



Gudon Ahmed, business owner and digital loan recipient, Jigjiga (Mercy Corps/Yosef Tiruneh, 2023)

Financial services in the lowlands of Ethiopia – The impact of multi-phase USAID investments

Inclusive and effective financial services are a key cross-cutting resilience capacity for households and businesses, not least in shock-prone contexts such as the lowlands of Ethiopia. In 2010, when Mercy Corps began working to strengthen financial systems in Somali and Afar regions, financial services were almost non-existent, presenting a major constraint to growth, job creation and resilience.

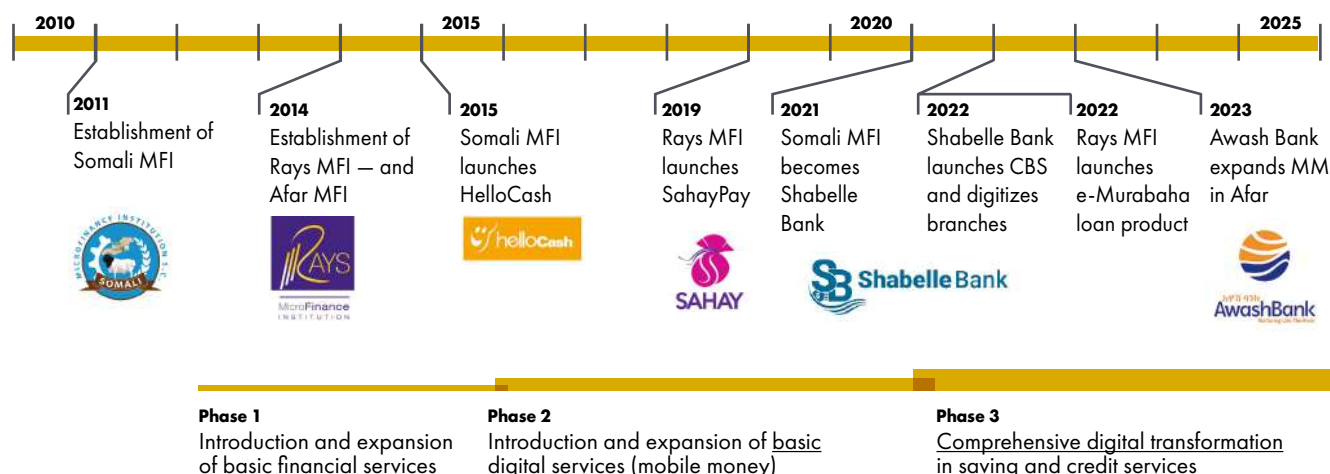
This learning brief describes how USAID resilience investments over more than a decade have enabled Mercy Corps to play a key role in transforming financial services in the lowlands, specifically through enabling three distinct iterations of partnership and innovation. The brief highlights the impressive reach that financial institutions have achieved including the latest innovations in digital credit services, but also the challenges faced in Afar region.

KEY CHALLENGES

- The arid and semi-arid lowlands pose a particular challenge for financial institutions, as the sparse, dispersed and mobile populations undermine the viability of the conventional 'brick and mortar' branch model.
- Lowland Muslim populations tend to be highly suspicious of formal financial services and require sustained education to trust that products and services are truly sharia compliant.
- Women face particular challenges in accessing financial services in the lowlands, due to mobility restrictions, lack of government ID cards and, as digital services have emerged, because of low digital literacy and low rates of mobile phone ownership.

In the course of 15 years of USAID-funded resilience programs in the lowlands, Mercy Corps has implemented three distinct phases of partnerships with financial institutions, with each iteration building on the achievements of the previous phase to respond to new opportunities and needs.

15 years of financial services programming in the lowlands of Ethiopia



PHASE 1:

Introduction of sharia-compliant financial services

In 2010, there were no financial institutions offering sharia-compliant products and services in Somali and Afar regions, and no branches of financial institutions outside the regional capitals.

In this phase, Mercy Corps played a key role in the **establishment of new financial institutions** (FIs) in the lowlands, including Somali MFI in 2011 (the first fully fledged Islamic Finance institution in Ethiopia), Rays MFI in 2014 (the first private sector IF institution) and Afar MFI in 2014. Support included start-up investment alongside government and private sector investments, capacity-building for FI leadership and staff, and facilitating policy conversations with the National Bank of Ethiopia. Once established, Mercy Corps next focused on accelerating the **expansion of branches and sharia-compliant services**, by co-investing in demand assessments, cost-sharing the establishment of new branches, and supporting technical assistance for the development of new sharia-compliant products.

PHASE 2:

Introduction of basic digital financial services

By 2015, financial institutions were well established, for example Somali MFI had 28 branches. At this point, however, there were still no Mobile Money services anywhere in the lowland regions of Ethiopia.

In this phase, Mercy Corps first played a catalytic role as a thought partner for Somali MFI in recognizing the Mobile Money (MM) opportunity, and then identifying a MM provider and **brokering a partnership** between Somali MFI and HelloCash. Somali MFI launched HelloCash as the first MM service in the region in 2015, with BelCash training Somali MFI on the platform and agent identification and Mercy Corps **buying-down-the-risk** as Somali MFI invested in their network of agents. Similarly, Mercy Corps' partner Rays MFI launched SahayPay in 2019.

In Afar region, Mercy Corps intended to support Afar MFI to develop MM services, but the institution faced a number of leadership challenges and is still not digitally ready. This phase therefore began later in Afar region through a partnership with Awash Bank in May 2023 to develop a network of agents and MM services.

PHASE 3:

Comprehensive transformation of digital financial services (DFS)

By 2019, Somali MFI and Rays MFI mobile money services had remarkable reach in Somali region. But their total number of savings customers (68,000) and loan clients (41,000) was still not fulfilling potential.



This phase was also supported by Jersey Overseas Aid (JOA) through the RAISE-DFS program.

A key starting point for this phase was building **foundational digital capacities**. This included Mercy Corps co-investment in digital transformation strategies, including with Somali MFI, Sinqee Bank in Oromia and Awash Bank. Mercy Corps also supported Somali MFI (which became Shabelle Bank in December 2021) to procure a digital Management Information System (MIS) and digitize branches for the first time.

Secondly, Mercy Corps supported partner institutions to **strengthen leadership and staff DFS** capacities to drive the digital transformation. This included learning visits to countries and institutions with advanced DFS, training for FI mid-level managers, and support for FI partners to build their in-house training capacities for DFS, through ToT training.

Thirdly, Mercy Corps supported FI partners to **develop new digital saving and loan products and services** targeting vulnerable producers and businesses. Through cost-share support to bring in technical expertise and co-investment in new digital platforms, Mercy Corps has helped foster three new digital saving and loan products, including Rays MFI's e-Murabaha loan product.

THE EXAMPLE OF RAYS MFI'S E-MURABAHA LOAN PRODUCT

By end-2021, despite their successful SahayPay mobile money platform reaching 540,000 users and daily transactions of more than \$7 million, Rays MFI had less than 4,000 loan clients in the country. RIPA-North aimed to address this challenge by signing a partnership with Rays MFI in 2022 to develop and roll-out the first digital and sharia-compliant micro-loan product in Ethiopia. Since Islamic Finance regulations require that Murabaha products be sold by a third party, concurrently Mercy Corps formed a partnership with the logistics company HudHud Express, to develop an e-commerce platform called CommercePal.

How the innovation works:



The success of the e-Murabaha product has exceeded expectations. By June 2024, within two years of launching the product, Rays MFI had reached 15,879 digital loan clients, more than quadruple the number of total loan clients previously. 52% of these loan clients are women, and for 74% of loan clients it was a first-time loan. The lower transaction cost of administering digital loans makes it profitable for Rays MFI to offer smaller loans that better meet the needs of target groups, and this is seen in the average Rays MFI loan size falling from \$1,200 before launching digital loans to \$530 today. A focus for Mercy Corps in designing the partnership was ensuring that the new loan products didn't just reach the low-hanging fruit of Jigjiga-based businesses, and this has been successful with 77% of loan clients based in woredas outside Jigjiga while 39% are agricultural-related loans.



1.2M
MILLION
INDIVIDUALS USING
PARTNERS' MM
SERVICES

\$41M
MILLION OF LOANS
CURRENTLY PROVIDED
BY PARTNER
INSTITUTIONS

5
OTHER FULLY-
FLEDGED ISLAMIC
FINANCE
INSTITUTIONS

INTERVENTION IMPACT

EVIDENCE OF SUSTAINABLE MARKET SYSTEM CHANGE

The first measure of systemic change is whether the innovations in financial services introduced through partnerships with financial institutions have been successful and sustainable. In Somali Region, Mercy Corps' partners Shabelle Bank (previously Somali MFI) and Rays MFI have been highly successful. These two partners now have 107 branches across the region, 297,000 savings clients, 80,000 loan clients, 8,000 mobile money agents, and more than 1.2 million active MM clients. Far from handholding them to achieve these results, Mercy Corps' strategic investments at key moments helped the institutions on new pathways of investment and growth: firstly, through the establishment of new institutions; secondly to launch Mobile Money services; and thirdly as they began their journey towards full digital transformation. In Afar region, Mercy Corps has achieved less success, due to the challenges experienced by Afar MFI (described below). The more recent partnership with Awash

Bank is progressing well, with 60 MM agents (up from just 6 pre-partnership), a 60% increase in MM clients and a 110% increase in daily MM transactions, though it is still too early to speak of sustainable systemic change.

The second measure of systemic change is the degree to which USAID/Mercy Corps investments have stimulated self-replication and crowding-in by other FIs. In Somali Region, Mercy Corps' partners became the 'first-movers', firstly as Islamic Finance institutions and then by introducing Mobile Money services. Today, the financial services sector in Somali Region is highly competitive and dynamic, with 7 Islamic Finance institutions, and 6 MM providers. Although many factors contributed to this development, there's no doubt that these strategic USAID investments played an important role in the wider growth of financial services in the region.



Eysa Hassan, business owner in Afar region
(Mercy Corps/Ezra Millstein, 2023)

The challenge of Afar MFI

Mercy Corps' partnership with Afar MFI has not been successful, for two major reasons. Firstly, since its establishment in 2014, Afar MFI has faced a major problem of non-repayment of loans, with 83% non-performing loans in its portfolio within two years of operations. A key factor was perceptions among communities that it was a government service provider and therefore repayment was not compulsory, compounded by large numbers of loans given to youth through a national 'Youth Revolving Fund' initiative that faced widespread repayment problems.

Secondly, Afar MFI has faced a prolonged leadership crisis. The previous CEO left in 2019, and the Afar MFI Board of Directors was not able to agree on a replacement CEO. Without a CEO in place, Afar MFI lost their National Bank of Ethiopia license to operate in 2019 and this has still not been renewed, despite Mercy Corps efforts to facilitate government leadership decision-making on the issue. While Mercy Corps still aims to partner with Afar MFI if appropriate leadership are in place, these challenges led to Mercy Corps starting a new partnership with Awash Bank.



60%
OF RIPA HHS HAVE
SAVINGS VS 17% IN
NON-RIPA AREA

\$80M
MILLION OF
DAILY MM
TRANSACTIONS IN
SOMALI REGION

15,000
JOB'S CREATED IN
MSES RECEIVING
DIGITAL LOANS

INTERVENTION IMPACT EVIDENCE OF IMPACT ON TARGET GROUPS

Financial services can contribute to growth and resilience in a myriad of ways. When businesses access loans, they usually increase the scale or quality of their services for customers and create new jobs as they grow. When households accumulate savings, they are better able to cope during shocks. And when mobile money services become widespread, trade transactions are easier and cheaper for rural producers and businesses.

There is strong evidence that new loan products stimulated through Mercy Corps partnerships with FIs have had a profound impact on business growth and jobs. RIPA-North's annual survey of Micro and Small Enterprises (MSEs) found that, on average, MSEs receiving an e-Murabaha loan from Rays MFI increased their revenue by 83% and their profits by 43%, compared with pre-partnership. Based on data from that survey which showed an average of 1.04

full time jobs created per MSE receiving a loan, RIPA-North estimates that these digital loans alone have created more than 15,000 full time jobs.

There is also data indicating that households in Mercy Corps target areas have improved their savings behavior. RIPA-North's annual recurrent monitoring survey (RMS) in 2023 found that 60% of households in RIPA target areas had savings, compared with just 17% of households in non-RIPA areas. Assessing the impact of easier and cheaper transactions due to Mobile Money services on household outcomes is extremely difficult to quantify. However, with daily transactions in the region of more than \$80 million on HelloCash and SahayPay, Somali region households are evidently finding MM services useful in their lives.

Participant Story

Khadir Abdosh started his mobile phone and electronics maintenance business in Jigjiga in 2021, but for the first few years his growth vision was frustrated by a lack of capital. As Khadir explains, "Expanding your business becomes wishful thinking if you don't have the financial resources", and for Khadir the burdensome bureaucratic and administrative requirements of getting a loan from existing institutions was an obstacle too far.

Six months ago, Khadir heard about Rays MFI's new e-Murabaha lending product and thought he would give it a try: "The first thing I noticed

was the ease of requesting the sharia-based loan product, with the only requirement my legal documents and some background on my business". Khadir's first loan of 100,000 birr (\$1,790) completely transformed his business. He hired four full-time staff, diversified the range of mobile accessories sold, and began offering laptop maintenance as an additional service. Within three-months he had repaid the loan and received a second loan of 200,000 birr, and now is the proud owner of one of the busiest electronic maintenance shops in bustling Jigjiga.



Khadir in his shop. Photo: Mercy Corps, Ethiopia/Ezra Millstein/2023



Gender

Mercy Corps' first phase of partnerships with financial institutions had a strong gender focus, with group-based lending resulting in women comprising more than 70% of saving and loan clients. Women in the lowlands have far lower levels of mobile phone ownership and digital literacy than men, and Mercy Corps recognized the risk that a shift to digital services may be disadvantageous for women. This risk was observed by the end of the second phase of partnerships introducing basic digital services, when less than 23% of mobile money clients in 2020 were female.

For this reason, gender integration was at the forefront of the partnership design approach for the third iteration of financial services which

aim to catalyze a more comprehensive digital transformation. New loan products with no or low collateral requirements are more accessible for women, and Mercy Corps has supported new approaches by FIs to increase the number of female MM agents as a strategy for ultimately attracting more female MM clients. The partnerships have also supported institutions to develop women-focused marketing strategies, and Rays MFI introduced digital kiosks to help women without smartphones to apply for the new e-Murabaha loans. These measures appear to be paying off, for example the percentage of Rays MFI female MM clients has increased from 23% in 2020 to 32% today and more than 50% of digital loan clients are women.

LESSONS LEARNED

1. Multi-phase programming has provided a unique opportunity to iterate and build on past approaches, and this has enabled Mercy Corps to achieve highly transformative and innovative solutions in financial systems.
2. Digital financial services can reach new and previously marginalized demographics with the right marketing approaches, for example 52% of digital loan clients are women and 74% had never received a loan before.
3. Focusing on just one financial institution partner in Afar region was risky given the fragility of the context and the weakness of the institution. Two partners is a better strategy in such contexts, as it reduces risk of failure, creates healthy competition, and the successes of one institution become the ambitions of the other.
4. Loans to agricultural market system actors such as traders and retailers have not yet taken off, and in future Mercy Corps should consider more deliberate mechanisms for financing these catalytic actors.
5. Financial services are complex systems and achieving sustainable systemic change takes time and expertise. Mercy Corps' successes were driven by sector leaders with first-hand financial services experience and achieved through relationships built over many years.



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The interventions described in this brief were implemented through three Mercy Corps-led USAID-funded programs, all implemented in Somali, Afar and Oromia regions of Ethiopia. **'Revitalizing Agricultural / Pastoral Incomes and New Markets' (RAIN)** was a five-year, BHA-funded Activity implemented from 2009 to 2014. **'Pastoral Resilience and Market Expansion' (PRIME)** was a seven-year, Feed the Future-funded program from 2012 to 2019. **'Resilience in Pastoral Areas - North' (RIPA-North)** is a five-year, \$45 million FtF-funded program being implemented from 2020 to 2025. RIPA-North's work on financial services was complemented by the **'Resilience and Incomes for Smallholders in Ethiopia through Digital Financial Services' (RAISE-DFS)** program, which is a three-year, £1.2 million program funded by Jersey Overseas Aid (JOA).