ST. MARY's UNVERSITY

SCHOOL OF GRADUATE STUDIES

A REVIEW ON CORPORATE GOVERNANCE IN ETHIOPIAN MFIs: LEARNING FROM EAST AFRICAN COUNTRIES

BY

TEKLE BEKELE

(SGS/0157/2011A)

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APPROVED BY BOARD OF EXAMINERS

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ENDORSEMENT

This thesis has been submitted to St. Mary's University, School of Graduate Studies for examination with my approval as a university advisor.

Advisor: Meskerem Mitiku (PHD) ________________________________

Signature

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May God Bless You All!

List of Abbreviations and Acronyms

ACSI	-	Amhara Credit and Saving Institution
AdCSI	-	Addis Credit and Saving Institute
AEMFI	-	Association of Ethiopian Micro Finance Institutions
AMFI	-	Afar Micro Finance Institute
AMIR	-	Association of Microfinance Institutions in Rwanda
BGMFI	-	Beneshangul Gumuze Micro Finance Institute
DBE	-	Development Bank of Ethiopia
DECSI	-	Dedebit Credit and Saving Institution
DMFI	-	Dire Dawa Micro Finance Institute
IFAD	-	International Fund for Agricultural Development
MFI	-	Micro Finance Institution
MFIs	-	Micro Finance Institutions
NBE	-	National Bank of Ethiopia
NBR	-	National Bank of Rwanda
NGO	-	Non-Governmental Organizations
NPL	-	Non Performing Loans
OCSSCO	-	Oromiya Credit and Saving Share Company
OMFI	-	Omo Micro Finance Institute
SACCOs	-	Saving and Credit Cooperatives
SMFI	-	Somali Micro Finance Institute

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ABSTRACT

The purpose of this study is to review the Corporate Governance general practices in the Ethiopian MFIs, identify the gaps and based on experiences from selected East African countries and offer suggestions for improving the performance of the corporate governance for various stakeholders that include Regulators, Networks, etc.. Among various research designing methods, this study used the descriptive research designing method. Interviews were conducted through questionnaires to Chief Executive Officers, micro finance departments at the National Bank of Ethiopia & Development Bank of Ethiopia and the Association of Ethiopian Micro Finance Institutions. Both the qualitative and the quantitative approaches were used to study the critical issues of Corporate Governance in MFIs. The results of the study show that Corporate Governance in the Ethiopian MFIs has gaps that need to be addressed to strengthen the MF Sector. Board members are not well skilled, not educated as expected, and not exposed to the international experiences. In addition, the participation of women and youth professionals is very limited. Ethiopian MFIs lack application of technologies/innovations, skilled and educated human capital, and infrastructures. Moreover, there is political interference on the MFI sector. These all helps to conclude that the governance of MFIs in Ethiopia has influences on the growth of the sector as compare to other East African countries. Therefore, regulators, owners of MFIs and other stakeholders' of MFIs are suggested to take appropriate measures in creating infrastructures, good working environment and enhancing capacity of board members in order to have appropriate measures on Corporate Governance for MFIs in Ethiopia thus facilitating enhancing microfinance sector in Ethiopia.

***Key terms**:- Corporate governance, MFIs, Ethiopia, East African countries*

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Corporate governance is the set of processes , customs, policies, laws and institutions affecting the way a company is directed, administered or controlled and defines the relationships among the various stakeholders. In principle, all enterprise, irrespective of size and ownership structure, need some principles to conduct business. However, firms of different size and ownership structures may require different sets of complexities of governance (Tilahun and Kibre 2007). According to Tilahun and Kibre (2007) the term corporate governance has come to mean a process by which companies are directed and controlled. According to Wolday Ameha (2008), governance is broadly defined as a system of checks and balances whereby a board is established to oversee the management of micro finance institutions.

Corporate governance has become an issue throughout the world because failures in corporations affect many stakeholders who have various interests on those corporations. The issue is more serious on financial institutions such as banks and micro finance institutions. Failures in corporate governance in financial institutions may result in the loss of significant amount of money like what was experienced mostly in the Western banks in 2008. It is not affecting developed nations only. Poor corporate governance and failures due to such poor management affects every economy and corporation. For instance, according to Olusbisi (2015) ,Nigeria lost almost 75 banks since 1914 primarily because of factors related to poor governance management and not because of banking business or customers. The main reason attributed for failure of Nigerian deposit Insurance Corporation, for instance, was interference by members of the board of company (Olusbisi, 2015).

In Ethiopia micro finance institutions are established as corporations as per the Commercial Code of Ethiopia 1960 (Commercial Code 1960). Proclamation No.

40/1996 of The Federal Democratic Republic of Ethiopia was the first regulatory framework for microfinance business in Ethiopia.

As per the amended Proclamation No. 626/2009 ((FDRE, 1996 and 2009):
"Micro-financing institution" means a company licensed under this Proclamation to engage in micro-financing business in rural and urban areas and other activities specified under Article 3(2) of this Proclamation. "Company" mean a share company as defined under the Commercial Code of Ethiopia in which the capital is wholly owned by Ethiopian nationals or organizations wholly owned by Ethiopian nationals, and registered under the laws of, and having its head office in Ethiopia;

"Financial institution" means insurance company, bank, micro-financing institution, postal savings, money transfer institution or such other similar institution as determined by the National Bank. Therefore, as per the proclamation stated above , an MFI in Ethiopia is a "share company" as per the Commercial Code of Ethiopia, a Financial Institution as per the Micro financing Business Proclamation and have the regulatory provision to provide a wide range of financial services including credit, savings, insurance, remittances etc. This indicates, therefore, micro finance institutions in Ethiopia like banks are corporations' governed by board members by rules and regulations.

In many countries , including Ethiopia, microfinance has emerged as a leading and effective strategy for poverty reduction with the potential for far-reaching impact in transforming the lives of poor people. Many governments have been chosen micro finance institutions as development tools believing that microfinance can facilitate the achievement of their development goals. Hence, the micro finance sector requires board members who are supposed to guide the industry with the skills and knowledge the industry demands. As financial institutions micro finance institutions are sensitive to changes within and outside their operating environments.

Like other business entities micro finance institutions can be affected by technologies, policy frameworks and other factors. As mentioned above, there are policy frameworks and many directives set by the National Bank of Ethiopia to regulate and monitor the micro finance sector in Ethiopia which is considered as one of the external factors affecting the governance of the sector and related business relations.

The financial system consists of a number of groups of actors including consumers, corporations, investors, traders, guarantors, financial services firms, professionals and financial sector workers and governments ((Mainelli , & Mills, 2018).

In Ethiopia the micro finance industry has been played significant roles in job creation for the active poor and small and medium enterprises. The sector is working with many development partners in many development programs targeting various beneficiaries. However, as mentioned on the study context part of this paper various studies and statistical based reports pinpoint that as compare to some East African countries the growth rate is still beyond what is expected to be. To do so the governance of Ethiopian micro finance institutions was assessed as in assessment with other some East African countries and the good practices are included in this study. The influence of various factors such as board capacity and level, policy and collateral issues, relation between board and management, government interferences and support, regulations and laws, application of technologies etc. on the overall growth and performance of micro finance institutions were assessed in details for comparison in this study. Hence, the gaps for such growth differences on micro finance institutions among those countries were analyzed on this study paper.

1.2 Statement of the Problem

According to Wolday Amha (2008) , although governance problems of Ethiopian microfinance institutions vary from one MFI to another, there are issues that should be properly addressed by all the key stakeholders in the entire microfinance industry, which include: lack of clear ownership; inadequate incentives of board members to conduct regular meetings and address core risks of the micro finance institutions; lack of well-defined performance evaluation indicators; absence of succession plans; absence of board committees to support the activities of the board and management; and the limited capacity of the regulators to implement the microfinance law and the directives of the National Bank of Ethiopia (WoldayAmha, 2008). On the other hand, according to the study conducted by Tekie and Sisay (2019) the main challenges that microfinance institutions face in the process of expanding their services to the people who do not have access to financial services include: Lack of loanable fund; Lack of financial education; Adoption of Technologies; Capacity of MFIs and Governance Problems; Lack of credit information Centers etc(Tekie and Sisay, 2019).The study conducted by Derk, Gebrehiwot, Haftu and Million (2009) raised the issues of microfinance governance and ownership in relation to the size of the board; board composition and election; board qualifications, board tenure; board committees; board documents; conflict of interest and board performance and evaluation.

Thus, researches conducted on the topic of corporate governance and related issues in MFIs brought many critical matters to the forefront. However, as to the knowledge of the researcher there are some gaps on touching governance issues which may have influence on the overall growth and development of MFIs in details and statistical presentations. Moreover, comparisons among MFIs in East Africa where they operate under different circumstances which may have direct influence on the overall growth and development of MFIs is not well assessed.

1.3 Research Questions

As of December, 2019 there are about 38 micro finance institutions in Ethiopia registered by the National Bank of Ethiopia (NBE, 2019). The MFIs in Ethiopia are classified as big, medium and small micro finance institutions based on their capital structures, asset accumulation, number of clients, branches etc. The ownership makeup is a combination of local non-governmental organizations, public or government organizations, associations and individual or private. All the nine current regions and the two administrative cities, Addis Ababa and Dire Dawa, do have their own micro finance institutions.

By June 2018 Association of Micro Finance Institutions in Uganda, AMFIU, had 117 members (includes ordinary micro finance institutions and associate members such as other institutions and individuals supporting micro finance activities. They are both micro-deposit and credit deposit institutions (AMFIU, 2018). According to the report from the Association of Micro Finance Institutions in Rwanda, AMIR, currently it has 347 active members, serving poor and middle class families throughout the country (The New Times, 2018). On the other hand, according to the Association of Micro Finance Institutions in Kenyan-AMFI-K, in 2018, the number of licensed MFIs has grown to 60 fully paid-up memberships serving for more than six million people (AMFI-K, 2018).

The main issue in the micro finance sector in these countries for this study paper is mainly related with board teams governing the sector, the way the regulatory body of governments are handling governance issues, particularly in regulations and capacity building aspects and the infrastructure supports by governments/regulators and other stakeholders. The countries in comparison for this research are Ethiopia, Kenya, Uganda and Rwanda. This is because they are operating in Sub-Saharan Africa and East Africa where the level of the technology and human resource development is almost similar. Moreover, the time in which the micro finance industry had started to operate and the target population they are serving is also similar. In all these countries the micro finance sector is considered as development tools by their respective governments.

Governance related challenges in Ethiopia were assessed in details using questionnaires prepared for chief executive officers of MFIs and infrastructures which contributed to the growth of MFIs in Ethiopia and the three East African countries are presented for comparison in this paper.

Therefore, focus of this study is to answer the following questions;

- What are the major governance factors that influence growth and development of MFIs in Ethiopia?
- How board members lead their respective institutions and the sector in general? What challenges they faced in the previous years in relation to governance?
- How should regulatory bodies of the government and other not-for-profit entities support in capacity building and regulatory set ups aspect for the micro finance sector in general and the board members in particular? and
- What are the good practices and learning in relation to governance from other East African MFIs would be considered in making the Ethiopian MFIs more effective?

1.4 Objectives of the Study

1.4.1 General Objective

The main objective of this study is to make a review on corporate governance on Ethiopian MFIs and investigate learning from East African countries to offer recommendations for networks, government bodies, development partners and other stakeholders.

1.4.2 Specific Objectives of the Study

- To assess ownership structures and challenges on governance of Ethiopian MFIs
- To identify gaps and challenges on the Ethiopian MFIs which may hinder their growth
- To assess whether or not corporate governance principles are being applied on the Ethiopian MFI industry
- To review how MFIs in East African countries are operating and compare with Ethiopian MFIs

1.5 Definition of Terms

- Governance is broadly defined as a system of checks and balances whereby a board is established to oversee the management of MFIs According to (Wolday , 2008)
- Corporate governance is the combination of rules, processes or laws by which businesses are operated, regulated or controlled (Margaret Rouse, 2019)
- Microfinance is defined as the provision of financial services, mostly savings and credit to the poor and low income households that otherwise don't have access to mainstream commercial banks. Microfinance industry is the primary source of credit and saving to low income earners (Chenuos, Mohamed, & Bitok, 2014)
- Microcredit is the provision of small loans to poor households and small business operators with or without guarantee (Obo, 2009)
- "Micro-financing institution" means a company licensed under this Proclamation to engage in micro-financing business in rural and urban areas and other activities specified under Article 3(2) of this Proclamation (FDRE, 1996 and 2009)
- "Financial institution" means insurance company, bank, micro-financing institution, postal savings, money transfer institution or such other similar institution as determined by the National Bank ((FDRE, 1996 and 2009)

1.6 Significance of the Study

This study was undertaken to assess the governance gaps and challenges in the Ethiopian microfinance sector which has been operating for more than a decade in the country. Many valuable studies have been conducted in the sector in relation to governance and related issues. However, as to the researcher's knowledge there is no study conducted on governance of MFIs comparisons among microfinance institutions in East Africa where they may operate under almost similar circumstances which may have direct influence on the overall growth and development of MFIs. Hence, this paper may serve as a beginning to fill the gap and contribute practical knowledge for further researchers , regulators, networks and practitioners on Ethiopian MFIs .

A study of different factors which may influence MFIs in relation to governance and the associated risks is vital. This is because it provides information which enables taking effective and appropriate measures to improve the governance of MFIs by the concerned bodies including the regulatory body. It will also enable the government and non-government supporters of the sector to bridge gaps which would in turn help for making various decisions in the microfinance area. The study is also, therefore, expected to contribute for the regulators by providing information regarding board members capacity, how MFIs are being governed in Ethiopia and on how they are going to stand by themselves in the competitive business environment in their future..

1.7 Scope of the Study

In order to cover significant data the study included all the five big micro finance institutions, namely ACSI, DECSI, OCSCO, OMFI, and AdCSI. In addition,15 micro finance institutions from the middle levels and 13 from the small institutions were considered in the sample. Hence, a total of 37 (97.4%) micro finance institutions were part of the study. Moreover, in this study, the regulatory body (NBE) , the Association of Ethiopian Micro Finance Institutions, and the Development Bank of Ethiopia were included.

The research was delimited methodologically, conceptually, geographically, capacity of the researcher and timely.

- Methodologically: - the research was investigating primary data analysis supported by secondary sources. The analysis was also document observation for secondary data and for primary data.
- Conceptually: - the research was investigating more of on the assessment of governance gaps and challenges in relation to the micro finance sector.

- Geographically: - the research was delimited on the Ethiopian Micro finance institutions operating in all the nine regional states and two administrative cities in Ethiopia. As a secondary data reports and some books from their respected networks were reviewed from the aforementioned East African countries for comparisons.
- Capacity of the researcher:- as the research is the beginner, the research was delimited with the capacity to analyze and interpret the collected data properly.
- Timely: - Due circumstances created the research was completed on July, 2020.

1.8 Limitations of the Study

The limitations to complete this paper in full were;

- complexity in reaching all board members and CEOs' on face to face to all the micro finance institutions. Questionnaires were developed and distributed through email and data were collected at a distance from the researcher's center. Phone calls were part of the solutions to mitigate this problem.
- inefficient data because of some secrecy nature of governance issues
- Due to the current situations difficulties in collecting similar primary data from other countries

The quality of this paper may be affected because primary data which may help to make detail comparisons among MFIs operating in East Africa is not collected on the other countries. Moreover, the paper may be affected by limitations in gathering all the details of data because of some of the secrecy nature of governance issues on the MFIs.

1.9 Organization of the Paper

The study has five separate chapters. The first chapter is an introduction part includes background of the study, statement of the research problem, objectives of the study, significance of the study, scope and limitation of the study. The second chapter presented important related literature review; chapter three contained and about the research methodology and the fourth chapter is about data presentation, analysis and interpretation and finally, the last chapter was contain summary, conclusion and recommendation.

CHAPTER TWO
LITRATURE REVIEW

2.1 Theoretical Review

2.1.1 Corporate Governance

According to Margaret Rouse (WhatIs.com, 2019) corporate governance is the combination of rules, processes or laws by which businesses are operated, regulated or controlled. The term encompasses the internal and external factors that affect the interests of a company's stakeholders, including shareholders, customers, suppliers, government regulators and management. The board of directors is responsible for creating the framework for corporate governance that best aligns business conduct with objectives.

Specific processes that can be outlined in corporate governance include action plans, performance measurement, disclosure practices, executive compensation decisions, dividend policies, procedures for reconciling conflicts of interest and explicit or implicit contracts between the company and stakeholders. An example of good corporate governance is a well-defined and enforced structure that works for the benefit of everyone concerned by ensuring that the enterprise adheres to accepted ethical standards, best practices and formal laws (Margaret Rouse et al , 2019).

According to Agrawal, & Chadha (2005) Corporate governance is the system of principles, policies, procedures, and clearly defined responsibilities and accountabilities used by stakeholders to overcome the conflicts of interest inherent in the corporate form. Moreover, corporate governance is the interaction between various participants (Shareholder, Board of Director and Company Management) in shaping corporation's performance and the way it is proceeding towards. Corporate governance deals with determining ways to take effective strategic decisions and developed added value to the stakeholder. It ensures transparency which ensures strong and balance economic development. This is also ensures that the interest of all shareholders (Majority as well as minority shareholder) are safeguard. (Agrawal, et al, 2005).

According to Agrawal, & Chadha, (2005) Corporate governance affects the operational risk and, hence, sustainability of a corporation. The quality of a corporation's corporate governance affects the risks and value of the corporation. Effective, strong corporate governance is essential for the efficient functioning of markets. Corporate governance has received increased attention because of high-profile scandals involving abuse of corporate power or alleged criminal activity by corporate officers. Therefore, laws and regulations have been passed to address the components of corporate governance.

2.1.2 Corporate Governance Principles

The Cadbury Report which was released in the UK in 1991 outlined that "Corporate governance is the system by which businesses are directed and controlled." Good corporate governance is a key factor in underpinning the integrity and efficiency of a company. Poor corporate governance can weaken a company's potential, can lead to financial difficulties and in some cases can cause long-term damage to a company's reputation (Cadbury, 1991)

According to Cadbury company which applies the core principles of good corporate governance; fairness, accountability, responsibility and transparency, will usually outperforms other companies and will be able to attract investors, whose support can help to finance further growth. The details of these core principles are presented as follows:

Fairness: Fairness refers to equal treatment, for example, all shareholders should receive equal consideration for whatever shareholdings they hold. In various countries there exist various acts to serve companies fairly their shareholders'. In addition to shareholders, there should also be fairness in the treatment of all stakeholders including employees, communities and public officials. The fairer the entity appears to stakeholders, the more likely it is that it can survive the pressure of interested parties.

Accountability: Corporate accountability refers to the obligation and responsibility to give an explanation or reason for the company's actions and conduct. In other words, the board should present a balanced and understandable assessment of the company's position and prospects; the board is responsible for determining the nature and extent of the significant risks it is willing to take; the board should maintain sound risk management and internal control systems; the board should establish formal and transparent arrangements for corporate reporting and risk management and for maintaining an appropriate relationship with the company's auditor, and the board should communicate with stakeholders at regular intervals, a fair, balanced and understandable assessment of how the company is achieving its business purpose.

Responsibility: The Board of Directors are given authority to act on behalf of the company. They should, therefore, accept full responsibility for the powers that it is given and the authority that it exercises. The Board of Directors is responsible for overseeing the management of the business, affairs of the company, appointing the chief executive and monitoring the performance of the company. In doing so, it is required to act in the best interests of the company. Accountability goes hand in hand with responsibility. The Board of Directors should be made accountable to the shareholders for the way in which the company has carried out its responsibilities.

Transparency: A principle of good governance is that stakeholders should be informed about the company's activities, what it plans to do in the future and any risks involved in its business strategies. Transparency means openness, a willingness by the company to provide clear information to shareholders and other stakeholders. For example, transparency refers to the openness and willingness to disclose financial performance figures which are truthful and accurate.

Disclosure of material matters concerning the organization's performance and activities should be timely and accurate to ensure that all investors have access to clear, factual information which accurately reflects the financial, social and environmental position of the organization. Organizations should clarify and make publicly known the roles and responsibilities of the board and management to provide shareholders with a level of accountability. Transparency ensures that stakeholders can have confidence in the decision-making and management processes of a company.

2.1.3 Governance Theories

Corporate governance is often analyzed around major theoretical frameworks. The most common are agency theories, stewardship theories, resource-dependence theories, and stakeholder theories.

2.1.3.1 Agency Theories

Agency theories arise from the distinction between the owners (shareholders) of a company or an organization designated as "the principals" and the executives hired to manage the organization called "the agent." Agency theory argues that the goal of the agent is different from that of the principals, and they are conflicting (Johnson, Daily, & Ellstrand, 1996). The assumption is that the principals suffer an agency loss, which is a lesser return on investment because they do not directly manage the company. Part of the return that they could have had if they were managing the company directly goes to the agent.

The theory suggests that board composition is important for effectively monitoring top management. Boards have to be diverse in terms of skills, experience, and gender balance. This creates a balance on boards and leads to effective monitoring and subsequently to the successful performance of the organization.

The concept of corporate governance presumes a fundamental tension between shareholders and corporate managers (Jensen & Meckling, 1976). While the objective of a corporation's shareholders is a return on their investment, managers are likely to have other goals, such as the power and prestige of running a large and powerful organization, or entertainment and other perquisites of their position. Therefore, shareholders monitor and controls managers through their representatives such as board of directors. Boards of directors are considered as an important device to protect shareholders from being exploited by managers and help to effectively control managers when they try to maximize their self-interest at the expense of the company's profitability. Fama and Jensen (1983) argues that in order to minimize agency problem that emanates from the separation of ownership and control the corporations need to have a mechanisms that enables to separate the authority of decision management from decision control. This would reduce agency costs and ensures maximization of shareholders wealth by effectively controlling the power and self-centered decisions of management.

According to this assumption corporate governance affects the growth of the company by affecting its financial and social performances. Therefore, improving corporate governance will result in enhancement of overall performance of the company and its growth. The corporate governance mechanisms considered in this research include Board Size, Board Composition, Board competency, Board experience in the sector, Meeting frequency of Board, Standing committee and size, and Board members gender.

2.1.3.2 Stewardship Theories

Stewardship theories argue that the managers or executives of a company are stewards of the owners, and both groups share common goals (Davis, Schoorman, & Donaldson, 1997). Therefore, the board should not be too controlling, as agency theories would suggest. The board should play a supportive role by empowering executives and, in turn, increase the potential for higher performance (Hendry, 2002; Shen, 2003). Stewardship theories argue for relationships between board and executives that involve training, mentoring, and shared decision making (Sundaramurthy & Lewis, 2003).

2.1.3.3 Resource-Dependence Theories

Resource-dependence theories argue that a board exists as a provider of resources to executives in order to help them achieve organizational goals (Hillman &Daziel, 2003).

Resource-dependence theories recommend interventions by the board while advocating for strong financial, human, and intangible supports to the executives. For example, board members who are professionals can use their expertise to train and mentor executives in a way that improves organizational performance. Board members can also tap into their networks of support to attract resources to the organization. Resource-dependence theories recommend that most of the decisions be made by executives with some approval of the board.

Resource dependency theory concentrates on the role of board directors in providing access to resources needed by the firm (Abdullah & Valentine, 2009). According to this theory the primary function of the board of directors is to provide resources to the firm. Directors are viewed as an important resource to the firm. When directors are considered as resource providers, various dimensions of director diversity clearly become important such as gender, experience, qualification and the like.

2.1.3.4 Stakeholder Theories

Stakeholder theories are based on the assumption that shareholders are not the only group with a stake in a company or a corporation. Stakeholder theories argue that clients or customers, suppliers, and the surrounding communities also have a stake in a corporation. They can be affected by the success or failure of a company. Therefore, managers have special obligations to ensure that all stakeholders (not just the shareholders) receive a fair return from their stake in the company (Dalton, D., C. Daily, A. E., & Johnson, J. (1998). The stakeholder theory is a theory of organizational management and business ethics that addresses morals and values in managing an organization. Stakeholder theory extends the narrow focus of agency theory on shareholders' interest to stakeholders to take into account the interests of many different groups and individuals, including interest groups related to social, environmental and ethical considerations (Freeman, Wicks, & Parmar, 2004). According to (Freeman et al 2004), stakeholder theory begins with the assumption that values are necessarily and explicitly a part of doing business. It asks managers to articulate the shared sense of the value they create, and what brings its core stakeholders together. It also pushes managers to be clear about how they want to do business, specifically what kinds of relationships they want and need to create with their stakeholders to deliver on their purpose. According to stakeholder theory the purpose of the firm is to serve and coordinate the interests of its various stakeholders such as shareholders, employees, creditors, customers, suppliers, government, and the community.

Generally, this study draws on agency theory to indicate relationships exist between corporate governance mechanisms and firms' growth. The agency theory framework has the ability to explain corporate governance mechanisms. It can also explain the expected association between corporate governance mechanisms and growth of the micro finance institutions.

2.1.4 The Concept of Microfinance

Microfinance has been variously defined in the literature. No single definition exists, variations are mostly a matter of emphasis Narrower definitions equate microfinance with microcredit, following early practice of NGO credit schemes. Microcredit is the provision of small loans to poor households and small business operators with or without guarantee (Obo, 2009).

Microfinance is defined as the provision of financial services, mostly savings and credit to the poor and low income households that otherwise don’t have access to mainstream commercial banks. Microfinance industry is the primary source of credit and saving to low income earners (Chenuos, Mohamed, & Bitok, 2014).Microfinance refers to the provision of formal financial services to poor and low-income (and, for credit, in particular, non-salaried) people, as well as others systematically excluded from the financial system. As noted, microfinance embraces not only a range of credit products (for business purposes, for consumption smoothing, to fund social obligations, for emergencies, etc.), but also savings, money transfers, and insurance (CGAP/World Bank, October 2012).

In Ethiopia, therefore, Microfinance institutions are a formal (i.e., legally registered) entity whose primary activity is provision of financial services. The Licensing and supervision of Microfinance business Proclamation No. 626/2009 defines micro-financing business as the provision of financial services like accepting savings, extend credit, drawing and accepting drafts payable, providing money transfer services and others specified in the Article 3(2) of the proclamation(Government of Ethiopia, 2009). This definition of microfinance business does not confine microfinance business to only credit as done elsewhere in some other countries. Microfinance is not limited to borrowing but also includes other financial services such as savings, micro-insurance, local money transfer, capital goods leasing etc.

2.1.5 Ownership and Regulatory Environment of MFIs in Ethiopia

Microfinance institutions' (MFIs) primary function is to provide financial services to low-income households who had been deemed 'unbanked". This segment of the population includes the self-employed and customers without collateral. Dedicated to improving the life of the poor in developing countries, MFIs provide the poor with the much needed credit: small amounts of loans to finance their entrepreneurship projects, and consumption, as well as to cope with illness of members of their family or for the education of their children without any collateral. (Conger, L., P. Inga, and R. Webb (2009))

According to Narayana, Agyeta, and Raghav, (2019) Ethiopian microfinance has been providing a broad range of services like micro savings, micro insurance, remittance and micro pension. Through the decades, the sector, has progressed from provision of microcredit to microfinance and now is working on financial inclusion. For becoming a sustainable development tool, microfinance needs prudential regulation. The challenge remains for the regulator to find ways to regulate the sector with heterogeneous players with social mission. Moreover, despite the extensive saving mobilization efforts exerted by MFIs, they have been able to satisfy only a limited proportion of the demand for loan.

Despite the fact that MFIs in many countries are unregulated and , hence, prohibited from mobilizing public deposits (Arun, 2005), all MFIs in Ethiopia are formally constituted as deposit-taking institutions. Hence, they are subject to regulation and supervision by the central bank according to the regulatory frameworks stipulated in the Micro-Financing Business Proclamation No. 626/2009 in order to enhance both the development and soundness of the microfinance business. MFIs with different ownership structure are expected to perform differently as they experience different challenges. Ownership structure determines MFIs' "legal status, financing structures, and the level of regulation" among others (Barry and Tacneng, 2014: 3). In Ethiopia, only the financing structure varies with the ownership structure. There are three distinct forms of MFI ownership in Ethiopia. Few MFIs are affiliated to the government, possess the largest portion of MFI capital, gross loan portfolio, public deposit and number of borrowers. This obviously gives them the scale advantage over usually small but many other MFIs that are either affiliated to local NGOs or recently emerging private MFIs. For simplicity, they can be classified as government MFIs, NGO MFIs and private MFIs. As stated by Gutierrez-Nieto, B., Serrano-Cinca, C. and Molinero, C. M. (2007), most MFIs have NGO status due to the wide objective of MFIs to fight poverty and empower women. Both NGO and private MFIs have bottlenecks in rising adequate financial capital so as to expand their operations and enjoy the benefits of economies of scale.

According to Tekie, and Sisay (2019) in terms of volume of transaction, much of the formal financial intermediation in Ethiopia is carried out by commercial banks. While this activity is weakly followed by MFIs in terms of volume of loans, in terms of participants the number is quite large in the latter. An important character vested on MFIs is their ability to deposit claims of savings from the public with the aim of transferring them to those that have demand for investment purposes or otherwise. This right is, however, constrained by regulations formulated by central organs known as Central Banks. In Ethiopia, it is the National Bank of Ethiopia (NBE) that has the authority to register, supervise and regulate financial institutions (FDRE, 2008)

The regulatory framework imposed by the NBE on MFIs in Ethiopia enforces MFIs to function only with the permission of the bank which is given this mandate by Proclamations No. 40/1996 and No 626/2009 (FDRE, 1996 and 2009). Prior to this proclamation, there was little integration of the poor in the formal financial sector. Much of the credit provided to the poor consisted of NGO driven loans in the form of revolving funds and related mechanisms starting as early as the 1980s. Much of this intervention was an integral part of their development activities. According to Wolday (2008), the NGOs introduced a number of innovative lending methodologies in offering credit to the poor; but they usually mixed their charity activities with financial interventions, which eventually lead to encouragement of financial irresponsibility.

As of 2015 the minimum paid up capital requirement for establishing an MFI is ETB 10 million. While to be established MFIs must satisfy this requirement, those that were established prior to this regulation have to attain this level by 2021 (Reg. No. MFI/27/2015). It is also imperative that the MFIs should maintain a sound liquidity level continuously for them to maintain a responsible activity. As a result of this, the NBE requires that each MFI maintains at least 20% of their deposits in the form of liquid assets. Total deposits include all forms of claims that have been kept in customer accounts of the institution; while liquid assets are cash in hand as well as balances of the MFI in other financial institutions (MFI/15/2002). A report of this information should reach the supervisory division of the NBE, three weeks after the end of each month (Tekie, A. and Sisay, R. ,2019).

As stated earlier, an important and direct mechanism through which regulation affects growth and stability is by influencing the day-to-day behavior such as the amount that an institution can lend to economic agents (Spratt 2013). Much of the loan size and conditions for extending loans is largely determined by the Board of the MFI. The product types and sizes, therefore, have been evolving over time.

According to Narayana, Agyeta, and Raghav (2019) in Ethiopia MFIs are categorized on the basis of ownership as well as size. As per the ownership pattern, there are three types of MFIs: government- owned; private MFIs and NGO-MFIs. The government owned MFIs are governed mainly by the regional governments and are used as a driver –institution to provide financial as well as non-financial services. In broad sense, these institutions work in harmony with regional government to support their specified objectives, which are many times out of the purview of financial institutions like MFIs. NGO-MFIs in Ethiopia are one of the oldest forms of credit institutions and this stands true in other countries also. The primary nature of NGO is social development and credit takes the second seat in their overall objectives. Although some NGO-MFIs have managed themselves in much professional way, but the management and the governing body always prefers social development over financial sustainability. These MFIs have pressure from their donors and have specific set products to deliver in the market, which depends upon the donors' perspective. NGO-MFIs do face close competition with other two types of MFIs, but have strong hold on its customers. The irregular cash-flows from donors is one of the daunting issues, these MFIs are facing.

Private MFIs are governed mostly by investors who are also the part of governance team and have high stake in the company, these investors try hard to make the institution financially sustainable and while achieving this objective, the social development mission of MFIs gets second priority. These MFIs also face issues while looking for access to finance from the commercial banks, as their nearest competitors are other financial institutions. In most of the cases, it has been observed that private MFIs are working with some specific segment of population or in specific geographical areas. Due to their quick decision taking ability, and technology orientation these MFIs are serving their clients in a better way.

Ownership of Micro finance institutions relates with governance and the results of this research paper show this fact. Some directives are also prepared by the National Bank of Ethiopia to support the sector in strengthening its governance and enhance performance. The directives are annexed in this study paper.

2.1.6 Challenges of MFIs in Ethiopia

According to Narayana, Agyeta, and Raghav (2019), despite the positive developments in the microfinance sector, there are issues which need the attention of the regulator. Some MFIs are larger than some private banks in Ethiopia, this call for some changes in regulatory framework on the basis of size. Under the current framework, those MFIs which are ready for transformation are expected to fit the banking act. Although the regulatory environment is relatively conducive and supportive for the growth of sustainable MFIs, there are some challenges in this area, listed below are major ones:

- Limited capacity of NBE to enforce prudential regulation
- Absence of a well-functioning and efficient legal system to enforce contracts
- Lack of clear property law
- Less effective foreclosure law creates problems for MFIs in asset-based lending
- Prohibition on international funds for MFIs sector
- Poor infrastructure limits the efficiency and effectiveness of the micro finance industry

On the other hand, Tekie and Sisay (2019) stated that there are various challenges that financial institutions face in the process of expanding their services to the people who do not have access to financial services. The following are the main challenges of that financial institutions claim to face in Ethiopia.

- Lack of loanable fund
- Lack of financial education
- Adoption of Technologies
- Weak Capacity of MFIs
- Lack of credit information Centers
- The declining demand for group lending
- Interventions with Good intentions that lead to market distortions
- Designing Products and Services that Fit the Creeds of Communities

2.2 Empirical Review:

Some MFIs Practices from Selected East African Countries

2.2.1 Uganda

Due to a strong market-enabling environment, macroeconomic stability and sound international donor commitment, the microfinance sector in Uganda has seen growth and stability. The industry was initiated in the early 1980s, when a number of socially oriented NGOs piloted microfinance projects to create access to financial services. During the following decades, the sector evolved into an industry with a growing outreach and commitment to sustainability. The main providers of microfinance in Uganda are - Commercial Banks, Credit Institutions, Microfinance Deposit-Taking Institutions , Savings and Credit Cooperative Organizations , and Non-Governmental Organizations, (Narayana, et al 2019)

Regulations : The Uganda Microfinance Regulatory Authority (UMRA) is a government agency responsible for - licensing, supervision and regulation of Tier-4 MFIs, moneylenders, savings cooperatives and any money-lending institution with capital of less than USh500 million (US$140,000). Tier-4 institutions are those that do not accept financial deposits and are not under the supervision of the Bank of Uganda, the Central Bank and National Banking Regulator.

UMRA came into existence on 1 January 2017. The new institution regulates money lending between Ugandans and the hitherto non-regulated Tier-4 Microfinance Institutions (MFIs) and other private moneylenders. It also authorizes the Minister of State for Microfinance, to set the interest rates which moneylenders should charge borrowers. (JuriAfrica , 2017)

Enabling Infrastructure (Apex Institutions / Credit Scoring Agency / Credit Rating Agency): According to Narayana, et al (2019), there are two institutions, UMRA and AMFIU, which are working professionally to strengthen the microfinance sector of the country. Although AMFIU is an association of Microfinance Institution, it is a self-regulated organization while UMRA, being a government agency, is in line with central bank's vision for microfinance sector in the country.

Bank of Uganda has Credit Reference Bureau (CRB) Services, to support robust growth of financial sector in the country. CRB does the following activity –

- Timely and accurate information
- Availing an improved pool of borrowers
- Reducing default rates

Other new credit information bureaus are entering in the country to strengthen the sector, new report states that - "A new credit reference bureau has been launched in Uganda and it promised to turn around the face of money transfer services in the country. Metropol Corporation (Kenya) Limited, which received an operating license from Bank of Uganda, projects that it will help more Ugandans have access to financial services by using mobile money."

Although there is no information available on debt structure within Ugandan MFIs, there are many International MFIs working Uganda. This shows that foreign players are allowed to work in MFI sector. Donor money is allowed in technical assistance for MFI strengthening and policy advocacy work, with the formation of UMRA in recent years, the MFI sector will undergo certain changes for the benefit of its clients and other stakeholders. (JuriAfrica , 2017)

Technology : According to Narayana, et al (2019) telecom companies like MTN Uganda and Airtel Uganda have started providing mobile money loans. MTN Uganda recently partnered/collaborated with Commercial Bank of Africa (CBA) to provide new service that offers its Mobile Money subscribers the option to save and access loans using their mobile phones. The service is called MoKash and it allows subscribers to activate a savings and loans account free of charge. Telecommunications Company, Airtel Uganda introduced a service to extend credit services to Ugandans via the Airtel

Money platform. This service was launched in partnership with JUMO. The credit service, also known as Wewole, provides a convenient way for Airtel Money customers and agents to access loan facilities and it can be utilized by any Airtel Customer or Agent, who is fully registered on the Airtel Money platform. Technology is playing a critical role in credit quality, assessment of debt repayment, credit worthiness of individual client and in other operational process to make it more transparent and quicker. There are several new products including mobile-based loan application, approval, disbursement and repayment. There are several new products in savings and credit side on offer by international MFIs; these include- loans for house making, education and other business activities.

Institutional Partnership : In Uganda, moneylenders are in the business until the establishment of government agency UMRA. International MFIs are using their own institutions while other microfinance operations were funded by moneylenders and commercial banks. Another model being used is mobile-based loan, which is again an innovation and disruption for the whole sector, as it requires credit rating for individuals, which is not available for most of the Ugandans and this step has created another issue of competitiveness among various stakeholders in the sector. Thanks to UMRA and AMFIU for playing an important role in the sector, this may change the face of Microfinance in coming time (Narayana, et al 2019).

2.2.2 Rwanda

The support of microfinance by the government of Rwanda and the international donor and relief community after the 1990s conflict has been a critical factor in the creation of access to finance for Rwanda’s population. The microfinance sector has achieved a speedy growth in terms of outreach and volume of gross loan portfolio. It is now addressing the challenges of a poor loan repayment culture among borrowers, issues of financial sustainability and consumer practices to promote responsible lending (Narayana, et al 2019)

Some important facts about microfinance sector in Rwanda, as mentioned in The New Times (New Times, 2016) :

- Central Bank's financial stability and monetary policy statement indicates that MFI sector assets have also improved marginally.
- Association of Microfinance Institutions in Rwanda (AMIR) indicated that it is currently working with stakeholders to support MFIs to improve efficiency and transparency.
- The co-banking software is designed to integrate MFIs, enabling them to share information across all financial system stakeholders.
- The performance monitoring software application (PMT) was tipped to enhance transparency and efficiency among MFIs.
- PMT also sought to ease access to credit by the rural poor and help create a one-stop center for data collection of all credit institutions at AMIR.
- MFIs continue to play a paramount role in fostering financial inclusion.
- Unlike in the banking sector, lending in MFIs improved in the wake of increased funding.
- Over time, as investment opportunities increase, MFIs are expected to invest this capital buffer in more number of income generating assets.

Regulations: The National Bank of Rwanda is mandated to regulate and supervise MFIs, which include - Savings and Credit Cooperatives (SACCOs) and some limited companies that operate microfinance activities. The supervision is conducted through three main activities viz., licensing of MFIs, off-site surveillance and on-site inspection of MFIs thus licensed (Narayana, et al 2019)

Enabling Infrastructure (Apex Institutions / Credit Scoring Agency / Credit Rating Agency) and Exclusive organizations: According to (Narayana, et al 2019) MFI in Rwanda do have good infrastructure which helped to have good governance for the sector. Some of them are included:

Credit Information System: The National Bank of Rwanda (BNR) collects credit information from financial institutions. It ensures the accuracy and reliability of the information and holds it in public credit registry database for supervisory and statistical purposes. In addition, it supervises the private credit reference bureau licensed by the NBR as per the law governing Credit Information System in Rwanda, whereby all financial institutions are mandatory participants.

The purpose of the establishment of private credit reference bureau is the sharing of credit information among financial institutions to ease the credit assessment and improve decision making before granting any loan.

Credit Rating System: In 2007, the Government of Rwanda, through the Ministry of Finance and Economic Planning established the Capital Market Advisory Council (CMAC) as a transitional body that will assist in the creation of a capital market. Moreover, in the year 2011, the Capital Market Authority (CMA) was born following the publication of the Law.

Exclusive Institutions: Network for East African Microfinance Capacity Development (NEAMCD) – Rwanda is one of the member countries in NEAMCD, working to establish a platform for exchanging experiences in capacity development in the microfinance sector. Rwanda Institute for Cooperatives Entrepreneurship and Microfinance (RICEM) and AMIR have signed an MoU under this network to share their knowledge and experience for the benefit of microfinance sector in the East African community (Narayana, et al 2019)

Rwanda Development Board – Overview of Financial Sector: Rwanda's financial sector has made great strides towards becoming modern. The sector is stable, well capitalized, profitable and liquid. The sector consists of a wide and growing array of institutions such as - Banks, MFIs, Savings and Credit Cooperatives (SACCOs), Insurance companies, and Pension funds, thus, becoming increasingly diversified (Narayana, et al 2019)

Technology (Core Banking Solution / Payment and Settlement / Risk Management)

As per the report published by Times Reporter in 2017, it stated that more and more no. of MFIs are embracing technology as the sector moves to enhance operations and reporting mechanisms. To boost these efforts, the MFIs in Rwanda (AMIR) and stakeholders are supporting MFIs to acquire new software that will enable them to automate their systems and improve efficiency and transparency. As per the officials, the co-banking software is designed to integrate MFIs, enabling them to share information among themselves.

Capital Structure (Bonds/ Equity / Debt / Preference Share / Securitization/ Commercial Papers)

Many MFIs are operating through foreign funds mobilized in the form of grants, while others are taking loan from commercial banks (Narayana, et al 2019)

Institutional Partnership (Co-lending / On-lending / Agency Model)

In Rwanda, BNR had to re-examine the regulation for agency banking given its prevalence. The review found the regulation to be quite restrictive and it was subsequently edited to include a set of minimum criteria for agent selection, which applied to payment service providers, banks, and MFIs. BNR also recognized the low penetration levels of insurance in the country, which propelled the creation of specific regulations that would enable environment for micro-insurance players to enter the market (Narayana, et al 2019)

Policy Changes: According to (Narayana, et al 2019) in Rwanda, there is also a National Financial Inclusion Strategy and National Financial Education Strategy to help further promote financial inclusion. Additionally, a Financial Consumer Protection Law has been drafted based on international practices and standards with the support of the World Bank. The law was expected to be passed at the end of 2018, following approval by Cabinet and Parliament.

The Association of Microfinance Institutions of Rwanda (AMIR) is currently implementing the Responsible Finance through Local Leadership and Learning

Program (RFL3) in Rwanda. The program, which seeks to scale up the application of consumer protection principles for low-income financial service customers in Rwanda microfinance sector, is being implemented in partnership with SEEP Network and the MasterCard Foundation. As per some government officials, they are currently working on this law (Narayana, et al 2019)

2.2.3 Kenya

According to (Narayana, et al 2019) the Central Bank of Kenya (CBK) is mandated to foster the liquidity, solvency and proper functioning of a stable market-based financial system. One way it achieves this through the licensing, regulation and supervision of financial institutions falling under its regulatory purview. These include commercial and microfinance banks, mortgage finance companies, money remittance companies, forex bureaus and credit reference bureaus.

Through the Microfinance Act 2006 and Microfinance (Deposit Taking Microfinance Institutions) Regulations 2008, the CBK is tasked with developing a vibrant, efficient, stable and sound microfinance banking industry through the regulation and supervision of microfinance banks (MFBs).

Innovation and dynamism within the microfinance industry has increased and the industry has experienced growth in the number of customers and diversity in the range of services and products provided. Since the first microfinance bank was licensed in May 2009, the number of licensed microfinance banks has increased to thirteen (13), eleven (11) being nationwide and two (2) being community-based micro finance banks MFBs).

The Microfinance sector has witnessed significant growth since 2008 when the first micro finance bank was licensed. The number of licensed MFBs has grown to 13 totaling to 114 branches as on December 2017.

Challenges: The Microfinance sector is currently facing various challenges, most of which are as result of the rapid growth experienced and the changing market dynamics. These challenges form the key drivers of change and include –

- The need for enhanced corporate governance structures and practices in the changing banking sector environment. This presents the need to review current shareholding structures and introduce new structures such as non-operating holding companies.
- Elevated credit risk, which has contributed to increasing non-performing loan portfolios.
- The need for improved transparency mechanisms and on-demand customer response mechanisms owing to growing consumer complaints.
- Emerging financial technology (FinTech) which has created new opportunities as well as new risks that need to be understood and mitigated.
- Change in pricing and uptake of credit due to imposition of interest rate caps.
- Political issues: Corruption is a major problem in Kenya.

Regulations: The banking system in Kenya is regulated by the Companies Act, the Banking Act, and the Central Bank of Kenya Act. In addition, there are several existing guidelines. The responsibility for monetary policy and the banking system is held by the Central Bank of Kenya, which also releases information about interest rates, banking guidelines, and the financial institutions. The Kenyan Microfinance Act was adopted in 2006 and became active in 2008. With the adoption of this act, institutions could apply for microfinance licenses at the Kenyan Central Bank either as a national or community institution.

In order to do so, these institutions must be registered as :Deposit-taking institutions, on deposit-taking institutions, Informal organizations (supervised by an NGO) (Narayana, et al 2019)

Enabling Infrastructure: Credit scoring: There is no advanced credit scoring system and the majority of lenders have not stated any official borrower requirements. However, some institutions require, having an existing business for at least 3-months, a small amount of cash, provide the institution with a business plan or proposal, have at least one guarantor, or to attend group meetings or training. For group loans, almost half of the institutions require group members to be guarantor for each other.

Credit Rating Agency: Kenya has credit rating agencies; as of report published by Capital Markets Authority, there were three credit rating agencies. Metropol Corporation Ltd, third in a row intends to focus on providing credit ratings to SMEs to increase their potential to access money diversified capital sources.

Exclusive Institutions : (Narayana, et al 2019) exclusive institutions which are working with MFIs in Kenya to enhance growth through capacity building and other activities include: Association for Microfinance Institutions , Capital Market Authority (CMA), International Investment (Investment in Bond/Debenture / Donor Investment)

Technology (Core Banking Solution / Payment and Settlement): National Bank of Kenya (NBK) says it has upgraded to "the fifth and latest version" of its core-banking platform, Fusion banking Essense, supplied by Finastra (formerly Misys). The project is expected to result in "enhanced performance, flexibility and real-time interfaces", NBK says. The bank originally signed to implement the Fusion banking platform in 2011 (at the time, it was known as Bank fusion). "Its integrated suite of components spans core processing, product factory, analytics, digital channels and branch applications," the bank says (NBK, 2018) . Kenya is leading the way when it comes to digital innovation for financial inclusion in Africa, according to research by the Consultative Group to Assist the Poor (CGAP). Kenya-based Apollo will test the ability of satellite images combined with land GPS locations to assess farmers' loan repayment capacity and cash-flow timing, with the goal of making it more cost-effective to lend to smallholders (NBK, 2018).

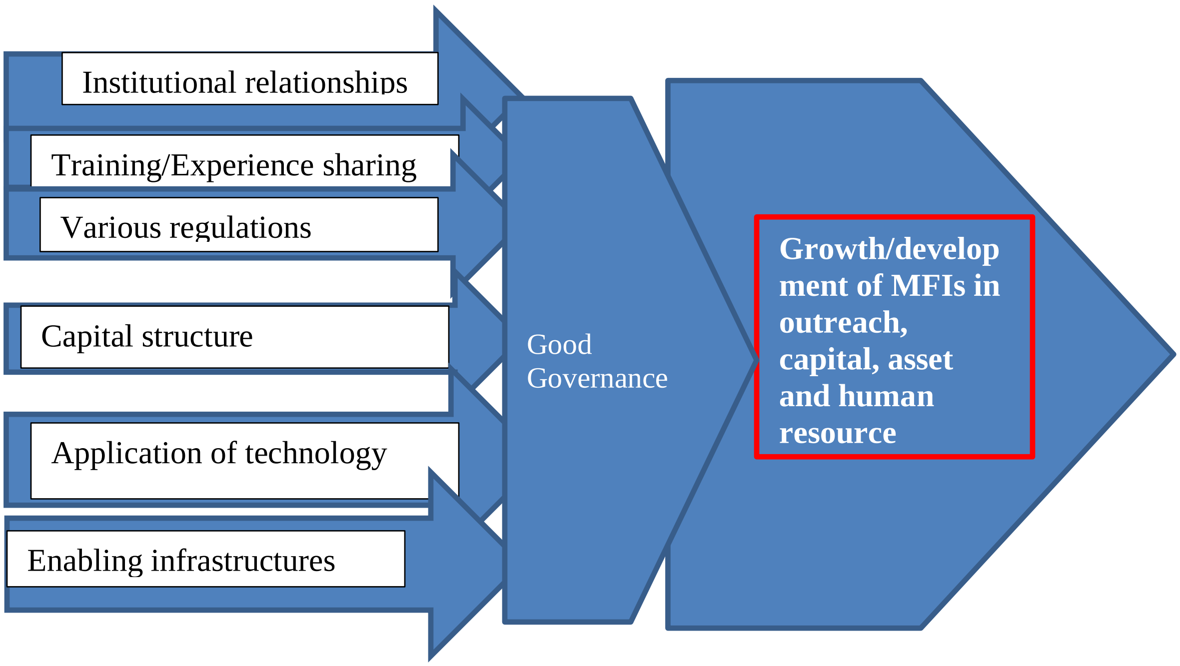
In general, the three countries MFIs are operating in better infrastructure than the Ethiopian MFIs. For instance, considering digital financial services Tekie and Sisay (

2019) summarized the situation by taking the Sub-Saharan average as a standard as follows.

Digital Financial Services	Ethiopia	Kenya	Rwanda	SSA Average
Mobile money accounts (in %, age 15+)	0.3	73	31	21
Debit card ownership (%, age 15+)	4	38	5	18
Made or received digital payments in the past year (%)	12	79	39	34
Paid utility bills using a mobile phone (out of adults who paid utility bills)	0	82	44	23
Paid utility bills using an account (out of adults who paid utility bills)	0.2	85	48	31
Received wages into an account (out of adults who received wages)	17	68	33	45
Received payments for agricultural products into an account (out of adults who received payments)	1	46	14	
Used a mobile phone or the internet to access a financial institution account in the past year (out of adults with a financial institution account, age 15+)	1	57	13	24

2.3 Conceptual frame work

Based on the empirical review and literature review on corporate governance and growth of micro finance institutions mentioned above the researcher developed conceptual frame or model as follows:



Source: Researchers own design

CHAPTER THREE

RESEARCH DESIGNAND METHEDOLOGY

In this section the researcher tried to address the overall research design and the methodology which were used in the study that includes the research design, population of the study, sources of data and methods of data collecting and methods of data analysis.

3.1 Research Design

Among different research designing method this study lied on the descriptive research designing method. The study considered what are the main governance problems and gaps in the micro finance sector in Ethiopia, how the institutions and the regulatory body are practicing it. For doing so the researcher used mixed approach that is both the qualitative and the quantitative research approaches. In the qualitative approach different theories, related articles and in-depth review of assessment works were used where as for the quantitative approach the researcher used questionnaires.

3.2 Population and Sample Size

The total micro finance institutions (MFIs) in Ethiopia are 38 (NBE, 2019). To increase the dependability and reality of the data analyzed out of those 38 MFIs, 37 MFIs are included in this study. The target respondents were CEOs of each MFI,CEO of AEMFI and Directors of MFI departments at the National Bank of Ethiopia and Development Bank of Ethiopia. Almost all MFIs are included were employed in the study. Data were collected from all size(15 large, 10 medium, and 12 small) and ownership structures of MFIs(11 government affiliated, 11 NGO backed and 15 privately owned) except one MFI. One MFI failed to respond the questionnaire and not included in the study. Hence, to ensure that the sample is representative of all the micro finance institutions which are being operating all over Ethiopia (both urban and rural), were included in this study paper.

3.3 Types of Data and Tools

As stated above the data collected are both primary data and secondary data. As an instrument of data collection questionnaires was developed by the researcher to be filled by Chief Executive Officers of MFIs and the researcher had also developed an open ended questionnaires and interviewed general manager of AEMFI , representatives from NBE and DBE.

3.4 Procedures of Data Collection

Both primary and secondary data sources were used for this study. Secondary and primary data were collected to extract qualitative and quantitative information on governance gaps and challenges of MFIs in Ethiopia. Primary data were collected through questionnaires designed to be filled by CEOs of MFIs. Moreover, interviews were conducted with department heads of the MFI Directorates of NBE and DBE, and CEO of AEMFI . Secondary data sources were taken by revising related literatures, reports, and research works regarding governance of MFIs, different published and unpublished documents of the sector from the Association of Ethiopian Micro Finance Institutions, the National Bank of Ethiopia, Development Bank of Ethiopia and others. The methods of collecting data included questionnaires and telephone interviews.

3.5 Methods of Data Analysis

The analysis involve desk examination and qualitative and quantitative data analysis . The desk review was included assessing and reviewing data from the following sources:

- Studies conducted on governance and ownership issues on the Ethiopian Micro finance sector abroad
- National financial strategies , directives and regulations designed by the National Bank of Ethiopia to regulate the financial sector in general and the micro finance industry in particular
- Documents and reports prepared by micro finance institutions to the National Bank of Ethiopia
- Documents, annual reports, bulletins prepared concerning the industry by the Association of Ethiopian Micro Finance Institutions and other developing country networks/associations
- Articles, reports, study results by micro finance institutions prepared at national and international levels
- International good practices and learning, policy statements etc.

Qualitative and Quantitative Data Analysis

After collecting the relevant data, processing data was taken place according to the research objectives set earlier. The data were classified, grouped, arranged and interpreted to have meaningful interpretation and information on the governance of MFIs. To analyze and processed the collected data the researcher employed both qualitative and quantitative data analysis techniques to describe findings on the problem from different prospective regarding MFIs governance, challenges and gaps. The data are presented in bar graphs, pi-charts and tables by using Stata 14.

CHAPTER FOUR

RESULT & DISCUSSION

4.1 Results/Findings of the Study

In this study all MFIs operating in Ethiopia were included. Big and medium sized micro finance institutions are operating in the nine regional states and two administrative cities basing their head offices at each respective center regional states cities. To the analysis of corporate governance's issues in the Ethiopian Microfinance Institution (Micro finance institutions), data is collected from 37 Micro finance institutions through a questionnaires which was distributed to CEOs via email across the country Ethiopia where each MFIs head office is located. One micro finance institution was not in a position to send back the questionnaire. Hence, 37 (97.4 percent) of micro finance institutions are included in this research paper and they are responded back the questionnaires. Geographically, from the 37 Micro finance institutions used for the analysis, 18 micro finance MFI have head office at Addis Ababa (capital city of Ethiopia), and the remaining are distributed across the nine regional states and Dire Dawa city administration. Moreover, CEO of AEMFI and representatives from the NBE and DBE were also part of the interview.

For the analysis purpose Micro finance institutions are classified by two criteria, based on ownership and size. Based on ownership structure Ethiopian micro finance institutions included in this study are classified into three: as government affiliated (11), NGO backed (11) and private share company Micro finance institutions (15). In terms of size they are also fall under various classifications. The base for the classification of micro finance institutions are: their portfolios amount, asset and capital accumulation, client base, outreach level etc. According to a report by the Association of Ethiopian Microfinance Institution/ Ethiopian Micro finance institutions performance analysis report bulletin-13 of 2018 publication, size and classification of micro finance is stated for the year. In the bulletin-13 micro finance institutions in Ethiopia are classified into three: small (Micro finance institutions with gross loan portfolio less than or equal to 40 million Ethiopian birr (ETB)), Medium (Micro finance institutions with gross loan portfolio between 40 and 160 million) and large (Micro finance institutions with gross loan portfolio less than or equal to 40 million Ethiopian birr (ETB)). Based on this classification the 37 Micro finance institutions include in this paper are classified as: 12 small, 10 medium and 15 large size Micro finance institutions. The summary of the classifications of micro finance institutions in terms of ownership and size in Ethiopia is given under Table 1 as follows:

Table 1: Summary Data on Classification of the MFIs in terms of Ownership and Size

	large	Medium	Small	Total
Government affiliated	8	3	0	11
NGO backed	7	3	1	11
Private share company	0	4	11	15
Total	15	10	12	37

Source: Derived from data collected from the questionnaires 2020

As shown on Table 1 above, there are 11 government affiliated micro finance institutions operating under the nine regional states and two of the administrative cites, Addis Ababa and Dire Dawa. Of these 11 Micro finance institutions eight of them are large and three medium in terms of size. There are 11 NGO backed micro finance institutions and seven are large, three medium and one small in their size. 15 micro finance institutions are privately owned and none are under the large category in terms of size. 10 are medium and 12 Micro finance institutions which are privately owned are small in their size.

According to Tekie, and Sisay (2019) there is significant variation among Ethiopian Micro finance institutions in many respects: some are very small while few large Micro finance institutions can compete in many aspects with most of private commercial banks in the country. The five large Micro finance institutions (ACSI, DECSI, OCSSCO, OMFI, and ADCSI) account for 92 percent of loan 94 percent of savings, and 92 percent of active borrowers. Furthermore, 82 percent of the capital in the industry is owned by four of them (ACSI, DECSI, OCSSCO, and ADCSI). Putting all the large and very small Micro finance institutions under one regulatory framework does not benefit both extremes. There is a need to provide a new regulatory space to larger Micro finance institutions that are ready for transformation. This will require revising the existing one-size-fits-all type regulatory framework and look for an alternative such as the tiered approach. On the other hand, Micro finance institutions are expected to implement social performance and environmental management, good governance, address unhealthy competition, and conduct value adding research to provide affordable and quality financial services to existing and potential clients. This indicates how huge is the gaps among micro finance institutions in Ethiopia and extremes in the micro finance industry. This gap has direct influence on the governance of the micro finance institution and on the existing/potential growth of the institution.

The figures direct that more than half of large micro finance institutions are government affiliated and some of the remaining large Micro finance institutions are backed by NGO (non-governmental organizations). From the data gathered and the results summarized there is no small Micro finance institutions with government affiliation and only one MFI which is backed by NGO is considered as small. Majority of private share companies of the micro finance institutions are small and there is no large private MFI at all.

Tekie & Sisay (2019) stated that building the capacity of Micro finance institutions through training, support to expand back-office and front-office technologies, establishing training institutions in the area of inclusive finance, enhancing mobility of Micro finance institutions, providing incentives (such as grants, duty free privileges to import vehicles and equipment) etc. as priority interventions to improve the capacity of Micro finance institutions in mobilizing savings, reduce client dropout and delivering quality financial services to the existing and potential clients. Building the capacity of excluded population through Business Development Services and financial education has also a significant impact on expanding the activities of Micro finance institutions.

On measure to see whether micro finance institutions in Ethiopia do have good governance or not is the way they are structured and functioning. It is obvious that if a company operates under different functional units its performance would be high and the governance would enhance. From the data collected in this paper, other than management information system/information technology (MIS/IT), core banking and marketing departments, more than 50 percent of Micro finance institutions have the departments/units of communication, planning, product development and risk management.

Table 2: Summary Data on Number and Percentage of units of Ethiopian MFIs

Department Unit	Government affiliated	NGO backed	Private share company	Large	Medium	Small	Total	% of total MFIs
MIS/IT	10	9	9	15	8	6	29	78.38
Core banking system	4	5	5	7	4	4	14	37.84
Communications	6	7	10	12	4	8	23	62.16
Product development	5	5	9	7	6	7	19	51.35
Risk management	9	8	10	14	6	8	27	72.97
Planning	7	4	9	8	6	6	20	54.05
Marketing	4	5	7	8	3	5	16	43.24

Source: Derived from data collected from the questionnaires 2020

Table 2 indicates micro finance institutions and their departmental establishments which help in having good governance facilities to operate and provide the necessary services to their respective clients. It is shown on the Table 2 that 90.9 percent of the government affiliated institutions do have the management information system/information technology units while 81.8 percent and 60 percent of the NGO affiliated and the privately owned Micro finance institutions do have this department under their structure. As depicted from Table2, 78.8 percent of micro finance institutions have management information system/information technology as departments 37.8 percent of these Micro finance institutions do have the core banking system and 62.2 percent the communications/public relations department to support their good governance enhance the performance of their institutions. 73 percent of Micro finance institutions do have the risk management unit on their structure. 66.7 percent of privately owned and 72.7 percent of NGO backed Micro finance institutions have established risk management risk mitigating department. Large Micro finance institutions have established this department (93.3 percent) while medium and small Micro finance institutions hold for 50 percent and 66.6 percent respectively. 36.4 percent of the government micro finance institutions operate under the core banking system while 45.4 percent of the NGO affiliated and 33.3 percent of the privately owned Micro finance institutions do have the core banking system. 54 percent of Micro finance institutions do have the planning department. This implies that 46 percent of Micro finance institutions in Ethiopia do not have planning department. Moreover, it is only 63.6 percent of the government affiliated Micro finance institutions which have the planning department. 36.4 percent and 60 percent of NGO affiliated and privately owned Micro finance institutions do have planning departments under their structure respectively. Out of 37 micro finance institutions considered in this study only 20 (54 percent) Micro finance institutions have planning department under their structure. Even large Micro finance institutions don’t have planning department (43 percent). Out of 15 large Micro finance institutions in their size it only eight large MFI (53 percent) that have established planning units under their structure.

Moreover, 43 percent of micro finance institutions established marketing department for the promotion of their services to the public while 57 percent do not have such units. It is only 36.4 percent of the government affiliated Micro finance institutions which have established the marketing department and 63.6 percent of government affiliates don’t have marketing department. 45.4 percent and 46.6 percent of NGO affiliated and privately owned Micro finance institutions do have marketing department under their structure. All these figures indicate the situations of departments established on Ethiopian Micro finance institutions to facilitate good governance and the standard deviations are also presented on Table 2.

As stated above, these figures indicated that micro finance institutions in Ethiopia are structured to support good governance facilities to operate and provide the necessary services to their respective clients. Especially the absence of planning (both strategic and short-term planning) department on about 45.95 percent of Ethiopian MFIs would have significant impact on the growth of the sector. A corporation like an MFI without the planning department is going ahead without knowing where to go about and this is clear indication of weak governance on the Ethiopian MFIs (45.95 percent of MFIs do not have such planning department and the plan).

As per the report published by Times Reporter in 2017, Rwandan most MFIs prepared their strategic plans which helped them to have good governance of MFIs in the country (Times, 2017). As it is indicated on Table 2 , the other serious problem of MFIs which affects good governance is the application of technology. Only 14 percent of MFIs are using the core-banking system. That means 86 percent of MFIs are using the manual . It is far behind as compared to other East African countries. For instance according to Times Reporter in 2017, regulated MFIs use core-banking software which is designed to integrate MFIs, enabling them to share information across all financial system stakeholders. Moreover, the performance monitoring software application (PMT) was tipped to enhance transparency and efficiency among MFIs. It also sought to ease access to credit by the rural poor and help create a one-stop center for data collection of all credit institutions at the Association of Micro finance Institutions in Rwanda (Times, 2017). According to Newspaper Supplement (2017), technology is playing a critical role in credit quality, assessment of debt repayment, credit worthiness of individual client and in other operational process to make it more transparent and quicker. There are several new products including mobile-based loan application, approval, disbursement and repayment. There are several new products in savings and credit side on offer by international MFIs; these include- loans for house making, education and other business activities. Newspaper Supplement (11 December 2017).In Kenya technology use by MFI is more better in the region. .According to Consultative Group to Assist the Poor (CGAP, 2018)Kenya is leading the way when it comes to digital innovation for financial inclusion in Africa. These comparisons implied how Ethiopian MFIs are far behind in the application of technology which affects to have good governance at each MFI.

4.2 Board size, Composition, Committee and Management Team

4.2.1 Board Size and Composition

The highest decision making body of micro finance institutions in Ethiopia is the general assembly. As share companies it is clearly stated on their working manuals for the privately owned micro finance institutions. For the NGO backed and government affiliated Micro finance institutions shareholders are not real owners. In all types of Micro finance institutions there are board members who are supposed to represent the shareholders and act in making high decisions on the governance of the Micro finance institutions. They do have their own duties and responsibilities stated on their respective manuals. As per the data collected from 37 Micro finance institutions the variables/observations are summarize using Table 3. The total numbers of board members for 37 micro finance institutions considered in this research paper are 254. The maximum number is supposed to be 333 board members for 37 micro finance institutions. The minimum number as per the requirement of the proclamation from the National Bank of Ethiopia to establish a micro finance in Ethiopia five board members and the maximum is nine.

The total number of board size for 37 Micro finance institutions are 254, with average number of board size 6.78 and minimum five and maximum nine board member. Based on ownership 70 board members with minimum five and maximum eight is for government affiliated; 74 board members with minimum five and maximum nine for NGO backed; and 108 board members with minimum five and maximum nine are for private share company Micro finance institutions. Large Micro finance institutions have the higher number of board members 100 with minimum five and maximum nine, followed by private share company Micro finance institutions 85 with minimum 5 and maximum 9 and Medium Micro finance institutions have 70 board members with minimum five and maximum nine.

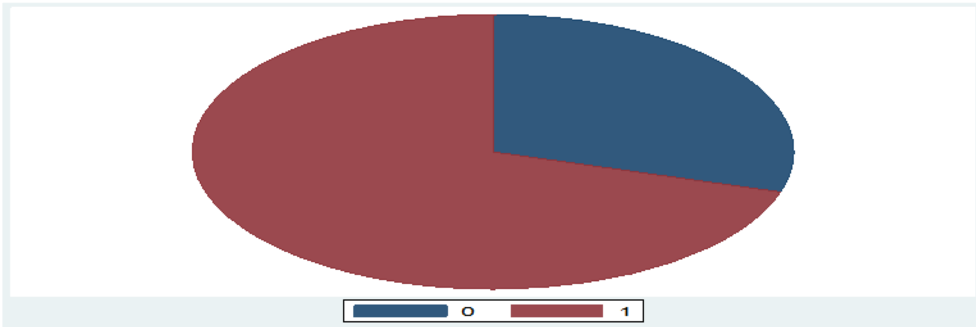
Table 3: Summary Data on Size and Composition of Board member

Variable	Observation	Percentage	Min	Max
Board size	254		5	9
Number of male	204	81.27	0	1
Number of women board member	50	18.72	0	9
Diploma holder board member	12	4.72	1	2
Degree holder board member	76	29.92	1	6
Second degree holder board member	158	62.20	1	7
PhD holder board member	8	3.14	1	2
Experience of board member-less than 10 years	37	14.56	3	20
Age of board member less than 35	2	0.78	2	2
Age of board member between 36 and 46	27	10.63	1	9
Age of board member between 47 and 57	34	13.38	1	9
Board member with age above 58	7	2.755	1	4

Source: Derived from data collected from the questionnaires 2020

The following figure depicts board appointments and elections on the 37 Micro finance institutions that are considered in this paper. For all the 37 micro finance institutions the board member selection by ownership category is also considered in the extracted figure 1 below.

Figure 1: Board Members Selection



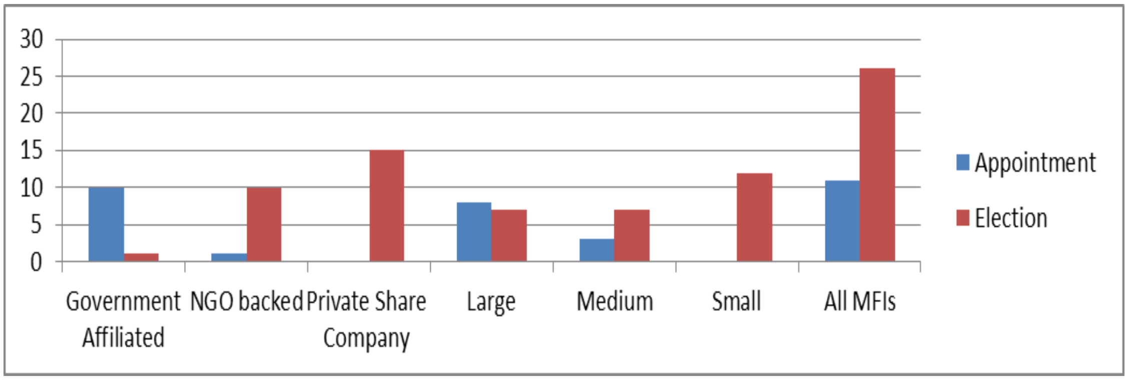
Source: extracted from the data collected

Note: Blue (0): board members are appointed by appointment

Red (1): board members are selected by election

For 26 Micro finance institutions (70 percent of 37 Micro finance institutions) the board members are selected based on election by the general assembly; to the remaining Micro finance institutions board's members are appointed by their respective regional governments and city administrations to lead the MFI. Except for one MFI, government affiliated MFIs board members are appointed or nominated to lead the MFIs. Again for NGO backed Micro finance institutions, except for one MFI for the remaining board members are selected based on election by the qusi-shareholders. All private share company Micro finance institutions board members are selected based on election by the general assembly. Based on size seven large, seven medium and all small Micro finance institutions board members are selected based on election. Figure 2 presents board members selection based on size and ownership. As stated above board members appointment is higher on government affiliated micro finance institutions and next higher in NGO affiliated/backed Micro finance institutions. As is shown on figure 2, election of board members by their respective general assembly/shareholders is higher on privately owned micro finance institutions. In the details from the data gathered it is shown that except for one MFI government affiliated Micro finance institutions board members are appointed to lead the Micro finance institutions. Again for NGO backed Micro finance institutions, except for one MFI for the remaining board members are selected based on election. All private share company Micro finance institutions board members are selected based on election. Based on size seven large, seven medium and all small Micro finance institutions board members are selected based on election.

Figure 2: Board Member Selection- Based on Size and ownership

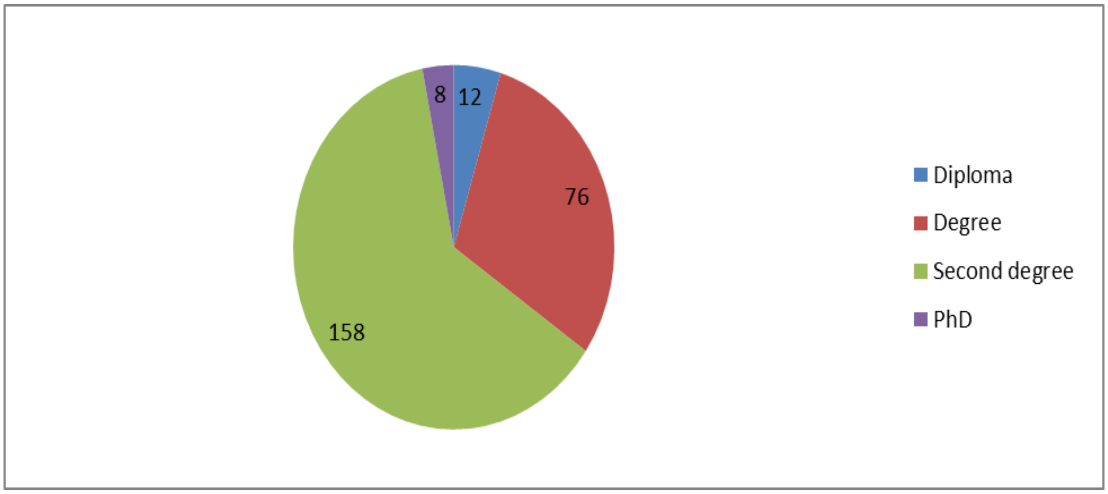


Source: Extracted from the data collected 2020

Of the 254 board members 204 (81.27 percent) are male, with average male board member of 5.66 and minimum none and maximum nine; while it is only 18.72 percent are woman board members. The number of women at the governance body is small as compare to men members. In 11 government affiliated Micro finance institutions board members composed of 49 male and 19 women (in government affiliated Micro finance institutions 1/3 members are women's), in NGO backed 65 man and nine women and in private share company 90 males and 19 females (17 percent of the total board members at the private Micro finance institutions) women; from this data we can see that women's participation as board member is higher in government affiliated Micro finance institutions because of government appointment/nomination. Looking at board composition in size; large Micro finance institutions have 75 males and 21 female board members, medium sized MFIs have 54 male and 16 female board members and in private share company has 75 male and 10 female board members.

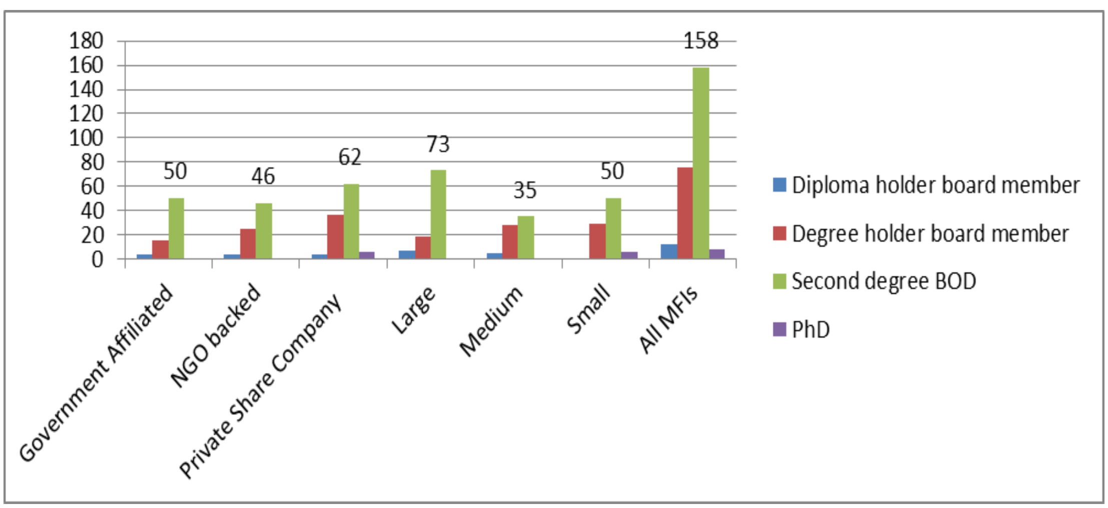
When educations is considered as a variable in assessing governance capacity in the Ethiopian Micro finance institutions, majority of board members, 158 (62.95 percent) have second degree, followed by first degree 76 (30.2 percent) , then 12 (4.78 percent) have diploma and 8 (3.02 percent) of them have PhD degree. In terms of education ownership and size does not make difference; majority of shareholders have second degree. Figure 3 shows the distribution of educational level of large, medium and small size micro finance institutions and for the government affiliated, NGO backed and privately owned Micro finance institutions.

Figure 3: Composition of board members in Education



Source: Extracted from the data collected 2020

Figure 4: Ownership and Size based Educational level of Board Members

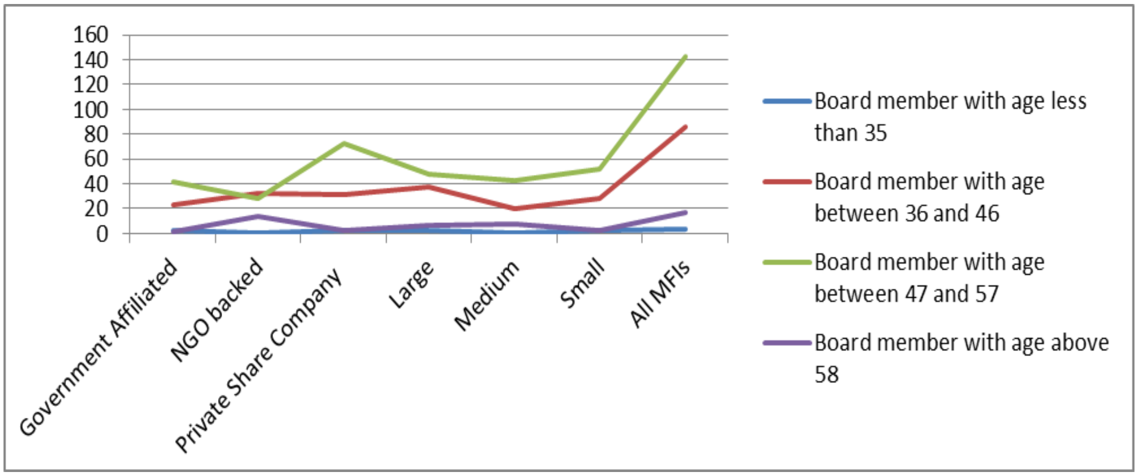


Source: Extracted from the data collected 2020

143 (56.97 percent) board members have age between 47 and 57, 86 (34.26 percent) between 36 and 46, 17 (6.77 percent) greater than 58 and 4 (1.59 percent) board

members have age less than 35 years. This implies the participation of the youth at higher governing body and decision making in the Ethiopian micro finance industry is so low. Again age of board members does not see any variation based on ownership and size; majority of board members aged between 47 and 57. Average experiences of board members are greater than 10 years for 25 MFI, greater than eight for six Micro finance institutions, greater than 12 for two MFI, greater than 20 for two Micro finance institutions and greater than three for two Micro finance institutions. The maximum work experience for a board member who is working as board members is 20 years and the minimum is three years. Figure 4 represents Board Members Age- Based on size and ownership.

Figure 5: Board Members Age- Based on size and ownership



Source: Extracted from the data collected 2020

These data indicated that the participation of the youth and women at higher governing body and decision making in the Ethiopian micro finance industry is so low. Although most of the board members (62.95 percent) have second degree and educated or qualified, they don’t have financial analysis skills, exposure to the international financial system and experience on the system. In some of the MFIs, board are high government officials .Directive No. MFI/03/96 of the NBE indicates the criteria for boards of MFIs. It says board members of MFIs ought to be high school complete with if possible with adequate managerial experience and with a minimum of 25 years of age. According to Wolday (2008) since the ultimate responsibility of guiding an MFI is placed with the board of directors, the first step towards effective governance is in the selection of the board. The composition of the board of directors is crucial to implementing proper guidance.. However, the data collected from the MFIs indicated that there are board members who are appointed by government bodies on government affiliated MFIs and by donors on NGO affiliated MFIs. As stated above the composition of board members by education, skills on management and financial analysis, age and gender is weak. These factors may contribute to the slow growth of MFIs in Ethiopia as compare to the growth of MFIs in Rwanda, Uganda and Kenya.

4.2.2 Board Committee and Management Team

In almost all the 37 micro finance institutions considered in this paper, there exists board committee as the higher governance decision making body. As stated above, they are either elected by shareholders or appointed/assigned by quasi-owners. There are also subcommittees which include: Asset liability Committee, Risk management Committee, Audit and Internal control committee, Human resource committee, and Business development/marketing Committee. Each committee has its own duties and responsibilities and various functional activities to have good governance for their micro finance institutions. This in turn is assumed to enhance the growth of the micro finance industry as compare to its African counter parts.

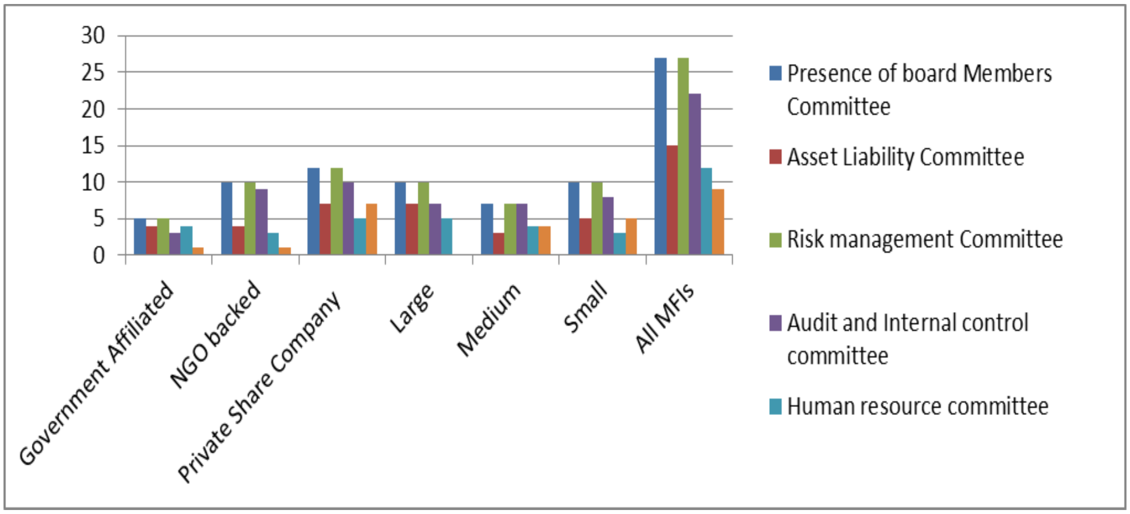
Table 4: Summary Data on Board Subcommittee

Type of Committee	Number of MFI	Percentage
Presence of board Members Committee	27	72.97
Asset Liability Committee	15	40.54
Risk management Committee	27	72.97
Audit and Internal control committee	22	59.46
Human resource committee	12	32.43
Business development/marketing Committee	9	24.32
Presence of Management Team	34	91.89
Executive decision	25	67.57
Strategic decision	9	24.32
Policy decision	8	21.62

Source: Derived from data collected from the questionnaires 2020

The next question to the top management of 37 Micro finance institutions in Ethiopia is the presence of board member committee, 27 MFI (73) answer the question by yes; and there is subcommittee in the board. That is 10 micro finance institutions (27 percent) answered no for the questions and have no such subcommittee structure under their board members. As stated above, the subcommittees of board members in the different Micro finance institutions are asset liability, risk management, audit and internal control, human resource and business development/marketing committee; the numbers of Micro finance institutions with the committee are 27 risk management, audit and internal control 22, asset liability management 15, human resource and 9 business development/marketing committee. One fact from this data, almost all Micro finance institutions who have subcommittee in the board have the subcommittee of risk management. 5 Micro finance institutions with government affiliation have subcommittee, 10 in NGO backed Micro finance institutions and 12 in private share company Micro finance institutions. Looking at the presence of subcommittee based on size; the presences of subcommittee have not much affected by size and ownership. However, as figure 5 depicts audit and internal committee higher existence at all micro finance institutions and there is variations on other committee set ups depending on the size and ownership of micro finance institutions.

Figure 6: Board Members Subcommittee-based on size and ownership



Source: Extracted from the data collected 2020

About the presence of management team in the Micro finance institutions; from 37 Micro finance institutions, 34 (91.89) of them have management team in the MFI. In those Micro finance institutions who have management team; the major decision made are administration decision and executive decision, also somehow they made strategic and policy decision. The management teams meet every week (15 micro finance institutions), within 15 days (9 Micro finance institutions), every month (nine Micro finance institutions) and every quarter (one MFI). The management team follows their decisions through structure, report, meeting and assessment and evaluation.

Nine governments affiliated, 14 private share company and all NGO backed Micro finance institutions have management team. Two government affiliation and big Micro finance institutions do not have the management committee. One privately owned micro finance institution has no management team. Based on size in large, medium and small Micro finance institutions, only one MFI in each has no management team, as mentioned above.

In most MFIs most Board members are not in a position to conduct meetings regularly let alone to participate on sub-committees to govern their respective institutions. Earlier study by Itana, Tsehay and Eshetu (2003), indicated that one major problem of the MFIs in which high-ranking Government officials are board members is irregularity of board meetings because of the engagement of the officials in priority government duties and responsibilities and unexpected absence for official travels. Similarly, in NGO backed MFIs in which board members are high-ranking officials, there is also irregularity of meeting. This research also proved that board members of most MFIs hardly meet even every four months , although the Articles of Association of most MFIs instruct that the Boards shall have a meeting every month. In some MFIs boards members were found to be unable to meet even within six months.

It is therefore, possible to conclude that most micro finance institutions (72.97 percent) have established board members but they are not well structured with subcommittees which enable them to function properly with the professional skills the industry demands. This implies the existence of limited governance on the MFI sector in Ethiopia.

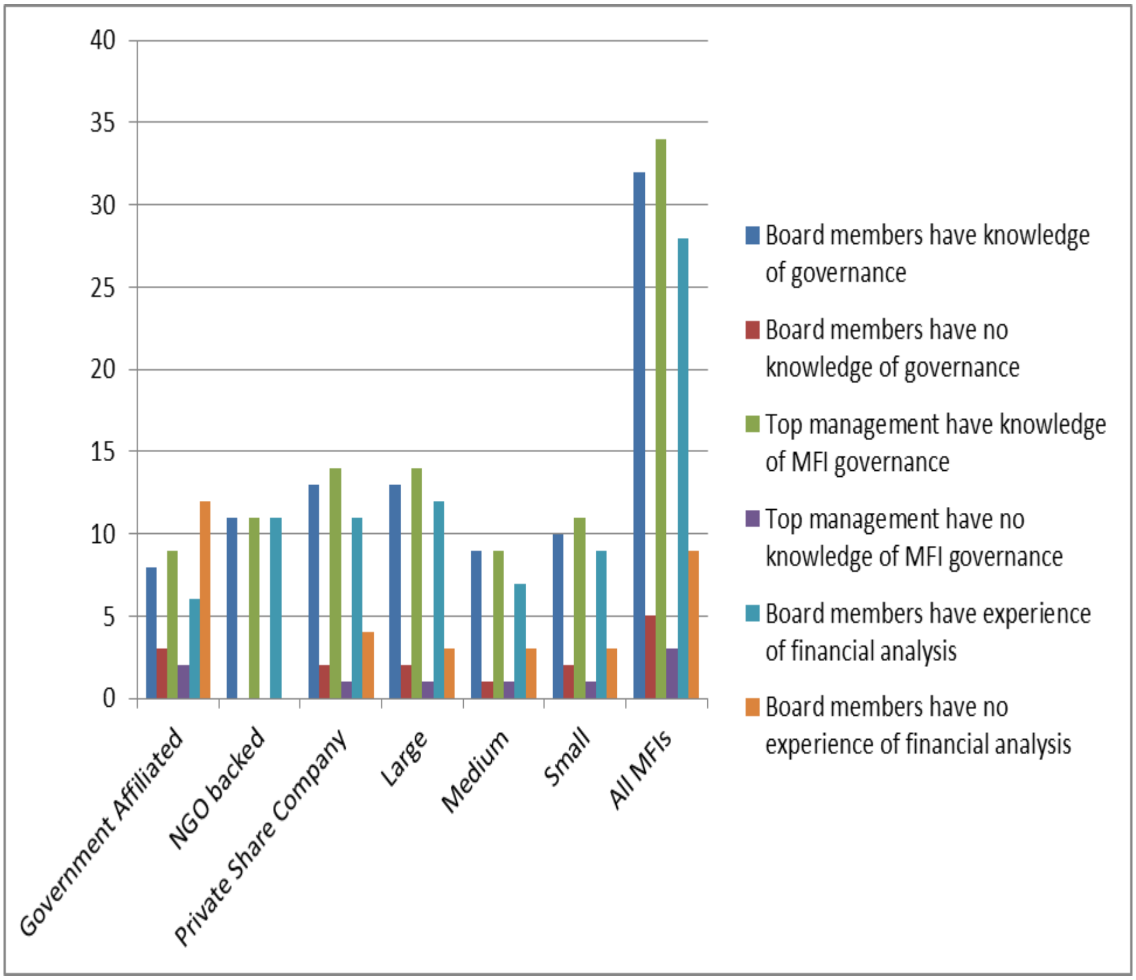
4.2.3 Knowledge, Training and Experience of Board Members

In most of microfinance institutions board members have the knowledge of governance and microfinance governance; those micro finance institutions who believe their board member have no knowledge of governance are now providing training or plan to provide training on micro finance institutions governance. To the question do board members of your MFI have received training on governance and strategic management in the past three years? 28 micro finance institutions answered yes. Nine MFIs offer training by themselves to their Board members, 10 MFIs get training for their Board members from academic institution, 25 micro finance institutions get training to their board members from NGO and government organization (such as AEMFI, NBE, DBE…) , three micro finance institutions get training to their board members from distance learning . In most case the training on strategic management and governance for micro finance institutions board are from 3-5 days.

About knowledge of financial analysis/accounting of board members, 30 micro finance institutions board members have experience of financial analysis/accounting. But only 11 micro finance institutions have independent board members who have the profession and skills of financial analysis. These board members are not shareholders but engaged on the governance of micro finance institutions because they are invited and engaged to share their experiences and expertise. From 254 board members 110 (43.3 percent) of them has the knowledge of financial analysis/accounting. Only 11 (29.7 percent) micro finance institutions have regular and formally planned training programs/schedules for their board members. Those Micro finance institutions that have regular and formal training to board members use 2 percent of their administrative cost and mostly the trainings are conducted biannually or annually. Only 11 (29.7 percent) micro finance institutions include experience sharing/exposure visit budget annually for the top management and board members. The exposure experience sharing/exposure most of the time planned by top management/ manger of each institution. Among the 11 government affiliated micro finance institutions eight institutions board members answered that their board members have the knowledge about governance. It is only six of government affiliated micro finance institutions who received training on governance in the past three years and the experiences they have on financial analysis. Out of the 11 government affiliated micro finance institutions it is only two institutions who have been involved independent board members that have the financial analysis experience and other necessary professional experts. Moreover, among the 11 government affiliated micro finance institutions, it is only one micro finance institution which have the formally planned training system to train board members. Otherwise, the training system is not formally planned and followed every year. In these governments affiliated micro finance institutions only five micro finance institutions have an exposure/experience sharing visit arrangements every year for their micro finance institutions aboard and within a country. As it is indicated on Table 5, NGO backed micro finance institutions have registered higher training and knowledge on governance for their board members. All the 11 NGO backed micro finance institutions board members have the knowledge and received training on governance of micro finance institutions. Board members from ten of these micro finance institutions have experience in financial analysis. Five of the NGO backed micro finance institutions have participated independent board members who have the knowledge and expertise on financial analysis and micro finance industrial management and governance. Five of these micro finance institutions have formal training plans for their board members and two micro finance institutions of the NGO backed have annual experience sharing budget allocated for their board members to gain experiences from international forums. Therefore, these figures indicated that the Ethiopian micro finance industry board members lacks knowledge of financial analysis/accounting and exposure to the sector. Moreover, most micro finance institutions do not have training plans for their board members both at national and international levels. These indicates that the capacity of board members to govern MFIs is limited and would have impacting their growth.

As it is indicated from Table 5, privately owned micro finance institutions have also showed high records on training and knowledge of governance for their board members. Out of the 15 privately owned micro finance institutions considered in this study 13 MFIs board members have the knowledge about governance. 11 micro finance institutions board members received training on governance of micro finance institutions in the last three years. Moreover, 14 micro finance institutions board members have the knowledge on financial analysis and financial management issues. Four privately owned MFIs have engaged some independent board members that have the knowledge and experts on financial analysis. Five micro finance institutions have formally planned annually implemented plans to facilitate training for board members in collaboration with other training institutions and allocate the budget for such activities. Moreover, four of the privately owned MFIs have annual budgets and plan to arrange experience/exposure visits to their board members in collaboration with other international organizations.

Figure 7: Knowledge, Training and Experience of Board members



Source: Extracted from the data collected 2020

As it is shown on Figure 5, in general knowledge, training and experience of Board members is higher in privately owned and NGO backed micro finance institutions in terms of ownership relations. It is also higher in small and large size micro finance institutions as compared with government affiliated institutions. As mentioned above, Figure 5 also indicates privately owned micro finance institutions have more knowledge on micro finance governance and received more training on the issue. As it is indicated on Table 5, it is only 29.72 percent of MFIs who have independent board members who have professional skills on financial analysis related issues. Moreover, it is only 29.72

percent of MFIs which have the training and experience sharing plans with the necessary budget allocated for the purpose.

According to Wolday (2008), the most important duty of the board of MFIs is to ensure that the management team has the necessary skills, knowledge, experience and sense of judgment to manage the affairs of an MFIs. The board should have a sound understand of the risks of MFIs and take reasonable steps to ensure that management has establish strong systems to monitor and control those risks. An MFI should have strong, skilled, knowable and experienced board members who can set sound policies and objectives, adopt sustainable business strategy, supervise the performance or financial position of the institution, maintain reasonable capitalization, etc. Moreover, Wolady (208) added that board members are expected to be independent, have decision making skills, communication skills, willing to work within a team and have the willingness to learn.

However, the data collected from the MFIs indicated that boards members do not have the right mix of professionals, age, and even gender to scan the internal and external environment, set and/or understand various polices, analyze risks of MFIs, establish a well-articulated strategic planning and implementing it, and led monitor an MFI and support the management.

Table 5:Summary Data on Knowledge, Training and Experience of Board member

	Government affiliated	NGO Backed MFI	Private share company	large	Medium	Small	Total MFI	% of total MFI
Do board members of your MFI received training on governance and strategic management in past three years?	6	11	11	12	7	9	28	75.67
Do your MFI have independent board members who have profession skills of financial analysis?	2	5	4	5	4	2	11	29.72
Does your MFI use a regular and formally planned training system to board members?	1	5	5	4	4	3	11	29.72
Does your MFI include experience sharing/exposure visit budget annually for top management?	5	2	4	5	3	3	11	29.72
Does your MFI include experience sharing/exposure visit budget annually for board members?	5	2	4	5	3	3	11	29.727

Source: Derived from data collected from the questionnaires 2020

4.2.4 Regulatory Systems and Documents

In Ethiopia the financial sector is regulated by the National Bank of Ethiopia. Micro finance institutions are one of the financial sectors which are regulated by the same bank. They are formal institutions ruled and regulated by the National Bank of Ethiopia through proclamations and various directives which are annexed in this paper. Some documents such as bylaws and establishments are mandatory by the regulatory body to get a business license for an MFI. However, for a micro finance to have good governance and high performing management there should be many documents and working manuals including: risk management guidelines, strategic plans, self-evaluation and regulatory systems, board bylaws, board minutes etc. These documents help Board members and management to make decisions and follow up implementations as well as evaluate results and to take corrective measures.

This paper tries to assess whether or not those manuals and working documents are in place in each micro finance institution and how they are implementing them. It is obvious that when working manuals and other documents are prepared for Board and top management and whenever there is culture of following and implementing such documents; governance and growth of MFIs would be enhanced. Table 6 summarized data collected from 37 micro finance institutions considered on this study paper on Board and/or management related regulatory systems and documents of the institutions. As it is shown on Table 6 , NGO backed and privately owned micro finance institutions have prepared working manuals and guidelines which are help full for Board members and top management than government affiliated micro finance institutions. In terms of size large micro finance institutions have developed working manuals for their Board members and top management to have good governance and better performance. Medium size micro finance institutions do have low records in this regard.

Table 6: Summary of Data on Regulatory Systems and Documents

Does your MFI board have…	***Government affiliated***	***NGO backed***	***Private share company***	***Large***	***Medium***	***Small***	***Total MFI***	***% of total MFI***
risk management guideline?	9	11	11	15	7	9	31	83.78
regular meeting system?	9	11	14	13	10	11	34	91.89
review minute in the next meeting	9	9	13	13	8	10	31	83.78
self-evaluation systems?	4	4	4	7	3	2	12	32.43
procedures/ bylaw to follow as a guideline?	6	8	12	9	8	9	26	70.27
succession plan for replacement of top management ?	5	7	8	9	6	5	20	54.05
limited term (s)	6	10	13	10	9	10	29	78.37
strategic plan?	8	10	14	12	9	11	32	86.48

Source: Derived from data collected from the questionnaires 2020

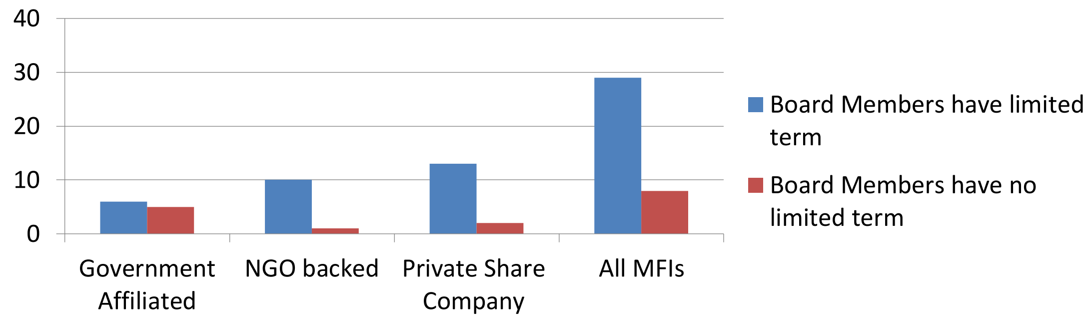
31 (83.78) Micro finance institutions have risk management guideline. Risk management unit in micro finance institutions report to both general manger and board of director (in 19 micro finance institutions); to board of director (in 8 Micro finance institutions); and to general manager (in 4 micro finance institutions). The boards role in risk management include give direction to risk mitigation, decision making, policy formulation and prepare strategic plan on risk mitigation.

Other than meeting in the time of basic decisions, in 34 micro finance institutions board members have regular meeting. Board member have meeting every quarter in 26 micro finance institutions and monthly in 8 micro finance institutions. All 37 micro finance institutions board members record/document their minutes for follow ups and evaluations. But only 31 micro finance institutions board members review the minutes in the next meeting.

12 (32.43 percent) micro finance institutions have board members evaluation system; board members evaluate every year in 4 micro finance institutions and quarterly in 8 micro finance institutions. In 26 micro finance institutions (70.27 of 37 micro finance institutions) board members have rules of procedures or bylaw to follow as a guideline. 20 micro finance institutions have succession plan for replacement of top management in case vacant situations are created. In 29 (78.37 percent) micro finance institutions board members have limited term; 2 years, 3 years and 4 years and they can be board members for two terms. 32 MFI (86.48 percent of 37 micro finance institutions) have strategic plan which the board and top management follows. In 8 micro finance institutions Board members have no limited term periods to serve the institution as members and higher governing bodies. This means they are either life time members or they are changed based on mutual agreements of stakeholders on unlimited time period based on situations. This seems higher in government affiliated MFIs. As it is indicated on Table 6, out of 11 governments affiliated MFIs only six have limited terms for the Board members to serve institutions as higher governing bodies.

Figure 6 depicts that Board members have limited term on privately owned and government affiliated micro finance institutions than NGO backed ones to serve their respective organizations. These figures implied that most MFIs board members have no limited terms and stay on the institutions without gaining the necessary experiences and skills. Board members who are young, educated, skilled and experienced with the sector are not replacing those board members. This implies that the growth of MFIs is impacted due to the limited composition of those skilled, experienced, exposed etc. board members.

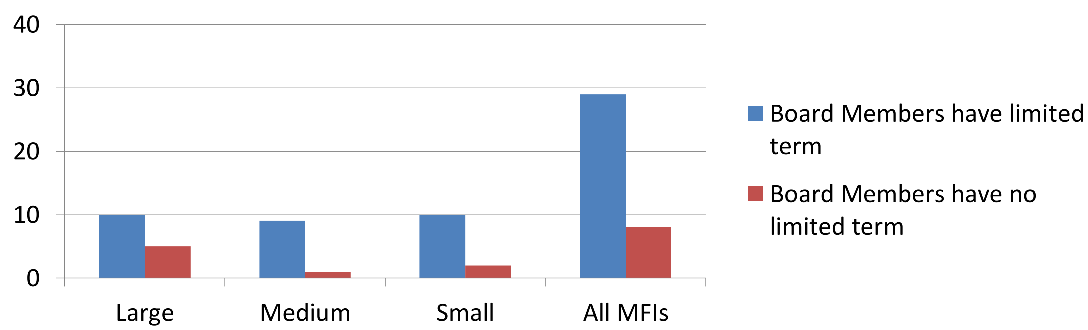
Figure 8: Board Members Term-based own ownership



Source: Extracted from the data collected 2020

Based on their size medium size micro finance institutions have more unlimited terms to serve as Board members. Figure 6 indicates that most micro finance institutions have limited term for their Board members. However, Small and Medium micro finance institutions have more unlimited terms for their Boards.

Figure 9: Board Members Term- Based on size



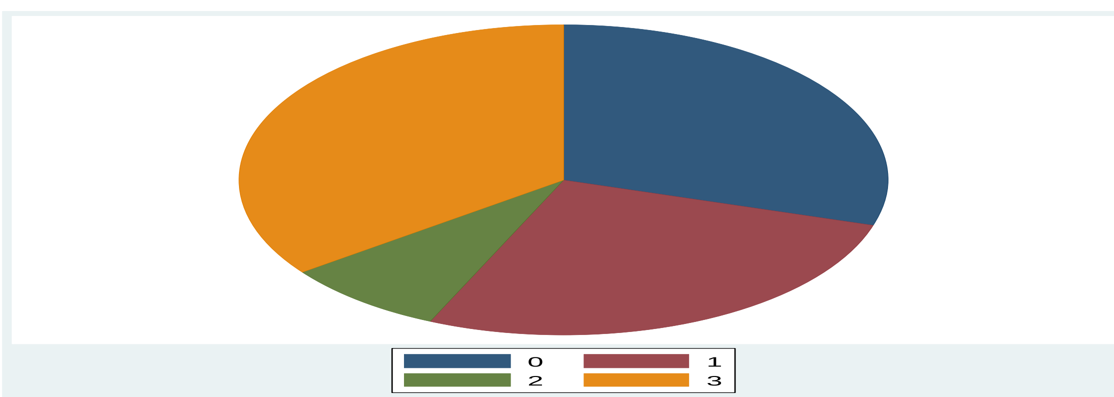
Source: Extracted from the data collected 2020

Board members in an MFI are expected to guide management in many aspects. According to Wolday (2008), the board should ensure that the MFI has adequate internal audit arrangements in place. It should also ensure that micro finance regulations are strictly followed by the executive management. However, the data gathered from the MFIs indicated that 32.43 percent of MFIs do have self-evaluation and regulatory systems. Moreover, almost half of the MFIs board members do not succession plans in case vacant positions are created. This implies there are gaps on governance on a significant number of MFIs in Ethiopia. Although in most MFIs do have limited terms the data gathered from the MFIs indicated that it is difficult to get full or above half board corms to conduct meetings because most board members in government affiliated and NGO backed are so busy in other duties . Hence, MFIs lack the necessary support and guidance from the board.

4.2.5 Source of Fund and Its Impact on Governance

From the 37 Micro finance institutions top management responses of questionnaire, 26 of them think that the collateral option in Ethiopia is narrow and affects growth of their micro finance institutions. 13 of them believe it is serious both in rural and urban area (the whole country), 10 believe it is serious in rural area and three of them believe it is serious in urban area. Figure 7 indicates the seriousness of collateral issue and its implications on the influence of governance on the Ethiopian micro finance institutions. As it is shown on Figure 7 whether it is in rural or in urban Ethiopia collateral issue is serious one and influences governance affects growth of micro finance institutions. Collateral issue is narrow in both rural and urban areas which affects the growth of micro finance institutions in both areas. Narrow It is more serious

Figure 10: Seriousness of Collateral Option



Source: Extracted from the data collected 2020

- Blue (0): Collateral option in Ethiopia is not narrow and affects growth of your micro finance institutions;

- Red (1): Collateral option in Ethiopia is narrow and affects growth of your micro finance institutions, and it is serious in rural area;
- Green (2): Collateral option in Ethiopia is narrow and affects growth of your micro finance institutions, and it is more serious in urban area;
- Yellow (3): Collateral option in Ethiopia is narrow and affects growth of your micro finance institutions, and it is more serious both in urban and rural area.

Table 6:Source of Fund and its Impact on Governance

	Government Affiliated	NGO backed	Private share company	Large	Medium	Small	Total MFI	% total MFI
Board members of MFI are committed in soliciting various funds including credit to the MFI	6	4	7	6	5		17	45.96
The amount borrowed/received from different sources by the MFI so far are enough to run the business	3	1	4	3	2	3	8	21.62
The MFI face challenges in relation to setting interest rate on loans	2	4	7	2	6	5	13	35.13
There is excess accumulation of fund	3	1	1	2	2	1	5	13.51
The MFI ever meet liquidity problem	4	9	10	8	6	9	23	62.16

Source: Derived from data collected from the questionnaires 2020

Source of loan able fund for Micro finance institutions include saving (33 micro finance institutions), share (30 micro finance institutions), loan from bank (22 micro finance institutions), 13 micro finance institutions from development programs from government/NGO and six micro finance institutions gate loan able fund in the form of donation. But most of the time source of loan able fund is combination of variables; for

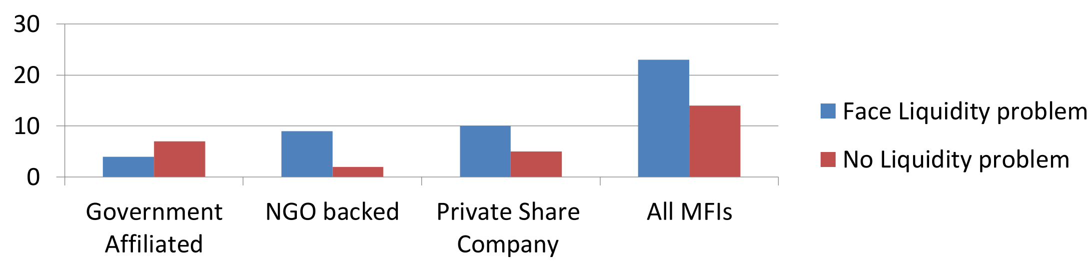
15 micro finance institutions source of loan able fund are from sale of shares, development program from government/NGO and savings, 13 micro finance institutions are share, loan from bank and saving and for nine micro finance institutions it is saving and share.

Only 17 micro finance institutions (45.94 percent of 37 micro finance institutions) board members are committed in soliciting various funds including credit. In addition it is only in 8 micro finance institutions the amounts of the available loan able fund (amount borrowed/received from different sources) are enough to run business. 17 micro finance institutions were denied credit (Loan able fund) due to criteria set by lender institution. The criteria set for the denials of loan able fund include physical collateral (8 MFI); number of client below the required criteria (five MFI); PAR<5% (four MFIs), not operating in rural area and repayment in foreign currency. Moreover, in 29 MFI there were profitable activities /business opportunities that the MFI could not undertake due to lack of loan able fund which affected the growth of the MFI.

Interest rate is the major source of income for micro finance institutions. For 13 micro finance institutions there are challenges in setting interest rate. Interest rate for micro finance institutions set by government, market force or the Micro finance institutions itself; interest rate of MFI set by government (two MFIs), market force (15) and MFI itself (37). From this we can understand in most case interest rate of MFI set by the MFI itself.

Only five micro finance institutions have excess accumulation of fund and five micro finance institutions top management believe the possibility of getting additional fund from donors or government while there are enough funds. Reason for additional fund while there are enough funds include loan guarantee, revolving fund and donors and government have trust on the MFI. However, 23 micro finance institutions were face liquidity problems; 22 of them face every year and one MFI face once. The solution to the liquidity challenge problem are intensive saving mobilization (23 MFIs); borrowing from private bank (eight Micro finance institutions); issuance of additional and new share (six Micro finance institutions); borrowing from government bank (especially DBE) (five Micro finance institutions); government support (three micro finance institutions) and avoid lending temporarily. As is shown on Figure 8, liquidity problem is more serious on privately owned and NGO backed micro finance institutions. Liquidly problem is less in government affiliated organizations/institutions because some government development programs are given to government micro finance institutions. As it is shown on Figure 7 and many previous studies in the micro finance industry indicated, lack of loan able fund and liquidity problems are major problems of the Ethiopian micro finance sector.

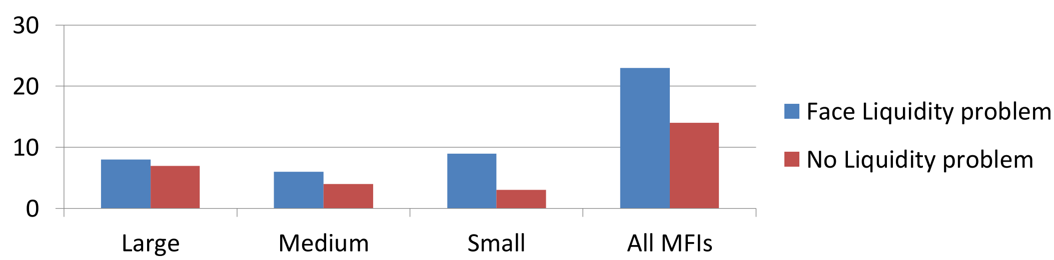
Figure 11: Challenge of Liquidity Problem: Based own Ownership



Source: Extracted from the data collected 2020

As it is shown on Figure 8, liquidity problems are higher on small and medium size micro finance institutions. Larger micro finance institutions which are mostly government affiliated micro finance institutions have less liquidity problems/challenges.

Figure 12: Challenge of Liquidity Problem: Based size



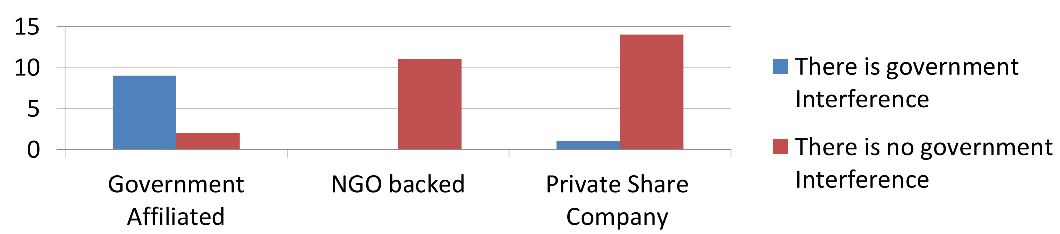
Source: Extracted from the data collected 2020

The implication of the above analysis is that significant number of MFIs are suffering from liquidity problem. However, board members (in 54.06 percent of MFIs) are not working on soliciting funds to their respective organizations. This is more serious in government affiliated and NGO backed institutions. In government organizations board members are not stable in their terms of service . In NGO backed institutions board members are not shareholders, they are rather nominees. They have low commitment in soliciting funds and these are the gaps which hinder the growth of MFIs in Ethiopia.

4.2.6 Interferences, Risks, and Regulatory Challenges/Support

In 27 Micro finance institutions there is no government interference which may affect governance and hinder the growth of micro finance institutions. 10 of the micro finance institutions which says government interference affect the growth of MFI list provision of loan to government target group, revolving fund loan and social mission (focus on loan distribution not repayment) are the major interference from government. In addition, 29 micro finance institutions do not face challenge from regulatory authorities of micro finance institutions. Only eight micro finance institutions face challenges from regulatory authorities. As it is indicated on Figure 9, there is more government interference on micro finance governance and operational issues on government affiliated micro finance institutions. There is also some interference on privately owned micro finance institutions.

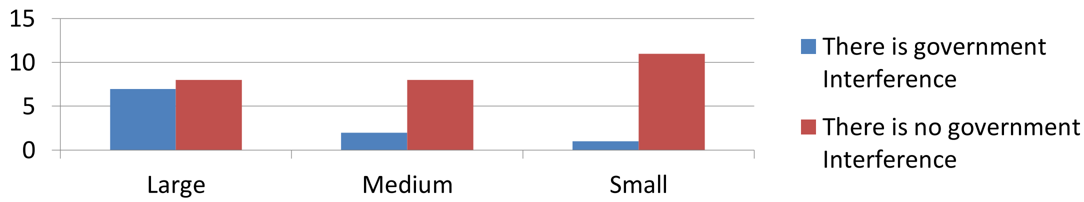
Figure 13: Government Interference based on Ownership



Source: Derived from data collected from the questionnaires 2020

Depending on the size of micro finance institutions government interference is higher in larger MFIs and the next ones are medium sized MFIs. This is so because government MFIs are in these categories. Small MFIs have lower interferences from government bodies**.** Figure 10 indicates this fact and as mentioned above government interferences are higher on larger and medium size MFIs. Hence, as size of an MFI increase government interference gets intense in the Ethiopian micro finance sector.

Figure 14: Government Interference based on Ownership



Source: Derived from data collected from the questionnaires 2020

In 13 (35 percent) micro finance institutions ownership structure have challenges on the governance of the MFI. For 30 Micro finance institutions there is no risk associated with governance negligence. Those seven micro finance institutions that face risk associated with governance negligence face the following risk: credit risk, poor lending requirement which lead to low repayment and failure to meet paid up capital requirement. MFI get support to strengthening the capacity of governance to cope with risks from AEMFI, NBE, DBE, regional government (government) and NGOs.

Table 7: Summary of data on Interferences, Structure and regulatory challenges/Support

	Government Affiliated	NGO backed	Private share Company	Large	Medium	Small	Total MFI	% total MFI
Is there any kind of government interference on your MFI which may influence the growth of your MFI?	9	0	1	7	2	1	10	27.03
Do you have risks associated with governance negligence at your MFI?	4	1	2	3	2	2	7	18.92
Do you have some challenges from the regulatory authorities of the MFI?	2	3	3	3	2	3	8	21.62
Do you think that the ownership structure have challenges on the governance of the institution?	5	5	3	8	2	3	13	35.14

Source: Derived from data collected from the questionnaires 2020

The above analysis indicated that the interference is more in big and government MFIs. The governance system lacks from accountability and the interference of the government is on appointments of board members, forcing management to set interest rates and political decisions such as selecting target clients to MFIs based on the interest of the government programs. The major challenges of ownership structure on the governance of micro finance institutions include: nominal shareholder, major shareholder interference and lack of experienced board. With regard to structure since ownership is not clear on government affiliated and NGO backed MFIs there is lack of actual heap in the MFIs. Moreover, conflict of interest is high on NGO backed MFIs because some board members are nominee board members as shareholders and managers at the same time. These all implies the presence of feeble governance on MFIs in Ethiopian MFIs.

4.2.7 Supports and Regulations to the Ethiopian MFIs

In terms of volume of transaction, much of the formal financial intermediation in Ethiopia is carried out by commercial banks. While this activity is weakly followed by MFIs in terms of volume of loans, in terms of participants the number is quite large in the latter. An important character vested on MFIs is their ability to deposit claims of savings from the public with the aim of transferring them to those that have demand for investment purposes or otherwise. This right is, however, constrained by regulations formulated by central organs known as Central Banks. In Ethiopia, it is the National Bank of Ethiopia (NBE) that has the authority to register, supervise and regulate financial institutions (Tekie & Sisay, 2019).

In this paper information is gathered from the National Bank of Ethiopia and Development Bank of Ethiopia through interview of MFI departments. As stated above the National Bank of Ethiopia is the regulatory authority for the formal financial sector which includes banks and micro finance institutions. *It has been facilitating necessary legal and capacity building issues for the micro finance sector through proclamations and directives.*

Moreover, according to the interview and information gathered from the National Bank of Ethiopia:

It representing the industry and the Bank works with the government on issues such as security of the sector from internal and external threats. It also works with regional and Federal government on collateral issues and on soliciting loan able funds. These regulatory supports and soliciting funds has supported on the enhancement of governance and growth of the micro finance sector.

The Association of Ethiopian Micro Finance Institution (AEMFI) also has been working with micro finance institutions in various aspects. According to the interview from AEMFI, the kind of supports or services the association is providing to the micro finance sector to strengthen governance includes:

- ✓ *Capacity building such as training, research , exposure visit, experience sharing for board members and management, employees etc.*
- ✓ *Advocacy and good relations like conference, workshops facilitation*
- ✓ *Financial education and literacy promotional facilities and assessments*
- ✓ *Negotiations with government and other development partners on governance enhancements and others*

According to the interview responses from AEMFI, from their experiences the major challenges of the Ethiopian micro finance institutions in relation to governance as compared to other African countries such as Rwanda , Uganda, and Rwanda are :
skill and knowledge gaps and political interference on the Ethiopian MFIs from the government bodies which stretches up to interest setting. Moreover, lack of ownership as nominal shareholders sit in the board of directors, political interference in nomination of both board members and chief executives of micro finance institutions especially for the government affiliated MFIs are the main challenges which influences the governance of the industry. Most of these challenges are emanated from the working environment /infrastructures problems of the industry in Ethiopia.

Moreover, as per the interview responses from AEMFI, Ethiopian MFIs government and the regulatory body have lessons to learn from other African MFIs such as Rwanda, Kenya and Uganda which includes the following:
MFIs should work on commercial principles and manage the business in a professionally accepted manner; the regulatory body support the sector, encourage innovations and work closely with MFIs to solve problems cropped up in the due processes of operations; the government should support the MFIs through policy environment by making the level ground for competition. In addition, AEMFI have more plans to support Ethiopian MFIs in improving problems in relation to governance. These includes, building capacity of board members and executive officers through training and exposure visits, work towards the implementation of effective governance

through cross liberalization of the experiences of other countries. According to the answer from AEMFI, if the financial sector including the MFIs is liberalized they can cope and exist in such competitive environment as business entity. Moreover, it is the belief of AEMFI the fact that they have competitive edge in customer base, understand local contexts they can cope and exist in the competitive market. But need to work hard to consolidate their/MFIs' capacity in terms of systems, management and technologies

For this research interview was conducted and information was gathered from DBE. For the question what kind of supports or services your organization is providing to the MFI sector in Ethiopia to strengthen governance? They gave an answer:

- ✓ *Supply of fund for the development of the sector*
- ✓ *Capacity building such as training, research, exposure visit, experience sharing*
- ✓ *Finance supply for credit*

According to the data collected from DBE, the major challenges of the Ethiopian MFI industry in relation to governance as compared to other African countries such as Rwanda , Uganda, and Kenya are:

- ✓ *Skill and knowledge gaps*
- ✓ *Lack of experience and*
- ✓ *Political interferences*

The bank has also stated the gaps/challenges in which influences governance of micro finance institutions emanated from the working environment of the industry in Ethiopia include:

Lack of competent knowledge and experience among the board members, insufficient, Remuneration when the board members site for regular as well as extraordinary meeting etc. Moreover, the data gathered from DBE on the Ethiopian MFIs government and the regulatory body that they have to gain lessons to learn from other African MFIs such as Rwanda and Nigeria are:

- ✓ *Micro finance institutions with the support of donor fund as well as from their own sources Ethiopian MFIs had arranged oversees lesson learned program and they should maintain this like at Rwanda , Uganda and Kenya in which many NGOs are working with them*

- ✓ *Regulatory body with the support of various donors the regulatory body (NBE) took lesson learned experience not only African countries as well as other Developed countries (India, Brazil ,Indonesia etc.)*
- ✓ *The government in collaboration with the donor as well as the representative of the key players the government had arranged various local as well as oversees exposure visit related to corporate governance in general.*

For the question DBE asked where it has plan to support the Ethiopian MFIs in improving problems in relation to governance issues, *the answer is yes*. In more details it is summarized as:

By considering and appreciating the problem of governance issue in the sector (MFI) our organization in collaboration with NBE with the support of Donor Fund (IFAD) a study was conducted and validated by the owner (MFI) and the final report is already produced by the consultant and submitted to the regulatory body waiting for implementation in the form of either working procedure or directives implemented by MFI. DBE believes that if the financial sector in Ethiopia is liberalizing the industry will not cope and exist in such competitive environment as business entity. This is because currently the MFIs industry is at its infant stage and most of the local MFIs do not have a shoulder to compete, so that first the existing MFIs first should equipped themselves in terms of human capital, technology, capital etc. The government has to review the existing policy and make suitable for the local MFIs which enables them to cop up the new environment and besides to this the government has to allow the capital market to be established which will be one of the option to raise funds. And the response from DBE concludes that to liberalize the MFI sector other partners/NGOs should share their International experience, gives technical assistance etc.

To sum up this section, the Ethiopian MFIs regulatory and support organizations confirmed that the main gaps and challenges of governance of MFIs as compared to the Ugandan, Kenyan and Rwandan MFIs are:

- ➢ Skill , knowledge and experience/exposure gaps of board members

- Weak infrastructures such as support organizations/institutions, use of technology and innovations, narrow collateral , capital market, ownership structure etc.
- Political interference on decision making of MFI governance issues
- Insufficient or no motivating factors for board members
- Same regulation and criteria applied by the NBE for all sized MFIs

4.3 Discussion

As stated on the literature review section in this paper, the Cadbury Report which was released in the UK in 1991 outlined that "Corporate governance is the system by which businesses are directed and controlled." Good corporate governance is a key factor in underpinning the integrity and efficiency of a company. Poor corporate governance can weaken a company's potential, can lead to financial difficulties and in some cases can cause long-term damage to a company's reputation (Cadbury, 1991). According to Cadbury company which applies the core principles of good corporate governance; fairness, accountability, responsibility and transparency, will usually outperforms other companies and will be able to attract investors, whose support can help to finance further growth.

However, the results on this paper indicated that micro finance institutions in Ethiopia which are being governed by board members appointed by government and non-government organizations lacks transparency and responsibility due to the ownership structure problems. This also has implies on the agency theory which is not perfectly applied on the Ethiopian micro finance institutions due to the ownership structural problems particularly on the government owned and non-governmental organizations' backed micro finance institutions.

Micro finance institutions in East Africa shares similar problems and challenges. Different research works indicated that the micro finance sector in East Africa has been serving similar targets to alleviate poverty under similar circumstances with similar time in emergence as a sector. However, in terms of regulation support, application or use of technology, capital structure and ownership structures they are different. In Ethiopia almost all big micro finance institutions are government affiliated while in Rwanda, Uganda and Kenya big micro finance institutions are privately owned. Moreover, existence of agency organizations, apex organizations, capital mobility and structure, relatively high use of technology or establishment of better enabling infrastructure in the aforementioned countries enabled the micro finance sector to have better governance than in the Ethiopian case. The difference on the increment of the number of micro finance institutions and growth on their outreach may be the result of such existing differences.

In general, the differences and similarities among those micro finance institutions mentioned in this paper are discussed in detail in the findings section and stated also on the conclusions part of this paper.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary of Findings

In this study among the 38 operating MFIs in 2020 in Ethiopia ,37 micro finance institutions CEOs, MFIs unit representatives from NBE and DBE as well as CEO of AEMFI are included. Through an open-questionnaires data were gathered from MFIs and analyzed. Interview was conducted from the regulatory and supporting organizations through structured and unstructured questionnaires. Secondary data were reviewed from books , reports and research works to compare Ethiopian MFIs with Kenya, Rwanda and Uganda. MFIs governance gaps and challenges which are signs of weak governance and affects the growth of MFIs are identified. The summary of the findings are presented briefly as follows:

- Planning (both strategic and shot term) and strategic decisions based on strategic planning is weaker
- Board size is small, composition is weaker, women and youth participation is very poor, participation of independent board members are highly limited , experience , knowledge/skills and exposure of board members is highly limited
- Participation of board members on subcommittees is very weak and their support to the MFIs management is poor
- Board members self-evaluation mechanisms , succession plan for the management are some serious problems
- Board members have limited contribution on soliciting funds for the growth of their respective MFIs through reducing liquidity problems
- Weak infrastructures such as support organizations/institutions, use of technology and innovations, narrow collateral , capital market, ownership & structural and problems etc.
- Political interference on decision making of MFI governance issues
- Insufficient or no motivating factors for board members

- Same regulation and criteria applied by the NBE for all sized MFIs
- Collateral issue is narrow in both rural and urban areas

5.2 Conclusions

Diversity in the composition, knowledge, experience, gender, age and the like of board members is important to have good and effective governance for MFIs to grow sustainably and profitably. Board members with different skills and experience and of both genders contribute to effective resource provision and to the beneficial performance of organizations maintain both social and profit objectives. Moreover, qualified and skillful board members can be considered as a strategic resource to provide a strategic linkage to different external resources. Both agency and resource dependency theories advocate that boards should have a diversity of competent members who are able to effectively monitor top managers and provide organizations with the resources they need. By performing these roles, board members are able to positively influence the growth and performance of organizations.

One measure to see whether micro finance institutions in Ethiopia do have good governance or not is the way they are structured and functioning. It is obvious that if a company operates under different functional units its performance would be high and its governance would enhance. Planning and use of core banking system/technology were one of the major problems of Ethiopian MFIs. Moreover, the committee and subcommittee under the boards of the micro finance sector are not well structured and organized.

In all types of micro finance institutions there are board members who are supposed to represent the shareholders and act in making high decisions on the governance of the micro finance institutions. They do have their own duties and responsibilities stated on their respective manuals. Hence, timely board decision is one major problem of Ethiopian MFIs.

Appointed or nominated board members are serving as quasi-boards. They are nominated and not shareholders. This is one key problem both in the development of human capital and in decision making process.

Weak exposure to the micro finance sector, poor knowledge on financial analysis and management, weak composition of board members in education, skills, knowledge, age, gender, political interferences etc. are found some major challenges on Ethiopian MFIs. This implies weak governance is endorsed to exist in the sector.

Same regulation mechanism to all sized MFIs , ownership and structural problems are also some of the gaps which have influences on the growth of MFIs due weak governance . Micro finance institutions are formal institutions ruled and regulated by the National Bank of Ethiopia through proclamations and various directives. Some documents such as bylaws and establishments are mandatory by the regulatory body to get a business license for an MFI. However, for a micro finance to have good governance and high performing management there should be many documents and working manuals including: risk management guidelines, strategic plans, self-evaluation and regulatory systems, board bylaws, board minutes etc. These documents help Board members and management to make decisions and follow up implementations as well as evaluate results and to take corrective measures. This paper tries to assess whether or not those manuals and working documents are in place in each micro finance institution and how they are implementing them. From the findings it is possible to conclude , therefore, the MFI sector in Ethiopia has weak evaluation system, weak succession plan for its human resource, and not clear terms for the board members, These pinpoints the existence of weak governance in the sector.

The data on this study indicated that there is political/government interference on micro finance governance and operational issues although it is more on government affiliated micro finance institutions. This affects the governance of the sector.

Although MFI are getting supports to strengthening the capacity of governance to cope with risks and other hindering factors from AEMFI, NBE, DBE, regional government (government) and NGOs, the enabling environment, regulation support, institutional partnership, policy changes to support the MFI, use of technology and innovations is very limited in Ethiopian MFIs as compared to the Ugandan, Kenyan and Rwandan MFIs.

To conclude, therefore, the Ethiopian micro finance sector lacks application of technologies/innovations, clarity on ownership and structure, skilled and educated human capital, additional regulatory frameworks and infrastructures, some laws like National Financial Education and Financial Consumer Protection etc. The infrastructure and support organization for the development of the sector is limited. Ownership clarity and board nominations are also some challenges of the micro finance sector in Ethiopia. The sector is closed to foreigners and foreign financial investments. Moreover, there is political/government interference on the sector. Board members are not well skilled, educated, exposed to international experiences. In addition, the participation of women and youth professionals is very limited. These all challenges have been affected and influenced the governance of the sector.

5.3 Recommendations

To improve the growth of micro finance sector and thereby to enhance governance of the industry, the government of Ethiopia through the National Bank of Ethiopia and the Development Bank of Ethiopia have been supporting the micro finance industry. The support ranges from the provision of regulatory services to the supporting to undertake researches/assessment, provision of various training and technical supports. Some MFIs are also allowed to get loans from the government owned bank-Commercial Bank of Ethiopia, by taking the collateral responsibility through regional governments for government affiliated MFIs. However, the regulation set by the National Bank of Ethiopia and all the platforms are the same for all size MFIs. There is a need to provide a new regulatory space to micro finance institutions according to their size.. On the other hand, micro finance institutions are expected to implement rules and environmental management, good governance, unhealthy competition, and conduct value adding research to provide affordable and quality financial services to existing and potential clients. This indicates how huge is the gaps among micro finance institutions in Ethiopia and extremes in the micro finance industry. This gap has direct influence on the governance of the micro finance institution and on the existing/potential growth of the institutions. Therefore, it is advised that various regulation mechanisms be in place based on ownership and size of MFIs so as to have good governance and sustainable growth for the sector.

According to the responses from AEMFI, Ethiopian MFIs government and the regulatory body have lessons to learn from other African MFIs such as Rwanda, Uganda and Kenya which includes the following: MFIs should work on commercial principles and manage the business in a professionally accepted manner; the regulatory body support the sector, encourage innovations and work closely with MFIs to solve problems cropped up in the due processes of operations; the government is advised to support the MFIs through policy environment by making the level ground for competition. Moreover, the fact that MFIs in Ethiopia have competitive edge in customer base, understand local contexts they can cope and exist in the competitive market if enabling environment and infrastructures are in place by government and regulators. But need to work hard to consolidate their/MFIs' capacity in terms of systems, management and technologies. Therefore, it is recommended for the government set regulations which attract international financial investment, legalize moneylenders, technology/innovations expansions and support, establishment of support organizations like the ministry of state for MFIs like in Rwanda and apex organizations in Rwanda, Uganda, and Kenya. These may have positive contributions on having improved governance system in Ethiopia.

The government regulatory body is advised to review the existing policy and make suitable for the local MFIs which enables them to cop up the new environment and besides to this the gov't has to allow the capital market to be established which will be one of the option to raise funds. Some participants in this paper recommended that to liberalize the MFI sector other partners/NGOs should share their international experience, give technical assistance, and give their support on the restructuring/transforming of the sector.

The regulatory body and the support institutions like AEMFI are recommended to coordinate their efforts to train and help MFIs in preparing and implementing their strategic plans. Moreover, since the composition of Board members in education/skill, age, gender, and experience is poor these bodies are suggested to coordinate their efforts to minimize these gaps/challenges and to put in place good governance in the micro finance sector.

Collateral problem is one of the major and hindering problem for the Ethiopian MFIs. In Rwanda, Kenya and Uganda land is also used as collateral for loans. There are also agent relationships among banks and MFIs in those countries which minimizes the collateral issue. Hence, there are good lessons to be learned and further investigations are advised to be under taken by Ethiopian regulatory and micro finance supporting organizations to minimize this collateral problem/challenge and to enhance governance for the sector.

The National Bank of Ethiopia is implementing National Financial Inclusion Strategy like Uganda, Kenya and Rwanda. However, the National Financial Education Strategy is in progress and not implemented well. Moreover, the micro finance sector in Ethiopia does not implement and in place the Financial Protection Law. Therefore, it is recommended for the regulatory body and the support partners to make these laws in place and have governance that is capable of implementing the laws even at a curriculums level in high schools and/or higher educational institutes. These all would have positive impacts on the enhancement and strengthening of MFI governance in Ethiopia and would result on the overall growth of the sector.

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Declaration

I, the undersigned, declare that this thesis is my original work, prepared under the guidance of Dr. Meskerem Mitiku. All sources of materials used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree.

Tekle Bekele **Signature**

St. Mary's University, Addis Ababa
July, 2020

Appendix-I

Questionnaires I

Interview for top management/Managers/CEOs of MFIs

Dear interviewee!

First of all, the researcher would like to express his gratitude for you that you have arranged your precious time for this interview. Your cooperation and support is highly appreciated and the details that you are going to provide to the researcher are highly valuable.

This questionnaire as tool of instrument is prepared for the study entitled "***A Review on Corporate Governance in Ethiopia MFIs: Learning from East African Countries***" in partial fulfillment of Maters of Business Administration at St. Mary University. The information you are going to provide is confidential and only used for the aforementioned academic purpose. Respectfully, thank you again!

Date ___________________________

Code ___________________________

Part I: General Information

1) Geographical Information of the MFIs

a. Region_____________________________Zone ____________________________

b. Wereda ____

c. Town/City ____

2) Does your MFI have the following departments? Please put (X) mark

MIS/IT	Yes/ No
Core banking system	Yes /No
Communications/Marketing	Yes/ No
Risk management	Yes/ No
Planning	Yes/ No
Marketing	Yes/ No

Part II : Board size and composition

3) What is the size/number of the total board members at your MFI? ___________

4) How they are elected? (Appointment or/and election)___________________

5) Can you specify their compositions in terms of:

a. Sex: Male_________Female___________

b. Education: Dip and below______Degree_______seconddegree_______PHD______

c. Experience in years: _________

d. Age: 25-35_____36-46______47-57______58-70______more than 70_______

6) Do board members have specified positions/sub committees to support the MFI?

a) Yes b) No

7) If the answer for question 6 is yes, would you mention the name of the positions please? ____

8) Is there a management team at your MFI?

a) Yes b) No

9) If the answer for question 8 is yes, what kind of decisions it makes? Please specify____

10) How frequent such team conducts meetings? ___________________________

11) How the management team gets feed backs and flow its decisions to the concerned units?

12) Do you think that the collateral option in Ethiopia is narrow and affects growth of your MFI?

a) Yes b) No

13) If the answer for question 12 is yes is it more serious in Urban or Rural areas? Or in both? _________

Part III: Knowledge, training and experience of board members

14) Do board members at your MFI have the knowledge about governance?

a)Yes b) No

15) Do teams of the top management, including the manager, at your MFI have the knowledge on MFI governance concept?

a) Yes b) No

16) If the answers for question 14 and/ or question 15 are No, what are the efforts have been done to make them aware/train?

a. ___________________________________

b. ___________________________________

c. ___________________________________

d. ___________________________________

17) Do board members of your MFI have received training on governance and strategic management in the past three years?

a) Yes b) No

18) If the answer for question 17 is yes, who provided the training? (you can select more than one training institutions)

a. The MFI itself

b. Academic institutions (public or private).

c. NGOs

d. Training institutions such as (national and international)___________________

e. Distance learning____

f. Others, specify ____

19) How often did board members your MFI receive training on governance of MFIs and strategic management? You can state/put it in terms of days, weeks or months.

a. ___________________________________

b. ___________________________________

c. ___________________________________

20) Do your MFIs board members have the experience in financial analysis/ accounting?

A) Yes B) No

21) If the answer for question 20 is YES, how many of them do have such experience and qualification? ___________

22) Does your MFI use a regular and formally planned training system for the board members?

A) Yes B) No

23) If the answer for question 22 is yes what percentage of your MFI administration cost was used for training for the past three years? ___________________________

24) If the answer for question 22 is yes how frequently training sessions are arranged?

a. Monthly

b. Quarterly

c. Biannually

d. Annually

e. Other, specify

Part IV: Regulatory systems and documents

25) Does your MFI have risk management guideline?

A) Yes B) No

26) If the answer for question 25 is yes, to whom the unit reports? What is the role of the board here?

a. __________________________________

b. __________________________________

c. __________________________________

d. __________________________________

27) Do board members of your MFI have regular meeting system?

A) Yes B) No

28) If the answer for question 27 is yes how often they are conducting meetings

a) Monthly

b) Quarterly

c) Semiannually

d) Yearly

e) Others, please specify

29) Do board members of your MFI record/document their minutes for follow ups and evaluations?

A) Yes B) No

30) If the answer for question 29 is yes, do they review on their next meetings for follow ups?

A) Yes B) No

31) Do board members of your MFI have self-evaluation systems?

A) Yes B) No

32) If the answer for question 32 is yes, how frequent the board evaluates itself? ________

33) Do board members of your MFI have rules of procedures or bylaw to follow as a guideline?

A) Yes B) No

34) Does the MFI have succession plan for replacement of top management in case vacant situations are created at the institution?

A) Yes B) No

35) Do board members at your MFI have limited term (s) to serve your MFIs?

A) Yes B) No

36) If the answer for question 36 is YES, for how many years and terms? _______

37) Does your MFI have prepared strategic plan which the board and top management follows accordingly?

A) Yes B) No

Part V: Experience sharing/exposure visits

38) Does your MFI include experience sharing/exposure visit budget annually for the top management?

A) Yes B) No

39) Does your MFI include experience sharing/exposure visit budget annually for board members?

A) Yes B) No

40) Who plans the exposure visit/experience sharing activities of your MFI?

a. Board

b. Top management/Manager

c. Team of management with Finance head

d. Others, specify

Part VI: Source of Fund and its impact on governance

41) What are the sources of loanable fund of your MFI for its operation? (Select applicable (by putting (X) mark)

a. Shares

b. Loans from banks

c. Donations

d. Development programs from government/NGO

e. Accrued expense

f. Advances

g. Savings

42) Are board members of your MFI committed in soliciting various funds including credit to the MFI?

A) Yes B) No

43) Is the amount borrowed/received from different sources so far enough to run the business?

A) Yes B) No

44) Has your MFI ever been denied access to credit due to criteria set by the lending institutions at any time?

A) Yes B) No

45) If the answer for question 45 is yes, what are the criteria set by the lender institution which could not be fulfilled by your MFI?

a. ____________________________________

b. ____________________________________

c. ____________________________________

46) Is there any profitable activities /business opportunities that your MFI could not undertake due to lack of loanable fund which the affected the growth of your MFI?

A) Yes B) No

47) How does your MFI get market related information? Please specify it.

a. ____________________________________

b. ___________________________________

c. ___________________________________

48) Who set the interest of various products/services delivered by your MFI to its clients? You can provide more than one actor.

a) Suppliers such as the government

b) Banks

c) Market force

d) The MFI itself

e) Other, specify

49) Are there challenges in relation to setting interest rate on loans on your MFI?

A) Yes B) No

Please specify____

50) Does your MFI ever meet liquidity problem?

A) Yes B) No

51) If the answer for question 49 is yes, how many times and why was so? ____

52) what coping mechanism does the MFI use?

a. Borrowing from government banks

b. Borrowing from private banks

c. Support from NGO

d. Issuance of additional shares to member share holders

e. Issuance of shares to new members

f. Cancellation of previous loans supplied from outsiders

g. Other, please specify it _________________________

53) Are your MFI products and services being computed at their cost?

A) Yes B) No

54) If the answer for Question 53 is No, what might be the reasons please? ____

55) Is there any excess accumulation of fund in the MFI ?

A) Yes B) No

56) Is there any possibility of getting additional fund from donors or government while there is enough funds in it?

A) Yes B) No

57) If the answer for question 56 is yes, what are the main reasons?

a. ___________________________________

b. ___________________________________

c. ___________________________________

d. ___________________________________

Part VII: Interferences, Risks, Structure and regulatory challenges/Support

58) Is there any kind of government interference on your MFI which may influence the growth of your MFI?

A) Yes B) No

59) If the answer for Q58 is yes, would you mention the kind of interferences please? ____

60) Do you have risks associated with governance negligence at your MFI?

A) Yes B) No

61) If the answer for question 60 is yes, would you mention some please? _________________

62) Which institution/ could be NGO, Government or other kind/ supports your MFI in strengthening the capacity of governance to cope with risks?

63) Do you have some challenges from the regulatory authorities of the MFI?

A) Yes B) No

If yes please specify?____

64) Do you think that the ownership structure have challenges on the governance of the institution?

A) Yes B) No

If YES, please mention some of the challenges _____________________________

65) Do you have independent board members who have the profession and skills of financial analysis at your organization?

A) Yes B) No

Thank you again for your cooperation and time devotion!

Appendix II

Questionnaires II

Interview for National Bank of Ethiopia, Development Bank of Ethiopia, and AEMFI

Dear interviewee!

First of all, the researcher would like to express his gratitude for you that you have arranged your precious time for this interview. Your cooperation and support is highly appreciated and the details that you are going to provide to the researcher are highly valuable.

This questionnaire as tool of instrument is prepared for the study entitled "***A Review on Corporate Governance in Ethiopia MFIs: Learning from East African Countries***" in partial fulfillment of Maters of Business Administration at St. Mary University. The information you are going to provide is confidential and only used for the aforementioned academic purpose. Respectfully, thank you again!

Date ___________________________

Code ___________________________

1. If it is your duty, what kind of supports or services your organization is providing to the MFI sector in Ethiopia to strengthen governance?

a) Supply of fund for the development of the sector

b) Regulatory

c) Capacity building such as training, research, exposure visit, experience sharing

d) Advocacy and networking like conferences, workshops etc

e) Establishing good relations with government agencies and development partners

f) Finance supply for credit

g) Financial education and literacy promotion

h) Others, please specify____________________________________

2. What do you think are the major challenges of the Ethiopian MFI industry in relation to governance as compared to other African countries such as Rwanda and Nigeria? You can choose as many as you may feel that is right.

a) Skill and knowledge gaps

b) Lack of experience

c) Political interferences (if any, please specify……………………….)

d) Regulatory problems (supportive examples…………………………)

e) Policy challenges in relation to collateral issues in relation to land ownership

f) Others, please specify______________________________

3. What do you think are the gaps/challenges in which influences governance of micro finance institutions emanated from the working environment of the industry in Ethiopia?____

4. Do Ethiopian MFIs government and the regulatory body have lessons to learn from other African MFIs such as Rwanda and Nigeria?

a) MFIs ____

b) Regulatory body____

c) Government____

5. Does your organization have a plan to support the Ethiopian MFIs in improving problems in relation to governance issues? Y/N

If yes, would you please mention some of the major areas of improvement points in your plan?__

6. If the financial sector in Ethiopia is liberalized do you think that MFIs will cope and exist in such competitive environment as business entity? Y/N

7. If the answer for question 6 is No, what do you suggest MFIs, government and other partners should do to the sector?

a)MFIs____

b)Goverenment____

c) Other partners/NGOs____

Thank you again!!

Appendix-III

NBE Directives on MFIs

No	Dir No	Date issued	Name of directive
1	MFI/27/2015	1/26/2015	Minimum Capital Requirements
2	MFI/02/1996	10/21/1996	Contribution in Kind
3	MFI/04/1996	10/21/1996	Conditions to be Met prior to Commencement of Operations
4	MFI/07/1996	10/21/1996	Branches
5	MFI/14/2002	5/1/2002	Penalty for failure to Comply with the Requirements of proclamation No. 40/1996 and Directives of the National Bank of Ethiopia
6	MFI/15/2002	5/1/2002	Minimum Liquidity Requirement
7	MFI/16/2002	5/1/2002	Minimum Capital Ratio to be Maintained by Micro-Finance Institutions
8	MFI/29/2017	10/11/2017	Interest Rates Applicable to Micro Financing Institutions
9	MFI/21/2012	6/1/2012	Requirements for Persons with significant Influence in a Micro finance Institution
10	MFI/23/2013	3/1/2013	Requirements for Licensing and Renewal of Microfinance Business
11	MFI/28/2016	12/12/2016	Limit on Loans, Repayment period and provisioning Requirement
12	FIS/01/2012	1/1/2013	Regulation of Mobile and Agent Banking Services
13	MFI/24/2013	10/1/2013	Investment in Equities of Allied Activities
14	MFI/22/2012	11/1/2012	Manner of Financial and Operational Information Reporting
15	MFI/26/2014	12/1/2014	Fraud Monitoring

Appendix-IV
Name of MFIs Included in the Study

Name of MFI	Head office	Size	Ownership
ACSI	Bahir Dar	large	Government Affiliated
ADCSI	Addis Ababa	large	Government Affiliated
Afar	Semera	medium	Government Affiliated
Benshangulgumuz	Assosa	large	Government Affiliated
DECSI	Mekelle	large	Government Affiliated
Dire dawa	Dire Dawa	large	Government Affiliated
Gambella	Gambella	medium	Government Affiliated
Harer	Harer	medium	Government Affiliated
OCCSCO	Addis Ababa	large	Government Affiliated
OMO MFI	Hawassa	large	Government Affiliated
Somali MFI	Jigjiga	large	Government Affiliated
BusaGonofa	Addis Ababa	large	NGO Backed
Eshet	Addis Ababa	medium	NGO Backed
Gasha	Addis Ababa	small	NGO Backed
Harbu	Addis Ababa	medium	NGO Backed
Meklit	Addis Ababa	medium	NGO Backed
Metemamen	Addis Ababa	large	NGO Backed
Peace	Addis Ababa	large	NGO Backed
SFPI-	Addis Ababa	large	NGO Backed
Sidama	Hawassa	large	NGO Backed
Vision MFI	Addis Ababa	large	NGO Backed
Wasassa	Addis Ababa	large	NGO Backed
Adeday	Mekelle	medium	Private share company
AFVL	Addis Ababa	small	Private share company
Agar	Addis Ababa	small	Private share company
Rays	Addis Ababa	small	Private share company
Debo	Addis Ababa	small	Private share company
Grand	Addis Ababa	small	Private share company
Kendil	Shashemene	medium	Private share company

krershi	Adama/Naziret	small	Private share company
Lafiyeda	Addis Ababa	small	Private share company
Leta	Addis Ababa	small	Private share company
Lideta	Adigrate	small	Private share company
Nisir	Addis Ababa	medium	Private share company
Sheger	Addis Ababa	small	Private share company
Tesfa	Addis Ababa	small	Private share company
Yemsearch	Addis Ababa	small	Private share company