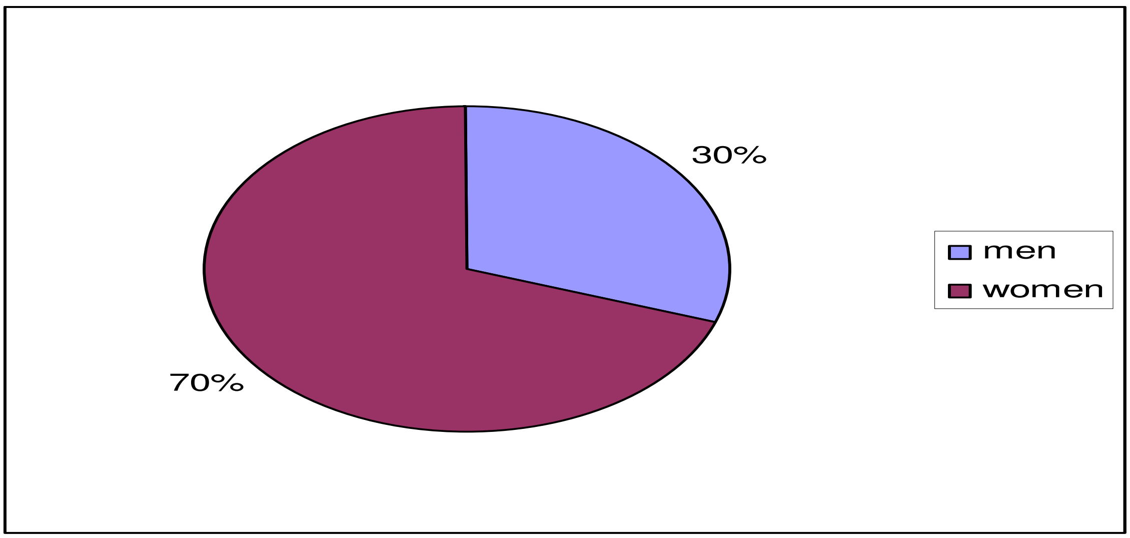

Figure 2. Women client share

that this microfinance registered the industry's breadth of outreach to rise in the period from 2009 to 2011 on average by 40.40 %.

Depth of outreach

In this case, the number of client is a mere indicator for how MFI is reaching the poor. Among the Various techniques to measure client poverty level, loan size is one of the simpler indicators that small loans represent poor clientele because of that better off clients are not interested in smaller loans. For comparison purposes, it is useful to express this indicator as a percentage of the host country's per capita GDP (atlas method). An average outstanding loan balance below 20% of per capita GDP or $US 150 (Birr 2628) is regarded by some as a rough indication that clients are very poor (Carla et al., 2003). In this regard, the study found that the Omo micro finance institute average outstanding balance was above $150, which is 3607.51 Birr.

On the other hand, one of the disadvantaged from economic empowerments point of view are women. The study found that the women clients participation was minimal in the study year. At the industry level women clients share was only 30% in 2011 as compared to men clients. (see Figure 2)

Collection performance

loan collection has proved to be a strong proxy for general management competence. Long experience with evaluating microfinance projects has shown that very few successful projects have bad repayment, and very few unsuccessful projects have good repayment. More than any other indicator, this one deserves special care to ensure meaningful and reliable reporting (Carla et al., 2003). In order to evaluate the collection performance of this institute, we have employed the following successive international measures of portfolio quality indicators.

PAR (>x days)

The standard international measure of portfolio quality in banking is *Portfolio at Risk (PAR)* beyond a specified number of days. For this study , we have used the data of 30 days late as it is a common breakpoint and which was calculated dividing the outstanding balance of all loans more than 30 days by outstanding balance of all loans and we have found 11.78 % PAR for this institute. Repayment of an MFI's loans is a crucial indicator of performance. Poor collection of microloans is almost always traceable to management and systems weaknesses. Portfolio or Loans at Risk (30 days or one payment period) above 10%, must be reduced quickly or they will spin out of control (IFAD, 2010).

LAR (>x days)

We didn't get any data to deal with this indicator.

CRR

The *Current Recovery Rate (CRR)*, can be computed by most MFIs, and gives a good picture of repayment performance. This can be calculated dividing cash collected by cash falling due according to the agreement made. So, the current recovery rate is 209.41%. The CRR indicator should never be used without translating it into an *Annual Loan-loss Rate (ALR).*

ALR

A loan loss rate tells us what percentage of a lender's loan portfolio is irrecoverably lost during a period (usually a year). There fore, this study exposed that the annual lose rate of this micro finance is 62.28 %. Annual Loan-Loss Rates above 5%, must be reduced quickly or they will spin out of control (IFAD, 2010).

Financial sustainability (Profitability)

The other indicator of performance of a micro finance institution is its financial sustainability. According to Webster and Fidler (1996), financial sustainability refers to the ability to generate sufficient revenues that cover total costs of service delivery, including operational and financial costs (the cost of the funds). Meyer (2002) indicated, "Measuring financial sustainability requires that MFIs maintain good financial accounts and follow recognized accounting practices that provide full transparency for income, expenses, loan recovery, and potential losses". In order to measure to measure financial sustainability of this MFI, we have calculated return on asset and return on equity. The result revealed 0.02 and 0.06 respectively.

DISCUSSION

Depth of outreach is measured by number of borrowers. This microfinance showed increment over years in the number of active clients. so this institute was good in this regard. However, large number of clients was not served as compared to millions of pro-poor people are reside in this region. As the depth of outreach is measured by average loan size, average loan size per GNI per capita for cross country comparisons and the percentage of women borrowers. This higher value for the average outstanding balance beyond the threshold level indicates the MFI was not good in reaching the poor and a lower value for the percentage of women clients indicates a bad depth of outreach as women are considered to be poor than men.

As the repayment is a critical indicator of the institute's collection performance, the study found that the Portfolio or Loans at Risk (30 days or one payment period) more than 10%. Hence, it tells us their repayment quality is not as such good that may affect their profitability in the long run that needs to be minimized. Moreover, the annual lose rate of the institute was above 5%. This showed that, the collection rate of this institute is very poor.

Operational self-sustainability is when the operating income is sufficient enough to cover operational costs like salaries, supplies, loan losses, and other administrative costs. And financial self-sustainability (which he referred as high standard measure) is when MFIs can also cover the costs of funds and other forms of subsidies received when they are valued at market prices. In this regard, the most common measure of profitability is *return on assets,* which reflects that institute ability to deploy its assets profitably and *return on equity*, which measures the returns produced on the owners' investment was small amount. Hence, the institute should work hard in order to profitable and self sustained. This reflects that the institute ability to use its assets productively was not good.

CONCLUSION

Based on the analysis made in the previous pages, the following conclusions are made on the performance of microfinance institute. Microfinance institutions, regardless of their social mission, are financial intermediaries. therefore, it should be financially viable and sound to achieve its mission. The paper examines the performance of MFIs in relation to outreach and financial sustainability. It reviews literatures on core performance indicators of MFIs. The institute was evaluated by major three indicators of performance on its outreach, collection performance and financial sustainability. From the outreach angle, it is found that individual MFI's outreach has shown increment over the period of the study with different rates of growth, leading the industry's outreach to rise in the period from 2009 to 2011 on average by 33.97 percent. It is also identified that while MFIs reach the very poor, their reach to the disadvantages particularly to women is limited (30 Percent) in 2011. From financial sustainability angle, it is found that MFI was not good. Their operational sustainable measured by return on asset and return on equity. The study also found out that the collection performance of the institute was bad.

In general, the study has also identified various challenges that constrain MFIs from efficient operations and the study recommends that different measures should be taken to strengthen the institute depicted here after accordingly. There should be a great attention given for women clients to address their problem. The institute gives strong attention for poor clients to meet the intended goal. The collection performance should be improved. It should work hard on profitability to be self sustained. Therefore, the results of this study confirm that poverty alleviation programmes need to be accompanied by a targeting strategy and a programme structure appropriate to the needs of the poor.

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