# COMPARATAIVEANALAYSISFINANMCIAL PERFORMANCEIN CASE OF WISDOM AND OMO MICRO FINANCE

## (IN CASE OF WOLKITE)

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**The Research Paper Submitted to the Department of Accounting and Finance in Partial Fulfillment of the Requirement for Bachelor of Art (BA) Degree in Accounting and Finance**

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## *ABESTRACT*

*Omo micro finance has a significant role for the development of one's country economic development by providing a credit and also a saving service for those productive clients. Though there are many factors that can affect the efficiency of the institution like, loan management and processing system, cash management, and loan collection performance. This study was conducted with the aim of analyzing the influence omo micro finance loan collection performance, specifically in garage omo micro finance and wisdom in Wolkite town using secondary data collected. This study intends to comparative analysis of financial performance in case of wisdom and omo micro finance performance of the book and employee in Wolkite omo micro finance of in order to a chive to this objectives, the study will adopted mixed research approach. Secondary data will be collected from 10 micro finance book and employee shading different positions selected through purposive/judgment sampling techniques. Moreover secondary data will be obtained from the annual financial report of Wolkite OMF. For the data analysis, descriptive statistics including table and percentage will be used to assess or described that influencing collection rate.*

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# List of Abbreviation

| | |
|---|---|
| IDA: | international development association |
| NGO: | non-governmental organization |
| MBB: | micro banker bullet |
| MF: | micro finance |
| OMF; | omo micro finance |
| WMF: | wisdom micro finance |
| ROA: | return on asset |

# CHAPTER ONE

# Introduction

## 1.1 Background of the study

Omo micro finance has a significant role for the development of one's country economic development by providing a credit and also a saving service for those productive clients. Though there are many factors that can affect the efficiency of the micro finance like, loan management and processing system, cash management, and loan collection performance. This study was conducted with the aim of analyzing the factors that influence omo micro finance loan collection performance, specifically in garage omo micro finance in Wolkite town. This study intends to comparative analysis of financial performance in case of wisdom and omo micro finance performance of the book and employee in Wolkite omo micro finance of in order to a chive to this objectives, the study will adopted mixed research .

Wisdom micro finance is the ability to think and act using knowledge, experience, understanding, common sense and insight. Wisdom is associated with attributes such as unbiased judgment, compassion, experiential self-knowledge, self-transcendence and n Wisdom is the ability to think and act using knowledge, experience, understanding, common sense and insight. Wisdom is associated with attributes such as unbiased judgment, compassion, experiential self-knowledge, self-transcendence and non at attach.

Wisdom was a deep understanding and realization of people, things, events or situations, resulting in the ability to apply perceptions, judgments and actions in keeping with this understanding. It often requires control of one's emotional reactions so that universal principles, reason and knowledge prevail to determine one's actions. Wisdom is also the comprehension of what is true coupled with optimum judgment as to action. Synonyms include: sagacity, discernment, or insight on at attach.

Omo Micro finance hat included the provision of financial serveries such as credit, saving and insurance to low income individual which fall just above the nationally defined poverty line and poor individuals which fall below that poverty line with the goal of creating social value. The creation of social value includes poverty alleviation and the broader impact of improving livelihood opportunities through the provision of capital for micro enterprise smoothing (Smith, 2006).Most poor people manage to mobilize resources to develop their enterprises and their

dwelling slowly over time. Financial services could enable the poor to leverage their initiative; accelerating the process of build in incomes; asset and economic security.

Wolkite was one of countries which adopted omo Microfinance and wisdom (OMFand WMF) as means of alleviating poverty in early nineties. Amha (2013) reported that omo Micro finance (OMF) in Wolkite was commenced in 1991 at the time the current incumbent government took office. Like other development countries the role of development organizations in Wolkite in terms of promoting the services of MF was significant. In this regard, Amaha has noted that later in the market towns development project financed by International Development Associations (IDA) government that aimed at provision of small loans to the poor engaged in micro enterprise activities, living in selected towns and fulfill the screening can be mentioned as the first successful micro financing. As Wolday (2007) reported following the economic reform in 1991, some of the none governmental organization (NGO) and government pilot credit programs engaged in financial intermediation transformed into formal (specialized or nonbank) microfinance.

The government proclamation on omo microfinance proved the way for the establishment of micro finance. Consequently, various OMF have legally been registered and started delivering microfinance services.

In Wolkite omo micro finance and wisdom micro finance are share companies that are registered and regulated by the National Bank of Ethiopia (NBE). Wolday said almost all of the MF operating in the country has a dual mission of reaching poor clients and being financially sustainable.

On the other hand, many of the omo micro finance and wisdom micro finance in Wolkite provide similar financial products and use predominantly the group lending methodology, while individual lending was employed to a limited extent Amaha, (2012). As (Bayeh, 2012) stated, the objective of microfinance as development organizations are to service the financial needs of un-served or underserved markets as a means of meeting development objectives such as to create employment, reduce poverty, help to develop existing business or diversify their activities, empower women or other disadvantaged population groups, and encourage the development of new business.

In order to meet the mentioned objectives OMF better financial performance were have a vital role. The mentioned objective of wisdom micro finance that was unique characteristic because use on line data. To improve both micro finance performances, they better know their

weaknesses and gaps in which areas are they performing well and in which did poor. This will help for better decision making to perform in cost effective way with the available resources. As was reported by Wolday (2007), the challenges that OMF and WMF in wolkite commonly face are three fold:

- It concerns, not only, financial sustainability,
- Outreach extending the services to greater numbers of poor, and
- Depth of outreach - trying to reach the poorest members of society.

As per the annual report of AEMFI (2014), the wolkite wisdom micro finance sector was unique: it is relatively young compared to the sector with the rest of omo micro finance, with the average age of 5 years. However, the sector has witnessed for rapid growth, an aggressive drive to achieve scale, broad geographic coverage. As per the same report this was due to the dominance of government backed OMF focus on rural house hold, provision of both credit and saving services and emphasis on sustainability. Whereas wisdom micro finance focuses in urban population However the status financial performance of Wolkite MF in relation to industry standard is not evaluated regularly. Therefore, this seeks to evaluate the financial performance of sample WMF and OMF operating in wolkite.

## 1.2 Statement of the Problem

To achieve these objectives the Wolkite town micro finance omo also established to provide financial service for poor e. many purpose of accounting in general and financial performance of in a particular is to provide financial information to be used for decision making .for example ,business executive and manager need the financial information provided by accounting system to help them to plan .con troll and evaluate companies business operation out sider such as micro finance potential.

The very rational behind for the emergency of WMF and OMF was to help poor people who are financial constrained and vulnerable, with financial services to enable them to engage in productive activities or start small businesses as stated in Consultative Group to Assist the Poor (CGAP, 2009).both micro finance provide financial services to low-income, economically active, borrowers who look for relatively small amounts to finance their businesses, manage emergencies, acquire assets, or smooth consumption (CGAP, 2003). But it is common that borrowers might lack credit histories, collateral, or both, and thus, do not have access to financing from mainstream commercial banks. For this reason, OMF are seen as playing a role in the creation of economic opportunity, and in poverty alleviation (CGAP, 2003).

Wolkite omo Micro Financing and wisdom micro finance Business proclamation No. 626/2009 also supported that both micro finance micro financing play important role in providing access to financial services to rural farmers and people engaged in other similar activities as well as micro and small-scale rural and urban entrepreneurs.

Performance effectiveness was necessary to reach large number of poor and to provide adequate financial service in sustainable fashion. To achieve their prime objective which was alleviating poverty, MF should be able to perform effectively in their outreach and sustainability.

Regarding OMF performance in Wolkite different researches have been conducted. To mention some of them; assess the financial performance and challenges of MF Ebsa et. al, (2012); However, this study has focused only selected issues such as the Legal frame work of micro-finance, Licensing of micro-financing business, Operational and financial requirements, Structure of ownership of micro-finance , The Financial performance of Micro finance and Challenges of the Micro Financing Industry, where financial performance of MF on this study focuses mainly on the number of clients and the amount of loan granted by the microfinance and the market share of the big MF in the country. Whereas the financial performance of wisdom can better be assessed compressively by considering detail and comprehensive indicators compared to the industry standard in this study.

Other studies by Befekadu, (2007) outreach and financial performance analysis of MF in Wolkite from NBE and financial performance analysis of a sample of Micro Finance Wolkite. (Letenah,2009).From the above studies, Letenah has conducted financial performance analysis on the OMF operating in wolkite and indicates the status of financial performance of Wolkite. To the knowledge of the researcher, since 2009 no study was conducted regarding the financial performance of WMF and OMF with comparing against the industry standard. Besides, the MF environment in Wolkite was changed every time in terms of number of both micro finance, size of investment and other economic factors, the researcher believes that conducting financial performance assessment on wisdom and omo micro finance was appropriate. In this study the researcher dealt with on assessing the financial performance effectiveness of WMF and OMF in Wolkite operated in by compared with the financial performance standards set by Micro banking Bulletin (MBB) from MIX Market online website. In other words the study dealt on that whether omo micro finance of Wolkite have good financial performance compare to wisdom micro finance

## 1.3 Objectives of the study

### 1.3.1 General objectives

Comparative analysis of financial performance in case of wisdom and omo micro finance financial performances from year 2004 to 2008.

### 1.3.2 Specific objectives

- ❖ To evaluate the impact of both micro finance
- ❖ To assess the effect of capital adequacy on both micro finance
- ❖ To measure the importance of asset quality on wisdom and omo micro finance
- ❖ To assess the role of management efficiency on wisdom and omo micro finance
- ❖ To investigate the impact of earning quality on both micro finance
- ❖ To assess the effect of liquidity, profitability and leverage ratio of both micro finance
- ❖ To assess top profitable wisdom and omo micro finance.

**Basic Research question**

- ✓ Why both micro finance negatively affect micro finance?
- ✓ What was the Capital adequacy of the both micro finance affects?
- ✓ How Asset quality affects wisdom and omo micro finance?
- ✓ Why Management affects wisdom and omo micro finance?
- ✓ Why retain earning affects in wisdom and omo micro finance?
- ✓ Why Liquidity, profitability and leverage affect wisdom and omo micro finance?
- ✓ How assess profitability?

## 1.4 Significance of the study

The findings of this study are expected to be significant for the following reasons: The findings of this study will help omo micro finance, within an insight into the benefits of using different factors studied in this research to appraise their performances. Government and other parties concerned in the financial performance improvement of WMF may use the findings of the study as additional information to address the problems uncovered in the area. In addition both graduate and undergraduate students may find the study relevant for their academic work. Therefore the above mentioned parties may use the study as a stepping-stone for further study in the area at an advanced level. Furthermore the findings may also be considered as important additions to the existing knowledge and literature in the area for the public at large.

## 1.5 scope of the study

The scope of the study was limited to the financial performance of wisdom and omo micro

finance excluding other activities that carried out by the company .it is also limited to the analyzing and interpreting ratio; trend and comparative. The researcher has been excluded the financial performance of this fiscal (audited financial performance of fiscal year) .the researcher has been used the audited financial performance five consecutive year (2004, 2005, 2006, 2007, 2008) the researcher study was not free from limitations.

## 1.6 Limitation of the study

There was some issue which has hindered the attainment of the study objective. Some limitations that the research face was shortage of time note to assess all aspect of the company operation unable to gather desire information or lack of adequate information mainly because of some time there is no internet connection since the researcher manly used secondary data .as a result of the above limitation the researcher could not conduct as the aim and on time.

## 1.7 Organization of the study

The research report will organize five chapters. The first chapters were study the background of the study, statement of the problem, objectives of the study, and significance of the study scope of the study, limitation of the study, and organization of the study. The second chapters were study about the literature review. This gives an insight issues related to the review of the theoretical and empirical literatures which has previously done on the area. The third Chapter was study the research methodology. This part provides the types and sources of data, methods of data collection and analyzing the collected data. The fourth Chapter was study about the analysis and interpretation. This part discusses the overall part of the findings from analyzing the data which provides to give some suggestions regarding to the thesis in general and it becomes a stepping-stone for concluding the remarks. The conclusions drawn from the findings, the recommendations made to address the factors identified on the growth of MF, and the implications of the findings for future research, practitioners, government and other support agencies.

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# CHAPTER TWO
# INTRODACTION

## 2. Literature Review

Under this chapter the theoretical and empirical evidences focusing on the factors of microfinance performances are reviewed. The first topics study the overall theoretical overview of microfinance financial performance concepts. The second topics study review of empirical studies on the financial performance analysis and determinant factors of both micro finance performance.

## 2.1. Theoretical Overview of wisdom and omo micro finance

The theoretical framework was, through a review of existing literature within the wisdom and omo micro finance field, serve as a plat form for the forthcoming empirical study.

### 2.1.1. Definition of omo Microfinance

Ledger wood (1999) defines omo microfinance as the provision of financial services like savings, credit, insurance and payment services to low-income clients, including the self-employed. In addition, Ledger wood presented microfinance activities as follows:

- Small loans, typically for working capital Informal appraisal of borrowers and investments
- Collateral substitutes, such as group guarantees or compulsory savings
- Access to repeat and larger loans, based on repayment performance
- Stream line loan disbursement and monitoring

### 2.1.3. Definition wisdom micro finance

Wisdom is the ability to think and act using knowledge, experience, understanding, common sense and insight. Wisdom is associated with attributes such as unbiased judgment, compassion, experiential self-knowledge, self-transcendence and non-attachment, and virtues.

### 2.1.4. Functions of omo micro finance

OMF provide financial services to low-income, economically active, borrowers who look for relatively small amounts to finance their businesses, manage emergencies, acquire assets, or smooth consumption (CGAP, 2003). These borrowers frequently lack credit histories, collateral, or both, and thus, do not have access to financing from mainstream commercial

banks. For this reason, MF are seen as playing a role in the creation of economic opportunity, and in poverty alleviation (CGAP, 2003).

### 2.1.5. Functions of wisdom micro finance

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- An element of personal character that enables one to distinguish the wise from the unwise. A piece of wise advice.
- The discretionary use of knowledge for the greatest good.
- The ability to apply relevant knowledge in an insightful way, especially to different situations from that in which the knowledge was gained*)*
- The ability to make a decision based on the combination of knowledge, experience, and intuitive understanding.
- The ability to know and apply spiritual truths.

## 2.2. History of wisdom and omo Microfinance: Global Perspective

Microfinance arose in the 1980s as a response to doubts and research findings about state delivery of subsidized credit to poor farmers. In the 1970s government agencies were the predominant methods of providing productive credit to those with no previous access to credit facilities—people who had been forced to pay usurious interest rates or were subject to rent seeking behavior Ladger wood (1999).

## 2.3. Sources of wisdom micro Finance in Wolkite

In Wolkite there are different sources of financial services. According to Wolday (2007) the major sources of loans or financial services in wolkite are as follows;

A. Commercial banks
B. MF
C. Cooperatives (savings and credit cooperatives and multipurpose cooperatives);
D. NGOs which are involved in the delivery of financial services
E. Governmental projects and programs involved in providing loans
F. Semi-formal finance (Iqqub, Iddir, Maheber, etc.)
G. Informal finance (money lenders/traders, suppliers credit, friends, relatives, etc.)

In his study the researcher mentioned the specific intervention that would contribute to the growth of WMF as follows:

1. Improving the institutional capacity of the MF by introducing an efficient organizational structure

2. Creating an enabling legal, regulatory and policy environment;
3. Selective donor support: and

OMF in Wolkite encounters different problems that hinder them to operate effectively to provide financial service to the poor. Muluneh (2008) mentioned some of the problems encountered OMF in Wolkite as follows.

- ✓ Poor Management Information System (MIS): Muluneh also added that the MIS of the micro finance in wolkite is not well organized to capture data and produce reliable report, which has led to weak internal control which opens loopholes for fraudulent Activities.
- ✓ Weak capital position: Muluneh also documents that as both micro finance shareholders have not paid there subscribed capital of the institution, capital position is week
- ✓ Poor saving mobilization: The other major weakness that WMF and OMF in wolkite
- ✓ Commonly face is lack of proper voluntary saving mobilization strategy and effort from the public. It is reported that the both micro finance are mainly engaged in mobilization compulsory saving for collateral purpose.

Violations pertaining to the Proclamation and directive set by the NBE: as well as own policies and procedure wisdom and omo micro finance.

- ✓ Inappropriate provisioning for non-performing loans reporting
- ✓ Untimely submission of financial reports and audit reports
- ✓ Untimely renewal of wisdom and omo micro finance business license
- ✓ Calculation of interest on past due loans exceeding one year
- ✓ Governance problem: Since the Board is established to oversee the activities of the management of the wisdom and omo micro finance it should fulfill the requirements of the shareholders, the NBE and other stakeholders. Some of the problems
- ✓ Irregularities of meetings by GA and bod due to preoccupation in other duties, lack of commitment & interest and lack of technical knowledge on the sector.
- ✓ Poor follow up and supervision exercised by the management in overseeing implementation.
- ✓ Distortion Weak internal control of wisdom and omo microfinance

- ✓ Of WMF and OMF Market; there are many unlicensed operators that are provided credit services to the potential market of the licensed wisdom and omo micro finance.
- ✓ Lack of loanable fund to expand outreach by the industry
- ✓ Absence of efficient legal system to enforce contract

Alemu (2002) in his study mentioned that fraud is the challenge to institutional sustainability of wisdom and omo micro finance in wolkite. Fraud practices in wisdom and omo micro finance reduce its financial performance both in terms of the volume of saving and portfolio quality, and also decreases its reputation as a dependable micro finance in the eyes of its stakeholder mainly of clients.

## 2.4. wisdom and omo micro finance indicator and financial performance indicators

As Ledger wood (1999) indicates, financial performance indicators usually are in the form of ratios, that is, a comparison of one piece of financial data to another. Comparing ratios over a period of time is referred to as *trend analysis,* which shows whether financial performance is improving or deteriorating.

According to the writer, financial performance indicators are organized into six categories:

1. Portfolio quality,
2. Productivity and efficiency,
3. Financial viability, Profitability,
4. Leverage and capital adequacy, Scale,
5. Outreach, and
6. Growth.

On the other hand CGAP (2006) explained that the core financial performance indicators for wisdom and omo micro finance recommended in Good Practice Guidelines for Funders of Microfinance categorized in to five by far relates to Ledger wood's categorization;

1. Breadth of outreach: How many clients are being served?
2. Depth of outreach: How poor are the clients?
3. Loan repayment (portfolio quality): How well is the lender collecting its loans?
4. Financial sustainability (profitability); is the MF profitable enough to maintain and expand its services without continued injections of subsidies? And
5. Efficiency; how well does the OMF control its operating costs?

In another bulletin of CGAP (2009) justified that the five indicators suggested by CGAP (2006) do not capture all relevant aspects of OMF performance. It indicates that additional assessment indicators need to be set by most funding agency project officers and investment analysts, and certainly wisdom and omo micro finance managers, for any given MF. Besides it is also indicated to include other important dimensions, like governance quality, that simply cannot be quantity.

## 2.5. Breadth of Outreach: Number of clients served

According to CGAP (2009) the best measurement of outreach was straight forward that is the number of clients or accounts that are active at a given point in time. The number of active clients includes borrowers, depositors, and other clients who are currently accessing any financial services. This indicator is more useful than the cumulative number of loans made or clients served during a period. Among other distortions, cumulative numbers make both micro finance that offers short-term loans look better than one that provides longer term loans, even though the latter may be more valuable for borrowers. To reflect actual service delivery, membership-based organizations should report on active clients, not just the number of members: members may be inactive for long periods, especially in financial cooperatives.

As Ledger wood cited Paxton and Fruman (1998), providing financial services to those excluded from formal financial services, and then it is important to define which sectors of society have little or no access to formal finance.

## 2.6. Depth of Outreach: Client poverty level

Rama and Tamrat (2013) explained outreach as the average loan size broken down by size dimensions. Average loan size by itself is a blunt and possibly inaccurate measure of depth. A more useful way to use average loan size was to break it down into its seven distinct dimensions, each of which can be measured: dollars disbursed, average balance, term to maturity, dollars per installment, time between installments, number of installments, and dollar years of borrowed resources. Smaller values along each dimension generally mean smaller loans and poorer borrowers.

According to Good Practice Guideline published by CGAP in 2006, Outreach depth or Client poverty level indicator refers to the average outstanding balance per client or account as a proportion of Gross National Income per capita as indicated in the following formula.

$$Average\ Oustanding\ Balance = \frac{Gross\ Amount\ of\ Loans\ or\ Savings\ outstanding}{Number\ of\ active\ clients\ or\ accountt}$$

This indicator is often shown as a percentage of per capita Gross National Income (GNI):

$$GNI = \frac{Ave.\ oustanidng\ loans\ or\ saving\ balance\ per\ client}{GNI\ per\ capita}$$

The guide line explains that the average outstanding balance includes only loan amounts that clients have not yet repaid, or savings that clients have not withdrawn. This point-of-time number should not be confused with total amounts loaned or deposited during the reporting period, or with the average initial amount of the loans in the portfolio.

Average outstanding balance is roughly related to client poverty, because better off clients tend to be uninterested in smaller loans or deposit accounts. But the correlation between account balances and poverty is far from precise.

As per the same guide line, low account sizes do not guarantee a poor clientele and in a similar way growing in average loan size does not necessarily mean that micro finance is suffering from "mission drift." It is obvious that most micro finance have a sequential ladder of loan sizes for clients. As an OMF matures and growth slows, a lower percentage of its clients are first-time borrowers, and average loan sizes will rise even if there has been no shift in the market it is serving. Likewise, MFIs sometimes discover that their limits on the size of initial loans are unnecessarily conservative; relaxing those limits produces loan size growth that has nothing to do with abandoning poorer clients

Ledger wood explained that the depth of outreach is proxies by average loan size or average loan size as a percentage of GDP per capita.

As Rama and Tamrat (2013) cited Degefe (2007) in that outreach depth is also measured by the following parameters.

- The extent of gender composition ( more women participation means deeper Outreach)
- The urban – rural composition of clients ( the more rural, the deeper the outreach)
- Household characteristics ( female headed, large household size, high dependency ratio, and older population represent vulnerable groups and if reached indicates depth of outreach)
- Educational status (illiteracy and low level of education indicate vulnerability) as Hulme and Musley (1996) cited in Bayeh (2012), without serving the poor the supposed objective Of both Micro Finance is no longer different from a bank. Their argument is that outreach should not be measured by just total number of clients but it should rather be based on the number of poor clients

## 2.7 Schools of Taught Regarding Depth and Width of Outreach

Letenah (2009) states that the different perspective on which the both micro finance financial performance is measured has created two opposing but having the same goals schools of taught about the microfinance industry. The first one is called welfarists and the second one is institutionalism. As Robinson (2001) cited in Rama and Tamrat (2013) explained that Microfinance 1990s was marked by the major debate between the leading views, the financial systems approach and the poverty lending approach. The two major concepts in this definition, the financial systems approach and the poverty lending approach, are equivalent to width and depth of outreach, respectively.

## 2.8. Portfolio Quality

According to CGAP (2009), a retail lender's ability to collect loans is critical for its success: if delinquency is not kept to very low levels, it can quickly spin out of control. Furthermore, loan collection has proved to be a strong proxy for general management competence. It was mentioned also ratios can be vague rather than clarify financial performance if they are not calculated according to international standards. Therefore, whenever any measure of loan repayment, delinquency, default, or loss is reported, the numerator and denominator of the ratio should be explained very precisely.

Ledger wood (1999) stated also Portfolio quality ratios provide information on the percentage of nonearning assets, which in turn decrease the revenue and liquidity position of an MF. Various ratios are used to measure portfolio quality and to provide other information about the portfolio even though they are all referred to here as portfolio quality ratios. The ratios are divided into three areas: Repayment rate, Portfolio quality ratio and Arrears rate.

**A .Repayment rates**

Repayment rates measure the amount of payments received with respect to the amount due, whereas other ratios indicate the quality of the current outstanding portfolio.

**B. Portfolio quality**

Three ratios are suggested here to measure portfolio quality: the arrears rate, the portfolio at risk and the ratio of delinquent borrowers.

**C. Arrears rate**

The arrears rate is the ratio of overdue loan principal (or principal plus interest) to the portfolio outstanding:

The arrears rate shows how much of the loan has become due and has not been received. However, the arrears rate understates the risk to the portfolio and understates the potential severity of a delinquency problem, because it only considers payments as they become past due, not the entire amount of the loan outstanding that is actually at risk.

**3. Portfolio at Risk**

The portfolio at risk refers to the outstanding balance of all loans that have an amount overdue. Portfolio at risk is different from arrears because it considers the amount in arrears plus the remaining outstanding balance of the loan. The portfolio at risk ratio reflects the true risk of a delinquency problem because it considers the full amount of the loan at risk this is particularly important when the loan payments are small and loan terms are long.

The number of days (x) used for this measurement varies. In microfinance, 30 days is a common breakpoint.

The PAR ratio should also include the outstanding value of all renegotiated loans, including rescheduled and refinanced loans, because they have higher than normal risk, especially if any payment is missed after the renegotiation.

**4. Loan Loss Provision**

The loan loss provision is the amount expensed in a period to increase the loan loss reserve to an adequate level to cover expected defaults of the loan portfolio. It is based on the difference between the required loan loss reserve and the current outstanding loan

**5. Loan Loss Rate**

There are two loan loss ratios that can be calculated to provide an indication of the expected loan losses and the actual loan losses for Micro Finance. The first is the loan loss reserve ratio and the second, the loan loss ratio.

## 2.8. Financial Sustainability and Profitability

The term sustainability is a common term used in the microfinance industry, it is used interchangeably with self – sufficiency, financial self - sufficiency, profitability, financial sustainability, viability, financial efficiency, Ledger wood, (1999). As Rama and Tamerat (2013) cited Degafe (2007) sustainability is defined as it is the long-term availability of the means required for the long-term achievement of goals. The same source also indicated that financial sustainability means that the Both Micro Finance is able to cover all its present costs and the costs incurred in growth, if it expands operations. It would mean that the MF

is able to meet its operating expenses, its financial costs adjusted for inflation and costs incurred in growth.

According to CGAP (2009), in banks and other commercial institutions, the most common measure of profitability is return on assets (ROA), which reflects that organization's ability to deploy its assets profitably, and return on asset, which measures the returns produced on the owners' investment. CGAP also stated about the profitability ratio measurement as follows;

- Profitability ratios measure wisdom and omo micro finance's net income in relation to the structure of its balance sheet.
- Profitability ratios help investors and managers determine whether they are earning an adequate return on the funds invested in the both micro finance.
- It assesses that does the MF earn enough revenue excluding grants and donations to make a profit

According to Ledger wood (1999), Profitability ratios stated as a percentage of return on assets (ROA), a return on business (ROB), and a return on equity (ROE).it was explained also Business refers to the result of adding assets and liabilities together and dividing by two; this ratio is useful for Mf that fund a majority of their assets with mobilized savings. The major ratios that help in measuring the profitability are briefly explained in the next text.

**Return on Asset**

Return on asset (ROA) falls within the domain of profitability measures and tracks wisdom and omo ability to generate income based on its assets. The ratio excludes non-operating income and donation. ROA provides a broader perspective compared to other measures as it transcends the core activity of both micro finance, namely providing loans, and tracks income from all operating activities including investment, and also assesses profitability regardless of the both micro finance funding structure. As per Katsushi.*et.al* (2011) ROA is expected to be positive as reflection of the profit margin of the omo micro finance and wisdom , otherwise it reflects non-profit or losses.

The return on assets (ROA) ratio measures the net income earned on the assets of an MF. For calculating the return on assets, average total assets are used rather than performing assets, because the organization is being measured on its total financial performance, including decisions made to purchase fixed assets or invest in land and buildings (in other words, using funds that could be used for other revenue-generating investments) or invest in securities.

Factors that affect the return on assets ratio are varying loan terms, interest rates and fees, and changes in the level of delinquent payments. The split between interest income and fee income also affects this ratio if loan terms and loan amounts change.

## Leverage ratio

Leverage refers to the extent to which wisdom and omo micro finance borrows money relative to its amount of equity. Capital also serves as a base for borrowing. Two common sources from which wisdom and omo micro finance borrow funds (leverage their capital base) are bank loans (commercial or central banks) and client deposits. An MFI's leverage is measured by calculating its debt to equity ratio. The debt to equity ratio states how much debt an OMF has relative to its equity Ledger wood, (1999).

$$\text{Leverage ratio} = \frac{Debt}{Equity}$$

As Bayeh cited, Kyere boah (2007) found that highly leveraged both microfinance have higher ability to deal with moral hazards and adverse selection than their counterparts with lower leverage ratios. As he also cited Ganka (2010), it states although how the capital has been structured affects the financial sustainability, having different sources of capital do not improve financial sustainability. He also mentioned that Ganka also identified that equity is a relatively cheaper source of financing and, therefore, improves financial sustainability.

According to Katsushi.*et.al* (2011), the major indicator used for measuring the financial performance of MFIs is efficiency. Efficiency of wisdom and omo micro finance is measured by the share of operating expense to gross loan portfolio in most cases. The ratio provides a broad measure of efficiency as it assesses both administrative and personnel expense with lower values indicating more efficient operations,

As Bayeh (2012) explained, the efficiency refers to the ability to produce maximum output at a given level of input, and it is the most effective way of delivering small loans to the very poor in microfinance context. This involves cost minimization and income maximization at a given level of operation, and it has an enduring impact on financial sustainability of microfinance institutions. Thus, efficiency can be measured by its productivity (for instance, number of borrowers per staff) and cost management (for instance, cost per borrower) dimensions.

Ledger wood (1999) showed that operating costs can also be broken down to measure the efficiency of specific cost elements such as salaries and benefits, occupational expenses such as rent and utilities, or travel. Since salaries and benefits generally make up the largest portion of operating costs, the ratio of salaries and benefits to the average portfolio outstanding is often calculated, as well as the average credit officer salary with the country's per capita GDP. Some of the ratios that measure efficiency are explained hereunder.

:

Christen *et.al* (1995), explained that successful wisdom and omo micro finance tend to have operating cost ratios. The following are components to determine the ratio.

| Financial l performanceIndicators | Variables | Definition | Measurement |
|---|---|---|---|
| ***Breadth of Outreach*** | Number of borrowers | the number of poor loan clients served by microfinance Institutions. | Number of borrowers with loans outstanding, adjusted for standardized write-offs |
| | Gross Loan Portfolio (GLP) | Gross Loan Portfolio, adjusted for standardized write-offs | Gross Loan Portfolio, adjusted for standardized write-offs |
| ***Depth of Outreach*** | Average loan balance per borrower | It is the adjusted gross loan per adjusted number of active borrowers | Adjusted Gross Loan Portfolio/ Adjusted Number of Active Borrowers |
| | Average loan balance per depositor per GNI per capita | Is the average outstanding balance per client or account as a proportion of Gross National Income per capita | Adjusted Average Loan Balance per Borrower/ GNI per Capita |

| | | | |
|---|---|---|---|
| | Percent of female Borrowers | The extent of gender composition of women clients or proportion of women from total loan clients. | Number of active women borrowers/ Adjusted Number of Active Borrowers |
| ***Portfolio Quality*** | Portfolio at risk ≥30 days | Is the outstanding balance of all loans that have an amount overdue | Outstanding balance, portfolio overdue> 30 Days + restructured portfolio/ Adjusted Gross Loan Portfolio |
| | Loan loss rate | If a loan that was previously written off is recovered | (Adjusted Write-offs - Value of Loans Recovered)/ Adjusted Average Gross Loan Portfolio |
| ***Financial Sustainability and Profitability*** | Return on assets | measures and tracks MFIs' ability to generate income based on its assets | (Adjusted Net Operating Income - Taxes)/ Adjusted Average Total Assets |
| | Return on equity | it measures the return on funds that are owned by the MFI | (Adjusted Net Operating Income - Taxes)/ Adjusted Average Total Equity |
| | Operational self sufficiency | MFIs generating enough operating revenue to cover operating expenses, financing | Financial Revenue/ (Financial Expense + Impairment Losses on Loans + Operating Expense) |
| | | Costs, and the provision for loan losses. | |

| | | | |
|---|---|---|---|
| ***Efficiency*** | Operating expense/ GLP ratio | comparison between an MFI's portfolio yield with its personnel and administrative expenses—how much it earns on loans versus how much it spends to make them | Operating expense/gross Loan Portfolio |
| | Cost per borrower | the cost of providing loans based on the number of loans made | Adjusted Operating Expense/ Adjusted Average Number of Active Borrowers |
| ***Productivity*** | Borrowers per staff member | Measures the number of Borrowers that got service per a staff member. | Adjusted Number of Active Borrowers/ Number of Personnel |
| ***Capital Structure & Asset Allocation*** | Debt Equity ratio | It measures to the extent to which an MFI borrows money relative to its amount of equity. | Total Liability/Total Equity |
| | Gross Loan Portfolio to Total Asset ratio | It measures the portion of loan to the total asset the MFI owns. | Adjusted Gross Loan Portfolio/ Adjusted Total Assets |

Source: Own summary from the literature review

## 2.9 Empirical Review of Studies Conducted on the financial performance of Omo micro finance and wisdom micro finance

There are some studies conducted on the financial performance and related issues of omo micro finance and wisdom micro finance operated in wolkite. Some of the studies, which are found more relevant to this particular study, are reviewed as follows.

Relatively recent research was conducted by Letenah (2009) on financial performance analysis of sample micro finance in wolkite. The study has tried to review various criteria by comparing with MBB bench mark and for some relative ratios comparison among them. The researcher found data from online only for 2 MF from the MIX Market website. For data analysis, he has

used one sample t test, one way ANOVA with Scheffe Post Hoc Comparison tests, Kruskal-Wallis test and Pearson correlation coefficients.

The research concluded that omo micro finance and wisdom in wolkite in general are poor performers on depth of outreach. They are not reaching the poorest of the poor. It was noted that the MF are also poor in terms of the ratio of GLP to assets, allocating a lower proportion of their total assets in to loans. They are also not using their debt capacity properly. The large and smaller MF are allocating more loan loss provision expense than the industry average and the related PAR is high for these MF. Wisdom and omo micro finance are good at breath of outreach, cost management, efficiency and productivity. They also charge low interest rates. The profitability and sustainability of the omo micro finance and wisdom depend on their size. From a simple correlation analysis it is found that there is a tradeoff between serving the poor and being operationally self-sufficient. MF age correlates positively with efficiency, productivity, the use debt financing (commercialization) and OSS. It is also found that the use of debt financing makes firms more efficient and productive.

The study conducted by Adino (2007) Outreach and Sustainability of the Amhara Credit and Saving Institution (ACSI), wolkite by using secondary data the operational and the audited financial reports for the period 2004 to 2008. Another study conducted by Befekadu (2007) entitled outreach and

Financial performance analysis of microfinance in Wolkite. It aims to assess the financial performance of micro finance in Wolkite from different angles using data obtained secondary source .secondary data.

From financial sustainability angle, it finds that omo micro finance and wisdom are operational sustainable measured by return on asset and return on equity and the industry's profit financial performance is improving over time. Similarly, using dependency ratio and Non-performing Loan (NPLs) to loan outstanding ratio proxies the study also finds that two micro finance are financial sustainable. Finally, it finds no evidence of trade-off between outreach and financial sustainability.

Bayeh (2007) studied on the Financial Sustainability of Microfinance in

Wolkite, which aimed at identifying factors affecting financial sustainability of MF in wolkite. The study followed a quantitative research approach using a balanced panel data from 2004-2008. The researcher the researcher used panel which is deemed to have advantages over cross section and time series data methodology.

The researcher concluded that microfinance breadth of outreach, depth of outreach; dependency ratio and cost per borrower affect the financial sustainability of both microfinance in wolkite.

However, the microfinance capital structure and staff productivity have insignificant impact on financial sustainability the study periods.

Ebisa *et.al* (2012) did a research on the topic filling the breach: Microfinance with the objective to assess the financial performance and challenges of micro finance. Relevant data for the study were based on secondary data from different Microfinance Institutions currently operating in the country. The method of analysis used in the study is descriptive analysis .

The researchers conclude that omo micro finance and wisdom Microfinance are decisive way outs from the vicious circle of poverty particularly for the rural and urban poor segment of the society. Where many people live barely below the absolute poverty line. The micro financing of wolkite is escalating in the face of the growing deep concerns for inflation and low interest rate in the microfinance industry affecting the financial health and viability of MF. The National Bank of Ethiopia though supporting the industry it needs to smooth out the regulations and supervisions. For instance, the regulations requiring the microfinance to operate in a tightened manner particularly their capital requirements. On the other hand, upgrading of the both micro finance microfinance scale of operation such as graduating to the level of banking institution should be backed by a strong regulatory frame work from the National Bank of Ethiopia.

Tilahun and Dereje (2012) conducted a research on the topic the financial performance and sustainability of microfinance during the current financial crisis. The objective of the research is to assess the financial performance and sustainability of omo micro finance and wisdom during the current financial. The study employed a descriptive research design. The data is quantitative and obtained from the MIX market website. For data analysis, descriptive analaysis such as percentage and graph are used.

The researchers concluded that there was a negative shift in the financial

research on financial performance of Microfinance Macroeconomic and Institutional perspective. The objective of the study is to investigate the effect of both institutional and the macro economy on the financial performance of both micro finance drawing upon the Microfinance Information Exchange (MIX) as well as cross country data macro economy, finance and institutions.

The researchers conclude that institutional factors affect MF financial performance, in particular, profitability operational expense and portfolio quality. They also found that macroeconomic and financial factors such as GDP and share of domestic credit to GDP have positive impacts on micro finance financial performance such as profitability, operating expense ratio and portfolio quality

Letenah *et.al* (2010) studied on Determinants of Sustainability and Outreach of wolkite microfinance: The case of Operational characteristics of Microfinance.

Gashaw (2014) conducted a research on Loan Outreach to the Poor and the Quest for Financial Viability on Micro finance wolkite. The objective of the research contextualizes microfinance depth-of-outreach and financial viability issues in three countries; analyses depth of loan outreach and financial viability nexus; and quantifies the path from depth to viability.

The researcher founds out that Operating-Expense-Per-Loan-Portfolio and Debt-to-Equity Ratio relate inversely with viability while 'Real-Yield' relates directly. The revealed positive association between lending to the poor and size of operating expenses, which indirectly hampers viability. Support to MF targeted to ensuring efficiency through reduced operational costs can reinforce a complementary outreach-viability nexus otherwise, tradeoff would be inevitable.

## 2.10 Summary of Empirical Review and knowledge gap

From the above empirical reviews, the researcher identified the knowledge gaps and summarized as follows.

The study conducted by Adino (2007) dealt on financial performance of outreach and sustainability by considering some financial performance indicators such as: number of borrowers, gross loan breadth of outreach, sustainability and efficiency for one specific omo micro finance and wisdom. Thus the study was limited to consider other financial performance indicators like productivity, profitability, and portfolio quality capital structure and asset allocation by taking in to account for two micro finance.

Befekadu (2007) study conducted on outreach and financial performance of wisdom and omo micro finance, which the financial performance assessment was mainly focused on outreach to the poor and their financial sustainability. The study was not consider other financial performance indicators like portfolio quality, productivity, efficiency, capital structure and other related financial performance indicators in comprehensive way.

Ebsa.*et.al* (2012) to assess the financial performance and challenges of MF. And the financial performance assessment part covers few areas of indicators mainly of breadth of outreach: number of clients and the amount of loan grant to borrowers. However, other financial performance indicators such as profitability, sustainability, efficiency, and portfolio quality capital structure and asset allocation were not get attention.

Tilahun & Dereje (2012) conducted assessment of financial performance& sustainability of both microfinance specifically at financial crisis period.

And this study was restricted on the crisis time for one MF.

Katushi. *Et.al* (2011) deals on the effect of institutional and Macro economy on financial performance on MFIs. Similarly Gashaw (2014) studied on the relation on Loan Outreach to the Poor and the Quest for Financial Viability on both Microfinance studies dealt on the relationship of variables and limited to see the performances of MF.

Therefore, by understanding the above mentioned gaps, the researcher preferred to conduct financial performance.

The pervious researches conducted about comparative analysis financial performance of micro finance are not used the profitability ratio analysis, liquidity ratio, asset management ratio, debt management ratio and market value ratio at the same time in their comparative analysis. The pervious study was conducted only to separate the micro finance that is doing poorly but the current study intends beyond this by identifying the micro finance that perform poorly and to will give better treatment to them. All pervious researches do not use the financial statement above five years but this research used the ten-year financial data of the micro finance.

In general, this research tried to uses the comparative and ratio analysis as the main tools in the study of omo micro finance and wisdom.

# CHAPTER TREERE;
# 3. RESEARCH METHODOLOGY

## 3. INTRODUCTION

A brief method of this chapter secondary covers the method was used. in this study from the process of data collection to the method of data analaysis was recognized.To solve the research problems the study attempt to apply research design, sampling techniques, source of data,method of data collection and method of analysis.

## 3.1 research design

The study focused on the comparative analysis describing the current situation of the wisdom and omo micro finance. This study covers on Enterprise Company in wolkite as mention earlier. The case company has been select on convenient basis and necessary data has been obtained from the company data base the stud has been under taken for the period of five year from 2004- 2008 EC. In order to Analysis Performance in Term of Liquidity, Solvency, Profitability and Financial Efficiency, Various Accounting Ratio has been used

the research has been used descriptive study method which are describe the observed data and converted financial performance in to that are comparable to certain standard like vertical analysis and ratio analysis .

## 3.2 sources of Data

From secondary source we took annual financial report of wisdom and omo micro finance as stated in the statement of the problem. Secondary data soures play a major role the study. The five years published financial statement and balance sheet are bases of the paper. Data collected from secondary sources represent in tabulation form of presentation. The tabulation data are analysis through ratio percentage.

The secondary data mean the data which have already been collected and analyzed by some else. The researcher use secondary data which is important for the analysis from the audit financial statements of the micro finance for the last five years collection .The research also used secondary data type to perform the study and also used secondary data collection method to better achievement of the study. The reasons why the researcher uses those method are because of more comfortable to the studding practice of the researcher and inability of researcher to meet the home office of the organization.

The research used more data from secondary data source which was collected from both micro finance written source. For this particular study, the research used secondary data like, annual report, financial statement, and others.

## 3.3 Methods of Data Analysis

The method of data analysis depends on three main issues. These are knowledge of the research, objective of the study and measurement of the data. Accordingly, this study will be used both quantitative and qualitative methods of data analysis. In this study quantitative data utilizes the descriptive statics such as tables and percentages. Table will be used to present the data, and also description about financial performance and its determinants of the performance of wisdom and omo micro finance. Quanitative data will be used to analyze through simple qualitative description about financial performance and it's determinants for the performance of wisdom and omo micro finance.

## 3.5 Research Approach

Among the three types of research approach those are quantitative, qualitative and mixed approach in this study relationship between the comparative analysis and financial performance is summarized quantitatively it is appropriate to used qualitative approaches and in order to obtain an understanding about the institutions specific comparative analysis of financial performance that would determine the occurrence of nonperforming micro finance is generalized in qualitative aspects.

## 3.6 sampling design

In gathering relevant data the response are selected purposely or by non-probability sample because of the reason that the main objective research is to comparative analysis of financial performance of two micro finance, the researcher purposely selected the population of the study.

## 3.7 data analysis

The analysis and result of the study have been describe used he computed ratio are compared against the related past ratio to analysis different factor that could affect the operation of the company. After the relevant data collection and arranged properly from the company analysis is being by looking at the audited financial statement of accompany for five years 2004-2008 fiscal period in this study descriptive analysis used . The study also used ratio analysis for comparative analysis of financial performance of the company.

# Chapter Four
# Data Analysis and interpretation

This chapter presents the findings of the study and analysis of the data collected using various analysis. Descriptive analysis is presented using chart and tables to see financial performance. To see the difference in financial performance of the micro finance in 2004-2008 is analysis different among peer micro finance groups analysis of variance (ANOVA) is used to test the hypothesis that the means of the peer micro finance group are the same on the several financial.

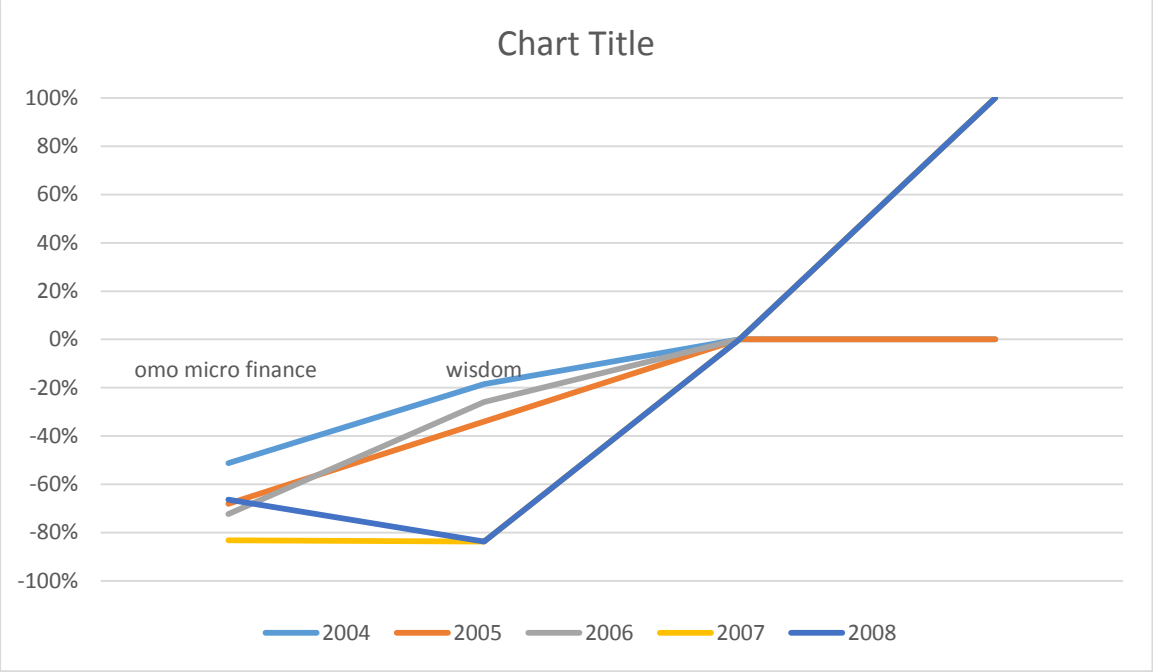
## 4.1 micro finance Sector Profitability Performance

*Table 1Profitability performance based on Return on Asset (ROA)*

It can be seen the two micro finance group are profitable. Under the period of study micro finance group with the measure of 2% and whereas wisdom micro finance ROA negative

| Micro finance | 2004 | 2005 | 2006 | 2007 | 2008 | average |
|---|---|---|---|---|---|---|
| Omo | -0.061 | -0.02 | -0.005 | -0.013 | 0.02 | 0.0084 |
| Wisdom | -0.025 | -0.021 | 0.011 | -0.078 | 0 | -0.0226 |

Table 4.1 shows omo micro finance have higher risk on ROA with the in which the maximum and minimum are recorded as 2% and -1.1% respectively. Wisdom micro finance have lower risk on ROA compared to omo micro finance with standard deviation of 1.41 and range of 4% in the maximum and minimum on ROA are recorded as 0% and % and -1.1% respectively.
Omo micro finance slight higher than wisdom profitability that means with the average ROA followed by 0.84%and wisdom followed by -2.26%. and -1.1% respectively. Wisdom micro finance has lower risk on ROA compared to omo micro finance. . However, omo micro finance have shown higher risk on ROA among the wisdom micro finance groups with the ROA , with maximum and minimum ROA of 2% and -0.5% respectively. The results further found that omo micro finance have moderate on ROA which is approximately to symmetric with the measure of 2% and whereas wisdom micro finance.




The above chart show the profitability results trends on ROA indicate an increasing on ROA for the two micro finance group but especially for omo micro finance peer group. Omo micro finance group shows an increasing on ROA trend from year 2004 to 2008. The omo micro finance groups have shown almost decreased ROA record from 2004 to 2007 except a slight increase on ROA in 2008, from -0.5% to 2% for 2006 to 2008. Similarly wisdom micro finance groups have also shown a record of an increasing on ROA from 2005 to 2006 from with a slight slight decrease in 2006 to 2005, from 1.1 % to -2.1 % then after it shows a slight increased 2005to 2006 on ROA -2.1% to 1.1%. omo micro finance groups recorded an increase of ROA for 2008 were 2%; whereas wisdom micro finance groups recorded an increase of ROA for 2006 were 1.1% which is omo micro finance slight higher than other wisdom micro finance.

The ROA result implies that there is an efficient utilization of their resources among two microfinance. Since the ROA measurement shows how efficiently the resources of the company are used to generate the income. It further indicates the efficiency of the management of a company in generating net income from all the resources of the institution. Therefore, the two micro finance with higher ROA (the omo micro finance peer groups) shows that the company is more efficient in using its resources than the wisdom micro finance peer group.

The general performance indicates that, Two Micro Finance groups performing, omo micro finance recorded higher ROE with 2% and lower ROA with -50% and wisdom micro finance recorded higher ROA with -1.1%and lower ROA with-1.1%. However wisdom micro finance has lower risk on ROE comparing with Omo micro finance

## 4.2 Liquidity Performance

In wisdom and Omo micro finance liquidity performance measures the ability to meet financial obligations as they become due and is crucial to the sustained viability of micro finance. It can be seen under the period of study from 2004 to 2008.

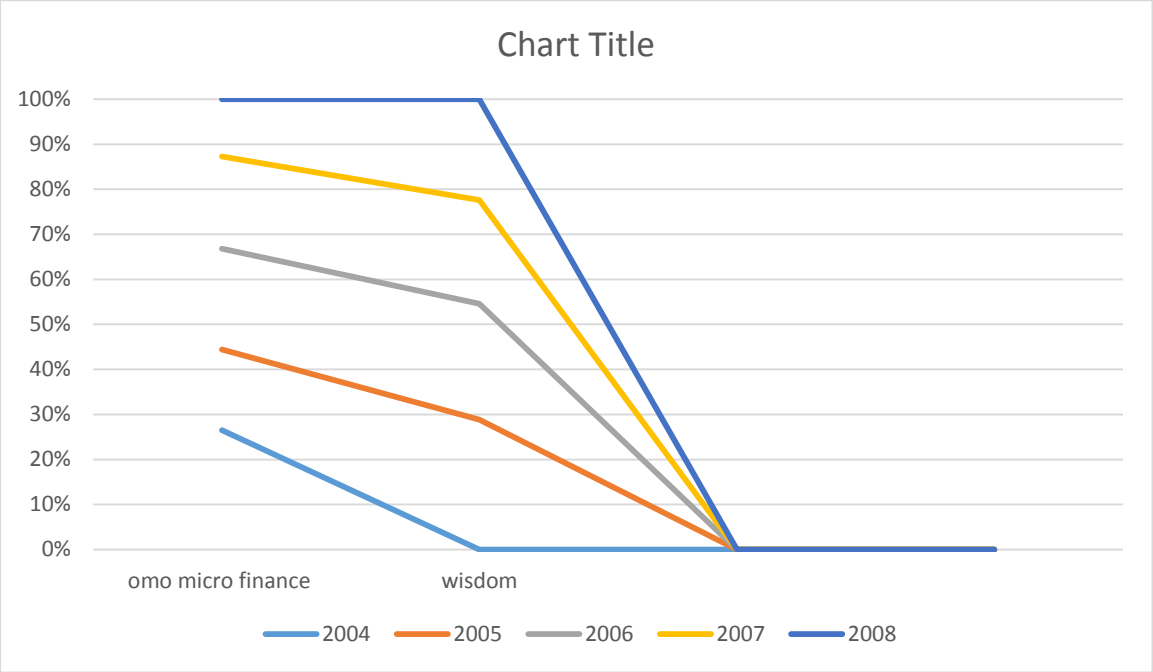
| micro finance | 2004 | 2005 | 2006 | 2007 | 2008 | Average |
|---|---|---|---|---|---|---|
| Omo micro finqnce | 0.229 | 0.155 | 0.194 | 0.177 | 0.11 | 0.173 |
| Wisdom | 0.124 | 0.129 | 0.115 | 0.103 | 0.1 | 0.1142 |

*Table 2 liquidity performance*

in above table show omo and wisdom micro finance have recorded liquidity level with of 22.9% and 12.9% respectively compared to the two micro finance liquidity level of omo micro finance 22.9% however this liquidity level for wisdom micro finance 12.9% is contributed by low mobilization of funds due to may be weak deposit mobilization strategy of these micro finance. Also high rate of non-performing loans is another reason for liquidity level. Further the results indicate that omo micro finance have high risk in liquidity level comparing to other wisdom micro finance groups with liquidity of 22.9% followed by wisdom micro finance with of liquidity of 12.9%. Liquidity of wisdom micro finance micro finance of 0.129 followed by wisdom micro finance groups while omo micro finance with highly positive distribution of 22.9

the above table liquidity positions trends of both micro finance sectors in Wolkite, the liquidity level of the two micro finance have shown increase record throughout the survey years. In year 2004 omo micro finance have shown a significant increase in liquidity than the wisdom micro finance. The wisdom micro finance has shown a tremendous decrease in liquidity until the end of year 2008. However, two micro finance groups are showing their liquidity is experiencing a decline trends this is may be due to the changes in the level of loan granted to the borrowers and the changes in the level of savings is moving in a different speed rate that is the incremental change in the total assets or deposit is faster than the change in the loan granted to the borrowers. This result would happen if their deposit strategy,

branch expansion and area of their concentration could not take all these factors in to considerations.




shows the above chart loan to total deposits liquidity positions trends of both micro finance sectors in wolkite, the loan to total deposits liquidity level of both micro finance have shown a decline record in the year 2008. In year 2004 omo micro finance have shown higher liquidity than wisdom micro finance. However, both micro finance groups are showing their loan to deposit liquidity is experiencing a betterment trends, this is may be due to the amount of loan granted to the borrowers are going in an incremental trends more than the resources mobilized, even though both loan and deposits are increasing in both micro finance .

From the liquidity measurements taken in to considerations under all the three scenarios i.e. loan to total assets, liquid assets to total deposits and loans to total deposits, we can conclude that wisdom and omo micro finance are showing an incremental trends in their deposit mobilizations from year to year. Hence, therefore, keeping the resource mobilization strategy in a wide and vast way to mobilize the resource in accordance with the capacity they have will help to sustain their performance growth and contribution to the country's econ the return on the owners' capital is magnified or "leveraged" (Brigham, Ehrhardt)

## 4.3 leverage ratio

It measures the percentage of funds provided by deposit to total asset and. (Brigham, Houston 2006). The formula used to calculate:

Leverage ratio = Total liabilities/ Total asset

Leverage ratio is calculation is shows the extent which debt financing has been financing has been used in business a high ratio is unfavorable form the firm's point of view. This introduces inflexibility in the firm's operations due to the increasing interference and pressures from creditors. A low deposit to total asset implies a greater claim of owners then creditors. From the point of view of creditors, it represents satisfaction capital structure of the business since a high proportion of equity provides larger margin of safety from them. (Brigham, Houston 2006)

The formula to calculate the ratio is:

Leverage ratio = Total debt/Shareholders' equity

Time interest earned ratio (Interest Coverage ratio): this ratio indicates the extent to which the earnings may fall without causing any embarrassment to the firm regarding the payment of the interest charges. And earnings before interest and tax are used in the numerator rather than net income, because interest paid with pre-tax dollars, the firm ability to pay current interest is not affected by taxes. A higher ratio is desirable; but too high ratio indicates that the firm is every conserve in using debt. A lower ratio indicates excessive use of debt, or inefficient operations. (Brigham, Houston, 2006)

*Table 3 leverage ratio indictor*

| Micro finance | 2004 | 2005 | 2006 | 2007 | 2008 | Average |
|---|---|---|---|---|---|---|
| Omo micro finance | 0.06 | 0.099 | 0.091 | 0.071 | 0.1115 | 0.21625 |
| Wisdom | 0.011 | 0.015 | 0.011 | 0.017 | 0.0126 | 0.0333 |

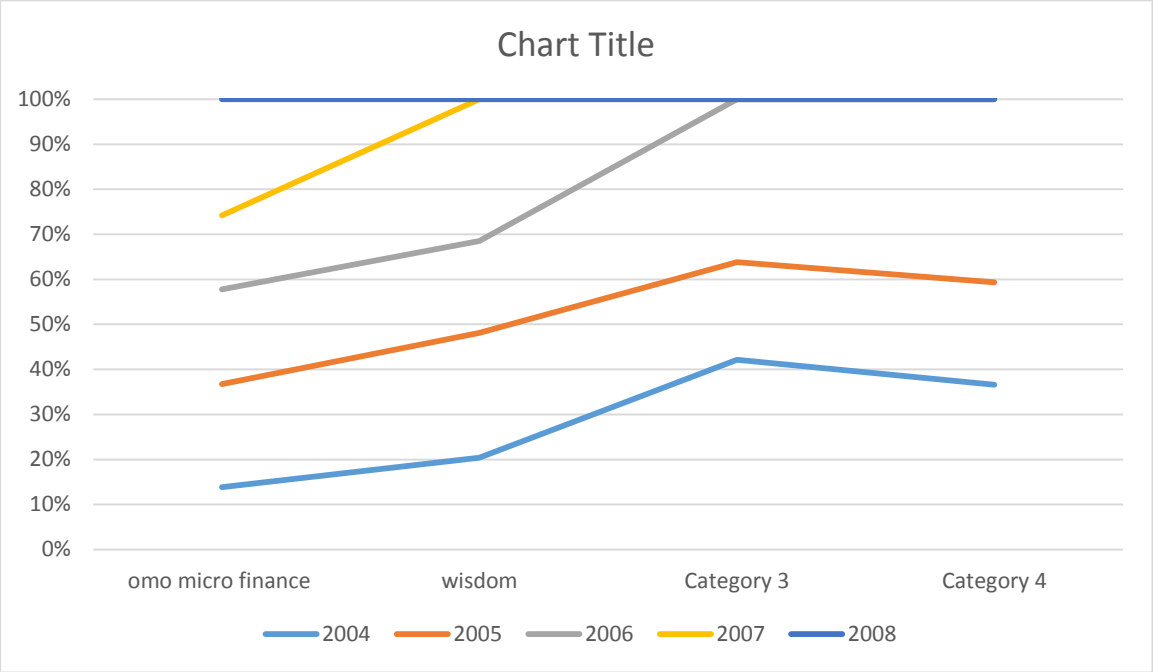
We can see from the table above the debt to equity ratio of omo micro finance show has been decline in the year 2004 and wisdom has been show decline in the year 2004and 2006 .the maximum debt to equity ratio of omo micro finance was registered in the year 2005.whereas the minimum was in 2004.the maximum debt to equity ratio of wisdom was registered in the

year 2007.whereas minimum was 2004and 2006. This was decrease in this ratio was due to increment of customer debt to equity ratio when current asset. When we look average customer debit to equity ratio of omo micro finance, customer deposit has been increased by 9.9%. When we look at customer debit to equity ratio trend of wisdom micro finance, customer debt to equity ratio has there for in the year been increased by1.7%. there for in the year 2004, omo micro finance and wisdom micro finance in the year 200and 2004 has been show some financial problem comparing with four years performance, the micro finance have recovered to its poison in the year 2007.the customer debt to equity ratio continuously increase throughout the time, because it blood and life of the micro finance industry but at different rate influence by different factor such as income per capital industrialization investment rate, interest rate and etc. Debt to equity ratio to customer ratio of omo micro finance has 9.9% .which implies that the omo micro finance has 9.9% in leverage ratio cover each birr of sudden with drawls. Leverage ratio to customer ratio of wisdom micro finance has 1.7% %.which implies that wisdom has1.7% in in leverage ratio to cover each birr of sudden with drawl. When we look at wisdom in the same fashion the micro finance borrowing ratio profitability ratio to customer deposit ratio Show up and downs. This was resulted from the unbalance increment of leverage ratio or current asset to customer deposit. The maximum ratio was achieved in the year 2005 .whereas minimum was in the year 2004 in omo micro finance this was due to the reason that the micro finance main agenda is to mobilize deposit and maximized deposit and maximize its market share to that micro finance promote different parties of society or classes of community to save or open its account of at minimum and encouraging people to save as wee as huge promotion work. In the particular year those leverage ratio component show smoothly increment. The leverage ratio

in the year 2005 of omo micro finance was increased by 9.9% .in the year of 2005 the profitability ratio to customer of wisdom was increased by 0.011 or 1.1%.on average profitability ratio of omo micro finance was 0.0084or 0.84% .which showed better poison compare with wisdom micro finance. This ratio means omo micro finance was 0.0084 or 0.84% cent to cover each birr sudden with drawls. On average the two micro finance have - 0.0071 cent to cover each birr of sudden with drawl made by the customer when compare the two micro finance .omo micro finance was more solvent than wisdom micro finance .because omo micro finance has 9.9% leverage pay any sudden customer request. Whereas wisdom micro finance has 1.1%.

Leverage ratio indicated that the extent to which cover return on asset. By looking at the given table above we could observe that of the both micro finance gradually decreasing, deposit to

total asset of omo micro finance is increase from 9.9%% for in 2005, show an decreasing 6% deposit to total asset for in 2006 . The return on asset of omo micro finance shows gradual decrements (decrease), from -0.005 cents of return on asset 2006, increase in 0.02 cents in 2008. In contrast the average returns on asset of omo micro finance the ability of to meet its return on asset higher




In the above chart leverage ratio indicated that the extent to which cover deposit to total asset. By looking at the given table above we could observe that the profitability of the both micro finance gradually decreasing, return on asset of omo micro finance is increase from 9.9% cents for in 2005, show an decreasing 6% cents of deposit to total asset for in 2004 . The deposit to total asset of omo micro finance shows gradual decrements (decrease), from 6% cents of return on asset 2004, increase in 9.9% cents in 2005. In contrast the average returns on asset of omo micro finance the ability of to meet its return on asset higher

Since Efficiency ratios measure the ability of a business to use its assets and liabilities to generate revenue. A highly efficient organization has minimized its net investment in assets, and so requires less capital and debt in order to remain in operation. Efficiency ratios are used to judge the management of a business. If an asset related ratio is high, this implies that the management team is effective in using the minimum amount of assets in relation to a given amount of revenue.

# Chapter Five
# Conclusions and Recommendations

## 5.1 Conclusions

This paper analyzed the financial performance of wisdom and omo micro finance in wolkite which cent which was wisdom has -0.0142 cent margin than wisdom micro finance (settle) any sudden with drawl requested by customer both micro finance not face such several problem of profitability ratio.

Over the period of 5 years from 2004 to 2008. The results indicate that the wisdom and omo micro finance financial performance in terms of profitability

The indicators of profitability of ROA demonstrate, wisdom and omo micro finance groups recorded an increase in the rate of profit in the five years of the study and omo micro finance profitability deteriorated during 2004 to 2008 as the micro finance operating environment deteriorated may be due to increasing bank operating costs related with high bank branch expansion and management cost. However, in 2016 all banks groups recorded an increase in the rate of profit. In the profitability indicator of NIM the performance indicates that, small banks have higher average NIM compared to large banks and medium banks, however, this high average NIM for small banks is caused by charging high interest rates on loans they offer to their client and the same times offering low interest rate for deposits while other small banks are not offering any interest for deposits.

The analysis has also covered the liquidity position of all private banks. From the liquidity measurements taken in to considerations under all the three scenarios i.e. loan to total assets, liquid assets to total deposits and loans to total deposits, we can conclude that all the private banks are showing an incremental trends in their deposit mobilizations from year to year. Hence, therefore, keeping the resource mobilization strategy in a wide and vast way to mobilize the resource in accordance with the capacity they have will help to sustain their performance growth and contribution to the country's economic development.

Furthermore, the study found that, there is a significant means difference of profitability among of banks groups in term of ROA, however, no a significance differences among banks group were existed in profitability in term of ROE and NIM. However, all banks groups are showing liquidity is experiencing a decline trends, this is may be due to high changes in the level of savings than the changes in loan provisions. In addition to this the

deposit strategy, the branch expansion and area of their concentration may have a mismatch from the loan seekers and business types.

The asset quality rating reflects the quantity of existing and potential credit risk associated with the loan and investment portfolios. The ability of management to identify and manage credit risk is also reflected. But, here the provision for doubtful loans from the gross loans is taken in to account in the evaluation of asset quality. Since the asset quality highlights the amount of existing potential credit risk related to the advancement and portfolios of investment, other property owned, and various assets, as well as some off balance sheet transactions the medium and the large banks are better.

Efficiency ratio is also taken in the study to evaluate the comparative performance of the private banks. Since Efficiency ratios measure the ability of a business to use its assets and liabilities to generate revenue. A highly efficient organization has minimized its net investment in assets, and so requires less capital and debt in order to remain in operation. Therefore, the small banks peer groups are using their assets and liabilities to generate more revenue than the medium and large banks peer groups under the study.

## 5.2 Recommendations

From the analysis so far, the following recommendations be put forward;

- ✓ To improve banks financial performance, the banks need a good regulatory environment, i.e. enhance enabling, creativity and innovation, smoothing the power distance through participation of the operators and minimizing too much control rather than risk based supervision. Regarding to their deviations from the mean that will enable them to expand their scope of business but strictly within the financial service sector. With a good regulation, supervision and corporate governance, unnecessary cost and expenses will be cut down and the profit will increase.
- ✓ The banks should put in place good corporate governance, which is, monitoring activities in order to ensure that clients will not fail on their debt which would not be possible if it were by the direct lenders to the firms. The key is that banks themselves are guided by prudence and have the discipline to contain them from taking excessive risks. Through continuous monitoring by banks, firms would follow a path of efficiency in their production and trading. Hence it will allow for transparency and minimize fraud in the bank (this is the case where some banks charge different interest rates within the same business groups, which would tend to create doubts on the clients).

- ✓ The Wolkite omo micro finance experiences a low return on asset so further additional investment is required to exploit the return from the sector.
- ✓ Clear business and financial model across its portfolio of businesses/products to create the roadmap for ROA improvement
- ✓ Strong measurement framework that deploys ROA improvement targets through the management structure of the organization
- ✓ Almost all banking groups are experiencing higher interest margin, further resource mobilization is a must in order to narrow the gap between the loan demand and its provision or supply of the financial resources.
- ✓ The private commercial banks required further performance improvement in order to lower the C/I ratio and becomes the better performer in the banking sector.
- ✓ Improving the ability of management to identify and manage credit risk is also required in order to have a better quality in asset.
- ✓ Improving the efficiency of assets and liabilities to generate more revenue is required in order to have highly efficient organization which could minimize its net investment in assets, and so requires less capital and debt.

The indicators of omo micro finance profitability of ROA demonstrate, wisdom and omo micro finance groups recorded an increase in the rate of profit in the five years of the study and wisdom and omo micro finance are found to be the more profitable in comparison to the m However,

Omo micro finance and wisdom micro finance are allocating more proportion of asset to loans which has dual benefit as it helps to earn more interest revenue and to allocate the resource to more clients which helps for better outreach

The indicators of profitability of ROA demonstrate, wisdom and omo micro finance groups recorded an increase in the rate of profit in the five years of the study and omo micro finance are found to be the more profitable in comparison to the wisdom and omo micro finance profitability decreased during 2006 as the banks' operating environment deteriorated may be due to increasing omo micro finance operating costs related with wisdom micro finance branch expansion and management cost. However, in2008 omo micro finance recorded an increase in the rate of profit. In the profitability indicator of the performance indicates that, omo micro finance have higher average profit compared to wisdom micro finance, however, this high average NIM for omo micro finance is caused by charging high interest rates on loans they offer to their client and the same times offering low interest rate for deposits while other small banks are not offering any interest for deposits.

The analysis has also covered the liquidity position of wisdom and omo micro finance. From the liquidity measurements taken in to considerations under omo micro finance and wisdom i.e. loan to total assets, liquid assets to total deposits and loans to total deposits, we can conclude that micro finance are showing an incremental trends in their deposit mobilizations from year to year. Hence, therefore, keeping the resource mobilization strategy in a wide and vast way to mobilize the resource in accordance with the capacity they have will help to sustain their performance growth and contribution to the country's economic development.

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- Both micro finance are generally performing well in terms of average loan balance per borrower and average loan balance per GNI per capita which is an indication for better depth of outreach. However, the MFIs are less performing in terms of percentage of women borrowers.
- Both micro finance are good performers on financial sustainability and profitability, efficiency and productivity
- WMF and OMF are poor performers in serving women borrowers but medium sized have better financial performance as serving more women also relates with poverty alleviation mission indicated by low average loan size and NGO form of structure and less commercialization of the MF industry.

- Both micro finance serve large number of borrowers than their industry average as breadth of outreach measured by number of borrowers. This is what should be encouraged.
- Both micro finance are good at cost management as they have low expense ratios as compared to their industry benchmarks. Between them the large MF have best cost management strategy and the same is true in loan loss provision.

## 5.3. Finding

- Omo micro finance and wisdom micro finance MF have lower value than the Industry average which indicates that they are at risk especially the wisdom ones with a big difference from the Industry average.
- Both micro finance are efficient as measured by operating expense to GLP and cost per borrower ratio and also productive measured by borrower per staff which is an encouraging performance.
- Although omo micro finance are better levered than wisdom micro finance, it is concluded that wolkite MF are not levered properly compared to the industry standard.

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# APPENDEX I

| Micro finance | 2004 | 2005 | 2006 | 2007 | 2008 | Average |
|---|---|---|---|---|---|---|
| Omo | -0.061 | -0.02 | -0.005 | -0.013 | 0.02 | 0.0084 |
| Wisdom | -0.025 | -0.021 | 0.011 | -0.078 | 0 | -0.0226 |
| micro finance | 2004 | 2005 | 2006 | 2007 | 2008 | Average |
| Omo micro finqnce | 0.229 | 0.155 | 0.194 | 0.177 | 0.11 | 0.173 |
| Wisdom | 0.124 | 0.129 | 0.115 | 0.103 | 0.1 | 0.1142 |

| Micro finance | 2004 | 2005 | 2006 | 2007 | 2008 | Average |
|---|---|---|---|---|---|---|
| Omo micro finance | 0.06 | 0.099 | 0.091 | 0.071 | 0.1115 | 0.21625 |
| Wisdom | 0.011 | 0.015 | 0.011 | 0.017 | 0.0126 | 0.0333 |