A Study on Institutional Viability and Financial Performance of Micro-Finance Institutions in Addis Ababa, Ethiopia- Special Reference with ADCSI, SFPI and Wisdom

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Abstract-*In this research paper, author would like to focus the micro-financing and its impact in Ethiopia. Currently micro-financing is one of the most powerful tools for combating poverty primarily by providing loan to the poor section of the society. The number of micro financing institutions serving the poor in Ethiopia has grown to over 30 with in short period of time. The growth and expansion of microfinance programs and increasing attention to microfinance as a poverty reduction strategy has given rise to a number of questions. What are the factors that are necessary for strong institutional viability and financial performance? What are the problems in achieving institutional sustainability and strong financial performance of MFIs? The case of three microfinance institutions namely, ADCSI, SFPI, and Wisdom operating in Addis Ababa were used to respond to the above questions. The main objective of the study is to assess the institutional viability and financial performance and draws conclusions and makes recommendations for improving the institutional viability and financial performance of the MFIs. The study used both quantitative and qualitative methods to obtain information on institutional viability and financial performance of the three sample MFIs. Primary data were collected through unstructured interview. Secondary data were mainly collected from audited financial statements. Finally, adjustments to financial data were made and the performances of the MFI were measured by taking selected indicators. The results of the study revealed that the ADCSI and Wisdom MFIs have achieved financial self-sufficiency in the years 2005 and 2006 respectively.*

Key words: *MFIs- ADCSI-SFPI-Wisdom-viability-financial- quantitative-qualitative- information*

1. Introduction

1.1. Background of the study

One of the most stylized facts of developing economies is that formal financial institutions leave the poorest population tightly constrained in their access to financial services. It is also widely recognized that economic progress relies largely on access to financial services such as savings, insurance, and credit. Where formal financial institutions fail the large majority of the poor population, there is evidence to support the proposition that microfinance institutions & credit unions can fill some of the gap (Barham, et. al., 1996). Micro-Finance Institutions (MFIs) can be defined as any activity that includes the provision of financial services such as credit, savings, and insurance to low income individuals which fall just above the nationally defined poverty line, and poor individuals which fall below that poverty line, with the goal of creating social value. The creation of social value includes poverty alleviation and the broader impact of improving livelihood opportunities through the provision of capital for micro enterprise, and insurance and savings for risk mitigation and consumption smoothing (Smith, 2006).

In Ethiopia, the poverty reduction strategy is becoming the operational framework to translate the global Millennium Development Goals (MDGs) targets in to national action (UNDP 2005). Microfinance (MF) is seen as one of the most efficient instruments to promote economic development and to fight poverty in poorer countries. Numerous microfinance institutions (MFIs) all over the world have proven that financial services can be offered on a sustainable basis with high outreach (Al-Bagdadi and Brüntrup, 2002). The goal of most MFIs is to alleviate poverty by targeting clients who previously have not had access to formal financial services. To a large extent, MFIs around the globe have succeeded in meeting this goal; indeed, it is safe to predict that the more MFIs are there, the more poor people will be able to invest in income-generating activities, accumulate savings, put their families on a more secure financial footing and generally improve their lives (Kristin, 2009).

1.2. Statement of the problem

The establishment of sustainable MFI that reach a large number of rural and urban poor who are not served by the conventional financial institutions, such as the commercial banks, has been a prime component of the new development Strategy of Ethiopia (Wolday, 2000). This indicates that there is a clear need, first in establishing the viability and importance of microfinance as a poverty alleviation approach for low income groups. It also helps in mainstreaming the concept of microfinance within the large development economic thought.

Institutional viability in this study refers to the extent to which institutions under takes projects that will help cover its costs, have its loans repaid and make profit (Seible, 1996 and Gutubig et. al., 1998). MFIs face a double challenge, not only do they have to provide financial service to the poor (outreach), but they also have to cover their costs in order to avoid bankruptcy (sustainability). Both dimensions must therefore be taken into account in order to assess their performance (Luzzi and Weber, 2006). MFIs in Ethiopia are facing problems of loan loss, limited fund for lending, unprofitable, problems related entrepreneurial quality of the client, staff with limited technical and banking skills, and weak supervision. Therefore, MFIs in Ethiopia lack the above qualities which are crucial for the viability and sustainability and able to be in business on its own and it is doubted that MFIs will continue as viable institution in future following the past condition as means of alleviating poverty, “creating social capital” and financial intermediation (Wolday, 2000). MFIs should start by defining a market gradually deal with finding the right client and appropriate mix of products, this means providing quality services in terms of timeliness, appropriateness of loan terms and condition given the customer; convenience and transaction cost of customer, clients relations etc. however, Chao-Beroff’s study explains, the service delivery methodologies and product of Ethiopian MFIs are supply driven instead of being demand driven. The MFIs usually start by copying the lending methodologies and products from other MFIs. In addition, clients are forced to fit into the procedures of the MFIs.

1.3. Objectives of the study

1.3.1. General objective of the study

The main objective of the study is to assess the Microfinance institutions operating in Addis Ababa, institutional viability and financial performance of the three microfinance institutions namely ADCSI, SFPI, and Wisdom.

1.3.2. Specific objectives of the study

The specific objectives of the study are:

1. To assessing institutional viability of microfinance operating in Addis Ababa;
2. To examine financial sustainability and performance of microfinance institutions, mainly in ADCSI, SFPI, and WISDOM;
3. To analyse the factors those are necessary for strong institutional viability and financial performance.
4. To assess the problems in achieving institutional sustainability and strong financial performance of MFIs.

1.4. Significance of the study

As discussed in the background and problem statements sections, the success of micro-financing operations has a paramount importance in the development endeavor of the country. The institutional sustainability in line with the two basic objectives is to improve the living standard of the poor and promote the mass mobilization in the nation's wealth creation as well as initiate other capable Ethiopians to participate in playing their role in the different sectors of the economy. Equally important, the micro-financing effort is currently backed by foreign donor countries and international agencies. So the effective coverage rate and service provision is expected to generate more assistance in the short-run while sustainable financial resource must be secured internally in the long-run. Besides, the government and pertinent offices have their own responsibilities. In line with the above facts, it is hoped that the results of this study will:-

1. Provide relevant information to decision makers (investors, donors, creditors, clients, or government) about how well the institutions are performing in reaching the poor and their contribution to poverty alleviation;
2. Give the management of the institutions the strengths and weaknesses of the current operating systems, and identifies the challenges of the MF industry; and
3. Suggest possible recommendations to improve or revise the existing financial performances of the institutions.
4. Furthermore, the result of the study is hoped to serve as a base for further research that enable the sustained operation.

1.6. Research Methodology

1.6.1. Sources of data and gathering techniques

The descriptive type of study was used to obtain information concerning the institutional viability and the quality of financial services offered by MFIs and to draw conclusions from the facts that were discovered. The research was conducted based on two types of data. Primary data were collected through self-administered unstructured interview questionnaires to Operation managers, human resource heads, and finance managers of the selected MFIs. The secondary sources of data were the main sources of data in this research project. The data were collected from an audited financial reports and annual reports of the institutions such as income statement and the balance sheet of Selected MFIs; business plan and policy documents; internal reports, data from books, journals, and publications and reports of various governmental and non-governmental organizations such as Association of Ethiopian Micro Finance Institutions (AEMFI) and national bank of Ethiopia and national bank of Ethiopia were used.

1.6.2. Target population and sample size

The actual numbers of registered MFIs as per the National Bank of Ethiopia (NBE) database are nearly 30. These MFIs operates at the different regions of the country and among them 12 MFIs are operating in Addis Ababa. Nonetheless, it will be much better and exhaustive for the study if there will be a chance of accommodating all MFIs found in Addis Ababa. However, to make the study manageable and to evaluate the problem in detail, the researcher was forced to delimit the study to incorporate only 3 of the MFIs found and operated in Addis Ababa. The selected microfinance institutions were:

1. Addis Credit and Saving Institution
2. Wisdom Microfinance Institution
3. Specialized Financial and Promotional Institution

1.6.3. Sampling techniques

To select the three MFIs out of the twelve that are operating in Addis Ababa according to their perceived performance, purposive sampling technique was used. The same sampling technique was used to draw respondents from the management and credit officers that are believed to provide the necessary information for the intended research.

1.6.4. Data analysis and Discussion

Different factors may be considered affecting the Institutional viability of MFIs. The institutional viability of the MFIs was evaluated with respect to the attainment of institutional goals, Ethiopian legal and regulatory framework for ownership and governance of MFIs, the capacity of employees of the MFIs, and Products and Services Offered by the Selected MFIs. The financial performance of the MFIs was assessed on the Portfolio Quality, Sustainability and Profitability, and Efficiency and Productivity of the selected MFIs. Qualitative data generated using the unstructured interview were analyzed in the course of data collection with the help of the target respondents by describing or narrating and interpreting the situation deeply so that the real picture of the institutional viability and financial performance will be understood vividly. Moreover, data generated from the financial statements were analyzed by using descriptive statistics such as percentages and was used in reporting the results. The results will be presented in tables.

2. Literature Review

2.1. Microfinance: Overview

The emergence of the global microfinance has a history of about three decades, yet has gone through stages of historical development. The microfinance industry is said to be in revolution: the service that was initiated in small scale and small village of South East Asia “Chintanga”, Bangladesh now turned to be international agenda and an issue addressing one of the main problems i.e. poverty in developing countries of the world (Arega, 2007). The term microfinance is of recent origin and is commonly used in addressing issues related to poverty alleviation, financial support to micro-entrepreneurs, gender development etc. There is, however, no statutory definition of micro finance. The taskforce on supportive policy and Regulatory Framework for Microfinance has defined microfinance as “Provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and improve living standards”. The term “Micro” literally means “small”. But the task force has not defined any amount.

However as per Micro Credit Special Cell of the Reserve Bank Of India , the borrowed amounts up to the limit of Rs.25000/- could be considered as micro credit products and this amount could be gradually increased up to Rs.40000/- over a period of time which roughly equals to $500 – a standard for South Asia as per international perceptions. (Biswas, 2002). Gonzalez and Rosenberg, (2005) often defined "Microfinance" as financial services for poor and low-income clients. In practice, the term is often used more narrowly, referring to services delivered by self-described "microfinance institutions" (MFIs) who usually use techniques developed over the last three decades to make and manage tiny uncollateralized loans. These techniques include group lending and liability, pre-loan savings requirements that test clients' willingness and ability to make regular payments, graduated loan sizes, and most importantly an implicit guarantee of quick access to future loans if present loans are repaid promptly. According to Robinson (2001), Microfinance refers to small-scale financial services – primarily credit and savings provided that to people who farm or fish or herd; who operate small enterprises or microenterprises where goods are produced, recycled, repaired, or sold; who provide services; who work for wages or commissions; who gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and groups at the local levels of developing countries, both rural and urban. Many such households have multiple sources of income. Savings services allow savers to store excess liquidity for future use and to obtain returns on their investments. Credit services enable the use of anticipated income for current investment or consumption. Overall microfinance service can help low-income people reduce risk, improve management, raise productivity, obtain higher returns on investments, increase their incomes, and improve the quality of their lives and those of their dependents. There are differences among countries and regions in the availability of microfinance services and in the level of unmet demand for these services. There are also differences in demand among small businesses, microenterprises, farmers, laborers, low-income salaried employees and others. Common to nearly all parts of the developing world, however, is a lack of commercial microfinance institutions – a shortcoming that unnecessarily limits the options and lowers the financial security of poor people throughout the world. But this pattern is changing. The microfinance revolution is emerging in many countries around the world. As used her the term refers to the large-scale, profitable provision of microfinance services – small savings and loans – to economically active poor people by sustainable financial institutions. These services are provided by competing institutions at the local level – near the homes and the workplaces of the clients – in both rural and urban areas. Financial services delivered at the local level refer to those provided to people living in villages and other types of rural settlements and to people living in low-income neighborhoods in semiurban or urban areas. Large-scale as used here means coverage by multiple institutions of millions of clients; or, for small countries or middle - and high-income countries with low demand, outreach to a significant portion of the microfinance market. Probability means covering all costs and risks without subsidy and returning a profit to the institutions. The evolution of the microfinance industry has led to a greater focus on the financial viability of MFIs (MIX, 2002). Microfinance services are provided by three types of sources:

1. Formal institutions, such as rural banks and cooperatives;

2. Semiformal institutions, such as nongovernment organizations; and
3. Informal sources such as money lenders and shopkeepers.

Institutional microfinance is defined to include microfinance services provided by both formal and semiformal institutions. Microfinance institutions are defined as institutions whose major business is the provision of microfinance services (ADB, 2000, 3).

2.2. The Development of Microfinance Institutions

The history of informal financial institutions, especially private money lending, can be traced to ancient Egypt and the Middle East. The Old Testament documents restriction on lending for interest among the Jews and describes morality issues related to collateral from the poor. (e.g. in the books of Deuteronomy, 23:20; 24:10-13, and Ezekiel, 18:8, 12,13,18) Thus, money lending to the poor with or without collateral must have been widely practiced, not only for commerce, but also for private consumption, since the provisions in these books of laws at the time were attempts to regulate the practice along religious and moral values, rather than to prohibit them (Degefe, 2009). According to Ledgerwood, J (1999), microfinance arose in the 1980s in response to the doubts and research finding about the delivery of subsidized in credit to the poor framers through government-owned specialized banks. The significant role of microfinance for development efforts around the world, particularly poverty reduction efforts, is undeniable. Where delivered appropriately, microfinance enables clients to protect, diversify, and increase their income, as well as to accumulate assets, reducing their vulnerability to income and consumption shocks. Thus, microfinance is an important component in strategies towards the achievement of the Millennium Development Goal (MDG) of halving absolute poverty by 2015 (Simanowitz, Anton, 2003). In the 1970s government agencies were the predominant methods of providing productive credit to those with no previous access to credit facilities people who had been forced to pay usurious interest rates or were subject to rent seeking behavior. Governments and international donors assumed that the poor required cheap credit and saw this as a way of promoting agricultural production by small landholders. In addition to providing subsidized agricultural credit, donors set up credit unions inspired by the Raiffeisen model developed in Germany in 1864. The focus of these cooperative financial institutions was mostly on savings mobilization in rural areas in an attempt to "teach poor farmer how to save" (Ledgerwood, J. 1999).

2.3. Microfinance Development in Ethiopia

Non-governmental credit schemes and informal sources of finance such as Rotating Saving and Credit Associations, known as Iquub and Iddir, and money lenders have existed in Ethiopia for many years (Aredo D., 1993). After economic liberalization in 1994, poverty and food insecurity led the government to adopt microfinance as a prime component of its new economic development agenda. The government, supported by international development community (bilateral donors, international NGOs, multilateral projects), promoted microfinance in the context of the poor performance of traditional banks in supplying suitable financial products for small framers. As in many developing countries, the banks had focused on granting medium-and long-term credits to more solvent clients. Ethiopia is one of the developing countries facing severe poverty. Ethiopia is located in the horn of Africa with a total surface area of 1.016 million square kilometers (CSA, 1997) and huge potential resources to produce agricultural output far beyond the need of its people. Despite its vast natural resource base Ethiopia is one of the most underdeveloped countries in the world (Al-Bagdadi and Brüntrup, 2002). As estimated by the World Bank the per capita income of Ethiopia is USD 110. It ranks 169 out of 175 countries in terms of the overall Human Development Index (UNDP, 2003). The country's economy is predominantly based on agriculture, which accounts for about 50% of GDP, 85% of exports and 85% of employment of the country (IFAD, 2001). Poverty and food insecurity are the main challenges and fundamental issues of economic and social development in Ethiopia (Gebrehiowot, 2002). It is estimated that in Ethiopia 44 percent of the population is living below absolute poverty line (Wolday, 2003). Poverty in this country is a manifestation of complex factors. Poverty in Ethiopia is not only indicated through the UNDP's Human Development Index (HDI), on which Ethiopia is ranked 169 of 175 countries, but also confirmed by national information sources (Al-Bagdadi and Brüntrup, 2002).

2.4. Conceptual framework for Supervision and Regulation of MFIs

Building sustainable financial institutions was accordingly considered by the government as a first priority for the microfinance industry. A next one was to build a genuine national microfinance industry. And, equally important, the old instrument of directed credit delivery was included in the regulation package. The government wanted MFIs to serve the rural subsistence farmers, as they represented the vast majority of the country's poor; microfinance had to play an important role in the national poverty reduction agenda (Ethiopian MFIs Country Scan, 2007). The main objective of regulation and supervision of any financial institution is to ensure sound practices and stability within the financial system. It is to protect the small depositors and maintain confidence in the financial system. In the case of MFIs, the key objective is to promote and protect the sustainability and stability of the rural financial system so as to ensure access by poor rural households to financial services. The other key objective of regulation and supervision of MFIs is to enhance their access to capital markets for leveraging commercial funds to expand their outreach. The laws governing the establishment and operations of MFIs in Ethiopia are directly or indirectly based on these objectives (Derk, et. al., 2009). The Monetary and Banking Proclamation of 1994 lays down the legal basis for the financial sector in Ethiopia. In this proclamation, the government clearly assigns the task of licensing and supervising banks, insurers and other financial institutions to the NBE. The key criterion for institutions is that they carry out banking business. This means the country follows a rather broad approach to banking supervision, which does not concentrate on deposit taking only, but instead explicitly includes lending of money as a banking activity, independent of the sources of this money. This formulation in the Monetary and Banking Proclamation has significant implications for the financial sector in general, as well as for the prudential regulation of microfinance. Unlike in many other countries, which focus on regulating only those intermediaries that mobilize deposits, the implication of the logic laid down is that the NBE also has to supervise and license all institutions that are involved only in credit extension.

2.4.1. Legal Framework for MFIs

The legal framework governing microfinance Institutions (MFIs) in Ethiopia comprises the Commercial Code of Ethiopia, proclamations issued by Government of Ethiopia (GOE)

(Proclamation No. 40/1996, and Proclamation No. 147/1998) and directives issued by the National Bank of Ethiopia. Microfinance institutions are required to incorporate as share companies in accordance with the provisions of Article 304 of the Commercial Code of Ethiopia. The applicable Articles of Proclamation No. 84/1994 dealing with the licensing and supervision of banking business and the Commercial Code of Ethiopia also provide the needed legal framework for incorporation and operation of MFI as well as their regulation and supervision by the National Bank of Ethiopia.

2.4.2. The Commercial Code of Ethiopia

The Commercial Code of Ethiopia clearly defines the manner of incorporation, governance and operation of all commercial companies and provides the criteria for formation, governance and winding up of such companies. The duties and responsibility of the shareholders, directors and the Chief Executives are also explicitly stated. The Commercial Code also provided that the elected board of directors is the decisive governing body of a share company next to the general assembly of shareholders, and accordingly is expected to safeguard the financial and business interests of the shareholders. The Commercial Code also defines share and the rights and duties of shareholders (Itana et. al., 2003). Prudential financial regulation according to Chaves and Gonzaliz - Vega (1994) has three major objectives (i) ensure the solvency and financial soundness of all intermediates; in order to project the stability of the country's payment system (ii) provide consumer (for example depositor) protection against undue risks that may arise from failure, fraud, or opportunities behavior on the part of the suppliers of financial services and (iii) promote the efficient performance of institutions and markets and the proper working of competitive market forces (Wolday 2000). Until very recently, the formation and governance of MFIs in Ethiopia were governed by the Licensing and Supervision of MFIs Proclamation (Proclamation No. 40/1996). This law is now repealed and replaced by the Micro Financing Business Proclamation (Proclamation No. 626/2009, herein after the MFI Proclamation). In addition, there are quite a few directives issued by the NBE that are still applicable. The Proclamation in force makes reference to the Commercial Code of Ethiopia (currently under revision) when it requires MFIs to be established in the form of a share company. When it comes to governance, we find provisions in all the above legal instruments.

2.4.3. Governance and framework of MFI ownership

In Ethiopia, MFIs are to be established in the form of share companies as defined under article 304 of the Commercial Code (CC). The Code defines a share company as "a company whose capital is fixed in advance and divided into share and whose liabilities are met only by the assets of the company." The NBE registers and licenses MFIs upon the latter fulfilling the requirements set by the MFI Proclamation and directives. A share company may not be established by fewer than five shareholders (Article 307 CC). An initial capital of ETB 200,000 is required to form an MFI. Like in the other financial services sub-sectors, capital/share of MFIs must be fully owned by Ethiopian nationals and registered under the laws of and having their head office in Ethiopia (Article 2(3) Proclamation No. 626/2009). Foreigners must not own an MFI, fully or partially. Any foreign national or organization fully or partially owned by foreign nationals may not be allowed to establish an MFI. Open branches or subsidiaries of a foreign micro-financing institution in Ethiopia or acquire the shares of an Ethiopian MFI (Article 25 of Proclamation No. 626/2009). This rule is a confirmation of what is seen in the investment regulation (Investment Regulation 84-2004).

In Ethiopia, the commercial banking system could not address the financial needs of poor households for the very fact that they are not their ultimate target clients. On top of that, the transaction costs and risks involved in serving poor households are perceived to be too high. In addition, even if there are few private banks that are interested in providing financial services to poor households, they have not developed yet a suitable credit methodology for micro lending activities and they do not have trained personnel for that (EBDSN, 2004). The first micro-finance service was introduced as an experiment in 1994 when the relief society of Tigray attempted to rehabilitate drought and war affected people through rural credit scheme (Micro-finance Development Review, 2000). Governance refers to a system of check and balance whereby a board of directors is established to oversee the management of the MFIs. The board of directors is responsible for reviewing, confirming and approving and plans and performance of the senior management, ensuring that the vision of the MFI is maintained of fulfilled (CGAP, 2000). Discussions on corporate governance have largely centered around large firms and in most cases in advanced economies. Stephen and Backhaus (2003) have highlighted that the problem of corporate governance is that of ensuring that enterprises operate in the interest of their owners and not the interests of managers and this emanates from the concept of separation of ownership and control. We focus on corporate governance because we believe the measures of corporate governance employed each have the ability to substantially influence the ability of investors to pressurize management to efficiently use resources available to microfinance institutions (MFIs). It is believed that, good governance generates investor goodwill and confidence. Thus corporate governance has been identified to have a significant impact on the performance of firms.

As a result, only a few MFIs are sustainable; most are not moving toward sustainability. In a context where resources are limited, “without self-sufficient financial institutions, there is little hope for reaching the numbers of poor firm households that are potential borrowers and depositors” (Ledgerwood, J. 1999). Viability is also important from an equity perspective because only viable institutions can leverage funds in the market to serve a significant number of clients and contribute to broad-based development. Viability is fundamental to reach a larger number of the poor which in turn is essential to have a significant impact on poverty reduction (ADB, 2000).

Table 1
Key Characteristics of a strong Microfinance Institution

Key areas	***Characteristics***
Vision	1. A mission statement that defines the target market and services offered and is endorsed by management and staff. 2. A strong commitment by management to pursuing microfinance as a potentially profitable market niche (in terms of people and funds). *3.* A business plan stating how to reach specific strategic objectives in three to five years.

Financial services and delivery Methods	1. Simple financial services adapted to the local context and in high demand by the clients described in the mission statement. 2. Decentralization of client selection and financial service delivery.
Organizational structure and Human resources	1. Accurate job descriptions, relevant training, and regular performance reviews. 2. A business plan spelling out training priorities and a budget allocating adequate funds for internally or externally provided training (or both).
Administration and finance	1. Appropriate performance-based incentives offered to staff and management. 2. Loan processing and other activities based on standardized practices and operational manuals and widely understood by staff. 3. Accounting systems producing accurate, timely, and transparent information as inputs to the management information system.
Management information system	1. Internal and external audits carried out at regular intervals. 2. Budgets and financial projections made regularly and realistically. 3. indicators that are most relevant to operations and are regularly used by staff and management in monitoring and guiding Systems providing timely and accurate information on key operations.
Institutional viability	1. Legal registration and compliance with supervisory requirements. 2. Clearly defined rights and responsibilities of owners, board of directors, and management. 3. Strong second level of technically trained managers.
Outreach and financial sustainability	1. Achievement of significant scale, including a large number of underserved clients (for example, the poor and women). 2. Coverage of operating and financial costs clearly progressing toward fill sustainability (as demonstrated in audited financial statements and financial projections).

Source*:* Ledgerwood, J. 1999.

2.7. Financial Performance of MFIs

MFIs earn financial revenue from loans and other financial services in the form of interest fees, penalties, and commissions. Financial revenue also includes income from other financial assets, such as investment income. An MFI's financial activities also generate various expenses, from general operating expenses and the cost of borrowing to provisioning for the potential loss from defaulted loans. Profitable institutions earn a positive net income (i.e., operating income exceeds total expenses). For the purpose of this review and to account for the institutional scale of operations, financial revenue and expense indicators as well as returns are compared against the institution's assets (MIX, 2005, 9). Effective financial management requires periodic analysis of financial performance. Performance indicators collect and restate financial data to provide useful information about the financial performance of an MFI. By calculating performance indicators, donors, practitioners, and consultants can determine the efficiency, viability, and outreach of MFI operations. The achievements of MFIs are examined through the lenses of standard industry performance metrics over a series of variables: Outreach (breadth and depth), financial structure, financial performance, efficiency and productivity, and portfolio quality (Lafourcade, et.al, 2005, 6). Several levels of sustainability can be applied to microfinance. In general, the first stage, operational sustainability, is referred to when a microfinance institution covers its administrative costs and loan loss expenses from its client revenues. A second level of sustainability, referred to as financial sustainability, is attained when an institution which is operationally sustainable is able to cover the cost of funds, including inflation. By borrowing from a commercial bank, the equity of the MFI is leveraged, and the institution is able to pay the additional cost of commercial borrowing from its income stream. Financially sustainable institutions can become licensed financial institutions. The implications of getting such license are considerable, since MFIs which have reached this stage can raise resources from their national financial market and are likely to have access to rediscount lines from central banks, in amounts that are five to ten times their equity (UNCDF, 1999, 12). Zeeler and Meyer (2002, 4) 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."

3. The Institutional Viability and Financial Performance of the Selected MFIs

3.1. Institutional Viability

Building sustainable financial institutions was considered by the government as a first priority for the microfinance industry. A next one was to build a genuine national microfinance industry. And, equally important, the old instrument of directed credit delivery was included in the regulation package. The government wanted MFIs to serve the rural subsistence farmers, as they represented the vast majority of the country's poor; microfinance had to play an important role in the national poverty reduction agenda. Different factors may be considered affecting the Institutional viability of MFIs. The institutional viability of the MFIs was evaluated with respect to the attainment of institutional goals, Ethiopian legal and regulatory framework for ownership and governance of MFIs, the capacity of employees of the MFIs, and Products and Services Offered by the Selected MFIs.

3.1.1. Vision and Mission of the Selected MFIs

The vision and mission of the MFIs under study are basically poverty alleviation through provision of sustainable financial services to the poor who do not have access to the financial support services of other formal financial institutions. The mission and vision of the selected MFIs have been well articulated in their documents of incorporation or their business plans.

Table 2
Vision and Mission of the MFIs

MFI	Vision	Mission
ADCSI	To become active contributor towards poverty reduction effort and would like to see improvement in the life of low-income people.	To promote micro and small enterprises to alleviate poverty and unemployment prevailing in Addis Ababa City Administration territory through provision of sustainable financial and other related service with particular attention to women
SFPI	To enhance the socio-economic empowerment of disadvantaged people especially women by accessing them to support services like credit saving and business training.	To facilitate socio-economic empowerment of under privileged people in rural and urban Ethiopia.
Wisdom	Improved economic, social and moral well being of the productive poor in the rural and urban settings of Ethiopia by way of promoting development of economically viable and sustainable micro enterprises though quality financial and non-financial services within accepted societal values and business ethics	Promoting development and expansion of economically viable and sustainable micro-enterprise through quality financial and non-financial services.

Source: From documents of the selected MFIs.

3.1.2. Ethiopian Legal and Regulatory Framework for Ownership and Governance of MFIs

In Ethiopia, there are numerous policies, laws and directives that affect the development of microfinance industry. The Monetary and Banking Proclamation No. 83/1994 empower the National Bank of Ethiopia (NBE) to license, supervise and regulate financial institutions such as banks, insurance companies, microfinance institutions and saving and credit cooperatives. The Licensing and Supervision of Banking Business Proclamation No. 84/1994 allowed for the first time the establishment of private financial institutions, thus breaking state monopoly. Until very recently, the ownership and governance of MFIs in Ethiopia were governed by the Licensing and Supervision of MFIs Proclamation

(Proclamation No. 40/1996). This law is now repealed and replaced by the Micro Financing Business Proclamation (Procl. No 626/2009, herein after the MFI Proclamation). In addition, there are quite a few directives issued by the NBE that are still applicable. The National Bank of Ethiopia (NBE) is authorized to license, regulate and supervise MFIs, which are required to be incorporated under Section 304 of the Commercial Code of the country as for-profit share companies, wholly owned by Ethiopian nationals or organizations owned by Ethiopian nationals. The Proclamation in force makes reverence to the Commercial Code of Ethiopia (currently under revision) when it requires MFIs to be established in the form of a share company. When it comes to governance issues, we find provisions in all the above legal instruments. In Ethiopia, the proclamations are enacted by the parliament and secondary legislations or directives that govern the operation of financial institutions are issued by the central bank.

3.1.2.1. Legal Structure and framework of MFI ownership

In Ethiopia, MFIs are to be established in the form of share companies defined under article 304 of the Commercial Code of Ethiopia (CCE). The Code defines a share company as "a company whose capital is fixed in advance and divided into share and whose liabilities are met only by the assets of the company." The NBE registers and licenses MFIs upon the latter fulfilling the requirements set by the MFI Proclamation and directives. A share company may not be established by fewer than five shareholders (Art. 307 of CC). An initial capital of ETB 200,000 is required to form an MFI. Like in the other financial services sub-sectors, capital/shares of MFIs must be fully owned by Ethiopian nationals and/or organization wholly owned by Ethiopian nationals and registered under the laws of and having their head office in Ethiopia (Art. 2(3) Proclamation No. 626/2009). Foreigners must not own an MFI, fully or partially. Any foreign national or organization fully or partially owned by foreign nationals may not be allowed to establish an MFI, open branches or subsidiaries of a foreign micro-financing institution in Ethiopia or acquire the shares of an Ethiopian MFI (Art. 25 of Procl. 626/2009). This rule is a confirmation of what is seen in the investment regulation (Investment Regulation 84-2003). This restriction of ownership in MFIs to Ethiopian nationals has led to the existence of nominal shareholders who normally hold shares effectively provided by foreigners, and who do not have real stake in the MFIs (cf. e.g. Ayana et al. 2003). In fact, most MFIs in Ethiopia receive a substantial amount of their capital either from foreign or local NGOs or regional governments. Some MFIs have grown out of NGO credit activities operating before 1996, i.e. before the MFI Proclamation was issued, while others have been newly established. From the NGOs, World Vision, Catholic Relief Services, and Christian Relief and Development Associations are known to have assisted some of the existing MFIs. ADCSI MFI receives its substantial amount of capital from regional governments. In recent years, banks have shown interest in contributing capital to the formation of some MFIs. Typical examples here are Dashen Bank and CBE both of which are shareholders of the Specialized Financial and Promotional Institution (SFPI). The banks' motive in investing in this particular MFI is not financial returns or to diversify their investment, but rather to fulfill their corporate social responsibility. For that matter, the Memorandum of Association of SFPI does not allow division of dividends among the shareholders.

The ownership structure of the 3 surveyed MFIs is shown in table 3 below. It is clear from the table that ADCSI, one of the biggest among the selected MFIs was established with paid up capital of Birr 517,000 where 96.7 % is owned by regional government and the remaining 3.3% by Associations and NGOs. It should be noted that the region-based and supported MFIs in Ethiopia do not get direct funding from the budget of the regional government. 50.6% of SFPI is owned by Commercial Banks and Insurance companies, 39.5% by Associations and NGOs, and the remaining by Individuals MFIs and it was established with paid up capital of Birr 406,000. Wisdom MFI was established with paid up capital of Birr 200,000 and has shown an ownership structure with 100% individuals as shareholders. In ADCSI MFI, board members are high government officials. The major problem of the MFI is which high-ranking government officials are board members is the irregularity of board meetings because of the engagement of the officials in priority government duties and responsibilities and unexpected absence for official travels.

Table 3
Ownership of MFIs – number and composition of owners

MFI	**No. of shareholders**	**Percentage share of shareholders by type**			
		Regional government	NGOs/ Associations	Individuals	Total
ADCSI	7	96.7	3.3	-	100
SFPI	8	-	80	20	100
Wisdom	37	-	-	100	100

Source: AEMFI, Ethiopian MFIs Performance Analysis Report: Bulletin, Addis Ababa, Ethiopia.

In ADCSI the respective regional governments own 96.7% of the Shares and there is no provision in its document of incorporation to transfer these shares to clients or to private investors. Under normal circumstances, government ownership sometimes may facilitate resource flow but it has some negative implication on loan recovery in case of say, political unrest. There is also risk of lack of diversification in ownership of this MFI. Shareholders in the sample MFIs were mobilized mainly to fulfill the requirements of the proclamation and the guide lines of the National Bank of Ethiopia. Therefore, the shareholders are just nominal owners. Moreover, when programs that were operated by NGOs or other subsidized government programs are converted into financial institutions, it is obvious that people deployed into the new system either as board members or chief executive, always come with dual mission. It is difficult for them to easily discard the welfare orientation and lead the MFIs as purely profit oriented financial institutions. These issues have their own implications in the effectiveness of the governance of the MFIs. In MFI such as ADCSI, where the regional government has the majority shares, gradual relinquish of shares to clients of this MFI, private organizations like banks, universities and foundations would help to diversify the ownership of this MFI.

Qualification of Board Members

There is only a degree of diversion in best practice papers as to which qualifications of boards members are preferable. Thus, CGAP (1997) does not refer to qualifications at all. WOCCU (2007) recommends that "all members of the board should have basic financial literacy, including the ability to interpret financial statements and standards, or commit to acquiring these skills through education or training within the first year of service", and this basic requirement should be complemented by "specialized financial or business skills and/or a member-focused viewpoint" of individual members. Directive No. MFI/03/96 is related to the criteria for selection of officers and directors. It says a minimum of first degree in the field of social science or equivalent in relevant field and a minimum of three (3) years experience in a senior post in a financial institution or related institutions. The minimum age required is 30. The board members are selected by considering the academic qualifications, adequate managerial experience in business and/or similar organizations, and being a member of the founder in the institution.

Table 4
No. and Qualifications of the board members of the MFIs

MFIs	No. of Board Members	Qualification of Board Members	
		2^{nd} Degree	1^{st} Degree
ADSCI	7	3	4
SFPI	5	1	4
Wisdom	9	3	6

Source: From author's computation, 2011.

Table 4 above indicates that, in almost all of the MFIs, the board members are qualified people who are committed to the cause of the MFIs. The educational level of each selected MFIs board members ranges from a first degree to masters level and complies with the requirements of the NBE directives. However, they have limited experience in microfinance management. The academic profile of the board members in ADCSI MFI fulfills. The competency of some board members in ADCSI MFI in terms of diversified skills and effectiveness in guiding the managers of MFIs is questionable. When documents of the ADCSI MFI reviewed by the researcher, it was identified that even though the boarded of directors of the institution consists well-educated and experienced on their own past duties, who can contribute significantly to good governance, there is an immense need for capacity building as most of the board of directors lack experience in microfinance business.

3.2. Financial Performance Measurement in Microfinance

Microfinance institutions, regardless of their social mission, are financial intermediaries. Therefore, it is important to assess the viability and soundness of MFIs. To evaluate the performance of micro finance institutions SEEP Network and CGAP (most widely used) evaluate financial and operational performance in terms of a. Portfolio Quality, b. Sustainability and Profitability and c. Efficiency and Productivity

3.2.1. Portfolio Quality

Since the largest source of risk for any financial institution exists in its loan portfolio, the quality of portfolio is crucial for MFIs. In case of microfinance institutions, whose loans are typically not backed by property collateral, the quality of portfolio is absolutely crucial. The most widely used measure of portfolio quality in the microfinance industry is portfolio at risk (PAR), which measures the portion of the loan portfolio 'contaminated' by arrears as a percentage of the total portfolio. This rule is much stricter than what is practiced among commercial banks, but it is justified, given the lack of bankable collateral. Any portfolio at risk (PAR 30) exceeding 10% should be cause of serious concern, because unlike all performances measures, portfolio at risk can be manipulated. The most common form of doing this is to write off delinquent loans. Portfolio at risk must therefore always be analyzed together with the write off ratio. On average all ADCSI, SFPI and Wisdom achieved relatively better portfolio quality as shown by low portfolio at risk rate which is on average below 5% for the fiscal years under consideration. The portfolio at risk rate of ADCSI improved from year to year. It registered 0.00% rate of portfolio at risk for the year 2007. The portfolio risk decreases from 3% in the year 2008 to 2.4% in the year 2009. The portfolio at risk rate for SFPI was high in the year 2007 (7.5%) but showed a significant decline in the subsequent periods, 4% and 3.2% in the year 2008 and 2009 respectively. Wisdom registered low rate of portfolio at risk in the year 2007. However, this rate continued to increase in the subsequent years. For example, from 3% in the year 2008 to 5% in the year 2009. The risk coverage ratio gives the indication of how the institution is prepared for the worst case scenario. For microfinance institutions, loan loss reserves usually range on average between 33% and 65% of portfolio at risk for the selected MFIs. SFPI and Wisdom MFIs, provide higher provision, almost two times greater than an average for ADCSI. One of the most impressive characteristics of Ethiopian MFIs is that the loan recovery rate is generally high. According to AEMFI's recent Ethiopian Microfinance Institutions performance Analysis Report (Peck and Ephrem 2009), the loan loss rate of Ethiopian MFIs ranges from 0% to 17%, at a weighted average of 5%. The selected MFIs showed a better performance in this regard. The write-off ratio measures the actual loan loss the MFI is suffering from loan provision service. The writing off of a loan is accounting transaction to prevent asset from being unrealistically inflated by loan that may not be recovered. The write-off ratios for ADCSI were below 2% on average and it indicates that ADCSI is good in this regard. SFPI registered write-off ratio of 4.92% on average and for the year 2009 registered 8.18% which is high as compared to the other years and above ADCSI and Wisdom MFIs. The higher write off rate contribute for low portfolio at risk of SFPI in the 2009 fiscal year. Like ADCSI the Wisdom's write of ratio is below 2% on average for the years under study.

Table 5
Portfolio Quality of Microfinance Institutions

ADCSI	**2009**	**2008**	**2007**	**2006**	**2005**	**Average**
Repayment rate	97.00 %	97.10 %	97.90 %	98.10 %	98.30 %	97.68 %
Portfolio -At-Risk (PAR) Ratio > 30 days	2.40 %	3.00 %	3.20%	3.50 %	0.90 %	1.96 %
Write-offs-Ratio	1.00 %	1.00 %	1.30%	1.50 %	2.20 %	1.40 %

Risk coverage ratio	20.00 %	23.00 %	27.00 %	47.90 %	70.00 %	32.18 %
Loan Loss Rate	1.00 %	1.00 %	1.30%	1.50 %	2.20 %	1.40 %
SFPI						
Repayment rate	79.78 %	78.03 %	76.08 %	29.80 %	93.69 %	71.48 %
Portfolio -At-Risk (PAR) Ratio > 30 days	3.2%	4.00 %	7.5%	4.0%	4.5%	4.6%
Write-offs-Ratio	8.18 %	2.00 %	6.1%	2.9%	5.40 %	4.92 %
Risk coverage ratio	71.00 %	72.00 %	70.5%	57.6 %	51.20 %	64.46 %
Loan Loss Rate	2.40 %	2.00 %	5.40%	2.90 %	6.10 %	3.76 %
Wisdom						
Repayment rate	98.00 %	97.00 %	96.00 %	98.00 %	98.00 %	97.40 %
Portfolio -At-Risk (PAR) Ratio > 30 days	5.0%	3.0%	2.70%	4.70 %	3.30 %	3.7%
Write-offs-Ratio	1.38 %	2.0%	3.30%	2.20 %	2.80 %	1.94 %
Risk coverage ratio	62.00 %	60.00 %	51.30 %	35.50 %	85.00 %	58.76 %
Loan Loss Rate	0.73 %	0.97 %	2.20%	1.20 %	2.20 %	1.12 %

Source: Researcher's own computation from financial statements

3.2.2. Sustainability and Profitability of Microfinance Institutions

Profitability and sustainability ratios reflect the microfinance institutions' ability to continue operating and grow in the future. Regardless of their nonprofit or for profit status; donors and investors alike look to fund sustainable institutions. Sustainability and profitability of microfinance institutions were measured and analyzed using Adjusted Return on Assets (AROA) and Adjusted Return on Equity (AROE); and operational and financial self sufficiency as follows:

3.2.2.1. Adjusted Return on Assets Ratio and Adjusted Return on Equity

Adjusted Return on Assets Ratio

Adjusted Return on Assets (AROA) indicates how well an institution is managing its assets to optimize profitability. The ratio includes not only return on portfolio, but also all other revenue generated from investments in other operating activities. Balance sheet percentages are usually based on the total assets (as 100%). This analysis was based on the statement of financial position and the profit and loss reports of the selected MFIs. For ADCSI MFI, from the year 2005 to 2009 the total assets show an increasing figures and the net worth at the end of 2009 increased compared to the previous years, whereas the firm's total liabilities during the years showed increasing pattern. The increase in assets and net worth are attributed to the higher operating income generated by the firm and thus, the adjusted return on assets showed positive ratios for the fiscal years of 2008 and 2009. This shows that ADCSI was good in managing its assets to optimize profit and related with the increase in net income. Whereas, in the fiscal year 2006 and 2007, its adjusted return on assets showed negative ratios of -6.50% and -8.10% respectively and this shows that ADCSI was not good in managing its assets to optimize profit in these years. Generally, the AROA showed an improvement on the recent years and this is because ADCSI improves how to manage its assets to optimize profit. The adjusted return on assets (AROA) for SFPI from 2005 through 2007 fiscal periods was -9.0%, -2.7% and -3.5%, respectively. From 2005 through 2007 fiscal periods the return on assets ratio showed negative ratio together with the decrease in net income. The return on assets reported in 2008 was 3% which is good of all the years under consideration. While this ratio in the fiscal year 2009, reduced to 1.5%. This low return on asset ratio reported in the fiscal year 2009 is mainly due to the low level operating income reported by the firm. Thus, this tells us that the firm did accomplish better in the years 2008 and 2009 as compared to the other year under consideration. On the other hand, in 2007, in its full year operation, Wisdom MFI reported a return on assets ratio of -7.80% which is a bad achievement for the firm. However, in 2008 the firm generated a total income of birr 17,728,420. As a result, it reported positive return on assets (0.0%). According to the officials the income reported in 2008 were due to the higher financial revenue generated during the period and the lesser expensed incurred during the same period. This shows a relative good performance made by the firm. However, the firm could not maintain its positive ratio in the fiscal year of 2009 and this shows that there is a problem in managing its assets. Based on the summary of the table 6 below, ADCSI MFI secured a better positive return on assets. But the remaining with SFPI performing well in the year of 2008, MFIs had a negative return. Thus, it can be concluded that microfinance institutions operating in Addis Ababa were doing well in the year 2008 from profitability and sustainability point of view. However, in general, the MFIs performance is not sufficient since the ratio showed negative in most of the years under study.

Adjusted Return on Equity (AROE)

Adjusted Return on Equity (AROE) measures net operating income less taxes as a percentage of total equity. The ratio indicates a microfinance institutions ability to build equity through retained earnings and demonstrates an institutions capacity to generate income from its core financial activity (SEEP, 2005). For ADCSI MFI the adjusted return on equity was measured based on its financial statements from 2005 to 2009 fiscal years. The results for both 2008 and 2009 show a positive ratio even though there were a decrease ration in the fiscal year of 2009 as compared to 2008 and this was because of the decreasing operating income over the year. Generally, the performance of the MF in this regard is better. When we look at the results of SFPI again in the same Table 6 below, the AROE in 2008 shows a good performance as compared to the previous year. However, in the fiscal period of 2009 it decreased as compared to the year 2008. This is due to the decreased amount of operating income. As many commercial financial institutions target AROE of about 15% to 25%, the results obtained for SFPI is also very low. But generally, the institution performed better in the 2008 and 2009 fiscal years.

For Wisdom MFI the results of AROE reflected mostly negative ratio except for the fiscal years 2006 and 2008 which are 2.60% and 0.00% respectively. The negative return on equity in 2005, 2007 and 2009 were due to the higher operating expenses incurred during the fiscal periods by the firm. Generally, under the years considered, this microfinance institution reported a negative return on equity. This shows that the institution's ability to generate income from its core financial service activity was not good. For a MFI that began formal operation in 2005, the result reported during the same year is not encouraging.

3.2.2.2. Operational Self-Sufficiency and Financial Self-Sufficiency

Operational self sufficiency indicates whether revenues from operations are sufficient to cover all operating expenses. It reflects the MFI's ability to continue its operations if it receives no further subsidies. The breakeven point of an MFI's operation is 100 percent. Whereas, financial self sufficiency measures not only MFI's ability to cover its operating costs but also its ability to maintain the value of its equity relative to inflation and to operate and expand without subsidies.

Table 6
Sustainability and Profitability of Microfinance Institutions

ADCSI	**2009**	**2008**	**2007**	**2006**	**2005**
Return on Assets	3.00%	4.00%	-8.10%	-6.50%	5.00%
Return on Equity	4.00%	6.00%	-11.90%	-9.20%	7.00%
Operational self-sufficiency	156.0%	192.0%	156.00%	135.20%	197.30%
Financial sustainability	49.10%	98.00%	63.10%	50.40%	106.60%
SFPI					
Return on Assets	1.5%	3.0%	-9.0%	-2.7%	-3.4%
Return on Equity	3.4%	6.0%	-23.0%	-5.1%	-6.5%
Operational self-sufficiency	110.0%	119.0%	111.3%	127.0%	104.0%
Financial sustainability	83.4%	54.0%	59.6%	84.60%	80.7%
Wisdom					
Return on Assets	-2.0%	-5.10%	-7.80%	1.10%	-2.10%
Return on Equity	-4.5%	-8.90%	-19.0%	2.60%	-4.90%
Operational self-sufficiency	92%	96.0%	99.10%	129.10%	107.1%
Financial sustainability	69%	56.0%	72.7%	105.2%	90.9%

Source: Researcher's own computation from financial statements

3.2.3. Efficiency and productivity of MFIs

Efficiency and productivity indicators reflect how well an MFI uses its resource, particularly its assets and personnel. This particular study employed operating expense ratio; personnel productivity (borrowers per credit officers); and cost per borrower as efficiency and productivity indicators.

Operating expense Ratio

This ratio shows administrative and personnel expense to the MFI's yield on the gross loan portfolio. It is the ratio of operating expense to average gross loan portfolio. The lower the ratio, the more efficient the MFI is. An attempt was also made to evaluate the operating expense ratio of the selected MFIs. The results obtained are presented for each of the MFIs as follows: From table 7 below, it can be observed that ADCSI's cost per unit of money lent ratio is 3.15% on average for the years under study for administration and personnel in order to provide a Br 1 loan to their customers. Thus, for ADCSI this cost for 2007 was 3.30% per unit of money lent which is less than the 3% ratio shown for 2008. However, in 2009 the ratio increases to 3.23%. Therefore, one can deduce from this that even though the operating cost ratio in 2009 increases, compared to SFPI and Wisdom, ADCSI was efficient in its operating expense. The results obtained for SFPI from the annual reports showed medium ratio as compared to ADCSI and Wisdom. The cost per unit of money lent for SFPI for the years under study reported 9.82% on average. Hence, one can infer from this that the institution seems efficient compared to Wisdom whereas inefficient compared to ADCSI. Wisdom has relatively high operational expense in relation to the other MFIs. In that, the firm reported an operating cost ratio of 17% on average for the years under consideration. Hence, it seems a bit inefficient and unproductive compared to the ADCSI and SFPI.

4. Recommendations

1. Ownership and Governance structure

Ownership structure of the three sample MFIs reveals that the ownership is mainly a mixture of NGOs, governments, association and private individuals. On the face value, it looks appropriate; nonetheless, there are risks involved mainly because of the nominal nature of shareholding and lack of diversification in ownership. This inherent flaw in the ownership structure of these MFIs may create a problem as the MFIs grow and in some cases, it may be bottleneck for growth. Therefore, the ownership and governance MFIs has to be revisited as follows:-

1. Although Board of Directors of sample MFIs are qualified people, they lack awareness and are generally less exposed to the microfinance industry. The appropriate training and exposure visits to the best practice MFIs in Asia, Latin America and Africa should be given to Board members.
2. In order to increase sense of responsibility and accountability it is necessary to develop code of conduct for Board members regarding attendance in meeting and mechanism of self evaluation and individual contribution.
3. Providing the necessary incentives to Board members could maximize the benefits by involving them in strategic issues.
4. In ADCSI where regional government own the majority shares, diversification in MFIs should be done by gradual relinquish of shares to clients of MFIs, private organizations like bank, universities and foundations.

2. Human resource Development

Lack of staff development primarily affects staff motivation and then the performance of institution itself. Secondly, it might end up in high staff turnover that force MFIs to lose the most experienced employee. Hence, sample MFIs should develop and put in place clear staff development strategy such as, carrier structure with attractive pay scheme and staff training policy. SFPI and Wisdom should consider introducing performance related incentive system and packages of benefits based on their financial capability. Moreover, it is important for sample MFIs to work closely with the regional government to get scholarship and sponsorship for best performing staff. Once staff training policy is developed, the project document developed and submitted to those donors in capacity building. In addition, policy could be adopted to allocate certain percentage of personnel cost for staff development each year to be built in annual plan.

3. Financial Sustainability

Even though the MFIs were doing well in terms of profitability and sustainability, certain MFIs should exert maximum effort to pass the minimum threshold level in connection with financial self-sufficiency to cover their costs, grow and sustain by their own. Since return on equity for Wisdom MFI is negative for majority of the years under consideration, this institution should work on it and move towards positive return on equity because this is the means to assure its survival in the market by its own, without the immense support of donors. MFIs should devise a means to obtain funds from diversified sources in order to minimize the risks associated with obtaining funds from few sources. SFPI and Wisdom MFIs should decrease their operating expenses in order to become more efficient through experience sharing with the most efficient counterparts and benchmarking themselves against best performers in the industry. ADCSI MFI should reappraise itself to ascertain whether it is reaching the poorer section of the society or not and act accordingly.

5. Conclusion

Microfinance programs and institutions are increasingly important in development strategies to reduce poverty. Microfinance, has the potential of addressing poverty both directly, by improving income growth and economic security, and indirectly, through the impact of greater economic security on social relation at community level and within the household. Paramount objective for MFIs to be successful is financial self-sustainability and in achieving this objective, MFIs have challenge in how to become viable institution that built a firm foundation of efficient operation. Institutional and financial viable microfinance institutions play a leading role in poverty reduction. Given this state of affairs the assessment of microfinance programs remains an important field for researchers, policy makers and development practitioners. This paper is designed to assess institutional viability and financial performance of the MFIs operating in Addis Ababa based on the case study of three institutions namely, ADCSI, SFPI and Wisdom. The study has used both quantitative and qualitative method to obtain information on institutional viability and financial performance of the three sample MFIs. After the gathering of the primary and secondary date, adjustment to financial data was made and then the performances of the MFIs were measured by using financial ratio analysis. Microfinance institutions, regardless of their social mission, are financial intermediaries. Therefore, it should be financially viable and sound to achieve its mission.

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