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Microfinance Institutions Performance in Hadiya Zone, Southern Region, Ethiopia

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Abstract
Microfinance institutions play a major role in poverty reduction by providing various financial services for the small-scale and medium enterprises which cannot afford to adopt new technologies and to startup new business activities from their own source. The aim of the study was to examine the microfinance institutions performance in Hadiya zone, southern region, Ethiopia. The study uses secondary and focused group discussions data of 14 Microfinance institutions operating in the zone. Descriptive statistics and econometric model were used to analyze the data. OLS model was used to identify the determinants of operating profit of microfinance institutions. The findings of the study show the presence of the positive impact by total asset, number of borrowers, Education level, Number of active deposit account and Microfinance institutions experience (age) on the performance of Microfinance institutions in the zone. The study recommends that, due to the fast growth of the Microfinance sector in the country, with increases in small and medium Microfinance institutions, the government and policy makers should create a good environment for the growth of these institutions. Better policies should be create which to facilitate growth and hence the performance of Microfinance institutions in the country. To the managers of Microfinance institutions, the study recommend that, they should monitor the institution's growth to ensure that assets, number of borrowers, Education of staff, Number of active deposit account increase with firm performance.
Keywords: Firm Performance, Microfinance Institutions, multiple regression, Hadiya zone, Hosanna, Ethiopia

1. Introduction

Development of microfinance in Ethiopia should be viewed as in one hand, an identification of considerable levels of unrealized demand and potential market growth for financial services and on the other hand a shift by the NGO sector and government from relief assistance to sustainable development which intersects at the point of institutionalization of microfinance provision (Fiona, 1999). Interventions through the delivery of microfinance services have also been considered as one of the policy instruments of the Government and Non Government Organizations (NGOs) to enable rural and urban poor increase output and productivity, induce technology adoption, improve input supply, increase income, reduce poverty and attain food security. The establishment of sustainable microfinance institutions 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.

Although the development of microfinance institutions in Ethiopia started very recently, the industry has shown a remarkable growth in terms of outreach particularly in number of clients. Since the issuance of Proclamation 40/1996, which provides the establishment of microfinance institutions, sixteen microfinance institutions (MFIs) have been legally registered by the National Bank of Ethiopia (NBE) and started delivering services, and two more applications by new MFIs are currently growth of Microfinance sector has been also supported by the increased need and importance of Microfinance institutions in the country. The sector has become the main source of finance not only to the poor and low income households but also to entrepreneurs and small and medium enterprises, in both rural and urban areas. This has led to the recognition of the sector by the government and policy makers as an important segment of the financial system for saving unbaked people in the country.

Though there is increased need and importance, the studies conducted on the performance of Microfinance institutions in the country have reported poor performance of most of the institutions as a result of higher operating costs, low revenue generation ability and highly dependence in subsidies (Marr & Tobarro, 2011).

The findings of the study provide information to policy makers on the relationship of factors affecting operating profits of microfinance institutions and firm performance, to enable the creation of better policies, which would facilitate the growth of Microfinance institutions in the country. The study is also beneficial to the owner of Microfinance institutions as it provides an understanding of the effect of factors affecting on their firm performance. This enables them to improve control and monitoring of the performance as firms grow in terms profitability. The study adds to the literature on the on firm performance from the evidences of Microfinance institutions of Hadiya zone.

2. Literature Review

The emergence of the global micro finance has a history of about three decades, yet has gone through stages of

historical development. The micro finance 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.

The objective of the MFIs is basically poverty alleviation through the provision of sustainable financial services to the poor who actually do not have access to the financial support services of other formal financial institutions. Since then these MFIs have been playing the role of promoting and accessing financial services to mainly the rural area. The microfinance sector is growing in terms of number and size. The sector is currently in Ethiopia serving more than 2.3 million clients. The total asset of the microfinance sector which was Birr 225 million at the end of 1997 has reached Birr 7,164 million (US$ 534 million) in 2009, showing a remarkable growth of 30.84 percent. According to Wolday (2008), the MFIs provide a variety of loan products which can be broadly categorized into agricultural loans, micro-business loans, micro and small enterprise loans (micro-bank loans), employee loans, package loans (food security loans), and housing loans. Many of the loans are group loans followed by individual loans and cooperative loans. The agricultural loans in many of the MFIs are end-term loans which are paid at the end of the loan period. Omo Micro Finance Institution (OMFI) was legally registered by the National Bank of Ethiopia, officially established and started its operation at the mid of 1997, as part of the national food security programme by the regional government. As per Wolday (2000), the shareholders of the institutions are the regional government, (owning 80% of the share); associations and local NGOs (19.5% of the share) and individuals (0.5% of the share).

Empirical evidences on Microfinance institutions performance have reported that despite the growing importance of provision of microfinance to the productive poor people, there are few studies made in the area. Although many of the studies conducted dealt with the impact assessment (focusing on household impact), assessment of the performance of microfinance institutions are very limited. But some researchers have attempted to study the performance of microfinance institutions in Ethiopia For instance wolday (2000), studied microfinance industry in Ethiopia. His results showed that the MFIs in Ethiopia in 2000 reached 471,966 clients; the loan portfolio amounted about Birr 526 million, outstanding loan was about Birr 273 million and saving mobilization reached about birr 129 million. The gross saving as percentage of loan outstanding was about 47 percent. This is an indication that the performance of MFIs is promising. Moreover, Wolday indicated that the repayment rate of the MFIs varied from 94 to 100 percent which is relatively a good performance. The majority of clients served are the rural poor. Out of the total clients, the number of females reached only 44%, which is very low compared with the Grameen Bank's women client which is over 94 percent.

Renee chao-Beroff et .al (2000) assessed the overall performance of six MFIs in Ethiopia namely SMFI, OMFI, ACSI, WMFI, OCCSCO and Bussa Gonfa MFI operating in southern, Amhara, and Oromia regions. The study comes with the findings that, the majority of the MFIs in the sample were efficient but due to low lending interest rate, they were not profitable. After adjustment for inflation, all MFIs showed adjusted operating loss. Taking financial self sufficiency, the least institute, which was said to be new, was 25% while the best one was 87%. The lending interest rates of MFIs in Ethiopia were relatively low. Their subsequent findings were that the majority of Ethiopian MFIs are deficient in their accounting and management information system and the information system is not integrated with to accounting system.

All MFIs did not have business plans that combine strategic planning and financial projection. Haile Selassie (2001) assessed the financial viability and outreach of two MFIs in Ethiopia, namely SFPI and PEACE operating in urban and rural area respectively. According to his study, the sample MFIs increased outreach and mobilized significant amount of savings. The number of savers as well as the value of saving has increased.

He also indicated that the repayment rate is very high (98% for SFPI and 99.6% for PEACE). With respect to financial viability, he found out, both institutions as subsidy dependent. The lending interest income and fees they generate did not cover the administrative expense. However, the trend of their financial performance demonstrates that there was encouraging and steady progress towards reaching operating self-sufficiency.

Wolday (2002) also studied the challenges and prospects of new product development in the microfinance industry in Ethiopia. He indicated that products of microfinance, institutions were not designed based on market analysis to meet the need and the preference of the clients, while keeping the financial institutions profitable. This has consequently affected dropout rates, outreach and long term objectives.

This implies that the growth of microfinance sector has not resulted in the growth of the number of people who have access to financial services. What constrains microfinance institutions in the country from reaching most of the unbaked people is still not yet documented. In order for Microfinance institutions, to reach more people they need to grow and increase their size in term of asset, number of borrower, education, staff as well as the geographical area covered. The growth of such institutions is also expected to increase with the age of the institutions as results of experience, innovations, technology as well economies of scale.

This study seeks to find evidence whether the assets, number of borrower, education, deposit, and staff number and other factors of Microfinance institutions in the zone have an impact on the firm performance, which constrains them from reaching the most of the poor and excluded people in the country. The findings of this

study are important to government, policy makers, managers and other stakeholders of Microfinance institutions in the country. The findings of the study provide information to policy makers on the relationship of factors affecting firm performance, to enable the creation of better policies, which would facilitate the growth of Microfinance institutions in the region as well as country wise. The study is also beneficial to the owner of Microfinance institutions as it provides an understanding of the effect of factors affecting on their firm performance. This enables them to improve control and monitoring of the performance as firms grow in terms of size and age. To study adds to the literature on the impact of factors affecting on firm performance from the evidences of Microfinance institutions in Ethiopia.

3. METHODOLOGY

3.1 DESCRIPTION OF THE STUDY AREA

The study was conducted in Hadiya zone of the SNNPRs. The administrative center of Hadiya zone is Hosanna town, which is located 232km southwest of Addis Ababa following the asphalt road that passes through Alemgena, Butagera to Arbaminch. Alternatively, it is located 282km southwest of Addis Ababa following the asphalt road that passes through wolkite to Wolaita. It is one of the 14 administrative zones of the SNNPRs with the population of 1,231,196 of which 49.7% are male and 50.3% are female. Out of these, 10.89% live in towns and the rest 89.11% live in rural areas (CSA, 2007). It has a total area of 3, 46958.5 hectares. Hadiya zone is bordered on the south by Kembata Tembaro (KT), on the southwest by the Dawro zone, on the west by the Omo River which separates it from Oromia Region and the Yem Special Woreda, on the north by Gurage, on the northeast by Silte, and on the east by the Alaba special *woreda*; the *woredas* of Mirab Badawacho and Misraq Badawacho form an exclave separated from the rest of the zone by KT.

It is approximately 2000 meters above sea level and its altitude ranges from 501-3000 meters.The area is divided into three ecological zones: Kola 12.9%(lowland <1500m), Woina Dega 68.1%(mid-altitude 1500-2300m) and Dega19% (highland > 2300m). Most of the area lies within the mid altitude zone. The report from zone administration indicated that Hadiya zone has 10 *woredas* and one administrative town with a total number of 329 administrative *kebeles* of which 303 rural, 8 are urban and 18 sub urban *kebeles.*

The microfinance institutions operating in the Hadiya zone are Omo microfinance, Wisdom and Agare microfinance institution in the different *woredas* and administrative town. The Omo microfinance institution was established in 1997, as part of the national food security programme by the regional government. Based on a broad federal food security objective of poverty alleviation through intensification of economic growth, the development of financial markets is one of the strategic interventions that the government has put in place. With this background, the Omo Microfinance Institution was established to promote access to finance in the region particularly in rural areas. The shareholders of the institutions are the regional government, (owning 80% of the share); local NGOs (19.5% of the share) and individuals (0.5% of the share). Currently, the Omo Microfinance Institution is operates at 10 sub branches of Hadiya zone, wisdom microfinance at three branches and Agare at hosanna town.

3.2 METHODS OF DATA COLLECTION AND ANALYSIS

Source of data: This study seeks to examine the performance of Microfinance institutions operating in Hadiya zone southern region Ethiopia. All the micro finance institutions which operate in the zone included in the study. The study uses a secondary and focused group discussion data of Microfinance institutions. The sources of the data used were National bank of Ethiopia and annual reports of individual Microfinance institutions.

Methods of Data Analysis: Descriptive statistics like means, frequencies, percentages, maximum, minimum, and range were used to describe the descriptive result while multiple linear regression model was employed to analyse factors affecting performance of microfinance institutions.

Specification of the regression model for microfinance performance: The Econometric model specification of microfinance performance function in matrix notation is

$Y_i = X'\beta + u_i,$

where;

Y_i is operating profitability of microfinance institutions,

X' is vector of explanatory variables,

β is a vector of parameters to be estimated, and

u_i is disturbance (error) term.

3.3 DEFINITIONS AND HYPOTHESIS OF VARIABLES

Dependent variable: operating profit of the microfinance institutions indicates the ability of the firm to cover operating costs using operating revenue. It is a continuous variable measured by birr, in 2016/2017 fiscal year.

Independent variables: Micro finance institutions performance was hypothesised to be influenced by various factors such as institutional, infrastructural, socioeconomic, etc. Based on the preliminary information and

literature reviews, the following variables were defined and hypothesised accordingly.

Asset of the Micro finance institutions: It is a continuous variable which refers to all the property owned by the microfinance institutions having value and available to meet their operations measured in birr that is received from business activities, governments, individuals and non-government organizations. Asset of the institutions help to generate more revenue and profit. Therefore, this variable expected to affect performance of microfinance institutions positively.

Number of borrowers: It is a continuous variable considered as the number of active borrowers available in the micro finances. This variable is commonly used as a performance indicator to measure MFI mission drift (Fernández *et al*., 2012). Generally, larger numbers of borrowers are accompanied by higher interest revenue for microfinance institutions. Thus, it is expected that number of borrowers will have a positive relationship with operating profit.

Experience of microfinance institutions (Age): It is a continuous variable considered as the number of years of microfinance institutions in operation. . It is expected to have positive relation with profit generating performance. It implies that more experienced microfinance institutions are expected to show a higher profit rate than relatively less Experienced.

Number of microfinance institutions staff: It is a continuous variable considered as the number of active staff in the micro finances. This variable is commonly used as a performance indicator to measure MFIs performance (Cull *et al*., 2007). Generally, larger Number of microfinance institutions staff are accompanied by higher operating cost for microfinance institutions. Thus, it is expected that number of staff will have a negative relationship with operating profit.

Educational level of microfinance institutions staff: It is a continuous variable considered as the number of active staff education average level measured in school year in the micro finances. It is expected to have positive relation with profit generating performance. It implies that higher educated staffs are expected to show a higher profit rate than relatively less educated staff.

Number of active deposit account: It is a continuous variable considered as the number of active deposit account available in the micro finances institutions. Prior studies have established that banks which take more deposits are more likely to have higher profit margins (Aboagye *et al*., 2008). It is expected that MFIs who take deposits will be managed efficiently which will translate into a higher profit margin. Thus, a positive relationship between operating profit and deposits is expected.

Ownership: it is a dummy variable of ownership. A value 1 was assigned to this variable if the investment is committed or made by a domestic investor and 0 otherwise. Earlier work in the study area has found that a larger proportion of approved projects and investment capital originated from the domestic private sector (Berhanu and Kibre, 2003). The effect of this variable on private investment decision making cannot be determined a priori.

Number of Women Borrowers: It is a continuous variable considered as the number of active women borrowers available in the micro finances. Many MFIs target mostly women. This is grounded on the common belief that women are rather more passionate about the welfare of their family or households than men (Pitt & Khandker, 1998). Thus, it is easier to drive the goal of poverty alleviation by rather extending microcredit to women than men. Another assertion holds that women have proved to be more reliable borrowers and are more likely to repay promptly than men. Pitt & Khandker (1998) concluded that women use borrowed funds better than men in microfinance programmes. Based on such a conclusion, it should not be unusual to find many MFIs rather charging lower interest rates on microcredit extended to women. On the contrary, Alesina *et al*. (2008) find that women pay a higher interest rate, although they are nor riskier than men. A positive relationship is therefore expected between operation profit and the women borrowers.

Table 1: variables used in the study

Variables	Measurement	Expected impact
Asset	Total assets in birr	+
Number of borrowers	No.of active borrower	+
STAFF	No.of active staff of MFIs	-
Deposit Account	No.of active deposit acc.in MFIs	+
AGE	No. of years in existence	+
Women borrower	No.of active women borrower	+
Educational	No. of average school years	+
Ownership	Dummy (1=domestic,0=foreign	indeterminant

Note: '+' means positive and '-'means negative

4. EMPIRICAL RESULTS AND DISCUSSIONS

This section presents and discusses the empirical results of the study. Section 4.1 discusses the results of descriptive statics and section 4.2. Briefly discuss the multiple regression results in OLS.

4.1. DESCRIPTIVE STATISTICS

The results in the following (Table 2) show a summary of the descriptive statistics of the collected data

Table 2: Variables Descriptive Statistics

Variables	Mean	SDV	Min	Max
ASSET*	44,181	77,733	240	713,641
Borrower	23,565	35,058	1,000	200,000
Deposit Account	11,321	16,452	200	18,654
Experience (Age)	11	9	1	25
Education	12	8	5	18
STAFF	23	9	8	35
Women borrower	15,642	13,954	856	18,548

* Figures in Millions of Birr

Source: Owen computation

The results of the descriptive statistics shows that the mean values of variables measuring the performance of Microfinance institutions were represented by total asset, staffs and number of borrowers. Descriptive statistics show high deviation in the performance of Microfinance institutions in all variables. The average age of Microfinance institutions reviewed was 11 years; this indicates that on average, the institutions reviewed had enough experience in the microfinance operations. The standard deviation was very high showing high dispersion on age among the institutions which also indicate differences in their experiences.

4.2. REGRESSION ANALYSIS

This section presents and briefly discuss ordinary least squares regression results on the relationship of firm's determinant factors of operating profit with financial performance is presented. OLS was used to identify factors affecting value addition at farm level. A VIF for continuous variables and contingency coefficient values for discrete variables were computed to check the existence of multicollinearity problem. The results revealed that no significant problems of multicollinearity and high degree of association among discrete variables were detected; then all the variables were included in the model. Besides, Breusch-Pagan test for checking the existence of heteroscedasticity problem was carried out; and the result (Prob > chi2 = 0.31) revealed that the problem of heteroscedasticity was not significant. The regression model was also checked if important variables are omitted from the model. The result of 'ovtest' (Prob>F = 0.47) showed that the model has no omitted variables. The OLS result revealed that five explanatory variables were found to be statistically significant in affecting *kocho* value addition at farm level. The F-test calculated value F (4, 12) = 60.42 was highly significant and the adjusted-R^2 was 0.78 implying that 78% of the variation in the dependent variable was explained by the explanatory variables included in the model (Table 3).

Table 3: Regression Analysis Results

Variables	Coefficient	Standard error	Z-value
Constant	1.896***	0.630	3.01
Asset	1. 099***	0.371	2.96
Borrower	0. 096***	0.037	2.59
Education	0.05***	0.02	2.50
Women BORRW	0. 043	0.091	0.48
Deposit Account	1. 172***	0.342	3.42
Staff	-0.008	0. 040	-0.22
Age	0. 010**	0.005	1.97
Ownership	0.008	0.011	0.82

Number of observations = 14, F (4, 12) = 60.42, Prob > F = 0.0000, Adjusted R^2 = 0.78, Root MSE= 0.22737, Multicollinearity (Mean VIF = 1.60), Model specification (ovtest: Prob>F = 0.47) Heteroscedasticity (Prob > chi^2 = 0.31), Dependent variable is operating profit in birr, ***, **&*, represents 1%, 5% and 1% level of significance, respectively.

Source: Own computation

Asset of the Micro finance institutions: Asset of the Micro finance institutions had a positive impact on operating profit and it was significant at 5% significance level. The positive and significant relationship between the two variables indicates that as the Asset of the Micro finance institutions gets more in turn increases operating profit. This implies possession of more resources, which are used to reach more poor people as well as enable the institution to be self dependent. The assets also indicate the growth of Microfinance institutions in terms of client base, geographical area covered as well as assets owned. The model output predicts that increase in assets *by* one birr causes the operating profit to increase by 0.02 birr Micro finance institutions. This result is consistent with the previous findings of Ramsay et al (2005) which reveal that the resources of microfinance had impact on the performance of microfinance institutions.

Number of borrowers: As hypothesized *a priori,* Number of borrowers holding significantly and positively influenced the operating profit of microfinance institutions. The result indicated that a unit increase in number of Number of borrower by the microfinance institutions increases operating profit by 0.096 birr. Number of borrower play a critical role by increasing interest revenue for microfinance institutions.

Education level: As expected education of the microfinance institutions affects operating profit at less than 1% significance level. The result indicated that on average, if the microfinance institutions staffs get educated, the amount of operating profit increases by 0.04 birr. This suggests that education improves level of profit in microfinance institutions.

Number of active deposit account: As was hypothesized, the Number of active deposit account has a positive effect on operating profit and statistically significant at 1% probability level. The model output predicts that a unit increase in number of Number of deposit account by the microfinance institutions causes operating profit to rise by 1.17 birr per kilogram. This result suggests that Number of active deposit account is more responsive to amount of operating profit in microfinance institutions. Prior studies have established that banks which take more deposits are more likely to have higher profit margins (Aboagye et al., 2008).

Microfinance institutions experience (age): Microfinance institutions experience (age) affected operating profit of microfinance institutions positively and significantly at less than 5% significance level. The result suggests that as microfinance institutions have high experience the operating profit increases. The result confirms that an increase by one year age of microfinance institutions increases the operating profit by 0.01 birr. This is in line with that of Abayie et al (2011) the age of Microfinance institutions has a positive effect on their performance in terms of efficiency, sustainability and profitability

5. CONCLUSION AND RECOMMENDATIONS

The aim of the study was to examine the microfinance institutions performance in hadiya zone, southern region, Ethiopia. The study uses data of 14 Microfinance institutions operating in the zone. Descriptive statistics and econometric models were used to analyze the data. OLS model was used to identify the determinants of operating profit of microfinance institutions. The study uses eight variables, total asset, number of borrowers, Education level of microfinance staff, Number of active deposit account, women borrowers, number of staff, ownership and Microfinance institutions experience (age).

The findings of the study show the presence of the positive impact on microfinance institutions by total asset, number of borrowers, Education level, Number of active deposit account and Microfinance institutions experience (age) on the performance of Microfinance institutions in the zone. The study recommends that, due to the fast growth of the Microfinance sector in the country, with increases in small and medium Microfinance institutions, the government and policy makers should create a good environment for the growth of these institutions. Better policies should be create which to facilitate growth and hence the performance of Microfinance institutions in the country. It is important to monitor the growth of these institutions to ensure better performance and attainment of intended objectives. To the managers of Microfinance institutions, the study recommend that, they should monitor the institution's growth to ensure that assets, number of borrowers, Education of staff, Number of active deposit account increase with firm performance.

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