



PRIME

Financial Services

BACKGROUND

Over the past decade, Ethiopia has exhibited strong economic growth- and average of 10.9% per annum - compared to the regional average of 5.3% (World Bank, 2014). However, this growth has not directly translated into equitable benefits across the country's diverse population.

In pastoralist areas, for example, populations are seasonally mobile and dispersed, market systems are weak, and the cost of entry for financial and insurance providers is high. Where systems and institutions do exist, formal state-owned banks follow government priorities in lending to agriculture and industry. Available financial products, therefore, do not satisfy the sectoral and cultural needs of pastoralists and people transitioning out of pastoralism (TOPs), who are predominately Muslim and engage in micro and small enterprises. In this environment, it is difficult for a household to secure their livelihoods, expand their businesses, and ultimately become more resilient to droughts and other natural disasters that are becoming more frequent in these regions.

In PRIME areas, up to 70% of households do not have access to financial services and products. Those with access to loans (mostly through family, friends and other informal networks) took on average 20-40 USD in a year and used them largely for subsistence needs, building dwellings, as business capital and for production inputs. Data also indicates a low savings and insurance culture – both critical aspects of resilience at the household level. (PRIME baseline, 2013)

Access to Finance and Financial Inclusion

According to CGAP – the World Bank's microfinance arm – access to finance should be distinguished from

the actual use of financial services, since non-use of finance can be voluntary or involuntary. Voluntary non-users of financial services have access to finance, but do not use financial services either because they have no need for them or because they decided not to use them due to cultural or religious reasons. Involuntary non-users want to use financial services, but do not have access because they are un-bankable due to their low incomes and high collateral requirements, or due to lack of information from credit registries. PRIME's market systems approach includes activities for both groups of non-users – at the systems level by strengthening financial institutions' capacity while supporting financial product development and innovations; as well as increasing awareness and training consumers in financial literacy.

PRIME Approach to Financial Services



PRIME is a 5-year USAID-funded initiative to increase household incomes and promote resilience to climate change through innovative, scalable, market-driven approaches in pastoralist areas of Afar, Somali and Oromiya regional states in Ethiopia.

INSTITUTIONAL STRENGTHENING

Formal Institutions

Micro-finance institutions (MFIs) and larger commercial banks have the potential to mobilize greater savings and offer innovative products but due to high market-entry costs, exacerbated by an unfriendly regulatory environment, there is a severe lack of MFIs and culturally-sensitive products (such as interest-free banking for Muslim clients) in PRIME's target geographical areas. Existing institutions are also constrained by a small savings base and a reliance on supply-driven products that do not meet the needs of pastoralists. PRIME works to build these institutions' capacity and enhance product offerings, while also supporting the establishment of the first MFI in the Afar region, the second MFI in Somali region, and entry into dry-land market areas by an existing Ethiopian MFI.

Informal and Semi-Formal Institutions

Due to their close relationships with local communities, focus on small-sized loans, and their use of non-traditional forms of collateral, Rural Savings and Credit Cooperatives (RUSACCOs) and Village Savings and Lending Associations (VSLAs), have the potential to provide needed capital to low income households and support a culture of savings through practice. PRIME facilitates the establishment of new institutions, while improving the organizational and membership management, loan capital growth and product expansion of existing institutions.

To date, PRIME has provided over 11,000 households access to financial services through MFIs, commercial banks, RUSACCOs and VSLAs.

Enabling Environment

One of the PRIME's main objectives is that the environment where financial services operate is conducive to include financial services to producers and entrepreneurs in pastoralist areas. PRIME provides technical assistance to the Association of Ethiopian Microfinance Institutions (AEMFI) to support its members. PRIME has also facilitated an agreement between Dire Dawa University and Umdurman Islamic University of Sudan for technical collaboration in Islamic financial service education and is working in establishing a working group amongst Ethiopian bankers and regulators to further discussion and sharing ideas in operationalizing interest-free banking and expanding Islamic financial products that will ultimately benefit pastoralist communities in the country. The project is engaging decision-makers in ensuring policies and directives are clear to operationalize inclusive financing for Muslim clients.

Exposure Trip for Bankers and Regulators to London: The UK Islamic Finance Council, with support from PRIME, facilitated a visit to London for Ethiopian Bankers and Regulators. The training on financial products, Sharia-compliance, regulation, legal issues, political perspectives, and discussion with a Mufti, exposed bankers to a successful system that integrates conventional and Islamic banking side-by-side and created linkage/platform for further discussion and sharing of ideas. Participants will share their experience with the Ethiopian Banking/Regulatory community in order to pave the way forward to provide Islamic banking products/services to the Ethiopian community.

INNOVATIVE FINANCIAL PRODUCTS

Islamic Financial Products

One of the most critical issues in financial services in PRIME areas is that traditional products offered by institutions do not serve the predominantly Muslim population. Despite the strong demand for interest-free and Sharia compliant financial products, most financial institutions serving pastoralist areas do not yet offer them, mostly due to a perception of institutional risk in adopting these products (PRIME financial services baseline 2014). The risk is indeed high when financial institutions lack the capacity to administer and market these offerings. PRIME works with Somali MFI, Oromiya MFI, Oromiya International Bank and other associations to roll out Sharia compliant products. During a single PRIME-supported interest-free banking marketing campaign with Oromiya International Bank, for example, 283 individuals and cooperatives opened accounts, mobilizing 4.4 million ETB (220,000 USD) in savings and future loans.

Index-Based Livestock Insurance (IBLI)

Designed by the International Livestock Research Institute (ILRI), IBLI is an innovative product designed to protect pastoralists from livestock loss as a result of prolonged drought. The product uses a uniform, community-wide index threshold level to measure the occurrence of risk, eliminating the high transactional costs associated with moral hazard (hidden behavior) and adverse selection (hidden information) present in traditional insurance systems. PRIME partnered with Oromiya Insurance Company (OIC) to implement a pilot for IBLI in Borena. Using its connections with local cooperatives, PRIME helped to increase the number of policies sold from 631 in 2012 to 1140 in 2014. In November 2014, OIC paid out its first ever IBLI insurance to 510 policy holders, with a total payout of 570,000 ETB (28,500 USD).

Mobile Banking

In rural areas where bank branches may not exist, mobile banking can be a powerful tool to allow people access to financial services. In Ethiopia, however, strict regulations within the financial sector have deterred mobile banking agents (such as small shops) from operating. PRIME's Innovation Investment Fund has provided a grant for Somali MFI and the Dutch mobile money company BelCash to pilot an agent-based mobile money service in Somali region – which has recently gained Ethiopian government approval to start. It is anticipated that 50% of mobile phone users will have improved access to financial services and that over 3000 agents will increase their incomes by 25%.

Innovation In Action



Umar Abdi, a livestock trader whose monthly income increased by 50% as a result of a Murabaha loan

Somali MFI's Murabaha Loans to Livestock Traders

- » 5 million ETB (250,000 USD) disbursed since January 2014
- » 25 livestock trader clients
- » 7000 households expanded their access to markets

Strengthening Demand

PRIME's technical support to VSLAs and RUSACCOs is meant to encourage people to start saving or increase saving. The project has adopted the Private Sector Provider (PSP) model to form, train and expand VSLAs in target communities with one of its core functions to improve the financial literacy of members and engage non-members in financial awareness. In addition, PRIME has facilitated Training of Trainers for promotional agency experts to develop and rollout trainings to improve RUSACCO's core functions while developing appropriate inclusive financial products for their members.

In order to regularly market products and services, PRIME is linking commercial banks, MFIs, VSLAs and RUSACCOs with the help of influential leaders (such as Imams) to inform individuals and businesses about the availability of Islamic financial products. As a result, 496 individuals and cooperatives have opened savings accounts in one commercial bank valued at 318,000 USD, while 18 businesses opened interest-free banking accounts with a value of 70,000 USD.

KEY CHALLENGES

- » **Weak culture of savings** that affects the ability of financial institutions to mobilize funds for loans to the community
- » **Navigating, interpreting and operationalizing financial services regulations** are constant burdens to financial institutions, partners, and ultimately their clients
- » **Perception of risk** amidst the financial service sector in adopting Islamic financial products
- » **Low institutional capacity to roll out innovative products** –financial institutions and their marketing partners need to understand product offerings well to correctly inform their clients of the terms of use

Emerging Best Practices

PRIME experience has revealed four effective practices in expanding financial access in Ethiopia's pastoralist areas.

- » Focus on creating an **enabling policy and regulatory environment** with clear guidelines for financial institutions to uptake products and provide greater coverage to underserved populations
- » **Strengthen a culture of savings**, working closely with beneficiary communities in financial literacy through groups and institutions they trust
- » **Employ demand-driven mechanisms to increase loan capital**, allowing large and small financial institutions to continue expanding their products and services
- » **Use networks to promote financial products**, strengthening their uptake as evidenced by PRIME's success in marketing IBLI.

For more information on the program, please contact:

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