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ISLAMIC MICRO FINANCE SERVICES IN ETHIOPIA: PERFORMANCES AND IMPLICATIONS FOR FINANCIAL INCLUSION AND POVERTY ALLEVIATION

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Abstract

Deprivations are a worldwide incident affecting people both in developed and developing countries. The study examines the performances Islamic micro finance institutions and their implication for financial inclusion and poverty alleviation in Ethiopia. Descriptive method of research is used to understand the general overview and performance of both conventional and Islamic micro finance institutions and observe the role of Islamic micro finance institutions towards ensuring financial inclusion and reducing poverty in the country. A survey was conducted on interest free micro finance windows in the existing conventional micro finance institutions in different parts of the country. The results revealed that most of the institutions provide murabaha which is a popular form of financing small entrepreneurs and businesspersons. However, the main challenges of interest free micro finance system are unavailability of clear and detailed legislation from the regulator National Bank of Ethiopia (NBE), shortage of trained and knowledgeable workforce related to interest free micro finance services, immense and arduous administrative cost of the system and clients' nonconformity with some Sharia principles like failure to deliver the item to the institution after they acquired it from the market on behalf the micro finance institutions.

Keywords: *Financial inclusion, micro finance institutions, Islamic financing, poverty alleviation*

JEL Classification: *E51, G21, I32*

1. Introduction

Poverty is one of the most critical socio-economic problems in most developing countries nowadays. According to the 2017 global poverty update from the World Bank, the overall number of poor people surged from 766 to 768.5 million which indicates a rise of 2.5 million additional poor in 2017 as compared to the year 2016 employing the International Poverty Line of 1.90/day. The report further pointed out that East Asia and Pacific, Europe and central Asia and Sub Saharan Africa regions experienced an intensification of poverty since these regions have more poor people as compared to the previous year. Ethiopia, a country in sub-Saharan Africa, is suffering from poverty and destitution. United Nations Development Program's (UNDP) human development index (HDI), which constitutes lengthy and healthy life, access to education and a better standard of living, the country's ranking is among the lowest in the world. Besides, a great number of people lead their life close to multidimensional poverty line according to the figure by human development report in 2016. The magnitude and severity of poverty is exposed mostly in rural areas of Ethiopia (Dercon et.al, 2012; Bacha et.al, 2011).

There are several mechanisms applied by institutions and government bodies to reduce poverty and improve the standard of living of the people. The approaches, however, might vary from country to county and the modus operandi of endeavoring to fight poverty depends on diverse policies and programs. Financial inclusion is deemed to be one of the tools to eradicate poverty through comprising the neglected portion of the society to be part of the production and growth of the economy (Zins and Weill, 2016). Financial inclusion is a vital enabler to plummeting poverty and enhancing the welfare low-income people (Park and Mercado, 2015; Schwittay, 2014; Cnaan et.al, 2012; Ssewamala, 2010).

Micro finance institutions are providing a wide range of financial services to the poor and abandoned segment of the community in different countries. The poor section of the society cannot benefit from the conventional financial institutions like banks, insurance, money markets and the like due to institutions' priority to the urban population with low-risk profile and requirement of collateral to get loan. Consequently, the poor people don't entitle to get loan and other financial services because of their high-risk profile. The situation in Ethiopia is not different from most African countries where a lot of people are deprived of financial access either from undeveloped financial sector or as a result of personal, family, cultural, religious and other reasons. Some empirical studies pointed out that religious view could be mentioned as a reason not to be involved in the current interest based financial system in Ethiopia in general (Hailu, 2019; Andualem & Rao, 2017; Deresse & Zerihun, 2017; Fredu & Edris, 2016; Demirguc-Kunt et.al, 2014) and micro finance sector in particular (Hailu, 2019; Derese and Zerihun, 2018; Deresse & Zerihun, 2017; Fareh, 2011; Guush, 2009). Hence, this study addresses the performances Islamic micro finance institutions and their implications for financial inclusion and poverty alleviation in Ethiopia. The remaining parts of the paper covers the theoretical frameworks, overview of micro finance institutions in Ethiopia, empirical evidences, alternative micro finance system, major findings and conclusion.

2. Literature Review

Financial inclusion can play a great role on poverty reduction and enhancing economic growth of nations. Yet most African countries have one of the least track records of financial inclusion in the globe (Zins & Weill, 2016). The situation in Ethiopia is not different from most African countries where plenty of people are deprived of financial access either from undeveloped financial sector or as a result of personal, family, cultural, religious and other reasons. Notwithstanding the financial sector has been improved especially since the time the government allowed private participation in the banking and insurance sectors, a lot has to be done to embrace people who are unable to get access to financial services because of internal or external reasons. According to NBE (2017), the proportion of banks and insurance companies congregated in the capital Addis Ababa were 36% and 54% respectively which illustrates that most of the rural people are neglected due to distance and other factors.

The World Bank Findex (2017) report discloses that around half or more of adults above the age 15 stated that they haven't got any account in the financial institutions in Ethiopia. These people who constitute above the total population of the country save, borrow or get insurance against risks via informal sectors. Besides, although 48% of the adults above the age 15 testified that they saved or kept some money somewhere, just 14% of them affirmed that they save at a financial institution. Likewise, 44% of the respondents stated that they borrowed some amount of money through informal means for different purposes but only 7% get credit from formal financial institutions. All in all, the report elucidates that the majority especially those who live in rural areas of the country are left out of the formal financial services and fail to improve themselves and their families and participate in investment and development process of the country.

NBE acknowledged the insignificant level of financial inclusion all over the country in its national financial inclusion strategy. The strategy referred the data from Findex 2014 and disclosed that the financial inclusion is suffering from lack of cognizance, faith and confidence and plenty of people dissociated themselves from the financial services because of inadequate fund, attitude, remoteness of the institutions, enormous cost of services, lack of documentation, suspicion and religion (NBE, 2017). Despite mentioning the need to scrutinize and disclose financial services based on Shariah-compliant and justify financial exclusion as a result of religion, the strategic report didn't state as to how the study is going to be conducted. This shows that the financial inclusion strategy fails to address this issue and lacks genuine grounds to embrace the neglected section of the society. Though not admitted, NBE disregarded the relevance of amending regulations as recommended by some studies (Hailu et.al, 2019; Derese and Zerihun, 2018; IFAAS, 2018; Adualem and Rao, 2017)

As it is clearly stated in the introduction part, religious reasons are among other things that are believed to be one of the reasons not to involve in the current MFIs operating in Ethiopia. In the following section, recent empirical findings which support our argument together with the comments and criticisms were presented. Hailu et.al (2019) examined the impact of Islamic financial product innovation towards tackling financial marginalization in Ethiopia. They conducted survey of 321 people who reside in three selected sub-cities in the capital Addis Ababa and interviewed some senior central and commercial banks personnel and came to conclusion that religious reasons are the main factors which make the Ethiopian Muslims distance themselves from the conventional financial services and institutions. Specifically, the interview result uncovers that 58.6% of the respondents do not use micro finance services because it is against their religious doctrine.

Derese and Zerihun (2018) identified that Muslim respondents of West Oromia region do not want to take loan due to interest rates charged by MFIs and they believe that this act is against their religion's principles but the authors didn't disclose what proportion of the respondents said so. Finally, the authors recommended that MFIs should devise Muslim friendly financial services in the study area where a great number of Muslim populations reside. Previously, the two authors Derese and Zerihun (2017) studied the factors of MSE managers to have access to bank loan in the same region. MSE managers' religion affects the access to have credit due to the managers' belief that Islam prohibits taking and giving money with interest.

In same way, another empirical study made by Andualem and Rao (2017) revealed that religious reasons are among the obstacles to access and use of funds from conventional financial institutions. In their survey study which took a sample from 34 kebeles in Addis Ababa, they uncovered that religious reason is among the factors mentioned as impediment to have access to financial services. Though this study mentioned religious reasons and lack of trust (cited as only reasons) as the sixth reasons in order with a proportion of 2% each, the representativeness of the sample (whether they included enough samples from every major religious followers and area of the sample) can be questionable.

A survey which included 11,810 respondents to analyze financial inclusion in Ethiopia was contributed by Gashaw and Gebe (2017) emphasizing respondents' ownership of accounts in financial institutions, utilizing formal account to save money and making use of financial services and products. The results of the study showed that there is a variance between Muslims and Christians indicating that the later have more accounts in the financial institutions that the former though not supported by econometric assessment. The empirical findings illustrate that religion is one of the critical hurdle to financial inclusion in Ethiopia.

Hussien et.al (2015) investigated financial outreach and use in Ethiopia using questionnaires and interviews of clients of financial institutions. They highlighted the role of financial inclusion as a significant instrument to reduce poverty. However, the capacity of these microfinance institutions (MFI) from human resource and finance point of view is not adequate to help accelerate access to finance both in rural and urban areas. They recommended that a lot should be done to uplift the cognizance of the low-income people about the delivery of financial services in agreement with their religious doctrines. Besides, Mackie et.al (2015) identified that in their interview with one of the businessman in the city of Hawassa, he revealed that the availability of borrowing with interest is contrary to his religion and cannot consider it as suitable way of financing. This finding also corroborates the fact that non-participatory nature of the financing sector in the country as one of the challenges of MSEs to do their business.

The survey results of Findex (2014) shows that a great deal of people mentioned insufficient fund (78%), distance (12%) and comparatively high cost of services (2%) as difficulties of engaging the existing formal financial institutions in Ethiopia. Moreover, unavailability of required documents, suspicion and religious motives each 1% was pointed out as reasons not to participate and get access to funds and other services from the institutions (Demirguc-Kunt et.al, 2014). Fareh (2011) studied regarding poverty reduction policies in pastoral communities of Somali Regional State in Ethiopia. The study employed focus group discussions, semi-structured interviews, and informal discussions with the dwellers of five villages in Somali region. One of the findings of the study showed that religious reasons (the prohibition of interest in Islam) were cited as a cause not to partake in the conventional micro finance system. However, the study did not disclose any figure up to how many people or how much proportion of the respondents of the survey expressed that.

Based on panel data of 400 rural households in sixteen villages of four zones in the Tigray region, Guush (2009) found that religious reasons which constituted 4% of the households (specifically mentioned the word haram which shows that the respondents were Muslims) stated as motives not to get involved in the existing MFIs. The fact that Tigray region is dominated by Christian population, 4% of the Muslim households is not insignificant and it gives the regulators and institutions a signal to introduce an alternative way of financial services.

To recapitulate, all of the above studies indicated that there is financial exclusion due to religious reasons in Ethiopia and they emphasized that there is marginalization to involve in the existing MFIs. This situation exacerbates not only insubstantial saving mobilizations from the low-income people but also encumbers poverty alleviation and human development in the country.

3. Data and Methodology

The study employed descriptive method of research. It enables to characterize the existing situation of Islamic micro finance services and its contribution to financial inclusion and poverty alleviation in Ethiopia. An open-ended interview was conducted with conveniently selected officers of the micro finance institutions which recently started providing Islamic services in some parts of the country. The questions were focused on the kinds of services, their performance, the challenges and suggestions to improve the alternative services provided by the newly commenced

Islamic microfinance services. The results of the interview were presented in the form of direct quotations and paraphrasing some explanations when necessary. Moreover, Data regarding the particular Islamic MFIs and types of clients, types of services, amount of services etc. were collected from the websites, annual and performance reports, development reviews and so on. These secondary data were analyzed using tables and percentages when appropriate.

4. Islamic Microfinance System: An Alternative Model

It has been emphasized that inclusive financial institutions play an ever increasing role towards promoting development, prosperity and reduce poverty and destitution in different parts of the world. Micro finance institutions have been engaging in providing a number of financial services to the neglected and believed to be "risky" segments of the society in the form of credit, saving, insurance and a variety of payment systems.

MFIs based on Islamic principles have emerged after the advent of Islamic banking practice in 1970s in Middle East to facilitate funds to small-scale entrepreneurs and alleviate poverty. This industry is an emerging one which is trying to target beneficiaries based on their Islamic beliefs and values emphasizing poverty alleviation, financial development and financial inclusion (Riwajanti, 2013). Islamic micro finance addresses the issue of achieving societal improvements and ensures the involvement every member to help attain growth of income, practical dissemination of income and encouraging equitable and fair opportunities for the entire members of society as constructive actions to advance the life of the low-income people over and above it implements the modus operandi of guiding the ownership of properties and also avoidance of mismanagements as precautionary actions (Mansori et.al, 2015).

In order to include those who are deprived of financial services due to their adherence to Islamic principles, alleviate poverty and uplift the welfare of the low-income people, several models and products have been devised by Islamic MFIs in most developing countries. Some of the widely used Islamic models and products are illustrated here.

4.1. Murabaha

This kind of financing is comprehensive and long-established not only in Islamic banking industry but also it is prominent in micro finance sectors throughout the world because of its straightforwardness as compared to other forms of financing. Murabaha is a form of financing based on buying and selling mechanisms adding markups on the cost of the product which enables the buyer to pay the price on installment basis (Khan, 2008). Murabaha can be used as an alternative financing model that entitles micro finance beneficiaries to own an asset for consumption or production with the opportunity to pay the cost of the asset on a deferred basis. This form of financing can be applied on a group arrangement in which each group member is responsible if there is default among the group members.

4.2. Mudarabah

Mudarabah is a partnership form of financing in which one party contributes money (rabbul mal) and the other (mudarib) brings his skill, expertise, time to do the business. Under this contract, both parties should agree on profit sharing ratio and the loss will be borne by the party who invests the money if there is no negligence and misconduct from the entrepreneur side (Ayub, 2007). Mudarabah model can be utilized in micro finance system where the MFI provides capital and micro entrepreneur acts as a mudarib who uses the money to do business (Abdul Rahman, 2007). When this model is applied in micro finance system, it has some shortcomings according to Dhumale & Sapcanin (1999). The ambiguity and inconsistency of the profit, probability that the entrepreneurs do not keep the accounts appropriately and creating load in managing loans and monitoring by loan officers.

6.3 Musharakah

Musharakah is the other partnership form of financing whereby both the capital provider and the micro-entrepreneur contribute some amount of money to a business venture agreeing to share the profit as per a predetermined ratio whereas the loss will be shared according to the capital each party allocated (Farooq and Ahmed, 2013). In this model, all partners have the privilege to take part in the administration of the business undertaking. Conversely, the parties have the right decide not to involve in the management (Smolo, 2012). Musharakah model can stay for a long time or it can be in the form of a diminishing musharakah (musharakah mutanaqisah) in which the share of one partner reduces progressively until the other partner fully owns the business or property. According to Abdul Rahman (2007), diminishing musharakah is the most appropriate partnership form of financing for micro finance scheme which enables micro-entrepreneur to entitle the ownership of the business slowly.

4.3. Ijara

This model resembles the conventional leasing but has some differences in application. In ijara contract, the owner of an asset or property allows the other party for the usufruct of the asset against prearranged rental payments until the end of the contract period (Hanif, 2014). The ownership rests in the hands of the owner during the ijara period and the client will be entitled to benefit from the rented asset. In recent times, a new breed of contract called ijarah wal iqtina or "hire - purchase agreement" come to practice which is a comparable to the conventional lease-purchase agreement. In this contract, along with the normal lease agreement, the owner of the asset pledges to sell or grant the leased asset to the lessee once the lease agreement come to an end. Scholars emphasize that the two agreements should be separate since both the lease and sell contracts cannot be made at the same time (Iqbal & Mirakhor, 2011). This type of contract is suitable for low-income people who want to use the usufruct of the asset until the completion of the agreement and have the opportunity to own the asset either in the form of gift, symbolic price or by a certain amount of money.

4.4. Qard Hasan

The other form of loan is qard hasan which is sometimes called benevolent loan or interest free loan. In this type of loan, the borrower is only asked to repay the principal without engaging either in partnership, lease, sale-based or any other form of contracts. Qard hasan enhances the transfer of wealth between people, creates an opportunity for the poor to set up their own business and produce something which ultimately change their life and contribute the economy which eventually help reduce poverty. Some scholars allow charging some percentage for service and administration costs that are considered actual expenses like office rent, salary to the staff and other office expenditures (Khan & Phillips, 2010). Even though the mainstream Islamic finance give little attention to qard hasan as an impressive means of financing, it is widely utilized by the Islamic MFIs in many countries to support the economic dream of low-income people as fund-raising and easy financing instrument. It is considered as "pure and effective" means of financing since it has solid ground from Shariah perspective as compared to other models (IRTI, 2007).

The above selected Islamic micro finance models not only contribute a lot to achieve financial inclusion but also help reduce poverty and enhance the living conditions of the poor in different developing countries. There are abundant empirical evidences of the positive impact of Islamic micro finance services on poverty alleviation. The studies conducted in south and south east region like Bangladesh confirmed that Islamic micro finance services enhanced income, ownership of assets, education of children and health care (Farooqi, 2017) and income level, employment and sources of water (Alam, 2016). In Pakistan, because of micro finance services improved the standard of living, per capita income, level of consciousness (educational status), moral principles, profitability, sustainability, infrastructure situation, employment level in the community, crucial to curb the inflation and imbalanced wealth dispersion (Aslam,2014) and monthly return and expenses of the respondents and improvements in ownership of assets (Mahmood,2015). In Indonesia, studies show that the provision of the services enhanced the living standards of the clients and set up their own businesses (Effendi,2013) level of income, children's education, health care, and improvement of business (Rokhman,2013).

Studies made in sub-Saharan African countries documented the same result. In Nigeria, Islamic micro finance services enhanced the level of income, creating educational opportunities for children, and facilitated the ownership of properties (Gumel,2014) and positive effect in terms of reducing poverty (Adegbemi & Adefisayo,2013). In Kenya, income, education, health, and housing were improved because of the services (Nasra, 2013); whereas, in Somaliland micro finance institutions were able to include some portion of the poor who are excluded from the financial services (Abdiqadir, 2012). Finally, Obaidullah (2008) examines case studies of three member countries in Islamic Development Bank (IDB) namely; Bangladesh, Indonesia, and Turkey. According to growth approach the beneficiaries of the programs aimed at alleviating poverty on sort-term basis for and support for the maintenance of the poor whereas the growth approach deals with the advancement of business development through targeting a small number of recipients of the financial services.

5. Major Findings and Discussion

In this part, the results that were acquired through interview and secondary data are presented and analyzed. Currently, Islamic windows for saving and loan are operating in conventional MFIs in some areas of the country especially in the eastern and south eastern part of the country. Some Islamic micro finance models, though limited, have been launched by a few micro finance institutions working in Muslim majority areas. Somali, Harar, Dire Dawa micro finance share companies, and Oromia Credit and Saving Sharing Company (OCSSCO) started providing saving and credit services based on Islamic principles.

5.1. OCSSCO

Following proclamation No.40/1996 which allows the establishment of private micro finance in Ethiopia, OCSSCO commenced several micro finance services. Recently, the institution is extending six conventional loan types in addition to interest free loan based on Murabaha. This kind of loan, as it was explained in detail previously, is asset-based mode which allows the clients to get access to finance in the form of owning goods paying the price on installment basis. Murabaha is offered in three forms for individuals, groups and small businesses from one to five years (see table 2). Moreover, a number of saving services are being provided including wadia saving account which enables the user to keep their money for safety purpose and can withdraw at any time. According to the institution, savings deposited in wadia account are kept separately from conventional system at interest free financial service window.

Table 2: Interest Free Credit Models Based on Murabaha

Product type	**Modality**	**Maximum Loan Size**	**Maximum Loan Term**	**Interest Rate**	**Collateral/ Guarantee**
Murabaha Individual Finance	As business entity	Depends on business plan & collateral	Up to 3 years depends on cash flow	Markup	Legal Urban House
Murabaha Micro and Small Enterprise Finance	As business entity	Depends on business plan & collateral	Up to 5 years depends on cash flow	Markup	Group liability
Murabaha Group Based Finance	In group	548 USD	1 year	Markup	Group liability

Source: OCSSCO website

5.2. Harar Microfinance Institution (HMFI)

HMFI started providing interest free saving in 2014 and interest free loan in 2015. Though there is a huge gap between what has been planned and the actual performance, HMFI is showing a great performance in terms of providing credit to low-income individuals, associations and small enterprises which are excluded from mainstream financial sources (see table 3). Like OCSSCO, HMFI provides interest free loan under three categories with different amount.

Table 3: Interest Free Micro Finance Eservices and Performance

Types of interest free credit	Measurement	2016/17	2017/18
Individual credit	Number of credit holders	307	181
	Amount in USD	460,515	533,675
Association credit	Number of credit holders	148	27
	Amount in USD	88,750	57,033
Private enterprise credit	Number of credit holders	159	154
	Amount in USD	371,764	476,642

Source: HMFI

One of the main challenges for interest free micro finance system, according to HMF officers is the unavailability of clear and detailed legislation from the NBE as how to implement interest free system and it didn't mention how to treat defaults when they happen. This situation makes the system vague and prone to misinterpretation and results in the absence of standardization.

5.3. Dire Micro Finance Institution S.C(DMI)

Aspired "to see the institution become competent micro finance service provider at national level", DMI, was established with a starting capital of 1 million birr to offer saving, loan, money transfer, counseling, interest free financing and saving services as well as promote saving culture in the administration. With the aim of addressing above 70% of the city's Muslim population, DMI launched interest free micro finance services around the mid-2013. As we can see in table 4, as of September, 2014, 7% of number of served clients and 44% of number of active loan clients use interest free micro finance services. 16% of the amount of loan is distributed related to interest free credit scheme and approximately 30% of values of loan outstanding dedicated to interest free services. There is a slight difference between the number of women clients under the conventional and interest free systems. This shows that DMI gives priority to women irrespective of the scheme they are employing.

Table 4: Credit and Saving Performance of Micro Finance Services Under Conventional and Interest Free

Activities	Conventional	Islamic	Total
1. Credit Performance			
No. of Served Clients	20,794	1,570	22,364
No. of Active Loan Clients	2,565	1,479	4,598
Amount Disbursed	129,655,814.52	24,778,150.00	154,433,964.52
Values of loan outstanding	29,141,166.81	13,427,487.60	44,989,342.64
Recovery rate	98.45%	90.59%	97.56%
Portfolio at Risk >30 Days	5.55%	11.88%	5.82%

Percentage of women Clients	63.11%	57.71%	62.73%
2. Saving Performance			
No. of Voluntary Savors	11,321	825	12,146
Amount of Net Saving Mobilized	18,680,222.43	6,525,389.12	25,205,611.55.33

Source: Dire Micro finance Institution S.C

DMI provides murabaha and ijara under its interest free loan service category. During 2014, the mark-up on murabaha was 15% in the first year, 23% in the second year and 30% in the third year. The murabaha financing product comprises four steps. First, the client applies for a credit by specifying the asset to be acquired. Next, agency contract will be signed between the micro finance institution and the client. After that, the institution will take delivery of the items bought by the agent/clients as agent/. Finally, by signing the loan contract the client purchase the goods with fixed markup on credit basis to reimburse the amount on a particular period in the future.

The other loan product is ijara which enables the client to benefit from the usufruct of assets owned by the institution like machineries, motors, vehicles and the like. This kind of service will be delivered to the client in exchange for amount of rental payments settled in short and long term period. The institution which possesses the asset is entitled to assume ownership until the total cost of the asset and the markup added is fully paid.

The saving products in the institution constitute wadia and mudaraba. Under the wadia saving deposit, the client saves his or her money without expecting return from the institution. Therefore, wadia scheme doesn't give the right to the client to share either profit or loss. Saving under mudaraba form, the saver places the deposit with the expectation to receive gain in case the business is successful or share the loss if the partnership fails to bring return.

Regarding the application and approval of the murabaha contract, DMF provides both personal and group loan services based on the item needed by the applicant/s. According to the loan manager, individual murabaha contract will be executed as follows;

"If a client wants to get personal loan, he or she has to bring one of the three guarantees namely salary guarantee, car ownership guarantees or legal document for house ownership. Once they applied based on legal document for house ownership, they will be entitled to get loan based on the market value of the house and they are required to save at least 10% of the requested money. In addition, it is necessary for applicants to submit identity card, business license certificate and marriage certificate (if he/she is married). After all the necessary documents submitted, the institution appoints the client as an agent to buy the item he/she wants then in the second phase the item will be fully transferred to the client."

The second form of loan is based on group of individuals from three to seven. Groups are formed by the members who they know each other very well. However, group debtors get less money as compared to personal debtors since the former cannot bring guarantee like stated above. DMF provides 5000 Birr for each group members and in case default happens all group members are responsible to recompense the amount unpaid. According to the loan manager;

"Group loan system enables low-income people to get access to finance without being asked to show guarantee. However, the loan will be made available to them after all required documents fulfilled like identity card and letter from lower administrative level of government to confirm the client is a resident in that particular area."

According to the presentation made by DMF about interest free banking on Agribusiness fair at Haramaya University, Ethiopia in 2014, shortage of trained and knowledgeable workforce related to interest free micro finance services, immense and arduous administrative cost of the system and clients' nonconformity with some Sharia principles like failure to deliver the item to the institution after they acquired it from the market on behalf the MFI.

5.4. Somali Microfinance Institution (SMFI)

SMFI, based in the southeast part of Ethiopia, established in 2012 under a private ownership of The Somali Regional Government and other shareholders. The institution aspires to provide financial access to the Ethiopian people. It gives credits to small entrepreneurs, small owners and businesspersons, transfer money, saving system and provide mobile banking. SMFI believe that by offering micro finance services to the poor section of the society, they will try to reduce poverty and achieve overall growth and development in the country. Financial services and training enable entrepreneurs to set up their own businesses assist their families and change the wellbeing of their communities. Like the above mentioned micro finance institutions, SMFI also stared to provide interest free micro finance services to its customers along with the conventional ones.

5.5. Rays Microfinance Institution (RMFI)

The other new MFI functioning in the same region is RMFI. It was founded in July, 2014 by six people, satisfying the expected minimum paid-up capital of 200,000 Br. The institution hopes to minimize the disaster of poverty through providing efficient and technologically supported micro finance services to the low-income section of the community in the region. Among interest free micro finance services, they offer to their clients include murabaha, salam and ijara. Group Guaranteed Loan (GGL), which is an instrument that permits a group of individuals to deliver collateral or credit assurance through a group reimbursement pledge, is one of the credit services RMFI will extend for people with low income. The first average loan amount for the first cycle of clients approaches 4,000 Birr in the first year of operation, which will be higher after that, with 10pc to 20pc loan interest rate per annum. RMFI also offers loans to cooperatives in the form of co-signatory or a permanent asset or vehicle as loan collateral. The average loan amount for first cycle loans is 7,500 Br in the first year of operation, which will grow after that. The loan term is one year with monthly repayment frequency with 10pc loan interest rate per annum.

6. Conclusion

Despite the fact that microfinance institutions have been operating in Ethiopia for more than two decades, they haven't devised a new mechanism to embrace those who are out of access to finance. Islamic micro finance system which deemed to be an alternative financial model come to reality to serve the neglected part of the poor. Right now, conventional MFIs like OCSSCO, HMFI, DMI, SMFI and RMFI are providing interest free micro finance services in the form of credit and saving. Murabaha, a popular form of financing small entrepreneurs and businesspersons, is being implemented by almost all MFI which offer interest free services. They buy an asset to a customer on his/her choices and sell him/her with disclosed cost plus markup. This type of financing become very common in today's MFIs since it is easy to apply. However, Special arrangements & watchfulness are essential for purchase & sale of goods as some clients may act as unscrupulous manner in the process. In addition to murabaha, ijara,salam and mudaraba are being delivered to MFI clients in the selected areas.

One of the main challenges for interest free micro finance system, according to HMF officers is unavailability of clear and detailed legislation from the NBE as how to implement interest free system and it didn't mention how to treat defaults when they happen. This situation makes the system vague and prone to misinterpretation and results in the absence of standardization. Moreover, shortage of trained and knowledgeable workforce related to interest free micro finance services, immense and arduous administrative cost of the system and clients' nonconformity with some Sharia principles like failure to deliver the item to the institution after they acquired it from the market on behalf the MFI are also cited as additional challenges. Financial inclusion will be achieved through a clear and comprehensive policy measures in all aspects. Besides, Awareness creation about system, proper documentation and follow up mechanism, producing skilled workers and minimizing transaction costs are also essential to attain financial inclusion. This study only focused on the significance and performances of Islamic microfinance services and their implication for financial inclusion and poverty alleviation employing interviews of the officers and secondary data from the institutions. However, the study could not cover the effect of the financial services on the life of the clients. Hence, it is one of the study areas left to researchers and other interested parties for further research and clarification.

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