



**THE EFFECT OF CORPORATE GOVERNANCE ON SAVING AND CREDIT
COOPERATIVE UNIONS FINANCIAL SUSTAINABILITY; THE CASE OROMIA
NATIONAL REGIONAL STATE OF ETHIOPIA**

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Abstract

The main objectives of this study was to analyze the effect of corporate governance on financial sustainability of SACCO Unions in Oromia national regional state of Ethiopia. The Gender Composition of Management Committee, Controlling Committee Role, Management Committee Size, measured the effect of corporate governance, on financial sustainability and Management committee independence, financial sustainability of the SACCO Unions was analyzed using multiple regression. From A sample 225 primary Sacco's was drown from Eight Unions having started their operation before 2008. The investigation and data collected was analyzed using descriptive statistics and multiple regression model to evaluate the effect of independent variables on dependent variable using SPSS 24 version. The study had shown weak corporate governance in Sacco Unions. Sacco's management committee elected by the general assembly to lead the unions without any knowledge of financial and cooperative leadership skill. There is no separate enforcing financial and operational regulation to guide the unions to apply cooperative laws to practice the Corporate Governance Functions (indicators) in the region at all. There is no role difference of management committee and hired management of the unions. Limited number of women in leadership, weak supervision of control committee. Most unions Management committees are dependent on chief officers (managers and employees) of the unions. As a result, the sustainability status of the SACCO unions in the region indicates 48% only. While the rest 52% of them are in danger to failure. By this study, we recommend that the least performing SACCO Unions should apply the corporate governance principles and try to design strategies to include educated, youth and women leaders, capacitate controlling (control) committees to check and balance the activities of both management committee and managers from dependence on external



funds and fraudulent actions that harms the sustainability of the unions. The region needs to have strong financial and operational regulations for saving and credit cooperative to apply corporate governance principles and values accordingly.

Key Words: *Saving and credit cooperatives, Unions, Financial Sustainability, Corporate Governance*

1. Background of the Study

According to Ethiopian cooperative proclamation No. 985/2016, cooperative societies saving and credit cooperative union” means a secondary level cooperative society established by primary cooperative societies having similar objective with a minimum number of members as prescribed in the Proclamation to provide service or to engage in activities that are beyond the capacity of primary cooperative societies;

In Ethiopia Cooperatives including SACCOS are key grassroots level organizations, which are critical instruments in implementing the objectives of various development programs and strategies such as rural development programs, poverty reduction, industrial development, agricultural marketing, food security programs, and financial intermediations (Wolday Amha 2012). In particular, SACCOS are locally established financial institutions to meet the financial needs of community, particularly to assist the poor who were not accessed to the formal financial systems in Commercial Banks and Microfinance Institutions and they considered the poor community as a risky option. Furthermore, the costs of accessing the credit worthiness of poor clientele was high compared to financial cooperatives. SACCO unions are safe financial intermediaries to provide financial service to their member and/or middle-income community and their associations with fair lending financial costs (EIFTRI, 2012, Kinde, 2012).

According to Federal cooperative agency report of (2019), despite the difficulties experienced, SACCO’s movement in Ethiopia had registered numerical growth over the past decades in terms of both number, membership and capital. However, membership was still much smaller towards the huge potential. The table below indicates that SACCOS have been constantly growing in terms of number, membership and capital mobilized over the period and contributing 4.29% to the national domestic saving.



According to Paraveen (2009), for any financial Cooperatives to be sustainable, it needs to have effective Corporate Governance System. Corporate governance is the scheme in which the SACCOs were directed and controlled in order to accountable to the members. It represents the bylaw, principles and values in which the power of the leaders exercised in the management of its assets and other resources to satisfy the needs of member societies.

According to Kifle, (2015) the major SACCOs challenges identified were Weak Corporate Governance, limited financial outreach, inefficient, and unsustain growth trends, lack of Management committee's financial knowledge , absence of financial regulation that govern their financial and operational activities.

The researchers concerned to investigate the effect of Corporate Governance on the financial sustainability of SACCO unions using five independent variables, namely the Number Of Women In Management Committee (NMW), Management Committee Independence, Internal Monitoring, Control Mechanisms, Corporate Governance Strength, Management Functions (Adams & Mehran, 2012; Andreou et al., 2014), some of which were used in this study. The number of Women in management committee represents the consistent number of members on a Management committee of directors; management committee independence was measured using the number of independent/non-executive committee member of a management committee, while control committee role was the number of control committee members of the societies. The intention here was to understand the dynamics of financial sustainability from the perspectives of corporate governance.

2. Research Methodology

The study adopted cross-sectional sample survey, in which questionnaires and document review used to collect data from Primary and SACCO Unions for analysis using descriptive statistics. Descriptive research design was applied, which involved the collection of longitudinal data. In this type of research design, quantitative descriptions of the trends, attitudes or opinions of a population obtained by studying a scientifically selected sample (Creswell, 2003; Mugenda & Mugenda, 2003). descriptive study describe or define a subject, often by creating a profile of a group of problems, people, or events, through the collection of data and the tabulation of the



frequencies on research variables or their interactions (Cooper & Schindler, 2006). The target population of the study was 225 primary SACCOs member to eight unions in operation and registered before 2008. The sample fairly represented the whole population and considered large enough to provide a general view of the entire population and serve as a good basis for valid and reliable conclusions. Primary data collected by means of observation and enquiry. To ensure the validity of the data collected, both internal and external validities were tested.

3.4. Sample Design

In Oromia National Regional State, there are 28 SACCO Unions (OCA, 2017). Multi-stage sampling technique was used to select study units. At the first stage, using three criteria, the seniority of the SACCOs Unions and large membership year of formation, size, and capital positions.

From the purposively selected 9 SACCO Unions, the researcher will randomly select five member SACCOs and five committee members as individual respondents considering the same criteria /followed. The sample size is determined by applying the following Yamane (1967) formula for sample size determination.

$$n = \frac{N}{1 + N (e)^2} = \frac{520}{1 + 520 (0.05)^2} = 225$$

Where

n = Sample Size

N = Population Size

e = Level of Precision. The level of precision is the range in which the true value of the population was estimated to be; it is expressed in percentage points (± 5).



S.N	Name Of Sacco Union	Number Of Society Selected	Number Of Respondent From Each Society	Total number of responders	Location Zone
1	Ifa Boru	5	5	25	Arsi
2	Qalata	5	5	25	Arsi
3	Duro Shala	5	5	25	W/Arsi
4	Abdi Gudina,	5	5	25	E/Shewa
5	Awash	5	5	25	E/Shewa
6	Biiftuu Batu	5	5	25	E/Shewa
7	Aga Dhagayii	5	5	25	E/Welega
8	Gudatu Gimbii	5	5	25	W/Welega
9	Waltane Ambo	5	5	25	W/Shewa
	Total	45		225	

Table 1.1: The primary societies selected for investigation are the following

3.5. Methods and Tools of Data Collection

The study needs both primary and secondary data and it requires qualitative and quantitative data. So the primary quantitative data was gathered from 172 members and societies directly through semi Structured Interview Schedule (SIS). Additionally, qualitative information collected from members of management committee, employs of the Unions (Union Managers, Accountants, credit officers and member service officers) through checklist. Focus group discussions was undertaken with key stakeholder’s supervisors (auditors and inspectors). The secondary information was gathered from the documents of the sample SACCOs (audit reports, financial record books, member saving books and ledgers, and other reports produced by the Management committee, region zonal and woreda SACCO promotion Agencies.



3.6 Methods of Data Analysis

To achieve the stated objectives specified data analysis such as descriptive statistics, variance analysis, and regression analysis were applied. To ensure the validity of the data collected, both internal and external validity were tested. Internal validity refers to the ability to draw conclusions from the study in a confident manner (Schram, 2005), and shows the causal relationship between the variables and the results obtained from the study. Pilot testing used where the respondents, to take corrective action, issued questionnaires to a small number of SACCO Unions s in order to anticipate problems of understanding the questions or any other source of confusion. Multiple regression model were employed to analyze the effect of independent variables on dependent variable.

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \dots + \beta_n X_n + E$$

The regression model applied for the SACCO corporate governance variable was as follows:

$$Y = \beta_0 + \beta_1 NMW + \beta_2 MCIND + \beta_3 CC\text{ ROL} + \beta_4 MCS$$

Where:

β_0 is the intercept i.e. $Y = \beta_0$ when $X_1, 2, 3, 4, k = 0$

$\beta_1, \beta_2, \beta_3, \beta_4 \dots \beta_k$ are the regression coefficients of the contribution of each measure of the independent variable.

The final model for Union’s corporate governance was as presented below:

$$\text{Log (FSS)} = 1.9905 - 0.615311 \text{ NWMC} - 0.1023330 \text{ CC ROL} - 0.211332 \text{ MCIND}$$

There is significant effect on the number of Women in Management Committee, Independence of Management Committee, and the Control Committee Role on the financial sustainability of the Unions. This means a unit increase in the number of Women in Management Committee increases the financial sustainability by 0.515311, and how often control committee increase their supervision frequency on the operations of the Unions, the financial sustainability increased



by 0.7433. The management committee independence from interference has also significant effect on Corporate Governance of the unions.

4. Result and Discussions

As stated in the literature review, the effect of corporate governance on the financial sustainability of the unions, Measured using five independent variables, namely the Number of Women in Management Committee (NMW), Management committee Independence, Control Committee Role in Decision Making Management Functions (Adams & Mehran, 2012; Andreou et al., 2014). Some of which were used in this study. The number of Women in management committee represents the consistent number of women members in Management committee; management committee independence was measured using the influence of non-executive committee member of a management committee, while control committee role was the number of control committee members of the societies. The intention here was to understand the dynamics of financial sustainability from the perspectives of corporate governance.

4.1.Composition of Women in Management Committee

Ethiopian coop. proclamation 985/2016, sub article 34, states that” where there is possible number of female, at least 30% of any cooperative society management committee shall be held by female members”. Leader’s gender diversity or the higher combination of women in management committee enhance corporate governance and firm sustainability (Fields & Keys 2003). The higher the number of committed and effective percentage of women in management committee have positive affect financial sustainability of the unions. As the firms making commitment to increasing the number of women in management committee they increases the firm’s efficiency and commitment, Carter et al. (2003).Gender diversity of management committees provides directors to more pay for performance motivations and that the management committees meet more frequently, Adams & Ferreira (2002). According to Cox & Blake (1991), managing management committee diversity can create competitive advantage for firms in six areas. These are cost, resource acquisition, marketing, creativity, problem solving, and organizational flexibility, which can directly affect the financial sustainability of the firms in one another.



Regression results of number of women in Management committee and financial sustainability indicates that there was significant relationship with financial sustainability as measured. A p-value of 0.039 was reported, which is less than 0.05. The results were significant at the 5% level. As the number of NWMC increases, so Financial Sustainability also increases. The study results indicate that there is a significant effect of NWMC on financial sustainability of Sacco Unions. A large number of NWMC result a better decisions since the management committee members made up of a pool of men and woman experts from different segments of the Experience, skill and exposures in their society. Better decisions be made and this result to better Sacco Unions performance. Better performance then lead to financial sustainability. This research finding indicates that increasing the number of women in management committee exerts a significant influence on Financial Sustainability of SACCO Unions. These findings support the term” Any cooperative society shall include requirements necessary to encourage participation of female members in the management committee of the society. Any cooperative society shall include activities to increase the active participation of women, youth and the disabled in their strategic and annual plans.

4.2.Management Committee Size

Ethiopian coop. proclamation 985/2016 sub article 34, “Any cooperative society shall have a management committee which are loyal and respectful and can overcome their responsibility and accountable to the general assembly and whose members and manner of election to be determined in the by-laws of the cooperative society”. Management committee is a central institution that is involved in the internal corporate governance of cooperatives (Guest, 2009). Its role is to monitor the activities of management and ensure protection of the interests of all members, as outlined by the members’ theory of corporate governance. Furthermore, it is the mandate of the management committee or Management Committee to resources utilized in the creation of wealth for the members, which is in line with the resource dependency theory of corporate governance (Franken & Cook, 2013; Lefort & Urzua, 2008). The management committee should protect the Unions from internal/external interferences as outlined in the political theory of corporate governance. The management committee should avoid nepotism, corruption, mismanagement and financial indiscipline in Unions, which are a manifestation of political interference with the management of



firms (Abdullah & Valentine, 2009). The number of its members determines the size of a management committee, which is in turn dependent on the profitability and financial sustainability of the SACCO Unions (Guest, 2009; Chenuos et al., 2014). The optimal size of a management committee was not clearly stated in the proclamation for all types of cooperatives. Depending up on their type and size of SACCO Unions suggested a minimum of five and a maximum of nine members; Kiel and Nicholson (2003). SACCOs with an average management committee size should be more financially sustainable (Guest, 2009; Horváth & Spirollari, 2012; Chenuos et al., 2014), because it's advantage, the diverse experience of the members and at the same time reduces disagreements during the process of decision making (Horváth & Spirollari, 2012).

The regression results of number of management committee and Financial Sustainability. The results show that there was significant relationship between number of management committee and financial sustainability as measured by Financial Sustainability. A p-value of 0.0312 was reported, which is less than 0.05. The results were significant at the 5% level. As the number of members on a management committee increases, so Financial Sustainability of Unions also increases. The study results indicate that there is a significant effect of number of management committee on financial sustainability of the unions. A Unit increase in the number of management committee increases the financial sustainability also increase by 0.8418. The results indicate that as number of management committee increases so does financial sustainability. A large number of management committee members result to better decisions since the management committee made up of a pool of experts from different sectors of the economy. Better decisions could made and it result better performance. Better performance then lead to financial sustainability of SACCO Unions.

Therefore, the study findings indicate that number of management committee exerts a significant influence on Financial Sustainability. These findings support the previous findings of Kifle (2015), Amha (2015), John et al. (2008), Yared (2008) who found that a positive relationship exists between number of management committee and financial sustainability as measured by financial sustainability.

4.3. Control Committee Role

A control committee is an independent committee elected by general assembly, which oversees and ensures SACCOs corporate governance, responsibility, and promotion of efficacy in controls.



The existence of control committee enhance accountability and transparency, thereby exposing transactions that hurt the interests of members. (Rezaee, Olibe, & Minmier, 2003). The control committee also enhance protection of members' interests, against interference, and ensure proper resource utilization (Abdullah & Valentine, 2009). SACCOs with control committees expected to be financially sustainable since accountability was enhanced and managers put in check (Rezaee et al., 2003).

The regression results show that a significant relationship exists between control committees role and financial sustainability as measured. A p-value of 0.0111 was reported, which is less than 0.05, hence the significant influence. Based on the above results, the null hypothesis is rejected, thereby concluding that control committees exert a significant influence on financial sustainability at 5% significance level. The results also indicate that the control committee role significantly influences financial sustainability. The present study findings indicate that control committees exert a significant influence on financial sustainability.

A SACCO Unions' corporate governance, measured by committed control committee; therefore, it exerts a significant influence on financial sustainability of Sacco unions. The finding support the agency theory relied upon by this study. Control committee ensure members interest protection, to control loan process, to aware managers and management committee members aware of their actions toward goals achieved. As control committee become strong and inspire, to monitor, theft, embezzlement, avoids unnecessary costs, reduces interest of conflicts that may raise. Therefore, as the management of Sacco unions become strong, operational and financial efficient, the firm increases and ensure financial sustainability.

4.4.Management Committee Independence

Management committee independence determined by the number of non-executive directors on a management committee (Horváth & Spirollari, 2012), as an independent or non-executive director is not an employee of the firm and has no financial or family ties with management (Adams & Mehran, 2012; Franken & Cook, 2013; Horváth & Spirollari, 2012). Management committee independence for SACCOs enhances the protection of members interests, protects the SACCO against political interference, smooths the acquisition of resources for members' wealth creation,



and can minimize agency conflict (Abdullah & Valentine, 2009; (Amess & The existence of an independent management committee enhances accountability, which would result in financially sustainable operations (Horváth & Spirollari, 2012, Chenuos et al., 2014).

5. Conclusion

The main objective of this paper was to analyse the effect of corporate governance on financial sustainability of SACCO Unions in Oromia National Regional State of Ethiopia. All independent variables derived from theoretical framework and empirical studies measures the SACCO Unions corporate governance indicated significant influence on financial sustainability. Therefore it was concluded that the number of women in management committee, and control committees roles do exert a significant influence on Financial sustainability of SACCO Unions.

The findings of the study indicate that corporate governance was one of the factors that influence a SACCO Unions financial sustainability in the region. SACCO management committee size was also found to influence financial sustainability; as the management committee size increases, so financial sustainability also increases. A larger number of management committee would result in better decisions being made for the benefit of all the members, and would increase a union's ability to deal with complex situations. This was the case, because management committee members sourced from different primary societies in the sector and considered to have vast knowledge to solve complex financial and leadership problems that assures the sustainability of the unions.

Control committee was the other measure of corporate governance, was also found to exert a significant influence on financial sustainability; SACCOs that had effective control committee members were more likely to be financially sustainable than those that did not. The control committees, resulting in accountability of the management committee, could attribute to the enhancement of the unions internal control systems. Furthermore, the existence of control committees reduces agency cost and conflict, and work for the benefit of member society

6. Recommendations

- 1) The effectiveness and sustainability of SACCO Unions depends on the skill of management committee/board members/ elected from the member societies. Competent management committee plays a key role in leading the unions in principle and reducing



agency costs by overseeing management's behavior. The cooperative promotion authority should be concerned on the skills the elected/candidates to be elected for management committee should possess the required financial in addition, leadership knowledge to understand the financial conditions, risks and reporting of the unions. Therefore, we recommend that the concerned authority shall fix for Age, Gender, Education level, experience, professional and ethical values that the management committee members to fulfill to be elected for SACCO Unions.

- 2) Women participation in leadership should be encouraged and supported accordingly to the proclamation.
- 3) Both management and organizing government agency should respect management committee independence for decision making at the union level.
- 4) Independent and active control committees, Internal Credit Committee has to be encouraged and supported.
- 5) The SACCO Unions shall form their own regional/national apex management committee that supports the Provision of relevant trainings in governance, risk management, credit and savings mobilization based up on the needs assessment of member SACCO unions.
- 6) The government shall allot Comprehensive financial and operational regulations that guides Effective Corporate Governance for SACCO unions in the region.

7. Further Research Investigations

Finally, we recommend that conducting further and in-depth study on corporate governance of SACCO unions with broader perspective in cooperation with academicians, practitioners, researchers, supervising agency and other stakeholders. Further research could be conducted on factors affecting sacco unions financial sustainability based on age of establishment, capital they owned, Categorizing Rural and Urban.

Acknowledgement

I greatly value the intellectual guidance, thought provoking and invaluable comments, patience and constructive criticisms from Dr. Workneh Abebe. I am really highly indebted for his



assistance. I also wish to thank my wife Gadise Lemi, for her encouragement during the time pursuing this degree.

My heartfelt acknowledgement also goes to Professor S.Nakkiran, Dr.M.karthikian Mr. Dagnachew Shiferaw, for their countless contributions. To all others who contributed in many ways towards the completion of this thesis, feel honored and appreciated, and may the God Almighty bless you all. Thank you all!

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