

Enabling Environment: Access to Financial Services in Ethiopia

AgriFin (September 2012) | This technical brief summarizes the Enabling Environment: Access to Financial Services and Transportation chapter of the World Bank report on Agribusiness Indicators: Ethiopia (http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTARD/0,,contentMDK:23184641%7EpagePK:210058%7EpiPK:210062%7EtheSitePK:3361 in April 2012.

The agriculture sector plays an important role in the Ethiopian economy. It contributes approximately 45 percent of GDP and accounts for 80 percent of both employment and exports. Financing for this sector comes from commercial banks, microfinance institutions (MFIs), and cooperative societies. Despite its considerable contribution to the economy, the agricultural sector received an average of only 9.6 percent of the total loan portfolio of commercial banks between 2005 and 2009. In addition, the greater part of this lending is directed towards investment in export facilities rather than production and distribution. This has had the effect of limiting the development of agri-business. To increase access to agriculture finance, the Government of Ethiopia helped to establish Oromia Cooperative Bank of Ethiopia (OCBE), a bank that specializes in financing agricultural enterprises.



Commercial banks often argue that the agriculture sector is a high-risk investment with high default rates. However, there are significant variations in non-performing loan (NPL) rates for agricultural loans among the major commercial banks in Ethiopia. For example, OCBE reported a 6 percent NPL rate, while the NPL rates of Commercial Bank of Ethiopia and Development Bank of Ethiopia were 0.2 percent and 12.8 percent, respectively, during the period 2005-2009. Based on interviews with financial institutions, the estimated overall default rate for agricultural loans was approximately 3 percent.

As of June 2011, the average lending rate of public banks was 9.5 percent and of private banks was 12.5 percent. The lending rate of informal financial providers could reach as high as 20 percent. Meanwhile, the average deposit rate of both public and private banks was 5 percent. The interest rate spread was measured at about 5.5 to 6.5 percent.

Ethiopia has a very low rural banking density and consequently one of the lowest financial inclusion ratios of Sub-Saharan Africa, with only 14 percent of adults having access to credit. Most of the bank branches are aggregated in urban areas, leaving the rural areas underserved. The ratio of the rural population to a commercial bank or MFI branch is 125,158 people. Thus it is unsurprising that only 1 percent of the rural population have bank accounts.

In order to increase access to agriculture finance, particularly for smallholders, the Ethiopian government implemented a law governing warehouse receipt financing (WRF) as proclamation 372/2003. The law was followed by the establishment of a WRF system in 2011 by the Ethiopian Commodity Exchange (ECX). Currently, there are 16 warehouses throughout the country. The ECX has an agreement with four commercial banks to allow farmers to use warehouse receipts as collateral to access loans. All ECX commodities except for coffee can be used to obtain WRF loans. The bank offers financing up to 60 percent of the commodity's value as a short-term loan at an interest rate of 9.5 percent, which will be processed within three to five days of application. The repayment period depends on the type of commodity, for example one month for sesame, two months for white pea beans, three months for maize, and four months for wheat. So far, the banks have only disbursed ETB 10M in WRF loans, which was well below the ECX's expectation.

In Ethiopia, the land belongs to the government and therefore cannot be used as collateral. Movable properties may be used as collateral; however, only "standardized agricultural machinery and equipment" are acceptable to the banks. This policy effectively excludes most smallholder producers.

To date, Ethiopia does not have a financial credit bureau or collateral registry. A mere 0.1 percent of Ethiopian adults are covered in a credit registry. The National Bank of Ethiopia hired a South Africa-based credit reference bureau to establish a Consumer and Business Credit Information Bureau that was intended to be launched by August 2011.

Category/Subcategories	Indicator	Base Year/Period/Value
Commercial Lending to Agriculture (2005-2009)	% of commercial bank loans to the agricultural sector	9.6%
Loan Performance by the Agricultural Sector (2005-2009)	% of loan approved that was disbursed to the agricultural sector	14.96%
	% of loan to agriculture sector that has been collected	13.12%
	% of loan outstanding	9.66%
	Non Performing Loan (NPL) as of June 2011	a) Commercial Bank of Ethiopia: 0.2%
		b) Oromia Cooperative Bank: 6%
		c) Development Bank of Ethiopia: 12.8%
Cost of Credit and Financial Services	Nominal average deposit rate	5%
	Nominal average lending rate	11%
Access to Credit and Financial Services	Commercial bank branch density/ratio of number of people per rural branch	125,158:1 - 1 branch per 125,158 people
	Average loan extended by MFIs in 2010	US\$170
	Access to finance by FBOs	Most FBOs in Ethiopia are cooperatives and do not have the capacity to meet the collateral requirement on their own unless credit is guaranteed by the government.
	Percent of rural households with bank accounts	1%
	Financial inclusion: percent of adults accessing credit	14%
Banking Sector Efficiency	Interest rate spread	6%
Warehouse Receipt Financing (WRF) System	Existence and extent to which the WRF is established and functional	Yes; Ethiopia Commodity Exchange (ECX) has just launched a very robust WRF system to be used by farmers as collateral.
Leasing Agreement and Movable Property as Collateral	Existence of a law on leasing	Yes; based on "Capital Goods Leasing Business Proclamation No. 103/1998."
	Existence of a law for use of movable assets as collateral	Yes; however, only standardized agricultural machinery and equipment are acceptable to the banks for collateralizing agricultural loans.
	Presence of a collateral registry	No; in Ethiopia, there is no collateral registry in operation that is unified geographically and by asset type.
	Existence of credit reference bureau	No; presently, there is no functional credit reference bureau although one was scheduled for launching on August 12, 2011.

Agribusiness Indicators in Africa
<http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTARD/0,,contentMDK:23184287%7EpagePK:148956%7EpiPK:216618%7EtheSitePK:336682,00.html>
 is a three-year (2010-2012) project, funded by the Bill and Melinda Gates Foundation, which is developing an approach for assessing the ease of doing agribusiness in at least seven pilot countries—Burkina Faso, Ethiopia, Ghana, Mozambique, Kenya, Tanzania and Zambia.

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