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CORPORATIVE UNION Vs. MICROFINANCE**ANTENEH EWNETU ABEBE****STUDENT, DOCTOR OF BUSINESS ADMINISTRATION, S P JAIN SCHOOL OF GLOBAL MANAGEMENT; &****Sr. LECTURER****LUNAR INTERNATIONAL COLLEGE****ADDIS ABABA****Dr. A SEETHARAMAN****DEAN - RESEARCH****S P JAIN SCHOOL OF GLOBAL MANAGEMENT****SINGAPORE****Dr. K. MADDULETY****DEPUTY DIRECTOR****DOCTOR OF BUSINESS ADMINISTRATION****S P JAIN SCHOOL OF GLOBAL MANAGEMENT****MUMBAI****ABSTRACT**

HSHARY Trading PIC, one of the leading medical equipment suppliers, faced a drop in sales. While evaluating the sales performance, the management came to understand that the major factor that contributed to the drop in sales is its inability to sell with credit and the availability of adequate financial service needed to finance its customers. In an attempt to solve its customer-financing problem and boost sales, the management of the company considered to establish a financial institute and entered into a dilemma of what kind of financial institution to establish

KEYWORDS

financial institute, sales performance, microfinance, corporative union.

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INTRODUCTION

Mr. Henock, the founder and Managing Director of HSHARY Trading PLC, one of the leading medical equipment importer and distributor in Ethiopia was reviewing the sales performance of the company with his chief sales and marketing Officer Mr. Nebyu and Miss Samrawit his Chief Financial Officer. The company sales target for 2018 was four million USD. However, the actual performance for 2018 was 3 million USD. Moreover, the company's six-month sale for the current budget year is 1.5 Million USD, which is one million less than the six-month target. As a result, Henock has become worried about the performance of the company

OBJECTIVE OF THE CASE STUDY

The objective of the case study is to present the different dilemmas in establishing a financial institute in Ethiopia

METHODOLOGY

Documents from the National Bank of Ethiopia were analyzed in order to understand the requirements of establishing financial institutes in Ethiopia. Moreover, group discussion was made with senior managers of HSHARY Trading Plc. and experts from the financial sector

SALES PERFORMANCE EVALUATION

Henock, while putting his eyes at the executive summary of the report, he expressed his concern about the current sales revenue of the company. "Guys, we are by far away from our biannual target, and I am frustrated with our performance." We need to understand our problem and improve our sales. We should even compensate for our six-month sales target in the coming two quarters". Looking at Nebyu, "what is the main problem in achieving our sales target?" "And how can we increase our sales to achieve our annual sales target in the coming two quarters?"

After taking a sip of water to wet his throat, Nebyu started explaining the main problem that has contributed to the slow sales of the company. "The main problem that is hindering us from achieving our sales target is our capacity for meeting our customers demand for credit sales." Nebyu continued, "as you both know, most of the hospitals and clinics want to buy medical equipment with a minimum of 18-months credit. On the other hand, our credit policy is only for six months. " This has made customers buy from our competitors. Samrawit interfered, Nebyu, "as we all know, we have a limited financial capacity, and we cannot provide 18 months credit, even 12 months credit is not doable with our current financial capacity." Nebyu replied, "I understand, but that is the major factor for our poor sales performance."

FINANCIAL SOURCE ARRANGEMENT FOR OUR CUSTOMERS

"Why can't we try to work with financial institutes like banks and microfinance to arrange finance to our customers?" Henock asked Nebyu. As you know, " Most of the Hospitals and Clinics in Ethiopia works in a rented facility and has no fixed asset collateral. All of the banks and microfinance do not want to provide a loan without fixed asset collateral since they have enough customers in other sectors that have fixed asset collateral. I have spoken with the different financial institute to hold the medical equipment as collateral and provide loan to our customers, but all of them refused"

According to the National Bank of Ethiopia, currently, there are 35 microfinance and 18 banks for a population of 107 million. These financial institutes have limited capital; as a result, getting loans has become a significant challenge of businesses in Ethiopia. Moreover, fixed asset collateral of more than 140% is required by most of the banks to provide a loan.

Looking at Both Nebyu and Samrawit, Henock asked them if they have any suggestion that will help them to solve this problem.

Samrawit replied, "the only solution for solving our customer's financing problem once and for all is to establish a financial institution that can provide loan to our customers." "Samrawit continued, Because of the National Bank regulation we cannot establish a Bank, so we need to go either for a microfinance or Corporative Union."

I also agree said Nebyu, "In the past two quarters we have lost more than 2 million USD accounts because of our inability of arranging finance.

"This is not something I can decide alone, I have to speak with the board of directors," Henock replied. I will let you know our decision in the coming two weeks. After leaving the meeting, Henock immediately phoned Helen, Rebeka, and Teddy, the shareholders and board members of the company to fix an appointment to discuss the recommendation of his management.

ESTABLISHING A FINANCIAL INSTITUTE

After greeting three of the Board members, Henock started explaining the agenda of the meeting to his shareholders. "The sale of HSHARY Trading PLC is not going as per our plan. One of the major factors that contributed to this issue is our financial capacity in selling with credit — currently, most of our customer's demands for 18 months of credit sales. As you know, we are not able to provide 18 months credit, and most of the financial institutes are not willing to provide financial assistance without fixed asset collateral. As a result, to keep HSHARY Trading growing, we need to find a way to finance our customers. Our chief sales and Marketing Officer and CFO have recommended us to establish a financial institute either microfinance or Corporative Union, which will be used to finance the credit sales need of the company." Tedy, one of the major shareholders and Board member, asked Henock, "how much the company lost because of unavailability of credit sales in this year?" "More than 2 Million USD, Henock replied. Wow, Helen jumped in, "I think establishing a financial institute is very important to accelerate the growth of the company as well as to be competitive in the medical equipment industry." Rebeka said, "I also agree but has some questions."

"What type of form the financial institution will have?"

"How is the application process?"

"What are the requirements for establishing the financial institute?"

"Because of the National Bank of Ethiopia regulation, we can only establish either microfinance or Corporative union," Henock continued explaining, "The application process of microfinance can take up to six months. The number and types of document required are also more than the one needed for Corporative Union. The corporative union application process is shorter than microfinance."

Teddy interrupted Henock and said, "If the application process for microfinance takes six months, then we have to go for corporative Union." Helen interrupted Teddy; "I think we should consider other factors as well before deciding on the Form of the financial institute formation."

I agree with Helen, Henock continued his explanation; "we should consider factors such Capital requirement, the minimum number of Shareholders requirement, Eligible scope of Operation, Taxation and industry regulation while making a decision regarding the form of the establishment."

REQUIREMENTS FOR ESTABLISHING A FINANCIAL INSTITUTE

Henock opened his laptop started his presentation. "The minimum capital requirement to establish microfinance is 10 Million Birr (nearly 335,000 USD). However, there is no minimum capital requirement to establish a corporative Union. Regarding the number of shareholders, the minimum number of shareholders to establish microfinance is five shareholders. There is no restriction on the number of shares a shareholder should have. However, in the Corporative Union, a shareholder cannot have more than 10% shares, and the minimum number of shareholders is fifty. The scope of operation is one of the other important factors to consider,"

Henock Continued, "Microfinance has a broader scope of operation than Corporative Union. A Microfinance can engage in all banking activities with the expectation of foreign currency-related services. However, Corporative Union operation is limited to saving and credit."

"Does this mean cooperative unions cannot give loan?" Helen asked. "No, no, no... Henock replied, "they can provide a loan, but the loan has to be related to saving." For example, if you do not have a saving in a corporative union, then you are not eligible to take a loan from this corporative.

After confirming Helen's satisfaction from her face, Henock continued to the next slide to present taxation. "Corporative Unions are exempted from 30% corporate profit tax. However, microfinance has to pay 30% corporate profit tax. But, both Corporative Union and microfinance shareholders have to pay 15% dividend tax."

"The other important factor that needs to be considered in our decision is the financial sector regulation," Henock continued, National Bank of Ethiopia governs Microfinance as a result; the microfinance business environment is highly regulated. Where us, Federal corporative agency is the one who is licensing and controlling Corporative Unions. In comparison, Corporative Unions business environment is less regulated than microfinance."

"So, what do you think, Shall we go for microfinance or corporative Union," Henock asked his board members while looking each of them at a glance.

Well, Rebka broke the silence; "I think we should go for corporative Union. Rebka continued, As we can see from Henock's presentation, the application process is simple and takes less time to get a license than microfinance, which is crucial since we can start quickly and compensate first and second-quarter sales performance in the remaining two quarters.

Also, there is no minimum capital requirement; therefore, we can start with minimum capital, which will help us to minimize our investment risk since we do not have financial institute market expertise.

Zero corporate profit tax and less regulated business environment makes the Corporative Union a better choice

"But, what about the restriction on the scope of operation" Teddy started explaining why Corporative Union will not work. Since the hospital has to make saving first for some time to take a loan, it will take time to be able to finance our customers. Do you think hospitals will agree to make saving for a certain period in a newly formed unknown Corporative Union? Also, do not forget that the minimum number of shareholders to establish a corporative union is fifty. As a result, it will be difficult to control the Corporative Union and make it operate as we want."

Teddy Continued, "I think, we should go for microfinance since the minimum number of shareholders is five, it will give us the power to control the operation of the company. Also, saving is not a requirement to take a loan, which will make us start the loan service quickly. Moreover, microfinance has a wider scope of operation and flexibility".

Rebeka turned her face to Teddy and started arguing. Know the discussion is getting fiercer and fiercer.

"Teddy, we can build the brand of the corporative Union by doing an aggressive promotional activity and can get the trust of the consumer. Moreover, please do not forget that microfinance has to pay 30% corporate profit tax."

Teddy interrupted Rebeka, "Rebeka; Narrow scope of operation will definitely affect the revenue of the corporative Union. So it is better to pay 30% corporate profit tax and engage with a wider scope of operation " "Also it will take time to build the brand of the corporative Union, even with aggressive marketing activities and success is not guaranteed."

Angrily, Rebeka replied, "Well that does not work for me" and continued explaining her points. "Guys, please do not forget that we need 10 million Birr which is nearly 350,000 USD to establish microfinance, from where will we get this Money?", Rebeka continued, "If we take 350,000 USD from HSHARY and establish the microfinance it will dry the working capital of HSHARY."

Helen jumped in; It seems when is supporting Teddy "even for corporative Union, we need capital and budget for promotional activities."

While Teddy and Rebeka are arguing, Henock understood that the discussion is getting intense and both Rebeka and Teddy have valid points. If they continue like this, it may take days to come into an agreement.

Therefore, he wanted to interrupt and make a proposal. "Both of you has valid points, and I understand if we continue like this, we will not make a decision sometime soon. So I would like to recommend sleeping on the matter for three days and voting to decide the way forward."

All of the board members agreed with the proposal and decided to meet after three days.

1. In countries where financial service is not adequately available, organizations should develop a strategy for financing their customers.

2. Organizations should evaluate their sales performance periodically in order to understand the current problem and to develop a strategy that will help to improve their performance.
3. Before deciding to enter into a new product portfolio, organizations should evaluate if the existing portfolio is served at the maximum and if the necessary resource is available.
4. Organizations should analyze the advantages and disadvantages of establishing a firm or entering into a new market before making their decision.

QUESTIONS FOR DISCUSSION

1. Shall HSHARY Trading PLC board decide to establish a Microfinance or Corporative Union?
2. Shall the company increase its product portfolio or focus on expanding the market share of its existing portfolio to boost its revenue?
3. In Ethiopia, most of the medical equipment buyers want to buy medical equipment with more than 18 months installment due to lack of capital. Shall the company establishing a leasing firm to tap this opportunity
4. Will joining the financial institute market where the company does not have enough expertise distract its focus and affect the medical Equipment business?
5. The government of Ethiopia has restricted foreign investors and financial institutes from operating in Ethiopia with the primary reason of protecting local financial institutes. Shall the government review its policy and open the financial sector to solve the problem of accessing the commercial loan facility

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