Evaluation

IFAD
Enabling poor rural people
to overcome poverty

profile

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Ethiopia: Providing poor people living in rural areas sustainable access to financial services

The objective of the Rural Financial Intermediation Programme (RUFIP) in Ethiopia was to enhance the access of poor rural people to regular and reliable financial services with a view to improving food security and family incomes, as well as to expand outreach to about 1.5 million rural households, develop a community banking framework, and promote linkages between rural financial institutions and the banking sector. Its main focus was to provide incremental resources for onlending through microfinance institutions (MFIs) together with targeted institutional support. It also provided support to the credit-cooperative sector, which was still in its infancy. The programme was financed jointly by IFAD, the African Development Bank (AfDB), Government of Ethiopia, Development Bank of Ethiopia (DBE) and other participating commercial banks, and MFIs.

RUFIP provided credit and training to microfinance institutions and also some support (mainly training) to rural savings and credit cooperatives. These rural financial institutions have a wide outreach, including to blacksmiths and tanners.

Main evaluation findings

The IFAD Office of Evaluation undertook an interim evaluation of RUFIP in 2009, both to assess its performance and to guide IFAD and the Government in preparing a possible second phase. The evaluation found that, overall, the programme had been relevant to a rural context where the demand for credit was high, formal banking outreach was almost non-existent outside the major towns, customary forms of credit were limited, and moneylenders and other traditional institutions charged high interest rates. During the period from project design in 2001 through 2008, the macro economy shifted from deflation to rising inflation, with a peak in 2008, calling into question both the relevance of promoting savings and the overall justification for debt finance from programme and commercial bank resources. While high inflation rates are generally a challenge for any programme aimed at developing financial services, the problem in Ethiopia was severely aggravated by its financial institutions' policy of not adjusting the interest rate, which led to grossly negative interest rates on both savings and loans. However, the rapid drop in the inflation rate during the first half of 2009, falling below 3 per cent in June of that year, leads one to hope that the problem may not persist.

Having expanded outreach to well over 1.5 million rural households and promoted linkages between rural financial institutions and the commercial banking sector, the programme generally achieved or exceeded most of its targets, and at similar costs to those estimated at appraisal.

In this connection, the clearest manifestation of programme success was in the provision of commercial credit lines to MFIs

PROJECT DATA

Project costs:

Total: US$88.73 million

IFAD loan: US$25.7 million

Contribution of the Government: US$4.5 million

Contribution of AfDB: US$37.5 million

Contribution of DBE/ commercial banks: US$20.2 million

Contribution of MFI: US$0.8 million

Cooperating institution: World Bank

Key dates:

Executive Board approval: 06 December 2001

Loan effectiveness: 06 January 2003

Project completion: 31 March 2010

through a growing number of commercial banks, indicating the increasing maturity of the sector. The programme also supported the expansion of the cooperative-credit sector (the community banking framework), although there are concerns regarding the sustainability of these grass-roots institutions. The single most important factor undermining the efficiency of the intervention, particularly in 2008, was the failure of MFIs to respond to inflation and to adjust lending rates to positive real levels.

RUFIP's success in achieving its objectives had a real and sustainable impact on rural poverty and in the development of MFIs that are now starting to consider raising capital on commercial terms (the ultimate sustainability litmus test for any financial institution). However, more remains to be done if continued expansion is to be sustained. In rural Ethiopia, which continues to be poorly served by commercial financial institutions, there is a huge, pent-up demand for financial services. At present, one of the most pressing issues is to increase access to financial resources in order to continue fuelling expansion and meeting demand. The emerging cooperative-credit sector has expanded rapidly with programme assistance, but there are real concerns that the vast, very rapid expansion of the rural savings and credit cooperatives may not be sustainable. Designing a fully functional cooperative-credit system and a system of appropriate regulation and supervision by a financial authority should have taken priority.

Key recommendations

- **Enhance savings mobilization in the microfinance sector.** Given the vast underserved rural market in Ethiopia, the shortage of loanable funds is one of the major constraints faced by MFIs in striving to broaden and deepen their outreach. Savings not only constitute an important source of funds but also provide the basis for institutional self reliance. Since their inception, Ethiopian MFIs have mobilized increasing amounts of savings, yet they are still far from exhausting this potential source of funds. Several different strategies will need to be pursued, particularly in terms of expanding outreach, including: (i) developing new savings deposit products and expanding outreach in savings mobilization efforts to rural households; and (ii) ensuring that attractive deposit rates are offered in order to mobilize deposits while MFIs continue to remain operationally sustainable institutions.
- **Engage in policy dialogue to facilitate the mobilization of funding for MFIs.** If the MFI sector is to continue to expand and to meet the huge unmet demand for microfinance in rural Ethiopia, commercial bank lending to MFIs should be encouraged. This would entail policy dialogue on several issues, such as creating an apex institution for MFIs in the medium to long term, assisting in establishing a credit guarantee fund that would make it possible for MFIs to borrow on commercial terms without significant collateral requirements, and studying collateral substitute mechanisms, including independent ratings of MFIs as currently implemented in other countries.
- **Separate sectoral focus on MFIs and credit cooperatives.** Both sectors have great potential, albeit with very different strategic requirements. Therefore, for a possible second phase of RUFIP, IFAD should consider supporting the two sectors independently.
- **Develop an appropriate regulatory and supervisory system for the credit cooperative sector.** Should it be decided to launch a second phase of RUFIP to provide continued support for development of the credit cooperative network, a system of appropriate regulation and supervision by a financial authority and a fully functional operating and reporting system would be needed, together with all the complementary institutional capacity-building functions that this would entail.

Depositing savings at Gasha MFI. Overall the programme has achieved both its primary objective of promoting access to financial services for the rural poor, and its specific objectives, expanding outreach to well over 1.5 million rural households targeted at appraisal, and promoting linkages between MFIs and the commercial banking sector.

Further information:

Federal Democratic Republic of Ethiopia, Rural Financial Intermediation Programme, Interim Evaluation, Report No. 2373-ET, March 2011, ISBN 978-92-9072-197-0, IFAD Office of Evaluation, Via Paolo di Dono, 44, 00142, Rome, Italy. The full report and Profile are available online at www.ifad.org/evaluation; email: evaluation@ifad.org.