ST.MARY'S UNIVERSITY
SCHOOL OF GRADUATE STUDIES

LOAN PROVISION, DEGREE OF COLLECTABILITY AND REASONS FOR DEFAULT: THE CASE OF ETHIOPIAN INSURANCE CORPORATION EMPLOYEES SAVING AND CREDIT COOPERATIVE ASSOCIATION (EIC-ES&CCA)

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DECLARATION

I, the undersigned, declare that this thesis is my original work, prepared under the guidance of Assistant Professor Simon Tarekegn Abay. All sources of materials used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree or diploma.

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St. Mary's University, Addis Ababa **June 2017**

ENDORSMENT

This thesis has been submitted to St. Mary's University, School of Graduate Studies for examination with my approval as a university advisor.

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St. Mary's University, Addis Ababa **June, 2017**

LIST OF ACRONYMS

ASCAS: Accumulating Savings and Credit Associations

EIC: Ethiopian Insurance Corporation

EIC-ES&CCA: Ethiopian Insurance Corporation Employees Saving & Credit Association

FCA: Federal Cooperative Agency

ICA: International Cooperative Alliance

MFI: Micro Finance Institutions

ROSCAS: Rotating Savings and Credit Associations

SACCO: Savings and Credit Cooperative

SMEs: Small and Medium Enterprises.

SPSS: Statistical Package for Social Sciences/ Statistical Product and Service Solution.

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ABSTRACT

In recent years, the growth and expansion of saving and credit cooperatives is playing its significant contribution to poverty reduction strategy of developing countries including Ethiopia in solving the financial problem of urban and rural residents. The main objective of the study was to assess the loan provision, degree of collectability and reasons for default in the primary employee based SACCO in Addis Ababa City. The study area was selected purposively, due the presence of long established SACCO. Using purposive sampling method, 161 members were selected and of these 130 of them were taken as sample size. As key informants the manager and finance head of the association were also considered. Structured questionnaire was used to generate primary data from sample respondents. To analyze qualitative and quantitative data descriptive statistic tools were employed. Result of the study indicates that loan is approved timely, members get loan as they require and no attention for training and promotion, strong collection mechanism and due to this reason the minimal or no default rate was employed. Better formal education level of members and contributes to have successful operation for long years and minimize loan default risk. The study recommended the financial product diversification and improving collateral system, revision of interest rate, adequate supervision, provision of adequate education and training for members & employees. These recommendations should get the attention of the association.

Key words: default, degree of collectability, interest rate, and loan provision

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CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Cooperatives have played a significant role towards achieving the growth and poverty reduction strategy by promoting income-generating activities and improving access to near banking services to rural and urban households, (Kifle, 2015). Nowadays, cooperatives are functioning through important sectors like saving and credit, coffee, beekeeping, seed multiplication, sugarcane, livestock, dairy, mining, marketing, consumer, fisheries, and construction etc. Thus, cooperatives in Ethiopia are playing multi-functional roles in rural and urban areas (Kifle, 2015).

The existence of clear and cooperative governmental policy and all inclusive structures and the government's commitment to transform the subsistence economy have created a conducive environment for the development of voluntary based Saving and Credit Cooperatives here in after the so called SACCOs. SACCOs can be the link that will give urban banks low-risk loan opportunities in rural areas and give rural businesses access to credit at costs for lower than interest rates currently charged by money lenders. (Kifle, 2011)

Even though the provision of loan has increasingly been regarded as an important tool for raising the incomes the total populations, mainly by mobilizing resources in a more effective uses and development takes place, the question that will arise is to what extent loan can be provided to the unserved economy in contribution to the development activities. For the low-income level people, maximizing wealth or capital is difficult. As a result, they need to get a working capital to involve in a profitable and sustainable business. Under such circumstances, loans; increase family income, it can help the poor to accumulate their own capital and invest in employment generating activities (Hossain, 1988).

According to (Adera, 1995), due to their lending criteria's and terms, the poor's need of getting a loan from commercial banks and formal financial institutions is difficult. These commercial banks and other formal institutions that have created the legend that the poor are not bankable, can't afford to bring the required collateral and considered as un-creditworthy. Smallholders and the poor especially in developing countries are limited to attain their plan of maximizing their income, wealth creation and to their personal creativities as a result of the limited or no access to the bank. This becomes the reason for arising of the informal institutions.

From these informal institutions, that serve the low or no income societies is the Saving and Credit Cooperatives. Saving and Credit Cooperatives (SACCOs) are voluntary, member-owned and controlled organizations. SACCOs stand for the provision of saving and credit services to their members. They mobilize savings from their members and return those funds to the members in the form of loans by charging an incomparably very small interest rate.

As well-known that, Ethiopia is a country with diversified nationalities, ethnic groups, languages, with its own unique culture and custom of living in entertaining different social activities. Our system of living is in cooperation mode of life that means; work in a group (plowing, harvesting, trashing, house construction), habits of eating together (in holidays, festivals), and living together is the common phenomena of Ethiopians in the nearby village, with relatives and in the workplace. In Ethiopia, there are three well-known traditional cooperatives or self-help groups namely Edir, Equb and Debo and they still exist and used by the society anywhere in the country.

To facilitate the establishment of modern cooperatives, cooperative Proclamation No. 44/1961 and proclamation 241/1966 were issued. It requires an ownership of a big land to being a member, so voluntary and open membership principle was not fully practiced. (USAID, 2013). In 1950 E.C, the employees of Ethiopian Road Authority established the first SACCO and followed the Ethiopian Air Lines workers in 1956 E.C.

Derg regime following the Imperial, except the urban SACCOs, all types of cooperatives (Agricultural Cooperatives, Housing Cooperatives, Saving and Credit Cooperatives and Mining Cooperatives) established. In this regime, another proclamation was issued, proclamation No. 138/78. Compared with the cooperatives in the Emperor regime, the types of cooperatives and their number were increased. (Federal Cooperative Agency, June 2016). Unfortunately, most of them were abolished by the late hour of the Derg regime.

After the falling of Derg, the current governor, EPRDF, release a new proclamation that governs the SACCOs. The SACCO societies established based on the former Proclamation No. 147/98, which is changed by the new Proclamation No. 985/2016 on December 23, 2016. According to the proclamation, a minimum of fifty members is required to form a primary cooperative. The cooperative will be established by individuals who live or work or engaged with a specific profession in a given area by fifty members, but the number may decrease and not less than ten with special cases. The new legislation requires all the SACCOs to be organized on share capital base.

This study is about one of the primary cooperatives in Addis Ababa under the organization of Ethiopian Insurance Corporation namely Ethiopian Insurance Corporation Employees Saving and Credit Cooperatives Association (EIC-ES&CCA) established in 1971 E.C, by borrowing beginning capital of 400,000.00 birr from Ethiopian Insurance Corporation and legally registered with the Federal Cooperative Agency (FCA). EIC-ES&CCA is dedicated to the elimination of poverty and the realization of a sustainable economy for Ethiopian Insurance Corporation employees and their families. Having started its operation, the organization is currently working with all EIC employees in Ethiopia to achieve self-reliance and improve the quality of their lives. The major focus area is the economic empowerment of the staff.

1.2 STATEMENT OF THE PROBLEM

Like other financial institutions, SACCOs play a very important economic role in a country in the form of provision of loans for individual member's development. For a long time, SACCOs have had numerous challenges in the form of inadequate funds to satisfy members' credit needs, loan defaulters, poor management of the societies, and misappropriation of funds etc. The presence of these challenges contributes to certain undesirable social and economic effects resulting to the burden of risk on the society (Rejda, 2008).

It is quite clear that saving and credit cooperatives are facing serious and fundamental problems. Issues at the center of these problems include such basic concepts as the nature and aim of the cooperative, as well as its structural and the principles on which it operates. Even worse, among the majority of members of SACCOs throughout the world and, in particular, among their administrators, there is a lack of understanding of everything connected with the processes by which this particular form of cooperative operates. Another key problem is the saving and credit cooperative's ability and, in practice, its failure to initiate projects for increasing revenues, both via the use of accumulated savings and by acting as a channel for transferring outside sources of finance to its members. The above mentioned problems transparent that saving and credit cooperatives around the world do not properly satisfy their members' needs. In most cases, in fact, the members of the cooperatives, including their administrators, are quite unaware and quite unable to comprehend the problems in question (Meron, 2008).

Saving and Credit Cooperatives in addition to serving those who have no access to the financial services from commercial banks and other formal financial institutions, they also contribute in minimizing the negative impact of local money lenders in their operational areas, however, it is surrounded by so many deep-rooted problems. A number of studies on saving and credit institutions in several countries have shown that the majority of those have come upon a serious loan recovery problems. According to his research, (Kifle, 2015), loan receiving criteria, lack of well-trained management and workforce, timely audit and inspection by the Bureau, the loan amount, collateral, and the interest rate charged are some of the problems that hinder the cooperatives to achieve their objectives. In SACCOs, the greatest interest rate risk occurs when the cost of funds goes up faster than the institution can or is willing to adjust its lending rates. The cost of funds can sometimes exceed the interest earned on loans & investments, resulting in a loss to the sector. Under normal circumstances, the overall costs are covered by interest income, and up to this point, it is considered as the low loan interest rate.

But by the member's perspectives, this cost is considered to be very high since the interest revenue that they receive on their saving is very less than the interest they pay on loans. This, in turn, discourages member's motive to save regularly, borrow wisely and repay promptly. Therefore the reason to undertake this research is to assess the loan provision and degree of collectability and to identify the main reasons that lead to default on the association under study and also on her research, (Meron, 2008), states that her research is limited to only loan service to business, and the association under study is providing different types of loan for different purposes including for business.

1.3 BASIC RESEARCH QUESTIONS

This research paper tried to see the problems by addressing the following questions:

- ☞ What are the requirements that have to be fulfilled by the members to receive a loan?
- ☞ Is the collection procedures convenient?
- ☞ What are the main reasons for default?

1.4 OBJECTIVE OF THE STUDY

1.4.1 General objective

The general objective of the paper is to examine the loan provision, collection criteria and default the case of Ethiopian Insurance Corporation Employees Saving and Credit Cooperatives Association.

1.4.2. Specific objectives

Based on the general objectives the following specific objectives were covered.

- ✓ To assess the loan provision criteria.
- ✓ To assess the collection procedures.
- ✓ To assess the benefits and challenges of the cooperative.

1.5 SCOPE AND LIMITATION OF THE STUDY

It was better and more satisfactory if the study includes other types of SACCOs in Addis Ababa with the same position to compare and show the common aspects of loan provision, collection, and default they have. But due to the time limit, cost and the different loan management style of most SACCOs, the study is limited to one saving and credit cooperatives which is EIC. Besides, identifying factors involved in loan provision, collection and default aspect of the cooperative is delimited the study. In addition, the researcher was not used variables which are measured and explained numerically and did not use other factors like level of education, human resource, governance, and management etc. that may affect the collectability and being reasons for default of SACCOs.

1.6 SIGNIFICANCE OF THE STUDY

The study findings are of benefit to stakeholders in the Co-operative environment, including the monitoring agency, in giving enough and better attention to SACCOs for their contribution in filling the gap and the pinpoint for the researcher. Besides, it is added values on understanding the microeconomic activities. The recommendations and solutions based on the findings show the strength and weakness of the association, it also indicates the way how they plan, use and pay their loans to both the committee and members. To summarize the significance:

1.6.1 SACCOs

The study is used assist SACCOs through their leadership to identify the challenges they are exposed to and ways to collect, provide, and minimizing the defaulted loan in order to avoid their impact on such organizations. It also increases and understands the knowledge on how to make their SACCO free from such types of problems and it assist in putting their strategies.

1.6.2 Members

The study contributes the management that they have elected to ensure that their cash and assets to be safe and also free from being uncollectable. It also creates awareness on members in having knowledge about the benefits of borrowing wisely and repay promptly.

1.6.3 Academicians and Scholars

The study helps in giving an insight of the requirements of provision of the loan, reasons for default, and degree of the collectability of loan in SACCOs and assist in encouraging the academicians and to do more and deeper research on the subject. Since SACCOs are a very important sector in the economy, there is a need for more research on the sector and this study is served as an eye opener to create interest for more studies.

1.6.4 Policymakers

For policy makers, it might be used as a reference in developing policies related with SACCOs how can minimize their risks by considering their current and future sustainable service to the poor community.

1.7 ORGANIZATION OF THE STUDY

This research is organized in five chapters in total. Chapter one is all about an introductory part and explained the general introduction to the research by uncovering the main agenda in the research. The rationale and objective of the study are mentioned with the expected significance of the study. Briefings on the delimitation and limitation of the study are also given. The rest of the paper is organized as follows. Chapter two provides a literature review on the topic; both empirical and theoretical aspects. Chapter three explains the research design and methodology followed in the study to achieve the objective of the study. Chapter four presents the analysis and finding of the study. The final chapter, chapter five, presents summary of major findings, conclusions, and recommendations.

CHAPTER TWO

2. REVIEW OF RELATED LITERATURE

The literature review consists of two parts; the theoretical review and the empirical review. Theoretical review part discusses about finance, features of informal financial system, cooperatives, models and theories of SACCOs types and purposes of SACCOs. The empirical literature part discusses about past studies that were conducted on the area or part of the topics of loan provision, loan interest rate, default, and collection of loan.

2.1 Theoretical Review

2.1.1 Finance

The art and science of managing money is called Finance. It includes financial service and financial instruments. According to Paramasivan & Subramanian (2010), it is referred as the provision of money at the time when it is needed. It also is the application of economic principles to decision-making that involves the allocation of money under conditions of uncertainty. In other words, finance is all about money and the future. The finance function is the procurement of funds and their effective utilization in business concerns.

2.1.1.1 Types of Finance

In any type of business activities, finance plays a major role. It also is an important and integral part any business. It is used in all areas of under different names.

The two major parts of finance are:

1. **Private Finance**: - which includes the Individual, Firms, Business or Corporate Financial activities to meet the requirements.
2. **Public Finance**: - which concerns with revenue and disbursement of Government such as Central Government, State Government, and Semi-Government Financial matters. (PAMELA and FRANK, 2010)

2.1.1.2 Importance of Managing Finance

Finance is the lifeblood of any business organization. It needs to meet the requirement of the business concern. Each and every business concern must maintain an adequate amount of finance for their smooth running of the business concern and also maintain the business carefully to achieve the goal of the business concern. The business goal can be achieved only with the help of effective management of finance. We can’t ignore the importance of finance at any time and situation *(ibid).*

2.1.2 The financial system

In any country financial system consists of entities like banks and microfinance institutions that help facilitate the flow of funds from those that have funds to those who need funds to invest. Wouldn't it be challenging and awkward to finance a purchase of a home by rounding up enough folks willing to lend you? In addition, wouldn't it require careful planning and lots of paperwork to keep track of the loan contracts, and how much you must repay and to whom? What about the folks you borrow from? How are they going to evaluate whether they should lend to you and what interest rate they should charge you for the use of their funds? All these problems are solved with the existence of financial institutions and their well-established financial system *(ibid).* Financial system consists of four important components:

- Financial Institutions
- Financial Markets
- Financial Instruments
- Financial Services (Paramasivan & Subramanian, 2010).

2.1.2.1 <u>Sources of Finance</u>

Finance sources are classified in different categories. Different authors classified sources of finance in many classifications. Some groups classify based on period, ownership, sources of generation, mode of finance, institutional and non-institutional, and degree of formality of operating within a given financial system. But in general, the sources of finance are classified as formal, semi-formal, and informal sources

Formal sources: - These are providers of finance who are subject to banking laws of the country of operation and are engaged in loan extension to customers and diversified financial intermediates. In Ethiopian context, the formal finance sources are Commercial Banks (private and publicly owned), Development Bank of Ethiopia and Construction & Business Bank.

Semi-formal: - These sources are financing organizations that are mostly registered NGOs and Micro Finance Institutions with a special character. Micro Finance Institutions (MFIs) originally were established in the form of rural finance providers. In recent years microfinance institutions have become one of the most important instruments in development policy. The idea of microfinance arose in the mid- 1970s when Mohammad Yunus started a pilot scheme lending small amounts of money to villagers in Bangladesh, due to a lack of collateral, had no access to conventional loans. Encouraged by high repayment rates, he founded the Grameen Bank to run such schemes on a larger scale. Today the Grameen Bank lends to more than 2 million people.

Informal: - This sector captures the residual sources of finance Saving and Credit Cooperatives, money lenders, *Iquibs, Idirs* and others *(Wolday 2002)*. On the other hand, the semi-formal and informal sector mainly comprises of financial institutions like saving and credit cooperatives, and *iqqub* and *iddir*, respectively. These institutions play a central role within the financial sector in providing liquidity for payment services and facilitating financial transactions of various entities (Kifle and Hailemichael, 2013).

2.1.2.2 Reasons for the Formation of Informal sources

According to Stiglitz (1993), as cited by (Meron, 2008), most of the informal sectors are incapable of getting financial resources benefit from formal financial intermediaries such as banks due to one of following reasons

- Smaller size of transactions
- Lack of Collateral
- Inexperience, illiteracy or innumeracy of the borrower.
- Physical remoteness of the informal sector enterprise.
- The mobility of many informal sector enterprises.
- Lack of bookkeeping or an appropriate compliance framework.
- Lack of general information about the borrower and predictability of the nearby transaction.

Generally, people with one of the problems mentioned above are considered credit risk to the conventional banks and hence they are excluded from the credit market. Here is where SACCOS, (along with other institutions such as MFIs) emerged to fill the financial service gap to the poor not attended by the banking system. Savings from members are the principal sources of lending operations to members, and this is viewed as the foundation for rural financial services to support the unbankable rural poor to engage in productive economic activities *(Muluneh, 2012)*.

2.1.2 Main characteristics/features of Informal Financial system

Although there are distinctive characteristics in informal financial transactions across sectors, there are common features as well.

2.1.2.1 Participants

The range of participants involved in the informal financial markets widely varies. These markets constitute people such as farmers, shop owners, professional and non-professional moneylenders, businessmen, and institution such as community-based organizations, voluntary credit groups, and cooperative societies. Each party has a different role in the market. Participation of certain parties in informal markets is a significant indication of the trust earned by these markets and participation itself generates more trust. This can be seen in the urban informal financial markets than rural financial markets.

2.1.2.2 Size of lending

The extent of the credits allowed in informal money related markets takes fairly generic pattern, which demonstrates that the size is normally bigger in the urban division than in other two areas. However, the majority of loans in the informal financial sector is small and spread over a wide range, depending on the economic activities. Credit is major form of external finance used by households, firms and governments in economy. When borrower approaches a financial institution for a loan facility the intention is to use it to finance a planned project and eventually repay the loan. Customers borrow funds for various reasons. The most common objectives for borrowing are for acquisition of assets like house, land or cars. As for business people, the need for funds would be to increase stock -in- trade, capital level or meet some current expenditure .In addition to the above primary needs the borrowers do sometimes approach financial institutions for bridging finance to take care of short-term needs (Peeters, 2003).

2.1.2.3 Price of the Loans (Interest rates)

Interest rates in the informal financial facilities range from zero to more than hundred percent per annum or in certain cases could be extremely high. The zero rate facilities are mainly provided by friends and relatives and every so often by voluntary organizations like ROSCAS and ASCAS for very small amounts. Furthermore, the interests charged in these methods vary depending on the size of the loan, previous experience and relationship with the borrower, nature of the situation of borrowing and the lender's expected return. In certain cases, the effective interest rate is not apparent, as they are charged in different forms.

2.1.2.4 Approval Procedures

Approving facilities for borrowers in the informal financial sector is purely lenders authority. The borrower does not have any authority to change the terms and conditions of the loan amount, repayment period, interest applicable, and other factors linked to the facility. Due to this reason, some argue that the lender exploits the borrower in an unfair manner and use it as a factor to justify regulating the informal financial sector. But if closely scrutinized, such claims could be seen to be exaggerations to a certain extent, as moneylenders provide an important service in the absence of formal sector facilities. Coexistence of informal money lending with formal lending activities in the economy itself testifies that the society benefits from their service. In certain cases, money lenders provide multiple services, such as the link between the city centers and business clients, advisor and also enter in certain economic activities. The clients receive such services free of charge in most cases.

2.1.2.5 Collateral/Securities

The informal lending or financial activities are not based on collateral or securities compared to formal sector lending of financial activities. This is the most important factor for survival of this industry all over the world today in the presence of the sophisticated formal financial sector. In some countries, both sectors work hand in hand. Informal financial sector emphasizes more on goodwill between the two parties than entering into formal loan agreements. However, some studies revealed that some of the transaction are covered with some securities such as equipment, machinery, consumer durables and immovable assets. But there is no ownership transfer or registering of mortgages by the borrower or lender. In most occasions possession will be changed, but after the repayment borrower will take back the asset. Most of the loans are unsecured in the informal financial sector and this is another reason for the lender to charge higher interest rates for higher risk. Borrower's goodwill thus becomes the main collateral in most of the time, with the future harvest of the borrower considered as the collateral.

2.1.2.6 Risk

Loans backed by intangible assets such as goodwill may create a vulnerable situation to the lender and therefore, the associated risk is very high. With the asymmetric information background, lender's selection of the borrower may be questionable. If the selection is poor, the loan becomes doubtful and the lender has a high risk of collecting his loan funds. But this is not valid for informal financial markets due to asymmetric information situation in the market. However, informal moneylenders have diversified their ways of assessment of borrowers through their long experience.

The lender knows the borrower well, and his network is capable of gathering most relevant information on the borrower. In other words, informal financial markets tackle this problem very cleverly by using all available sources of information and use credit scoring models very effectively. Furthermore, the presence of the free rider problems is relatively less in the informal financial market compared to the formal sector. Therefore, most types of risks are mitigated substantially. If any defaults occur due to genuine reasons, he will make rescheduling arrangements with new loans to the borrower. This analysis shows that informal credit is less risky than formal credit most of the lenders provide facilities to known parties. (Karunagoda, 2007)

In the activity of cooperatives there are identified five major risk categories, namely:

a) Market risk;

b) Liquidity risk;

c) Operational risk;

d) Reputational risk;

e) Credit risk.

These types of risks are not excluding each other, given the fact that a product or service can expose the cooperative banks and other banks at multiple risks.

a) The market risk

It is defined as the risk of record loss or of failure to accomplish estimated profits arising from changes in the market prices, interest rate, and exchange rate. As part of the market risk, we distinguish the interest rate risk arising from fluctuations in market interest rates. Market risk also defined as; the risk that the value of an investment will decrease due to moves in market risk factors. Standard market risk factors are interest rates, stock indices, commodity prices, foreign exchange rates, real estate indices, etc.

b) The liquidity risk

It is defined as the risk of loss record or of failure to accomplish estimated profits resulting from the incapacity of cooperative banks to cope with the decrease of funding sources or the need for increased investment returns without involving costs or losses that cannot be supported.

c) The operational risk

Operational risk as the risk of loss record or of failure to accomplish estimated profits and it is determined by internal factors (inadequate performance of internal activities or the existence of untrained staff) and external factors (economic conditions, changes in environment of the cooperative bank etc.). As part of the operational risk, it is also identified the legal risk, which may occur due to the lack of correct or poor implementation of legal or contractual provisions that adversely affect the operations of the cooperative bank or the state of the cooperative bank.

d) Reputational risk

It is defined as the risk of record loss or of failure to accomplish estimated profits due to lack of public confidence in the integrity of the cooperative bank. Risk management is an important component of the strategy of a cooperative bank to obtain a desired level of profit while maintaining an acceptable risk exposure. In the domain of risk management, a cooperative bank guides itself by the operational legal provisions.

e) The credit risk

It is the risk of record loss or failure to accomplish estimated profits due to non-fulfillment from the counterparty of its obligations stated in the contract. It is the risk of default or change in the credit quality of issuers of securities to whom a company has an exposure. More precisely, default risk is the risk of loss due to a counterparty defaulting on a contract. Traditionally, this applies to bonds where debt holders are concerned that the counterparty might default. Rating migration risk is the risk resulting from changes in future default probabilities (ibid)

For the modeling of credit risk, the following elements are therefore crucial:

- Default probabilities: probability that debtor will fail to pay on its obligations to repay its debt;
- Recovery rate: proportion of the debt's par value that the creditor would receive on a defaulted credit, and
- Transition probabilities: the probability of moving from one credit quality to another within a given time horizon. (*American International Journal of Contemporary Research, 2014)*

2.1.2.7 <u>Credit Information</u>

If a firm does want credit information on customers, there are a number of sources. Information sources commonly used to assess creditworthiness include the following: (Ross, Westerfield and Jordan, 1998)

- Financial statements: A firm can ask a customer to supply financial statements like balance sheet and income statement. Rules of thumb base on financial ratios can be calculated.
- Credit reports on the customer's payment history with other firms: Information obtained from firms that sell information on the strength and credit history of business firms.
- Banks: Banks will generally provide some assistance to their business customers in acquiring information on the creditworthiness of other firms.
- The customer's payment history with the firm: The most obvious way to obtain an estimate of a customer's probability of nonpayment is whether he or she has paid previous obligations and how quickly they have met these obligations.

2.1.2.8 <u>Credit Evaluation and Scoring</u>

Once information has been gathered, the firm faces the hard choice of either granting or refusing credit. Many financial managers use the "five C's of Credit" as their guide. (Ross, and Jaffe, 1999)

Using the Five C’s of Credit

1. Character: The historical backdrop of the business and experience of its administration are basic figures evaluating an organization's capacity to fulfill its money related commitments. Look at how long the business has been under the same control, and check for any previous litigation or bankruptcy information. Also, get a clear understanding of who owns the business, and who is ultimately responsible if a problem arises. Always get a list of the company's officers with their ages and backgrounds. Research the financial worth of principals for proprietorships and partnerships. Identify the exact business name and legal form of the organization. What products does it sell? On what terms? Is it a seasonal business? What are its margins? Get a sense of the character of the owners and the business's ability to compete in its markets.

2. Capacity: Make sure to assess the capacity of the business to operate as an ongoing concern in every credit decision. Principals in small businesses are often forced to wear many hats. Businesses must be able to allocate resources evenly to the various functions of the organization such as marketing and sales, production and finance. Keep an eye on management. Assess their experience and their ability to manage all aspects of the company without compromising efficiency. Does the organization have the facilities to handle your business needs?

3. Capital: Analyze the financial capacity of the organization in order to determine its ability to meet financial obligations in a timely fashion. Its ability to pay may be much more important. It is critical to understand the difference. Watching customer payment habits over time is an excellent indication of cash flow. Also, check bank and trade references, as well as any pending litigation or contingent liabilities. Check for a parent company relationships. A parent company's guarantee may be available. Intercompany loans might affect financial solvency. Check agency ratings that predict slow payment or default to complete your investigation.

4. Conditions of the times: General economic conditions in the nation, in the community, and in the industry will exert a modifying influence on the financial analysis of an account. Watch for any news items or special events that could affect the firm's ability to continue as an ongoing concern.

5. Collateral: A pledge of assets in the case of default. When entering into a relationship with a new customer, consider these two very important questions. Will I be paid slowly? And, will I be paid at all? Some companies are willing to accept some level of slow pay based on their goals & objectives and how much risk they are willing to take. Few firms are willing to accept no payment at all. Financial analysis will help you determine a prospect's financial capacity to pay obligations in a timely fashion as well as their ability to maintain an ongoing relationship. Your decision to conduct business with this firm will vary based on whether they appear to be a one-time purchase or a long-term account. Therefore, an effective use of the above-mentioned guides leads to minimize the risk and default rate.

2.1.2.9 Credit Approval and Appraisal Process

The individual steps in the credit approval process and their implementation have a considerable impact on the risks associated with credit approval. The quality of credit approval processes depends on two factors, i.e. a transparent and comprehensive presentation of the risks when granting the loan on the one hand, and an adequate assessment of these risks on the other. Furthermore, the level of efficiency of the credit approval processes is an important rating element. Due to the considerable differences in the nature of various borrowers and the assets to be financed as well a large number of products and their complexity, there cannot be a uniform process to assess credit risks.

The quality of the credit approval process from a risk perspective is determined by the best possible identification and evaluation of the credit risk resulting from a possible exposure. The credit risk can distribute among four risk components (Oesterreichische, 2000). The most important components in credit approval processes are: Probability of default (PD), Loss given default (LGD), and Exposure at default (EAD), While Maturity (M) is required to calculate the required capital, it plays a minor role in exposure review. The significance of PD, LGD, and EAD is described below.

A loan appraisal is a request/application for loan/funds on credit evaluated on its merits by a microfinance institution. Among others aspects, the purpose of loan, genuineness of its need, its quantum, borrower’s repayment capacity, security etc are assessed on some parameters before loan is actually granted. Loan appraisal process plays a big role in assuring the lender of minimal circumstances on losing his/her money hence if the officers designated to loan appraisal are competent then high chances of leading money to non-deserving customers would be high. . (Boldizzoni, 2008).

A. Probability of default (PD)

Exploring a borrower's likelihood of default is essentially done by assessing the borrower's present and future capacity to satisfy its advantage and important repayment obligations. This evaluation has to take into account various characteristics of the borrower (natural or legal person), which should lead to a differentiation of the credit approval processes in accordance with the borrowers served. Furthermore, it has to be taken into account that — for certain finance transactions — interest and principal repayments should be financed exclusively from the cash flow of the object to be financed without the possibility for recourse to further assets of the borrower. In this case, the credit review must address the viability of the underlying business model, which means, the source of the cash flows required to meet interest and principal repayment obligations have to be included in the review (Oesterreichische, 2000).

B. Loss given default (LGD)

The loss given default is affected by the collateralized portion as well as the cost of selling the collateral. Therefore, the calculated value and type of collateral also have to be taken into account in designing the credit approval processes. (ibid)

C. Exposure at default (EAD)

In the vast majority of the cases described here, the exposure at default corresponds to the amount owed to the institution. Thus, besides the type of claim; the amount of the claim is another important element in the credit approval process. (ibid)

2.1.2.10 Credit Decisions

Extending credit - it's the careful balance of limiting risk and maximizing profitability while maintaining a competitive edge in a complex, global marketplace. Credit analysis is the process of deciding whether or not to extend credit to a particular customer. It involves two steps:

1. Gathering relevant information and
2. Determining credit worthiness (Ross, Westerfield and Jordan, 1999).

2.1.2.11 <u>Debt Collection Procedure</u>

A powerful debt collection system begins with a clearly thought out credit policy and credit management tools to enforce this policy Achievement originates from the general execution of the entire credit esteem chain. The gathering capacity inside monetary associations can have the effect of a decent execution for the business and a magnificent execution. The collection function within financial organizations can make the difference between a good performance for the business and an excellent performance. By making use of opportunities to make the collection processes strategically effective, operationally efficient and customer orientated, an organization can expect the collection function to add significant value to the business (Kitua, 2002).

A collection procedure is a detailed statement of steps to be taken regarding when and how the past-due amounts of a debt are to be collected. Each company has its own collection procedure, with information such as due dates, grace periods, penalties, date of repossession, date of turnover of delinquent account to collection agency, among others. The collection procedure for any loan arrangement should be spelled out as part of the loan terms. It is important for borrowers to be aware of the details of the collection procedure so as to avoid penalties, and in the case of collateral or secured loans, repossession of the collateral. While collection procedures may vary for each company they should all be complaint with existing laws. Third party collection agencies must also adhere to set Acts, not just in the collection procedure details but also the manner in which the collection takes place (Latifee, 2006).

The debt collection process can be defined as a legitimate and necessary business activity where creditors and collectors are able to take reasonable steps to secure payment from consumers who are legally bound to pay or to repay money they owe (Kitua, 2002). Once a loan or credit agreement has been granted and paid out to a consumer, the next phase of the credit provider's tasks will start. The credit agreement has to be actively managed over its life cycle as payment dates on which the consumer should pay fall due. As a result of various reasons, the payment of agreements doesn’t always occur as anticipated, and some of the payments may become overdue.

2.1.2.12 <u>The Concepts of Loan Delinquency and Loan Default</u>

According to Addae-Korankye (1999), a loan is delinquent when a payment is late. A delinquent loan becomes a defaulted loan when the chance of recovery becomes minimal. Asari (2011) defined Non-performing loan as defaulted loan in which banks are unable to profit from them. Generally, loan falls due if no interest has been paid within 90 days, however, different countries may have different experience in this regard. The long run relationship clearly revealed that interest rate has a significant impact on non-performing loans. Inversely, there exist insignificant relationship between inflation rate and non-performing loans. However in short run, both interest & inflation rates will not impact the non-performing loans, as confirmed by Asari (2011). Delinquency is measured because it indicates an increased risk of loss, warnings of operational problems, and may help to predict how much of the portfolio will eventually be lost because it never gets repaid. There are three broad types of delinquency indicators:

1. Collection rates: which measures amounts actually paid against amounts that have fallen due;
2. Sum unpaid (arrears) rates: measures overdue amounts against total loan amounts; and
3. Portfolio at risk rates: which measures the outstanding balance of loans that are not being paid on time against the outstanding balance of total loans (ibid).

Default occurs when a debtor has not met his or her legal obligations according to the debt contract. For example, a debtor has not made a scheduled payment or has violated a loan covenant (condition) of the debt contract (Amankwah, 2011). A default is the failure to pay back a loan. Moreover, Pearson and Greeff (2006) defined default as a risk threshold that describes the point in the borrower’s repayment history where he or she missed at least three installments within a 24 month period. This represents a point in time and indicator of behavior, wherein there is a demonstrable increase in the risk that the borrower eventually will truly default, by ceasing all repayments. The definition is consistent with international standards and was necessary because consistent analysis required a common definition. This definition does not mean that the borrower had entirely stopped paying the loan and therefore been referred to collection or legal processes, or from an accounting perspective that the loan had been classified as bad or doubtful, or actually written-off. Loan default can be defined as the inability of a borrower to fulfill his or her loan obligation as at when due (Alimi, 1990).

The Causes of Delinquency to SACCOS Members

Friends consult LTD (2012) have found several factors which can lead to poor loan repayment performance to SACCOS which are as follows:

i. Failure of the board of directors to establish a proper loan policy.
ii. Poor loan tracking policy.
iii. Lack of effective delinquency control.
iv. Poor organizational policy and strategy for example loan term frequency.
v. Non supervision of borrowers.
vi. Diversion of loan funds by borrowers.
vii. Non-effective loan utilization
viii. Short time of loan repayment schedule
ix. Poor loan appraisal

2.2 Co-operatives

Co-operative is a self-governing relationship of people joined intentionally to meet their regular financial, social, and social needs and goals through a together claimed and fairly controlled enterprise. These are organizations possessed and keep running by and for individuals. Regardless of whether the individuals are the clients, representatives or occupants they have an equivalent say and ideal in what the business does and an offer in the benefits.

There are diverse sort of cooperative societies based on their working groups, agricultural cooperatives, handicrafts and small-scale industry cooperatives, housing cooperatives, saving and credit cooperative and mining cooperatives (Kifle, 2015).

Since businesses are driven by values and just not by profit, co-operatives share internationally agreed principles and act together to build a better world through co-operation. *(International Co-operative Alliance (ICA))*

2.2.1 Models and theories of SACCOs

SACCOS operates on the principles governing financial institutions, these are depository taking and loan disbursement. In practice, when performing their duties, they follow all principle of commercial banks. Due to increasing difficulties of getting loans from formal banks and other financial institutions, they have been the most preferred alternative. Members are urged to join them, make their respective contributions and then borrow at low-interest rates and other soft conditions which can be met by low-income members. But, to be sustainable, it must operate on formal business principles, hence realizing its profits which will be used to strengthen its members borrowing capacity. In order to realize significant amounts of profits, members are supposed to invest fully the borrowed funds they have borrowed from SACCOS into profitable projects, while at the same time, repaying fully their borrowed funds so that their respective SACCOS become financially strong. How can SACCO's sustainability be achieved? This is explained by different theories and models that have been examined by various scholars worldwide.

2.2.1.1 The Raiffese in Model

The study by Prinz (2002), as cited by OBADIA (2014), explained that Friedrich Wilhelm Raiffesein was the first German to develop savings and credit cooperative society and agriculture cooperatives in 19 century which operated primarily in the rural world. He also wanted to make credit accessible to farmers based on Christian morals. The participation of the rich would enable them to help the poorest; however, the control of the organizations remained in the hands of the best off. One of his principles was: Loans are granted to members only and funded by their savings. This came to be known as Raiffesein model which is the source emergence of microfinance in German today.

2.2.1.2 The Schulze-Delitzsch Model

As cited by OBADIA (2014), Lazarevic (2011) explains that Hermann Schulze-Delitzsch developed organizations for craftsmen, small merchants, and independent employers. Also, Lazarevic (2011) used the principle of subscriptions (The banks offered remunerations on capital). The Lazarevic principle was that the members are bound to participate in the administration and management and make decisions as a whole in the last instance.

2.2.1.3 The Luzzati Model

The Luzzati model developed the first "people's banks" around the 1860s located in the cities offering services to the rural environment. The model stressed the moral side of cooperative action, evaluating the borrowers' morals. A reserve fund funded by annual profits and low-cost and transferable equity shares are some of the Luzzati's principles (Kadam, 2011), cited by OBADIA (2014).

2.2.1.4 Agency Theory

This theory places emphasis on transaction costs and contractual analysis following the work of Coase (1937), Jensen and Meckling (1981), cited by OBADIA (2014). The work of these writers points to the challenges that surround ownership, contractual agreement, management and the interrelationship between small businesses and financial providers. The theory is relevant to this study as is help to understand challenges that surround ownership, contractual agreement, management interrelationship between small business owners and external providers including SACCOs. Agency theory has been developed to identify problems of establishing incentives-compatible relationship and roles for different types of stakeholders. Agency theory and the institutional discussion of property rights often describe "residual claimant" as being the beneficiaries of joint action whether it is an investor-owned firm or a cooperative if a traditional model of principal-agent relationship is applied then you have ambiguous definitions of what group is the primary recipient of fruits of the organizational effort.

2.2.1.5 Organization Transition theory

According to Solmossy (2011) transition from an entrepreneurial to a larger organization is a challenge to both the founding entrepreneur and the firm. The theory explains how small entrepreneurially founded businesses transform itself to enable sustained growth. In explaining the transition theory (Fenn, 1996) asserts that entrepreneurs to a growing organization present personal challenges to the founding entrepreneur as well as to the firm. He also argues that few businesses succeed in making the transition to dynamic, growing and successful organization. The theory takes the idea of (Schumpter, 1983) cited by (Solymossy, 2011) who argues that creative and innovative whether by invention or by an innovative combination of previous of existing elements and managerial and administrative issues are the key components for the growth of entrepreneurial enterprises. The theory has important applications in this study since the study analyses their contributions on growth and sustenance of small businesses. The growth and sustenance of small businesses can be attributed to myriad factors including managerial and administrative issues, innovation and creativeness of the business owners and availability financial services as well. SACCOs is one of the financial institutions established for the purpose of providing financial services to its members including small businesses. Its presence can bring up their impact to growth and sustenance.

The primary saving and credit cooperatives were set up in the mid - nineteenth century, in Germany. Herman Schultz-Delitsche and Freidrich Reifeisen, who built up credit cooperatives for minor craftsmen and the urban white middle classes, and the organizer of the rural credit cooperatives respectively, are considered as the founding fathers of the credit cooperative development. In Italy, by combining the authors of the SACCOs thought, Luigi Luzzatti built up credit cooperatives. Credit cooperatives turn into a typical sort of cooperative both in the modern and third world (Galor, n.d).

Saving and Credit Cooperative Organizations (SACCOs) are self-improvement foundations that empower individuals with a common vision to pull resources together to help themselves. They admit members who pay membership fees, buy shares and save. In turn, these resources are intermediated through loans among the members at interest rates set by the Sacco. The SACCOs can also borrow from wholesale lenders for onward lending to their members. To ensure their operations remain sustainable, SACCOs normally fix an interest rate and set other fees for accessing various services - provided these are agreeable collectively by the members. This is because these institutions are owned, managed, used and governed by the members. (Nathan, n.d).

SACCO Society are financial institutions intended for individuals, to have their own particular productive monetary administration giving establishments that enable themselves in building resource by showing thrift culture and make themselves available to credit economically. (Getachew, 2006). The distinction amongst SACCO and different types of co-operatives is that SACCO can accept deposits from its members as savings and furthermore issue out advances to qualifying members of the SACCO. *(Henama, 2012)*

Types of SACCOs

As per Bwana and Mwakujonga (2013), different sorts of SACCOs exist, contingent upon the participation profile and the products stretched out to the SACCO members differ accordingly. Generally, there are three broad classifications of SACCOs:

- Community-based SACCOs: These SACCOs can be found in urban areas or regional towns, but are most frequently encountered on the village level. A variety of group and individual loans can be found, including women solidarity loans, business loans for individual members, or loans for small and micro enterprises.

- Employee-based SACCOs: These represent SACCOs where all the members are drawn from one employer and these SACCOs are generally located in urban areas or regional level. Specific salary-based loans are extended which are often guaranteed by the employer.

- Agricultural SACCOs: To date, these represent primarily small-scale cane growers in areas such as the rural region. Both individual farmers and farmers' associations can be clients of the SACCO. Loans are extended for various purposes, including agricultural production loans. *(Bwana, and Mwakujonga, 2013).*

Purposes of SACCOs

As indicated on the research (USAID, 2013), the motivations behind SACCOs are to empower funds, provide low premium advances which will encourage financial and social advancement, enhance personal satisfaction for individuals by giving them credit to support or begin monetary movement, control expansion, increment work through the making of independent companies, provide banking services, and promote democracy.

2.2 Empirical Review

Various studies have been conducted on SACCOS by a number of researchers; Most Non- Bank Financial Institution such as Co-Operative face problems which are attributable to a lot of reasons, the most prominent causes pertain to the improper portfolio risk management, inadequate credit history of these firms and lack of attention to economic changes and other changes as well, can lead to the collapse of these credit institutions. (www.iiste.org)

The potentials of SACCOs on supporting the growth and sustenance of small businesses in Mbeya City, Tanzania, is still low due to the higher rates of interest charged on loans advanced to members and poor training given on how members should improve significantly their businesses. Findings concluded that the contributions of SACCOs to promote the growth and sustenance of small businesses in Mbeya City is poor due to the combinations of challenges. Among these include; high interest rates charged on loan to members, absence of seminars and training to business proprietors (OBADIA, 2014).

Management of Savings and Credit Cooperatives from the Perspective of Outreach and Sustainability - (Kifle 2011) and he concluded that those grassroots and member-owned financial institutions called the saving and credit cooperatives were able to mobilize huge financial resources and to provide credit and savings services to a large mass base at a standard compared to that of formal financial institutions. According to him, SACCOs are viable financial institutions whose development must be strongly supported. Also, he addressed that lack of awareness and poor saving culture, weak organizational arrangement and governance problems, policy and regulatory environment, weak institutional capacity, low capital base, lack of differentiated products, inappropriate loan security requirements are identified as the factors that affect the growth or outreach of SACCOs.

By his several studies on the area, (Kifle, 2015) states that the business mission of SACCOs is to provide financial service to members and become viable community-based financial institutions by providing value-added services such as education, training, and financial services on a sustainable basis. In connection with this, their progress made by both primary and union SACCOs in terms of providing demand-driven financial services to members and ensuring the sustainability during the last 50 years of its existence is not very impressive.

SACCOs are considered to have immense potential in financing short term loans for agricultural production technologies and undertake off-farm income generating activities in areas where both the state and the private sector have failed. Serious efforts are being made to strengthen capital resource of SACCO's base through increasing members' subscription and mobilization of savings in rural and urban areas (Kifle, 2015). He identifies challenges such as, absence of financial cooperatives policy and regulatory environment, weak institutional capacity, narrow product range and inappropriate loan security requirements.

As specified above different reviews were conducted on the management, Source of assets, credit risk, contribution, and Sustainability of SACCO's. Many of the factors studied by those authors could be affected by the extent of outreach (the activity of providing service) of SACCO's to the potential population. Cooperatives have not yet given request driven items that could address the necessities of their individuals despite their older age and a better effort to the grassroots level and unbanked group. In general, there are no planned and structured ways of developing new products or revising the existing products.

According to Ahmad, (1997), causes of loan default include; lack of willingness to pay loans coupled with the diversion of funds by borrowers, willful negligence and improper appraisal by credit officers. In addition, Hurt and Fesolvalyi (1998), cited by Kwakwa, (2009) found that, corporate loan default increases as real gross domestic product decline, and that the exchange rate depreciation directly affects the repayment ability of borrowers.

Balogun and Alimi (1988) also identified the major causes of loan default as loan shortages, delay in time of loan delivery, small business size, high-interest rate, and the age of debtors, poor supervision, non-profitability and undue government intervention with the operations of government-sponsored credit programs. Moreover, Akinwumi and Ajayi (1990) found out that farm size, family size, the scale of operation, family living expenses and exposure to sound management techniques were some of the factors that can influence the repayment capacity of farmers. According to Olomola (1999), loan disbursement lag and high-interest rate can significantly increase borrowing transaction cost and can also adversely affect repayment performance.

After surveying different banks in India, Berger and Young (1995) identified the main causes of default of loans from industrial sector as improper selection of an entrepreneur, deficient analysis of project viability, inadequacy of collateral security or equitable mortgage against loans, unrealistic terms and schedule of repayment, lack of follow-up measures and default due to natural calamities.

The study conducted by Okorie (1986) in Ondo state, Nigeria, revealed that the nature, time of disbursement, supervision, and profitability of enterprises, contributed to the repayment ability and consequently high default rates. Other critical factors associated with loan delinquencies are the type of the loan, term of the loan, interest rate on the loan, poor credit history, borrowers' income, and transaction cost of the loans. Besides, Okpugie (2009) indicated that high interest charged by the creditors has been discovered to be the reason behind the alarming default. This was also confirmed by Vandel (1993), who also found that high-interest rates charged facilitate default by borrowers.

According to Gorterand Bloem (2002), non-performing loans are mainly caused by an inevitable number of wrong economic decisions by individuals and plain bad luck (bad weather, unexpected price changes for certain products, etc.). Under such circumstances, the holders of loans can make an allowance for a normal share of non-performance in the form of bad loan provisions, or they may spread the risk by taking out insurance. The problem of non-performing loans is widespread. Nishimura, Kazuhito, and Yukiko, (2001) state that one of the underlying causes of Japan's prolonged economic stagnation is the non-performing or bad loan problem. They explained that some of the loans made to companies and industries by financial institutions during the bubble era became non-performing when the bubble burst. This delayed structural reforms and prevented the financial intermediary system from functioning properly. Most of the defaults arose from poor management procedures, loan diversion, and unwillingness to repay loans, Kohansal and Mansoori (2009). According to them a number of factors can cause loan defaults some of which are: Interest rate ceilings usually imposed by the government, monopoly power in credit markets often exercised by informal lenders, large transaction costs incurred by borrowers in applying for loans, moral hazard problems and much more.

From the findings of the study conducted by Warue (2012) in Kenya, most cases of loan delinquency are caused by microfinance institutions and self-help groups' management failure to efficiently manage specific factors which are considered to be within the direct control of the lenders' and Self Help Groups'(SHGs') management. The external factors outside the direct control of the creditors' and SHGs' management seem to contribute little to the levels of delinquent loans. Therefore, for effective management of delinquency, it is critical for the creditors to understand and focus more on the internal causes of delinquency which they have more control over and seek practical and achievable solutions to redress these problems. The upheaval that hit mainstream financial markets and the effects that continue to be felt across the globe from the resulting economic crisis impacted associations and their members. The early stages of the downturn saw SACCOs experience significant liquidity shortages, but as the capital markets recovered, concerns turned from funding to asset quality (CGAP, 1999).This scenario points to links between external factors and loan delinquency.

The relationship between the macroeconomic environment and loan quality has been investigated in the literature linking the phase of the business cycle with lending institutions stability. For instance, Fofack (2005) studied causal analyses and macroeconomic implication on loan default in Sub-Saharan countries. He showed that macroeconomic stability and economic growth are associated with a declining level of default; whereas adverse macroeconomic shocks coupled with higher cost of capital and lower interest margins are associated with a rising scope of nonperforming loans.

On the findings of his study, Waweru & Kalani (2009) categorized that some of the causes of non-performing loans in Kenyan were a national economic downturn, reduced consumer buying ability and legal issues. The study appreciates that the nonperforming loan and loan delinquency concepts are similar. Inadequate financial analysis according to Sheila (2011) is another cause of loan default. This is when in the loans department the officers do not take a careful study of the applicants to ensure that he/she has a sound financial base such that the risk of loss is mitigated in the case of default.

Sheila (2011) also points out that in Uganda; the issue of inadequate loan support is another cause of loan default. He says that it is very important that the loan personnel collectively ascertain the position in which the loanee finds himself/herself so that in case he needs support, it's availed to him or her. Unfortunately, that is not the case even when the support is given it is not adequate which leaves the business crumbling and hence leading to default. The research also pointed out that illiteracy and inadequate skills were another cause of default**.** The majority of the clients are engaged in traditional, low paying businesses and rarely diversify their businesses and skills. This implies that they do not have enough knowledge about alternative marketable skills that can benefit them when their businesses do not function properly. Secondly, most of them do not know how to read, write and make simple calculations. As a result, they do not know how to account for their businesses even when the lender makes an error, the borrowers are held liable for the loan. Again disappearance of loan clients was seen as another cause. Poor business practice is yet another cause**.** Kasozi (1998) was of the view that, there are weaknesses of the borrower over which the lender has little control. Management of the business is also an essential part that needs to be emphasized. Many borrowers lack the technical skills like keeping records and checking on the business performance until the time of paying back the loan. This is usually hard because they never plow back the profits leading to loan default in the long run.

The study conducted by Nguta and Guya (2013) in Kenya showed that one of the causes of loan default is the characteristic of the business. It was revealed that high cases of default of loan repayment were common (67.9%) in the manufacturing sector. This was followed by the service industry (64.0%) then by the agriculture (58.3%). The trade sector recorded the least (34.9%) cases of loan repayment defaults. This could be attributed to the observation that trade industry deals in fast moving products on high demand which could translate into good business performance and increased revenue that accounts for low default cases.

Kohansal and Mansoori (2009) were of the view that, lenders devise various institutional mechanisms aimed at reducing the risk of loan default. These include pledging of collateral, third party credit guarantee, use of credit rating and collection agencies, etc.). Kay Associates Limited (2005) cited by Aballey (2009) states that bad loans can be restricted by ensuring that loans are made to only borrowers who are likely to be able to repay, and who are unlikely to become insolvent. Credit analysis of potential borrowers should be carried out in order to judge the credit risk with the borrower and reach a lending decision.

Loan repayments should be monitored and whenever a customer defaults action should be taken. Thus banks should avoid loans to risky customers, monitor loan repayments and renegotiate loans when customers get into difficulties (Amankwah, 2011). SACCOs need a monitoring system that highlights repayment problems clearly and quickly so that loan officers and their supervisors can focus on delinquency before it gets out of hand (Warue, 2012). Sheila, (2011) is of the view that proper and adequate appraisal is key to controlling or minimizing default. This is the basic stage in the lending process. According to Anjichi (1994), the appraisal stage is the heart of a high-quality portfolio. This includes diagnosing of the business as well as the borrower.

Before beginning the process of collecting information on the client for the purpose of determining credit limits, the loan officer should have specific information available which will guarantee that the data and figures provided by the client will have a pro-margin error (Sheila, 2011). The majority of the information is obtained by the loan officer through direct interaction with the client in such a way that each loan analysis provides valuable insights for evaluating the application for the future client. However, most clients withhold a great deal of information making the evaluation a difficult and unreliable exercise. Furthermore, the loan officer should visit the home or the workplace of the client with the main objective of determining whether the client needs the loan programs or not. This information will help the loan officer to assess the ability to effectively utilize the loan. Hunte (1996), observed that the time to assess the applicant's credit worthiness also matters. He argues that the longer it takes to assess the applicant, the better. This is because he believes that a shorter time is not enough to fully assess the applicant. In contrary, Bigambah (1997) who contends that it is necessary to analyze the client before a loan is issued; the applicant has to be screened to assess his or her credit worthiness. That is the ability to repay the loan, the business and the guarantee to secure the repayment of the loan. He also observed that the loan default in Uganda has identified loan appraisal as the key factor. In a number of cases, the information received is not verified, in some cases the information received is doctored or falsified. It must, therefore, be emphasized that credit risk analysis is another important element in loan appraisal. When lending out money, the lender should consider the borrowing proposition and subsequent repayment in isolation from security. It should be noted that the borrower should be screened based on the future and the past. Lending should be based on capital, character, capability, purpose, amount, repayment, term and security. Basing on the knowledge above, the lender should investigate on the customer’s record, ability, and experience. Security tends to come towards the end and is considered only after the borrowing proposition has met the criteria. This process of appraising the client will help the officer to assess the ability of the borrower to utilize the loan effectively. Furthermore; the loan officer will be able to predict the likely changes or effect on the business for which the money is being lent out.

Another stage in the lending process which is critical to minimizing default is the disbursement stage according to Sheila (2011). This stage is regarded as the most demanding to borrowers which often times leads to failure to meet their loan obligations. This is because most of the financial institutions take long to disburse funds to successful applicants. This affects the borrowers in that they take long to buy inputs needed to carry out their activities hence end up spending unnecessarily. The most affected are those involved in the agricultural sector because their activities are usually in line with the prevailing weather conditions. If the people involved in the agricultural sector receive the loan late, this will delay the planting season hence they end up not making any profit in time or may yield less, as a result, they are not able to pay their loans in time. To control default SACCOs should also carefully examine the monitoring and control stage in the lending process (Sheila, 2011).

Anjichi (1994) lamented that many of the agonies and frustrations of slow and distressed credits can be avoided by good loan supervision which helps in keeping a good loan good. This is done by visiting the borrowers’ premises to investigate the general state of affairs, checking on the state of borrowers’ morale and physical stock of finished goods. The general business policy and advice are considered. If the micro creditors are sensitive to business development, it can revise its own credit policies and loan procedures as well as advise its customers. It can also monitor the disbursed loans by the use of loan tracking sheets, checking the amount deposited and the remaining balance of the borrowers. He further says that early recognition of the loan default is crucial, and therefore tries to give guidelines on managing loan losses.

These guidelines include immediate recognition of non-performing loans, re-appraising the borrowers’ financial positions in respect to the market share and extending of payment period where necessary.

CHAPTER THREE

3. RESEARCH DESIGN AND METHODOLOGY

This chapter presents the methods used, explain the research design, gives detail information about the population, sample size, sampling techniques, data gathering tools, instruments and methods used in data collection, and data analysis techniques.

3.1 Research Design

This survey study employed a descriptive research method. Descriptive research examines the situation as it is and which enables us to understand the assessment of provision of loan criteria, degree of collectability and reasons for default the case of Ethiopian Insurance Corporation Employees Saving and Credit Cooperative Association.

3.2 Sources of Data

The study was used both primary sources of data. The primary data source was collected from the members and employees of the association by conducting questionnaire and interview respectively.

3.3 Data Gathering Tools

In this study, mainly qualitative and quantitative data collection methods and the instrument are engaged in order to get general information. This instrument includes interview and questionnaire were used as primary data collection method because, it is a quick method of data collection, it is less time consuming, and offers greater assurance of secrecy. Both closed-ended and open-ended questions were included in the questionnaire. To assess the loan provision, degree of collectability and reasons for default, the researcher also conduct an interview.

3.4 Target Population

All the 761 members of the association are considered as the total population in this study. Given that the members of the cooperative are homogenous in nature which means that; all members are employees of E.I.C., the way of monthly deduction are performed in the same manner, and the type and purpose of the required loan are almost the same.

3.5 Sample Size and Sample Size Determination

A sample is a smaller group of subjects obtained from the accessible population (Mugenda, 1999). Sampling is the statistical process of selecting a subset (called a “sample”) of a population of interest for purposes of making observations and statistical inferences about that population. Social science research is generally about inferring patterns of behaviors within specific populations. We cannot study entire populations because of feasibility and cost constraints, and hence, we must select a representative sample from the population of interest for observation and analysis (Bhattacherjee et al. 2012). Kerlinger (1975) as sited by Barasa (2014), suggested that the main factors considered in determining the size are to find a sizable and manageable sample. This enabled the research to derive detailed information at an affordable cost in terms of time, finances and human resources (Mugenda, et al, 1999). To determine sample size Taro Yamane mathematical formula was used as shown below:

$$n = \frac{N}{1 + N(e)^2}$$

Where:

n = Sample size;

N= Total number members in EIC-ES&CCA;

e = Error margin, fixed as 7% (0.07);

n = 761 / 1 + 761 (0.07)2 = 161

Based on the above sample size calculation, 161 sample members were obtained.

For this research, purposive sampling techniques were employed. Because the sample members were selected who took a loan and still they have not settled the loan. Again the method helps to reduce the potential of human bias in the selection of respondents to be included in the sample. As the result, purposive sampling provides the researcher with a sample that is highly representative of the population being studied. The total population is 761, and of which, 161 of them were selected as a sample. The questionnaire was distributed to 161 members who were selected by using the above-mentioned techniques and out of them, 11 were not filled the questionnaire. Besides, from the 150 respondents, 20 of them were not taken any loan from the association. Therefore, the analysis was consider only 130 members and interviews were conducted for the manager and finance head from the employees of the association selected by the criteria of long - term experience and their direct involvement with the loan process in relation to the study subject concerned.

3.6 Data Analysis Techniques

The collected data had entered into Statistical Product and Service Solution (SPSS) version 20 to run the descriptive data. The SPSS software is selected by the researcher, it enables to get results in the form of percentages and tables. Hence, the researcher used it to analyze the collected data and also have used both qualitative and quantitative method.

CHAPTER FOUR

4. DATA ANALYSIS, PRESENTATION, DISCUSSION AND INTERPRETATION

This chapter presents research findings that resulted from the data collected from the area of study. The chapter presents the findings and discussion related to loan provision, the degree of collectability, and reasons for default of EIC – ES&CCA in Addis Ababa City. In the parts that follow, data are described and interpreted in details with the help of appropriate tables and graphs in order to address four formulated specific objectives identified in the beginning chapter of the study. Mainly, these objectives were to assess loan provision, the degree of collectability, and reasons for default.

4.1 Response Rate

Questionnaire and interview guide were used as tools for the data collection. The sample size was 161. The researcher distributed 161 questionnaires to the selected respondents. But, only 150 questionnaires were filled and collected and of these 150, only 130 of them takes a loan. Therefore, the analysis consider the 130 responses. The response rate was 86.67%. According to Nachmias (2000), as cited by Barasa (2014), this percentage was found to be adequate. The interview targeted the manager and finance head of the association and responded.

Table 0-1: **RESPONSE RATE CATEGORY**

	Target	Loan User Respondents	Response Rate in %
Members of the Association	**161**	**130**	**86.67%**
Employees of the Association	**2**	**2**	**100%**
TOTAL	**163**	**132**	**86.84%**

Source; Computed from SPSS 20 result

4.2 Demographic Information of respondents

The study sought to find the demographic information of the respondents, by focusing on gender, age group, marital status, and educational level of the respondents.

4.2.1 Gender of respondents

Table 4.2 below shows the response rate (Gender) for the study showing how the respondents participated in the research. In the table below males who participated in the study were 68 (52.30%) and 62 (47.70%) females and therefore indicate that the number of females participate in the cooperative society becomes promising and it shows that there is no significance difference between males and females. The proportion of males and females in getting access to loans within the SACCOs was promising. The SACCOs also provide loans to all members without gender discrimination (Dessalew, 2014)

4.2.2 Age of respondents

Balogun and Alimi (1988) identified that the age of debtors is one of the major causes of loan default in addition to loan shortages, delay in time of loan delivery, small business size, and high-interest rate.

In the same table below, Table 4.2, the cooperative societies were dominated by workers age 36-50, 70 (53.80%), followed by those falling between the age bracket of 26-35 years 38 (29.20%). Members in an age range of 18-25 years 21 (16.20%), and above age 50, 1 (0.80%) formed the least representation respectively. This implies that, This implies that majority of SACCO members are in the age bracket of between 36-50 and in this age peoples coming to settle, responsible, participate on social activities and probably because this is the age of young adults who seek money from financial institutions to establish their homes and educate their children.; the second highest age group lie on 26-35 which peoples wants to form family, and the cost of capital expenditure becomes very high. Between18-25, implying that these group are currently employed youth who have not acquired enough resources to invest and form a family. Above age 50 peoples wants to clear their liabilities, most of the time they are in settled condition and ready for retirement.

Table 0-2: DEMOGRAPHIC INFORMATION

	Value	Count	Percent
Gender	Male	68	52.30%
	Female	62	47.70%
	Total	130	100%
Age Group	18-25	21	16.20%
	26-35	38	29.20%
	36-50	70	53.80%
	Above 50	1	0.80%
	Total	130	100%
Level of Education	Diploma	9	6.90%
	First Degree	100	76.90%
	Second Degree	21	16.20%
	Total	130	100%

Source; Computed from SPSS 20 result

4.2.3 Level of education

The educational status of both the employees and the client will have an impact on their behaviors as well as on the loan provision and collection procedures. Thus, educational background of respondents is an important factor to be considered with regard to making business and household decision. Education improves the skill, capacity, communication and access to developments. The level of education of the borrowers reduces the default rate in turn facilities heavily the collection procedures (Meron, 2008).

From Table 4.2 above, member level of education was led by the first degree graduate which is 100 (76.90%) among the respondents, 21 (16.20%) were post-graduate fellows and the rest 9 (6.90%) had graduated from college with a diploma. This implies that, the default rate is decreased, minimize unwillingness to repay, and investment is increased due to the members are educated.

4.2.4 Number of dependents

On their research, Kolandavel and Nigatu (2017), Family size and expenditure were inversely related to savings, for obvious reasons. Thrift habit was recommended to be inculcated among members having large family size and expenditure. This study also enquires on the number of dependents the members have. Many researchers found that numbers of dependents affects thr ability to pay loans as the more dependents one have the more the possibility to fail to repay. Loans from SACCOs can be directed to family obligation rather than intended use.

From the study 95 (63.33%) of respondents had no dependents, 29 (19%) have 1-3 dependents, 22 (14.67%) have 4-6 and 4 (2.67%) have 6 and more dependents. Which indicates that in the SACCO under study, the effect of number of dependents is very minimal due to the formation of the SACCO is employee-based. It implies majority of members do not have dependents, which may reduce the number of inability of repayment. Consider table 4.3 below;

Table 0-3: NUMBER OF DEPENDENTS

	Value	Count	Percent
Numbers of dependents	No dependent	77	59.20%
	1	6	4.60%
	2	7	5.40%
	3	15	11.50%
	4	3	2.30%
	5	10	7.70%
	6	8	6.20%
	Above 6	4	3.10%
Total		130	100.00%

Source; Computed from SPSS 20 result

4.3 Descriptive analysis

Below responses are to show out some of the reasons why most of the members default after taking loans from the association.

4.3.1 Loan users

Access to means of secure savings and credit at non exploitive terms is of the greatest importance for the poor and those at risk of becoming poor. SACCOs provide credit on reasonable terms, either to render more efficient the house hold sector (house construction and maintenance, to have furniture and goods), to provide capital for entrepreneurial activities, or provide resources at times of emergency. They enable the poor to avoid dependency on money lenders and permanent indebtedness.

The study indicated that, 130 (86.67%) of the members have taken loan at least once from the association and the rest 20 (13.33%) did not take any. The result indicated that majority of loan users a served by the SACCOs. Moreover, it shows the lending capacity or giving access to invest or use of the funds. Consider table 4.4 below;

Table 0-4: LOAN USERS

	Value	Count	Percent
Loan taken from the association	Yes	130	86.67%
	No	20	13.33%
Total		150	100.00%

Source; Computed from SPSS 20 result

4.3.2 Redundancy of Borrowing /Frequency of loan

As indicated in Table 4.6 below, the study shows 28 (21.50%) once, 49 (37.70%) twice, 26 (20.00%) three times, 21 (16.20%) four times, and 6 (4.60%) take five times.

Table 0-5: FREQUENCY OF LOAN

	Value	Count	Percent
Redundancy of Borrowing	1	28	21.50%
	2	49	37.70%
	3	26	20.00%
	4	21	16.20%
	5	6	4.60%
Total		130	100.00%

Source; Computed from SPSS 20 result and the researcher computation

4.3.3 Purpose of loan

Members have taken loan for different purpose. Table 4.7 shows, Majority of the respondents, 49 (37.70%) of the borrowers used for house construction, 36 (27.70%) to fulfill household goods, 27 (20.80%) for consumption and the other 18 (13.80%) of respondents used the loan for doing business.

Table 0-6: PURPOSE OF LOAN

	Value	Count	Percent
Purpose of loan	Trade / Doing business	18	13.80%
	For household goods	36	27.70%
	House construction	49	37.70%
	For consumption	27	20.80%
Total		130	100.00%

Source; Computed from SPSS 20 result

4.3.4 Loan Procedure

Most of the defaults arose from poor loan management procedures, loan diversion, and unwillingness to repay loans, Kohansal and Mansoori (2009).

Table 4.5 below, shows that 130 (100.00%) of the respondents reply that they followed procedures from asking the loan to taking loan. Which implies the association has a loan procedure.

Table 0-7: WHETHER THERE IS LOAN PROCEDURE

	Value	Count	Percent
Followed procedures in order to ask the loan	Yes	130	100.00%
Total		130	100.00%

Source; Computed from SPSS 20 result

4.3.5 Collateral

Wolff (1910) observed that many individuals bring small amounts of share capital into a common pool, which collectively amounts to significant base of collateral; and that borrowers, lenders and guarantors live near one another (for example in the same village), making it convenient for the lender and guarantors to monitor the growth of the borrower, and manage any problems that may come up. The calculated value and type of collateral also have to be taken into account in designing the credit approval processes (Oesterreichische, 2000).

As the results in Table 4.13 show, from the total sample respondents, are members who were not take any kind of loan from the association, 4 (3.10%) replied that they required compulsory saving, and the remaining 126 (96.90%) who has a significant number, reply that they required other voluntary member to their loan as collateral. The result implies that the association uses two types of collateral, personal (members) and saving. From the result, majority of loan users prefer members for collateral.

Table 0-8: COLLATERAL

	Value	Count	Percent
Types of collateral required	Asset collateral	0	0%
	Group guarantees	0	0%
	Personal	126	96.90%
	Compulsory Saving	4	3.10%
Total		130	100.00%

Source; Computed from SPSS 20 result

4.3.6 Collection of loan

By making use of opportunities to make the collection processes strategically effective, operationally efficient and customer orientated, an organization can expect the collection function to add significant value to the business (Benveniste, 2002).

The collection procedure of the association under study is convenient to members and collected properly; according to the respondents are considered to be effective, since it leads to low default rate. A member who has taken a loan from the cooperatives has to pay both the principal and the interest monthly from his salary. Human resource and the accounts department of EIC take the responsibility of deducting the saving and loan repayment amount from his salary based on the association letter. There is no grace period for the loan, any borrower is expected to start to pay his liability from the nearest salary.

From the total respondents taken 130 (100%) and 113 (86.90%) of them stated that the loan collection procedure and proper collection of repayment were very strict and manageable for them, respectively because every deduction was performed on time from their salary which enhance them to save and pay their principal and interest wisely and promptly. The result implies that loans given by the SACCO are 100 percent collaterally secured. Consider table 4.8 below;

Table 0-9: COLLECTION OF LOAN

	Count	Percent	Count	Percent	Total
Value	Yes		No		
Convenience of collection procedure	130	100.00%	0	0%	130
proper repayment collection	113	86.90%	17	13.10%	130

Source; Computed from SPSS 20 result

4.3.7 Timely loan repayment

When we consider table 4.10 below; the study found out that 129 (99.20%) of the respondents reply that they are able to pay their loan properly and 1 (0.80%) says he can't pay his loan due to his personal problem. Which indicates that the system of collection or the link between the mother company (EIC) and the association leads to minimize the default rate.

Table 0-10: WHETHER LOAN IS TIMELY REPAID AND REASONS

	Value	Count	Percent
Reason Not to pay	I am able to pay	129	99.20%
	Personal problem	1	0.80%
	lack of follow up	0	0.0%
	unwillingness to pay	0	0.0%

Source; Computed from SPSS 20 result

4.3.8 Fairness of interest rates

Under normal circumstances, the overall costs are covered by interest income, and up to this point, it is considered as the low loan interest rate (Kifle, 2015). Since the National Bank of Ethiopia has removed the maximum lending interest rate, the different financial institutions provide different interest rate. However the National Bank of Ethiopia continued setting a minimum interest rate for deposits and loan. The minimum interest rate for deposits set by the National Bank of Ethiopia is currently 5 % for saving and 8.5% for loan per annum. Currently the National Bank has set the ceiling for financial institutions other than bank stating that the saving interest rate has to start from a minimum of 3% and the maximum lending interest rate has to go up to 12.5%. The nature of the interest rate for the SACCO under study is fixed rather than fluctuating. The saving interest rate is fixed at 5% and the lending interest rate is also fixed at 8.5%.

This study shows, 92 (62.30%) respondents reply that, the interest rate for the loan charged by the association is not fair. Which indicate that the members belief that the cost of the loan is less than from what they pay and implies the profit margin of the association is high. Whereas, from the respondents, 48 (36.90%) answered the interest rate charged by the association is moderated and fair. From the respondents, 1 (0.80%) did not reply. Consider table 4.11 below;

Table 0-11: FAIRNESS WITH PROPOSED INTEREST RATE

Fairness of the rate	0	1	0.80%
	Yes	48	36.90%
	No	81	62.30%
Total		**130**	**100.00%**

Source; Computed from SPSS 20 result

4.3.9 Effects of high interest rates

In the response on table 4.12 below, 85 (65.40%) respondents reply that they were not being defaulted due to high interest rate charged by the association, 40 (30.80%) agreed that default occurs because of high interest rate charged on loans, and 5 (3.80%) have no say about the case. This proves that higher interest did not the factor that leads to members fail to repay the loans. Even though, the higher interest rates didn’t affect the ability to pay, the respondents claim on minimizing the rate as much as possible. But, because of this reason; their living status, families, development, social and economic well-being of them may affected.

Table 0-12: WHETHER DEFAULT IS CAUSED BY HIGH INTEREST RATE

	Value	Count	Percent
Being default due to higher interest rate	0	5	3.80%
	Yes	40	30.80%
	No	85	65.40%
Total		130	100.00%

Source; Computed from SPSS 20 result

4.3.10 Multiple loans

As a result of this 'fight' for the same client and fast way of accessing loans from this institutions some SACCO are experiencing high rate of multiple borrowing among their clients. The loan burden overtime leads to loan delinquency among the affected clients (Nkuru, 2015).
The study revealed that 88 (67.70%) of respondents have two or more loans from association and 42 (32.30%) respondents do not have multiple loans. Consider table 4.13 below;

Table 0-13: MULTIPLE LOANS

	Value	Count	Percent
Other loans from the association	Yes	88	67.70%
	No	42	32.30%
Total		130	100.00%

Source; Computed from SPSS 20 result

4.3.11 Impact of multiple loan on repayment

The problem of multiple borrowing among members could be minimized if the SACCO agree and collective develop a mechanism of identifying such clients to enable each of them make better decisions in the process of assessing debt capacity.

The study revealed that 29 (22.30%) of respondents having multiple loans faced problems in loan repayment and 101 (77.70%) does not have problem on repayment. Consider table 4.14 below;

Table 0-14: IMPACT OF MULTIPLE LOANS ON REPAYMENT

	Value	Count	Percent
Impact of having multiple loan	Yes	29	22.30%
	No	101	77.70%
Total		130	100.00%

Source; Computed from SPSS 20 result

4.3.12 Training

Chacha, C (2006) amd Motogoro, N (2009) found that SACCO members and management did not acquire effective training before and after joining the institutions, training will equip them with relevance knowledge of management skills, entrepreneurial skills, business planning and proper use of loan. According to Kifle (2015) Members are not well informed and trained about the basic cooperative principles and values and create the inspiration among members to rally around their grass root financial service institutions. Regrettably, no special efforts have been made in this direction. People look upon these institutions as means for obtaining loans from the government and / NGOs. The study found out that all of the respondents indicated that they had not received any training from the association. And the study revealed that 76 (58.50%) of the respondents said that training would help to effective use of loan and increase their income, while 54 (41.50%) said that training did not help to members. Which implies that the members are in need of training and it is an indicator of existence of knowledge gap. Consider table 4.15 below;

Table 0-15: TRAINING GIVEN TO MEMBERS

	Value	Count	Percent
Training given by the asso.	Yes	0	0.00%
	No	130	100.00%
Is the training helpful	Yes	76	58.50%
	No	54	41.50%
Total		130	100.00%

Source; Computed from SPSS 20 result

4.3.13 Adequate Supervision on Repayment

Loan repayments should be monitored and whenever a customer defaults action should be taken. Thus creditors should avoid loans to risky customers, monitor loan repayments and renegotiate loans when customers get into difficulties (Ameyaw-Amankwah, 2011). Moreover, Loans need a monitoring system that highlights repayment problems clearly and quickly, so that loan officers and their supervisors can focus on delinquency before it gets out of hand (Warue, 2012). Anjichi (1994) lamented that many of the agonies and frustrations of slow and distressed credits can be avoided by good loan supervision which helps in keeping a good loan good.

The study found out that 76 (58.50%) of the respondents indicated that they had been supervised on loan repayments, while 54 (41.50%) of the respondents indicated that they had not been supervised on loan repayments. Which is an indicator of a good performance of the association with regard to repayment supervision. Consider table 4.16 below;

Table 0-16: ADEQUATE SUPERVISION OF LOAN REPAYMENT

	Value	Count	Percent
Supervision of loan repayment	Yes	76	58.50%
	No	54	41.50%
Total		130	100.00%

Source; Computed from SPSS 20 result

4.3.14 Loan default

There are three broad types of delinquency indicators: collection rates which measures amounts actually paid against amounts that have fallen due; arrears rates measures overdue amounts against total loan amounts; and portfolio at risk rates which measures the outstanding balance of loans that are not being paid on time against the outstanding balance of total loans (CGAP, 1999).

Table 4.17 shows, 2 (1.33%) of the respondents did not give answer, 3 (2%) of the sample replied that they have a chance to be default, and 145 (96.67%) replied that there is no chance to be unable to pay. In addition to willingness to pay, the strong collection criteria and system is used as a controlling tool.

Table 0-17: LOAN DEFAULT

	Value	Count	Percent
Chance of unable to pay	0	2	1.33%
	Yes	3	2.00%
	No	145	96.67%
Total		150	100.00%

Source; Computed from SPSS 20 result

4.4 Response from Loan Officers and Managers

4.4.1 Loan giving procedure

According to the respondents, any employee of EIC can be member of the association. After three consecutive saving deposits from his salary, he can ask and have a mandate of taking a loan and being guarantee to others. Any member of the association can apply for loan by using the format that was designed by the association. Based on his request, the accounts and the human resource departments of the employer fills the information about the member (employee) like his basic salary, net pay, and retirement period and confirmed by the authorized persons signature and office stump. Then backed to the association and after receiving the form and date stump for makes it sequential, the accounts division checks and fill whether he take a loan before, how much saving he has, the membership period and how much he pays for the previous loan. Next step will be the form transfer to loan session and there will be waiting for the decision of the committee. Once the loan is approved, the member will informed that how much he can take and bring the guarantee person (persons) based on the amount and capacity to pay their own and the expected loan repayment due to being a guarantee. The final step after signing the guarantee, the check will issue and side by side the deduction procedure (preparing a letter to EIC) will continue.

4.4.2 Loan default and Measures taken to ensure timely repayment of loans

Their response was that there is no loan default in their organization. Because, the employer organization take the collection responsibility as an agent. The members may leave the organization (EIC) but as soon as the association knows the situation or the repayment stop for three consecutive months, the case will inform orally to the guarantee. If he can communicate him and settle his loan, the guarantee will be free. If not, letter will issue for the employer by copying the guarantee and on the fourth month deduction start automatically from his salary on the next month based on the guarantee agreement he entered. The other case that leads most SACCOs to default is the death of members, but here if it happens, the group insurance police purchased by the association will take the responsibility of settling the remaining loan.

4.4.3 Fairness of loan interest rate

The respondents' belief that the rate is fair and also it is a minimum base set by NBE. On the response, they mentioned as their association is the one who use the lowest interest rate.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

Introduction

On the basis of the major findings discussed earlier, in chapter four, the summary, conclusions, and recommendations are offered here under.

5.1 Summary of major findings

Based on the results obtained from the primary and secondary data, the study found that the credit management principles, systems of collateral/ risk minimization/ controlling mechanisms, and loan provision were strong and performed according to the guideline. Hence, the study indicates that the occurrence of being defaulted was very minimal and rare, therefore, there were no reasons to be default was reflected from the result. It was also found that the use of being trained is how much essential, the training culture of the association was poor, and majority of the respondents rely on the supervision of the association in relation to repayment was not promising. However, the documents show that the monthly repayment expected to deduct was collected timely and properly. From the respondents, majority of them complain on the fairness of loan interest rate, of these members, most of them were also suggest to be decreased the loan interest rate. In contrary, the respondents agreed that they were not affected due to higher loan interest rate. The employees of the association argued that the rate is the lower base that the National Bank of Ethiopia was set. House construction, maintenance, household goods, and consumption were observed from both data sources as the reasons that members take loan from the association. The study found that, using a multiple types of loan was common and most of them were enjoy it, and they were not face any challenge was seen from the result.

5.2 Conclusions

Despite the growth in numbers of SACCOs and its accompanied members, the contributions of SACCOs to promote the growth and sustenance of small businesses in Addis Ababa City have been lower due to the combination of challenges that these SACCOs face. These are unconducive trading environment, poor follow up of SACCOs on how SACCO's members use the loans they acquire from SACCOs, poor business size expansion strategies by SACCO's members who use SACCO's loans. Others are absence of seminars and training to business proprietors, and poor Government Support to enable SACCOs to promote its roles on the growth and sustenance of small business. Hence, in addressing the intended research objectives, this study focused to answer key research questions relating to provision, default, interest rate, and degree of collectability.

5.2.1 The Assessed loan provision

On the basis of the findings, respondents indicated that their association made use of credit management principles. The employees gave examples as substantial security criteria, circumstance of taking the loan, credit history, ability to pay and general character of the loanee. The association provide credit on reasonable terms, either to render more efficient the house hold sector (house construction and maintenance, to have furniture and goods), to provide capital for entrepreneurial/ business activities, or provide resources at times of emergency. The present study concluded that the loan is providing in the designed framework and which is comfortable and also accepted by the members.

5.2.2 Degree of Collectability

Based on the results, the loan repayment is collected properly and there is a strong supervision on repayment. Because of the association's establishment structure, which is an employee base structure and also starting from the establishment the association get a strong support from EIC, then the monthly collection of saving and loan repayment is performed by EIC directly from their salary. The study concluded that the collection procedure is safe and convenient to members.

5.2.3 Loan interest rate

Loan interest is the major and the only income of the associations which enhance them to cover the operational cost plus interest expense for savings. When the loan interest is high and the cost of the association is low, then the excess on revenue becomes a profit. It was concluded that the members complain on interest rate that they charged. In addition, they expect to decrease the existing interest rate by 50%. But the higher interest rate didn't affect the association activity and the borrowing tendency of the members.

5.2.4 Default

Reasons for default are poor loan and appraisal procedure, weak collection mechanism, proper supervision, and others. The study reported that there is a strong loan provision criteria, collection system, well designed security system, and adequate supervision. It was concluded that the default rate is low and the study indicate almost no default at all.

5.3 Recommendations

The following recommendations are suggested as possible solutions on the basis of the major findings and conclusions discussed above.

- As seen on the analysis the loan provision processes are made according to the procedure made by Ethiopian Insurance Corporation Employees Saving & Credit Cooperative Association, have a good repayment collection mechanism, and a promising minimal default rate.
- The study recommended that to improve the financial product diversification and collateral system
- According to both the new proclamation number 985/2016 and the former 147/91, from the total profit 30% is reserve for capital and 70% profit of the association is paid to the member as dividend. But the motive of the SACCOs is not getting higher profit, rather it is serving its members by using their own saving provide them a loan. Taking in to consideration of the above fact, the association needs to revise his loan interest rate by considering the operating costs, inflation rate, loan loss and profit growth rate. This interest rate change may increase the number of borrower and amount of loan. The interest rate established by the cooperatives should consider also the borrowers, since they are the major clients, owners and backbone of the organization. The interest rate impact on the members should be one factor to consider while changing the interest rate.

- The reason to establish cooperatives is, to share and solve their social and economic problems. In making members efficient in their investment or participate on income generating activity, the association should provide a continuous training to the members before being a member, when asking or taking loan, and the utilization of loan whether it uses for intended purpose. Besides the way how to use their money effectively should consider as after sales service. The provision of adequate education and training, it is critical for effective performance of SACCOs. Mainly on business management, financial management, cooperative governance and entrepreneurial skills, and saving.

- In addition to the above recommendation made, the association has also increase the size and qualifications of the staff. Staff development should be done with more cooperative related trainings and workshops. The lean size of the staff has created a burden on the existing officers which in turn will have an impact on efficiency of the work being done. Focusing on the basic record management, accounting principle and practice, business management, financial management, cooperative governance and entrepreneurial skills, saving and, internal control and management information disciplines.

- It also recommended to provide adequate supervision and follow up to make sure that members use well the loans they have acquired from SACCO only for intended business purposes. In order to enable members' effective uses of SACCO services and to expand significantly their businesses, the association should design a mechanism. Finally keeping the strong minimal default rate at least as it is.

Areas of further research; in the association under study focused on the assessment of loan provision, loan interest rate, degree of collectability, and reasons for default. The researcher recommends that there are other issues like the relation between loan size and loan interest rate, determinants of loan size, internal and external audit, factors affecting profitability, human resource related issues and others could be researchable. A similar study could be carried out in other associations to find out whether the same results would be obtained.

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ST. MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

Questionnaire for Employees

Dear Sir/Madam

Subject: Survey Questionnaire for Assessing the Loan Provision, degree of Collectability & Reason for Default: Ethiopian Insurance Corporation Employees Saving and Credit Cooperative Association

I am Menilik Tekalign; an MBA (Accounting and Finance) student of the St. Mary's University of Addis Ababa, ID number MBAAF/0452/2008A. I am conducting a study to assessing the loan provision, degree of Collectability & Reasons for Default.

You have been randomly selected as a participant in this study. Please kindly you are requested to participate in answering the questions in the questionnaire honestly and completely. The information you give shall be treated with confidentiality and will be used only for the purpose of this study. Moreover the result of this study will be used as additional reference for those who want to conduct detailed research on the area.

Eventually, I promise you that, the information you will provide me is going to be reported and communicated in aggregate and utmost care will be taken for its confidentiality.

Thank you for your cooperation,

QUESTIONNAIRE FOR LOAN PROVISION, DEGREE OF COLLECTABILITY AND REASONS FOR DEFAULT THE CASE OF ETHIOPIAN INSURANCE CORPORATION EMPLOYEES SAVINGS AND CREDIT COOPERATIVE ASSOCIATION

Fill in the space provided and tick where APPROPRIATE

I. Personal details of respondent

1.1. Gender;

(i) Male ☐ (ii) Female ☐

2.2. Age in years;

(i) 18-25 ☐ (ii) 26-35 ☐

(iii) 36-50 ☐ (iv) Over 50 ☐

2.3. Marital Status:

(i) Single ☐ (ii) Married ☐

(iii) Divorced ☐ (iv) Windowed ☐

2.4. Level of education:

(i) Preparatory (11-12) ☐ (ii) Diploma /TVET/ Vocational ☐

(iii) First Degree (iv) Second Degree ☐

3. Numbers of your dependents- 1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐ 6 ☐ above 6 ☐

4. How much is your monthly income by source?

(i) From Employment _______________ (ii) Business (Investment) _____________

(iii)Other _________________ specify the source ___________________________________

5. For how long you are a member of the association?

Less than 3yrs ☐ 3 to 7yrs ☐ 7 to 12yrs ☐ More than 12yrs ☐

II. Loan Provision Procedures, Collection and Default related

1. Have you take a loan from the association?

Yes ☐ No ☐

2. For how many times did you take the loan? _____________________________

3. For what purpose you want to borrow the loan?
   (i) Trade / Doing business ☐ (ii) For household goods ☐
   (iii) House construction ☐ (iv) For consumption ☐
   (v) Medical treatment ☐
4. What procedures have you followed in order to ask the loan?
   (i) By using form ☐ (ii) Phone ☐ (iii) Other ☐
5. What are the types collateral required to receive a loan?
   (i) Asset collateral ☐ (ii) Personal guarantees ☐
   (iii) Group guarantees ☐ (iv) Compulsory savings ☐
6. Did the collection procedure convenient?
   Yes ☐ No ☐
7. Did your repayment collected properly by the association?
   Yes ☐ No ☐
8. Do you pay your periodic loan repayment? If not, what is the reason?
   (i) I am able to pay ☐ (ii) Unable to pay due to personal problem ☐
   (iii) Unable to pay lack of follow up ☐ (iv) I am unwilling to pay ☐
9. Do you think that the loan interest rate is fair for you?
   Yes ☐ No ☐
10. Can you default because of higher interest rates?
   Yes ☐ No ☐
11. Do you have other loan(s) (multiple loan) from the association?
   Yes ☐ No ☐
12. Do you face any difficulty on loan repayment as a result of having multiple loans?
   Yes ☐ No ☐
13. Is there any form of training provided by the association?
   Yes ☐ No ☐
14. Has training help to increase business income?
   Yes ☐ No ☐
15. Is there any form of supervision on loan repayment by the association regarding your loans?
   Yes ☐ No ☐
16. Have you ever been a chance of unable to pay (Default)?
   Yes ☐ No ☐

INTERVIEW QUESTIONS

I. Personal details of interviewee

1. Gender:

(i) Male ☐ (ii) Female ☐

2. Age in years:

(i) 18-25 ☐ (ii) 26-35 ☐

(iii) 36-50 ☐ (iv) Over 50 ☐

3. Marital Status:

(i) Single ☐ (ii) Married ☐

(iii) Divorced ☐ (iv) Widowed ☐

4. Level of education:

(i) Preparatory (11-12) ☐ (ii) Diploma /TVET/ Vocational ☐

(iii) First Degree ☐ (iv) Second Degree ☐

II. Work related questions

1. What is the loan giving and guarantee procedure of the association? From the request to giving or reject the loan

2. How do you collect the repayment from each member?

3. What measures taken to ensure timely repayment of loans?

4. Is there a possibility of loan defaulted?

5. Do you think that the loan interest rate charged by the association is fair?

6. Do you give training for the members before and/or after being a member, the time of loan request, or after taking a loan?

Thank you again, for your cooperation.

Menilik Tekalign