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Review Article

Review on Determinants of Rural Youth to Access Formal Credit and their Perception Towards Credit Provision in Ethiopia

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Abstract

In recent years, the Microcredit has a lion share in fighting against poverty. Microcredit is one of the key sustainable development strategies that adopted at the international level. It enable the youth engage in income generation activities by providing sufficient credit to make them own economic decisions. This study was aimed to review youth perception, determinants and constraints of credit use among youth in Ethiopia. The study was based on reviewing secondary data from books, journal articles, published and unpublished reports of national and multinational organizations based on their relevance to the topic. According to many literatures, variables such as sex, prior saving requirement, perception of the application procedure for loan, distance from the lending institution and loan size were more likely to negatively influence formal credit access by rural youth. Hence, all the stakeholders, the government and other policy makers, need to enhance appreciation of saving habit, enrolment of formal education, improving of financial infrastructures, expansion of road, provision of awareness creation training towards the benefit of credit, and modifying the lending system in order to improve youth livelihoods.

Keywords: Access, Determinants, Formal credit, Rural youth, Perception

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1. Introduction

1.1 Background of the study

Ethiopia is one of the poorest nations in the world and second most populous countries in Africa, with a population of 108.383 million and growing rate of 2.85% per year (UNFPA, 2013). Until now, agricultural sector is the backbone of the nation's economy. Therefore, it has immense contribution for the growth other sectors and consequently the whole national economy is determined by this particular sector. It covers over 50% of the gross domestic product (GDP), more than 90% of the foreign exchange earnings and accounts for over 85% of the labor force of the nation.

Ethiopia is labeled as a nation of a young population as the majority of its population (33.8%) aged between 10-24 years old. According to Central Statistical Authority (CSA) (2014), in the country, majority of the economic activities are run by the youth productive force which accounted for 39.7 percent of the total labor force; out of which 19.6 percent were urban youth and 80.4 percent were rural youth. The youth engagement in productive activities has positive consequences in both social and economic dimensions. However, the intensity of youth unemployment is quite prevalent and widespread in Ethiopia. Large numbers of youth especially those in rural areas are living in poor economic conditions (Deribie et al., 2013). Since 2014, the unemployment rates of youth aged between 15-29 years nationally estimated as 26.7 percent (Zeru, 2018).

In developing countries like Ethiopia, one of the key factors that affect the sustainable development of agricultural production and productivity is lack of modern inputs and technologies. This also caused by lack of access for finance for the rural farm households (Martha Welday, 2014). Therefore, to enhance the adoption of improved and new agricultural technology, rural income generation and alleviating the poverty, the expansion rural financial service is crucial. (Getaw Tadesse, 2018)

The government has been working to eliminate the major enemy of the country, poverty, from Ethiopia. As discuss above, in contributing for the government's strategic plan, provision of credit has a substantial role in alleviating poverty from rural community by mobilizing recourses for enhancing their agricultural production and productivity. Facilitating the credit availability enhances the economic activity of youth in several ways particularly in enabling them applying modern technology, alternative markets and accessible to required resources for production. In under developed nations like Ethiopia, credit is a vital ingredient in securing sustainable growth and development so youth need to start an enterprise and increase business productivity (Bekele & Worku, 2008).

Recent evidence shows that in March 2016, there were only 35 Micro Finance Institutions providing financial services in Ethiopia. Despite significant efforts, their penetration ratio is still low. For instance, thirteen Micro Finance Institutions (48%) are located in Oromia region and eleven Micro Finance Institutions (41%) are located in the Addis Ababa, with 18.2% and 21.1% of the shares in total capital of all the Micro Finance Institutions, respectively. Moreover, about 81.3% of total capital of all Micro Finance Institutions in the country are belonging to only four of them i.e Amhara (25.6%), Dedebit (24.3%), Addis (16.3%) and Oromia (14.7%) (Gosa Tafese, 2014). Moreover, around 15% of the rural poor have access to savings and credit services. Similarly, the saving and credit cooperatives societies even though they established with the aim of providing credit by collecting savings from the members, their contribution is remain insignificant as compared to the credit demand of the community (IMF, 2015).

Empirical researches have indicated that access to formal credit can be served as a base for self-employment and income generation as well as promote healthy living (Dereje, 2017). However, in Ethiopia, low credit accessibility is a crucial obstacle in obstructing the production, productivity, and income of rural people including rural youth(Kiros, 2012). The majority of the population do not accessed credit particularly the rural youth proportion of access to formal credit is low in Ethiopia (Wolday, 2015). Youth constitutes a smaller share of overall clientele in the ordinary financial service facilities in comparison to the financial service other part of the community enjoy. There are few efforts done to achieve and improve the availability of formal credit to youth in rural areas of Ethiopia (FAO, 2014)

The rural youth may face a great challenge to access formal credit from lender institutions. The challenges that rural youth face could be related to high rates of interest, lack of the collateral, the high transaction cost of accessing credit, lack of prior saving capital and other demographic characteristics that may affect rural youth from accessing formal credit (Dalla, 2012).

This study aims to review the perceptions of rural youth towards formal credit delivery methods and to review determinants of formal credit access by rural youth.

2. Review of literatures

2.1. Definitions and Concepts of Microfinance and Credit Services

The definitions given to microfinance institutions are vary from authors to authors and from organizations to organizations. In spite of this, the meaning they tried to deliver in their definition is usually the same. They all agree that “microfinance refers to the provision of financial services primarily savings and credit to the poor and low-income households, attempt to improve access to small deposits and small loans for poor households neglected and did not have access to commercial banks" (Alemayehu & Fenet, 2016). Thus, microfinance engaged in providing credit service facilities like saving, micro loan and insurance to poor people, unemployed, emerging entrepreneurs and to others who are living in poverty and have no access for bank. These individuals are those who are living in both urban and rural areas but have low access for formal financial sector. This low accessibility of the poor community for the ordinary financial service is due to lack of presenting the required collateral, lack of regular job and have no good credit history unable them even not to fulfill the minimum requirement to guaranty credit facility (Asante-Addo et al., 2011)

Most of the time, the terms" microfinance" and "microcredit" are usually referred interchangeably, it is good to clarify and show the difference between them since the terms are often confused. Kiros Habtu (2012), states that the term microfinance is used where NGOs and Micro Finance Institutions provide the loans with other financial services (insurance, savings, etc.), whereas microcredit refer to small loans. Microcredit is, therefore, a component of microfinance in that it involves providing credit to the poor, but microfinance also involves additional noncredit financial services such as savings, insurance, pensions and payment services (Negussie & Catherine, 2017). Credit provision is creating access to credit service (money) to borrowers either in short-term or long-term basis and they are required to repay the principal with its interest. Most of Micro Finance Institutions' clients business are seasonal in nature especially those engaged in farming activities get earnings during harvesting time and they consumed their incomes and during the cultivation season they need credit or money to buy and fulfill all the agricultural inputs for production (Endrias & Tilahun, 2017)

2.1.1 Rural Youth

Rural youth refers to individuals whose age is reached the defined age for youth and live out of cities and towns in a given country. The youth are the age category found between the old and young generations. They are agents of change, carriers of values and information which need to be transferred from the passing generation to the new generation. The age range in classification of youth varies from nation to nation depending on geography, culture, agencies and institutional conventions. For example, in Uganda youth is between 12-30 years, the UN considers individuals between the age group of 15-24 as youths, and in Nigeria individuals between 18 and 35 years considers as youth (ILO, 2005).

In the Ethiopian context, youth are the individuals whose age is between 15-29 years (EMYS, 2004). For this study, the youth are those who attained the age group of 15 to 29 years that was articulated by the Ethiopian ministry of youth and sport.

2.2 Theoretical Literature Review

2.2.1. Reasons for Needs of MFIs to Expand into Rural Areas

To ensure the local development and achieve sustainable agricultural growth, the provision of credit and facilitate the financial access to the farmers plays an indispensable role. The availability of Local credit contributes as a catalyst for agricultural production by providing assurance in time of deficit in individual savings. When Local credits are accessible to farmers, it enables them to afford expensive agricultural technologies which boost their agricultural production. Since most of small-scale farmers lack liquid cash, the financing of agricultural activities should ensure this gap. As a result, the expansion of local credit amounts is efficient in improving agricultural productivity (Nigusie, 2019).

Enhancing the financial accessibility is crucial for the advancement of the agriculture sector. The transformation from the level of subsistence farming to commercial agricultural production requires sufficient funds. For those who have low source of income, it is difficult to have an accumulated reserved savings. In such conditions, provision of credit facilities enable this kind farmers to engage in investment to increase production and productivity (Dereje, 2017). Credit facilities enable small-scale farmers to invest on improving fertility their lands as well as exploit agricultural technologies to increase their farming output. Ensuring the peasant's access to credit is significantly contributed for poverty reduction and household food security. Therefore, in developing countries when important policies and research questions are developed on the credit markets, it should consider the availability of credit facility to enhance agricultural output, food security and other developmental aspects in rural community.

In Ethiopia, the financial accessibility is primarily arranged through the banking sector and Micro Finance Institutions. However, most of them are located in Addis Ababa and regional cities, while the rural areas (which constitute 80% of the population) quite far from the access to financial services. Even though rapid growth and efforts had made, there were only 35 Micro Finance Institutions that provided financial services to the population in March 2015. It means that as compared to the population being served, their penetration ratio is still low with less than four percent.

Studies undertaken in Ethiopia shows that, credit provision to poor farmers created same improvement yet the productive inputs are not available on the farm and some farmers are not able to purchase them due to their insufficient resources. In addition to insufficient accessibility of the agricultural inputs, they are the most expensive which are unaffordable by the smallholder farmers to purchase them in cash (Zemen Ayalew, 2014). Hence, as a poverty reduction strategy, access to credit services is an important way to increase productivity, advance personal incomes and motivates farmer enable to afford technologies and other essential inputs for their production. Additionally, it facilitates the process of commercialization in the rural economy (Gashaw, et al., 2016). Therefore, rural credit service is crucial to be eligible agricultural inputs and labor which requires liquid cash that often is not readily available to the farmers and it is essential to expand at large to progress productivity (Getaw, 2018).

2.2.2 Rural financial service in Ethiopia

Over the past decade, remarkable progress have made in Ethiopian agricultural sector. Nevertheless, the sector continues to face a number of limiting factors such as: underdeveloped markets, lack implementation capacities of the federal and regional governments, safety nets account for a large proportion of agricultural spending, no attention is given for irrigation, lack of improved agricultural inputs, and key areas of the enabling environments require improvement (Auma, 2014). He also identified that the financial sectors considers the agricultural sector is less attractive sector than other business sectors like construction, tourism and other business activities. This is because of the sector's outlook as risk-return profile.

In Ethiopia, since rural households the large proportion of their income spend on food consumption, the recent rise of the price of food make the life of poor households (both rural and urban) more challenging to secure their food consumption. The problem is more serious because of the speed of the inflation is more on food prices than the prices of non-food items. Over the past year, the price of agricultural inputs such as fertilizer has increased more than doubled in addition to the skyrocketing food prices. As the price are continue to increase, it forced farmers to reduce the application of fertilizers and selected seed due to low purchasing power, which again impact the future agricultural production and productivity as well as economic growth (Melesse, 2019).

In Ethiopia, where 85 percent of the populations' life are based on the agriculture, majority of the farming activities are dominated by smallholder farmers (about 11.7 million) which constitute about 95% of agricultural GDP. Even though, around 51.3 million hectares of cultivable land are available in Ethiopia, which is immense potential for developing the agricultural sector, only maximum of 12.6 million hectares of land are currently being cultivated that means about 21 percent of the total arable land. Moreover, the most critical bottleneck to consistent poverty alleviation process in rural Ethiopia is the strong relationship between low agricultural productivity, land deprivation, and rural poverty (Assifaw & Gemechu, 2016).

2.2.3 Role of access to formal credit in developing youth owned SME

Aliero & Ibrahim (2013) stated that formal credit is recognized as a prerequisite to growth and poverty reduction. Improving the access to credit service for poor people will help to alleviate poverty ensuring the supply of finance to the needy while lack of credit can hinder the economic growth which then leads to increase poverty and income inequality. He argued that in order to achieve the strong economic growth a well-established programs is crucial to enhance the access to factors of production like credit. They revealed that the capacity of the youth would be significantly improved when the credits are provided sufficiently which can increase job opportunities and enhance income thereby lead to the youth welfare and poverty reduction.

According to Mano et al. (2012), transforming youth job-seekers into job-makers are considered to be a key strategy to avoid or reduce poverty. As indicated by Temesgen (2019), the youth owned small and micro enterprises (MSEs) in developing countries considered as a main source of generating youth entrepreneurs and increase their income. As these parts of the community become active economic participant, they would have an immense contribution for the economic development of the nation as well as poverty eradication. Hence, the supply of credit services enables the youths to engage in their personal choice of business activities and freed themselves from the bondage of poverty in a sustained way (Page, 2012).

Studies undertaken in Ethiopia shows that, credit provision to poor farmers have same improvement yet the farms have low access to the basic productive inputs and due to their insufficient resources some farmers are unable to purchase them. Because the commercial inputs are most of the time expensive which cannot easily affordable by smallholder farmers to purchase them from their own cash earnings (Zemen 2014). Hence, as a poverty reduction strategy, access to credit services is an important way to increase productivity, advance personal incomes and motivates farmer enable to afford technologies and other essential inputs for their production. Additionally, it facilitates the process of commercialization in the rural economy (ADBG (African Development Bank Group), 2005); (Getaw, 2018). Therefore, rural credit service is crucial to be eligible agricultural inputs and labor which requires liquid cash that often is not readily available to the farmers and it is essential to expand at large to progress productivity (Getaw, 2018).

Looking at empirical studies in the world indicate that access to formal credit have emerged various SME and that play a vital role in the economies of those countries. During 2013/14, some 200,319 new micro and small enterprises were established and employed 2.5 million people in the country (Mackie, 2015)

2.3 Empirical Literature Reviews

2.3.1 Perceptions towards institutional methods of formal credit provision

According to (Wendmagegn Assefa, 2019) the reason why people approach formal financial institution is that they perceive the formal financial institutions could meet their additional financial requirements for various purposes such as for agricultural production, professional purposes, constructing homes, trade purposes, etc. He also argued that among the issues that influence access to credit is the perceptions, behavior and attitudes of the people towards institutional methods of formal credit provision. Asmamaw (2014) stated that there are different type of financial service design which provided by MIFs targeting individual client's specific interest. It applies different models to provide formal credit to the poor. He found three main methods of lending: Group, Individuals, and Village Banking Models.

Group based lending is the most unique lending methods of serving significantly large size of clients with small amount of money without request for collateral. Instead of collateral in this system, all the group members are equally responsible for the repayment loans. Instead of property collateral in this type of lending system, each member is collateral of each other. The peer pressure they have and the shared liability they sign stimulate the repayment chance of the group (Aschenaki, 2016). The empirical evidence of Sisay (2008) revealed that clients perceived group lending is an important lending method which can encourage clients by solving the request for collateral for loan, minimize the misuse of borrowed funds and reduces the risk of default, while strongly criticizing the isolation of very poor from the group formation.

Loan size is the amount money that can advance to the client whether small, medium or big. Efficient loan sizes the amount that fit the borrower's capacity and which can stimulate the economic empowerment of the borrowers (Abreu, 2021). A useful loan is sufficient amounts of loan which enable borrower to invest in production activities. He also stated that for a loan to have an intended effect and to be repaid, it should be adequate enough. The author also identified that when the loans are too smaller than the required amount for the productive purpose it likely to be diverted to other unplanned purposes and the likelihood of its repayment can be challenging, due to the loan was invested on unproductive purpose.

Farmers' loan attitude and formal credit awareness are decisive factors which can affect their investment, management decisions and farm production. Risk avoidance farmers are less willing to engage on activities and investments that have high risk and high expected outcomes, in preventing risks of failure. This study is aims to assess the perceptions of farmers on catastrophic risks, their attitude towards risk and identify farm and farm household characteristics, their access to information and credit sources on their risk perceptions and risk attitude (Martha, 2014). Youth who got funds from the financial institutions spend majority of the returns from investment in paying the cost of capital, thus nothing left with them or little savings for reinvestment. Due to this reason, the majority of youth are not interested to apply for credit in microfinance institutions.

2.4. Empirical Studies on Determinants of Credit Access to Youth

The household characteristics can significantly affect the person's access to formal credit. According to Hussien (2007), the chance of selecting the formal credit sector is positively affected by the gender, the level education, household labor and farm size. He also proved that the education level, credit related information and extension visit are positively contributing in increasing the information base and decision-making abilities of the household farmer including the potential to compare merit and demerit of the type of available credits and choosing the appropriate one and selecting modern production technology.

There is a deviation in major determinants of household access to credit between other developing countries and Ethiopia in many aspects (the geography, religion, culture, governance, institutions and others). Moreover, very few researches have conducted on the Ethiopian financial sector specifically microfinance. Hence, this study aimed at assessing determining factors for demand and access to credit by Alamata woreda rural households, Ethiopia. By doing so, it provide insight to the current literature identifying the demand and access to credit facilities to the rural youth in Ethiopian context.

Education is one of the important variables that determine households' access to credit. Most developing countries are known by having high illiteracy rate most of them are confined to the rural areas. The poorly educated the households are the lower ability to evaluate the credit risk and profitability of loans and savings. Moreover, education level also positively related to credit use. Education was underscored as a tool that helps farmers make important and right decisions during credit utilization (Zemen, 2014).

Yuna (2016) examined factors determining the accessibility of formal financial services at household level in Hawassa city. He identified that demographic factors such as age, gender and educational background, institutional factors such as the involvement of households in extension package program, the lending procedure, and family labor, the socioeconomic factors like size of farm land, livestock ownership, and experience in credit use, and the communication factors such as distance from lending institutions and extension contact are the most significant determining factor of access to formal credit.

The interest rate determines access to formal credit by rural youth. The higher the interest rate the lower the investment could be. The rationale behind this fact is, in high interest rate the probability of making a profit out of an investment is very low. Therefore, youth like to borrow from financial institutions at a lower interest rate (Aliero & Ibrahim, 2013). Moreover, the request of collateral as one of the requirements for access to credit facilities by the majority financial institutions also determined the demand for formal credit by rural youth. In fact collateral is one of the risk minimization mechanism that normally applied by financial institutions. This enable the financial institutions to cover part or all loan taken by the borrower, when he/she unable to repay. As a matter of fact, most youths in under developed nations are below the poverty lines that don't have enough property which can consider as collateral for loans. This becomes a constraint among youths access to credit because most of them do not have a property acceptable as a collateral to secure loan (Martha, 2014).

The bureaucracy of the financial institution or the procedures designed has been a major constraint to access formal credit by youth from formal financial institutions. In these institutions, the procedures of business registration and costs make the provision of credit service more rigid and discouraging for the youth. In developing countries especially these rigid structure often associated with bureaucracy, corruption and lack of transparency or accountability. In this context, youths get easily tied and lose their enthusiasm for formal credit (Selamawit, 2014).

Kiros (2012) identified that age and the probability of being constrained to get credit have a U-shape pattern with a minimum age of 47, where the older aged individuals have less constrained than younger aged individuals because they are considered to have low default risk.

This implies that operations of formal institutions are limited to address credit need in rural areas. Findings confirmed that more than half of the respondents faced problems of walking long distances to reach financial institutions.

Selamawit, 2(014) had assessed the major determinants of access to credit. The result of her study shows that age, level of education, asset owned, lending procedure and loan repayment period have significant effect on access to credit.

Mesfin & Regasa (2015) found that lacks of sufficient asset for collateral and self-doubt to repay the loan are the main determining factors for losing interest for credit.

According to Sisay Yehuala (2008), the determinant factors that positively and significantly affecting smallholder farmers' access to formal credit in Ethiopia are involvement in extension package programs, familiarity using credit from the formal sources, the size of a cultivated land and being member in multipurpose cooperatives. Nevertheless, the perceptions of farmers in group lending and number of livestock in Tropical Livestock Unit can have a negative significant effect on accessing to the formal source credit. Moreover, the study was identified that the status of women and different wealth groups also affect access to formal and informal credit sources.

Conclusions

In Ethiopia, credit is one of the tools to reduce unemployment and poverty among the youth by which the youth can engage in income generation activity to improve their living conditions. Like that of access to land and other economic factors, access to credit is very important to start income generation activity. The youth need credit to cover the costs of activity as well as to expand their business in an improved way.

The empirical evidence of this review indicates that the determinant factors of credit use are levels of Educations, the size of the land hold, the frequency of extension, the habit of saving, understanding the application procedure for loan, the saving as a requirement for loan, loan size and proximity to the lending institution. Based on this review result the researcher recommend the major stakeholders, the government and microfinance institutions, need to be consider the identified factors which constrain the formal credit access by the rural youth and improve the system to make the finance accessible to the marginalized group, the rural youth.

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