

Determinants of Financial Performance of Microfinance Institutions in Ethiopia

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Abstract

Poverty is the major challenges faced by developing countries in pursuit of their social and economic development. Microfinances are established to provide opportunity mainly to rural poor to become financially self-sufficient and come out of poverty. Due to the very high contribution of MFIs in poverty reduction and economic development in developing countries like Ethiopia exploring factors determining the financial performance of these institutions is doubtless. The objective of this study is to identify the effect of firm specific, industry specific and macroeconomic factors determining the financial performance of selected microfinance institutions in Ethiopia. In order to achieve the stated objective, quantitative approaches and explanatory research design were employed. The study used financial ratios of eleven (11) purposively selected MFIs for a period of 12 years from 2003 to 2014 with a total of 132 observations. Return on asset and return on equity were used as measure of financial performance. Portfolio at risk, firm size, operating cost, portfolio to asset, capital adequacy, market concentration, gross domestic product and annual inflation rate were used as independent variables. Descriptive and random effects regression analysis was used to analyze the data. The result revealed that Loan portfolio, Portfolio at Risk, operating cost ratio, market concentration, GDP are the major determinants of financial performance. MFIs in Ethiopia are recommended to revise their credit procedures and policies to increase their repayment rates and the government has to intervene and support their operation so as to make them financially viable and strong to reduce poverty.

Keywords: Ethiopia, Determinants, Financial Performance, Microfinance Institution

INTRODUCTION

Micro financing institutions play significant role in the development of nations in general and developing countries like Ethiopia in particular, where women and other rural poor are excluded from the financial sector. One of the major challenges faced by developing countries in pursuit of their social and economic development is poverty. The macroeconomic growth of countries may not trickle down to the poor and hence, millions are suffering from such poverty especially in developing countries. Therefore, according to Yunus & Abed (2004) microfinance is provided to low-income people or unemployed people having no access to traditional financial institutions and it has proved itself as one of the most effective tool for poverty alleviation in many developing countries especially in Africa and Asia.

In Ethiopia, financial institutions like bank operate mainly in the urban areas and thus the rural poor were excluded from the financial service for a number of years. Hence, micro-credit started as a government and non-government organizations motivated plan. According to Alemayehu (2008), though in a very limited and not sustained manner, many GNOs started to offer micro credit along with other relief activities following the 1984/85 severe drought and famine. Cognizant to this fact, Rosenberg (2009) also stated that the poor are generally excluded from the financial services and hence, microfinance institutions have emerged to bridge the gap.

The primary objective of microfinance is to provide an opportunity to financially deprived people to become financially self-sufficient and come out of poverty. Providing

financial service to the excluded segment of the population is an important development tool. It helps in creating employment and increases the income and consumption of this segment and would, in the final analysis, reduce poverty and contribute to the implementation of the country's transformation and development plan (GTP).

Literature indicated that microfinance industries plan significant role in improving the livelihood of women and other rural poor in such industries. For instance, Mori & Randoy (2011) witnessed that microfinance industry is a unique field in different aspects such as its newness, its diverse organizational structure and its social mission in which it largely focuses on the women and the poor. Fersi & Boujelbene (2016) also acknowledged microfinance mechanisms which provide access to financial service to poor people who are excluded from formal financial system. Microcredit, micro insurance or remittance, are the main financial service provided by microfinance institutions.

Regardless of such enormous contribution to filling the gaps that banks and other financial institutions couldn't bridge, microfinance institutions are bottlenecked by various factors. Absence of flexible loan, micro insurance and leasing products, as well as convenient money transfer, saving, and other financial instruments, is a major constraint limiting the accumulation of assets by the poor and the development of indigenous enterprises (AEMFI, 2015). Literatures provide inconclusive finding as far as the determinants of financial performance of the microfinance institutions is concerned. This study therefore, aimed at analyzing the determinants of financial

performance of microfinance institutions in Ethiopia.

Statement of the problem

Microfinance institutions are engines of economic development of nations in general and of developing countries in particular. Rural poor especially women are excluded from the financial system of developing countries where banks are concentrated in the urban centers. Hence, microfinance institutions play significant role in including rural poor in their group based loan for those who are in short of fixed assets used as collateral in bank loan.

According to Assefa, Hermes & Meesters (2010), microfinance industry has been growing at a significant rate in several countries and become an important sub-sector of the formal financial markets. Nanayakkara and Iselin (2012) recommend that for Africa to move forward with economic development and alleviate poverty, it has to integrate and transform the microfinance institutions.

Poverty alleviation is at the heart of microfinance institutions regardless of where they are. The objective of almost all of the microfinance institutions in Ethiopia also geared towards poverty alleviation. Financial wellbeing is the basic enabler of poverty reduction goal of financial institutions in general and microfinance institutions in particular. Cognizant to this fact Alemayehu (2008) posited that to achieve their objective of poverty alleviation, micro finance institutions should be financially viable and sustainable.

There are various measures used by authors to measure the financial wellbeing of

microfinance institutions. The accounting and market based measurements are the most commonly used proxies used to measure the financial viability of financial institutions and particularly the microfinance institutions. According to Odunga (2006) accounting based measures that involve analysis and interpretation of financial statements assist users in predicting the future by means of comparison, evaluation and trend analysis. Since financial performance is deemed to be more important than fulfillment of social objectives, it is only right that accounting based measures shall be used to measure and compare financial performance of MFIs.

Literature indicated inconclusive results as far as the determinants of the financial performance of microfinance institutions are concerned. For instance, Rai and Rai (2012) studied about the factor affecting financial sustainability of microfinance institution and found that capital adequacy, the ratio of operating expenses to loan portfolio and portfolio at risk are the main factors that affect the performance and sustainability of microfinance institutions. On the other hand, a study by Jorgensen (2011) found that operating expense over loan portfolio had a positive influence but the number of active borrowers had a negative influence. Due to the very high contribution of MFIs in poverty reduction and economic development in developing countries like Ethiopia exploring factors determining the financial performance of these institutions is doubtless and this inspire the researcher to put his contribution on this arena. Accordingly Kinde (2012) found that breadth of outreach has a positive impact on financial sustainability. The study conducted by

Abebaw (2014) reveals that, operational efficiency, GDP and size affect financial performance of microfinance Institutions. However his study was designed to focus on limited determinant variables and used only return on asset to measure financial performance.

Studies on microfinance institutions globally and locally focus more on outreach, financial and operational sustainability and limited up-to-date. Given the passage of time and limitations of case studies as far as generalization of results to the population is concerned, there is need for the present study to be conducted. In Ethiopia as far as the knowledge of the researchers is concerned, despite the increasing reliance on micro finance to reduce poverty, there has been little work under taken on determinants of financial performance of micro finance institutions in Ethiopia.

Hence, the current study which, uses key determinant variables which were not included in some of the previously mentioned researches such as portfolio to asset and inflation as independent variables. In addition, this study has used both return on asset and return on equity as dependent variable to measure financial performance. Therefore, this study tried to fill the stated research gaps in our country's context and also add body of literature to the existing stock of knowledge on determinants of financial performance of microfinance institutions in Ethiopia.

Objective of the study

General Objective

The general objective of the study is to examine the determinants of financial per-

formance of microfinance institutions in Ethiopia.

Specific Objectives

1. To examine the effect of firm specific determinants of the financial performance of MFIs in Ethiopia.
2. To analyze the effect of industry specific determinants of financial performance of MFIs in Ethiopia.
3. To evaluate the effect of macroeconomic factors on the financial performance of MFIs in Ethiopia?

LITERATURE REVIEW

Assefa, Hermes and Meesters (2010) investigated the relationship between competition and the performance of microfinance institutions (MFIs). The findings revealed that competition among MFIs was negatively associated with various measures of performance. A study by Jorgensen (2011) examined the factors that determine profitability of microfinance institutions using a sample of 879 MFIs. The study indicated that capital asset ratio, age (new) and the gross loan portfolio are the factors that statistically influenced profitability. The study also found that operating expense over loan portfolio has positive influence but the number of active borrowers has negative influence. Njogu (2011) investigated the factors that determine financial performance of the 41 MFIs that are registered and regulated by the AMFI in Kenya. The study revealed that inflation rates, corporate governance practices, distribution networks, sustainability, outreach, growth of informal sector, leverage levels of the institution, donor subsidies, access to capital, capitalization require-

ments, management information systems, external Intervention, Product diversity, real Interest rates, levels of citizen income, donor support, education levels of citizen, liquidity of the institution, communication costs, transition to service based economy, operational costs, existence of micro - finance market, risk management practices, information costs, transaction costs, education levels of staff and human expertise are the major determinants. Duwal (2012) conducted a research on MFI of Nepal and concluded that Portfolio at Risk, Operating Expense ratio and Gross Loan portfolio to total asset are significant factors that determine financial sustainability of MFI. Furthermore, study by Tehulu (2013) shows that the while size has significant positive impact; portfolio risk and management inefficiency has negative effect on sustainability of MFI. Sima (2013) on his study examined internal and external factors affecting profitability of microfinance institutions in Ethiopia by including a total of thirteen microfinance institutions covering the period of 2003-2010. The researcher uses quantitative research mainly documentary analysis. The outcome of the study indicates that age of microfinance institutions has a positive and statistically significant effect on their profitability. However, Operational efficiency and lack portfolio quality have a negative and statistically significant effect. However, capital adequacy, size and GDP are found to be statistically insignificant effect. The study conducted by Abdurahman and Mazlan (2014) showed that size has significant impact on performance of MFI whereas; operating expense ratio and breadth of outreach have negative impact on sustainability of MFI. Abebaw (2014) conducted a research on determinants of financial performance of MFIs in Ethiopia

and found that operational efficiency, GDP and size of MFIs affect MFIs financial performance significantly. The study further shows that age of microfinance institutions has a positive but statistically insignificant effect on their financial performance. The other explanatory variables which is Portfolio at risk > 30, gearing ratio, capital to asset ratio and market concentration affect negatively and are not significant. A study conducted on determinants of financial performance of microfinance institutions in Kenya by Kipkoech & Muturi (2014) using both quantitative and qualitative approaches using sample of 52 respondents from selected microfinance institutions in Nakuru town found that number of borrowers, capital adequacy and branch network have significant on performance of microfinance institution. Ngumo & Collins (2017) examine the determinants of financial performance of Microfinance banks in Kenya. The study adopted a descriptive research design and used secondary data from 7 Microfinance banks for a period of 5 years from 2011 to 2015. The study found positive and statistically significant relationship between operational efficiency, capital adequacy, firm size and financial performance of microfinances. However, the study found an insignificant negative relationship between liquidity risk, credit risk and financial performance.

RESEARCH DESIGN AND METHODOLOGY

The research was mainly based on secondary data collected from the microfinance institutions. Explanatory research design was employed because of researches of such types involve examining cause and effect relationships among variables. To examine this nature of relationship quantitative

panel data of 11 MFIs for 12 years, from 2003 to 2014 was used. Purposive sampling technique was used to selected sample MFIs based on the availability of balanced panel data for the period. Descriptive and random effect regression analysis of panel data were employed to analyze the collected data using STATA version 13 software. Descriptive analysis was used to describe patterns of behavior or relevant aspects of the data values and detailed information about the variables selected. Whereas; the random effect regression analysis indicated the major

determinants of financial performance of microfinance institutions in Ethiopia. All the classical linear regression model assumptions were tested and the result indicated that the data are healthy and ready for further analysis. In addition both Hausman specification test and Breusch and Pagan Lagrangian multiplier test for random effects indicated that, random effect model is the appropriate model to analyze the determinants of financial performance of microfinance institutions in Ethiopia.

Model specification

$$ROA_{i,t} = \alpha_i + \beta_1(PAR)_{i,t} + \beta_2(FSZ)_{i,t} + \beta_3(OPC)_{i,t} + \beta_4(LPA)_{i,t} + \beta_5(CAR)_{i,t} + \beta_6(MKC)_{i,t} + \beta_7(GDP)_{i,t} + \beta_8(IFN)_{i,t} + \mu_{i,t}$$

$$ROE_{i,t} = \alpha_i + \beta_1(PAR)_{i,t} + \beta_2(FSZ)_{i,t} + \beta_3(OPC)_{i,t} + \beta_4(LPA)_{i,t} + \beta_5(CAR)_{i,t} + \beta_6(MKC)_{i,t} + \beta_7(GDP)_{i,t} + \beta_8(IFN)_{i,t} + \mu_{i,t}$$

Where,

$ROA_{i,t}$ = return on asset for MFI “i” for “t” time period.

$ROE_{i,t}$ = return on equity for MFI “i” for “t” time period

α_i = Constant term

$\beta_1(PAR)_{i,t}$ = Coefficient of Portfolio at Risk for MFI “i” for “t” time period

$\beta_2(FSZ)_{i,t}$ = Coefficient of Size for MFI “i” for “t” time period

$\beta_3(OPC)_{i,t}$ = Coefficient of operating cost for MFI “i” for “t” time period

$\beta_4(LPA)_{i,t}$ = Coefficient of Loan Portfolio to Total assets for MFI “i” for “t” time period

$\beta_5(CAR)_{i,t}$ = Coefficient of capital adequacy Ratio for MFI “i” for “t” time period

$\beta_6(MKC)_{i,t}$ = Coefficient of market concentration for MFI “i” for “t” time period

$\beta_7(GDP)_{i,t}$ = Coefficient of gross domestic product for MFI “i” for “t” time period

$\beta_8(IFN)_{i,t}$ = Coefficient of inflation for MFI “i” for “t” time period

$\mu_{i,t}$ = random Error Term

RESULTS AND DISCUSSIONS

Descriptive Statistics

The following table summarizes the descriptive analysis of the variables of financial performance and determining variables.

Table 1: Summary of descriptive statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
ROA	132	0.016928	0.055383	-0.11	0.23
ROE	132	0.072478	0.193387	-0.508	1.43
PAR	132	0.037861	0.040283	0	0.238
FS	132	8.094149	0.889283	6.394372	9.927381
OPC	132	0.107714	0.074481	0.0188	0.418
LPA	132	0.744833	0.11874	0.23	0.94
CAR	132	0.378644	0.181682	0	0.886
MKC	132	0.249373	0.032815	0.198556	0.292517
GDP	132	10.84333	1.016811	8.7	12.6
IFN	132	15.48333	10.63184	2.8	36.4

Source: SATA output results for sampled MFIs from 2003-2014

Table 1 presents the mean, standard deviation, minimum and maximum value of each variable for sample of 11MFIs for the period of 12 years from year 2003-2014 with a total of 132 observations. As it is presented the mean value of profitability measured by ROA was on average 1.69 percent. It means that, Ethiopian micro finance institutions generate on average 1.69 percent from their total assets employed. The standard deviation of return on asset (ROA) is 5.53 percent and it shows that the value of return on asset can vary both sides by 5.53 percent from the mean. Its minimum value is -11 percent while the maximum is 23 percent. The mean value of ROE was 7.24 percent with the maximum and minimum value of 143 and -5.08 percent respectively. This revealed that micro finance institutions in

Ethiopia were able to generate an average positive return of 7.24 percent on their equity for the last 12 years.

Table1 also shows portfolio at risk has an average value of 3.78 percent. From loan portfolio the portion of the portfolio in arrears or unpaid is 3.78 percent averagely that is good and the maximum 23.8 percent implies that the credit portfolio of some MFIs in the sample is fairly risky. Firm size, which is measured by the natural logarithm of adjusted total asset, is 8.09 on average and standard deviation is 0.88. The minimum and maximum values of firm size for the sampled MFIs are 6.39 and 9.92 respectively. Operating expense ratio is averaged 10.77 percent for the sampled MFIs in Ethiopia. Meaning sampled MFIs incur on average 10.77 cents in

operating expense for each birr in the gross loan portfolio.

Operating expense ratio can vary both sides by 7.44 percent from the mean value and the value for operating expense ratio sampled firms ranges between 1.88 percent and 41.8 percent of minimum and maximum values respectively. The mean value of portfolio to asset is 74.48 percent. The standard deviation is 11.87 percent and the value portfolio to asset for sampled MFIs ranges between 23 percent and 94 percent of minimum and maximum values respectively. The mean value of capital adequacy was 37.86 percent with a maximum of 88.6 percent and minimum of 0 percent for the sampled MFIs. The

standard deviation statistics for capital strength was 18.16 percent which shows the existence of variation of equity to asset ratio between the sampled MFIs in Ethiopia. In addition, the minimum and the maximum value of market concentration as a proxy of Herfindahl-Hirschman index shows 19.85 percent and 29.25 percent respectively and the mean value of 24.93 percent.

Regression Analysis

Random effect regression analysis was used to analyze the determinants of financial performance of microfinance institutions in Ethiopia and the result is indicated in the following table.

Return on Asset Model

Table 2: Random Effects GLS Estimation Result for Model I

xtreg ROA PAR FS OPC LPA CAR MKC GDP IFN, re			
Random-effects GLS regression	Number of obs	=	132
Group variable: ID	Number of groups	=	11
R-sq: within = 0.5934	Obs per group: min	=	12
between = 0.4555	avg	=	12.0
overall = 0.5624	max	=	12
	Wald chi ² (8)	=	173.78
corr(u_i, X) = 0 (assumed)	Prob > chi2	=	0.0000

ROA	Coef.	Std. Err.	Z	P>z	[95% Conf. Interval]	
PAR	-.2413757	.0952201	-2.53	0.011	-.4280037	-.0547477
FS	-.0018259	.0100458	-0.18	0.856	-.0215154	.0178636
OPC	-.1467752	.0953306	-1.54	0.124	-.3336198	.0400694
LPA	.1435423	.0355818	4.03	0.000	.0738033	.2132813
CAR	.0036721	.0247322	0.15	0.882	-.044802	.0521462
MKC	-.5379328	.1665865	-3.23	0.001	-.8644363	-.2114292
GDP	-.0133225	.0053789	-2.48	0.013	-.023865	-.00278

IFN	-.000354	.0003843	-0.92	0.357	-.0011071	.0003991
_cons	.2324363	.1326673	1.75	0.080	-.0275869	.4924595
sigma_u	.01888746					
sigma_e	.03387705					
Rho	.23713007	(fraction of variance due to u_i)				

Source: Random Effect Regression output of collected data

The result of regression shows that the adjusted over all is R^2 of 56.24 percent. This implies that 56.24 percent of the variations in ROA are explained by the independent variables. In addition, the value of wald chi2-test which used to explain the overall fitness of the model, as it is indicated by the F-value of 173.78 which is highly significant at 1percent with p-value of 0.000. C is the coefficient of the intercept of the model and it represents the average value of ROA when all explanatory variables took a value of zero. This indicates the model used to measure the determinants of financial performance of microfinance institutions is fit to achieve the purpose.

Loan repayment which measures portfolio quality is an essential ingredient for financial performance of MFIs. A low repayment rate is expected to reduce the probability of MFI survival. Loan repayment was measured by Portfolio at risk (PAR). The random effect regression result indicates that, coefficient of PAR is -0.2414 with its p-value of 0.011 and had a negative relation with financial performance measured by return on asset. This means that, keeping other variables constant a 1 percent increase in portfolio at risk results a decrease in ROA of sampled microfinance institutions by 0.2413 percent and statistically significant at 5 percent of significant level which shows that the higher the PAR value, the lower will be the re-

payment rates and that will affect the financial performance of MFI. The finding is consistent with the findings of Marcel and Nyamsogoro (2010), Muriu (2012), Yonas (2012), Tehulu (2013) and Beg (2016). The finding also shows that firm size negatively affects ROA with coefficient of -0.00185 but it is not significant.

Efficiency refers to the cost per unit of output. Common efficiency ratios include operating expenses ratio, salaries and benefits to average portfolio outstanding, average credit officer salary as a multiple of per capita GDP, cost per unit of currency lent, and cost per loan made. Here, we use the operating expenses ratio (OPC) to measure efficiency. The result of the operating expenses ratio is -0.1467 with its p-value of 0.124 indicating that operating expenses ratio has no statistically significant effect on performance. Loan portfolio to Asset is an indicator of the financing structure of MFI. It shows how MFI has allocated its assets to lending activities. The regression output for LPA indicates positive coefficient of 0.1435 with its p-value of 0.000. This implies that, keeping other variables constant, an increase in LPA by one unit cause an increase in ROA nearly by .144 birr. This finding is consistent with the findings of Jorgensen, (2011) but against the finding of (Beg 2016).

Regression result also indicates that there is a positive relationship between capital

adequacy ratio and financial performance of MFIs with a coefficient of 0.003672 as it was hypothesized to have but not significant even at 10 percent significance level. Market concentration index is used to measure competition in the microfinance industry. Herfindhal-Hirschman index (HHI) was used as a measure of competition. A low concentration index is associated to high competition and vice versa. The regression output indicated that market concentration is found to have negative coefficient of -0.5379 and is significant at 1 percent significance level. The result suggests that the more concentrated (less competition) the microfinance market the higher the financial performance of MFIs in Ethiopia.

A stable macroeconomic environment is necessary for the viability of MFIs. The result revealed coefficients of -0.0133 for GDP and -0.000354 for inflation revealing the fact that there is no statistically significant relationship between inflation and GDP growth and financial performance of Ethiopian MFIs. This could be because of the establishment mission of microfinance institutions which forces them to focus on poverty reduction than maximizing their profit.

Return on Equity Model

The following table indicates the regression output for the determinants of financial performance using return on equity as a dependent variable.

Table 3: Random Effects GLS Estimation Result for Model II

xtreg ROE PAR FS OPC LPA CAR MKC GDP IFN, re vce(robust)						
Random-effects GLS regression				Number of obs = 132		
Group variable: ID				Number of groups = 11		
R-sq: within = 0.4657				Obs per group: min = 12		
between = 0.0127				avg = 12.0		
overall = 0.3647				Wald chi2(8) = 581.91		
corr(u_i, X) = 0 (assumed)				Prob > chi2 = 0.0000		
(Std. Err. adjusted for 11 clusters in ID)						
ROE	Coef.	Std. Err.	Z	P>z	[95% Conf. Interval]	
PAR	-1.053177	.306804	-3.43	0.001	-1.654502	-.4518526
FS	-.0721482	.0703402	-1.03	0.305	-.2100123	.065716
OPC	-1.121324	.4920892	-2.28	0.023	-2.085801	-.1568467
LPA	-.003952	.4120797	-0.01	0.992	-.8116134	.8037094
CAR	.001493	.1107942	0.01	0.989	-.2156597	.2186457
MKC	-2.584895	1.112621	-2.32	0.020	-4.765592	-.4041978
GDP	-.0444225	.0143586	-3.09	0.002	-.0725647	-.0162802
IFN	-.0010542	.0010153	-1.04	0.299	-.0030442	.0009357
_cons	1.962104	1.28518	1.53	0.127	-.5568028	4.481011

sigma_u	.05095413	
sigma_e	.13724628	
Rho	.12113748	(fraction of variance due to u_i)

Source: Random Effect Regression output of collected data

From the regression output it is indicated that portfolio at risk, firm size, operating cost, portfolio to asset; capital adequacy, market concentration, gross domestic product and annual inflation rate are regressed against ROE. The Adjusted R² overall in this model specification is 36.47 percent indicating that, holding other explanatory variables constant, the explanatory variables in the regression explains 36.47 percent of variations in the financial performance measured by ROE and F statistics of 581.91 and P value of (0.0000). Thus the independent variables collectively are significant in explaining the financial performance.

The regression result shows that portfolio at risk is found to have a negative coefficient of -1.053177. This coefficient is significant at 1 percent significance level suggesting that; portfolio at risk has a statistically significant negative influence on financial performance of sample MFIs measured in terms of ROE.

It is also indicated that size has no statistically significant effect on the performance of microfinance institutions measured by return on equity. The result of the random effect regression output also shows that operating cost ratio have negative effect on financial performance of MFIs with coefficient of -1.121324, but it is not significant even at 10 percent significance level. The result of the regression analysis also indicated that capital structure measured by loan to total assets and capital adequacy have no statistically significant effect on

performance of MFIs measured by return on assets. The regression coefficient of market concentration is -2.584895 and p value of 0.020 is significant at 5 percent significant level. This indicates the fact that there is negative relationship between competition and financial performance of microfinance institutions.

The regression result also shows negative and significant relationship between GDP and financial performance of MFIs measured with ROE with coefficient of -0.044225 and p value of 0.002. Abebaw (2014) who found the same result depicted that despite the country's continuous economic growth, MFIs in Ethiopia were not profitable because they are established for minimizing poverty as the main goal or social orientation than profit maximization. Finally, the result of the random effect regression analysis indicated that inflation has no statistically significant relationship with performance measured by return on equity of the microfinance institutions in Ethiopia.

CONCLUSION AND RECOMMENDATION

The finding revealed higher portfolio at risk decreases financial performance indicating that in order to become good financial performer, MFIs should increase their repayment rates. The finding also shows that operational cost inefficiency reduces return on assets requiring MFIs to work on minimizing their avoidable costs. Significant positive relationship between

loan portfolio to asset and financial performance of MFI in Ethiopia implies that as if MFIs allocate a high amount of their assets to lending activities, they could increase their likelihood of attaining financial performance. The negative regression coefficient of market concentration in the model shows the reverse impact of competition on financial performance. Portfolio at risk, market concentration and GDP

has significant negative effect on financial performance of Ethiopian MFIs while the remaining variables have insignificant effect on their performance. MFIs in Ethiopia are recommended to revise their credit procedures and policies to increase their repayment rates and the government has to intervene and support their operation so as to make them financially viable and strong to reduce poverty.

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