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# LEGAL INFRASTRUCTURE FOR MICROFINANCE

## PANELISTS:

Dr. Gebrehiwot Ageba, *Dean of Faculty of Business and Economics, Addis Ababa University*

Getaneh Gobezie, *Amhara Credit & Savings Institution*

April Rinne, *Unitus Investment Group*



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# Overview of Microfinance

## What is Microfinance?

- “The provision of financial products and services to those who would not otherwise have such access”
  - “Unbanked poor”
- The most common product historically has been small loans
  - Often made to groups based on “social collateral”: friends, family, peer pressure
  - Frequent repayment schedules and short loan cycles
- Today includes many other products – savings accounts, microinsurance, pensions
- MFI: Microfinance Institution

## History and Growth of Microfinance

- Microfinance has existed internationally for many decades
- 2006: Nobel Peace Prize awarded to the Grameen Bank (Bangladesh) and its founder Muhammed Yunus for pioneering work in this sector
  - Microfinance and economic stability and progress as means to promote peace
  - Additional benefits: income generation, individual empowerment, education, family stability, growth of small enterprises and entrepreneurialism

# Microfinance in Ethiopia

## Legal History

- 1994 / 1996 revisions to Ethiopian Law permits private MFIs to exist
- NBE has sole right to license and supervise domestic MFIs
- Strict limitations on foreign investment (FDI) and foreign participation in MFIs
  - Restrictions on entry: FDI, foreign purchase of shares, transfer of proceeds upon liquidation
  - Post-entry restrictions: limited if any access to privatization, limitations on entry of key personnel
- No significant MFI performance requirements established under Ethiopian Law
- Today: Draft MFI regulations under review

## Role of Local Law / Practice

- Ability to enforce contracts, collect on collateral if default, other enforcement mechanisms, consideration of other types of collateral
- Promotion of a more competitive MFI market by the NBE (and Ethiopian government generally)

# Current Status of Microfinance in Ethiopia

- MF Law and regulations → Revisions → Implementation by MFIs
  - Gradual improvements, but more needed
  - Onerous registration requirements each time an MFI “mobilizes” capital (US \$~115,000)
  
- Key issue remains FDI limitations (part of current draft regulations)
  - Pros of FDI
  - Cons of FDI
  - NBE treatment of, and ability to regulate, domestic vs. foreign participants
  
- Need for greater *rural* expansion by MFIs
  - Various models for this exist internationally
  - Greater % of underserved women and “very poor” in rural areas
  
- MFI performance
  - Most are subsidized currently
  - Ability to grant multiple loans to individuals and/or offer a suite of products and services to clients?

## Questions and Issues for Microfinance in Ethiopia Today

- What is the proper role of FDI in microfinance?
- How can / should the NBE properly supervise and ensure proper implementation of the regulations?
- How to ensure proper governance of the MFIs themselves?
- What is the appropriate definition of MFI performance / “success”?
  - Financial self-sufficiency and sustainability?
  - # of clients reached... and *who* is the client (focus on serving the poor)?
  - Impact of microfinance (credit and savings) on its clients?
- How to expand microfinance, especially in rural areas with limited infrastructure and more difficult economies?

The background of the slide is a photograph of the Addis Ababa University building facade, featuring a stone structure with a large sign that reads "ADDIS ABABA UNIVERSITY".

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Dr. Gebrehiwot Ageba, *Dean of Faculty of Business and Economics, Addis Ababa University*

Tsegaye Anebo, *Sidama Coffee Farmers' Cooperative Union*

Getaneh Gobezie, *Amhara Credit & Savings Institution*

April Rinne, *Unitus Investment Group*



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