**CHAPTER 6: BUSINESS FINANCING**

**6.1 INTRODUCTION**

Sourcing money may be done for a variety of reasons. Traditional areas of need may be for capital asset acquisition- new machinery or the construction of a new building. The development of new products can be costly but capital may be required. Such developments are financed internally, whereas capital for the acquisition of machinery may come from external sources. In this day and age of light liquidity, many organizations have to look for short term capital in the way of loans, working capital etc., in order to provide a cash flow cushion. This chapter of the module discusses about financing of firms.

**Chapter Objectives:**

By the end of this module, trainees will be able to:

* Learn about the cost of starting an enterprise.
* Know the different sources of finance to start a business venture.
* Understand lease financing.
* Learn micro finances.
* Understand crowd funding.
* Know micro financing.
* Learn about traditional financing in Ethiopia.

**6.2 Financial Requirements**

All businesses need money to finance a host of different requirements. In looking at the types and adequacy of funds available, it is important to match the use of the funds with appropriate funding methods.

1. **Permanent Capital**

The permanent capital base of a small firm usually comes from equity investment in shares in a limited company or share company, or personal loans to form partners or to invest in sole proprietorship. It is used to finance the start - up costs of an enterprise, or major developments and expansions in its life - cycle. It may be required for a significant innovation, such as a new product development.

Equity from private investors may also be sought to take a small firm into the medium or large size category or as an exit route for the original investors. Ideally, permanent capital is only serviced when the firm can afford it; investment in equity is rewarded by dividends from profits, or a capital gain when shares are sold. It is not therefore a continual drain from the cash flow of a company, such as a loan, which needs interest and capital repayments on a regular basis. Equity capital usually provides a stake in the ownership of the business, and therefore the investor accepts some element of risk in that returns are not automatic, but only made when the small firm has generated surpluses.

1. **Working Capital**

It is short-term finance. Most small firms need working capital to bridge the gap between when they get paid, and when they have to pay their suppliers and their overhead costs. Requirements for this kind of short-term finance will vary considerably by business type. For example, a manufacturer or small firm selling to other businesses will have to offer credit terms, and the resulting debtors will need to be financed; the faster the growth, the more the debtors, and the larger the financial requirement.

A retailer, a restaurant, a public house, or other types of outlet selling directly to the public will often collect cash with the sale, however, earns the cash flow will be advantageous. In some cases, this will be sufficient to finance the start - up of a small firm, so that suppliers are effectively financing the business.

However, even these types of business may need working capital to fund temporary loses, caused by seasonal fluctuations, or to cope with prepayment of expenses such as rent payable in advance. Although short-term finance is normally used to fund the trading of a business, it is also sometimes needed to purchase assets, which are short-lived such as company vehicles, which may be changed every 4 or 5 years.

1. **Asset Finance**

It is medium to long term finance. The purchase of tangible assets is usually financed on a longer-term basis, from 3 to 10 years, or more depending on the useful life of the asset. Plant, machinery, equipment, fixtures, and fittings, company vehicles and buildings may all be financed by medium or long-term loans from a variety of lending bodies.

**6.3 Sources of Financing**

Financial resources are essential for business, but particular requirements change as an enterprise grows. Obtaining those resources in the amount needed and at the time needed can be difficult for entrepreneurial ventures because they are generally considered more risky than established enterprises. As we shall see, financing means more than merely obtaining money; it is very much a process of managing assets wisely to use capital efficiently.

Managing assets effectively is crucial because underwriting assets creates liabilities that, if uncontrolled, can devastate a business. Cash is the most important asset to manage, and to generate cash, business must generate sales. In order to generate sales, most businesses must have inventory and facilities. Service enterprises need offices and staff, and manufacturers face more extensive requirements, including plant and equipment. Assets management for the start-up entrepreneur is a matter of determining what is needed to support sales, and then gaining access to those assets at the optimum cost. The term “gaining access” is used because there are alternatives other than a cash purchase of assets. Equipment can be leased, for example, and office furniture can be rented. Manufactured products initially can be subcontracted rather than made, thereby avoiding the expense of procuring materials, equipment, and plant facilities. Entrepreneurs, therefore, have choices about what assets to obtain, when they must be obtained, and how to gain access to them.

The critical issue in financing is to assure sufficient cash flow for operations, as well as to plan financing that coincides with changes in the enterprise. Businesses obtain cash through two general sources, equity or debt, and both can be obtained from literally hundreds of different sources. The various sources of finance may be broadly be classified as follows:

**6.3.1 Internal Sources (Equity capital)**

Owner’s capital or owner’s equity represents the personal investment of the owner(s) in a business and it is sometimes called risk capital because these investors assume the primary risk of losing their funds if the business fails. However, if the venture succeeds, they also share in the benefit.

**Sources of Equity Capital**

* + - 1. ***Personal saving:*** The first place entrepreneurs should take for startup money is in their own pockets. As a general rule, entrepreneurs should provide at least half of the start- up funds in the form of equity capital.
      2. ***Friends and relatives:*** After emptying their own pockets, entrepreneurs should turn to friends and relatives who might be willing to invest in the business. The entrepreneur is expected to describe the opportunities and threats of the business.
      3. ***Partners:*** An entrepreneur can choose to take on a partner to expand the capital formation of the proposed business.
      4. ***Public stock sale (going public):*** In some case, entrepreneurs can go public by selling share of stock in their corporation to outsiders. This is an effective method of raising large amounts of capital.
      5. ***Angels:*** These are private investors (or angles) who are wealthy individuals, often entrepreneurs, who invest in the startup business in exchange for equity stake in these businesses.
      6. ***Venture capital companies*:** Are private, for profit organizations that purchase equity positions in young business expecting high return and high growth potential opportunity. They provide start -up capital, development funds or expansion funds

**Comparison of Angles and Venture Capitalist**

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| --- | --- |
| **Angels**   * Individuals who wish to assist others in their business venture, * Usually found through networks, * Reasonable expectations on equity position and ROI, * Often passive, but realistic perspective about business venture,   Exit strategy is important, | **Venture Capitalists (VCs)**   * Finance, small scale new technology and any risky idea. * Funds are more specialized versus homogeneous * High expectations of equity position and ROI, |

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| --- |
| ***ADDITIONAL REMARKS ON SAVING***  ***WHAT ARE SAVINGS?***  Savings are money or other assets kept over a period of time, usually not to be consumed immediately but in the future. Savings can be kept in a bank or any other safe place where there is no risk of loss, spending, or making profit.  **Savings can be done through**   * + **Small but regular deposits** – this happen when someone has decided to sacrifice current consumption (use of assets, e.g. of money and goods) in order to increase the availability of assets for future consumption. It therefore involves postponing expenditures in order to accumulate a sizeable amount of resources for future use.   + **Automatic deductions from salaries, wages or income** - this type of saving is not voluntary. It is a system used by most employers under the labour law.   **Advantage of saving**   * To provide for specific needs in the future * To have access to monetary or other assets whenever needed * To ensure financial independence * To make one’s own resources inaccessible for others without one’s approval * To safely store surplus * To acquire skills for proper money management and self-discipline * To qualify for certain types of loans   **Investments**  These are monetary assets purchased in the hope that they will generate income, reduce costs, or appreciate in the future. In short, investment means the use of money to make more profit in the future.  **Personal Budget**  A **personal budget** is a finance plan that allocates future personal income towards expenses**,**  Savings and debt repayment.  How to prepare a personal budget for saving purposes?  Identify your sources of income and how much you earn from each source   * Add up to get total income per month. * Track all your expenses daily, weekly or monthly * Then divide them by categories * For daily expenses, multiply each by four to get monthly expenses and add them to get a monthly total for daily expenses * Take the total income per month and subtract the monthly total for daily expenses. The difference can be taken as savings. If the difference is negative or the expenses exceed the income then:   o Cut back your expenses  o Adjust your expenses |

**6.3.2 External Sources (Debt capital)**

Borrowed capital or debt capital is the external financing that small business owner has borrowed and must repay with interest. There are different sources as discussed here below:

* + - * 1. **Commercial banks**: Commercial banks are by far the most frequently used source for short term debt by the entrepreneur. In most cases, commercial banks give short term loans (repayable within one year or less) and medium term loan (maturing in above one year but less than five years), long term loans (maturing in more than five years).

To secure a bank loan, an entrepreneur typically will have to answer a number of questions, together with descriptive commentaries.

* What do you plan to do with the money?
* When do you need it?
* How much do you need?
* For how long do you need it?
* How will you repay the loan?

**Bank Lending Decision:-**The small business owner needs to be aware of the criteria bankers use in evaluating the credit worthiness of loan applications. Most bankers refer to the five C’s of credit in making lending decision. The five C’s are capital, capacity, collateral, character, and conditions.

1. ***Capital:*** A small business must have a stable capital base before a bank will grant a loan.
2. ***Capacity:*** The bank must be convinced of the firm’s ability to meet its regular financial obligations and to repay the bank loan.
3. ***Collateral:*** The collateral includes any assets the owner pledges to the bank as security for repayment of the loan.
4. ***Character:*** Before approving a loan to a small business, the banker must be satisfied with the owner’s character. The evaluation of character frequently is based on intangible factors such as honesty, competence, willingness to negotiate with the bank.
5. ***Conditions:*** The conditions surrounding a loan request also affect the owner’s chance of receiving funds. Banks consider the factors relating to the business operation such as potential growth in the market, competition, location, and loan purpose. Another important condition influencing the banker’s decision is the shape of the overall economy including interest rate levels, inflation rate, and demand for money.

The higher a small business scores on these five Cs, the greater its chance will be of receiving a loan. In the Ethiopian context, collateral is very critical.

* + - * 1. **Micro Finances**: provide financial services mainly to the poor ,micro and small enterprises(detail to be discussed later in part 6.7)
        2. **Trade Credit**: It is credit given by suppliers who sell goods on account. This credit is reflected on the entrepreneur’s balance sheet as account payable and in most cases it must be paid in 30 to 90 or more days.
        3. **Equipment Suppliers**: Most equipment vendors encourage business owners to purchase their equipment by offering to finance the purchase.
        4. **Account receivable financing**: It is a short term financing that involves either the pledge of receivables as collateral for a loan.
        5. **Credit unions**: Credit unions are non-profit cooperatives that promote savings and provide credit to their members. But credit unions do not make loans to just any one; to qualify for a loan an entrepreneur must be a member.
        6. **Bonds:** A bond is a long term contract in which the issuer, who is the borrower, agrees to make principal and interest payments on specific date to the holder of the bond. Bonds have always been a popular source of debt financing for large companies in the western world.
        7. **Traditional Sources of Finance:** “Idir”, “equib” (detail to be discussed later in 6.5)

**6.4 Lease Financing**

Lease financing is one of the important sources of medium- and long-term financing where the owner of an asset gives another person, the right to use that asset against periodical payments. The owner of the asset is known as lessor and the user is called lessee. The periodical payment made by the lessee to the lessor is known as lease rental. Under lease financing, lessee is given the right to use the asset but the ownership lies with the lessor and at the end of the lease contract, the asset is returned to the lessor or an option is given to the lessee either to purchase the asset or to renew the lease agreement.

**6.4.1 Types of Lease**

Depending upon the transfer of risk and rewards to the lessee, the period of lease and the number of parties to the transaction, lease financing can be classified into two categories. Finance lease and operating lease.

**Finance Lease**

It is the lease where the lessor transfers substantially all the risks and rewards of ownership of assets to the lessee for lease rentals. In other words, it puts the lessee in the same con­dition as he/she would have been if he/she had purchased the asset. Finance lease has two phases: The first one is called primary period. This is non-cancellable period and in this period, the lessor recovers his total investment through lease rental. The primary period may last for indefinite period of time. The lease rental for the secondary period is much smaller than that of primary period.

From the above discussion, following features can be derived for finance lease:

* A finance lease is a device that gives the lessee a right to use an asset.
* The lease rental charged by the lessor during the primary period of lease is sufficient to recover his/her investment.
* The lease rental for the secondary period is much smaller. This is often known as peppercorn rental.
* Lessee is responsible for the maintenance of asset.
* No asset-based risk and rewards are taken by lessor.
* Such type of lease is non-cancellable; the lessor’s investment is assured.

**Operating Lease**

Lease other than finance lease is called operating lease. Here risks and rewards incidental to the ownership of asset are not transferred by the lessor to the lessee. The term of such lease is much less than the economic life of the asset and thus the total investment of the lessor is not recovered through lease rental during the primary period of lease. In case of operating lease, the lessor usually provides advice to the lessee for repair, maintenance and technical knowhow of the leased asset and that is why this type of lease is also known as service lease. Operating lease has the following features:

* The lease term is much lower than the economic life of the asset.
* The lessee has the right to terminate the lease by giving a short notice and no penalty is charged for that.
* The lessor provides the technical knowhow of the leased asset to the lessee.
* Risks and rewards incidental to the ownership of asset are borne by the lessor.
* Lessor has to depend on leasing of an asset to different lessee for recovery of his/her investment.

**Advantages and Disadvantages of Lease Financing**

At present leasing activity shows an increasing trend. Leasing appears to be a cost-effective alternative for using an asset. However, it has certain advantages as well as disadvantages.

The advantages of lease financing from the point of view of lessor are summarized below:

* **Assured Regular Income:** Lessor gets lease rental by leasing an asset during the period of lease which is an assured and regular income.
* **Preservation of Ownership:** In case of finance lease, the lessor transfers all the risk and rewards incidental to ownership to the lessee without the transfer of ownership of asset. Hence the owner­ship lies with the lessor.
* **Benefit of Tax:** As ownership lies with the lessor, tax benefit is enjoyed by the lessor by way of depreciation in respect of leased asset.
* **High Profitability:** The business of leasing is highly profitable since the rate of return based on lease rental, is much higher than the interest payable on financing the asset.
* **High Potentiality of Growth:** The demand for leasing is steadily increasing because it is one of the cost efficient forms of financing. Economic growth can be maintained even during the period of depression. Thus, the growth potentiality of leasing is much higher as compared to other forms of business.
* **Recovery of Investment:** In case of finance lease, the lessor can recover the total investment through lease rentals.

Lessor suffers from certain limitations which are discussed below:

* **Unprofitable in Case of Inflation**: Lessor gets fixed amount of lease rental every year and they cannot increase this even if the cost of asset goes up.
* **Double Taxation:** Sales tax may be charged twice. First at the time of purchase of asset and second at the time of leasing the asset.
* **Greater Chance of Damage of Asset:** As ownership is not transferred, the lessee uses the asset carelessly and there is a great chance that asset cannot be useable after the expiry of primary period of lease.

**6.5 Traditional Financing in Ethiopian (Equib/Edir, Etc.)**

While Ethiopia has one of the least-developed formal financial sectors in the world, it possessed a rich tradition in indigenous, community-based groups such as savings and credit   
associations and insurance like societies. These "iqub" and "idir" groups provide a source of credit and insurance outside the formal sector but much rooted in Ethiopian society. The contributions of these groups, especially iqub, to economic growth is difficult to quantify but can be assumed to play an important role. Iqub is a traditional means of saving in Ethiopia and exists completely outside the formal financial system. An iqub is a form of savings.

People voluntarily join a group and make a mandatory contribution (every week, pay period or month or example). The "pot" is distributed on a rotating basis determined by a drawing at the beginning of the iqub. Amounts contributed vary according to the ability of the participants. Iqub is widespread, especially in urban areas. Iqub offers a savings mechanism for the "unbanked" group in Ethiopia, both urban dwellers who do not have access to a traditional bank within a reasonable distance from their dwelling. Ethiopia has one of the lowest bank penetration rates in the world, with less than one bank branch for every 100,000 residents. Currently, real interest rates are significantly negative -- at least negative 12% so iqub has advantages over the formal financial system for participants. Ethiopian banks have been paying negative real interest rate for more than 25 years.

Additionally, the social and communal aspects of iqub give participants a confidence that they may not have in Ethiopia's shaky financial system. Most formal banks require a high level of   
collateral and/or a guarantor for loans, which discourages start-up borrowers and does not allow for borrowing for personal needs. In the absence of loans from formal banks, Ethiopians also turn to loan sharks (Arata Abedari in Amharic) who require guarantors and charge   
as much as 120% per year interest.

Iqub can be a driver of economic growth and development. At lower levels, a study by Tegegne Gebre Egziabher and Mulat Demeke (year) of the Institute for Development Research at Addis Ababa University examined small business owners in rural towns. The study found that the group surveyed most frequently used their payout for expanding their business (41% of participants). At higher levels, a prominent local businessman described iqubs in Addis Ababa with payouts in excess of 15 million birr (over $500,000). They stated that much of the construction boom in Addis is being financed with iqub rather than through the formal banking system. The central bank governor has told researchers that only 5% of the country's total loan portfolio is in construction loans, Iqub is filling a vital role in providing capital for physical infrastructure expansion.

While ‘*Iqub*’ is a means of savings and may be substitute for formal banking credit, "Idirs" are burial societies that provide a traditional form of insurance. Idir contributions are used to pay   
for expenses in the event of the death of a family member. Idir is the only means, other than personal savings, to pay for these expenses. Idir contributions are generally small compared to Iqub, usually around Br.10-25 per month. Some idirs provide additional coverage, for example, in cases of illness, destruction of a member's house or death of livestock. Due to their ubiquity and influence in their communities, Idir associations are also forming the basis for some foreign assistance programs, particularly those focused on HIV/AIDS treatment and prevention.

Ethiopia's formal financial system is extremely underdeveloped and for the most part confined to cities and larger towns. The traditional systems of Iqub and Idir are perhaps   
centuries old, yet continue to play a vital role in Ethiopia's finance. Quantifying the magnitude of funds held in these systems, particularly in iqub, is difficult. However, based on both the formal studies and anecdotal information sources, iqub provides an alternative savings and loan structure rooted in tradition, practicality and availability that acts as an engine for a portion of Ethiopia's economic growth.

**6.6 Crowd Funding**

Crowd funding is a method of raising capital through the collective effort of friends, family, customers, and individual investors or even from the general public. This approach taps into the collective efforts of a large pool of individuals primarily online via social media and crowd funding platforms and leverages their networks for greater reach and exposure.

**6.6.1 How is Crowd Funding Different?**

Crowd funding is essentially the opposite of the mainstream approach to business finance. Traditionally, if you want to raise capital to start a business or launch a new product, you would need to pack up your business plan, market research, and prototypes, and then shop your idea around to a limited pool or wealthy individuals or institutions. These funding sources included banks, angel investors, and venture capital firms, really limiting your options to a few key players.  You can think of this fundraising approach as a funnel, with you and your pitch at the wide end and your audience of investors at the closed end. Fail to point that funnel at the right investor or firm at the right time, and that’s your time and money lost.

Crowd funding platforms, on the other hand, turns that funnels on-end. By giving you, the entrepreneur, a single platform to build, showcase, and share your pitch resources, this approach dramatically streamlines the traditional model. Traditionally, you’d spend months sifting through your personal network, vetting potential investors, and spending your own time and money to get in front of them. With crowd funding, it’s much easier for you to get your opportunity in front of more interested parties and give them more ways to help grow your business, from investing thousands in exchange for equity to contributing Br.500 in exchange for a first-run product or other reward.

**6.6.2 The Benefits of Crowd funding**

From tapping into a wider investor pool to enjoying more flexible fund raising options, there are a number of benefits to crowd funding over traditional methods. Here are just a few of the many possible advantages:

Reach**:** By using a crowd funding platform   like Fundable, you have access to thousands of accredited investors who can see, interact with, and share your fund raising campaign.

Presentation**:**  By creating a crowd funding campaign, you go through the invaluable process of looking at your business from the top level its history, traction, offerings, addressable market, value proposition, and more and boiling it down into a polished, easily digestible package.

PR & Marketing**:** From launch to close, you can share and promote your campaign through social media, email newsletters, and other online marketing tactics. As you and other media outlets cover the progress of your fund raise, you can double down by steering traffic to your website and other company resources.

Validation of Concept**:** Presenting your concept or business to the masses affords an excellent opportunity to validate and refine your offering. As potential investors begin to express interest and ask questions, you’ll quickly see if there’s something missing that would make them more likely to buy in.

Efficiency**:** One of the best things about online crowd funding is its ability to centralize and streamline your fund raising efforts. By building a single, comprehensive profile to which you can funnel all your prospects and potential investors, you eliminate the need to pursue each of them individually. So instead of duplicating efforts by printing documents, compiling binders, and manually updating each one when there’s an update, you can present everything online in a much more accessible format, leaving you with more time to run your business instead of fundraising.

**6.6.3 Types of Crowd Funding**

Just like there are many different kinds of capital round raises for businesses in all stages of growth, there are a variety of crowd funding types. Which crowd funding method you select depends on the type of product or service you offer and your goals for growth. The 3 primary types are donation-based, rewards-based, and equity crow funding.

1. **Donation-Based Crowd Funding**

Broadly speaking, you can think of any crowd funding campaign in which there is no financial return to the investors or contributors as donation-based crowd funding.  Common donation-based crowd funding initiatives include fund raising for disaster relief, charities, nonprofits, and medical bills.

1. **Rewards-Based Crowd Funding**

Rewards-based crowd funding involves individuals contributing to your business in exchange for a “reward,” typically a form of the product or service your company offers. Even though this method offers backers a reward, it’s still generally considered a subset of donation-based crowd funding since there is no financial or equity return.

1. **Equity-Based Crowd Funding**

Unlike the donation-based and rewards-based methods, equity-based crowd funding allows contributors to become part-owners of your company by trading capital for equity shares. As equity owners, your contributors receive a financial return on their investment and ultimately receive a share of the profits in the form of a dividend or distribution.

**6.7 Micro Finances**

**6.7.1 What is Micro Finance?**

Microfinance is a term used to describe financial services, such as loans, savings, insurance and fund transfers to entrepreneurs, small businesses and individuals who lack access to banking services with high collateral requirements. Essentially, it is providing loans, credit, access to [savings accounts](https://www.thebalance.com/best-online-savings-accounts-4159971) – even insurance policies and money transfers to small business owners, entrepreneurs (many of whom live in the developing world), and those who would otherwise not have access to these resources.

[Dr. Mohammad Yunus](https://en.wikipedia.org/wiki/Muhammad_Yunus) is considered a pioneer of modern microfinance. He experimented with making small loans, which he funded himself, to women in Bangladesh making bamboo furniture who had previously relied on loans with unfair and predatory terms to purchase raw materials. He discovered these very tiny loans, which traditional banks did not want to make due to the perceived risks and costs, could make a disproportionate difference to a poor person and given the chance they would pay them back creating a viable business model. He would go on to found [Grameen Bank in 1983](https://en.wikipedia.org/wiki/Grameen_Bank) and win the [Nobel Peace Prize in 2006](https://www.nobelprize.org/nobel_prizes/peace/laureates/2006/yunus-facts.html) for his invention of micro finance.

**6.7.2 Importance of MFIs**

Microfinance is important because it provides resources and access to capital to the financially underserved, such as those who are unable to get checking accounts, lines of credit, or loans from traditional banks. Without microfinance, these groups may have to resort to using loans or payday advances with extremely high interest rates or even borrow money from family and friends. Microfinance helps them invest in their businesses, and as a result, invest in themselves.

While microfinance can certainly benefit those stateside, it can also serve as an important resource for those in the developing world. For example, [cell phones are being used as a way to bring financial services such as micro lending](https://www.nytimes.com/2016/09/22/business/dealbook/cellphones-not-banks-may-be-key-to-finance-in-the-developing-world.html) to those living in Kenya. In fact, women are major microfinance borrowers, making up 84 percent of loans in 2016, according to the [2017 Microfinance Barometer](https://group.bnpparibas/en/news/microfinance-barometer-2017-global-trends-sector). Most of these women – around 60 percent – live in rural areas.

The microfinance industry is also growing rapidly. In 2016, there were [123 million microfinance borrowers, for a total of $102 billion in loans](https://group.bnpparibas/en/news/microfinance-barometer-2017-global-trends-sector). India accounted for most of these borrows, followed by Vietnam, Bangladesh, and Peru.

While some have lauded microfinance as a way to end the cycle of poverty, decrease unemployment, increase earning power, and aid the financially marginalized, some experts say that it may not work as well as it should, even going so far as to say [it’s lost its mission](https://www.fastcompany.com/3036212/has-microfinance-lost-its-mission). Others argue that microfinance simply makes poverty worse since many borrowers [use microloans to pay for basic necessities](https://www.theguardian.com/global-development-professionals-network/2015/jun/10/the-microfinance-delusion-who-really-wins), or their businesses fail, which only plunges them further into debt.

For example, in South Africa, 94 percent of all microfinance loans are used for consumption, meaning, the funds are used to pay for basic necessities. This means borrowers aren’t [generating new income](https://www.thebalance.com/investments-to-live-off-357880) with the initial loan, which means they have to take out another loan to pay off that loan, and so forth and so forth. This translates into a lot more debt. However, other experts say that [microfinance can serve as a valuable tool](https://www.huffingtonpost.com/kadita-tshibaka/microfinance-poverty_b_1543925.html)for the financially underserved when used it properly. They also cite the industry’s high repayment rate as proof of its effectiveness. Either way, microfinance is an important topic in the financial realm, and if done correctly, could be a powerful tool for many.

**6.7.3 Micro Finances in Ethiopia**

Micro-finance in Ethiopia has its origin in traditional informal method used to accumulate saving and access credit by people who lacked access to formal financial institutions. Ethiopia has also more 38 MFIs (in 2018) and practice is one of the success stories in Africa even though there are certain limitations.

The history of formal establishment of Ethiopia Micro finance institution is limited to about less than twenty years (since 2000). The first groups of few MFIs were established in early 1997 following the issuance of Proclamation No. 40/1996 in July 1996. The objective of the MFIs is basically poverty alleviation through the provision of sustainable financial services to the poor who actually do not have access to the financial support services of other formal financial institutions.

The microfinance industry is growing in terms of number and size. The MFIs in Ethiopia have been able to serve the productive poor people mainly with savings, credit, money transfer, micro-insurance and other related services. Governmental and other developmental organizations have played a vital role for impressive performance the microfinance sector in the country.

The known micro finance institutions in different regions of Ethiopia with more than 90% market share are

1. Amhara Credit and Savings Ins. (ACSI) S.C.
2. Dedebit Credit and Savings Ins. (DECSI) S.C.
3. Oromiya Credit and Savings Ins. S.C (OCSCO).
4. Omo Credit and Savings Ins. S.C.
5. Addis Credit and Savings Institution S.C.(ADCSI)

**6.7.3.1 Types of Activities Carried Out by Ethiopian MFIs**

According to Article 3(2) of the aforementioned proclamation, MFIs are allowed to carry out the following activities:

* Accepting both voluntary and compulsory savings as well as demand and time deposits.
* Extending credit to rural and urban farmers and people engaged in other similar activities as well as micro and small scale rural and urban entrepreneurs.
* Drawing and accepting drafts payable within Ethiopia Micro-insurance business as prescribed by NBE,
* Purchasing such income generating financial instruments as treasury bill and other income generating activities,
* Acquiring, maintaining and transferring any movable and immovable property including premises for carrying out its business,
* Supporting income generating projects of urban and rural micro and small scale operators,
* Rendering managerial, marketing, technical and administrative advice to customers and assisting them to obtain services in those fields,
* managing funds for micro and small scale business,
* Providing money transfer services,
* Providing financial leasing services,