

184. PROFILE ON MICRO FINANCE SERVICE

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I. SUMMARY

This profile envisages the establishment of an institution that provides micro finance service with a loan capacity of Birr 15,000,000 per annum.

The present demand for loan from microfinance institutions in Addis Ababa is estimated at Birr 1.5 billion and the demand for saving is estimated at Birr 0.5 million. The demand for saving service from micro financial institutions will reach about Birr 1.6 billion in 2017 and the demand for loan will reach about Birr 4.7 billion by the same year.

The total investment requirement is estimated at Birr 4.31 million, out of which Birr 600 thousand is required for equipment. The service will create employment opportunities for 27 persons.

The project is financially viable with an internal rate of return (IRR) of 20.97 % and a net present value (NPV) of Birr 2.36 million, discounted at 8.5%.

II. SERVICE DESCRIPTION & APPLICATION

Micro-finance Institution (MFI) is an institution that provides small/micro loans to the poor entrepreneurs, unemployed people, and others living in poverty that lacks collateral, steady employment and verifiable credit history.

Hence, Micro-finance or micro-enterprise development has been an increasingly important area of development activity in developing countries. Micro-finance institutions are very diverse and the sector is currently undergoing a period of rapid innovation. While many of these innovations can intuitively be expected to increase the contribution of micro-finance to poverty reduction, empowerment and other development goals, impact assessment will be crucial to testing this.

II. MARKET STUDY AND SERVICE CAPACITY

A. MARKET STUDY

1. Service Supply and Demand

Micro Finance Institutions are institutions that provide small loans or micro loans to the unemployed, to poor entrepreneurs and to others living in poverty that is not bankable. These individuals lack collateral, steady employment and a verifiable credit history and therefore cannot meet even the most minimum qualifications to gain access to traditional credit. They also provide other micro finance services to the very poor; apart from loans, it includes savings, micro insurance and other financial innovations.

The number of Micro-Finance Institutions (MFIs) that operate in the country has reached 25 at the end 2004/05. Their total capital stood at Birr 568.2 million and their total asset Birr 1.9 billion. They mobilized deposits to the tune of Birr 509.6 million and advanced loans amounting to Birr 1.48 billion by the end of the review period (2004/2005). Of the total MFIs, 13 of them (or 52%) are operating in Addis Ababa. The list of MFIs operating in Addis Ababa with their registered capital, asset, savings mobilized and credits disbursed is provided under Table 3.1 that follow.

As can be observed from the table the total capital of MFIs that are operating in Addis Ababa as of June 2005 is about Birr 48.6 million¹ constituting about 8.5% of the total capital of MFIs operating in the country. They have about Birr 255 million worth of assets, which is about 13.4% of the total assets registered in the industry. They have mobilized about Birr 64.5 million savings from their customer constituting 12.7% of the total savings mobilized by the industry in the country. The amount of credits they have extended to clients has reached to Birr 186.9 million, accounting 12.6% of the total micro credit disbursed by the industry in the country as of June 2005.

¹ Figure for Megedela, Harbu, and Leta is not available and are not included in the computation of total capital, savings, credit and assets of MFIs.

Table 3.1

**ACTIVITIES OF MICRO FINANCE INSTITUTIONS OPERATING IN
ADDIS ABABA AS OF JUNE 2005**

Name of MFI	Amount in Thousand Birr			
	Capital	Saving	Credit	Assets
Specialized Financial & Products Ins.	8,073.70	5,352.2	12,101.9	15,861.2
Gasha Micro-fin. Ins.	2,415.60	4,583.5	10,935.7	15,243.1
Wisdom Micro-financing Ins.	12,352.60	6,770.2	23,364.5	29,963.0
Aser Micro-financing Ins.	848.5	236.6	812.9	1,137.0
Africa Village Financial Service	3,075.70	1,255.4	3,710.8	6,072.0
Peace Micro-finance Ins.	4,706.10	2,471.2	11,031.4	14,447.5
Addis Credit & Saving Ins.	9,592.00	39,703.0	118,076.0	137,800.0
Meklit Micro-financing Ins.	1,137.30	2,547.7	3,370.8	5,786.8
Metemamen MFI	2,655.20	-	1,103.1	2,673.0
Agar MFI	3,718.20	1,597.2	2,373.2	26,073.3
Total MFIs in Addis Ababa	48,574.9	64,517	186,880.3	255,056.9
% Share of MFIs in Addis Ababa	8.5	12.7	12.6	13.4
Total Industry	568,200.0	509,585.5	1,482,153.9	1,904,256.9

Source: National Bank of Ethiopia Annual Report, 2004/05

From the MFIs operating in the city, Addis Credit and Savings Institution is the single largest, which alone accounted for 19.7 percent of the total capital, 61.5 percent of the savings, 63.2 percent of the credit and 54.0 percent of the total assets of MFIs operating in Addis Ababa by end fiscal year 2004/05.

It could be concluded that the current demand for loan from microfinance institutions in Addis Ababa is Birr is about Birr 1.5 billion and the demand for saving about Birr 0.5 million

2. Projected Demand

By and large the services offered by MFI targets micro business operators. The demand for loan is a function business and economic activities. As the business grows so is the demand

for loan. When the economy grows there will new entrants into the business. In other words economic growth and the demand for micro credit services are directly related. Accordingly, assuming that both the demand for loan and saving will grow by the planned rate of the growth of the economy which is 10%, the demand for both loan and saving service from micro finance institution for the coming 10 years is projected and provided under Table 3.2.

Table 3.2
PROJECT DEMAND OF SAVING AND CREDIT

Year	Demand in Thousand Birr	
	Saving	Credit
2005(actual)	509,585.5	1,482,153.9
2006(estimated)	560,544.1	1,630,369.3
2007(estimated)	616,598.5	1,793,406.2
2008	678,258.3	1,972,746.8
2009	746,084.1	2,170,021.5
2010	820,692.5	2,387,023.7
2011	902,761.8	2,625,726.0
2012	993,030.0	2,888,298.7
2013	1,092,341.8	3,177,128.5
2014	1,201,576.0	3,494,841.4
2015	1,321,733.5	3,844,325.5
2016	1,453,906.9	4,228,758.0
2017	1,599,297.6	4,651,633.9

As can be referred from Table 3.2 the demand for saving service from micro financial institutions will reach about Birr 1.6 billion in 2017 and the demand for loan will reach about Birr 4.7 billion by the same year.

3. Interest Rate

Addis Credit and Saving Institution S.C. is the single largest MFI in Addis. It has offices in 88 kebeles in Addis Ababa. It is believed that the interest rates charged by this institution

will represent the industry in the City. Accordingly information is collected regarding the types of charges and the interest the institution charges when lending and it pays for saving.

It pays 4.5% annual interest rate for saving deposit and up to 5% for time deposit.

The lending rate varies depending on the type and amount of the loan. The detail is given in table 3.3.

Table 3.3

INTEREST RATE CHARGED BY ADDIS CREDIT AND SAVING INSTITUTION

S.C.

Types of Activity	Loan Amount in Birr	Loan Period in Months	Interest Rate in % per annum	Service Charge in %²	Grace Period in Months	Payment Schedule
Micro business	3,000-5,000	24	9	2	1	Monthly
Small business	5,000 & above	36	9	2	4	Monthly
Agriculture	-	18	9	1	No	At once
Equipment leasing	-	36	9	2	4	Monthly
Consumption	Up to 5,000	24	10	-	No	Monthly
Short term	Up to 5,000	6	1.5/ month	2	No	At once
Housing renovation	Up to 5,000	60	10	-	1	Monthly
Others	3,000-5,000	24	9	2	1	Monthly

Source: Addis Credit & Saving Institution S.C.

B. CAPACITY AND SERVICE PROGRAMME

1. Capacity

Taking in to account the market study on existing condition of Micro Finance Service in the country, generally, and in Addis Ababa, particularly and the economic scale of service

² One time payment

provision, the envisaged MFI will have a total loan capital of Birr 15,000,000.00(Fifteen million Birr) per annum with an intention of providing services to various activities with a limited loan amount, loan terms, loan sizes and interest rates. The service will be given for one shift of eight hours, per day.

2. Service Programme

The envisaged MFI requires some years to penetrate in to the market and capture a significant share. It will start providing services at 75% and 90% of its rated capacity in the first and second year of service provision, respectively. Full service provision shall be attained in the third year and then after. The proposed service provision program is shown in Table 3.4.

Table 3.4
SERVICE PROVISION PROGRAMME

Sr. No.	Service	Service Year		
		1	2	3- 10
1	Total loan capital/annum (‘000 Birr)	11,250.00	13,500.00	15,000.00
2	Service provision capacity (%)	75	90	100

IV. MATERIALS AND INPUTS

A. RAW MATERIALS

The main materials and inputs required for the provision of Micro Finance Service are given on Table 4.1. The cost of these and other related materials are estimated to be of Birr 15,600,000, all in local currency, while the center reaches at its full capacity.

Table 4.1

**RAW MATERIALS AND CONSUMABLES REQUIREMENT AT FULL
CAPACITY AND ESTIMATED COST**

Sr. No.	Materials	UOM	Req. No.	Cost ('000 Birr)		
				FC	LC	TOTAL
1	Annual capital loan	Birr	15,000,000.00	-	15,000.00	15,000.00
2	Design and publication of electronic interfaces	Lump sum	-	-	200.00	200.00
3	Development of database management	Lump sum	-	-	100.00	100.00
4	Design and Publications of Promotional items	Lump sum			100.00	100.00
5	Training Resource materials	Lump sum	-	-	50.00	50.00
6	Stationery materials	Lump sum			50.00	50.00
7	Miscellaneous expenses				100.00	100.00
	TOTAL				15,600.00	15,600.00

B. UTILITIES

The major utilities required by the envisaged MFI are electricity and water. The estimated annual requirement at full capacity and the corresponding cost is given in Table 4.2.

Table 4.2

ANNUAL UTILITIES REQUIREMENT AND ESTIMATED COST

Sr. No.	Description	Unit of Meas.	Qty.	Unit price (Birr)	Cost ('000 Birr)
1	Electricity	kWh	5000	0.4736	2.40
2	Water	m ³	1000	3.25	3.25
	Total				5.65

V. TECHNOLOGY AND ENGINEERING

A. TECHNOLOGY

1. Service Process

It cannot be assumed that microfinance institutions will necessarily be able to provide better services than those already available and/or fulfill the diversity of needs, which poor people have. It is crucial to ensure that externally supported microfinance interventions integrated with and complement existing arrangements rather than displacing or undermining them.

There may be ways of stimulating and supporting informal sector microfinance provision working with informal sector to increase their access to capital, increasing efficiency and developing networks in order to decrease interest rates and/or improve the services they provide.

The envisaged MFI will provide its services to various activities with a specified loan amount, loan terms, loan sizes, and interest rates and other related parameters are indicated below:

Table 5.1
LOAN SIZE, LOAN TERM AND INTEREST RATE

Sr. No.	Type of Loan Activity	Loan Size (Birr)		Loan Term (Month)		Interest Rate Per Annum (%)	Service Charge (%)*
		Minimum	Maximum	Minimum	Maximum		
1.	Urban Agriculture Loan	500	5,000	3	18	9	1
2.	Petty Trade Loan	500	5,000	1	36	9	2
3.	Construction Loan	500	5,000	3	12	9	2
4.	Service Loan	500	5,000	1	12	9	2
5.	Housing Renovation Loan	750	3,000	2	12	10	2

* One time payment

Loan Eligibility Criteria:

- Potential clients should be able to make pre-loan compulsory saving while taking a seven-day training;
- Permanent residence of the concerned 'Kebele';
- He/she should be active poor;
- His/her age should be between the range of 18 to 64 years;
- He/she should be free of any debt.

Type of Collateral Needed

- Group Guarantee is the only collateral needed for all loan types.

Grace Period

- A grace period of two months is provided to clients with urban agricultural loan the rest are given one month.

Time needed to process and get loan:

- Maximum of four days.

Loan Application Format

The loan application format has the following contents:

- Biographic data of the clients, type of activity the loan is required for, profit ability of the business, availability of market for product/service of the borrower.

Savings Products:

Table 5.2
SAVINGS PRODUCTS

Sr. No.	Type of Saving	Annual Deposit Rate	Remark
1.	Regular Saving by the borrower	4%	
2.	Compulsory Saving by the borrower	4%	5% of the loan required should be deposited before accessing the loan.
3.	Voluntary saving by the borrower		This can be as small as Birr 2
4.	Solidarity Group saving		
5.	Center saving		Center is a cluster of groups

The provision of the service doesn't have any adverse impact on the environment.

B. ENGINEERING

1. Machinery and Equipment

The list of machinery, equipment and other facilities required for provision of Micro-finance services and the estimated cost required in local currency is given in Table 5.3.

Table 5.3
MACHINERY, EQUIPMENT & OTHER FACILITIES REQUIREMENT

Sr. No.	Description	UOM	Qty	Total cost ('000 Birr)
1	Broadband internet line	Unit	3	60.0
2	Desk top computers	Set	10	150.00
3	Lap top computers	Set	2	40.00
4	Scanner	Pcs	1	7.00
5	LCD with screen	Set	1	30.00
6	Digital camera	Pcs	2	10.00
7	Video camera	Set	1	11.00
8	DVD player	Set	1	2.00
9	Printer	Set	3	30.00
10	Fax machine	Set	1	10.00
11	Cafeteria facilities	Set	1	90.00
12	TV-set	Set	2	10.00
13	Photo copy machine	Set	1	50.00
14	Other miscellaneous items			100.00
	Total			600.00

2. Land, Building and Civil Works

The envisaged micro finance service provider requires a built up area of 500 m² of which reception accounts for 100m², toilet (40m²), training rooms (160m²), conference rooms (200m²)

It is assumed that the envisaged project will rent the required space. Accordingly, at the rate of Birr 50 per m² / month the annual rental cost is estimated at Birr 300,000.

VI. MANPOWER AND TRAINING REQUIREMENT

A. MANPOWER REQUIREMENT

The total manpower requirement, including skilled and unskilled labor is 27 people. The corresponding total labor cost, including fringe benefits, is estimate at Birr 337,500. Table 6.1 shows the list of manpower required and the estimated annual labor costs.

Table 6.1
MANPOWER REQUIREMENT & COST

Sr. No.	Job Position	Req. No.	Salary (Birr)	
			Monthly	Annual
1.	General manager	1	4,000	48,000
2.	Snr. Secretary	1	1,000	12,000
3.	Documentation attendant	1	900	10,800
4.	Financial clerk	1	800	9,600
5.	Secretaries	3	2,250	27,000
6.	Counseling supervisor	2	4,000	48,000
6.	Driver	2	1,200	14,400
7.	Cashiers	2	1,400	16,800
8.	Cleaners	4	2,000	24,000
9.	Guard	7	3,850	46,200
10.	Cafeteria Attendant	2	700	8,400
11.	Gardener	1	400	4,800
	Total	27		270,000
	Workers benefit (25% of BS)	-		67,500
	Grand total	27		337,500

B. TRAINING REQUIREMENT

Counseling supervisors, clerks and secretaries need to get local tailor made training and attachment training at similar centers. The cost of training is estimated at Birr 10,000.

VII. FINANCIAL ANALYSIS

The financial analysis of the micro finance project is based on the data presented in the previous chapters and the following assumptions:-

Source of finance	30 % equity
	70 % loan
Bank interest	8.5 %
Discount cash flow	8.5%
Accounts receivable	30 days
Material and input local	30 days
Cash in hand	5 days
Accounts payable	30 days
Repair and maintenance	5% of equipment cost

A. TOTAL INITIAL INVESTMENT COST

The total investment cost of the project including working capital is estimated at Birr 4.31 million. The major breakdown of the total initial investment cost is shown in Table 7.1.

Table 7.1**INITIAL INVESTMENT COST ('000 Birr)**

Sr. No.	Cost Items	Local Cost	Foreign Cost	Total Cost
1	Land lease value	-	-	-
2	Building and Civil Work	-	-	-
3	Equipment	600.0	-	600.00
4	Office Furniture and Equipment	125.00	-	125.00
5	Vehicle	450.00	-	450.00
6	Pre-production Expenditure*	245.69	-	245.69
7	Working Capital	2,892.76	-	2,892.76
	Total Investment cost	4,313.45	-	4,313.45

* *N.B Pre-production expenditure includes interest during grace period (Birr 135.69 thousand), training (Birr 10 thousand) and Birr 100 thousand costs of registration, licensing and formation of the company including legal fees, commissioning expenses, etc.*

B. OPERATION COST

The annual production cost at full operation capacity is estimated at Birr 16.63 million (see Table 7.2). The material and input cost accounts for 93.79 percent of the operation cost. The other major components of the operation cost are working premises rental, depreciation and financial cost which account for 1.80%, 1.16% and 1.0% respectively. The remaining 2.24 % is the share of direct labour, utility, labour overhead, and repair and maintenance.

Table 7.2**ANNUAL OPERATING COST AT FULL CAPACITY ('000 BIRR)**

Items	Cost	%
Material and Inputs	15,600.00	93.79
Utilities	5.65	0.03
Maintenance and repair	30.00	0.18
Labour direct	162.00	0.97
Labour overheads	67.50	0.41
Administration Costs	108.00	0.65
Working premise rental	300.00	1.80
Total Operating Costs	16,273.15	97.84
Depreciation	192.50	1.16
Cost of Finance	167.13	1.00
Total Production Cost	16,632.78	100

C. FINANCIAL EVALUATION**1. Profitability**

Based on the projected profit and loss statement, the project will generate a profit through out its operation life. Annual net profit after tax will grow from Birr 382.30 thousand to Birr 1.17 million during the life of the project. Moreover, at the end of the project life the accumulated cash flow amounts to Birr 8.38 million.

2. Ratios

In financial analysis financial ratios and efficiency ratios are used as an index or yardstick for evaluating the financial position of a firm. It is also an indicator for the strength and weakness of the firm or a project. Using the year-end balance sheet figures and other relevant data, the most important ratios such as return on sales which is computed by dividing net income by revenue, return on assets (operating income divided by assets), return on equity (net profit divided by equity) and return on total investment (net profit plus interest divided by total investment) has been carried out over the period of the project life and all the results are found to be satisfactory.

3. Break-even Analysis

The break-even analysis establishes a relationship between operation costs and revenues. It indicates the level at which costs and revenue are in equilibrium. To this end, the break-even point of the project including cost of finance when it starts to operate at full capacity (year 3) is estimated by using income statement projection.

$$\text{BE} = \frac{\text{Fixed Cost}}{\text{Sales} - \text{Variable Cost}} = 31 \%$$

4. Payback Period

The pay back period, also called pay – off period is defined as the period required to recover the original investment outlay through the accumulated net cash flows earned by the project. Accordingly, based on the projected cash flow it is estimated that the project's initial investment will be fully recovered within 6years.

5. Internal Rate of Return

The internal rate of return (IRR) is the annualized effective compounded return rate that can be earned on the invested capital, i.e., the yield on the investment. Put another way, the internal rate of return for an investment is the discount rate that makes the net present value of the investment's income stream total to zero. It is an indicator of the efficiency or quality of an investment. A project is a good investment proposition if its IRR is greater than the rate of return that could be earned by alternate investments or putting the money in a bank account. Accordingly, the IRR of this project is computed to be 20.97 % indicating the viability of the project.

6. Net Present Value

Net present value (NPV) is defined as the total present (discounted) value of a time series of cash flows. NPV aggregates cash flows that occur during different periods of time during the life of a project in to a common measuring unit i.e. present value. It is a standard method for using the time value of money to appraise long-term projects. NPV is an

indicator of how much value an investment or project adds to the capital invested. In principle a project is accepted if the NPV is non-negative.

Accordingly, the net present value of the project at 8.5% discount rate is found to be Birr 2.36 million which is acceptable.

D. ECONOMIC BENEFITS

The project can create employment for 27 persons. In addition to supply of the domestic needs, the project will generate Birr 2.94 million in terms of tax revenue. The establishment of micro finance institution will contribute to the poverty reduction programme and to the overall development goals of the country.