European Journal of Business and Management
ISSN 2222-1905 (Paper) ISSN 2222-2839 (Online)
Vol.5, No.28, 2013

Loan Provision by Micro Financing Institutions for Poverty Reduction and Its Linkages with Local Economic Development Strategies in Ethiopia

Muhammedamin Hussen*

Department of Management, College of Business & Economics, Haramaya University, Ethiopia
* E-mail of the corresponding author: aminoojuuu@gmail.com or aminoojuma@yahoo.com

Abstract

Micro Financing Institutions (MFIs) loan provision to poor is proving as a key strategy for poverty alleviation and inadequate access to credit by the poor has been identified as one of the contributing factors to poverty. To this end, this studies aims at assessing linkages between MF loans Provision in line with local economic development and provide basis for policy formulation at regional and national level in regard to MFIs and LED. To attain this objective, studies from Ethiopia and other countries have been reviewed. Empirical reviews showed that these institutions provided opportunities for self-employment; improved women's security; autonomy, self confidence and status within the society and household; helped in improving children's Education. Above all, as pro-poor program; they targeted the most vulnerable groups in society, particularly women, who remain confined to households with little or almost no assets. In Ethiopia, great efforts are being made since last two decades by expanding MFIs loan provision services to the various groups of the people specifically the poor to facilitate poverty reduction effort. Despite the increasing reliance on MFIs as one of the instrument to reduce poverty in Ethiopia; very little work has been undertaken to examine the linkage of the microfinance expansion with local economic development (LED) strategy of the particular region. The studies reviewed revealed that there has been duplication of business undertaken in various parts of the region. This is due to lack of linkage and synergy of the loan provision by MFIs to the LED strategy of a given local area in particular and regions in general. The reviewed literature indicated that on account of decentralization of the development plan to optimize the potential of each region and mobilize resources; the local governments have been empowered to undertake social and economic development endeavor.

It has also been found that, the Growth and Transformation Plan (GTP) (2010/11-2014/15) and LED were closely aligned. The interconnection between GTP and LED existed directly through the micro-small scale enterprises (MSE), cooperatives and other associations. Since LED aims to create efficient and functioning local economies as a consequence it has a direct alignment with growth and transformation efforts. Therefore, linking the microfinance loan provision to the local development priority appeared is very critical for the sustainability of the MSE businesses to benefit from local available potential resources for poverty alleviation program. Empirical evidences reflected that the current urban policy, the MSE strategy and the regional development framework provided additional opportunities for the implementation of LED and creating synergy between MFIs & MSE in Ethiopia. In light of the above view, the current MFIs loan provisions and local development priority of various regions as very important point of emphasis unseen in Ethiopia. Moreover, the findings of the study revealed that there is clearly identified lack of synergy between MFIs, MSE, Cooperatives Agency, Local administrative apparatus and LED in various regions in Ethiopia. This necessitates the stakeholders have to set policy that fills up the gap and create strong linkage between MFIs loan provisions to LED priority of particular regions to assure the sustainability of MSE businesses; and enhances the contributions of MFIs for poverty alleviation in Ethiopia. All in all, the researcher recommends that both Federal, regional government and other concerned stakeholders to work towards digging deeper to find keys to success.

Key words: MFIs Loan Provision, Linkages, LED strategy

1. Introduction

Ethiopia is one of the poorest countries in the world with per capita GDP of only $357 (Plummer, 2012) and with 29.6% of its population starving below the national poverty line (US$ 0.6 per day) (Geiger and Goh, 2012). Enrolment in primary school has increased from 33% in 1991 to 95% in 2007, however more than half the population lives in a household where nobody has completed primary school[1]. Ethiopia's GNI per capita in PPI terms is $971 which, although is one of the fastest growing falls below average for sub-Saharan Africa. The income gap between the financially wealthy and the poor is also high with the inequality adjusted HDI index standing at 0.247 as of 2010. It is also one of the most populous countries in Africa having a population growth rate 3 % per annum. The infant and child mortality rates are 118/1000 and 173/1000 children, respectively[2].

Hence , as an intervention strategy, Ethiopia crafted and engaged implementing Growth and Transformation Plan (2011/12-2014/15) where campaign against poverty reduction are central to the government's development agenda. In this respect many policies, goals and objectives are focused on targeting the most disadvantaged households. To realize the plan microfinance (MF) is considered by the government to be one of the important tools in fighting poverty and thus, the expansion of micro and small scale enterprise and efforts to reach the poor and expanding self employment opportunities especially for the youth and women are the current policy direction. The objective of the MFIs in Ethiopia is basically poverty alleviation through the provision of sustainable financial services to the poor who actually do not have access to the financial services of other formal financial institutions (Yigirem K, 2010). In Ethiopia the sector has a strong focus on loans to the very poor, as indicated by the relatively small loans when compared to neighboring countries. The government is heavily involved in the sector, and has prioritized facilitating the loan access to the urban and rural poor (MFTransparancy, 2011). In line with these, five top MFIs established which are backed by regional governments with the view of cascading GTP plan at regional and districts levels; namely, ACSI (Amahara), DECSI (Dedebit), OCSICO (Oromiya), ADCSI (Addis) and Omo. In aggregate they serve about 84.7% of the total clients of the sector; and account for more than 90% of the sector's total assets (NBE quarterly report as at June 30, 2012) as cited in Sintayehu (2013).

However, significant efforts should be made by the concerned stakeholders to sustain the services, reach out and target the pro-poor plan of the government; reducing poverty through lessening the financial constraints of the poor and enabling them to create job opportunity for themselves and others youth with particular emphasis on local economic development priorities. These requires aligning with regional GTP and Local economic development(LED) strategies which are crafted with existing local conditions involving the concerned stakeholders of the regions (Rodríguez, *et al*, 2009). It is the joint-efforts of all state and non state development actors in urban & rural Ethiopia towards building the economic capacity & competitiveness of their respective urban & rural local government entities so as to create decent jobs and improve the quality of life for their residents (Mathewos, 2006). But most local officials, until recently, do not recognize or give adequate attention to local economic development issues. Since most economic development constraints are found at the local level such as access to land, skills development, micro and small scale enterprise mobilization and loan provision and other infrastructure, the rational for LED becomes imperative (*ibid*). These have to be closely linked to microfinance loan provision for poverty reduction program of the regions as pro-poor strategy to achieve the GTP target of the regions in particular and the country in general.

In the Ethiopian Scenario, even though various researches conducted on performance, financial profitability and operational viability income generation, agricultural productivity and on the micro finance outreach areas etc, which have been accessed, in terms of significances of the topics and the dynamic nature of the problems on the areas a lot research gap can be observed. More importantly, despite the increasing reliance on MF to reduce poverty in Ethiopia there has been surprisingly little work under taken to link the micro finance expansion with LED strategy of the regional states in Ethiopia. Hence to assess the synergy and performance of MFIs within the framework of cascaded regional and districts GTP of regions in Ethiopia. Therefore, this study try to identify ways through which the contribution of MFIs in alleviating poverty enhanced, the lessons to be adopted for poor nations like Ethiopia to overcome the century long enemy i.e. poverty, to assess the link of microfinance expansion with LED strategies and how both serve as input to one another to harness economic development of the country.

2. Objectives of the Study

The general objective of this study is to critically ascertain how micro-financing can be used as an effective instrument to reduce poverty and development of micro and small scale enterprises by linking with local development strategies and cascaded GTP of particular region in Ethiopia, with specific objective of:

[1] Human Development Report, 2010. http://www.hdr.undp.org/en/reports/global/hdr2010/
[2] Human Development Report, 2010. http://www.hdr.undp.org/en/reports/global/hdr2010

1. Assessing the contributions of microfinance institutions in poverty reduction and its alignment with local development strategies
2. Examining the interdependence of MFI loan provision with LED strategies and GTP in Ethiopia;
3. Examining the challenges, opportunities and threats of micro and small scale enterprises and the link towards LED strategies.

3. Materials and Methods

To meet the objectives listed above the researcher used the available pertinent documents, particularly works produced in recent years are extensively reviewed. The review includes: research reports, LED project reports, studies, reports, papers, published and unpublished documents of donors, international organizations, government agencies, researchers and conference proceedings; federal/regional level documents containing policy statements.

4. Theoretical Arguments on Microfinance and Local Economic Development Strategies

In this part of the paper the researcher reviewed the theoretical perspectives of microfinance expansion as an instrument for poverty alleviation in line with local economic development potential and strategies of regions in developing countries including Ethiopia.

4.1 Definition and Evolution of Microfinance Institutions

The emergence and evolution of the microfinance in the development discourse by policy makers, academician credited back to Grameen Bank established by Mohammed Yunus in Bangladesh in the late 1970s, spreading rapidly to other developing countries. Since then MFIs and their loan provision services are mainly viewed as an economic development strategy, and particularly relevant approach in countries where disadvantaged groups tend not to benefit from involvement in the formal economy. With these rational justifications for more than 30 years microfinance has been portrayed as a key policy and programme intervention for poverty reduction and 'bottom-up' local economic and social development tools in most developing countries including Ethiopia.

The literature reviewed showed that academicians, researchers and policy makers have tried to define the term from various perspectives. Lashley (2004) defined; microfinance as "lending small amounts of money for enterprise development to achieve a sustainable rise in incomes above the poverty line". However, it has been controversial issues by the researcher to clearly attest, partly due the difficulties of reliable and affordable measurement, the methodological challenge of proving causality, and other factors (Stewart, 2010). Furthermore, poverty alleviation effort requires understanding the realities of local communities' conditions and mobilizing the stakeholders toward the effort of poverty reduction. The rational of MFIs loan provisions which further reinforces the vicious cycle of poverty seems plausible to serve as vehicle through which the poor are empowered, thereby providing a valuable tool to assist the economic development process (Akinlo and Oni, 2012). Elsewhere, microfinance is seen as a credit scheme that uses collateral substitutes to short-term working capital of micro entrepreneurs (Hubka and Zaidi, 2004). But, such definitions ignore two important aspects of microfinance: saving services and loans for consumption purposes. Similar to banks, saving mobilization perceived important for micro lenders to ensure the repayment of non-collateral-based loans (Adam, Graham and Pischke 1984, Hulme and Mosley, 1996).

Theoretically, several literatures have been written inline with the role and contributions of MFIs for development endeavor highly needed particularly in developing countries. However, microfinance is poorly understood, and it remains unclear whether it delivers on its promises. In this respect the reviewed literature that assess the effect of MFIs loan provision on poverty alleviation reported mixed and disputed so far in developing countries including Ethiopia. Thus, there seems a missing element like alignment of the loan provision with local development strategies of communities. Studies conducted by (Taiwo, 2012; Okumadewa, 1998; Sowmyan, 2011) reported the loan provision serves as an effective way for poor people to increase their economic security and thus reduce poverty. Moreover, it enables poor people to manage their limited financial resources, reduce the impact of economic shocks and increase their assets and income. In contrary Srinivas (2004) disproved it facilitate the diversion of valuable aid money from untested and non-viable microfinance programs- away from vital programs on health, education that are in dire need of such funds. Similarly, Hulme (2008) argued that MF has other indirect negative effects as it introduces households to a culture of debt that might change its well-being adversely. NPOWG (2006) also emphasized that although most MFIs aim to reach poor people, it has become increasingly apparent that they rarely serve very poor people. Most MFIs reach the 'upper poor' in much greater numbers than the 'very poor'. To sum up, these conflicting views surrounding microfinance and its effectiveness at reducing poverty in the less developed economies (LDCs) has led to several empirical studies on microfinance and poverty reduction in the developing economies (Akinlo and Oni, 2012). Furthermore, it requires re-visiting again and again the policies and strategies of MFIs loan provisions program towards poverty reduction and fill the gap in line with the local communities realistic conditions, potential resources, beneficiaries and markets demands by mobilizing the concerned stakeholders under the framework of local economic development strategies in particular countries, regions and districts can be considered as alternatives tools to facilitate the momentum of poverty reduction.

4.2 Definition and Initiatives of Local Economic Development (LED) Strategies

The term Local economic development (LED) was originally referred to deliberate intervention to promote economic development in a specific area that is not the national area-from a very small neighborhood through to fairly large sub national region. A common definition of LED refer a process in which partnership between local government, the private sector and the community is established to manage local and access external resources to stimulate the economy of a well defined territory (Meyer, 2003). As per Boxer & Josie the strong justifications for LED are that each community has unique local conditions that help or hinder its economic development. Before a community can commence with economic development strategies it needs to understand the nature of the local economy. Creating an inventory and profile by collecting data, then analyzing the data by evaluating the profile and inventory, provides the factual basis for economic development goal setting and strategy development. As the success rate of any poverty alleviation program depends on the availability of accurate, reliable and up-to-date information and statistics and thus, the community must be fully informed about their own town or city, their own region and their national economy (Boxer & Josie, 2007). Hence, micro and small scale enterprises mobilization effort and MFIs loan provision should be carried out as per the road map of the particular regions and districts LED strategies to assure the sustainability and development endeavor.

Moreover, Rodríguez-Pose, *et al*(2009) argued, while LED no panacea, may be a valid complement to traditional top-down strategies in order to deliver sustainable development and in many cases may deliver greater economic efficiency by mobilizing resources that otherwise may have remained untapped and a large number of social benefits, by promoting voice, participation, and sustainability across territories where institutional conditions have been far from ideal. In connection to these, Ethiopian government has crafted GTP (2011/12-2014/15) which is supposed to be cascaded down to regions and districts as per the existing local conditions to end vicious circles of poverty. The plan envisages accelerated growth in the industrial sector by creating an enabling environment that will make the sector the basis of future economic development. To this end, the focus is on the development of MSEs that utilize existing potential resources of regions as competitive advantage to harness the development plan of the country. To facilitate more the situations the government has launched MFIs loan provision program which are backed by regional governments, micro and small scale enterprises agency, vocational and technical schools to train manpower in line with local development priorities of regions in Ethiopia. Thus, it can be achieved by strengthening the MSEs in a manner that unleashes the full growth potential of the MSEs to grow in medium and large scale domestic enterprises by properly utilizing potential resources and addressing local development priorities. Therefore, these need mobilizing and synergizing the stakeholders concerned and engaged in poverty alleviation as per the local economic development demands of the regions which requires strong emphasis on the journey of GTP in Ethiopia.

4.3 Linkage between MFIs Loan Provisions and LED Strategies

Microfinance programs focus on expanding local economic activities and improving the standard of living of their clients by providing loan needed to establish micro and small businesses enterprises or cooperatives (Shannon, *et al*, 2005).Thus, it has increasingly been positioned as one of the most important poverty reduction and local economic and social development policies. Its appeal is based on the widespread assumption that simply 'reaching the poor' with microcredit will automatically establish a sustainable economic and social development trajectory animated by the poor themselves. However, empirical research reveals that participation in microfinance did not result in increased household wealth and poverty alleviation desired by developing countries (*ibid*).Thus, it is clear that economic policies and strategies pursued in the past and continuing on to the present have neither produced sustainable growth nor reduced poverty. These to fill the gap as one alternatives tool pursuing and mobilizing and synergizing the fight against poverty through LED strategies is essential.

The reviewed research shows that overwhelming majority of micro enterprises are running duplicated businesses here and there copied from urban areas. The loan provision is also suspected more pro-rich than pro-poor in most developing countries and thus failed to exploit the available resource opportunities and potential in particular regions in a way to benefit the majority poor. Moreover, most economic initiatives were centrally planned and failed to effectively mobilize local resources and structures. Hence, the very essential missing factor from the process was the active LED strategies (*Simon, 2003).* Thus, linking microenterprises establishment plan and hence loan provision in line with local economic development strategies are very essential and plays significant role for the sustainability of the institutions (Sowmyan, 2011). Similarly, Meyer-Stamer (2003) argued that LED is also about the competitive advantage of local firms as well as the competitive advantage of the locality. Through the creation of competitive conditions at a specific locality, investment may be attracted which otherwise would go elsewhere and create jobs and income in another locality.

4.4 Evolution and Performance of Microfinance Institutions in Ethiopia

Ethiopia has taken MFIs as one of the instruments effort towards reducing hunger, famine, youth unemployment and overall harness the economy of the country, 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 through mobilizing and engaging abundant labor and other resources towards development endeavor designed by the country. These urgently need reaching out the poor and marginalized people by facilitating their financial constrains of initiating and running entrepreneurial business and thus, creating employment opportunities in the country. Having recognized the positive contributions of MF, legislations were adapted to license and supervise service providers in 1996 (Adeno, 2007). However, it is found still at infant stage. At its inception four MFIs owned by government were established which plays a dominant role and managed closely by regional states in Ethiopia.

Key Facts : Microfinance in Ethiopia

By CGAP [1]	No. of MFIs	No. of Borrowers	Borrowers Population[2]	Borrowers/Poor[3]
22		1,420,000	2%	5%
By MIX[4]	No. of MFIs reporting (2009)	No. of Active Borrowers	Gross Loan Portfolio (USD)	Average Balance per Borrower (USD)
22		2.3 million	409.4 million	140
By MFT[5]	No. of MFIs (2011)	No. of Active Borrowers	Gross Loan Portfolio (ETB)	% Products with a Flat Interest Rate
31		2,470,641	6.9 billion	70%

Source*:* MFTransparancy, 2011

According to MFTransparancy (2011) report the number of MFIs has risen to thirty one with 433 branches and 598 sub branches by end of 2011. Studies estimate that this figure serves between 10-25% of the total microfinance demand in the country. Even though, the institutions have extended total credit of 6.9 billion ETB to 2,470,641 active borrowers. However, the coverage so far achieved is very insignificant relative to the existing demand for such microfinance credit and related services. It is only 2% of the total population and 5% of the poor has been reached by the institutions since their inception. The sector has been showing alarmingly increasing growth trend since its establishment in 1996. The total asset of the Microfinance sector has increased to Birr 13.3 billion as at June 30, 2012 from Birr 5.3 billion as at June, 2008; an increment of 149.2%. This was mainly financed by liabilities (71.8%), of which saving mobilized from the public constituted the major portion of (41%). About 30.8% is contributed by borrowings (10.2%) and other short term (15%) and long term (5.6%) liabilities. The remaining 28.2% of the total assets is financed by total capital. Gross loan grew to Birr 9.3 billion as at June,2012 from Birr 4.5 billion as at June 30,2008; an increment by 107.6%. Total savings grew from Birr 1.5 billion to Birr 5.5 billion and capital from Birr 1.3 billion to Birr 3.8 billion; in the same period (Sintayehu, 2013).

[1] Consultative Group to Assist the Poor (CGAP), 2010. http://www.cgap.org/m/africa.html
[2] MFI borrowers as a percentage of the country's overall population
[3] MFI borrowers as a percentage of the poor population based on national poverty rates
[4] MIX Market, 2010. http://www.mixmarket.org/mfi/country/Ethiopia
[5] This row of the table is populated with data from MFTransparency's Transparent Pricing Initiative in Ethiopia

5. Empirical Studies: Nexus of MFIs Loan Provisions and Poverty Alleviation Program

The notional view of MF as a panacea to poverty reduction has attracted wide empirical research and public policy discourse in the past couple of decades. Though several empirical studies have been conducted to ascertain the impact of microfinance on poverty alleviation worldwide; no consensus has emerged on the impact of microfinance on poverty reduction (Akinlo and Oni, 2012). The questions of whether MFIs actually reach and empower the poor and/or whether MF is better than some other types of development project for the poor is not settled once and for all (Flore & François, 2011). Recently growing studies showed it has positive impacts to boost the ability of poor people to improve the conditions in which they live and enhance the development program of the countries. Akinlo and Oni (2012) studies attest that loan empowerment has a significant positive effect on beneficiaries' welfare. As the access to credit allowed the beneficiaries take advantage of economic opportunities by providing a fundamental basis for planning and expanding business activities. Similarly, in Zimbabwe, extremely poor clients of Zambuko Trust increased their consumption of high protein foods at a time when food expenditures across the country as a whole were decreasing (Barnes 2001). Taken as a snapshot, the evaluations successively conducted in 2001 and 2004 indicate that the clients' enterprises recorded better average performance than enterprises without funding. With a dynamic perspective however, the results are more nuanced. In Ethiopia too some research conducted on the area attest this reality on the ground (Flore & François, 2011).

In contrast to the above, many empirical studies reported the nexus between MF loan provision and poverty alleviation programs is insignificant and they fail to find out the direct link between microfinance and poverty reduction. Hence, MF loan provision did not play significant change in the livelihoods of the poor (Hulme and Mosley, 1996; Majoux , 2001; Doung and Izumela , 2002; Bakhtiari, 2006). Kah *et al* (2005) studied the evolution, sustainability and management of ten microfinance institutions (MFIs) in Gossas, Senegal, using the data over a period of three years. They found out that MFIs have helped to create some positive changes, but that there was no clear and marked evidence of poverty reduction and stated that the expectations of what microfinance can do to help lift communities out of poverty is a bit too optimistic. Essentially, the general consensus from studies that reported little or no positive impact of micro credit on poverty is that former is a necessary but not sufficient condition for poverty reduction (Akinlo and Oni , 2012).

In Ethiopia Alemu (2006) reported positive impact of microfinance on the poor in five different zones of the Amhara region. In particular, the results reported that microfinance helped the poor to smooth their income in the study area. All the same, the study reported cases of loan diversion. Some clients were found to have used their loans for unintended purposes. Similarly Asemelash (2003) also attest that loan provision to the poor by microfinance had positive impact on the poor. Specifically, the results showed that microfinance led to increased income for the poor. Asides, it helped to increase poor people access to better schools and medical facilities. Nur (2006) indicated that, microfinance beneficiaries have more diversified incomes than the non-beneficiaries. Furthermore, studies conducted on microfinance outreach, sustainability, loan repayment performance areas shows that (Daba, 2004 ; Asmelash, 2003; Fiona, 2000); Berhanu, 1998), the credit provided to the poor has brought a positive impact on the life of the clients as compared to those who do not get access to these microfinance services. They showed that MF has brought a positive impact on income, asset building, and access to schools and medical facilities of the household in the study area. Results show that borrowing indeed causally increased consumption and housing improvements. A flexible specification that takes into account repeated borrowings also suggests that borrowing has cumulative long-term effects on these outcomes, implying that short-term impact estimates may underestimate credit effects (Guush and Cornelis, 2011).

Despite the prominence of MF in development policy, only few rigorous impact evaluations have been conducted to date, a large majority in Asia. The results of two parallel large scale randomized controlled trials completed between 2003 and 2006 in rural Amhara and Oromiya (Ethiopia) indicated that micro-credit was overall associated with significant improvements in school attendance among 10-16 years old boys and (in Amhara only) among children of age 6-9 of either gender (Jaikishan, *et al*, 2011). In contrary, Getaneh (2005) indicated MF has brought very little impact in poverty reduction and enterprise development. Moreover, (Bekele (2002) recommended that not one-fits-all, but area-specific approaches or fitting with local development strategy are important for MFIs to be successful in meeting their objectives. Although participants improve their incomes, it is not clear whether these benefits accrues to the society and positively affect other people in the community and national levels (Midgley, 2008). On the other hand, Tassew (2005) showed that the most important activities that best fit into the current microcredit system in the region are petty trading, goat fattening and poultry development. Thus, the researcher emphasized in the research that idea of working very well on local development priorities which vary from place to place in the country.

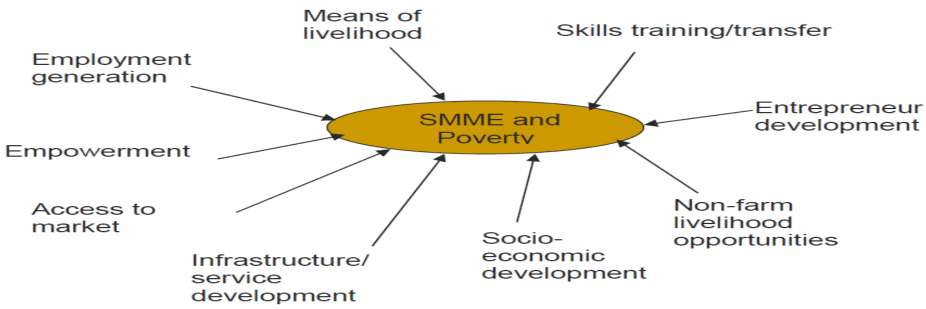
In Ethiopia most loan is provided for cobblestone construction which probably good in some towns and may not in other towns. Therefore, in order to harness theses problems there should be synergy among all stakeholders in the region to work to gather so that micro and small scale enterprises established here and there can be based on the local development priorities of the region which sustain the success of their business and help to alleviate the poverty endeavor program in the region. To substantiate Getaneh (2007) argued that MF holds a good promise as one key sector to poverty alleviation and microenterprise development in particular, where appropriate financial products and methodologies suited to local circumstances are available, considerable achievements can be registered. Hence, though MF 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 availability of credit alone could not be a solution to the problems of the ultra poor and its impact on poverty reduction remains in doubt (Adeno, 2007).

In spite of theoretical concerns about bottom-up development paths and skepticism about MF being over ambitious, the sector possesses a strong goodwill among development partners and tends to be a core component of the development strategy of most developing countries (Chowdhury, 2012). Similarly, Sintayehu (2013) argued that the impact MF on poverty would have been higher, if the clients had been equipped with appropriate entrepreneurial skills; and thus, aligned with potential competitive advantages areas of regions. Therefore, it can be inferred as a research gap from the above empirical reviews that local development strategies can be a missing element which can play a significant role against poverty reduction. Thus, aligning microenterprise mobilization and microfinance loan provisions program with practical, actual potential resources of particular region can enhance the poverty alleviation program via microfinance institutions and facilitate the GTP target of the country.

6. The linkages of MSEs Development, LED, MFIs Loan Provision and Poverty Alleviation

There is consensus among policy makers, economists, and business experts that micro and small enterprises (MSEs) are drivers of economic growth. The sector contributes prominently to the economy through creating more employment opportunities, generating higher production volumes, increasing exports and introducing innovation and entrepreneurship skills. The dynamic role of MSEs in developing countries insures them as engines through which the growth objectives of developing countries can be achieved (NCR, 2011). Therefore, MSEs have been accepted in most developing countries including Ethiopia as instrument of harnessing development endeavor and grass root level poverty reduction effort. The basic justification is that the sector could serve as catalyst in the socio-economic development of any country through reaching out to the marginalized people or communities and thus, play significant role for the achievement of national macroeconomic objective in term of employment generation at low investment cost and enhancement of local innovation and entrepreneurship for poverty alleviation endeavor. Kombo *et al* (2011) argued that MSEs entrepreneurs who include agriculture and rural businesses have contributed greatly to the growth of Kenyan economy. The sector contributes to the national objective of creating employment opportunities, training entrepreneurs, generating income and providing a source of livelihoods for the majority of low income households in the country accounting for 12-14% of GDP (Republic of Kenya, 1982, 1989, 1992, 1994). It is estimated that MSEs employ 22% of the adult population in developing countries. In the same way a recent study conducted by Abor and Quartey (2010) estimates that 91% of formal business entities in South Africa are MSEs, and contribute between 52 to 57% to GDP and provide about 61% to employment. Similarly, the United Nations Industrial Development Organization (UNIDO, 1999) estimates that SMEs represent over 90% of private business and contribute to more than 50% of employment and of gross domestic product (GDP) in most African countries cited in NCR (2011).

In light of these arguments no wonder that government, particularly in the developing countries has made tremendous efforts and establish policies to enhance the capacity of MSEs. However, empirical research indicates that MSEs have fallen short of expectations and thus, the loan provision program towards poverty alleviation endeavor. Therefore, these generated serious concern and skepticism on whether MSEs can bring about economic growth and national developments in developing countries. SMEs are faced with significant challenges that compromise their ability to function and to contribute optimally to the economy of developing countries and thus, add value towards poverty alleviation campaigning (Osotimehin, 2012). Junior (2006) also argued that despite their significant importance and contribution to economic growth, SMEs across the whole world in general and developing countries in particular are still faced with numerous challenges that inhibit entrepreneurial growth and as well as a catalyst for poverty alleviation program. The most challenging factor is failing to align with and capitalize on existing potential resources as well as lack of synergy among stakeholders involved in training, mobilizing and finance provision institutions of particular region. Hence it is observed that MFIs extend loan to business ideas that have little or no chance of success, or those that may have a negative impact on their intended outcomes. Here below presented actors involved on the linkage between MSEs and poverty reduction effort in line with local economic development strategies that requires significant emphasis by the concerned stakeholders and policy makers in developing countries including Ethiopia. Therefore, if the countries need to use MSEs as instrument for poverty reduction and development endeavor need re-visiting the policies towards the mobilization of the sectors according to the concern and actual realities to address the problem at hand.



Source: Roggerson (2006)

In Ethiopia the empirical studies conducted on MSEs are widely acknowledged to contribute towards promotion and development of inventions, and thereby generate employment opportunities in the country. They are particularly important in the context of the country's poverty-reduction strategy because they are seedbed for the development of medium and large enterprises, and because they absorb agriculturally under-employed labor, and diversify the sources of income for farming families (Tiruneh, 2011). It is natural to say that every small business owner starts with high hopes of success, but it is a usual phenomenon that each year firms go out of businesses. Although failure is not the sole reason for enterprises to leave the business, many enterprises do fail each year. Thus, the odds of forming a profitable venture are a critical issue for those weighing the risk of starting a business (Dennis and Fernald, 2001), and understanding of why firms succeed is crucial to the stability and health of the economy (Pompe and Bilderbeek, 2005).

To address these problems GTP clearly indicteted that MSEs devlopment is the key industrial policy direction contributing to the envisaged structutal trasfroamtion of the economy and hence poverty alleviation program among urban and rural poor people in the country. In connetion to these it was decribed that GTP targets for MSEs include the following: i) Provide comprehensive support to micro and small scale enterprises so that create employment opportunities for tabout three mln people and thus, enhace citizens' income,contribute to a rise in domestic saving, improve the benefits of women and youth from the sector so as to reduce unemployment and poverty. ii)Provide training of trianers for 10,000 professionals in the sub-sector iii)Provide cpacity building and basic skills training for about 3 mln operators in the areas of enterprnuerships, technical and vocational skills. iv)Prepare and devlop 15,000 ha of land fro working premises, and construct shade and buildings for MFIs.v) Provide microcredit and marketing infromation and work with producers to identify bottlenecks and provide support where solutions are identified(MoFED,2010).

Sintayehu (2013) about performance of GTP from MF loan provision perspectives attest that the government of Ethiopia has given due attention to financial access on its five years (2010/11-2014/15); specially, microfinance sector is expected to play its vital role in two dimensions: to contribute its part in expanding access to finance from 20% as at base year (2009/10) to 67% at the end of GTP period and in increasing Gross Domestic Saving to GDP ratio from 5.5% as of base year to 15% as at the end of GTP period. To this end, microfinance institutions are expected to finance 50% of their gross loan through savings mobilization during the first two years and 80% at the end of the period. Savings mobilized by the sector have shown higher growth rate during the last two years of GTP period than before; i.e. increased by 43.2% on average, in the last two years. As result, the sector financed 58.7% of its gross outstanding loans by savings as at June 30, 2012; this was an increment by 13% from the base year of GTP (45.6% as at June 30, 2010); on average 6.6% in the last two years, and above the plan (to finance 50% of its gross loan with savings in the first two years of GTP period). During the last two years of GTP period, saving has grown by higher rate (43.2%) than gross loan (26.5%); on average, but still to catch up gross loan (to finance 80% of gross loan with savings at the end of GTP period); saving needs to grow by more rate as loan by itself shall grow by higher rate than this to achieve GTP target.

While the practical reality in many parts of the country show there is a big problem of innovativeness and the trend of business establishment is a duplication of retail shops. There is a pressing need to induce innovation in new businesses as per the local comparative resources and demands if we are to spur sustainable development in to the economy. Nevertheless, there may not be a shortcut way to see sufficient number of innovative business in the economy. However, as much as possible doing a level best effort to address the problems are essential to assure the sustainability of MSEs and hence achieve the GTP target accordingly. It seems empahsis towards local economic devlopment strategies is missing element that could have been adreesed clearly in the plan. On the other hand, Minilek & Chinnan (2012) identified that the compound annual growth rate of MSE in employment aggregately were 3.86% and the enterprises add annually 0.18 workers on average. When looking separately, the mean annual compound growth rate of small scale and micro enterprises were 2.4 and 4% on average respectively. Small enterprises add 0.19 workers per firm and micro enterprises add 0.14 workers per firm annually. Shortage of working capital and working space are the most important problems. Towards this, the Ethiopian Government has a firm belief in pivotal role of microfinance in poverty reduction; as result decentralized MFIs to regional states to ease the finance problems of MSEs. However, the MEs mobilizations has to be carried out with the road map of GTP and local development strategies to bring satisfactory result and overcome the complicated problems in the arena.

7. Conclusion and Policy Implications

Ethiopia crafted and engaged implementing Growth and Transformation Plan (2011-2015) where MF serves as pro-poor tools to facilitate access to loan and hence enhance employment for youth and women. Similarly the regional states administrations are expected to cascade the national GTP and prepare regional plan inline local development priority of the regions. This is expected to be materialized by zones and districts' accordingly. Within these framework the country engaged in mobilizing micro and small scale enterprises in various parts of the regions both urban and rural parts of the country. In light of these view this research has been carried out to evaluate loan provision by MFIs for poverty reduction and its linkages with local economic development strategies in Ethiopia.

The empirical reviews showed that there are mixed result on the effect of loan provision by MFIs for poverty reduction in various parts of the developing countries including Ethiopia. On the basis of theoretical and empirical discussion of relevant literatures, MF alone cannot alleviate the poverty from the grass root level of society and thus, requires linking the MFIs loan provisions with potential resources and competitive advantage of particular regions. Though regional authorities are putting a level best effort to address the poverty problems through mobilizing micro and small scale enterprises, providing facilities including training etc., it seems these efforts are conducted without synergy among the necessary stakeholders. Furthermore, the empirical reviews indicate there are duplications of business services provided by the MSE. MFIs should give due emphasis to developing entrepreneurial skill of their clients in line with local development priority and resources of particular regions along with loan provisions. Thus, it requires collaborating with necessary development stakeholders of regions per GTP. Thus, this study showed that the impact of loan provision by MFIs would have been higher and the country can achieve the GTP target , if the MSEs mobilization work are aligned with local economic development strategies and as well as synergy among stakeholders engaged in poverty reduction in local areas in particular and the country in general. These further facilitate the success of the MSE business and hence it has strong implication for MFIs sustainability and outreaches the target poor people both in rural and urban areas of Ethiopia. Therefore, the studies provokes policy makers and development actors to revisit the loan provision particularly by regional government backed MFIs , MSEs mobilizations and efforts to sustain the local development endeavor, entrepreneurship and innovations by the concerned stakeholders to harness development momentum towards GTP target in 2014/15 in Ethiopia.

Acknowledgement

The author gratefully acknowledges Dr. Adem Kedir from Haramaya University & all participants of the National Research Conference on **"**Loan and Investment"Organized by College of Business and Economics, Mekelle University & Ethiopian Public Financial Enterprises Agency at Axum Hotel, Mekelle – Ethiopia on

September 20-21, 2013 for their constructive guidance and valuable comments in all aspects of the work.

References

Adeno Kidane Ereda (2007) Outreach and Sustainability of the Amhara Credit and Saving Institution (ACSI), Ethiopia, Department of International Environment and Development studies Norwegian University of life sciences.

Ajit Kumar, Bansal & Anu Bansal (2012) Microfinance and Poverty reduction in India. Integral Review- A Journal of Management ISSN: 2278-6120, Volume 5, No. 1, pp 31-35

Akinlo Anthony Enisan & Oni Isaac Oluwafemi (2012) Impact of Microfinance on Poverty Alleviation in Ondo State, Nigeria: Australian Journal of Business and Management Research Vol.2 No.09 [31-37]

Alemu, B. A. (2006). Microfinance and Poverty Reduction in Ethiopia. A Paper Prepared Under the Internship Program of IDRC, ESARO, Nairobi.

Asemelash, (2002). The Impact of Microfinance in Ethiopia: The Case of DCSI in Ganta Afeshum Woreda of Eastern Tigray. M. A. Thesis, Department of RLDS, AAU.

Asiama, J.P. & Osei, V. (2007) "Micro finance in Ghana: An Overview‟, Research Department Working Paper Bank of Ghana 07/01. Accra.

Astia Dendi, H. J. Heile, Mahman, Rukyatil Hilaliyah and Rifai Saleh Haryono(2004) Alleviating Poverty through Local Economic Development: Lessons from Nusa Tenggara,Jakarta.

Befekadu B. Kereta (2005) Outreach and Financial Performance Analysis of Microfinance Institutions in Ethiopia: National Bank of Ethiopia Economic Research and Monetary Policy Directorate

Boxer L. Mpontshane & Josie Rowe-Setz (2007) The DRAFT District-Wide Integrated Local Economic Development (LED) Strategic Plan: uMgungundlovu District Municipality- Draft Final Integrated LED Strategy Blueprint

Chowdhury Abdullah, Al Mamun, Nazmul Hasan and Arif Rana (2012) The Correlation between Micro-Credit and Poverty Alleviation in Bangladesh: An Empirical Analysis

Dennis, W.J. and Fernald, L.W. (2001) "The chances of financial success (and loss) from small business ownership", Entrepreneurship Theory and Practice, Vol. 26 No-Available at, www.questia.com/PM.qst?a=o&d=5002434876.

DPLG (2004) Local Economic Development Policy and strategy. Pretoria: Government Printer: South Africa.

Flore Gubert and François Roubaud (2011) The Impact of Microfinance Loans on Small Informal Enterprises in Madagascar. A Panel Data Analysis:

Geiger, Michael and Goh, Chorching (2012 Ethiopia Economic Update: Overcoming Inflation, Raising Competitiveness. The World Bank Working Paper Number 74385

Getaneh Gobezie (2007) Successes in Expanding Microfinance Opportunities in Rural Ethiopia – Where There is Little Entrepreneurship? A paper submitted for the International Finance Corporation & Financial Times "Essay Competition", 2007, www.ifc.org/competition]

Guush Berhane and Cornelis Gardebroek (2011) Does Microfinance Reduce Rural Poverty? Evidence Based on Household Panel Data from Northern Ethiopia: American J. of Agricultural Economics Volume 93, Issue 1

Hulme, D. (2008). Is Micro debt good for Poor People? A Note in the Dark Side of Microfinance in T. Dichter & M. Harper (Eds.), What's Wrong with Microfinance? : Practical Action Publishing.

Idwe House & Bhisho (2010) Local Economic Development Information Booklet: Department of Economic Development and Environmental Affairs: South Africa Cape town

Taiwo (2012) The impacts of Microfinance on welfare and Poverty alleviation in South west Nigeria: A PhD Thesis Submitted in Partial Fulfillment of the Requirements for the Award of PhD (Banking and Finance) Covenant University, Ota

Jaikishan Desai, Kristin Johnson, and Alessandro Tarozzi (2011) On the Impact of Microcredit: Evidence from a Randomized Intervention Rural Ethiopia

Junior R. Davis (2006) Evaluating and Disseminating Experiences in Local Economic Development: Observations on Integrated Development Programmes of the Free State, Republic of South Africa

Kombo, Justus, Murumba and Makworo (2011) “An Evaluation of the Impact of Risk management Strategies on Micro-Finance Institutions’ Financial Sustainability: A case of Selected Micro finance institutions in Kisii Municipality, Kenya”: Educational Research, Vol. 2 (5) pp.1149-1153.

Mathewos (2006) Local Economic development Strategy manual: Federal Urban Planning Institute: Addis Ababa

Meyer-Stamer, J. (2003) Principles of local economic development: Options for South Africa, Community Self Reliance, 3, p.1-4.

Mftransparency (2011), Promoting Transparent Pricing in the Microfinance Industry, country survey, Ethiopia.

Mike, Keshishian (2006) Local Economic Development: Making Cities Work Assessment and Implementation Toolkit: EGAT/PR/UP Cognizant Technical Officer USAID

Milinda Brink (2008) Sol Plaatje Local Municipality: Local Economic Development Review –Report-South Africa

Minilek Kefale and K. P. M Chinnan(2012) Employment growth and challenges in small and micro enterprises Woldiya, North East Amhara region, Ethiopia Educational Research and Essays Vol. 1(2), pp. 21 - 26,Available online at http://www.wudpeckerresearchjournals.org/ERE , Wudpecker Research Journals

Ministry of Finance and Economic Development (MoFED) (2010) Growth and Transformation Plan (GTP) 2010/11-2014/15: Addis Ababa.

National Credit Regulator (NCR) (2011) Literature Review on Small and Medium Enterprises’ Access to Credit and Support in South Africa: Underhill Corporate Solutions (UCS).

NPOWG (Network Poverty Outreach Working Group) (2006) Microfinance and Non-Financial Services for Very Poor People: Digging Deeper to Find Keys to Success

Nur Abdi Mohammed (2006) The Role of Microfinance in Strengthening Pastoral Household Food Security A Comparative Study between Microfinance Service Beneficiary and Non-beneficiary Households in Filtu and Dollo Ado Districts of Somali Region Somali Regional State Pastoral and Agro pastoral Research Institute

Okunmadewa, F., (1998) “Domestic and international response to poverty alleviation in Nigeria.” Proceedings of the 7th Annual Conference of the Zonal Research Units Organized by Research Department, CBN at Makurdi, 8th - 12th June, pp: 296- 309.

Osotimehin, Jegede and Akinlabi(2012) An Evaluation of the Challenges and Prospects of Micro and Small Scale Enterprises Development in Nigeria: American International Journal of Contemporary Research Vol. 2 No. 4

Pfister M. W., Gesesse D., Amha W., Mommartz R., Duflos W., Steel E. (2008) Access to finance in Ethiopia: Sector Assessment study volume 2, GTZ

Pompe, P.M. and Bilderbeek, J. (2005), “The prediction of bankruptcy of small-andmedium sized industrial firms”, Journal of Business Venturing, Vol. 20 No. 6. Available at, econpapers.repec.org/article/eeejbvent/default20.htm.

Rodriguez-Pose (2008) Milestones and challenges of LED practice and academic research, local. glob 5, 22-24.

Rodríguez-Pose, Andrés Tijmstra, Sylvia (2009) On the emergence and significance of Local economic development strategies: Department of Geography and Environment Spatial Economics Research Centre London School of Economics Houghton St.

Roggerson (2006)-Small business development and poverty alleviation

Ruth Marjory Adhiambo Ocholah, Cainan Ojwang, Fredrick Aila, David Oima, Simeo Okelo and Patrick B. Ojera (2013) Effect of micro finance on performance of women owned enterprises, in Kisumu City, kenya Greener Journal of Business and Management Studies ISSN: 2276-7827 Vol. 3 (4).

Shannon Doocy, Dan Norell, Shimeles Teffera, and Gilbert Burnham(2005) Outcomes of an Ethiopian Microfinance Program and Management Actions to Improve Services: Journal of Microfinance, Volume 7 Number 1.

Simon Peter Gregorio(2003), Local economic development: Stimulating Growth and Improving quality life, Philippines-Canada Local Government Support Program (LGSP)

Sintayehu Desalegn (2013) Ethiopian Microfinance Sector: Growth, Socio-economic Impacts and Challenges

Examiner, Micro Finance Institutions (NBE) Birritu No.115 Birritu is a quarterly magazine published by The National Bank of Ethiopia.

Sowmyan Jegatheesan, Sakthi Ganesh, and Praveen Kumar S.(2011) Research Study about the Role of Microfinance Institutions in the Development of Entrepreneurs International Journal of Trade, Economics and Finance, Vol. 2, No. 4.

Stewart R, van Rooyen C, Majoro M, de Wet T (2010) What is the impact of microfinance on poor people? A systematic review of evidence from sub-Saharan Africa: Social Science Research Unit Institute of Education 18 Woburn Square London W10 5 UJ United Kingdom

Tiruneh Abebe (2011) Analysis of the Success Factors of Micro and Small Business Enterprises in Addis Ababa: A thesis submitted to the School of Graduate Studies of Addis Ababa University in partial fulfillment of the requirements for the Degree of Masters of Business Administration

UNDP (2012) Entrepreneurship development Programme in Ethiopia-Project document: Addis Ababa.

USAID (2011). Assessing and Training a Local Economic Development (LED) Initiative: EGAT/UP and the Urban Institute: Agency for International Development.

Yigrem Kassa, March (2010) Regulation & Supervision of Microfinance Business in Ethiopia: Achievements, Challenges & Prospects.