



**OUTREACH, SUSTAINABILITY AND  
GROWTH OF RURAL SAVING AND CREDIT  
COOPERATIVES: THE CASE OF AWASH  
RURAL SAVING AND CREDIT  
COOPERATIVES UNION**

**BY**

**DANIEL KABTIMER  
SGS/0045/2005**

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**APPROVED BY BOARD OF EXAMINERS**

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**Dean, Graduate Studies**

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**Signature & Date**

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**Advisor**

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**Signature & Date**

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**External Examiner**

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**Signature & Date**

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**Internal Examiner**

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**Signature & Date**

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## **Acronyms**

ADB: African Development Bank

CGAP: Consultative Group to Assist the Poor

CPB: Cooperative Promotion Bureau

FCA: Federal Cooperative Agency

FSS: Financial self-sufficiency

GDP: Gross Domestic Product

ICA: International Cooperatives Alliance

IFAD: International Fund for Agricultural Development

MDGs: Millennium Development Goals

MFI: Micro Finance Institution

NGO: Non-Government Organization

OSS: Operational Self Sufficiency

PEARLS: Protection, Effective Financial Structure, Asset Quality, Rates of Return and Costs,  
Liquidity and Sign of Growth

PSACCO: Primary Saving and Credit Cooperative

ROA: Return on Asset

ROC: Return on Capital

RUSACCO: Rural Saving and Credit Cooperative

SACCO: Saving and Credit Cooperative

WB: World Bank

WOCCU: World Council of Credit Unions

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## **Abstract**

*Awash Rural Saving and Credit Cooperatives Union has 8,898 members under 78 primary SACCOs and it has been in business since 2005. The objective of this research to measure the growth, sustainability and outreach of the union for the period covered from 2007 to 2013. This study employed exploratory research which examined the secondary data collected from the annual audit report of the union. The financial data is analyzed using WOCCU PEARLS model to assess the growth, sustainability and outreach of the union. Awash RUSACCO Union is found to be not on the right track in terms of sustainability with inconsistent and low growth in key indicators such as poor performance in raising internal source fund, very low earning, high operational cost impede financial service expansion and outreach. Therefore, based on the findings it is recommended that the union shall control operational costs, charge market based interest which covers cost of fund, operational costs and contribute building the institutional capital, introduce new saving products and design appropriate marketing strategy to attract new members and saving, improve its rigid procedures and make member friendly service, revise the basis of dividend payment and decrease dependence on external creditors.*

**Key words:** *Outreach, Sustainability, Growth, Rural saving and credit cooperatives*

# CHAPTER ONE

## INTRODUCTION

### 1.1 Back ground of the study

The International Cooperatives Alliance (2014), an apex organization that represents cooperatives worldwide, define a cooperative as an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise.

Cooperative is a user-owned and user controlled business that distributes benefits on the basis of use. More specifically, it is distinguished from other business in three concepts or principles: first, the user owner principle. Persons who own and finance the cooperative are those that use it. Second the user-control principle. Control of the cooperative business is by those who use the cooperative. Third, the user benefits principle. Benefits of the cooperative are distributed to its user on the basis of their use (Cobia, 1998).

In Ethiopia successive regimes, starting from the Imperial period to EPRDF government, gave due recognition to the role of cooperatives and made deliberate effort to promote same. However, the principles and approaches followed were markedly different, reflecting the political thinking and ideology of the regimes (Gebrehiwot et al, 2011)

According to Veerakumaran (2007) modern form of cooperatives started in Ethiopia during the ruling era of Emperor Haile Selassie I. In 1960 the first legislation called “Farm Workers Cooperatives Decree” was decreed as Decree No.44/1960. The objectives the decree were:

- To accelerate the development of the agricultural economy of the country.

- To provide for proper framework for the establishment of such cooperative enterprises.

Starting from 1974 following the overthrow of the monarchic feudal system and the establishment of the Dergue regime with its socialist principle, the formation of peasant associations were given legality by proclamation no. 71/1975. In this proclamation, the objectives, powers and duties of peasant associations, service cooperatives and agricultural producer cooperatives were clearly stated.

It was during this time that a number of “Ye’irsha Mahber” was unwillingly organized in quota bases in most of the then provinces. The Cooperative Societies Proclamation No. 138/1978 was issued later in order to include other type of cooperatives like Housing, Thrift and Credit and Handicrafts etc (Veerakumaran, 2007).

It was high time that the government fully committed to annex cooperatives as government structure and hijack the movement of the cooperatives and divert the very ethos of the cooperatives.

After the downfall of the Derg regime, there was a gap between 1991- 1995 in the cooperative movement of Ethiopia. This gap was created due to the fact that the government’s attention was mainly drawn towards stabilizing, bringing peace and creating administration organs. Later on due to cooperative experts dedication and devotion and the government’s commitment towards cooperative development, it became necessary to enact new cooperative proclamation which suits to the current economic system (Veerakumaran, 2007).

### **1.1.1 Saving and Credit Cooperatives (SACCOs) in Ethiopia**

Ethiopia has a strong culture of informal financial systems. Friends and relatives provide the bulk of the informal credits. Many people are member of informal savings and credit associations such as iqqub (Rotating Credit and Savings Associations), iddir and mehaber.

The First Consult (2009) study described that it is clear that the financial sector is underperforming, savings mobilized in the country has grown by 20% between 2005 and 2008 and ETB 44 billion mobilized in bank loans, and still only 14% of the population have access to financial services.

It is obvious that even this low percentage of access to financial service highly concentrates in the urban areas of the country.

On the other hand, not less than 60% of Ethiopians approach informal financial institutions for loan. The loan can take the form of family loan, society based loans (Iqqub and Iddir) or loan from money lenders. But the majority of the loan, however, is believed to come from the latter (Habtu et al, 2008).

Even though microfinance institutions have been able to gain some outreach, still only 10% of the population have an account (CGAP, 2009).

Savings and credit co-operatives (SACCOs) can be designated as semi-formal financial institutions. They are outside the control of the central authorities with respect to ownership of assets and management. As a semi-formal financial sector, the SACCO can establish a link between the informal (the iqqub and iddir) and formal sector. SACCOs are promoted not only for money; they contribute to the promotion of total human development. SACCOs develop people's minds by providing motivation, creating initiative, promoting self-development and self-reliance and providing leadership (Dejene, 1993).

The history of savings and credit cooperatives (SACCOs) establishment in Ethiopia dates back to the reign of Emperor Hailesaleie. According to Dagnew (2004) the first saving and credit cooperative in Ethiopia was established by the employees of Ethiopian Road Authority in 1957.

Early attempts to promote SACCOS remained mainly urban phenomenon focusing on persons with permanent jobs—employees of government and non-government organizations. However, the cooperatives movement has come long way since then. Cognizant of the role cooperatives,

successive governments, took measures to promote cooperatives (including SACCOs), in both urban and rural areas, for their respective ends (Gebrehiwot et al, 2011)

Yebeltal (2008) argued that despite the long age of other forms of cooperatives in the rural areas, especially during the command economy, like agricultural, marketing, dairy and other forms of cooperatives, the organization and development of Rural Saving and Credit Cooperatives is a recent phenomenon.

During the Derg period, SACCOs (Thrift and credit cooperatives as they were called then) were rightly perceived as financial institutions and hence placed under the purview of the National Bank of Ethiopia (Gebrehiwot et al, 2011).

Rural Saving and Credit Cooperatives (RUSACCOs) are members' owned and members' managed financial cooperatives enabling the poor rural society to own and manage its institution. At the end of June 2006 there were 1,166 RUSACCOs and these constituted 21% of the 5,437 saving and credit cooperatives in the country, having 64, 655 members or about 17% of the total membership of SACCO (Mekonen et al, 2007).

With agriculture remaining the backbone of Ethiopia's economy, the provision of financial services is expected to have a substantial impact in activating the largely under-utilized productive potential in the rural areas. Financial analysis of a typical cross-section of investments in, and non-farm enterprises shows significantly high returns on investments in crop production, draught animal power, livestock fattening, bee-keeping, tailoring and petty trading (IFAD, 2011).

Traditionally, the role of finance was considered as passive in the development process in general and rural development in particular. However, it was recently recognized that rural finance is a strong tool to reduce poverty and contribute towards rural development (Biruk and Yuvaraj, 2013).

As of 31<sup>st</sup> of March 2007, Ethiopia recorded 19,147 cooperatives with individual membership of 4,617,800 of which 4,178 were primary saving SACCOs and the primaries have formed 21 secondary level Unions (Veerakumaran, 2012).

As per the study conducted by MICRONED (2011) there were about 39,000 cooperatives and 212 unions of which 8,623 SACCOs 4,337 are RUSACCOs. Among the 56 SACCO unions 54 are RUSACCO unions.

### **1.1.2 Rural SACCO Governance**

In Ethiopia the cooperative organizational structure is envisaged to have 3 ladders. Primary Cooperatives formed by ten or more individuals voluntarily form primary cooperatives. Cooperation of Cooperatives (Cooperative union) will be formed by two or more voluntary primary cooperatives form a cooperative union. Cooperative Unions are established when there are problems that cannot be solved by primary cooperatives. National Cooperative Federation is established by two or more voluntary Cooperative unions and to establish national Federations, there must be a problem that could not be solved by individual cooperative unions. The establishment of National Cooperative Federation is on process and currently 4 Regional cooperative Federations are established in the three Regions.

The governance of both the rural SACCOs at primary and union level is based on the board of directors who are elected from the membership of the SACCO using the principle of one member one vote. With the board of the rural SACCO it is elected from the primary SACCOs, where voting power in the 2nd tier structure is equally split between individual primary SACCOs regardless of their respective size.

Boards and committees are generally elected for a 3 year term. The credit committees perform the loan approval and follow up while the control committee is the same as supervisory committee and is elected directly from the general assembly.

Generally boards of directors would have 5-9 members and each committee have 3 members each, none of which are on the board of directors. All major operational and strategic decisions need the approval of the general membership e.g. dividends, interest rates etc. All board and committees are volunteers.

Primary SACCOs will be a member for saving and credit cooperative union while individuals will be directly member of the primary SACCOs. Currently the SACCO development is two tier structures – primary SACCOs and SACCO unions; though there is practice in other countries having the third tier i.e. federation in Ethiopia the absence of apex organization results poor activities in advocacy.

### **1.1.3 Rural SACCO Regulatory Framework**

The SACCO sector in Ethiopia is regulated at national level by the Federal Cooperative Agency (FCA) and at local level through the Cooperative Promotion Bureau (CPB).

Cooperative promotion structures (Agencies, bureaus, offices etc) are established throughout the country (Federal, Regional,Zonal, District and Kebele level). The role of all these structures is to give technical supports and regulate the activities of Cooperatives. For this they give audit, inspection and legal services. Moreover the cooperative promotion structures organize, strengthen cooperatives, promote the cooperative ideas and intervene in capacity building.

The legal and political environment for financial cooperatives is characterized by two phenomenons:

- There is no specific regulation for financial cooperatives: the law and regulation of Ethiopia makes no distinction between different type of cooperatives, they are all treated as ‘general’ cooperatives whether multi-purpose, marketing or financial cooperatives. Supervision of cooperatives is under Ministry of Agriculture and its federal and regional departments. The Ministry of Agriculture has no specialized staff for financial

cooperatives. Ministry of Finance and Central Bank are not at all involved in regulation and supervision of financial cooperatives.

- The Government is directly involved in daily affairs of all cooperatives, through the cooperative offices under Ministry of Agriculture. Many General Managers of cooperatives are on the payroll of the local government bureau, and many basic conditions of cooperatives (for financial cooperatives i.e. interest rate) are determined by Government in phenomena.

## **1.2 Back ground of the organization**

Awash rural Saving and Credit Cooperative Union was established in 2005, with 20 primary SACCOs and the number of founding members was 2,002. The starting capital at the inception of the union was birr 35,400, saving mobilized at the end of the same year was around birr 5,000.

Awash RUSACCO union operates in Oromia Regional State in East Shoa zone in seven woredas and located at Mojo town and found in between Bishoftou and Adama relatively bigger towns.

Though its establishment dates back to 2005, in reality the union started operation in 2007/08. Following formation of the union, its operation was stagnant mainly due to lack of resources since the saving it managed mobilized was very low so that it could not able to meet the members high demand for loan. As SACCOs follow save-first approach and members who made their regular saving demand loan and this put the union in very difficult position. Even the existence of the union was in question due to member frustration of not getting loan-the main reason for them joining the union. The promoters of the union had promised that members will secure credit from the union which is a misleading promotion which is most of the time advocated by local cooperative office promoters.

However, with intervention of NGO support which is working in cooperative development, the union moved its operation within two years to the level of better performing SACCO union. The

capital donation by the NGO has boosted the union lending capacity so that members request for loan has been addressed.

Awash rural saving and credit cooperative union has grown and has 78 primary Saving and credit cooperatives with 8,898 members, of which 53% are women.

In terms of financial positions in 2013, the Union has Birr 10.9 million outstanding loan portfolio, birr 6.2 million saving and 0.9 million members share capital.

The union is still getting financial and capacity building support from NGO in developing the capacity of its staff. The union has moved from the one small size room office which it got free from multipurpose cooperative in the area to its G+1 building which enables the Union to provide a better service with similar office setup like the formal commercial banks in the country. The union has six full time staff including the general manger who is responsible in managing the day to day business operation of the union.

The Eastern Shoa zone cooperative bureau supervises the union and also conduct annual audit and present its audit report to the general assembly of the union.

### **1.3 Statement of the Problem**

The rural saving and credit cooperatives in Ethiopia are believed important tools to implement various development programs and considered as an alternative financial service provider for the rural poor since the regular commercial banks are not attracted and not interested to address high financial demand yet.

Conventional Banks can not lend to poor and very small business due to the risk factor that arises from the informal nature of the business of the poor, lack of fixed asset acceptability for collateral, susceptibility to business failure and high transaction cost. Due to this global fact conventional banks in Ethiopia also failed to address the rural poor.

Commercial Banks in Ethiopia tend to cater to mainly for large and medium enterprises, and give little attention to small loans, which they consider as too risky, unprofitable and not fitting with their business. With the exception of the indirect interventions in fertilizer and improved seed credit, formal banks in Ethiopia consider the poor as credit risks and unbankable. The fact that the majority of the banks' branches in the country are located in Addis Ababa and other major towns is one indication of this factor (Habtu et al, 2008).

The major problem of poor households has been lack of flexible financial services on a sustainable manner, despite the high potential demand for the services, especially for micro-credit. Micro Finance Institutions are making their effort to fulfill this demand, but their limited financial and institutional capacities have become serious constraints to expand outreach to the bulk of the population (ibid).

Hence, the unmatched high demand for finance and very limited supply necessitates intervention by member owned financial institution dedicated for the interest and wellbeing of the poor where by the relevance of RUSACCOs is unquestionable.

The importance of the RUSACCO to create financial access and reach deep the rural poor, and participate all sections of the society, was not given chance or attention in the past (Berhane, 2008).

The RUSACCOs will bring the poor households to pursue various socio-economic goals; they are sometimes forced to forgo opportunities that could help them improve their own well-being because they lack access to finance. It is undeniable fact that member's loan demand is very high and incompatible compared with the availability of loan able funds.

Some studies indicate that only 20% of the loan-demand of the rural area is being satisfied currently. Hence, 80% of the loan demand is still un-met (Berhane, 2008).

Hence, RUSACCOs will serve as financial service provider with different financial products that would address the unmet demand the rural people.

The contemporary view of rural finance is aimed at providing financial services to the poor, with the belief that these services allow the poor to develop income-generating activities and improve their ability to cope with shocks by building household capital.

However, the RUSACCO business in Ethiopia has been encountering various challenges of awareness of the rural people about RUSACCOs leads to small number of membership, government policies, and lack of trained man power for managing the day to day operation.

On the other hand despite all the problems the RUSACCO has opportunities that could create favorable conditions since the high unmet demand for credit in rural Ethiopia, untapped opportunity by the formal financial institutions like Commercial banks and Micro Finance Institutions. Thus RUSACCOs could address this high demand for credit if they organized and operated in sustainable and viable model.

The Saving and credit cooperatives sector in general and the rural saving and credit cooperatives in particular was not dealt and deeply studied in terms of outreach, sustainability and growth, to the extent or level of significance having the assumption the majority of the population, 85% is still living in rural and access to finance is very rare and unthinkable or even have little or no access to formal financial services. Poor people have little or no access to formal financial services since they are often considered to be unreliable and un-bankable.

Studies made on Micro Finance Institutions (MFIs) for rural finance, but MFIs are not exclusively for rural finance, they are provided by entities organized to operate like any financial institutions and restricted by certain principles.

The studies conducted on RUSACCOs focused mainly on studying the challenges of RUSACCOs, products development, assessing regulatory frame work and related areas.

Hence, this paper will bring understanding of the rural financial cooperatives major challenges and critical determinant for viable RUSACCO. Accordingly this study will focus deeply on

RUSACCO growth, sustainability and outreach which are the most crucial aspects for rural finance service provider by examining Awash RUSACCO.

Therefore, this research fills the gap in studying RUSACCOs regarding the outreach and sustainability in rural Ethiopia by showing the challenge and opportunity from these critical variables of RUSACCOs to appraise its' prospects as alternative and viable financial service provider.

## **1.4 Research Questions**

1. What is the growth trend of Awash RUSACCO union?
2. What is the outreach improvement of Awash RUSACCO union?
3. How sustainable is Awash RUSACCO union to continue as viable financial service provider?
4. How healthy and effective is the balance sheet structure of Awash RUSACCO union?

## **1.5 Objectives of the Study**

The major objective of this paper is investigating the sustainability and outreach of Awash RUSACCO Union that univocally contribute to the growth of the union and to their contribution as sustainable alternative financial service provider by reaching whose demand for finance unmet in rural part of Ethiopia.

The specific objectives of this study are:

1. To evaluate Awash RUSACCO union operational and financial sustainability
2. To evaluate the outreach of Awash RUSACCO union
3. To measure the growth of Awash RUSACCO union

4. To analyze the balance sheet structure of the union which is critically important for saving and credit cooperative sustainability

## **1.6 Significance of the Study**

This study will have a practical contribution in the RUSACCO development by showing the challenges and workable solution to reach rural poor marginalized by the formal financial sector ,further it and will also show the way improving rural finance through RUSACCOs regarding outreach and sustainability model of RUSACCOs by examining the most important parameters- sustainability and outreach so as to evaluate the expansion of financial service in rural Ethiopia to enhance entrepreneurial capacity of economically active citizens.

This study will be also an additional input in the RUSACCO discourse in the academia since most studies focused on more generalized and broad topics regarding the challenges of the sector while this paper will spotlight the most significant issues by evaluating sustainability and outreach Vis-à-vis financial performance in the case of RUSACCO.

It will give insights to evaluate RUSACCOs from sustainability and outreach aspects so that they continue their service for the greater number of the rural poor who is badly in need of finance.

## **1.7 Scope and Limitation of the study**

The scope of data presented in this study covers from 2007 to 2013.The study is a case study of one RUSACCO Union in the country which comprises 78 primary saving and credit cooperatives and may not be generalized for all RUSACCO unions in the country.

This study is a case study on Awash RUSACCO union and it has a limitation to apply the study due the difference in social, economic and other factors in other parts of the country.

## **1.8 Structure of the Paper**

The first chapter of this paper is about the introductory part including objective, research question, the problem statement, scope and limitation and significance of the study. The second chapter deals with related literature on the topic. Chapter three explains the research design and methodology. The empirical data, presentation and analysis of findings will be discussed in chapter four. The fifth chapter presents conclusion and recommendation.

# **CHAPTER TWO**

## **LITERATURE REVIEW**

### **2.1 Theoretical Review**

#### **2.1.1 Definition of Cooperatives**

Cooperation has been the very basis of human civilization. The inter-dependence and the mutual help among human beings have been the basis of social. It is the lesson of universal social history that man cannot live by him-self and for him-self alone (Biruk and Yuvaraj, 2013).

According to Andrew (2006) Cooperatives are owned, controlled and operated for the benefit of their members. Most corporations are controlled based on the number of shares owned, and distribute profits based on investment. But co-ops operate on the basis of one member, one vote, and return dividends based on patronage.

Cooperatives are independent of government and not owned by anyone other than the members. They are associations of persons, which can mean individual people but also 'legal persons', organizations that may themselves have members (Johnston, 2003).

The "modern cooperative era" began in 1844, when the Rochdale Equitable Pioneers Society was established in Rochdale, England. Its members documented the principles by which they would operate their food cooperative, implementing the central tenets around which cooperatives are structured today (Babajide, 2013).

The Cooperative Movement believes that democratic procedures applied to economic activities are feasible, desirable, and efficient. It believes that democratically-controlled economic organizations make a contribution to the common good (Daman, 2003).

Cooperatives are motivated not by profit, but by providing a service to satisfy members' requirements for affordable and quality goods or services

Cooperatives are economic enterprises, but they are not driven by investment return. They are designed to provide member benefit, but that benefit may be defined and derived in a myriad of ways, social and cultural as well as economic. And even within the economic sphere, cooperatives typically also offer their members a wide variety of benefits in place of or in addition to, the financial returns they receive based upon their patronage (Margaret, 2013).

The other main distinguishing features of cooperatives relates to the three peculiar features of cooperatives, i.e. “user-owned”, “user-controlled”, and “user benefit” (Dagnachew et al, 2009).

As the word cooperation used in common parlance designates the idea of living and working together cooperative efforts have occurred throughout history. Since early man cooperated with others to help kill large animals for survival, people have been cooperating to achieve objectives that they could not reach if they acted individually.

Cooperation has thus occurred throughout the world. Ancient record show that Babylonians practiced cooperative farming, that the Chinese developed savings and loan associations similar to those in use today (Dagnachew et al, 2009).

## **2.1.2 Why are cooperatives established?**

The main reason and driving factor to establish cooperatives emanate from the very nature humanity living together and striving to overcome challenges together with collective effort for the common good of the society at large.

Cooperatives empower people to improve their quality of life and enhance their economic opportunities through self-help". The cooperative's objectives were to address members' needs for better housing, employment, food, education and other social requirements (King et al, 2007).

The various cooperative types provide members with diverse products and services, including financial services, equipment and farm supplies, marketing of agricultural products, consumer goods, utilities (e.g., electricity, telephone), housing, and other services (e.g., insurance) (King et al, 2007).

Consumer cooperatives provide their members with food and other products they need, while housing cooperatives provide shelter and worker cooperatives provide decent work. Credit cooperatives provide savings and credit, while agricultural cooperatives help farmers to organize the inputs they need to grow crops and keep livestock, and then help them to market and process their products (Johnston, 2004).

According to World Bank (2003) financial cooperatives create access of the rural poor to a suitable diversity of products and institutions that fill the financial needs of low income rural clients in income generation and reduction of vulnerability. Well-functioning financial markets facilitate rural economic growth and poverty reduction by mobilizing and transferring funds, allocating them to productive investments (including improved agricultural technology and non-farm enterprises), and enabling households to smooth consumption and mitigate risks.

Accordingly cooperatives will try to solve the unmet needs of the society by the mainstream establishments both by the private and public sectors since their objectives and primary purpose derived from the cooperative values and principles which enable them to work and prioritize for addressing the needs of the people.

### **2.1.3 Types of Cooperatives**

Cooperatives could be classified on the basis of the purpose for which they are established and on the nature of services rendered by them. Accordingly, they could be single purpose cooperatives or multipurpose cooperatives as is the case with most cooperatives (Dagnachew et al, 2009).

#### **Consumer cooperatives**

Consumer cooperatives trace their origins back to the Rochdale Pioneers who, in 1844 set up their store in Rochdale, in the rapidly industrializing textile belt of northern England. At that time, retailing was provided by small shopkeepers who charged high prices for poor quality, often adulterated food, lending money to their customers and thus preventing them from having much choice (Johnston, 2004).

Consumer cooperatives are owned by the people who do business there. One particularly common business is in retail food sales (Andrew, 2006).

The purpose of the consumer cooperatives is to protect the society from unreasonable and inflated price on the consumption products and services and create an alternative market with fair and affordable price so that they will also play an important role by stabilizing the market as well.

## **Worker cooperatives**

Worker cooperatives are businesses which are owned by the employees. This is one of the most versatile of cooperative forms, and can be used even by a small group of business partners running, for example, a bakery or bookstore. However, they can also run large industrial operations, including some of the world's largest co-ops (Andrew, 2006).

## **Housing cooperatives**

Housing cooperatives are owned by the residents. This can range from a single house to apartment complexes with thousands of units. It also includes co-housing projects, in which dozens of homes are cooperatively owned. Condominiums are a relative of coops, although with condos each member owns their own unit; in a cooperative, each member owns a share of the co-op that owns all of the property (Andrew, 2006).

## **Agricultural cooperatives**

The most successful type of cooperative, measured by market share, is the agricultural cooperative. Ever since the industrial revolution turned them into producers of food for distant markets rather than just for local consumption, farmers have needed to take control over three processes: farm inputs (such as fertilizer, seeds and livestock); marketing of the produce; and food processing to add value to the product. They have also needed a supply of credit, to smooth out the seasonal variability in farm incomes (Johnston, 2004).

As the most common and strong cooperatives the agricultural cooperatives play a significant role for their members by collectively doing marketing of their products which gives them a better negotiation power in the market so that they will benefit with better return. By the same token it is also advantageous for farmers and agricultural cooperative members to do their purchase of agricultural inputs via the cooperative with good better price and payment modalities.

## **Saving and Credit cooperatives**

Saving and Credit cooperatives have been developed to meet the fundamental human need to find a way of saving and borrowing without taking risks and without handing over too much power to a money-lender. They were invented in Germany, by two business leaders: Raiffeisen, who set up a rural credit banking system linked to the agricultural cooperative sector, and Schulze- Delitzsch, who founded the urban cooperative banks (Johnston, 2004).

SACCOs are member-based institutions that intermediate savings into loans. SACCOs are usually rather small, independent financial institutions. The business model of most SACCOs is to collect savings from their members and to intermediate them into loans. This enables the rural and poor population to deposit savings as well as to take loans (Markus et al, 2011).

Even in some cases SACCOs are also providing members with micro insurance products that could be affordable by the community they are serving and fit to the purpose of their members' day to day life.

## **Health and social care cooperatives**

It is useful to divide health cooperatives into those that provide insurance to enable people to afford health care, and those that actually provide the care. Health insurance mutual provide by far the largest contribution, in many countries being the main way in which both public and private funding are channeled into health care (Johnston, 2004).

### **2.1.4 Principles of cooperatives**

The seven internationally recognized cooperative principles are: voluntary and open membership; democratic member control; member economic participation; autonomy and independence; provision of education, training and information; cooperation among cooperatives; and concern for the community (King et al, 2007).

Cooperatives have: voluntary and open membership; democratic member control; economic participation on the basis of membership rather than size of investment; autonomy and independence. Because they are member owned businesses they need to make a commitment to the education and training of their members, and because they share similar values are expected to cooperate with each other. Finally, though they exist primarily for the benefit of their members, they also have responsibilities to the wider community (Johnston, 2004).

The International Cooperatives Alliance (2014) elaborates the seventh cooperatives as follows:

#### **Voluntary and Open Membership**

Co-operatives are voluntary organizations; open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political, or religious discrimination.

#### **Democratic Member Control**

Co-operatives are democratic organizations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary co-operatives, members have equal voting rights (one member, one vote) and co-operatives at other levels are also organized in a democratic manner.

#### **Member Economic Participation**

Members contribute equitably to, and democratically control, the capital of their co-operative. At least part of that capital is usually the common property of the co-operative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their co-operative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the cooperative; and supporting other activities approved by the membership.

### **Autonomy and Independence**

Co-operatives are autonomous, self-help organizations controlled by their members. If they enter into agreements with other organizations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their co-operative autonomy.

### **Education, Training, and Information**

Co-operatives provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their co-operatives. They inform the general public-particularly young people and opinion leaders-about the nature and benefits of cooperation.

### **Co-operation among Co-operatives**

Co-operatives serve their members most effectively and strengthen the cooperative movement by working together through local, national, regional, and international structures.

Seventh Principle:

### **Concern for Community**

Co-operatives work for the sustainable development of their communities through policies approved by their members.

## **2.1.5 Benefits of cooperatives**

Values, principles, ethics and business competence constitute the cooperative advantage for members and for the communities in which they operate. Cooperatives put people first – they are member-owned; they are controlled under democratic principles; and they are competitive enterprises which are at least as efficient in their business operations and use of capital as others in the market place (Daman, 2003).

The cooperative advantage extends to the users of the cooperatives and indeed to the communities in they operate. Cooperatives set industry standards by putting into practice their

values and ethics. Cooperative advantage is improving the lives of people everywhere (Daman, 2003).

The UN regularly recognizes the contribution of cooperatives to poverty reduction (Johnston, 2003). Cooperatives are also used to voice the concern of the poor through their institution and apex organization to advocate for policies that would benefit their members and the society at large. Cooperatives protect members from exploitative pricing by the market by intervene in provision of goods and services with reasonable price as their primary motives is not profit but also social responsibility.

Cooperatives as their core principle they will work on capacity building for members to equip the necessary skill that would improve their livelihood. Various types of cooperatives Creates employment for the society since their operation and business they are engaging is diversified from financial sector to agricultural , from manufacturing to real-estate.

Cooperatives are also helping people in poverty reduction through impacts on income and access to credit from SACCOs to engage in income generation activities.

Savings and credit cooperatives reach clients and areas (e.g., rural) that are unattractive to banks and well-run savings and credit cooperatives have low administrative costs and may be able to make loans at interest rates that are lower than those charged by other microcredit providers (Brian,2005).

## **2.1.6 Common Challenges of Financial Cooperatives**

**Governance weaknesses:** Savings and credit cooperatives are usually governed by a volunteer board of directors elected by and from the membership. Small, young savings and credit cooperatives are also often staffed entirely by volunteers. As they grow, more sophisticated and risky operations require professional managers. Problems occur when

volunteer board members continue to make operational decisions, after professional managers have been recruited, instead of focusing on monitoring operations. It is difficult for board members to balance the contradictory interests of net borrowers and savers. Borrower domination is unhealthy because net borrowers have few incentives to ensure prudential discipline or profitability, unlike net savers who are most interested in protecting their deposits and earning an attractive rate of return (Brian, 2005).

**Inadequate regulation and supervision:** Savings and credit cooperative systems in developing countries have a history of instability. Competent external regulation and supervision can identify, avoid, and resolve many common problems. Savings and credit cooperatives are often supervised by the same government agency that is responsible for all kinds of non-financial cooperatives, including agricultural and marketing. Such agencies do not have the financial skills and political independence needed to oversee financial intermediaries effectively. Supervising savings and credit cooperatives requires understanding their unique risk profile and adapting supervision accordingly (Brian, 2005).

On the other hand Berhane (2008) also argued that general cooperative law cannot accommodate the specific nature and operation of SACCOs in general and RUSACCOs in particular.

**Limited products:** In traditional savings and credit cooperatives, only one type of loan product—a 3:1 or 5:1 multiple of a member's savings balance—is offered, with no variation according to risk levels—borrower repayment capacity, type of activity financed, and other risk factors (Brian, 2005).

**External credit:** Donors have channeled funds through savings and credit cooperatives to target specific types of clients. Experience shows that this practice tends to harm participating savings and credit cooperatives: external funds decrease the incentive to mobilize deposits, skew

incentives toward net borrowers, and are not managed as carefully as the members' own money. External funding does have the advantage of being a resource for longer-term loans, but it should be limited in relation to members' deposits and the internal capacity for managing a larger loan portfolio (Brian, 2005).

**Limited membership and participation:** According to Fredrick (2013) effective participation is a major determinant of the success of cooperatives. By the same token the absence of active and vibrant member participation in deposit and share contribution the financial cooperatives would obviously face challenge of growth and sustainability.

### **2.1.7 Regulatory Framework and its impact on Cooperatives**

The regulatory frame work which saving and credit cooperatives governed and statutory requirement should be tuned in such a way assuring members interest and also contributing for the growth of the financial cooperatives.

Hence, the regulations and directives accordingly designed specifically for the unique nature of the saving and credit cooperatives nature and operation. This requires workable regulatory frame work in cognizant of unique nature of saving and credit cooperatives from other types of cooperatives.

The development of clear policies and regulations, on the one hand, put the various financial elements back in their rightful places and effectively prevent cooperative finance from being alienated, and on the other hand, encourage and promoted the development of genuine rural credit cooperation. This is what should be achieved by deepening the reform of the rural financial system. The government should not interfere, but simply play the role of a catalyst, and should particularly avoid setting targets and tasks or applying too much pressure while cooperatives develop. But to genuinely support and not interfere in cooperatives, local governments need to remove institutional and structural obstacles (Bruno, 2013).

Proper regulation and supervision is overdue and should be the next step to enhance the sustainability of the SACCO sector (Markus et al, 2011).

Fredrick (2013) also describes cooperative policy and legislation that gave the state power to strictly supervise these organizations led to state interference in the governance and management of these institutions, with the result that cooperatives ended up being politicized; corruption and mismanagement became prevalent; cooperatives' monopolistic position in the economy never helped them to realized adequate returns on their businesses, thereby weakening their financial base; cooperatives were unable to provide services to members; and members lost morale to participate in the governance of their organizations, with some of them regarding them to be extensions of the government.

Overt government control over the cooperative movement is counter-productive, but there is still need for some governmental regulation of cooperatives to ensure that unscrupulous leaders do not exploit other members. Such regulation should also guarantee a conducive environment for cooperatives to transact their businesses. The challenge is to strike a balance between the freedom for cooperatives to organize and state power to effectively regulate the cooperative movement. In this regard, the legal framework should emphasize facilitation of the freedom to organize and do business rather than supervision and control of cooperatives (Fredrick, 2013).

A blanket type of regulatory framework was not suitable to create competent and viable financial institutions on a sustainable basis. Therefore, a separate regulatory framework for cooperative financial institutions in which RUSACCOs are a part by recognizing the general financial institutions and aligning the specific nature of the cooperative should be in place (promulgated). Besides the placement of an appropriate supervisory body separate from that of other type of cooperatives but part of the cooperative movement is mandatory (Berhane, 2008).

## **2.1.8 What are measurements of sustainability?**

Sustainability and profitability of SACCO were measured and analyzed using operational self-sufficiency; return on assets; and return on equity ratios (Kifle, 2011).

Return on asset (ROA) is an overall measure of profitability that reflects both the profit margin and the efficiency of institutions. It gives an indication how efficient institutions are in utilizing their assets.

Return on equity (ROE) makes little sense for comparing SACCOs, which have widely divergent liability and equity structures. Return on asset is more appropriate to measure SACCOs performance (CGAP, 1998) cited in (Kifle, 2011).

The Return on Equity (ROE) is considered to be one of the profitability performance ratios, this measure contains two elements, efficiency (total assets turnover), and effectiveness (profit margin). ROA reflects the bank management ability to generate profits by using the available financial and real assets (Kifle, 2011).

According to Anuchachart (2011) financial sustainability can be assessed in two ways.

### **i. Operational self-sustainability**

This is when operating income is sufficient enough to cover operational costs like salaries, supplies, loan losses and other administrative costs.

### **ii. Financial self-sustainability**

This is when microfinance institutions can cover costs of funds and other forms of subsidies received when they are value at market prices.

## **2.1.9 What are measurements of outreach?**

According to Yaron (1992) cited in (Biruk and Yuvaraj, 2013) the indicators of outreach are the depth (types of clients reached and level of poverty) and breadth of outreach (number of clients served).

Richardson (2009) describes outreach is measured in terms of the number of clients and members. However, Anuchachart (2011) further elaborates and categorizes the indicators of outreach by 4 sub categories:

### **1. Number of clients served**

This number basically indicates numbers of clients now served that were previously denied access to formal financial services. Reasons could be lack of collateral required, perceived as too risky to serve and in turn impose high transaction costs on financial institutions because of their small size of their financial activities and transactions.

### **2. Number of women served**

This is included in the criterion for a reason which is in usual cases women are considered facing greater problems than men in accessing financial services.

### **3. Depth of outreach**

How well microfinance institutions can reach the very poor and it is apparent that the vast majority of the poor still could not enjoy the benefits offered by the government while the proportion of the non-poor people who are cunning in participating in these programs increased over time. This means that the institutions remain incapable of reaching the truly poor.

### **4. Variety of financial services**

If efficient and secure savings, insurance, remittance transfer and other services are provided in addition to the loans that are the predominant concern of policy makers are added to the products offered by microfinance institutions as the poor demand, better welfare would be achieved.

## **2.1.10 What are measurements of growth?**

Kifle (2011) describes the growth of the microfinance institutions involves:

- ✓ A permanent increase in the size, scale, and complexity in activities and various results being achieved by MFIs overtime. This includes increases in number of clients, outstanding loan portfolio and turnover, size of savings, etc.
  
- ✓ The other most important meaning of growth is the one signifying changes in character of institutions itself.

First, growth enables the microfinance institutions to reach large number of clients. Second, growth reduces average operating cost for the MFIs. It reduces or eliminates losses, not by increasing lending interest rates, but by reducing operating costs. Third, growth improves operational and financial sustainability of MFIs. Fourth, it helps institutions to satisfy their client's need through various services. Fifth, it gives better image of the institutions to attract loanable fund from banks for further expansion and increases the borrower's willingness to repay.

## **2.1.11 What are major challenge that inhibit growth, sustainability and outreach**

- **High loan demand**

High level of poverty induces demand for loan. In practical terms, high demand for loan is an opportunity for financial cooperatives or any financial institutions, yet it turns out to be a challenge when the financial cooperatives have liquidity problems (Kelifa, 2008).

- **Dependency on subsidy**

Many SACCOs, especially smaller ones, are over-dependent on subsidization. The quality of the SACCOs loan portfolio, a main indicator for the capability of lending institutions, seems to be another critical point that threatens the viability of many SACCOs. Due to the enormous demand

for financial products in rural areas (in particular loan products), the SACCO sector as a whole is growing considerably (Markus et al, 2011).

- **Institutional Capacity**

In many SACCOs, internal control suffers from a lack of capacities of board members. The apex institutions provide training for management and staff to improve their capacities, but the training is not unified and standardized. The reporting structure between the management and the board of directors is still weak in most SACCOs, as no written evidence of the meetings exists. Most SACCOs also do not have a Management Information System (MIS), which makes it difficult to monitor the performance adequately (Markus et al, 2011).

Lack of skilled professionals to manage rural SACCOs on the one hand, and limited capacity of rural SACCOs to hire skilled professionals are also other factors, which complicate rural SACCOs management and affect their development (Kelifa, 2008).

- **Low savings**

Member deposits contribute to the sustainability of SACCOs. In general, MFIs are increasingly providing formal saving opportunities. They have realized that savings, especially long-term deposits, are a cheap and reliable refinancing tool and can increase their funding base – thereby contributing to their sustainability (Markus et al, 2011).

Rural SACCOs growth depends on members' collective savings, and the level of saving is affected by a number of factors among which: members capacity and willingness to save , members confidence to save with rural SACCOs ,presence of other financial institution (like MFI)in rural SACCOs operational area and available alternative investment in the locality ,are the most important factors affecting savings, and growth of rural SACCOs (Kelifa,2008).

## ▪ **Management Information System**

Saving and credit cooperative as financial institution has responsibility of maintaining financial prudence and safety of members saving, which requires the SACCO to know its financial position. In order to ensure this SACCO should put in place appropriate Management Information Systems (MIS) and also be on top of crucial issues in their day to day business like assuring transparency, making it easier to raise capital and lower borrowing cost, increased efficiency in time to service members and process transactions, improved management of the business with current and accurate information on the financial state of the cooperative.

According to Kazeem (2011) quality information allows SACCOs to be more deliberate in their use of limited resources, eliminating waste that result in higher costs to members. On the other hand information is critical to sustainability and efficiency as well.

The availability of appropriate fit to the financial cooperatives purpose is a challenge for their growth and sustainably provides service to their members and reaching those who needs it most.

## **2.1.12 Importance of Rural Finance**

The study of the world bank (2003) describes rural finance describes as financial intermediation outside of urban areas, including deposits, loans, payment and money transfer systems, trade credit, and insurance, to rural households as well as to farm and non-farm enterprises. Microfinance refers to small transactions involving low-income households and microenterprises, using character-based methodologies.

Pearce et al (2004) defines rural finance as ‘financial services offered and used in rural areas by people of all income levels’, and agricultural finance as ‘a sub-set of rural finance dedicated to financing agriculture-related activities, such as input supply, production, distribution and wholesaling, and marketing’.

Rural financial markets are important because financial intermediation facilitates general economic growth and poverty reduction financial intermediaries mobilize funds, allocate them among competing uses, create money, and function as a payments system. The efficient provision of loan, deposit, payment, and insurance services enable entrepreneurship, innovation, and production to develop and flourish. Safe savings facilities, payment services, access to credit, and reliable insurance mechanisms enable poor households to reduce vulnerability by smoothing consumption and mitigating risks (WB, 2003).

The availability of appropriately-designed financial services is an essential component of the enabling environment for rural economic growth and poverty reduction.

Access to working capital or investment credit offered by rural finance institutions can substantially accelerate the adoption of modern agricultural technologies and production patterns which improve the ability of the rural sector to provide for the subsistence needs of the poor, produce the surplus in primary and intermediary products required for urban consumption and export, and avoid environmental degradation (ibid).

Making improvements in the financial sectors of developing countries will contribute significantly to achieving global development priorities, particularly the Millennium Development Goals (MDGs) of halving poverty and hunger by 2015 (Pearce et al, 2004).

### **2.1.13 Rural Financial Market Characteristics and Development Constraints**

Low population density, small average loans, and low household savings increase the transaction costs per monetary unit of financial intermediation (WB, 2003).

Rural households often lack the resources they need to mitigate risk. Rural borrowers therefore present a high credit risk and this, combined with the high administrative costs of service

delivery, make the rural market unattractive to formal financial intermediaries (Pearce et al, 2004).

Lack of infrastructure (communications, electricity, transportation, etc.) and social services (education, health, etc.) and low integration with complementary markets result in highly fragmented financial markets that involve high costs of overcoming information barriers and limit risk diversification opportunities. Seasonality of agricultural production and susceptibility to natural disasters (such as flood, drought, and disease) heighten the probability of covariant risks (in prices and yields) and add to the risks and costs of rural financial intermediation (WB, 2003).

The rural economy is financially very fragile. Lack of credit is a significant and sometimes binding constraint, limiting investment in productivity-enhancing technology and inputs. Finance is also required for commodity marketing, sometimes through inventory-backed financing, which offers rural producers, traders and processors the opportunity to improve household income through adopting better produce marketing and raw material procurement strategies (ibid).

There is still low financial intermediation in Ethiopia, particularly in rural areas; the main reason is that like in many other poor countries, the Ethiopian context also manifest structural problems of market failures and absence of markets (Getaneh, 2008).

Economists have long linked the expansion of financial markets to the spread of broader economic activity. By the same token, economists have focused on ways that barriers to financial markets undermine economic efficiency. In the 1970s, economists turned their focus on regulations in many countries that capped interest rates on loans. Interest rates serve many roles, and one is to screen the quality of investments. When interest rates are set artificially low, borrowers are undeterred in investing in businesses that have relatively low returns. Artificially low interest rates also lead to excess demand for credit-and thus, inevitably, to credit rationing (Rodrikand et al, 2009).

## **2.1.14 Challenges to rural financial intermediation**

Cooperatives Savings and credit cooperatives (SACCOs) and traditional informal savings and credit associations can facilitate agricultural development through pooling and management of financial resources within the local community, in the absence of – or as a means of mobilizing – financing from external institutions(WB, 2003).

Risk high, and often covariant, risks in the rural economy are related to the dominance of agriculture, which accounts for a high percentage of Gross Domestic Product (GDP) (one third in the case of Africa) and employment (two-thirds in Africa) (Human Development Report, 2000).

The long gestation period for many agricultural investments and the seasonality of output usually lead to uneven cash flow and variable demand for savings and credit. Agricultural production is largely dependent on the weather and the use of productivity-enhancing inputs is very low (both leading to ‘yield’ or ‘production’ risk), especially in sub-Saharan Africa where the average consumption of fertilizer is only 10–15 kg per hectare, compared to about four times that on the Indian sub-continent (Andersen et al, 1999).

## **2.1.15 Rural Saving and Credit Cooperatives and Outreach**

Outreach is measured in terms of the number of active clients (with outstanding loan), loan size, number of saving clients, volume of saving, percentage of loans to clientele, percentage of female clients, range of financial and non-financial services offered to the poor, the level of transaction costs levied on the poor and the extent of client satisfaction with respect to financial services (Kifle, 2011).

Turto (2008) described Outreach or coverage<sup>l</sup> measures the scale and depth of penetration of services (extent of services and number of clients in certain categories or areas) by providers of financial services to a targeted clientele—generally the poor. The recommended measurement of

outreach is relatively simple; it is the number of clients or accounts that are active at a given point in time in the portfolio of an institution or service provider.

As per the World Bank (2003) the best measurement of outreach is straightforward, the number of clients or accounts that are active at a given point in time. This indicator is more useful than the cumulative number of loans made or clients served during a period. Among other distortions, cumulative numbers makes a RUSACCO offering short-term loans look better than one providing longer-term loans. Hence, the recommended measure counts active clients rather than “members” in order to reflect actual service delivery: members may be inactive for long periods of time, especially in financial cooperatives.

Getachew (2006) argued that SACCO should broaden its service by giving Safe place for savings, lending for various activities, and increasing the penetration rate within the society by encouraging women, the Youth and the poor to be members.

However Turto (2008) argued expanding outreach is expensive while most financial cooperatives in developing countries are relatively weak financially, and have been established for the economic advancement of their members, not for reaching out to a more risky or more expensive clientele.

Financial cooperatives offer an opportunity to achieve rural outreach at costs considerably lower than those of urban-oriented financial institutions. The reasons for lower costs are several, including lower salaries, more modest premises, commonly practiced freedom from taxation, benefiting from local knowledge in lending operations and local ownership by the members (ibid).

### **2.1.16 Rural saving and credit cooperatives and Sustainability**

Sustainability refers to the ability of an organization to survive over the long term. Critical aspects of sustainability include the permanency or stability of ownership, governance, management, and financial viability. Despite its service orientation, a financial cooperative must be profitable; otherwise it will not be able to cover its costs and provide its members with financial services over the long term (Turto, 2008).

Basu & Woller (2004) in Ssebaale (2011) defined Sustainability as the ability of a SACCO to cover its operating and other costs from generated revenue and provide for profit. It is an indicator showing how the SACCOs can run independent (free) of subsidies.

The financial performance of financial cooperatives is an important indicator because it shows the sustainability of current outreach as well as the potential for additional outreach (Turto, 2008).

Turto (2008) described improved operational systems and governance, increased capacity building, Clear regulations and better supervision and improved financial performance are some of the key factors facilitating sustainability—and allow expansion of outreach—for financial cooperatives in developing countries.

Jonathan et al (2005) mentioned the flexibility of the repayment schedule is theoretically expected to influence financial sustainability to the extent that it affects the effective rate of interest, which in turn has an effect on the break-even interest rate. To the extent that a more frequent repayment schedule generates a higher effective interest rate, a weekly payment schedule should be negatively (positively) associated with financial unsustainability (sustainability).

Appropriate loan sizes for clients matching their needs, realistic interest rates, savings as a prerequisite, regular, short and immediate repayment periods and achieving scale can contribute to sustainability. This is because as the number of clients increases, MFIs/SACCOS enjoys economies of scale and hence reduce costs which help them to be financially sustainable (Ssebaale, 2011).

According to theory, group lending is expected to positively influence financial sustainability for microfinance institutions because the peer pressure that group members exert on each other should lead to lower default rates on the number of loans disbursed (Jonathan et al, 2005).

This holds true and works for the RUSACCOS as well since it is the most common and preferred way guaranty most RUSACOs preferred. On the same token Kifle (2011) argued and further noted that group-based loan delivery method was the most important determinant of sustainability.

On the other hand according to Jonathan et al ( 2005) the amount of loans disbursed is theoretically expected to be negatively (positively) related to financial unsustainability (sustainability) because it reduces per unit cost of the lending.

The Members and elected committee of the SACCO should work to build reserves from yearly financial margin and preserve them every year to protect from possible future unexpected risk. As well as; the elected committee should build transparent methods; encourage member's participation and member's sense of ownership (Getachew, 2006).

### **2.1.17 Financial Sustainability of Rural Saving and Credit Cooperatives**

According to the IMF (2006) in (Ssebaale, 2011) the MFIs /SACCOS that have become self-sustainable tend to be larger and more efficient however they also tend not to target the very poor, as targeting the less poor leads to increases in loan size and improved efficiency indicators, whereas MFIs focusing on the poorest tend to remain dependent on donor funds. This is where the compromise exists. In order to achieve such sustainability, while at the same time reaching those most in need, microfinance programmes need to be managed in a rigorous and professional manner, subsidies must be removed, and tight credit control procedures and follow-up on defaulters needs to be in place.

According to Ahmed (2001) in (Ssebaale, 2011) financial sustainability is looked at in terms of financial self sufficiency and operating self-sufficiency. Financial self-sufficiency (FSS) relates to the MFI's ability to meet all the financial costs including inflation to maintain value of the asset due to inflation from their income whereas operating self-sufficiency relates to the MFI's ability to meet the operating costs from their income.

Financial sustainability is the RUSACCO profitable enough to maintain and expand its services without continued injections of subsidies or donor funds (World Bank, 2003).

## **2.1.18 Operational Sustainability**

Many have large equity base built up through donor funds; others have little equity and are funded through soft loans. Hence, return on asset is more appropriate to measure SACCOs performance (Kifle, 2011).

Operational sustainability is normally not the main constraint for SACCOs, although sometimes the spread between the interest paid on savings and interest charged on credit is too small to cover their costs. Institutional sustainability is more often a constraint, as SACCOs tend to have complex governance and managerial issues, especially when they reach a substantial scale (Gabrielle, 2008).

Dhakal (2004) in (Ssebaale, 2011) further marks that the operating self -sufficiency ratio is defined as the financial income divided by sum of financial costs, operating costs and loan loss provision. The OSS indicates whether enough revenue is earned to cover organization's cost (losses, financial cost and administrative cost etc.) with return on equity (net of any subsidy received), and consequently function without subsidies.

## **2.2 Empirical Studies on Saving and Credit Cooperatives**

Empirical evidence from additional studies confirms the strong, positive link between national savings (aggregate income less total expenditure) and economic growth (World Bank, 2004).

Correlation between the level of financial savings (savings held in liquid form in the formal financial sector) and growth is even stronger. Savings are important as they allow households to maintain precautionary balances against shocks (ibid).

Various authors studied outreach and sustainability of MFIs where OSS and FSS and average loan size and number of borrowers or female borrowers were used to measure outreach and sustainability respectively and microfinance breadth of outreach, depth of outreach; dependency ratio and cost per borrower affect the financial sustainability of microfinance institutions in Ethiopia (Kifle, 2011).

The study justified the receipt of subsidies, reduction of operational costs and charging of market interest rates for MFIs which serve the poor in remote rural areas in order to achieve financial self-sufficiency and expand outreach. The study noted that outreach was positively determined by average loan size, debt-equity ratio, loan repayment rates and salaries (Kifle, 2011).

According to World Bank (2003) for comparison purposes, it is useful to express this indicator as a percentage of the host country's per capita GDP. An average outstanding loan balance below 20% of per capita GDP or US\$150 is regarded by some as a rough indication that clients are very poor.

Conning (2009) in (Kifle, 2011) argued that always there is a tradeoff between outreach and financial sustainability because reaching the poorest of the poor is more costly. The study further argued that considering sustainability is important because currently even donors and policy makers are interested with the financial sustainability.

Internal finance and location of SACCOs have a significant contribution to breadth of outreach and sustainability of SACCOS while the relationship between financial linkages on SACCOs breadth and depth of outreach and sustainability was not significant (Kifle, 2011).

# **CHAPTER THREE**

## **RESEARCH DESIGN AND METHODOLOGY**

### **3.1 Research Design**

The study is a case study on outreach, sustainability and growth at Awash Rural saving and credit cooperatives.

This study applied explanatory research which examined the secondary data collected from the annual audit report of the union

### **3.2 Target Population**

Population: Since it is a case study in one organization the population for the study is Awash rural saving and credit cooperative union.

### **3.3 Sample Design and Size**

Sample: This study is a case study on Awash rural saving and credit cooperatives union and no sampling technique used.

### **3.4 Source and Nature of Data**

The source of data for this paper was secondary sources by referring to publications of Federal and Regional Cooperatives Agency, proclamation and annual audit reports.

The data were collected from annual audit report of rural saving and credit cooperatives and relevant financial indicators were treated and interpreted with the help of analytical tools such as ratios, percentage share, graphs and tables to show the outreach, growth and sustainability of Awash rural saving and credit cooperative union.

### **3.5 Data Collection Method and Data Analysis**

This paper used simple descriptive statistics methods of data analysis to analyze the outreach, performance, growth and sustainability of a RUSACCO union. Descriptive statistics was used to summarize the qualitative and quantitative aspect of the study. In order to meet the stated research objectives descriptive type of analyses-tables, graphs and percentages were employed to analyze the data.

### **3.6 Data Collection Instruments**

The data collection instrument this paper used is documentary collection since the data that were collected is secondary data.

### **3.7 Data Analysis Method**

The study undertakes an evaluation on the growth, sustainability and outreach of Awash rural SACCOs for seven years data using WOCCU PEARLS model.

World Council of Credit Unions (WOCCU) created PEARLS in the late 1980s .The World Council of Credit Unions PEARLS toolkit Series presents the tools and methodologies developed in the field of credit union development carried out through World Council of Credit Unions activities. World Council has refined and adjusted PEARLS over the past decades and this study applied the 2009 version World Council of Credit Unions Toolkit Series.

The 2009 WOCCU PEARLS version have a set of financial ratios or indicators and in total there are 44 quantitative financial indicators that facilitate an integral analysis of the financial condition of any financial institution. This study applied 20 WOCCU PEARLS quantitative financial indicators that fit to the research objective. Each indicator has a prudential norm or associated goal. The target goal, or standard of excellence for each indicator is put forth by World Council of Credit Unions.

## **PEARLS Input, Process and Output for Saving and Credit Cooperatives**

The PEARLS set of financial ratios or indicators help standardize terminology between institutions. In total, there are 44 quantitative financial indicators that facilitate an integral analysis of the financial condition of any financial institution. The purpose for including a many of indicators is to illustrate how change in one ratio has ramifications for numerous other indicators.

Each indicator has a prudential norm or associated goal. The target goal, or standard of excellence for each indicator is put forth by World Council of Credit Unions based on its field experience with strengthening and modernizing credit unions and promoting savings-based growth.

The primary goal of evaluating the protection indicators is to ensure that the financial institution provides depositors a safe place to save their money. Provisions for loan losses are the first line of defense against unexpected losses to the institution. Allowances for loan losses are essential, since delinquency signals that loans are at risk; thus, the institution must set aside earnings to cover those possible losses so that member-client savings remain protected.

The financial structure is the most important variable that affects growth, profitability and efficiency. The effective financial structure area of PEARLS focuses on an institution's sources of funds (savings, shares, external credit and institutional capital) and its uses of funds (loans, liquid investments, financial investments and non-earning assets).

Asset Quality is the main variable that affects institutional profitability. An excess of defaulted or delayed repayment of loans and high percentages of other non-earning assets have negative effects on credit union earnings because these assets are not earning income.

The Rates of Return and Costs indicators monitor the return earned on each type of asset (use of funds) and the cost of each type of liability (source of funds). On the assets side, one can determine what types of assets earn the highest returns. On the liability side, one can determine what the least and most expensive sources of funds are.

Yields and costs directly affect the growth rates of an institution. The intent is for an institution to: pay real rates of return on savings and shares, charge rates on loans that recover all costs and pay competitive salaries for employees.

Signs of Growth reflect appropriateness of product offerings and financial strength. Growth directly affects an institution's financial structure and requires close monitoring to maintain balance.

PEARLS process the financial indicators calculated based on the financial data of the saving and credit cooperatives for so to achieve the intended objective. In the case of this study to the objective is to measure the growth, outreach and sustainability.

The output of PEARLS is comparing against the WOCCU standard and used to conclude about the saving and credit cooperatives.

Hence, PEARLS objective and standardized financial ratios and formulas eliminate the diverse criteria used to study and evaluate saving and credit cooperative operations. It also creates a universal financial language that everyone can speak and understand.

Therefore, the literature reviewed did not based on PEARLS WOCCU model to give the bigger picture about saving and credit cooperatives in very important variable like sustainability, growth and outreach which reveals the challenge and prospect to continue as alternative financial service provider to address the unmet demand poor in the rural.

# **CHAPTER FOUR**

## **DATA PRESENTATION, ANALYSIS AND INTERPRETATION**

This chapter presents the results of the data analysis. The first section of this chapter deals with the Effective Financial Structure of Awash RUSACCO Union Balance sheet. The second part of the chapter provides the analysis of Awash RUSACCO Union Growth Trend .The third and fourth part covers the Outreach and Sustainability of the union respectively.

### **4.1 Effective Financial Structure of Awash RUSACCO Union Balance sheet**

The financial structure of the saving and credit cooperative union is the single most important factor in determining growth potential, earnings capacity, and overall financial strength. Saving and credit cooperative unions are encouraged to maximize productive assets as the means to achieve sufficient earnings.

On the other hand effective liquidity management becomes a much more important skill as the saving and credit cooperative union shifts its financial structure from member shares to more volatile deposit savings.

In many movements following the traditional model, member shares are very illiquid and most external loans have a long payback period, therefore there is little incentive to maintain liquidity reserves.

Liquidity is traditionally viewed in terms of cash available to lend--a variable exclusively controlled by the credit union. With the introduction of withdrawable savings deposits, the concept of liquidity is radically changed. Liquidity now refers to the cash needed for withdrawals-a variable the credit union can no longer control.

An effective financial structure is necessary to achieve safety, soundness, and profitability, while at the same time, positioning the credit union for aggressive real growth.

The indicators in this section measure the composition of the most important accounts on the Balance Sheet.

Table 4.1 Effective Financial Structure

<b>Indicators</b>	<b>NORM</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>Average</b>
<b>Net Loans/Total Asset</b>	70-80%	1%	92%	85%	69%	77%	62%	68%	65%
<b>Liquid Investment/Total Asset</b>	Max 20%	0%	0%	0.32%	0.28%	0.25%	1%	0.75%	0%
<b>Saving Deposits/Total Asset</b>	70-80%	3%	38%	39%	46%	52%	41%	39%	37%
<b>External credit/Total Asset</b>	Max 5%	6%	7%	13%	0%	0%	28%	37%	13%
<b>Member Share Capital/Total Asset</b>	10-20%	18%	5%	4%	4%	5%	4%	6%	7%
<b>Institutional capital/Total Asset</b>	Min 10%	18%	9%	7%	10%	12%	9%	10%	11%

Source: Author Calculation

Loan portfolio is the most important assets of the saving and credit cooperative and maintaining 70-80% of the total asset is very important. The net loan to total asset percentage was very insignificant and low in the year 2007 the saving the union had mobilized was very low and the members share was not that much sufficient as well.

For the following years the loan to asset ratio continued to show good sign and progress consistently until year 2011 and decreased to 62% in 2012 and in the following year 68% less than the standard according to WOCCU PEARLS model.

The maximum liquid investment percentage to total asset of the union is 1% during the period covered in this study. According to the PEARLS model liquid investment to total asset ratio should not exceed 20%. Excess liquidity is discouraged because the margins on liquid investment are significantly lower than those earned on the loan portfolio.

A healthy percentage of saving deposits indicates that the saving and credit cooperative has developed effective marketing programs of saving mobilization and is well on the right track achieving financial independence. It is also indicates that members are no longer saving in order to borrow money , but instead saving because of competitive rates offered and improving saving culture of the members.

The saving to total deposit of Awash rural saving and credit cooperative union shows serious concern by deviating consistently from the standard from PEARLS model 70-80%. The maximum percentage was 52% in 2011.

The external credit of Awash is far high from the standard that the union has outstanding bank loan continuously increasing across the years except 2010 and 2011. This shows high indebtedness and leverage.

Members share percentage on the total asset has shown very low ratio below the WOCCU PEARLS standard 10-20%. The members share percentage total asset ranges 4-6% for the period covered in this study except in the year 2007 of 18% and this is due to the low asset value since the union was not started operation actively.

The institutional capital of Awash seems in good track for year 2007, 2010, 2011 and 2013 and for the rest of the years remains below the minimum 10%. In 2007 because of the low amount of asset it shows relatively higher percentage of 18%.

## **4.2 Awash RUSACCO Union Growth Trend**

The only successful way to maintain asset value is through strong, accelerated growth of assets, accompanied by sustained profitability. Growth in itself is insufficient and should be linked with profitability, as well as to other key areas by evaluating the strength of the system as a whole.

Growth is measured in seven key areas total asset, loan portfolio, saving and institutional capital and membership growth, borrowed funds and member shares.

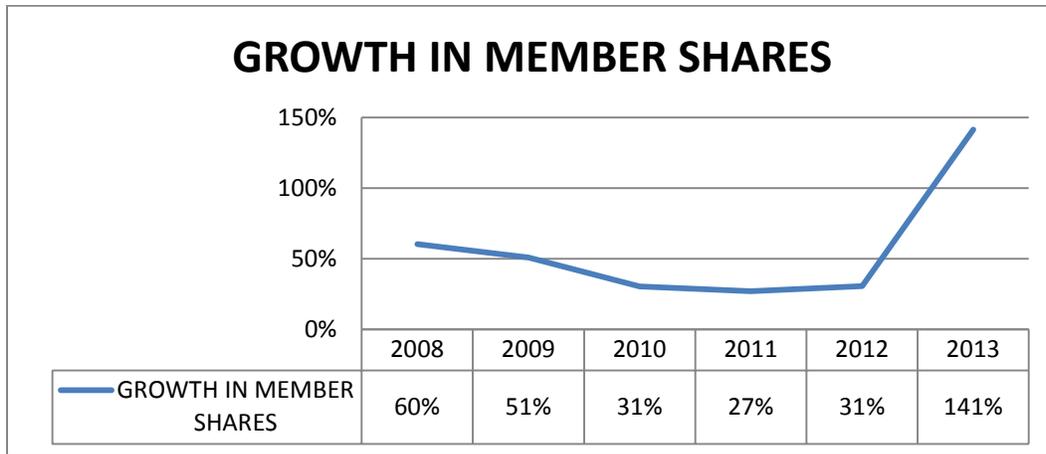
Table 4.2 Trend of Growth

SIGNS OF GROWTH	2007	2008	2009	2010	2011	2012	2013	Average
Growth in Membership	NA	16%	28%	9%	4%	3%	10%	12%
Growth in Total Assets	NA	518%	87%	14%	15%	73%	51%	126%
Growth in Loans	NA	516%	73%	-7%	28%	40%	66%	119%
Growth in Savings Deposits	NA	8742%	92%	37%	28%	36%	45%	1497%
Growth in Borrowed Funds	NA	637%	232%	-100%	0%	NA	100%	174%
Growth in Member Shares	NA	60%	51%	31%	27%	31%	141%	57%
Growth in Institutional Capital	NA	214%	48%	57%	39%	33%	57%	75%

Source: Author Calculation

The members' share growth rate of Awash SACCO union in Table 4.2 shows a decreasing trend for four consecutive years from 2008 to 2011 , from 60% to 27% and then for the last two years covered by this study shows little increase in 2012 and then trend and significantly increased in 2013 to141%. The fact that the union could not sustain members share growth implies that it could not maintain mobilizing additional capital from the members.

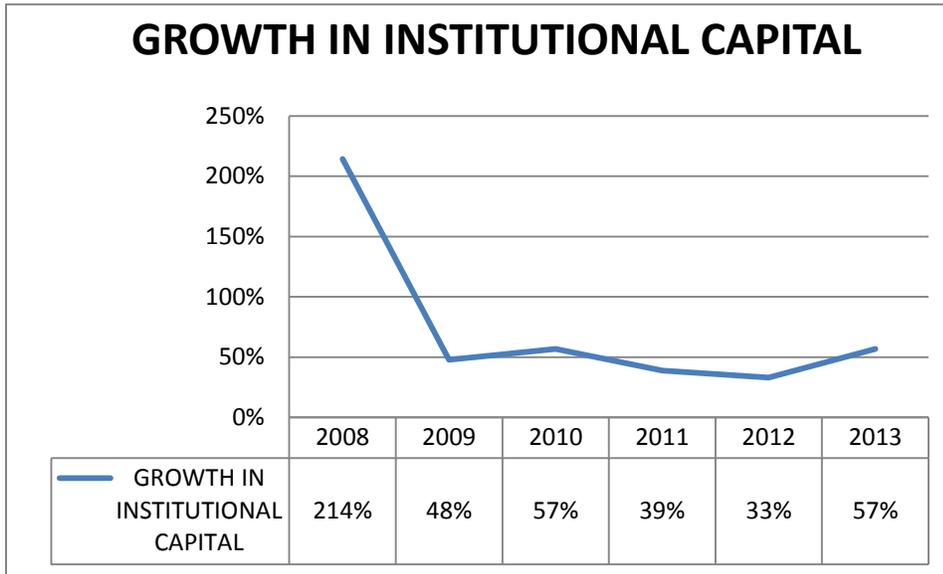
Graph 4.1 Growth in Members Shares



Institutional capital growth is the best indicator of profitability with in saving and credit cooperative unions. A static or declining growth trend in institutional capital usually indicates a problem with earnings.

The institutional capital growth of Awash RUSACCO union in Table 4.2 shows a constant decrease except in 2010 and 2013. Moreover, the growth rate and trend of Awash RUSACCO union institutional capital is by far less than the growth in total asset except for 2010, 2011 and 2013 which implies that there is a sustainability problem. As per WOOCU PEARLS model sustainable growth of a SACCO will be assured when institutional capital growth usually greater than the growth of total asset.

Graph 4.2 Growth in Institutional capital



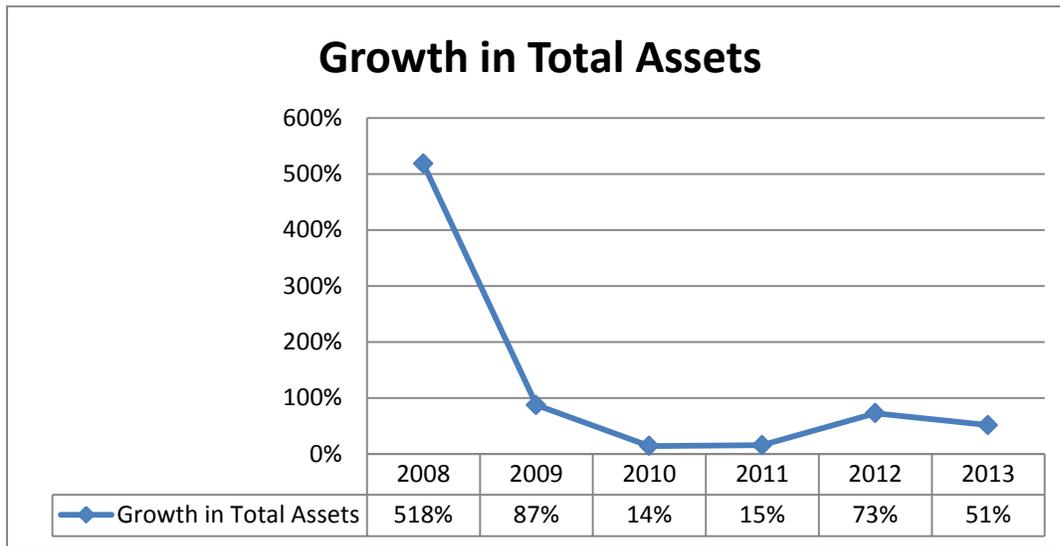
In Table 4.2 the growth in total assets over the years in this study shows mixed growth rate trends, very high growth rates in 2008 and 2009. For the following two years the rate significantly decreased to 14-15% and then shows high increase of 73% in the next year and in the final year under study decreased to 51%.

The growth in total asset for Awash RUSACCO union is showing real positive growth, although does not show consistency across the years except for 2010 and 2011. So, Awash's total asset growth trend is showing positive increase net growth after considering inflation except for two consecutive years covered in this study.

The WOCCU model insisted growth in total asset should be real positive growth i.e. net growth after inflation. The main factor contributing for the union increase in growth of total asset is the significant increase of fixed asset and since the union was constructing its office and the building cost took the lion share.

SACCOs can maintain asset values through strong, accelerated growth of assets, accompanied by sustained profitability.

Graph 4.3 Growth in Total Asset



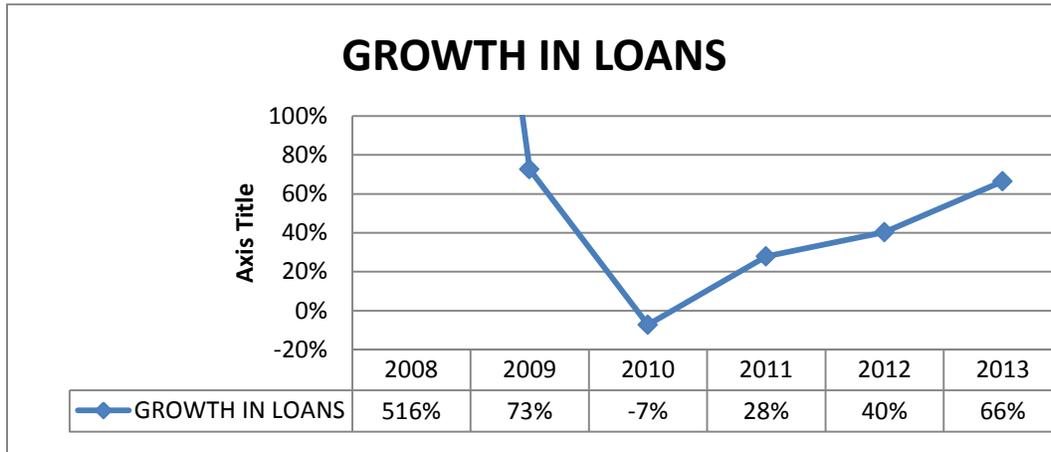
Loan portfolio is the most important asset of a saving and credit cooperatives union. As per the WOCCU model the sign of growth in total loan should keep the same pace of the sign of growth in the total asset.

The growth trend in loan portfolio in the first years of the study was significantly decreasing and showed negative trend even negative growth in 2010. Then, after the negative growth rate it showed improvement and constantly increases from 2011 to 2013. The growth in loans portfolio seems unhealthy in the first year of this study which show increase 516% and decreased after the significant increase. In the last three years of this study the growth in loan seems consistent increased show 40% and 66%.

It is observed that the loan growth rate of Awash RUSACCO union is lower in relative to the growth in total asset except for two years in 2011 and 2013 and this implies the investment of funds in less profitable assets. SACCOs rather should focus on higher growth in loan portfolio that contributes for their profitability.

In general the union loan portfolio growth is inconsistent and not sustainable to bring the union more and increasing profit that will cover its operational and financial costs and further enhance its institutional capital.

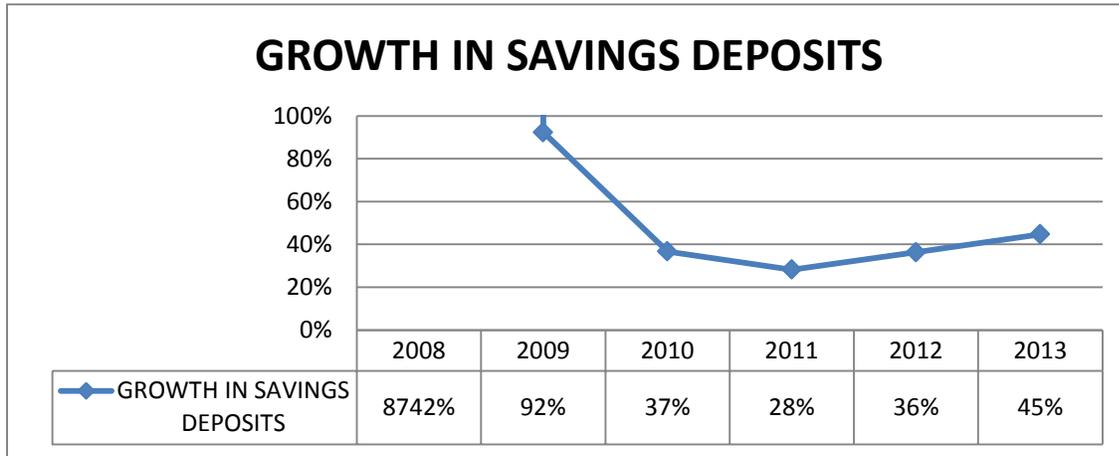
Graph 4.4 Growth in Loan Portfolio



Members’ Savings are a major source of fund with low financial cost compared to external sources like creditors. The growth in savings in the first year of this study was unhealthy and because of the members saving showed very dramatic increase from a little over 10,000 to almost 1 million birr; and in the third year the saving is doubled. For the following two years the increases in saving deposit decreased by more than half of the percentage of the saving deposit. Then for the last two years of this study the deposit increased and shows consistency but relatively low, 8-9%.

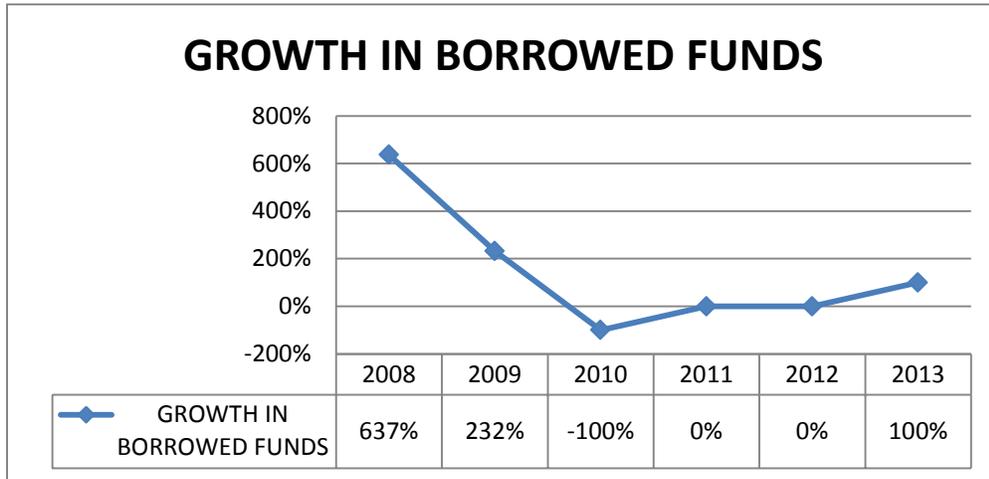
Awash SACCO union could not able to continue maintaining the deposit mobilizing from already existed and new members for most of the years covered in this study which put the union in to difficult position to seek external sources of credit with relatively higher costs. This affects the union profitability and sustainability that will significantly contribute to continue as financial service provider for the rural poor.

Graph 4.5 Growth in saving



The growth of the borrowed fund from external source shows decreasing trend for the period covered in this study, decreased by 405% from 2008 to 2009 and further decreased by-100% since Awash RUSACCO union fully settled its loan in 2010. In the following year the union did not have any outstanding borrowed fund and the growth remains at zero percent. But for the last two years in 2012 and 2013 the borrowed fund increased significantly since the union borrowed 2.9 million in 2012 and the growth of the borrowed fund also increased by the same amount as the union did not have any borrowed fund in 2011. In the year 2013 the borrowed fund doubled from 2012. The union’s external credit growing significantly which leads to be highly indebted and this implies the union is not focusing on internal fund mobilization from members saving. By the effect cost of capital on external credit is significantly higher compared to the internal source of funding-saving and shares which directly affects the profitability of the union.

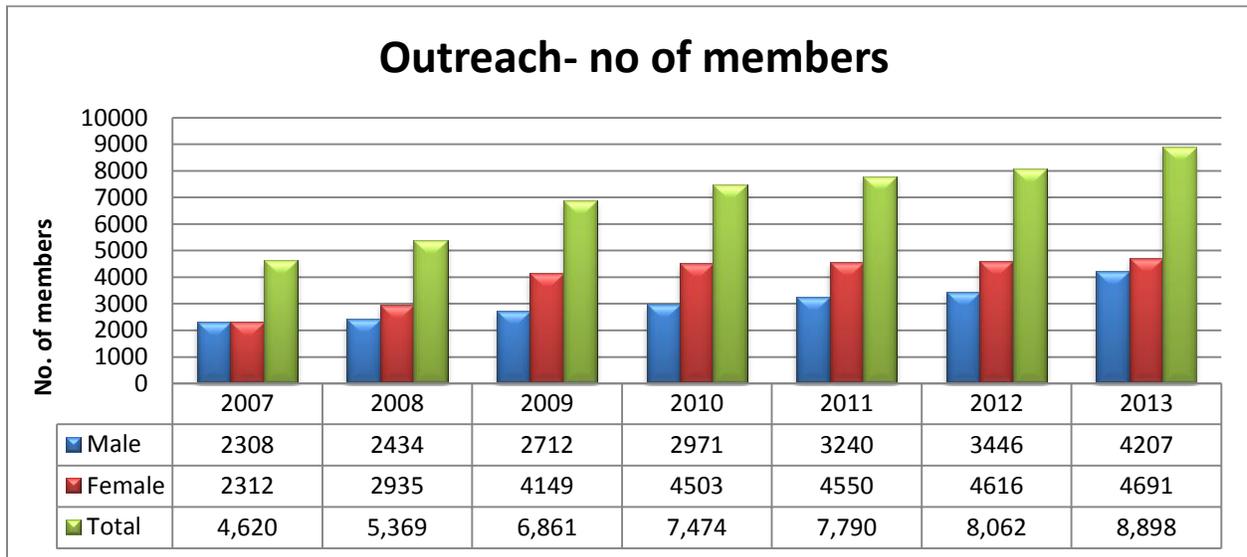
Graph 4.6 Growth in Borrowed Fund



### 4.3 Outreach of Awash RUSACCO Union

This part deals with Awash rural saving and credit cooperative union outreach data for seven years.

Graph 4.7 Outreach



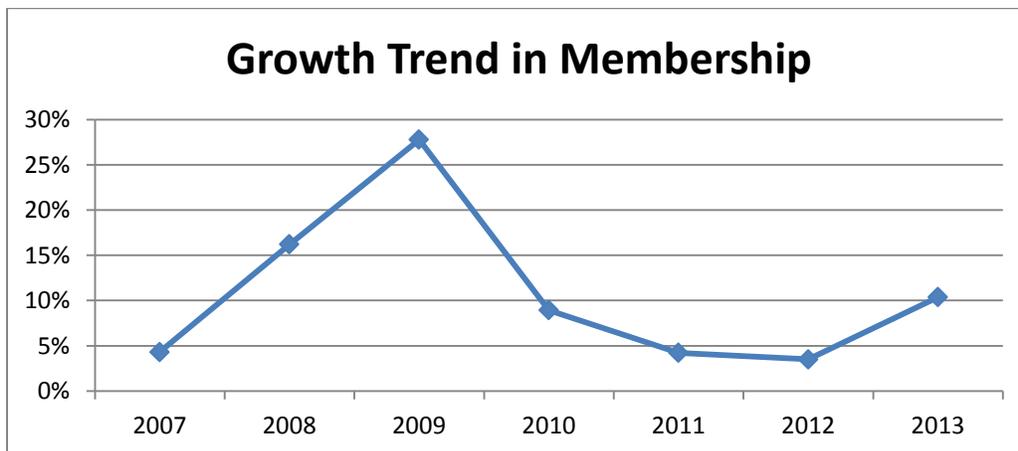
Awash SACCO union is not doing well in terms of outreach which is implied by the growth in membership below the standard of 12% set by WOCCU model. Except for two years covered by this paper 2008 and 2010 16% and 28% respectively, the outreach was very limited during the years.

The growth in members is a key to the long run viability of the financial cooperatives however the case in Awash remains the opposite and this has direct impact on the growth of deposits.

In terms of competition from similar financial cooperatives Awash faces almost none since the government policy do not allow rural SACCO union to be operate in same area. Awash does not have marketing plan that establish the strategy to attract new members and to build a strong customer base.

The other challenge in mobilizing members is that in current Ethiopian SACCO union structure individual cannot be a member a SACCO union rather through Primary SACCOs individual could join the union. Thus, Awash should work expanding its members base either at PSACCO level, by creating awareness at the grass root level that individuals join PSACCOs in their Kebele or village for those PSACCOs who already joined the union. The other strategy could be the union to promote members of other type of cooperatives like general purpose cooperatives to join the union. The cause for decline in members growth is decreased and limited borrowing capacity of the union as the loan portfolio growth decline and new members reluctant to join since their main objective of joining a cooperative is to get loan.

Graph 4.8 Outreach Growth Trend



## 4.4 Awash Rural SACCO Union Sustainability

This part covers the presentation and analysis rates of return and costs that have an effect on sustainability and critical factors that determine it.

Table 4.3 Rates of return and costs

Key Indicators	NORM	2007	2008	2009	2010	2011	2012	2013	Average
Net Loan Income / Average Net Loan Portfolio	Market Loan Interest	28.45%	2.63%	2.45%	2.67%	2.86%	3.08%	3.84%	6.57%
Total Interest Cost on Savings Deposits / Average Savings Deposits	Market Rate	5%	3%	5%	5%	5%	5%	6%	4.86%
Total Interest Cost on External Credit / Average External Credit	Market Rate	0%	0%	7.48%	19.01%	0.00%	7.84%	7.34%	5.95%
Total Interest (Dividend) Cost on Shares / Average Member Shares	Market Rates	0%	24.23%	59.87%	44.81%	38.04%	31.35%	43.76%	34.58%
Total Operating Expenses / Avg. Total Assets	<=5%	7.08%	6.98%	5.35%	5.75%	6.30%	6.69%	7.26%	6.49%
Net Income / Average Total Assets (ROA)	>1%	-0.41%	0.69%	1.06%	0.79%	0.75%	0.55%	0.93%	0.62%
Net Income / Avg. Institutional + Avg. Trans Capital (ROC)	> Inflation Rate	-1%	4%	8%	7%	6%	6%	16%	6.57%

Source: Author Calculation

Market Rate	2007	2008	2009	2010	2011	2012	2013
Saving	3%	4%	4%	4%	5%	5%	5%
Loan	10.50%	10.50%	10.50%	11.50%	12.25%	12.25%	11.88%

Source: National Bank of Ethiopia Annual Reports

The net loan income percentage to net loan is very low, below 4% compared to the WOCCU standard that should be at least the market loan interest rate and shows slow growth over the period covered in this study except in 2007 which is due to the low interest the union is charging for its loan. In this regard the union should revise its loan interest charging members so that the union would not ruin the small financial service providers market by offering very low interest which is not help itself to be sustainable so as to continue providing its service and the members to have access to finance.

Awash RUSACCO union is providing a competitive market interest rate for members saving for the years covered by this study and this is will keep its members from looking other options to deposit their saving.

The interest cost for borrowed fund is within the minimum market interest rate except for 2010. So Awash RUSACCO union is getting funds from external source with the best possible advantage in terms of minimizing costs of funds.

The dividend the union is paying for its members is as per the WOCCU standard except in year 2007 when the union was in loss. This in return encourages members to further invest and buy more shares which improve the union capital base.

As per PEARLS model a financial cooperative operating expense should not exceed 5% of the total asset. However, Awash's operating expenses for the period covered from 2007 to 2013 exceeds the standard. On the other hand it shows decreasing trend from 2007 to 2009 but shows increasing trend over the years from 2010 to 2013.

**Operational sustainability:** Awash rural SACCO union is not in good shape in terms of operational sustainability. For the years covered in this study the total operating expense is greater than the standard of 5% and falls in the range from 5.35% to 7.26%.

It is obvious that high administration costs are one of the reason that contribute SACCOs could not be profitable. However, Awash maintains the percentage of admin costs within the acceptable range of 3-10% of average total asset.

**Financial sustainability:** Awash rural SACCO union paying interest for borrowed fund with in the market rate except in 2010.

The loan yield which should be at least equal with the market rate and further contribute to capital levels which maintains institutional capital at least 10% of total asset however the case for Awash is otherwise except 2007 while the rest of the years in this study remains very low that fall in the range between 2.45% -3.84%.

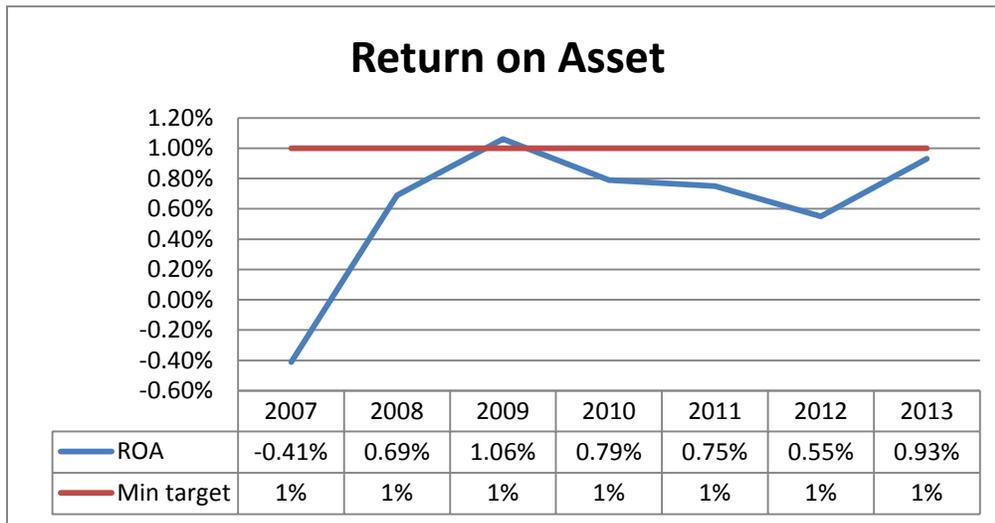
This is the result of charging too low interest on loan while the union is getting fund from bank with higher interest rate. On top of this the union does not have loan pricing policy that applies competitive and sustainable interest rate considers the cost of fund.

The costs of fund –saving and loan from external source for Awash SACCO union is in line with the WOCCU standard 40%-50% of the financial income across the years covered in this study despite continuous increases.

**Return on Asset (ROA):** The return on Asset (ROA) of the union shows serious problem implied the union operational sustainability is far from to be achieved. The trend of ROA is showing below the standard except for the year 2009. Furthermore the ROA trend is inconsistent whereby it records positive increasing trend for two years, after negative return in 2007, though it was below a standard that could not bring operational sustainability. It was continuing falling down for consecutive three years in 2010, 2011 and 2012 and in the next year ROA increased by 0.38% but still below the standard.

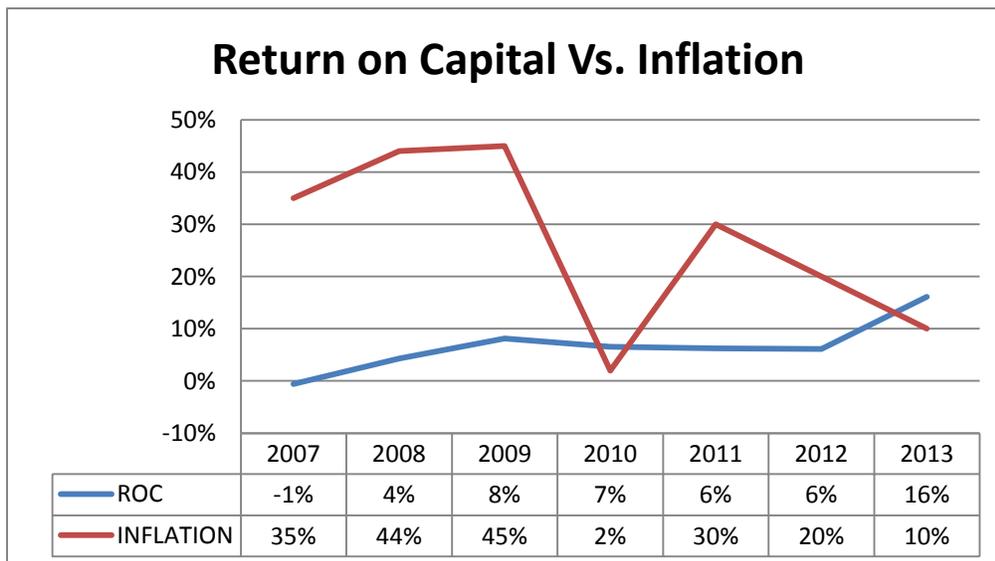
ROA is expected to be more than 1% and to maintain institutional capital at 10% of the total asset. This implies that the union asset is not productive enough and generating income. So, the Awash SACCO union should critically evaluate in its investment.

Graph 4.9 Return on Asset



**Return on Capital:** The return on capital (ROC) of Awash for the years covered in this study shows less than the inflation rate across the years. In 2007 ROC was negative since the union incurs loss. For the next two years ROC shows progress at 4% and then increased by double. After showing increasing trend returns back the opposite trend by falling by 1% in 2010. In 2011 and 2012 it remains constant at 6%. The highest return on capital achieved in 2013 at 16% though it still below the inflation rate at that time. Hence, it can be concluded the union is not in a position to be operationally sustainable.

Graph 4.10 Return on Capital



# **CHAPTER FIVE**

## **CONCLUSIONS AND RECOMMENDATIONS**

Based on the results of data analysis and interpretation in the previous chapter the following conclusions and recommendations are given.

### **5.1 Conclusions**

- The growth of loan portfolio is less than the relative total asset growth for most of years covered in this study and the percentage of total loan outstanding decreased in relative to total asset. So, the union most profitable asset, the loan portfolio, compared to the liquid investment, financial investment and other non-financial investment is growing in lesser percentage means the return the union made in its asset is lesser accordingly which affect its profitability. Moreover it shows that the union did not have system to evaluate strategic decision on investment of its asset making.
- The decline growth trend in Savings deposits implies that the union is not maintaining a good marketing program that stimulates growth in savings that in turn affect the growth of other asset as well. With the emphasis on saving mobilization in financial cooperatives, savings deposits are the corner stones of growth and the union is not doing in managing its growth.
- The growth of institutional capital decreases and increases relative to total asset growth. As Institutional capital growth is the best indicator of profitability with in financial cooperatives, Awash RUSACCO union's declining trend in institutional capital usually indicates a problem with its earnings. Since the union earnings are low, it faces great difficulty in adding to institutional capital reserves. One of the indisputable signs of

success of a robust SACCO is a sustained growth of institutional capital, usually greater than the growth of total asset.

- Saving ratio to total asset is very low 30-50% of the total asset, this is not a healthy percentage and failed to develop marketing programs and is not well on its way to achieving financial independence.
- As saving is the cheapest fund to mobilize compared to external credit, Awash RUSACCO union is depending on external finance from bank and capital donation from NGO which is significantly affecting its sustainability.
- The external credit to total asset is too high which shows Awash RUSACCO union is highly dependent on external creditor.
- The union is weak in mobilizing shares as well from its members as alternative internal fund mobilization.
- In terms of institutional capital the union is in the minimum level since the union earning is low and not retaining enough surplus. On the other hand capital donation the union got from a Non-Government Organization contributes to build its institutional capital and helped to generate even the minimum standard.
- The loan to asset ratio is below the WOCCU standard for the years covered in the period except only for two years and this indicates that the union is not effective in maintaining productive asset as the means to achieve sufficient earning.
- The loan yield is too low compared the PEARLS standard and this implies that the union could not able to cover financial, operating and contributes to institutional capital. The low loan yields indicate the union is earning below the market rates on its loan.
- The total operating expense of Awash RUSACCO union is more than the maximum 5% standard and this is one of the reasons that contribute the low profitability and significantly affect its sustainability.

- The operational cost impedes and limits financial services expansion and penetrations in to the rural areas, and on top of this operational cost is one of the major factors affecting the scale of operation.
- On the other hand the return on asset is below the standard minimum 1% for the years under this study except in one year and this is because the union is not effectively placing its productive resources in to investments that produce the highest yield, the loan portfolio, by comparing financial structure with yields.
- The outreach which is measured by membership growth is less than the WOCCU standard of more than 12% and this implies that there is no workable strategy in place in increasing the membership base and there seems no responsible body assigned in recruiting new members.
- There is a challenge of raising adequate internal sources of fund, saving and member share.

## 5.2 Recommendations

- The union should design a strategy so that members shall regularly contribute towards share contribution.
- Profitability can only be achieved through a combination increasing income and managing operational costs to the minimum. A profitable rural SACCO can deliver its financial services on a sustainable to attain its objectives. Control operational costs to improve performance in terms of profitability and part of the profit can be used to expand operations as internal resources.
- The union should strictly control operational expense to limit it below 5% of total asset.
- It is also advisable that the loan ratio increase to 70-80% of the total asset of the union as per WOCCU PEARLS model in order to make appropriate balance between in order to strike appropriate balance between effective financial structure and asset yields of the union.
- More over the union should improve the growth of loans so that the loan yield could be improved. On the other hand the union could improve loan yield by charging market based interest rate.
- The union should work hard in member saving mobilization by increasing the minimum regular compulsory saving amount, currently birr 10/month/member, by setting high minimum saving but within the capacity of members for compulsory savings.
- The union shall decrease the level of dependence on external credit to assure sustainable internal funding sources –member saving and share.
- The union could introduce new products of saving and loans- voluntary saving, time deposit, minor saving account. Besides Agricultural loan which has high risk since paid at one time, providing short term loans which repayment made weekly or monthly basis

for petty traders and local business could be also taken as input to new financial product designing.

- Instead of membership the union and its primaries should also focus on the well to do individuals to be members and deposit their surplus money by explaining the possible benefits of joining SACCO compared to MFIs and commercial banks. This requires also to have alternative and variety of products other than the compulsory savings that fit to the demands of such individuals.
- The union should charge interest rate on loans which cover operational cost, cost of fund and margin which is used to expansion of its services. This needs to have both social and business concepts balanced in the union mission so that the union could continue as alternative financial service provider in sustainable manner.
- The basis of dividend payment better to be revised, members should get dividends only based on share contribution but not on their saving since they are getting interest for that as well.
- The union could also work closely with other types of cooperative like multipurpose cooperatives found in the locality to deposit their money, based on the principle of cooperation among cooperatives.
- The management committee can also play an important role towards increasing membership by creating awareness in the community about the unique nature and benefit of SACCO for the rural people as not only a financial service provider but also as institution that creates sense of proud and cooperation among the society.
- Integrate with the community based organization such as Iqub and Idder as strategy for deposit mobilization and working closely with CBOs.
- The union should improve its profitability in line with the capital growth so that return on capital improves in a way that assures greater than the inflation rate to motivate members to invest in additional share capital. Thus, the union is benefited from internal source of loanable fund mobilization with lesser cost of capital.

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## **DECLARATION**

I, the undersigned, declare that this thesis is my original work, prepared under the guidance of my advisor, Dr. Degefe Duressa. 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.

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Name

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Signature & Date

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

**November, 2014**

## **ENDORSEMENT**

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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Advisor

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Signature & Date

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

**November, 2014**