



ASSESSMENT OF CREDIT DEFAULT RISK IN OROMIA CREDIT AND SAVING SHARE COMPANY (OCSSCO) OF ETHIOPIA

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Abstract

Although current situation of many countries have high focus on microfinance institutions to reduce poverty in meaning full way, the risk management aspects of micro-financing could not be overlooked. This paper highlights several incidences of default risks in OCSSCO. The problem identified was that the OCSSCO performance is in detrimental fashion because of delay in repayment and high default rates. Hence, it was important to establish if these limitations prevailed in the selected six OCSSCO in Ethiopia schemed by determining the default rate and the grounds of the observed trends. Therefore, in order to address those issues, the researcher used primary data collected through structured and unstructured questionnaire and referred secondary sources of data. As a result, the collected data and information were compiled and analyzed for possible indications of problem areas. So, the outcomes revealed that the OCSSCO default rate increased over the review period. The major causes of default were found to be poor business performance, in terms of low profitability or business losses. Besides, credit diversion to unprofitable uses, poor timing, inadequate supervision to borrowers, inadequate loan size, unfair screening mechanism non flexibility of the nature of repayment period, not quick process were other factors that caused credit default and in addition natural disaster, poor infrastructure, poor management and presence of negligent staffs were identified and taken as causes for credit default risk. Further, the inference results of the descriptive statistics show that awareness creation is important and significant factors that enhance the credit repayment performance. Moreover, the processes should be worked out to identify borrower capacity and any obligations that may interfere with repayment. Finally, the selected OCSSCO should intensify recovery of outstanding balances from defaulters through increased borrower follow-up.

Keywords: *Micro Finance Institutions, Credit Default Risk, Trend, Garret Ranking Technique.*

Introduction

Microfinance is the provision of savings accounts, loans, insurance, money transfers and other banking services to customers that lack access to traditional financial services, usually because of poverty. The beginnings of the microfinance movement are most closely associated with the Economist Muhammad Yunus, who in the early 1970 was a professor in Bangladesh, In the midst of a country-wide famine; he began making small loans to poor families in neighboring villages in an effort to break their cycle of poverty. The experiment was a surprising success, with Yunus receiving timely repayment and observing significant changes in the quality of life for his loan recipients. Unable to self-finance an expansion of his project, he sought governmental assistance, and the Grameen Bank was born. In order to focus on the very poor, the Bank only lent to households owning less than a half-acre of land. Repayment rates remained high, and the Bank began to spread its operations to other regions of the country. In less than a decade, the Bank was operating independently from its governmental founders and was advertising consistent repayment rates of about 98%. Micro Finance is relatively new industry in Ethiopia which arose in the early 1980's after the failure of the government delivery of subsidized credit to poor farmers. Micro finance, therefore, come in as the beginning of seeking effective market oriented solutions to the provision of sustainable and effective financial resource to poor groups of people who do not have access to financial service from formal government and private financial institutions. Hence, micro finance emerged as the provision of financial services and financial resources to the poor, low income and active group of people living in both urban and rural areas in general. These groups of people face lack of capital to start up new business or to improve the existing one. Micro fiancé service here refers mainly to credit provision and saving mobilization. Some micro finance institutions also offers insurance, salary and pension management and money transfer service. In addition to financial intermediation, many micro financial institutions (MFI) provide other social oriented service; such as group formation, development of self-confidence and training in financial literacy and management capabilities among members. This serves as a conduct for developing the sense of cooperation or team work to campaign on the common enemy that is poverty.

Review of Related Literature

Rose (2007), Micro-financing is a strategy for alleviating poverty. It is broadly accepted that robust, labor-intensive, and equitable economic growth combined with larger outlays for social programs is a winning formula in the fight against poverty (UN 1997).

Fidler and Webster (1996) noted that although informal credit markets operate widely in rural areas, moneylenders typically charge very high interest rates, inhibiting the rural poor from investing in productive income generating activities.



Reikne (1996) assessed the factors that lead to the failure of group based lending system in urban areas and went on to the extent that the study recommended an individual credit system for a better credit repayment. According to him presence of high geographical mobility, low attachment to specific neighborhoods and peer groups consisting of competitors are the factors that frustrate the solidarity of groups in urban areas, and hence group lending is more applicable to the rural environment than to urban society.

Kassim, Salina and Rahman (2008), it can be concluded that the MFIs are only concerned about extending financing without much effort being done to provide any form of post disbursement supervision. Post-disbursement supervision is highly relevant in ensuring the success of microfinance project due to the fact that around 80 per cent of the recipients of microfinance are illiterate women. Furthermore, around 82 per cent of these women had no business experience before joining the microfinance program, while the rest 18 per cent had some basic business experiences. The illiteracy of the recipients is rather serious to the extent that some do not even know how to count the amount of money that they received from the MFIs.

Statement of the Problem

Now a day countries of the world are giving more attention on poverty reduction and improvement of the life of the people as a main issue of all development effort. In order to reduce poverty and improve the living standard of the people, microfinance institutions like OCSSCO have high contribution. Financial institutions have the primary motive of enhancing the financial welfare of their clients by granting several types of loans. Default problems destroy lending capacity as the flow of repayment declines, transforming lenders into welfare agencies, instead of a viable financial institution. It incorrectly penalizes creditworthy borrowers whenever the screening mechanism is not efficient. Credit default may also deny new applicants access to credit as the bank's cash flow management problems augment in direct proportion to the increasing default problem. A series of defaults could lead to liquidity problem in the MFI and would consequently limit the ability of the MFI to extend credit/loan to other recipients. Although the performance of the OCSSCO in selected study area has been impressive since its establishment, this research project study revealed that its performance now a day experiencing an incremental default rate and the result is obvious that it becomes credit default risk. There are problems from both the loan providing institutions (OCSSCO) and client or borrowers of the company. Regard to the client the problems are starts from paying loan not at the right time due to utilizing of credit for household expenses that is out of the business plan, sales on credit in the local market not paid back on time, loss of acquired assets and totally unprofitability of the business activities and that leads to the major causes of credit default:-business closure, poor timing, not utilizing loan according to the business plan and finally poor business performance. From Loan providing institutions(OCSSCO) part it has its own contribution on the credit default risk in terms of providing inadequate loan, although there is sudden loan size amendment by trend, it is not as considerable as the current market situation. Weak screening mechanism, as per the study finding the screening mechanism is not fair ,most of the time it is based on interest of concerned bodies to conduct screening process ,even if there is procedure on the table as per the borrowers comment. Another issue that is crucial for the implementation of loan is adequate supervision ,actually there is supervision sometimes, but it is not scheduled and affordable for clients to reduce the problem .The repayment period of loan is critical time for both lending institution and borrowers ,but since process is not quick from initial and there is increment in the market price and in addition the repayment period is not flexible the borrowers faces many challenges ,which aggravates the credit default risk.

Objective of the Study

The general objective of this study is to examine the credit default risk in OCSSCO generally and six selected branches particularly to make repayment on time or to increase credit performance.

Specific Objectives

1. To identify purpose of credit (loan) provision
2. To identify the causes for credit default
3. To evaluate the repayment performance of the clients
4. To evaluate the opinion of clients or borrowers about the support from OCSSCO branches

Research Questions

1. For what purpose the credit /loan/ is provided?
2. What are the main reasons for credit default?
3. Is the clients repay the credit/loan/ properly?
4. What is the opinion of clients or borrowers for support from OCSSCO branches?



Methodology

This study will be undertaken on OCSSCO which are operating in the Oromia Region and the selected branches are located in west Guji and Borena zone. Oromia is one of the nine regions of the Federal Republic of Ethiopia well known for its cultural heritages and cattle resources. The region is also known in its endowment with several natural resources and favorable climatic conditions for agriculture. Unfortunately, the rural people are excluded from basic financial services in history until the inception of micro finances in the region. Yet, this still does not mean that the coverage of financial services for this people is uniformly distributed. This study employs both the qualitative and quantitative research strategy as the researcher sought to address the research project problem to satisfy the objectives. The sample for the study was drawn from the total target populations of 12661 which constitute 3432 Abaya, 1670 Gelana, 3417 Bule Hora, 1500 Gerba, 1300 Melak soda, 1342 Yabelo. And it is stratified into four according to the geographical correlation of the borrowers in each branch. Based on the stratified sampling formula 388 respondents were distributed and 310 (80%) respondents returned. The researcher used questionnaire for collecting primary data; in addition the secondary data was collected from reports bulletins and documents of the study organization. Data were collected using primary data gathering tools of questionnaire and personal interview. The questionnaire was designed in a concise and precise language to avoid ambiguity, and also to arouse the respondent's interest.

Data Analysis

The researcher analyzed and interpreted data by linking them to the theory, problem, purpose and research questions and he made sure that there is coherence throughout the entire research project. It helps to describe relevant aspects of phenomena of default risk of OCSSCO. The main tools applied are Garrett ranking Technique and trend analysis along with percentages.

Significance of the Study

OCSSCO is engaged in providing credit to the poor, so that they can generate income and employment for themselves. To be able to render such a service on a permanent basis, it should be viable and sustainable. This requires an efficient credit repayment performance as well as an impact to be observed on the target beneficiaries. Although some studies have been conducted on the credit schemes that targeted the poor in Ethiopia, so far, this study believed to be relevant for: one, it will gravitate the concerned bodies to look for more effective solutions for the problems. Second, the concrete suggestions of the study will use by the concerned body at least to minimize the credit default problems that exist in the microfinance. Finally, the study will have valuable importance for further study and add new idea to the existing knowledge of microfinance and credit default risk.

Scope of the Study

The finding of the project would have been more satisfactory if it were able to cover all Oromia credit and saving share company (OCSSCO), but due to time and the scattered location of the members and branches, the study is limited to six credit and saving share company branches, which are located in west Guji zone and Borena zone. The study focused on credit default risk and other related issues in the company.

Results and Discussions

The study on Credit Default Risk in selected Oromia Credit and Saving Share Companies Branches reveals that starting from the purpose of loan provision, causes for credit default risk, some credit process variables and its impact on the borrower's loan performance was assessed in detail. Descriptive statistics by SPSS version 20, garret ranking analysis model and manual secondary data analysis was carried out to accomplish the above-mentioned tasks.

The descriptive statistics show that majority of the respondents are under the age group 35-45 (35.48%). According to the result majority of respondents were borrowed the credit at appropriate age. The descriptive statistics indicate only 34.84 % of the respondents are female. This indicates that little is done on the part of the lending institutions in terms of woman empowerment, particularly in the rural areas. 64.52 % of the respondents were married and often from the different marital status more respect is given for the married in Ethiopia. Therefore the study result is very good in relation to the marital status. Large respondents (32.58%) educational level is grade 1- 8, this implies that through time the prevalence of education and school is increasing and it has positive contribution for the loan performance of borrowers. Hence majority of the people in Ethiopia are highly dependent on agricultural activities, 43.87 (136) % of respondents have taken loan for agricultural activities, in fact every business activities should have to focus the potential occupation of the area. Therefore the respondents who were highly engaged in agricultural activities in the study area is the right decision for borrowers and lending institutions also. Respondents who have experience below 6 years by the related occupations were only 14.84 % and majority of respondents, 38.06 % are within the range from 6-10, consequently the lending institution screening mechanism focuses the experiences of the respondents that have positive contribution to minimize credit default risk.



Basically the main purpose of the borrowers is to generate income by taking loan from lending institution by preparing their business plan and saving the initial deposit. With regard to the statement, the purpose for taking loan for agricultural products have high score, that is 109 (35.16%), this implies that the study area major occupation is agricultural related activities and it is good approach for lending institutions, since the respondents were focused on the potential products of the study area.

Status of loan payment is very important part for the lending institutions, in order to evaluate the past experience and to take care for the future activities. By the study finding 103 (33.25%) of the borrowers were in the status of repayment in arrear, that is more than repayment in schedule, even though it is less than repayment in schedule.

As per the analysis of garret ranking model the unprofitability of business activities with the highest mean score of 72 was taken as the first causes for repayment in arrears by the respondents and the last social and credit process given fourth with mean score only 27. Therefore it can be concluded that whether the borrowers were not performed their planned activities as the business plan submitted to the lending institution and implementing other activities without studying the market situation of the study area or lack of concrete attention for the implementation planned activities.

Regard to major causes for credit default risk:-the mean by garret score for poor business performance is 75 and the mean score for business closure is 24, which means poor business performance by the highest mean score was given the first rank by the respondents and in the same way fourth rank for business closure the rest variables lay in between the two. By conclusion poor business performance is the most and the highest causes for credit default risk.

Concerning the credit process variables such as size of loan provided, nature of repayment, interest payment on loan provided, screening mechanism, supervision, awareness creation and quick process credit, the respondents level of agreement is low beside the mean less 3 and standard deviation less than 1.8 except awareness creation with mean score 3.64 which is greater than 3 and accordingly it has lowest impact on the credit default risk, while the six variable are in the status of low level, for that reason the lending institutions should have to pay attention in this regard also.

The secondary data analyzed for default rate starting from the year 2011 to year 2015, consequently each six branches disbursement, recovery, outstanding balance and default rate by percentage on their bases had been analyzed, the first branch Abaya disbursement was on incremental base for last five years, amount recovery and outstanding balances shows decrement and lastly default rate is on fluctuating rate, but on average incremental. Bule Hora amount disbursement except for the year 2015 increased though out these years, outstanding balance, amount recovered and default rate on fluctuating base. For branches Yabelo and Gelana both disbursement and amount recovered increased through time and outstanding balance and default rate decreased in these years. For the rest two branches, that is Gerba and Melka soda loan disbursement, recovery, outstanding balance and default rate increased time to time. Generally total default rate is relatively very high in Yabelo and low in Abaya branches.

As per the study through interview in addition to the above mentioned causes and problems of credit default risk, there are other additional problems, like natural disaster (drought), presence of negligent staffs, lack of infrastructure, especially road, poor management and utilization of loan by the borrowers themselves.

Recommendations

Based on findings and discussions this study has found that improving the selected OCSSCO performance is a prerequisite to make it more effective in carrying out its mandate and providing technical support to micro-enterprises so as to improve their profitability. To this end, the selected OCSSCO branches should consider the following recommendations:

- As per the research project study result, the proportion of female is less than male. In respect to the national goal of Ethiopia, that is empowering women by participating in overall aspects and consequently creating job for them, the OCSSCO as microfinance institution should have to work more on female to provide different benefits particularly for women and supporting the national goal generally.
- The OCSSCO should provide the best mechanism to reduce repayment in arrear, which leads to credit default and collect properly in time the loan provided.
- The borrowers should have to implement according the business plan that is submitted to the lending microfinance institution in order to reduce the un-profitability of business activities or poor business performance.
- The loan size and supervision should be adequate; there should be quick process for loan provision, the nature of credit repayment period should be flexible and fair screening mechanism should be there.



- Finally all six selected branches needed more attentions and follow up from concerned bodies in order to reduce the causes for the increment of default rate, which leads to the credit default risk.
- The borrowers should have to manage and utilize the credit or loan they have taken from the lending institution (OCSSCO) and should prepare their business plan that is affordable for the current climate condition, the OCSSCO staffs should have to good team spirit and discipline to achieve the institutional goal and improve the life status of the borrowers generally and personal promotions and benefits particularly.

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