How to Escape the Microfinance Lending Squeeze: Evidence from Ethiopia

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Introduction

Across the world, small-scale lenders—including microfinance institutions, community-based financial institutions, and other nonbank financial institutions—have grappled with uncertainty through the COVID-19 pandemic as portfolio quality deteriorated and capital buffers were drawn down. In many contexts, the resulting scenario is one in which lending has contracted substantially, posing threats to millions of borrowers who have historically relied on small-scale credit.

Ethiopia’s microfinance borrowers—particularly micro- and small enterprises (MSEs)—are currently facing a financing squeeze that undermines their resilience during the COVID-19 crisis and threatens to slow their recovery. Although Ethiopian microfinance institutions (MFIs) entered the crisis in good financial health, they soon began to face deteriorating portfolios and a contraction in liquidity. Their resulting reluctance to issue new loans adds to the predicament of MSE borrowers who were already struggling as a result of the pandemic. Although the end of Ethiopia’s state of emergency in September 2020 has allowed for a gradual normalization of business activity in most regions, MSE lending remains depressed. This poses a challenge for firms affected by new spikes of the pandemic—such as in early 2021—and is an obstacle for a faster return to pre-pandemic levels of growth.

Drawing on data collected from a panel of major MFIs, this policy brief provides an overview of the microfinance lending squeeze in Ethiopia and outlines ways to overcome it. Sections 1 and 2 look at the impact of the COVID-19 pandemic on Ethiopian microfinance institutions and on their borrowers, respectively, and show how MFIs responded to liquidity constraints by cutting off financing to MSEs. Sections 3 and 4 discuss possible ways out of the crisis, outlining four concrete ways to “ease the squeeze” and highlighting new interventions in Ethiopia that provide emergency financing to MFIs and the MSEs they serve. The aim of this brief is to shed light on the lending squeeze in Ethiopia, and to share lessons for post-pandemic microfinance lending globally.

1 As the COVID-19 pandemic started to intensify, the government of Ethiopia declared a state of emergency under Article 93 of the Constitution on April 8, 2020.
2 The authors acknowledge Kenno Itana, Getachew Mekonnen, and Alberto Didoni for the collection of data cited in this brief and they are grateful for the support provided by the World Bank’s Africa Gender Innovation Lab.
1. The Impact of COVID-19 on Ethiopia’s Microfinance Institutions

Ethiopia’s financial sector is dominated by state-owned banks and microfinance institutions (MFIs) and—with the recent exception of the capital leasing sector—remains closed to foreign investment. While this has its downsides, this measure has effectively meant that the industry has been sheltered from international financial crises in the past, such as the Great Recession of 2007–09 (Mishra 2011). However, the global COVID-19 pandemic is different, and Ethiopia’s MFIs, in particular, are feeling its sting.

Microfinance institutions are an important pillar of Ethiopia’s financial sector. The country now has 39 MFIs, although the market is dominated by five quasi-public institutions serving the largest regional states. MFIs are regulated by the National Bank of Ethiopia (NBE) under the revised Micro-Financing Business Proclamation No. 626/2009. All registered MFIs are licensed to take deposits, but NBE data shows that public MFIs, which have access to concessional funds from regional governments, take on a lower share of deposits than their privately owned peers (World Bank 2020a). Foreign investment in Ethiopian MFIs is not allowed under existing regulation, limiting competitive pressure and the adoption of new technology. In line with the overall expansion of the Ethiopian economy, the microfinance sector has seen considerable growth in recent years. Statistics for 2018/19 show that, together, Ethiopian MFIs manage Br 58.7 billion (US$2 billion) in credit outstanding and Br 41.9 billion (US$1.44 billion) in savings deposits, with year-on-year growth of 30 percent and 26 percent, respectively (NBE 2020).

Ethiopia’s MFIs serve a large unbanked and underbanked community. According to NBE data, more than 5 million Ethiopians are currently borrowing from an MFI, compared to just 250,000 who have taken out loans from commercial banks (World Bank 2020a). While MFIs account for no more than 5 percent of total banking sector assets, they serve 20 times the number of clients of commercial banks – a statistic which underscores their systemically important role in fostering inclusive finance in Ethiopia. About 45 percent of MFI borrowers are women, and the majority live in rural parts of the country where bank branches are few and far between. To serve clients with limited access to collateral, Ethiopian MFIs use group lending mechanisms, and the average loan size of US$300 is significantly smaller than the typical amount of a collateralized loan from a commercial bank (World Bank 2020a).

In recent years, MFIs have become an increasingly important source of finance for micro- and small-business owners. Ethiopia’s business community is highly credit constrained: private sector credit from commercial banks and MFIs amounts to just 13 percent of gross domestic product (GDP), compared to an average of 22 percent for the 20 largest African economies (World Bank 2020a). Micro- and small enterprises (MSEs) face the additional challenge that commercial banks are hesitant to lend to micro- and small businesses and rarely issue loans below US$50,000 (World Bank 2015). With support from World Bank programs such as the Women Entrepreneurship Development Project (WEDP) and the Small and Medium Enterprise Finance Project (SMEFP), MFIs are filling this market gap by issuing single-borrower loans between US$5,000 and US$25,000.

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3 In addition to MFIs, microfinance services are provided by Rural Savings and Credit Cooperatives (RuSACCOs), which offer agricultural credit, as well as informal savings circles known as iqubs. However, the analysis in this brief focuses only on MFIs licensed by NBE.
### Figure 1.1: Ethiopia’s MFIs at a Glance

<table>
<thead>
<tr>
<th>Metric</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of registered MFIs</td>
<td>39</td>
</tr>
<tr>
<td>Percent of female borrowers</td>
<td>45%</td>
</tr>
<tr>
<td>Market share of five largest MFIs (percent of total credit outstanding)</td>
<td>89%</td>
</tr>
<tr>
<td>Total number of borrowers</td>
<td>≈ 5 mln</td>
</tr>
<tr>
<td>Total credit outstanding</td>
<td>Br 58.7 bln (US$2 bln)</td>
</tr>
<tr>
<td>Total savings deposits</td>
<td>Br 41.9 bln (US$1.44 bln)</td>
</tr>
</tbody>
</table>

**Source:** National Bank of Ethiopia Annual Report 2018/19; authors’ own data
A Resilient Industry...

Three structural characteristics made the Ethiopian microfinance sector relatively resilient to the kind of shock introduced by the pandemic. First, the sector was in good shape at the time the virus hit the country. Data collected from Ethiopian MFIs showed an average PAR90⁴ of 5.1 percent for the overall portfolio and 1.8 percent for borrowers under WEDP, which provides larger individual-liability loans to female entrepreneurs in urban areas.⁵ At 1.4 percent, the average cost of risk of Ethiopian MFIs (calculated as the ratio of annual loan loss provisions to total loans outstanding) was within the 1 to 2 percent range recommended by the Consultative Group to Assist the Poor (CGAP 2002), and the average capital adequacy ratio⁶ of more than 30 percent was more than twice the regulatory minimum.

Second, Ethiopia’s microfinance sector has a strong rural component. Like the overall population, the majority of Ethiopia’s MFI borrowers live in small towns and villages, and farming households make up a large part of the MFI loan portfolio. The spread of COVID-19 in rural regions seems to have been limited to date, though testing capacity is limited. Agriculture was less affected by government measures to contain the virus than other industries, although it experienced a number of unrelated stressors during the same time period including widespread displacement as a result of the conflict in the Tigray region, localized political violence in other rural regions, and a locust invasion that destroyed crops across the Horn of Africa. A major disruption of agricultural production would put a major strain on MFI balance sheets—as evidenced by the 2015–16 drought (AEMFI 2020)—but has not materialized to date.

Third, commercial viability is not an existential question for many microfinance institutions. Public MFIs affiliated with regional governments continue to dominate the industry: in 2019, the five large public MFIs made up 83 percent of the sector’s capital and 88 percent of outstanding loans. A second group of MFIs is affiliated with philanthropic organizations-community-based institutions as well as local chapters of international nonprofits. Purely commercial MFIs, on the other hand, are a relatively new phenomenon and account for a small (though growing) share of industry capital. Although some industry experts expect a consolidation of the microfinance industry as a result of the COVID-19 crisis (CGAP 2020), there are currently no indications of this happening in Ethiopia.

... Hit by a Global Pandemic

The combination of strict public health measures during the initial months of the pandemic and the drawn-out nature of the crisis has put significant strain on Ethiopia’s MFIs. On the one hand, the efforts to prevent the spread of the virus have disrupted the relationship-based business model of the microfinance industry, which relies on group lending and regular face-to-face interactions with loan officers. Ethiopian MFIs were quick to respond to the challenge: by April 2020, most MFIs were providing masks and sanitizer to staff, instituting shift work to reduce office occupancy, and replacing meetings with phone calls when possible. However, the limited adoption of mobile financial services among both MFIs and clients has meant that a shift to digital platforms and communication channels, as witnessed in other countries, has not yet occurred.

At the same time, loan portfolios have deteriorated due to COVID-19. MSEs across the country were hit hard by public health restrictions during much of 2020, and their ability to serve their outstanding loans suffered (see next section for details). Data from 11 MFIs—which together account for close to 90 percent of outstanding microfinance loans—shows that the percentage of borrowers in arrears increased significantly for all institutions. The average share of loans with payments overdue by more than 30 days

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⁴ "PAR90" is the 90-day portfolio at risk, that is, the weighted percentage of loans that have been overdue for more than 90 days.
⁵ For more information on this data, see box 1.2.
⁶ Capital to risk-weighted assets.
(PAR30) rose from 5.7 percent prior to the pandemic to 8.8 percent in June 2020, while the longer-term PAR90 indicator increased from 5.1 percent to 6.9 percent over the same period—slightly above the continental average for African MFIs reported by CGAP (2021). The end of the state of emergency in September 2020 did not have an immediate effect on portfolio health, with both indicators staying flat or increasing slightly by the end of the year.

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Though all MFIs have seen their portfolios deteriorate, the severity of the impact varies across institutions. Data from the WEDP portfolio indicates that urban MSE clients were particularly affected: the average PAR30 (PAR90) for WEDP loans more than doubled from 3.6 percent (1.8 percent) to 7.7 percent (4.3 percent) between December 2019 and September 2020, increasing faster than the rest of the portfolio. This likely explains why private MFIs—which predominantly serve urban markets that, pre-COVID, saw rapid and sustained growth—have fared worse than their larger public counterparts. The (portfolio-weighted) average PAR90 for public MFIs has increased from 5.2 percent before the pandemic to 7.4 percent in September 2020, while the average for private MFIs has jumped from 3.7 percent to 7.2 percent. This increase is particularly challenging because private MFIs, whose larger public competitors not only enjoy economies of scale but also receive concessional financing and in-kind support from regional governments, have significantly higher operational costs (13 percent of loan portfolio in 2019, compared with 6.7 percent for public institutions) as well as a higher cost of funding (5.8 percent versus 4 percent).

Because of the widespread use of payment moratoria in mid-2020, it is reasonable to suspect that the actual rate of nonperforming loans during the months previously cited was even higher. Although the Association of Ethiopian MFIs (AEMFI) reported in April 2020 that MFI managers were reluctant to consider concessional measures, this changed as the pandemic dragged on (AEMFI 2020). Of the MFIs surveyed, only one formally rescheduled loans by extending

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**Box 1.1. COVID-19 in Ethiopia**

Ethiopia registered its first case of COVID-19 in March 2020. In response, stringent public health measures such as limitations on public meetings and cross-regional transport were introduced under a five-month state of emergency that lasted from April until September 2020. The government also postponed the country’s general election until June 2021, triggering a conflict with the government of the Tigray region. Cases spiked during the summer months but gradually subsided after September, before spiking again in March and April 2021. As of early May 2021, the country has registered more than 260,000 cases and close to 4,000 COVID-related deaths (JHU 2021). However, limited testing capacity and a high positivity rate suggest a significant undercounting of cases. A vaccination campaign using the Astra Zeneca vaccine distributed via the COVAX Facility began in March 2021, but only a small percentage of the population has been vaccinated to date. Ethiopia aims to vaccinate 20 percent of its population by the end of 2021 (WHO 2021).
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their tenure by 6 to 12 months. All other institutions instead provided a payment moratorium of three to six months during which partial or nonpayment was tolerated and fees were waived. Most moratoria were “silent,” that is, the repayment moratorium was applied without notifying the clients, and all MFIs report that their moratoria ended after September 2020. Because the NBE has temporarily allowed financial institutions not to categorize rescheduled loans as substandard, a considerable segment of struggling borrowers may not be reflected in the above indicators. In several MFIs, management also seemed unclear about the full extent of the problem, suggesting uncertainty around the ultimate impact of the pandemic and a need to support stronger mechanisms for portfolio restructuring and crisis management.

Box 1.2. Methodology

This policy brief draws on two rounds of data collection on portfolio indicators from Ethiopian microfinance institutions in July/August 2020 and December 2020/January 2021. Senior management from 11 microfinance institutions (MFIs), including the five public institutions accounting for more than 80 percent of the industry’s loan portfolio, were also interviewed about the impact of COVID-19 and their institutions’ response to the pandemic. Because of the ongoing conflict in northern Ethiopia, second-round data could not be collected from Dedebit Credit and Savings Institution, the public MFI serving Tigray regional state whose operations have been severely disrupted since November 2020. The brief also draws on data collected from the same institutions for a loan pricing assessment conducted in January 2020.
2. The Micro- and Small Enterprise Lending Squeeze

The deteriorating portfolio quality of Ethiopian microfinance institutions (MFIs) as a result of the pandemic undermines the progress these institutions have made as pillars for financial inclusion. This is particularly true for micro- and small enterprises (MSEs) that, already under pressure from the fallout of COVID-19, have seen their financing options dwindle at a time when their needs are particularly urgent.

MSEs Are Suffering from the Pandemic...

As elsewhere in the world, micro- and small-business owners in Ethiopia have been severely affected by COVID-19 and the public health measures put in
place to control its spread. Also, Ethiopian MSEs experienced a demand shock after the government-issued state of emergency in April 2022 brought public life to a temporary standstill. A high-frequency survey of Ethiopian firms, conducted jointly by the World Bank and the Ethiopian Job Creation Commission (JCC), shows that the effect of the state of emergency was most acutely felt in June 2020, when close to 40 percent of businesses reported zero revenue and nearly all firms (98 percent) indicated that they had been negatively impacted by the pandemic (World Bank 2020b). Primarily as a result of reduced demand, firm profits plummeted, with 69 percent of firms surveyed reporting “significantly lower” profits compared with the previous year. Smaller businesses were more likely to be closed, while midsize and larger businesses were more likely to lay off staff—although dismissals were minimized by regulations that restricted the practice during the pandemic. Although firm closure and revenue indicators have improved markedly since the end of the state of emergency, the increase in COVID-19 case numbers registered in early 2021 points to continued uncertainty ahead (World Bank 2020b).

Data from the World Bank’s Africa Gender Innovation Lab (GIL) shows that Ethiopia’s female entrepreneurs were hard hit by the pandemic. Female-owned businesses are concentrated in trade, services, and tourism—predominantly urban, customer-facing sectors at a high risk of business closure. Although these firms showed significant growth prior to the pandemic, by September 2020 18 percent of them remained closed due to COVID-19 and the average business reported a 50 percent year-on-year decline in revenue, according to the results of a high-frequency phone survey of female MSE owners (World Bank 2020c). More than half of those businesses with outstanding loans reported missing at least one payment. These findings are supported by similar data from World Bank and JCC, which shows that the pandemic widened the gender gap in business earnings, with female-owned firms experiencing a sharper drop in revenue and profits than their male counterparts (World Bank 2020b).

...and the Lending Squeeze Is Adding to the Hurt

MSEs relying on MFI loans, and female entrepreneurs in particular, have long been credit-constrained in Ethiopia. However, the pandemic has exacerbated this financing gap. With revenue falling faster than expenses, firms have depleted their working capital, and owners have often dipped into their personal savings to cover costs. Concessional financing has been severely limited in the absence of a small-business

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**Figure 2.1: New Loans Made by Ethiopian MFIs**

![Graph showing new loans made by Ethiopian MFIs from 2-Dec-23 to 2-Nov-24.](source: Authors' data)
grants program, although some grant financing was provided by the Mastercard Foundation. Informal financing channels have also dried up over the past year, with iqubs—traditional savings associations—dissolving because of a lack of available funds (AEMFI 2020). As a result, the percentage of firms surveyed by the World Bank and JCC that expressed a need for new credit increased over subsequent rounds of data collection (World Bank 2020b). Similarly, close to two thirds of female business owners in the September GIL survey were seeking additional financing (World Bank 2020c).

Although demand for new loans is high, MFIs currently lack the liquidity to meet it. All MFIs surveyed indicated that they have encountered significant liquidity constraints as a result of the pandemic. This is a consequence of the drop in loan collections, as fewer borrowers were able to make their payments on time, combined with rising administrative costs. The growth in savings deposits also slowed, despite MFIs’ efforts to open new accounts, reach new types of customers such as local associations, and disbursing loans into savings accounts. Because few MFIs were able or willing to access commercial financing at market rates, they have instead concentrated on reducing the outflow of funds from their institution. As a result, many MFIs turned risk averse and limited lending to small businesses. Although MFIs were able to keep liquidity ratios—liquid assets as a percentage of total deposit—above the 20 percent threshold mandated by the central bank, they have done so at a cost for borrowers, and MSE owners in particular, who are facing a steep drop in new lending. This may have perpetuated the asset quality issues discussed above, as clients lost an important reason to repay existing loans when future lending became uncertain.

Figure 2.1 shows the contraction of lending from Ethiopian MFIs since mid-2020 (the period between March and June is the main season for agricultural credit, which is dominated by the public MFIs and has been less affected by the pandemic). Several MFIs issued a complete stop on new loans during this time, while others introduced restrictions on loan size and the number of borrowers. In addition to reducing lending overall, MFIs also shifted resources from urban to lower-risk rural borrowers; the drop in lending to city-based, single-borrower entrepreneurs in the Women Entrepreneurship Development Project (WEDP) is even steeper than the portfolio average.

The lending restrictions are not just a problem for new borrowers: scaling up loans over time, as a firm’s creditworthiness becomes more apparent, is key to the microfinance process. More importantly, the liquidity squeeze poses a risk to kickstarting economic growth post-COVID. Although the risk of a new wave of infections remains, public health measures have become more targeted in nature, and most economic activities have now resumed.

**Box 2.1. The COVID-19 Microfinance Squeeze across Africa**

Consultative Group to Assist the Poor data shows that Ethiopia’s microfinance lending squeeze is not an outlier (CGAP 2021). Overall, African microfinance institutions (MFIs) reported a stark decline in lending in early 2020: monthly disbursements dropped by an average of more than 80 percent year-on-year, and more than 50 percent of the total outstanding portfolio was covered by payment moratoria. Compared with Ethiopia, where a state of emergency continued to restrict business activity until September 2020, other African MFIs recovered more quickly and gradually resumed lending in mid-2020. By the end of the year, monthly disbursements almost reached pre-COVID levels. However, the level of nonperforming loans has doubled over the same period, and the profitability of African MFIs has plumme...
3. Four Ways to Ease the Squeeze

Initial evidence on policy responses to support small businesses during the COVID-19 pandemic indicates that improving access to new financing has greater benefits than allowing for deferred payments on existing debt (Cirera et al. 2021). Therefore, the low level of new lending to Ethiopian entrepreneurs remains a concern for a balanced recovery. Below are four ways to “ease the squeeze” and support Ethiopian microfinance institutions (MFIs) in providing new loans, particularly to small-business borrowers. The first is focused on providing immediate support, while the others take a longer-term perspective geared toward the future resilience of the sector.
1. Provide Additional Liquidity and Guarantees to MFIs

Liquidity constraints are a major driver behind the financing squeeze, so making new funds available to Ethiopian microfinance institutions has to be part of the response. An infusion of Br 1.2 billion (US$30 million) provided as a liquidity facility to MFIs by the National Bank of Ethiopia (NBE) early on in the pandemic helped MFIs tide over the initial months of the pandemic. However, these funds have long been disbursed, and the Ethiopian government is unable to mobilize stimulus funds at the same levels seen in high-income economies. Therefore, new financing is necessary. These funds can be mobilized directly, in the form of capital increases by shareholders, or indirectly through new financing from external sources. The latter include commercial lenders such as local banks or development finance institutions. Helping MFIs to de-risk their lending—in the form of concessional lending or guarantee facilities—will also help them to direct the new lending to the micro- and small enterprise (MSE) borrowers they may currently perceive as too risky. The World Bank has launched two such programs to support lending to Ethiopian MSEs, which are highlighted in section 4.

2. Help MFIs Better Understand Their Client Base

The COVID-19 pandemic is not affecting all firms the same way. World Bank data from Ethiopia shows that urban businesses have suffered more than rural ones, client-facing service firms more than manufacturers, MSEs more than large firms, and that female entrepreneurs have experienced particular stress. Most Ethiopian MFIs, however, only have a rudimentary understanding of their clients’ varying needs and lack the technology to properly distinguish between different types of borrowers and risk profiles. An internal World Bank study of the credit pricing policies of Ethiopian MFIs, conducted just before the pandemic, highlighted that loan terms barely vary across borrowers. Supporting MFIs with client segmentation and the diversification of their product offering is key to help them prioritize at-risk clients during future waves of the pandemic, and to grow their portfolio in the aftermath.

Although Ethiopian MFIs have professionalized their operations in recent years, their financial accounting often remains patchy, with manual bookkeeping and a lack of systematic reports. As a result, MFI management have incomplete information about the performance of their portfolios, and external stakeholders—such as shareholders, regulators, and lenders—are uncertain about the validity of the figures communicated. The introduction of the International Financial Reporting Standards (IFRS), formalized by a 2014 law, provides a framework for resolving this problem. IFRS adoption may represent a challenge for some MFIs, but the larger, government-affiliated MFIs are well placed to lead the initiative. Introducing or updating management information systems and adopting accounting practices that follow internationally accepted standards will help MFIs to better understand risk, restructure liabilities where necessary, and channel scarce liquidity to where it can be most effective. It will also increase their ability to access financing from commercial sources such as domestic banks, thus broadening their financing options in preparation for the next liquidity shock.

4. Ramp-up Digital Finance Offerings

Although Ethiopian MFIs have professionalized their operations in recent years, their financial accounting often remains patchy, with manual bookkeeping and a lack of systematic reports. As a result, MFI management have incomplete information about the performance of their portfolios, and external stakeholders—such as shareholders, regulators, and lenders—are uncertain about the validity of the figures communicated. The introduction of the International Financial Reporting Standards (IFRS), formalized by a 2014 law, provides a framework for resolving this problem. IFRS adoption may represent a challenge for some MFIs, but the larger, government-affiliated MFIs are well placed to lead the initiative. Introducing or updating management information systems and adopting accounting practices that follow internationally accepted standards will help MFIs to better understand risk, restructure liabilities where necessary, and channel scarce liquidity to where it can be most effective. It will also increase their ability to access financing from commercial sources such as domestic banks, thus broadening their financing options in preparation for the next liquidity shock.
4. World Bank Support to Relaunch Microfinance Institutional Lending

Assisting small-business owners is an important part of the World Bank’s COVID-19 response in Ethiopia. The World Bank has made US$300 million in additional financing available to Ethiopia’s Ministry of Finance via two projects: the Small and Medium Enterprise Finance Project (SMEFP), which provides loans and business services to small and medium-size enterprises; and the Women Entrepreneurship Development Project (WEDP), which focuses on smaller, female-led firms. Both operations leverage their existing networks of public and private microfinance institutions (MFIs)—and, in the case of SMEFP, commercial banks and leasing firms as well—so beneficiaries can be reached quickly. The additional COVID-19 relief financing for the two projects will support new lending to small-business owners while also supporting MFIs in better serving their borrowers at this time.
Credit Lines for Small-Business Owners

The additional financing—US$200 million for SMEFP, US$100 million for WEDP—will provide significant liquidity to Ethiopian MFIs, using the Development Bank of Ethiopia (DBE) as a wholesale lender. Participating financial institutions can borrow from DBE’s revolving line of credit to issue new loans to small-business owners. Eligibility is restricted to viable firms that were not in distress prior to the COVID-19 pandemic, and MFIs set their own loan terms to ensure their lending is commercially feasible. With an average size of US$10,000 for WEDP and US$48,000 for SMEFP, these loans are well above the typical maximum of US$1,000 to US$2,000 offered by Ethiopian MFIs—although smaller working-capital loans may be made to help firms deal with the impact of COVID. Experience shows that participating financial institutions are able to mobilize their own funds to serve small-business clients once the business case is proven.

The two programs also introduce new features to address the distress brought on by the COVID-19 pandemic for both financial institutions and entrepreneurs. WEDP has established a Rescue Facility that allows MFIs to provide payment holidays, loan extensions, and interest rate reductions to existing borrowers that have been affected by the pandemic. SMEFP, on the other hand, has created a De-risking Facility that shares in the default risk associated with lending to SMEs at this time and stops the “flight to safety” that has limited financing options for small businesses. Both projects also aim to lower the wholesale lending rate and allow for an increase in the provision of shorter-term bridge financing for viable firms, in addition to the long-term loans for those firms that are ready to invest.

Future-Proofing Ethiopia’s MFIs

Although additional liquidity is key to get MFIs lending again, increasing their capacity to understand and serve the small-business market segment will help them emerge from the crisis as stronger institutions. Thus, MFIs accessing the WEDP line of credit have access to technical assistance focusing on timely challenges such as restructuring loans, assessing the repayment capacity and existing debt load of borrowers, and tailoring credit products to specific clients, as well as stress testing and liquidity management. SMEFP offers similar support for financial institutions in its network, while also continuing its work on building a strong infrastructure for SME lending in Ethiopia, such as a movable collateral registry. This assistance is designed to help Ethiopia’s MFIs—and particularly the budding private institutions which have been severely affected by the COVID crisis—to professionalize their operations, realize productivity gains by introducing new technology, and diversify their financial base towards a sustainable, market-based approach.

A second focus is on the digital readiness of Ethiopia’s microfinance sector. This includes the introduction of new lending technologies that help MFIs to circumvent the need for traditional, fixed-asset collateral—a major constraint for borrowers, especially women. SMEFP provides technical assistance to MFIs on simplifying loan processes and reducing turnaround times through the use of alternative data, including credit bureau information. Similarly, WEDP includes a separate “WEDP X” financing window that harnesses financial technology innovations and a new movable collateral registry to enable borrowers to access loans without fixed asset collateral. Collateral-alternative products will include tablet-based psychometric tests that predict the ability of borrowers to repay a loan, point-of-sale readers that capture transaction data in a business to generate a credit score, and revenue-based financing models that better distribute both risk and upside between lender and borrower. Future-proofing Ethiopia’s microfinance institutions not only helps to mitigate the impact of the COVID-19 pandemic on SME financing, but also puts them in a better position to weather the next crisis.

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7 This work is supported by a €1.6 million grant from the European Investment Bank.
REFERENCES


