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A STUDY ON IMPACT OF INTEREST RATES ON CREDIT AND LOAN REPAYMENT IN ETHIOPIA WITH REFERENCE TO CREDIT COOPERATIVE UNIONS

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ABSTRACT

Interest rate is an impact on demand for credit because the higher the cost of loan is leads to inability to repay the loaned amount by customers. Again the lower the interest rate by itself also has impact on the development of investment in the country. From the lenders perspective, the interest rate is considered as the premium paid to savers for making surplus funds available to financial intermediaries. From the borrower's point of view, the interest rate is the user cost of capital incurred by using funds for investment. This paper focuses on to identify on impact of interest rates on credit and loan repayment in Ethiopia with reference to credit cooperative unions. To achieve this objective, the study was employed by using both descriptive and explanatory research design with quantitative and qualitative methods with simple random sampling, which is used to select sample co-operatives and members. Since the members of the cooperatives are homogenous in nature, then 100 samples are selected for the study. From this the descriptive statistic finding shows that there were significant association between dependent variable with respect to education level, loan diversion, loan size, training, time laps between loan application and disbursement, repayment period and all business types. Researcher found the significance difference between defaulters with respect to age, family size, and number of dependent's, business experience, repeatedly borrowing, and supervision.

KEYWORDS

Ethiopia, interest rates, impact of interest rates, credit cooperative unions.

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INTRODUCTION

The existence of clear and accommodating governmental policy and all-inclusive structures and the government's commitment to transform the subsistence economy have created conducive environment for the development of voluntary based cooperatives in the country. Microfinance has been addressed by many to be one of the most effective tools in fighting global poverty in the developing world. It has been especially effective and beneficial in bringing products such as savings deposits, insurance and credit to the customers. (Fobozzie frank. J Foundations of financial markets and instaurations page 202) there is no one interest rate in any economy. Rather, there is a structure of interest rtes. The interest rates that a borrower will have to pay depend on a many of factors. Experts agree that high interest rates intuitively make it more difficult for poor people to repay micro loans; High interest rates in the sector are generally seen as related to the high operational (and transaction) costs involved in providing high numbers of what are often considered to be relatively small loans. Another commonly cited driver of interest rates is the need for MFIs to achieve financial sustainability. Some have suggested that high interest rates might only justifiably be criticized where they produce excessive profits for MFIs, or where they result from operating inefficiencies that could be avoided (Rosenberg, Gonzalez and Narain, 2009).

With respect to the impact of interest rates on demand and indebtedness, the evidence is inconclusive and the literature raises a number of qualifications to the notion of a straightforward relationship between high interest rates and negative effects on borrower wellbeing, Where high interest rates ensure the profitability and sustainability of the sector, and therefore the capacity of lenders to reach out to poor and remote users, some have argued that the impact of high rates, therefore, needs to be judged against the relative harm of poor people not having access to microcredit at all (Roodman, 2011). (Mankiw) p.327, Interest rate, the higher interest rate in turn has two effects those were: The higher IRT reduce investment, the long run implication is reduced capital accumulation and lower economic growth. And also the higher IRT reduce demand for money, and this allows a higher level of income for any given money supply.

Helms and Reille (2004) argue that interest rate have an impact on demand of credit and repayment.

OBJECTIVE OF THE STUDY

This paper focuses on to identify on impact of interest rates on credit and loan repayment in Ethiopia with reference to credit cooperative unions.

SCOPE OF THE STUDY

The scope of the study covers the conceptual, geographical and the time scope. Conceptual Scope - the study was focus on examining issues related to identify on impact of interest rates on credit and loan repayment in Ethiopia with reference to credit cooperative unions. Geographical Scope -the research was carried out geographically Ethiopia. Time Scope - The study used the most recent year data from the fiscally year of 2012 to 2018.

RESEARCH GAP

The review of literature has shown some theoretical and empirical gaps that necessitate this study. The direct link between effects of interest rates charged by MFIs to borrowers and the demand for credit did not come out clearly under the studies reviewed. Therefore, this study aims at focus on examining issues related to identify on impact of interest rates on credit and loan repayment in Ethiopia with reference to credit cooperative unions. Recent theoretical and empirical work in economics has established that credit markets in developing countries work inefficiently due to a number of market imperfections. The literature cites a number of market imperfections which lead to loan default.

THESE IMPERFECTIONS INCLUDE

1) Interest rate ceilings usually imposed by the government.
2) Monopoly power in credit markets often exercised by informal lenders (Bell et al., 1997).
3) Large transaction costs incurred by borrowers in applying for loans.
4) Moral hazard problems are some of them Koopahi and Bakhshi (2002).

METHODOLOGY OF THE STUDY

This paper focuses on to identify on impact of interest rates on credit and loan repayment in Ethiopia with reference to credit cooperative unions.

RESEARCH DESIGN

The study was employed by using both descriptive and explanatory research design with quantitative and qualitative methods. The quantitative aspect of the data focused on description of socio- economic variables, loan and related variables, and business related variables and analysis of relationship among the dependent and explanatory variables of the union.

POPULATION AND SAMPLING TECHNIQUE

Currently the number of cooperatives registered by Ledet saving and credit union has reached 137. Out of this ten of them are selected randomly for the study with random sampling technique, which is used to select sample co-operatives and members. Since the members of the cooperatives are homogenous in nature, 100 members from the 10 cooperatives are selected to fill the questionnaires.

DATA COLLECTION METHODS

Data were collected using primary data gathering tools of questionnaire, personal interview, and the researcher's onsite observation. Questionnaires that contain both open and closed ended questions are prepared and distributed to staff members and to members of the cooperatives selected randomly. Interview is also prepared and administered again to both employees and members of the cooperatives.

The researcher was also collected literature relevant to the subject before and during the study (interest rates and loan repayment) in banks, other saving and credit institutions, obtained from previous studies, text books, internet, journals and reports from the union itself under secondary data requirement.

DATA ANALYSIS METHOD

Data from the field was carefully collected, classified, edited, and basing on clarity, completeness, accuracy and consistence to ensure reliability. Data analysis was based on the objectives of the study and done by use of Statistical Package for Social Sciences on collected data to draw meaningful interpretation and conclusion to give findings and suggestions, which reflect a high magnitude of the problem, were selected from interview, observation and questionnaires. And, the raw data are analyzed, presented, and interpreted to give solutions for the research problem. Some of the data were summarized and presented in tables and graphs. Percentages for these data are calculated in order to facilitate the analysis and to make it presentable for the readers. Since the data collected is more of qualitative in its nature; it is presented by using descriptive analysis**.**

The model's description was fashioned to capture the relationship between the dependent and independent variables as stated below.

DC = f (IR, PRO, OE)………………………………………… (1)

Where

- DC- is the demand for credit which is defined as the amount of loan applied for by the SME and households.
- IR- is the Effective Interest Rates charged by MFIs,
- PRO- is the annual profit and
- OE- is the Owner's equity.

Multiple Regression analysis was used to analyze the relationship between interest rate and demand for credit or loans as stated above. The independent variables were interest rate, profit and owner's equity. The annual profit was meant to show the viability of the enterprise and likelihood of being considered for loans by the lending institution. The following Multiple Regression Model description will be used to capture the relationship between the variables.

$Y_t = \alpha + \beta 1X1 + \beta 2X2 + \beta 3X3 + e$ ……………………………………………… (2)

TABLE 1: OPERATIONAL DEFINITION OF VARIABLES

Symbol	Variable
Y	A Constant term
X1	Credit Demand(loans extended to the SMEs)
EIR	The Effective Interest Rate which is the actual price of the loan that the borrower pays
X2	Annual profit before interest payment (EBIT)
X3	Owner's equity
E	Error term normally distributed about a mean of 0
β1	Interest rate elasticity of demand for credit
β2	Profit elasticity of demand for credit
β3	Owner's equity elasticity of demand for credit
T	Period between 2012 to 2018

Priori restrictions were that $\beta 1<0$, $\beta 2>0$, $\beta 3>0$. The relationship acknowledges that interest rate influences the demand for loans (Nehman, 1973). This was expected on both empirical and theoretical grounds.

REGRESSION ANALYSIS AND RESULTS

The research findings indicated that there was a very strong positive relationship (R= 0.942) between the variables. The study also revealed that 88.5% of demand for credit by SMEs could be explained by the variables under study. From this study it is evident that at 95% confidence level, the variables produce statistically significant values and can be relied on to explain demand for credit. The findings are as shown in the following Tables:

TABLE 2: REGRESSION ANALYSIS

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
	.942	.887364	.399	.94425

TABLE 3: ANOVA

Model	Sum of Squares	Degree of f.dom	Mean Square	F	Sig.
Regression	1.518	99	.138	.746	.004
Residual	.185	1	.185	NA	NA
Total	**1.702**	**100**	NA	NA	NA

Source: Research Data 2018 (Ethiopian calendar)

TABLE 4

Coefficients	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant) beta	2.131	.138	.156	.947	.350
Effective interest rate	.880	.198	.069	.403	.031
Annual profit (EBIT)	.799	.232	.258	1.289	.016
Owners'Equity	.648	.131	.192	1.123	.029

Source: Research Data 2018 (Ethiopian calendar)

From this study it was evident that at 95% confidence level, the variables produce statistically significant values for this study (high t-values, $p < 0.05$). A positive effect is reported for all the variables under study hence influence the demand for credit by the saving and credit cooperatives union positively. The results of the regression equation below show that for a 1- point increase in the independent variables, demand for credit by individuals is predicted to increase by 2.131, given that all the other factors are held constant.

The equation for the regression model is expressed as:

Y = a+ β1X1+ β2X2+ β3X3 +£

Y= 2.131 + 0.880X1 + 0.799X2 + 0.648X3

Where

- β1, β2 and β3 are correlation coefficients
- Y= Credit demand
- X1= Effective interest rate
- X2= Annual profit (EBIT)
- X3= Owner's equity

ANALYSIS AND FINDINGS

- This research sought to evaluate the effect of interest rates on demand for credit and loan repayment in the country. Further, 58% of the respondents were male and 42% of them were female. Majority (55%) of them were business owners hence could give the relevant information sought. All the respondents had attained grade 10 and diploma level of education hence could articulate the issues under study easily. A significant 65% of them had been in business for between 4-10 years to qualify for credit from lending institutions. 88% of them indicated that they were small scale enterprises. 77% of them were in the trading industry, 22% of them were service industry, and the remaining 1% of them from the manufacturing industry.
- Another 65% of them indicated that their primary source of financing was through savings. 23% of them indicated that they had obtained loans and the remaining 12% of them indicated otherwise. Studies carried out by International Labor Organization (ILO) following financial crises in East Asia (Mark 2003), on financial support for micro and small enterprises in Thailand, revealed that 36% of these enterprises had difficulties in arranging start-up funds, 55% had funded their enterprises with their own funds, 17% obtained funds from government subsidized programmers and 20% of the survey group had borrowed from a bank. 50% of them indicated that they had obtained loans twice after startup phase.43% of them had applied for amount between cash 1-50,000; 26% of them cash amount between 200,000-500,000, 20% were 100,000-200,000, 10% between 50,000-100,000 another 1% of them had applied for amounts between 500,000-1,000,000. However, majority of them categorically indicated that they amount they had applied for were not the amount they received. These study findings complement the findings of (Swain, 2002) who established that loan quantity rationing arises when the potential borrower is denied credit while loan size rationing occurs when the loan amount received by the borrower is smaller than the one they demanded.
- 78% of the respondents categorically indicated that they were charged interest rates of 12%. They were followed by those charged 13% represented at 12% and the rest 10% were the interest rate is14%. Possession of collateral (2.9745) was the most important aspect for one to access credit from lending institutions. This was followed by availability of guarantors (2.6854) and financial statements (2.8642) respectively. 52% of them indicated that they were not satisfied while the remaining 48% of them indicated otherwise. Reasons for not being satisfied ranged from: High interest rates, short repayment period and longtime taken to process the credit facility.
- Further, 79% of them indicated that they did receive the loan on time while the remaining 21% of them indicated otherwise. Loans delayed for periods of between 1-2 weeks. 67% of them indicated that they had failed as required and 33% of them indicated otherwise. Majority of the respondents were motivated to repay their loans on time in expectation to get another loan (4.5623). This was followed by the fact that majority of them did not want to lose their collateral at means of 4.1521. Knowing that paying union loan was their obligation (3.4434) and to keep social status (3.4524) followed respectively.
- All the respondents categorically indicated that they considered the interest rate charged as an important factor before they applied for any loan. 84% of them indicated that interest rates should be charged according to the size of loan applied for where small loan amounts should attract small interest rates and vice versa. Majority of the respondents indicated that interest charged by the lending institution (4.1010) was significant in determining demand for credit by SMEs. This was followed by business annual profits (3.9912) and owner's contribution to business (3.8556) respectively.

CONCLUSION

The finding of this study revealed the age of respondents, and education level, negatively and significantly determines the loan repayment performance of borrowers. This indicates that the elder respondents and educated individuals have better repayment performance than youngsters. And the elders were more responsible to repay loan than youngsters also the educated respondents were more responsible to repay loan than illiterates. The researcher not recommends excluding youngsters. However, the care must be taken when starting from applicants' screening to through repayment periods, the special attention for follow up and supervision is necessary.

The reason behind the demand for credit and loan repayment problems were lack of creation of awareness is the main point for achieving the planned goal; therefor, the institution must give awareness creation before and also after the borrowers take money. Not only this but also proper and planned supervision also a very important tool like the Amhara credit and saving institution (ACSI) house to house supervision where the borrowed amount they invest weather based on their business plan or not must be assured.

The institution first and foremost made reengineering or assigned properly especially the loan department officers because some of them are not familiar with their job and also they did not well commitment, professional quality and also well trained and experience then this makes the loan repayment problem and the process also in question. The education level determines loan repayment positively and significantly. The borrowers who attained higher education level able to pay better than the borrowers who were in lower level schooling. Therefore, institution should motivate educated people and also easy to provide training. Time lag between loan application and disbursement should be reduced to increase repayment rate. The complicated loan processing procedures, which might lead to delay in disbursement, further, it will increase default rate.

The supervision made by the loan officers and borrowers ratio should be reduced and it leads to increase follow-up services. However, it is recommended that institution should compute thoroughly the borrowers' business proposal loan size before approving and sanctioning. Borrowers who have small number of or no dependents' in the household perform better in loan repayment. The borrowers who support large number of dependents also perform well with proper supervision. Loan diversion was also found as essential and significant determinant of loan repayment rate negatively. This means, diverting loan into non-income generating activities increases default rate. Therefore, it is recommended that the institution should give attention to continuous follow-up on proper loan utilization. Repayment period is also found to be a significant determinant of loan repayment performance of borrowers. Suitability of loan repayment period for borrowers was found to significantly increase the probability of repaying loan. Therefore, the institution has to give enough time to clients. The union must and better to use the credit insurance, not to reduce the default but also eliminate totally the default rate or the loan repayment problem.

Finally, this study has focused on certain variables related to determinants of loan repayment performance of borrowers. However, loan repayment performance on behalf of institution was not investigated. Thus, further researches can conduct on this issue to breach the gap in this area.

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In this age of Commerce, Economics, Computer, I.T. & Management and cut throat competition, a group of intellectuals felt the need to have some platform, where young and budding managers and academicians could express their views and discuss the problems among their peers. This journal was conceived with this noble intention in view. This journal has been introduced to give an opportunity for expressing refined and innovative ideas in this field. It is our humble endeavour to provide a springboard to the upcoming specialists and give a chance to know about the latest in the sphere of research and knowledge. We have taken a small step and we hope that with the active co-operation of like-minded scholars, we shall be able to serve the society with our humble efforts.

Our Other Journals