

**ASSESSING THE IMPACT OF NONPERFORMING LOANS ON
MICROFINANCE INSTITUTIONS (CASE STUDY: - OROMIA
CREDIT AND SAVING SHARE COMPANY (OCSSC), JIMMA
WALQO BRANCH)**



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DECLARATIONSS

Here with I declare that, this paper prepared for the partial fulfillment of the requirements for BA Degree in Accounting and finance entitled Assessing The Impact Of Nonperforming Loans On Microfinance Institutions (Case Study: - Oromia Credit And Saving Share Company (Ocsc), Jimma Walqo Branch) I have made it dependently with the close advice and guidance of our advisor.

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Abstract

Microfinance institutions are very important financial institutions which help on raising the economic development of any country. MFIs played a great role, in providing loan for different economic sectors. Moreover, it also involved in financing high residential and business construction project to individuals and state sectors. Thus, there was also short term, medium term and long-term loans for working capital and business men as well. So, this indicates the role of MFIs to the development of economy as a whole. The purpose of the study was to find out the major impact of nonperforming loan in Oromia credit and saving s.c. Since loans forms greater portion of the total asset in institution, these assets generate huge interest income for the institution and also determines the financial performance of the banks. Institutions play a critical role in an economy, therefore it is essential to identify problem that affect the institutions. This is because nonperforming loans can affect the ability of intuitions to play their role in the development of the economy. The researcher study specifically aimed to identify the major case of nonperforming loans and managing technique of the institution to decrease the effect of nonperforming loans. In order to achieve the objective, the study the researcher was gathered data using both primary and secondary source. The primary data were collected using questionnaire and interview while the secondary data were collected from loan procedure of the institution. The collected data were analyzed and interpreted by using tables and percentage.

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ACRONYMS

OMFI: Oromia micro Finance Institution

NPLs: Nonperforming Loans

OMFI: Oromia Microfinance Institution

FNGOs: Financial nongovernmental organizations

WALQO; Waldaa Aksiyoonii Liqii fi Qusannaa Oromiyaa.

OCSSC: Oromia credit and saving Share Company

Table of Contents

DECLARATIONSS.....	I
Abstract.....	I
Acknowledgment	II
ACRONYMS	III
List of table.....	VII
CHAPTER ONE	1
1 INTRODUCTION	1
1.1. BACKGROUND OF THE STUDY.....	1
1.2. Background of the Organization	2
1.3. Statement of the Problem	2
1.4 Research Questions	3
1.5. Objective of the study.....	3
1.5.1. General objective	3
1.5.2. Specific objective	3
1.6. Significance of the study	4
1.7. Scope of the study	4
1.8. Limitation of the study.....	4
1.9 Organization of the study	4
CHAPTER TWO	5
2. LITERATURE REVIEW	5
2.1Theoretical review of literature	5
2.1.1 Definition of Microfinance	5
2.1.2 Evolution of Microfinance.....	5
2.1.3 Micro Finance in Ethiopia	6
2.1.4 Role of microfinance on poverty reduction	7
2.2 Factors Influencing Non-Performing Loans of Microfinance Institutions.....	7
2.2.1 Knowledge of Borrowers.....	7
2.2.2 The Types of Loans.....	7
2.2.3 Policy and Objectives	8
2.2.4 Loan Staff	8
2.2.5 The Schedule and the Amount of Loan Installments.....	8

2.2.6 Staff Training	8
2.2.7 Management Information Systems	8
2.2.8 Incentives for Borrowers.....	8
2.2.9 Incentives for Staff.....	9
2.2.10 Loan Amount.....	9
2.2.11 Location.....	9
2.2.12 Women’s Participation	9
2.2.13 Flexibility for Borrowers to Use the Borrowed Money.....	9
2.2.14 Savings	10
2.2.15 Income of Households	10
2.2.16 Interest Rates	10
2.3 Empirical Review	11
2.3.1 The need for microfinance.....	13
2.3.2 Techniques of client appraisal	13
2.4 conceptual frame work of the study.....	15
2.5 Knowledge of Gaps	16
CHAPTER THREE	17
3. RESEARCH DESIGN AND METHODOLOGY	17
3.1 Research Design.....	17
3.2 Source of Data.....	17
3.3 Study Area.....	17
3.4 Data Collection Methods	18
3.4.1. Primary data collection	18
3.4.2. Secondary data collection.....	18
3.5 Target population	18
3.6 Sample and sampling techniques	18
3. 7 Data analysis Techniques	19
CHAPTER FOUR	20
DATA PRESENTATION AND ANALYSIS	20
4.1. Data Analysis.....	20
4.1.1 Demographic Characteristics of Respondent.....	20
4.2. Staff manager interview and his response	28

CHAPTER FIVE	32
CONCLUSION AND RECOMMENDATION	32
5.1 conclusions.....	32
5.2 Recommendations	33
REFERENCES.....	35
APPENDIX.....	36

List of table

[Table 4.1 sex, age, and educational background of the respondents](#) 20

[4.1.2 Analysis of NPLs and loan Credits](#) 22

[Table 4.2 Employee response about practical guide line](#) 22

[Table 4.3 employee response on MFIs pre-loans management technique](#)..... 23

[Table 4.4 Employee Responses on customer repayment](#) 23

[Table 4.5 Employee Responses on the major cause of NPLs in OMFI](#)..... 24

[Table 4.6Employee Responses on the Impact of NPLs on Performance of OMFI](#) 24

[Table 4.7 Employee Responses on evaluation technique to Minimize risk of NPLs](#) 25

[Table 4.8. Employee Responses on methods of motivation](#) 25

[Table 4.9 Types of loan gathered by OMFI](#)..... 26

[Table 4.10 operation system of OMFI on NPLs](#) 26

[Table 4.11 Employee Responses on treatment of collaterals in OMFI](#)..... 27

CHAPTER ONE

1 INTRODUCTION

1.1. BACKGROUND OF THE STUDY

According to the International Monetary Fund (IMF,2009); a non performing loan is any loan in which interest and principal payment are more than 90 days overdue; or more than 90 days' worth of interest has been refinanced. On the other hand Basel committee (2001) puts nonperforming loans as loans left un paid for a period of ninety days. But whatever it is there are no global standards to define nonperforming loans at practical level. Various exist in term of classifications system, scope and content of loans. According to Chodhury et, al (2002; page 21-54) states that no performing loans refers to those financial assets from which banks no longer receive interest and installment payment as scheduled.

It is obvious that an efficient and well-functioning financial sector is essential for the development of any economy, and for the achievement of high and sustainable growth. One of the indicators of financial sectors health is loan qualities. Even though Granting loans have their own financial and nonfinancial contributions on micro finance institutions, the main problem of granting loans is that loan default. The causes for loan default are different and have a multidimensional aspect. Theoretically there are so many reasons as to why loans fail to perform. Some of these include depressed economic conditions, high real interest rate, inflation, lenient terms of credit, lack of credit orientation, and poor monitoring of loans. In general loans become nonperforming when it cannot be recovered within certain stipulated time that is governed by some specific law.

Most scholars decide that there are two sets of factors on NPLs over the time. One group focuses on external events such as the overall macro-economic conditions, which are likely to affect the borrower capacity to repay their loans. While the other group focuses on more about the variability of NPLs across banks, attributes the level of NPLs to bank.

The essential function of microfinance institution system is to act as intermediaries between other MFIs to borrowers. In addition to that, micro finance mainly provide loan service to the investor. Financial Institutions play a critical role in an economy, therefore it is essential to identify problem that affect the institutions. The main factors that affect the position of micro finance in the development of the economy are nonperforming loans. Nonperforming loan may exist when loan cannot be re paid with in specific date. That is why student researcher motivated to assess the major impact of nonperforming loans on of micro finance institutions. Beside to that the researcher was motivated to identify the real cease and control techniques of the intuitions on nonperforming loans. The research was done by taking Oromia credit and saving s.c, jimma WALQO branch as cease area.

1.2. Background of the Organization

Oromia Credit and Saving Share Company /OCSSC/ is one of the largest MFI in Ethiopia that was established in August 1997. It has been providing MF services mainly in Oromia National Regional State. Besides Oromia regional state, it has branches in Harari National regional state and Addis Ababa City Administration, which is the capital of the federal states in the country. OCSSC also opened branches in Dire Dawa City Administration particularly to provide loan for women entrepreneurship in collaboration with Women Entrepreneurship Development Program /WEDP/. Although OCSSCO is a successful self-sustained MFI, it has challenge in fulfilling the credit demand of the poor people and entrepreneurs due to shortage of loanable funds. In addition, company needs assistance in area of capacity development, training, exposure visit, scholarship etc. to become center of excellence in the microfinance industry of Ethiopia. OCSSC is a micro finance institution that strives to strengthen the economic base of low-income earning people in both urban and rural parts. The company operates in Oromia national regional state setting its head quarter in Addis Ababa and 18 zonal offices in the capital of 18 Oromia zonal administrations. The numbers of full-fledged branches of the company reached 305 in 2015, from those Jimma branch is the one. OCSSC in Jimma branches have been delivering the credit service to the poor way group guarantee mechanisms that does not require material collateral. Delivering loan to the poor through peer pressure requires only good character. Saving and loan with limited sub- products were the only products of OCSSC at establishment. On demand based research and product development effort, the company has presently 'four major products with multiple sub-products. Among the products and sub- products, the following are widely implemented in all branches; including loan, saving, insurance, local money transfer and advisory services.

1.3. Statement of the Problem

The success of MFIs largely depends on the effectiveness of their credit management systems because these institutions generate most of their income from interest earned on loans extended to small and medium entrepreneurs. Extension of credit facilities is one Companies, Rural banks, Financial Non-Governmental Organization (FNGOs) and credit Unions. This is usually evidenced by the large proportion that loans constitute in the overall operating assets of these lending institutions. A World Bank policy research working paper on NPLs in Sub-Saharan Africa revealed that NPLs are caused by adverse economic shocks coupled with high cost of capital and low interest margins (Fofack, 2005). Goldstein and Turner (1996) stated “ the accumulation of NPLs is generally attributable to a number of factors, including economic downturn, macroeconomic volatility, terms of trade deterioration, high interest rate, excessive reliance on overly high-priced inter-bank borrowings, insider borrowing and moral hazarding loans or lending operations, microfinance institution faces different forms of risks. The first one is financial risk including both liquidity and credit solvency. The second one is operational risk related to fraud operational error and system related to the information problems. The third and the most types of risk are business risk associated to the microfinance industry as a whole in connection with the overall economy of the nations.

In general the above risk and other related various reasons affect the collectability of loans on microfinance institutions and have more interruption in credit operations. According to different researcher, there are factor of the non-performing loans. Such as; Problems of lack customers, skills, and lack of income social problems, Poor management of nonperforming loans, follow up and collection problems Timely decision-making problems in the case of risk and Collateral assessment in their life span.

As per the knowledge of the researcher, there is no research done on the topic of the impact of nonperforming loans on Oromia microfinance institution in recent years even though Most studies undertaken in the past few years have focused mainly on credit models used by MFI's and their impact on profitability (Migiri, 2002).Some study mainly focused on the factors causing nonperforming loan. For instance there is a research study done on assessment of factors causing nonperforming loans (by Kassahun Fiseha). On the above study the researcher mainly focused identifying the factor that causing nonperforming loans. That is why; the researcher was very interested to do a research on this topic so that to identify the main factors that affects profitability of the microfinance. The researcher was identified major problem occurring customer to repayment loan with 90 days and above.

1.4 Research Questions

By taking the above and other facts in account, the researcher was studied trying to address the following questions.

- 1, what are the main reasons loans becoming nonperforming?
- 2, what is the major impact of nonperforming loans of OMFI?
- 3, does selected micro finance institution in Oromia commit nonperformance loan practices?
- 4, what are elements in nonperformance loan structure that impact on micro finance institution of selected OMFIs in Ethiopia?

1.5. Objective of the study

1.5.1. General objective

The general objective of the study is to assess the impact of nonperforming loans on Oromia microfinance institution (OMFI).

1.5.2. Specific objective

In addition to the above general objective, this study also has the following specific objectives.

- To analysis the impact nonperforming loans on OMFI.
- To identify the reason for loans become nonperforming.
- To implementing the cause of losing repayment with long term time.
- To identify the major cause of defaulting of loans and techniques to manage it.

1.6. Significance of the study

The researcher believes that, the result of this study was had the following significance.

To show those concerned costs associated with nonperforming loans and its impact.

Give insight how manager use possible recommendation regarding nonperforming loans.

Those how are interested to conduct comprehensive study regarding the impact of nonperforming loan on microfinance institutions (MFI).

More over study also have importance to the researcher giving tangible knowledge by deep finding to NPLs, and by doing this study to get the reward of Bachelor Degree in the profession of accounting and finance.

1.7. Scope of the study

Due to limited time and financial resource, the study is limited to commercial the researcher was designed to investigate the impact of nonperforming loan on of Oromia credit and saving s.c.

1.8. Limitation of the study

The researcher has faced some problems when conduct the research. For the most the manager micro finance institution in Ethiopia change his field work and the researcher obligated to start new relation with new description. In addition to that loan department office unable to give full secondary source for the researcher and unwillingness of few respondents to fill the questionnaire.

1.9 Organization of the study

Five chapters have organized the study in the following manner: Chapter one presented background of the study, statement of the problem, objective of the study, significant and scope of the study. The second Chapter presented related review of Literature. The third chapter presented methodology of the study. The fourth chapter presented data result and analysis. Finally, chapter five presented Recommendations and conclusions.

CHAPTER TWO

2. LITERATURE REVIEW

2.1 Theoretical review of literature

2.1.1 Definition of Microfinance

Finance refers to the process by which market deals with cash flows. It is the situation that make possible to borrow and lend or save financial intermediaries are institutions that match borrower and lender or savers. Financial intermediaries include commercial banks insurance company and MFIs other informal financial services. It is the first necessary to make explicit definition of microfinance and poverty on which this section attempts to investigate relationship. Microfinance refers to the delivery of financial services of such as credit saving insurance etc. to clients who are without access to the service of formal sector financial institutions on sustainable basis, (Joan Parker 2006). Microfinance, those small scale financial services, primarily credit and saving provided to people who farm or fish or herd and who operate small scale enterprise or micro enterprise where goods and services are produced. Microfinance institutions are often defined as in terms of the following characteristics:

Promoting small business, building capacity of the poor, expanding small loans without collaterals, combining credit without saving and charging market rate of interests.

“Microfinance” refers to as small-scale financial institutions to the rural and urban poor to provide credit, self-employment and small business, and including saving and technical assistance. Granting loan is a contractual agreement in which a borrower receives something of value now and agrees to repay the lender at same date in the future, generally with interest. The term also refers to the borrowing capacity of an individual or company (<http://www.wisegeek.com>).

Generally, those rural financial institutions have intended to financial service to clients that are usually extended from formal financing smallholder farmers. Women’s and the poor they have done this by employing variety of operating models such as, improved saving.

2.1.2 Evolution of Microfinance

Mobilization and flexibility in service delivered, (Daba and Moti 2006). Economists have proposed several theories of joint liability lending that streets various aspects of its informational

enforcement advantages over other forms of lending institutions that rely on joint liability to facilitate lending the poor have a long history and are now a common feature of money developing countries. The economic models of joint liability lending institutions (JLLI) formalize the idea that a well-structured JLLI can deal effectively with the major problems adverse selections, moral hazard, auditing costs and enforcement facing lenders by utilizing the local information and social capital that exist among borrowers. Most joint liability lending institution operates in environments where borrowers do not have physical asset to pledge as collateral group. Lending have a long practical history but much recent stems from microfinance was intended by Dr Mohammed Yenus, financial project research 1976 as a research project to test the of hypothesis of weather provision of small-scale financial services to the poor to reduce their poverty or not. From this research result, it was observed that the concept of lending be rationalized for sustainability of both the borrowers and the lenders. The project was replicated in five districts of Bangladesh during 1979-1982 in collaboration with banks. This was evaluated and showed good performance in term of sustainability. In 1983 the project was transformed to Grande banks of the government. The bank puts the mechanism of giving microfinance service to the poor people having objectives of attacking poverty and increase economic of growth and development of the country. Setting group of the lending methodology and group formulation criteria was sated. The bank stated to provide financial service to the poor the evidence provided that, the German banks lends to the poor peoples and others, (Daba&Moti2006).Credit term formulated by the microfinance institutions affect the loan performance; the involvement of credit officer and customers in formulating credit terms affect loan performance (Moti, 2012).

2.1.3 Micro Finance in Ethiopia

In pre 1996 financial service formal establishment MFIs, in Ethiopia is recent phenomenon which can be traced backed ten years. There were however other financial service rendered in the 1970s and 1980,s many international donor, governmental organization and the governmental of Ethiopia have supported the expansion of credit service in country ,mainly rural area .They were not financial intermediaries instead ,They were the tool of distributing fund in order to increasing production and productivity , for instance , if we look at the repayment performance of agricultural and industrial development bank of Ethiopia it various between 68% and 1 1% in 1992 and 1993 respect . Doe to this and other similar problem on the financial service of the economy a legal foundation for the establishment of MFIs will aid in 1996 Getnet, 2007.

The industry is noncompetitive and provide uniform credit saving product client .Against poverty through provision of credit and related like saving, advisory service to potential borrower particularly to people have little or purchasing power operational manual of Oromia credit and saving association .In pre 1996 financial service formal establishment MFIs, in Ethiopia is recent phenomenon which can e traced backed ten years. There were however other financial service rendered in the 1970s and 1980,s many international donor, governmental organization and the governmental of Ethiopia have supported the expansion of credit service in country ,mainly rural area .They were not financial intermediaries instead ,They were the tool of

distributing fund in order to increasing production and productivity , for instance , if we look at the repayment performance of agricultural and industrial development bank of Ethiopia it varies between 68% and 11% in 1992 and 1993 respectively. Due to this and other similar problem on the financial service of the economy a legal foundation for the establishment of MFIs will aid in 1996. (Getnet,2007 , there are 23 micro finance institutions registered and licensed under NBE and reaching 905000 credit and saving product to client (Getahun ,2007) .The industry is noncompetitive and provide uniform credit saving product client .Against poverty through provision of credit and related like saving ,advisory service to potential borrower particularly to people have little or purchasing power operational manual of Oromia credit and saving association . Currently, in Ethiopia there are 38 microfinance institutions licensed to operate regional states and throughout the country (Solomon et al., 2019) many researchers result showed that income played significant role on consumption, capital formation and other indicators of human well-being.

2.1.4 Role of microfinance on poverty reduction

Poverty could be conceived as a situational syndrome consisting of deficiency in food consumption, high mortal and morbidity level, poor sanitary and housing conditions and low educational level and existence of widespread marginal population in all aspect of life. Webster's university defines poverty 'lack of means of providing material needs of comforts.' According to Joan Parker (2000), poverty has always been a concern of microfinance and some microfinance institutions follow the methods that target a very poor as a separate client groups. While other microfinance institutions are do their work based on not targeted financial service to their clients. For all those who lack access to formal credit institutions. Financial intermediation is a process, which involves surplus units depositing funds with financial institutions who then lend to deficit units. Matthews and Thompson (2008) identify that financial intermediaries can be distinguished by four criteria: first their main categories of liabilities (deposits) are specified for a fixed sum which is not related to the performance of a portfolio.

2.2 Factors Influencing Non-Performing Loans of Microfinance Institutions

2.2.1 Knowledge of Borrowers

Knowledge on record keeping and business may help borrowers to manage their cash flows and make better business decisions, especially for borrowers who a restarting new business. Training and education level (Bhatt, 2002) are believed to be affecting the business performing ability of borrowers. However, Bhatt also points out that training for borrowers could prove to be costly for borrowers who need the loans quickly to capture the opportunities.

2.2.2 The Types of Loans

Different kinds of investment give different returns. Some farm produce may give better returns than other produce. Concentration of types of loan may affect the performance of MFIs. Investment in low earning or high-risk farm products and businesses may result in a lower repayment rate. Specifying the kind of investment for borrowers may be limiting the opportunity

and result in higher risks. MFIs should be encouraged to lend to non-farm enterprises and non-farm households (Sacay and Randhawa 1995).

2.2.3 Policy and Objectives

Clear policy has to be communicated well among the staff and clients with proper signals. Without clear policy, communicated objectives may not be set clearly or not taken seriously. Unclear objectives on loan collection, for example, may result in low quality of loan portfolios. Without clear objectives of outreach, loan officers may not concentrate on serving the target group (Holt and Ribe, 2003).

2.2.4 Loan Staff

Loan officers in MFIs have to take care of many small loans, with more borrowers to handle, the monitoring and advisory functions of the staff may be affected, and may result in higher loan defaults.

2.2.5 The Schedule and the Amount of Loan Installments

Small and frequent payments may make it easier for small borrowers to manage the cash. Many successful MFIs require small regular repayment from borrowers, recognizing that farm households have many and varied sources of income and types of expenditure (Wright, 2000). Terms of loan payment should reflect the borrowers' needs. According to Wright, institutions with short-term loan products and technologies may be more competitive to informal lenders. Branches with a higher ratio of short-term loans may be doing better financially.

2.2.6 Staff Training

Training of MFIs' staff is considered to affect the performance. Loan collection may be affected by the quality of loan officers. Poor screening and insufficient monitoring of loans affect the quality of loans (Yaron, et.al, 1997)

2.2.7 Management Information Systems

Management information systems are essential for accurate data and monitoring of customers' progress (Sacay and Randhawa, 1997). There should be effective management information systems in tracking payments, due loans, and overdue loans in order to systematically monitor loan performance (Yaron, et.al., 2005).

2.2.8 Incentives for Borrowers

Incentives provided for the borrowers to pay back may be a determinant of repayment rate. More access to credit after full repayments may be a major incentive for borrowers. Continuing access to repeat loans have been identified as a critical factor in keeping a low default rate (Wright, 2000). Inadequate incentive for clients to pay back is a factor that affects the quality of loans (Yaron, et.al, 2002). Borrowers need to have a clear signal from the MFIs that loan repayment is serious. Late payment of loans often occurs because borrowers often test the MFIs, knowing that MFIs are non-

Profit organizations and the staff is not responsible for making profits (Norell, 2002).

2.2.9 Incentives for Staff

A staff incentives system affects the performance of micro-finance institutions. Rewards, including monetary incentives and promotion contribute to the efficiency of successful rural financial institutions (Yaron, et al., 2002).

2.2.10 Loan Amount

Larger loans have greater risk exposure, so the variable costs per-dollar is higher (Schreiner, 2001). If lenders don't take extra care, there could be more loan defaults. Greater loan size means less depth of outreach for the borrower, but usually means more profitability for the lender (Schreiner, 2002). According to Schreiner (2002), average balance, a proxy for depth of outreach, is directly proportional to revenue and default risk. Average loan size to GNP, as a proxy of depth of outreach, was found to have a statistically significant inverse relationship with financial self-sufficiency (Woller, 2002). The amount of loans could be a factor causing NPLs, as it directly relates to risk.

Many MFIs have had problems with the repayments of clients whose loans issued exceed their capacity to repay (Wright, 2000). Higher loan size on the average may imply the overestimation of borrowers' repayment capacity. On the other hand, higher loan size could mean that the borrowers have higher capacity to earn and to repay the loans. Loans too large for business needs may result in the use of loans for personal needs and results in the inability to pay from income (Norell, 2002).

2.2.11 Location

Locations of lending institutions affect the transaction costs of the borrowers and lenders (Bhatt, 2002). It is easier for lenders to acquire information and provide assistance to the borrowers and easier for the borrowers to travel to the lenders with shorter or more convenient routes of transportation. In Sharma and Zellers study (2003), trying to achieve "marginal impact of credit services" may be the cause of concentration of branches of credit organizations in the area with better access to transport and communication infrastructure where clients' income covariance seem to be lower. Branches with poor locations may cause inconvenience in communication resulting in inefficiency in consultant services and services related to loan collection.

2.2.12 Women's Participation

Women in many developing countries do not have as many opportunities as men do in finding jobs and credit. Some argue that women's participation has led to economic empowerment of women and thus higher loan repayment rates on women borrowers (Bhatt, 2002).

2.2.13 Flexibility for Borrowers to Use the Borrowed Money

This may be an important factor that helps borrowers to take the opportunities of earning better income rather than having to go through the loan application process again. Often loans are diverted because there are better opportunities or emergencies. Wright (2000) points out those

successful MFIs do not tie their loans to specific types of projects and where there is a strict policy on providing loans for productive uses there would be a mechanism to provide facilities to meet other needs.

2.2.14 Savings

Egiatsu (1992) claims that the traditional “credit first theory” had serious defects of poor loans recovery. According to Egiatsu, the new view, “the deposit first theory” argued that if the loans are externally funded, borrowers know that there is no “real root in their own economic life”. Some financial organizations consider outside money to be “cold money” and fear that the discipline may be reduced among the members (Wright, 2000). In the case of MFIs, self-financing reduces dependence on external resources and improves financial discipline (Khandker, 1998)

The clients established relationship with the bank may contribute to the necessary data bank used in considering loans and may contribute to better credit assessment and loan collection. Clients and the bank can have some knowledge of each other and feel at ease since more is known before the first loans or larger loans are granted. Clients’ savings habit is useful information in credit evaluation (Ravicz, 1998; Matin, Hulme and Rutherford, 2002). More savings could imply that the branches have a good relationship with the clients and have more access to clients’ information.

2.2.15 Income of Households

Household income may represent the capacity to pay back the loan. Incomes from other jobs or from other family members may be used for loan repayments and increase the capacity of loan payment (Bhatt, 2002). Since a goal of MFIs is usually to help the poor discriminating those with lower household income by using income as a criterion for credit may seem unsuitable. In trying to cut down some bad loans, the credit officers may be more inclined to consider income of the households as a major criterion for loan approval. Income of the borrowers may be a major factor affecting the ability to repay the loans but may not necessarily affect the willingness to pay. Income fluctuation from ill health, theft, job loss and fluctuation in demand may have caused dropouts from credit programs (Copes take, Bhalotra and Johnson, 2001).

2.2.16 Interest Rates

Interest ceilings and interest rates fixing has been very damaging because interest rates are critical in the mobilization, and allocation of resources (Yaron, et al., 1997). According to Yaron, et all, government’s restrictions on interest rates restrict the levels and types of participation by financial intermediaries in rural financial markets because interest rates on directed agricultural credit are usually fixed below market rates. Restricting interest rates discourages savings and may discourage lending to small borrowers. The demand for loans may not be significantly affected by the level of interest rates (Rhyne, 1998), but interest rate setting is related to client selection (Meyer, 2000). More promising projects might be selected at reasonable market rate. Loan collection performance might be better if poor projects are not selected.

Subsidized rates lead to rationing, which tends to favor the wealthy and politically connected and borrowers might not take the loans seriously enough (Muraki, et al., 1997). Borrowers may take loans less seriously since the rate is lower than the market rate and money may not be used for the best investment available in the market. However, lower interest rates may be helpful for small borrowers who may not know many high return investment opportunities.

2.3 Empirical Review

Analyzing the potential positive effects associated with group dynamics, some studies examine the impact of different levels of peer selection, peer monitoring and peer pressure. Wenner (1995) presents a methodology to test whether the selection mechanism has an impact on the repayment performance of 25 Costa Rican credit groups and whether group members use local information for the screening of their peers. His study shows that lending groups use private information to select their peers and that this selection mechanism increases the group repayment performance. On the same issue, the above-mentioned study of Zeller (2008) confirms the positive role of peer selection (internal rules of conducts) on repayment performance. Wydick (2009) uses data from 137 Guatemalan credit groups to show how social cohesion affects group performance in terms of repayment rates, group insurance and moral hazard. He found that peer monitoring in urban groups and peer pressure in rural ones significantly affects group performance. Vigano (2003), employing a credit scoring model for development banks based on 118 sample borrowers, taking the case of Development Bank of Burkina Faso, found out that customers characteristics, enterprise characteristics and customers activity, profitability and revenue stability, asset value and composition, financial situation, loan use, bank-customer relationship, contractual conditions and credit risk control, quality of information and the customers banking behavior are identified to influence the bank's credit risk. The study revealed that being women, married, aged, proximity to the bank, use of better technology and being flexible to adjust to market changes, proper use of the loan, project diversification, frequency of loan maturity, collateral, personal guarantee and being a pre-existing depositor are negatively related to loan default risk. Loans in kind, long waiting period from application to disbursement and being younger firm, past default, existence of other loan are those positively related to loan default rate.

An empirical study made by Ajayi (2002) on factors which influence default in mortgage finance institution with particular reference to the Federal Mortgage Bank of Nigeria using correlation and multiple regression analysis based on 128 samples (62.7% of the population) showed that default has largely been positively influenced by cost of construction, monthly repayment, loan to value ratio, market value of property, age of borrower and the annual income of borrower. The expected rental income from property, however, had a negative influence on default.

Hunt (2006) examined the credit rationing technology of lenders and the repayment behavior of borrowers at a rural financial institution based on 504 sample observations. Loan rationing equation and loan repayment equations estimated employing Tobit model using survey data at Guyana Cooperative Agricultural and Industrial Development Bank revealed that only 33% of the criteria utilized identified credit worthy borrowers implying that the screening technology was not efficient and needed to be repaired. The results also indicated that tightening the loan contract terms by reducing the grace period on loans and rejecting applications which had long processing times enhanced the pool of credit worthy borrowers. Female borrowers were also not rationed differently than male borrowers, nor were they worse repayers than male borrowers (i.e. the variable sex was insignificant in both equations), but wealthy borrowers were bad credit risks as their repayment performance is poor. In general, the study showed that only four out of twelve explanatory variables (fishing, males in food crops and livestock, credit experience and sugar cane) enhance creditworthiness, while other variables especially grace period, delays, and joint borrowers contribute significantly to the default problem.

2.3.1 The need for microfinance

Microfinance has become very famous in the past decade & has boosted among the public interest on poverty reduction tools. The majority of the people in developing countries are considered very poor & unable to accumulate substantial saving. They need external finance to break away from the vicious of circles of poverty. Lack of access of institutional credit is one of the circular factors impeding peasant agricultural production& rural development in general (Daba&Moti).

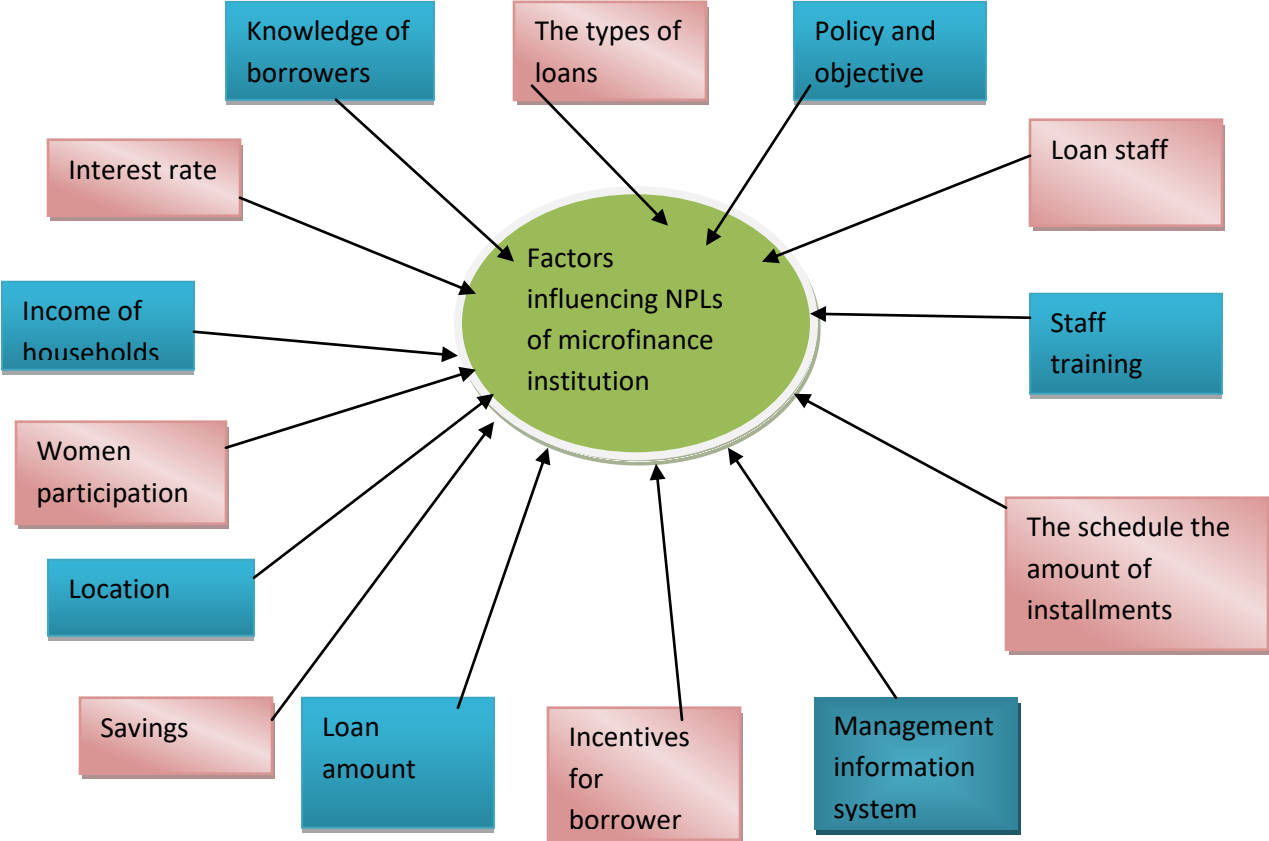
2.3.2 Techniques of client appraisal

Micro finance institution uses the 5Cs model of credit to evaluate a customer as potential borrower (Abdi2000). The 5Cs help MFIs to increase loan performance, as they get to know their customer better. These 5Cs are character, capacity, collateral, capital & conditions.

Character basically is a tool that provides weighing values for various characteristics of a credit applicant and the total weighed score of the applicant is used to estimate credit worthiness. This is the personal impression of the client makes on the potential lender. The MFIs will consider the cash flow from the business, the timing of repayment & the successful repayment of the loan. Anthony (2006) defines cash flow as the borrower has to pay his debit. Cash flow helps the MFIs

to determine if the borrower has the capacity or ability to pay the loans. Collateral is any asset that customer have to pledge against debit (Lawrence & Charles 1995), it represents asset that the company pledges as alternative repayment source of loans. Most of collaterals are in the form of hard asset such as real estate or manufacturing equipment. According to Weston & Eugene (1996), capital is measured by the general financial position of the borrower as indicated by financial ratio analysis, with special emphasis on tangible net worth of the borrower business. Thus, capital is money the borrower has personally invested in the business and is an indication of how much the borrower has a risk should the business fail. Condition refers to the borrower sensitivity to external forces, such as interest rate. Inflation rate business cycles as well as competitive pressure. The condition focus on the borrower vulnerability (Haron.O&Moti, 2012).

2.4 conceptual frame work of the study



2.5 Knowledge of Gaps

As previous the knowledge of the researcher, there is no research done on the topic of the impact of nonperforming loans on Oromia microfinance institution in recent years even though Most studies undertaken in the past few years have focused mainly on credit models used by MFI's and their impact on profitability (Migiri, 2002).Some study mainly focused on the factors causing nonperforming loan. For instance there is a research study done on assessment of factors causing nonperforming loans (by Kassahun Fiseha). On the above study the researcher mainly focused identifying the factor that causing nonperforming loans. That is why; the researcher was very interested to do a research on this topic so that to identify the main factors that affects profitability of the microfinance. The researcher was identified major problem occurring customer to repayment loan with 90 days and above. The researcher was trying to identify the addition factors that influencing on nonperforming loan on Oromia micro finance institution (in case jimma WALQO branch):- these are loan amount, the type of loans and management information system the mainly factors that affected on profitability Oromia microfinance institution.

CHAPTER THREE

3. RESEARCH DESIGN AND METHODOLOGY

3.1 Research Design

The study was focused on the assessing the impact of nonperforming loans on micro finance institutions in case of Jimma WALQO branch. The study were used quantitative research approaches in order to achieve the research objective the researcher was analyzed the data using descriptive technique. Descriptive technique one of the common types of data analysis technique that describes the state of nature or affairs as it exists as present. This type of research design aims to describe and reports only what will be appended or its happening. The data presented by using table, percentage.

3.2 Source of Data

In order to attain the objective of the study the student researcher was utilized both primarily and secondary source of data. The researcher was used primary source of data because this source of data enables the student researcher to collect reliable and use full data about the study directly from the respondent. The student researcher also utilize secondary source of data, which mainly support the primary source in order to fulfill the shortage of data from the respondent. The primary sources of data were questionnaires and personnel interview from credit department and loan officer. The secondary data source was company's documents such as Oromia microfinance loan files and its leading procedure, annual report and internet.

3.3 Study Area

The study was taken place in Jimma city by taking of Oromia credit and saving S.C (jimma WALQO branch) as a study area. The area is selected because of the branch have large number of customer and borrower and also there were no research done in last recent years on this topic on this branch.

3.4 Data Collection Methods

3.4.1. Primary data collection

The primary data were collected by interview, questionnaire with both open and close-ended questionnaires with the organizational manager and employees of institutions. The open-ended question help respondent to express their idea in an unlimited way and close ended provide actualize questions to the respondent. The researcher was on focus on this method of data collection because it is preferable to elaborate the problems which are statuses in the basic research questions and to obtain detail information regarding to research questions.

3.4.2. Secondary data collection

The researcher collected secondary data by using secondary data collection techniques. These secondary data collection techniques will be a means by which the student researcher collected supporting evidence for his primary source. Secondary data collection tools were assessed the document of Oromia microfinance institutions like, its leading procedure, and

3.5 Target population

The target population of the study are the employees of Oromia credit and saving s.c those are mainly worked on loan in credit service and other employees those have good knowledge about nonperforming loan and its impact on the organization.

3.6 Sample and sampling techniques

The researcher used non-probability sampling techniques; that is judgmental sampling. Because judgmental sampling enables the student researcher to collect reliable and sufficient information by taking more well experienced and acceptable respondent to the study. The researcher took only OCSSC (Jimma branch), 22 employees of the institution. However, the only respondent to the researcher were 13 employees who had more work experience more than five years; those were one-loan managers from economics, five accountants, four from management and three from other department employees who have good knowledge about nonperforming loans. Therefore, the researcher was collected data from all respondent through open and closed end equations and through personal interview.

3.7 Data analysis Techniques

The researcher processed the data through editing, coding and classifying based on their similarities. After this, the data were presented through tabular and percentage. Then descriptive analyses were used on the basis of the summered facts.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

Under this chapter attempts have been made to present data in a manner that attract the readers attentions and in a way that can address the issues that are raised in chapter one of the study. Accordingly, data has been collected and research finding are presented in the following sections.

4.1. Data Analysis

In addition to the fact in the preceding sections a questionnaire has been designed and was gathered to meet the research questions raised in chapter one of the study.

4.1.1 Demographic Characteristics of Respondent

In order to meet the research objectives, data were collected from OCSSC credit department, loan officers and other representative employees. The following table summarizes the characteristics of respondents in OCSSC.

Table 4.1 sex, age, and educational background of the respondents

	Variables	No of respondent	Percentage %
1	Gender composition		
	Male	9	69.2%
	Female	4	30.8%
	Total	13	100%
2	Age composition		
	18-28	7	53.8%
	29-38	2	15.4%
	39-48	2	15.4%
	49-58	2	15.4%
	59& above	-	-

	Total	13	100%
3	Qualification composition		
	Certificate	-	-
	Diploma	-	-
	First degree	6	46.2%
	Master & above	8	53.8%
	Total	13	100%
4	Professional composition		
	Accounting & finance	5	38.5%
	Economics	1	7.7%
	Management	4	30.7%
	Other	3	23.1%
	Total	13	100%
5	Work experience		
	2year	4	30.8%
	2-5 year	5	38.5%
	Above 5 year	4	30.7%
	Total	13	100%

Source: - survey result and own computation, 2015

From the table 4.1 distribution of gender category most of the employees 69.2% of the respondent are male and 30.8% of them are female. In addition to this most of the respondents that is 53.8% are under the bracket of 18-28 years old. This shows that most of the workers are on the productive age brackets that is range of youngster age. It is very important to the organizations. 46.2% of the respondents have college degree and 53.8% of the respondents have the master. This show that in most cases they are educated and skilled it leads to productive for

the organization. Concerning their profession, 38.5% of the respondents are accounting & finance, 7.7% economics, 30.7% management and remaining, 30.7% cooperatives accounting and banking and finance area of specifications. Their work experiences also 30.8 percentage and 38.5 percentage of the respondents were maximum they have 2 years and between 2- and 5-years working experiences respectively. This shows that most of the employees are less experienced on their profession. This may affect the institution profitability and productive level. The Oromia microfinance institution after 2 year automatically merger to siinqee bank only will stay until loan payment that will be gathering from all borrowers of five year medium loan term payment while loan term beyond five year borrower will payment to siinqee bank.

4.1.2 Analysis of NPLs and loan Credits

The questions were designed to collect information from credit department employees and -loans officers with regard to responses on NPLs and credit practices of the OCSSC. Accordingly, data has been collected and the findings were presented here under in the following few pages.

Table 4.2 Employee response about practical guide line

Questions	Responses	No of respondent	Percentage (%)
What type of loan is granted by OMFI?	Short term	7	53.9%
	Medium term	2	15.4%
	Long term	4	30.7%
	Other	---	---
	Total	13	100%

Source: survey result and own computation, 2015

From the table 4.2 53.9% OCSSC loan service are short-term loan, it may be increase short run profitability of the intuition but it cannot consider long run capital gain of the intuition. And 30.7% of loan services are long-term loans it has some effect like providing of long-term loan leads the institutions to bankruptcy. Because it may be uncertain to payback and also from time to time the interest rate and other financial regulation were be changed and so on. The long-term service of the business depends on the ability to earn sufficient revenue from the customer to offset the benefit of the intuitions from its fund what it granted to the its customers. Therefore, table 4.2 shows both positive and negative implications of loans provided by the intuitions.

Table 4.3 employee response on MFIs pre-loans management technique

Questions	Responses	No of respondents	Percentage (%)
Do the OMFI consider customer performances before the granted to them?	Yes	9	69.2%
	No	4	30.8%
	Total	13	100%

Survey result and own computation, 2015

From the table 4.2 almost the majority (69.2%) of the respondents show that the institutions evaluate customer's performance loans. This shows that OCSSC have the checking mechanism to grant loan to the customers. It means that the company use pre-granting control techniques to decrease the level of nonperforming loans. However, the table also shows that there is some problem on the company to measure the customers before granting the loans to the customers. The remaining 30.8% of the respondents agreed on this.

Table 4.4 Employee Responses on customer repayment

Questions	Responses	No of respondents	Percentages (%)
Does the customer pay at the right time?	Yes	7	53.8%
	No	6	46.2%
	Total	13	100%

Survey result and own computation, 2015

From table 4.4, 53.8% of the respondents believe that the customers of OCSSC pay at the right time and 46.2% of the respondents disagree on this point. This shows that there is weak loan provision and collection system. It affects the organizations profitableness by given up good investment opportunity that may invested by uncollected fund from customers.

Table 4.5 Employee Responses on the major cause of NPLs in OMFI

Questions	Responses	No of respondents	Percentages (%)
From your experience which of the following are the major cause of NPLs insomnia?	Lack of customer awareness	9	69.2%
	Quality of Employee	3	23.1%
	Absence of motivation	1	7.7%
	Total	13	100%

Survey result and own computation, 2015

Table 4.5 shows that most of the respondent 69.2% answer there is lack of customer awareness about loans. Most of the time the customers use the loaned fund on less profitable area even for personal emergency, this leads unable to repay the loans and become nonperforming ones. In addition, 23.1%the respondent explains the reason of nonperforming loan is quality of employees' control technique, which starts from granting the loans until they repay the loan. As per the respondent of the researcher, absence of motivation is not the major factor for loan become nonperforming. So, the major case of the non-performing loans is Lack of customer awareness and Quality of Employee about granting and control technique of loan.

Table 4.6 Employee Responses on the Impact of NPLs on Performance of OMFI

Questions	Responses	No of respondents	Percentages (%)
Which of the following are the major impacts of NPLs on the performance of OMFI	On productivity (efficiency) of the organization	4	30.7%
	On profitability of the organization	6	46.2%
	On stability of the organization	3	23.1%

	Others	-	-
	Total	13	100%

Survey result and own computation, 2015

From table 4.6 most respondent or 46.2% are explained their answer the impact of nonperforming loan is mainly on the profitability of the organization. But 30.7% of respondents explained that nonperforming affect the productivity of the organization. From this and table 4.5 we can conclude that if there is lack of awareness on the customer about loans leads to decrease the profitableness of the intuitions. This means that profitableness of the intuitions has direct relationship to customer awareness. If the intuitions increase the awareness of the customer, they can possible to increase the profitableness of company.

Table 4.7 Employee Responses on evaluation technique to Minimize risk of NPLs

Questions	Responses	No of respondents	Percentages (%)
From your experience what are the best ways to minimize the risk of NPLs?	To evaluate the borrower ability & willingness to repay	7	53.8%
	To assess accept/reject decision	2	15.4%
	Others	4	30.8%
	Total	13	100%

Survey result and own computation, 2015

From the table above 53.8% of the respondents explained that to minimize NPLs the institution essential to evaluate the borrower ability & willingness to repay the loans. And 15.4% of the respondents also choice it is better to assess the accept/reject decisions. The remaining 30.8% of the respondents said that strict follow-up and supervision and loan review of the officers is the important ways to minimize the level of risk. This shows that OCSSC essential to apply the 3Cs that is character, capacity and capital of the borrower. Because ability means capacity and willingness means character and capital is financial soundness of the borrower.

Table 4.8. Employee Responses on methods of motivation

Questions	Responses	No of respondents	Percentages (%)
What type of method do you use to motivate debtors to	By telephone calling	6	46.2%
	By giving notice	4	30.7%

repay the loan or to reduce NPLs?	By sending message	2	15.2%
	Other	1	7.9%
	Total	13	100%

Survey result and own computation, 2015

From the above table most of the respondents 46.2% agree on the method of calling by telephone and 30.7% of the respondents say giving notice to the customer and 15.2% of them said that by send message to them and the remaining of them said it is better to go to their home or work place and tell them to pay their loans to the institutions and also contact personally and contact with them face to repay the loans. But use telephone calling it is very risky because it is costly and some of the customer may be switch off their telephone or change their phone No and increase the probability of nonperforming loans.

Table 4.9 Types of loan gathered by OMFI

Questions	Responses	No of respondent	Percentages (%)
What type of loans do OMFI give to the customer?	Group based loan	1	7.7%
	Individual based loans	2	15.4%
	Both of them	10	76.9%
	Total	13	100%

Survey result and own computation, 2015

From the table above 76.9% of the respondent that is almost all of the respondents said that OCSSC provided both individual and group-based loans. As we can see from table 4.2 OMFI provided short term, medium term, and long-term loans. These two tables show that if there is large number of customers in group or individual to take long term loan it is very difficult to the institutions. Because these grouped peoples may be disagreed and become dissolved their business and leads additional cost.

Table 4.10 operation system of OMFI on NPLs

Questions	Responses	No of respondent	Percentages (%)
How to operate the	By manual bases	2	23%

operations of NPLs?	By computer base	5	38.5%
	Both of them	5	38.5%
	Total	13	100%

Survey result and own computation, 2015

From the table above we can see that the operation system of OCSSC is mainly computer base that is 38.5% of the respondents agree on this point. Computer based operation system may enable the institution to provide sufficient and quality service at appropriate time and place without significant error. The above data show that the institution also uses manual based operation system, around 23% of the respondents agree on this system. Manual base may be difficult to follow up the customer's situation and very difficult to provide efficient and competent service to the customers. It also leads to corruption because it may be lost of documents if there is manual base of operation system. Manual based may decrease the satisfaction of the customer what provide by the OCSSC and the motivation of the customer to return back the loan also may affect similarly. Generally, Table 4.12 shows that the company use both computer and manual based system. However, as shown the response the intuitions neither use computerized nor manual based rather it was in the process to change from annual into fully computerized technique.

Table 4.11 Employee Responses on treatment of collaterals in OMFI

Questions	Responses	No of respondents	Percentages (%)
How to treat collaterals if loan becomes non-performing & to compensate the loss of the organization?	Sell to market by bid price	2	15.4%
	Simply use the collateral	6	46.2%
	Simply sell to the market		15.4%
	Total	13	100%

Survey result and own computation, 2015

As we shown on table 4.11, the institutions use the collaterals rather than sale to the market, 46.2% of the respondents agree on this point. But 15.4% of the respondent said the institution sell it to the market at bid price. In addition, remaining respondents are agreed on the intuitions' sell the collateral to the market if the loans become non-performing one. From this, we conclude that collateral managing system is very difficult. Because the organization use the collateral; it

changes cash to fixed asset, leads to shortage of mobilization of money in the market, and affect its liquidity.

In addition to the above data presentation, employee give their opinion on the strength and weakness of the institution, such as create business opportunity to many un employed citizen, provide adequate period to loan repayment, locate easily accessible place to the community poor market assessment, poor staff motivation.

4.2. Staff manager interview and his response

1. What types of loans granted by the institutions?

The intuitions give both individual and grouped loans

As the finding of interview from the manager Oromia credit and saving s.c give loan for individual investor and grouped one. The grouped loan includes either formal (by government) or informal group.

2. What are the criteria for granting for the customers?

Renewed his business license.

Preparing his own work plans.

Renewed his ID card.

Saving or 20%pre loans saving.

Take the Training about loan repayment.

The above response shows that after one customer assessed by his or her capacity and willingness the customer must full fill the above criteria to get loan from the intuitions’.

3. What are the major impacts of nonperforming loans?

The company profit can be decrease.

Other customers lose the service of loans.

The company employee cannot growth.

The companies lose other investment opportunities.

As the response of the manager show-nonperforming loan have multidimensional effect on the intuition. Nonperforming loans affect the profitableness of the company on one hand and the customer and employees on the other hand.

4. What are the techniques used by OMFI to manage nonperforming loans?

Supervisions of the level of loans monthly, sum-annually and annually.

Give answer for the question ‘When the customers do granted loans?’

Giving training for employees and customers about loans.

The company rule and regulation give directions for the day-to-day activities.

As the finding show, Oromia credit and saving s.c use both pre and post grant control technique to manage the negative impact of nonperforming loans. Pregranting loan control technique is essential to manage the loan before the loan is granted to the customer. But post grant control technique used the company to control the loans after it grant to customer.

In addition to above, primary data the student researcher also utilizes some secondary source of data, which mainly support the primary source in order to fulfill the shortage of data from the respondent and to answer some research questions.

1. Loan made by Oromia credit and saving s.c

Oromia credit and saving s.c guideline for” loan processing activities” group loans in time according to the maturity date thus;

- **Short-term loans:** - loan with initial maturity of one year or less.
- **Medium-term loans:** - Loans extending beyond one year but exceeding five years.
- **Loan-term loans:** - Loans exited beyond five years. Both medium and long-term loans are termed as “term-loans” and they are usually referred as such.

2. Loan grant procedures in Oromia credit and s.c

The institution has the following leading procedure for their lending loans: -

Initiation

⇒ Evaluation

⇒ Approval

⇒ Disbursement and follow up

Initiations: - The first approach win normally be to have general information about the lending procedure and the type of credit facilities available with the institution. In this perspective the customer should get complete information about loan amount requested, purpose of loan, term of loan with made up of payment, type and value of the collateral proposed to secure the loan when

loan applications received by the institution, if it is necessary to examine and identify as to who the applicant is, to ensure that the loan requested is initiated by legitimate body and the loan application is signed by authorized person.

Evaluation: - once the loan application and accompanying relevant documents are reserved check and fund to be in order to complete the loan process is evaluating by the intuitions. This includes -

⇒ Preliminary screening (selection and identification based on available general information)

⇒ Application of the “know you customer approach” a test of the basis of credit decoration i.e. five CS of credit

This are: -

⇒ **Character:** - The previous credit experience of the borrower, which includes manner of meeting financial obligation. This also includes the general institution ground history, company culture and attitude, internal and external communication.

⇒ **Capacity:** - points to be resend and evaluated under this aspect should include determination of the loan to be availed. Amount to be availed should be sufficient for smooth operation. It should neither active, which will lead to upland diversion. It includes monthly income, stability of business and the cash flow to verify.

⇒ **Capital:** - Does the customer have alternative source of capital to repay the loan in the event of adverse situations. In this connection factory like net worth, equality in home and another asset should be taken as indicator.

⇒ **collateral:** - credit is not only money expected to be repaid inclusive of cost of money (interest). Therefore, the intuitions ask security collateral to minimize the rise of loan collectables. Hence it is necessary the collateral questions.

Conditions: - General economic conditions forecast to prevail over the life of the loan stability of size and magnitude of business and the resultant income relative to these conditions.

Approval: - if the proposed loans have been found to be feasible, the institution summarizes the facts founded during evaluating stage of the loan process a format known as “loan approval form” this approval from shall be handled by committees organized at different levels. It starts from exercise of discretion by the intuitions’ loans committee and goes up to the lending power of the boards of director’s finance and credit committee.

Disbursement and follow up: - after having ascertained completion of formalities required to be met prior disbursement, the loan officer will disburse the loan. Once funds are disbursed, the institution designs a system where borrowers are persuaded to repay their loans regularly.

The researcher has found some strengths and weaknesses from data presentation and analysis part of the study.

Strengths of OMFI

There is a productive age area of the employees' composition.

Most of the employees are qualified, that is they hold first degree in their profession.

The employees have good professional compositions.

Provide both individual and grouped loan services for its customers.

There is consideration of customer performance to provide loans. It is a very important habit of the institutions.

The evaluation of the customer considers 5Cs. That is character, capacity, and capital collateral and conditions.

Using pre and post grant control techniques to manage the impact of nonperforming loans

Using computerized bases of operations.

Weaknesses (shortcomings of OMFI)

There is a lack of customer awareness about the business.

Low working experience on their professions.

The telephoning method is very costly and may switch off the telephone by the customer.

Inefficient way of treating collaterals.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATION

5.1 conclusions

This study was conducted on the “Assessing the impact of nonperforming loans on the microfinance intuitions” by taking Oromia credit and saving s.c as a case area. Financial institution is an institution that provides financial services for its clients or members. Financial institution serves as intermediaries by channeling the saving of individuals, businesses and governments in to loans or investments.

Granting loan is the primary function of micro finance institution. When financial institution granting loan to their customer there may probability for the existence of default loan. It means that nonperforming loans are controversial issue for all micro financial institution. The student researcher interested to assess the impact of the impact of nonperforming loans on micro finance intuitions. Especially the researcher study was concerned with identify the major cease of nonperforming loan and control technique to manage it. For this research paper, both primary and secondary data sources were used. After the data was gathered from different source, it was analyzed using descriptive methods to the indicated result.

The major parts of data analysis and interpretation are presented as follow: -

Most (53.9%) of respondent agreed that, Oromia credit and saving s.c loan service are short term loan. But the institution providing all type of loans.

Majority (69.2%) of the respondents show that the institutions concede customers performance before granting the loans.

46.2% respondent of the study also believes that there is problem on customer to repayment of the loan.

Most of the respondent agreed on the prevalence of low customer awareness about loans.

Most respondent or 46.2% are agreed on the impact of nonperforming loan is on the profitability of the organization.

The institution uses both manual and computerized operation system.

Almost all of the respondents agreed that OCSSC provided both individual and grouped based loans

Most respondent believe that the institution essential to evaluate the borrower ability & willingness to repay to minimize the risk of nonperforming loans.

Most of the respondents argue that to minimize NPLs the institution essential to evaluate the borrower ability & willingness to repay the loans.

The institutions mostly use the collaterals as compensation for uncollected loan.

Based on the above major finding of the study the following conclusions were made;

As the research finding shows us that, the institution providing all type of loans. That is long term, medium term and long-term loans. However, it may have its own some effect on the institution. Short-term loan of the institution may be increase short run profitability of the intuition but it cannot consider long run capital gain of the intuition. But short-term loan may decrease the level of nonperforming loan by narrowing loan repayment time. Long-term loan may have some effect on the institution like bankruptcy of the institutions by decrease the amount of loan repayment. Mostly if long-term loan increases the level of nonperforming loans. The institutions also consider customer performance before providing or granting loans to the customers. But even though there is consideration, there was also lack of customer awareness about the business for what purpose they borrowed. It means that most of the time the customers use the loaned fund on less profitable area even for personal emergency, this leads to the customer unable to repay the loans and become nonperforming one. The major impact of NPLs on the institution is that, on the profitability of the organization. Beside to that nonperforming loan affects the institutions' productivity and stability of the organization.

Oromia credit and saving s.c provides both individual and group-based loans. However, grouped leads disagreement between individuals and become dissolved their business and leads additional cost. The institution uses both manual and computerized operation system. Computer based operation system may enable the institution to provide sufficient and quality service at appropriate time and place without significant error. The custom of customers to repay the loan is very weak. It may affect the organizations profitableness by given up good investment opportunity that may be invested by uncollected fund from customers. Regarding collateral management of OCSSC has very poor management system. Because their uses the collateral rather than sale it to the market. It may affect mobilization of money in the market and its liquidity by changing the cash of the intuition into fixed asset of the borrower.

5.2 Recommendations

It was believed that, the key to proper credit administration lies on the ability of the OCSSC's management office. The following are some of the suggestion of the researcher. The porpoise of OCSSC's loans departments and concerned parties for the handling of credit and preventing nonperforming loans;

The MFI must try to diversify its loans types such as Agricultural loans, Commercial and Industrial loans. Since most of the outstanding balance of the short- and long-term loans. But the institution must be emphasis on short term loans and medium-term loans because short term loans are very importance to the institutions and also encourage fixed deposit rather than current

deposit. After two-year OCSSC merger to Siinquee bank, they will get more capital and more profitability by performing best financial performance. If the researcher will be study on siinquee bank, they will extremely good if determined loan amount and conducting proper time repayment of agreement. However, after year all decision will be decided only by siinquee bank.

The institution should provide training about entrepreneurship and credit awareness and give technical assistance to the customer before granting the loan.

It is advisable to the institutions must be considered seriously the impact of environmental factors such as natural disasters during the credit assessment process.

Once found are disbursed, the bank designs a system where by borrowers are persuaded to repay their loans regularly. The institutions must have to develop strong loan collection and follow-up system to collect the dispersed loans before it becomes non-performing after granting the loans.

The company should use fully computerized based operation system provide sufficient and quality service at appropriate time and place and for company's attractiveness.

The institution must develop a strong credit assessment, analysis, follow-up, and credit review program to facilitate the controls of loans of customers. Generally, the intuition should strengthen its own pre and post grant control technique to manage the impact of nonperforming loans.

It is advisable to the institution to provide incentives techniques for the borrowers to motivate them to repay back the loan what they borrowed.

The institution has to increase the number of well-experienced professionals, especially proposal analyzing professional to protect false or wrong full business activities. This gives strength to the institutions.

Finally, OCSSC should use fair market of the collaterals as compensation for uncollected loan. Otherwise, it may affect mobilization of money in the market and its liquidity by changing the cash of the intuition into fixed asset of the borrower.

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APPENDIX

WOLKITE UNIVERSITY

COLLEGE OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING & FINANCE

Questionnaire will be filled by employees

This questionnaire will be prepared to collect information for the purpose of research on the title of “Assessing the impact of non-performing loans on micro financed institution” for partial fulfillment of BA Degree in Accounting and Finance. The study is only focused on educational purpose and your responses have never any impact on any other entity. The study area is Oromia credit and saving Share Company (OCSSC, jimma branch). I will like to thank you for your cooperation in advance. Uses (√) mark in the box.” Don’t write your name”.

Personal Data

Sex

Male Female

Age

18-28 49-58
29-38 above 59
39-48

Education status

Certificate First degree
Diploma Master and above

About your work experience

Less than 2 year above 5
2-5

Questionnaires for OMFI employees

What is your area of specification?

Accounting & finance Management
Economics other_specify_____

Terms of loans granted by OMFI

Short term long term

Medium term

What are the basic requirements granted loans to the customers phase specify _____

Does the micro finance institution consider customer performance before the loan granted?

Yes No
If your answer in no.4 is yes please explain _____

What type of contribution does the OMFI played to the unemployed (i.e. frictional unemployment) please try to explain _____

What are the major causes of non-performing loan (NPL) on the MFIs?

Lack of customer awareness
Inability of the employee's performance
Absence of employee's motivation
If any _____

What type of loans do you give to the customer?

Group based both
Individual based

Which of the following method is use to motivation of creditors is importance or reducing non-performing loans?

By telephoning by giving notice
By sending message other
method _____

10. Which of the following is the major impact of NPLs on MFIs?

On productivity of the organization
On profitability of the organization

On suitability of the organization

All

11. From your experience what are the best ways to minimize risk of NPLs?

To evaluate borrower's ability & willingness

To assessing, accepts or reject decision

If _____ any
other _____

12. Does the customer pay at the right time?

Yes

No

13. How the institution does operate the operation of NPLs?

By manual basis both

By computer basis

How to treat collaterals if loans become non-performing & to compensate the loss of the organization?

Sell by the market

Simply use the collaterals as it is

Simply sell to the market directly

Other

methods _____

Interview question for staff manager

1. What types of loans granted by the institutions?
2. What are the criteria for granting for the customers?
3. What are the major impacts of nonperforming loans?
4. What are the techniques used by OMFI to manage nonperforming loan?
5. What are the main reasons loans becoming nonperforming?