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ADDIS ABABA UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
DEPARTMENT OF ACCOUNTING AND FINANCE

**Governance in Saving and Credit Associations Operating
in Addis Ababa**

A Thesis Prepared in partial fulfillment of the Requirements
for the Degree of Master of Accounting and Finance (MSc.)

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Addis Ababa, Ethiopia

**ADDIS ABABA UNIVERSITY
FACULTY OF BUSINESS AND ECONOMICS
ACCOUNTING AND FINANCE (MSC PROGRAM)**

**GOVERNANCE IN SAVING AND CREDIT ASSOCIATIONS OPERATING
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DECLARATION

I do declare that this thesis proposal is my original work. No part of this research document has previously been submitted for any academic degree to any university. All the matters embodied in the research document is duly acknowledged.

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15th January 2017

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ENDORSEMENT

This thesis has been submitted to Addis Ababa University College of Business & Economics for examination with my approval as a university advisor.

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December,2016

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ABBREVIATIONS

ACCOSCA	Africa Confederation of Cooperative Savings and Credit Association
ACSDS	Agricultural Cooperative Sector Development Strategy
ADLI	Agricultural Development Led Industrialization
CEO	Chief Executive Officer
CRS	Catholic Relief Services
EEPCo	Ethiopian Electric Power Cooperation
ENTACCS	Ethiopia Thrift and Cooperative Societies
ETB	Ethiopian Birr
GDP	Gross Domestic Product
GTP	Growth and Transformation Plan
NED	Non-Executive Directors
OECD	Organization for Economic Cooperation and Development
PEARLS	P rotection, E ffective financial structure A sset quality, R ates of return, L iquidity, and S ign of growth
SACCO	Saving and Credit Cooperatives
SCA	Saving and Credit Associations
SNNP	South Nations Nationalities and People's
SPSS	Statistical Package for Social Sciences
WOCCU	World Council of Credit Unions

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ABSTRACT

Corporate Governance in Saving and Credit Cooperative Societies (SACCOs) is pivotal for such institutions having a peculiar nature of member-owner attributes. This study aimed at the assessment of governance practices in SACCOs. The study has targeted on three functional SACCOs in Addis Ababa of Ethiopian Electric Power Corporation (EEPCo), Ethiopian Airports Enterprise, & Catholic Relief Services. Purposive sampling techniques were used to gather data from the selected SACCOs. Pertinent data were collected through primary data sources using structured questionnaires and secondary data sources. Data collected has been entered, edited and analyzed using SPSS tool. Based on the study, there are no consistencies as to ownership within the SACCOs. The Board size ranges from seven to nine members in these SACCOs with limited representation of female members at around 30% of total board size. The study identified challenges in conducting periodic meeting and performance assessments at Board level. Annual audits in the SACCOs were not conducted timely after closure of a fiscal period. Trainings related to governance and management of SACCOs was not adequately provided to Board members. Incentive schemes either in cash or in kind for Board members are poor, if not none at all like at CRS. SACCOs mostly pay an annual interest rate of 5% on saving depositors which is the risk free market rate offered in most commercial banks on saving accounts. Interest rate on loans of the three SACCOs remains stagnant ranging from 6% to 8% which doesn't consider at least yearly inflation and time value of money. Finally, it is commendable to consider on a clear definition of ownership, improving capital adequacy position, periodic and timely supervision and audit, strengthening sound financial discipline in optimal utilization of huge savings mobilized to productive loan portfolios and better investment opportunities. It necessitates revisiting interest rates both on savings and loans to reflect administrative costs, cost of funding, inflation and elements of capitalization.

CHAPTER ONE

1. INTRODUCTION

1.1. Back ground of the study

Saving and Credit Cooperatives (SACCOs) have played a tremendous role towards supporting the economy of developing countries. SACCOs are effective input to alleviate poverty through provision of financial services to the marginalized part of developing countries including Ethiopia.

Savings, Credit and Cooperative Societies (SACCO) represent one of the most important sources of financing in developing countries and over the last few years, SACCOs have experienced tremendous growth all over the world with their importance increasingly being recognized by academics since they are also increasingly contributing an active role in the microfinance market today (Labie & Périlleux, 2008; Armendariz & Morduch, 2005; Magill, 1994). Today, there are more than 46,000 SACCOs, servicing about 172 million people in 92 countries. In 1996 in Africa, Asia and Latin America, a total of 20,512 SACCOs were servicing 16 million members; by 2006 the numbers had increased to 31,725 SACCOs, servicing more than 59 million members (WOCCU, 2006). Therefore, within 10 years, those regions have seen a growth rate of more than 54% in the number of SACCOs, and more than 268% growth in the number of members (WOCCU, 2006; Odera, 2012).

Savings and Credit Cooperatives (SACCOs) in Ethiopia are playing an active role both in rural and urban areas. Their number has increased from 5,437 in 2006 to 14,453 in May 2014 showing a growth rate of 28% per year. The aggregate number of membership during the same period increased from 0.38 million to 1.7million and their capital increased from one billion birr to 5.2 billion birr. These figures indicate that financial cooperatives have had the support of the people in undertaking activities contributing to their economic development. SACCOs are considered to have immense potential in financing short term loans for agricultural production technologies

and undertake off-farm income generating activities in areas where both the state and the private sector have failed. Serious efforts are being made to strengthen capital resource of SACCO's base through increasing members' subscription and mobilization of savings in rural and urban areas (Kifle, 2015).

Cooperatives have played a significant role towards achieving the growth and poverty reduction strategy by promoting income generating activities and improving access to near banking services to rural and urban households. In response to the changing needs of farmers-members, the government instituted an overarching strategy of Agricultural Cooperative Sector Development Strategy 2012-2016 (ACS DS). One of ACS DS's derivative features is to improve smallholder farmers' productivity and income by leveraging a cooperative sector; hence the promotion of cooperative movement is in line with the national strategy. Moreover, in the Growth and Transformation Plan (GTP) due emphasis was given for the cooperatives as the driving force for agricultural productivity and savings mobilization. Based on the savings mobilized domestically a resource will be generated to finance the various investment opportunities from time to time. (Kifle, 2015).

According to Federal Cooperative Agency (May 2014) the number of SACCOs in Ethiopia are 14,453, out of this 1,705 are found in Addis Ababa and the capital accumulated is birr 5,126,912,681 and 4,555,102,303 respectively. According to different document analysis and field experience results indicate that SACCOs in Ethiopia are entangled by the number of challenges that need to be addressed in order to enable them improve on soundness and stability, effectiveness and efficiency, governance, product diversity and integration to the formal financial system (Kifle 2011). Thus, the study aims to identify elements that hinders good governance practice in SACCOs so that to provide possible recommendation for the successful implementation of services to SACCO members. The next sections of this chapter highlight the concept of corporate governance, explains the role of Saving and Credit Cooperatives (SACCOs) in creating access to finance for peoples in developing countries including Ethiopia. The chapter presents the role of governance on SACCOs performance. The objective of the study and key research questions are also presented in this chapter. In addition, it also addresses significance, scope, structure and limitation of the study.

1.2. Organizational Profile of Saving and Credit Cooperatives

All the selected SACCO's has been in service for decades. Employees saving and credit association of Ethiopian Airports Enterprise Employees was established in 1965 E.C, Ethiopian Electric Power Cooperation was in 1975 E.C, and Catholic Relief Services in 1988 E.C. Currently Ethiopian Airports Enterprise Employees saving and credit association has 1,500 members, Ethiopian Electric Power Cooperation Employees saving and credit association with 8,660 members and Catholic Relief Services Employees saving and credit association has 156 members. At the end of the financial year of 2005 E.C, each of them own a total asset worth of Ethiopian birr 17,529,744, 16,975,224, & 16,064,670, mobilized savings amounting 15,121,132, 15,234,155, & 15,490,090 and disbursed loans amounting 14,941,126, 13,054,700, & 11,213,090. These SACCOs are operating under the proclamation for Cooperative Societies Proclamation No. 147/1998. All of the above mentioned SACCO's adopt their own organizational charter in line with the Ethiopian proclamation for cooperative societies.

1.3. Statement of the problem

Governance challenges are prevalent in SACCOs and even gets complex as they get larger with diverse members requiring specific knowledge and skills to make a range of institutional decisions (Branch & Baker, 1998). Individual member owners are not likely to possess the required managerial skills and technical knowledge. This may require that managers be hired to make the critical management decisions (Fama & Jensen, 1983). The specialization of decision management increases the organization's ability to operate in an entrepreneurial manner by hiring professional expertise. Yet this separation of ownership and decision making leads to principal-agent problems. (Odera, 2012).

According to Labie & Périlleux (2008), corporate governance tends to be more complex in management structures of SACCOs due to their democratic principle for decision-making but also because their ownership and also complex in cooperative structures, compared with classical firms, due to their democratic principle for decision making, but also because their ownership is usually much more diffuse. This makes corporate governance a fairly touchy issue for credit unions, even more so when they enter growth dynamics. Firstly, there is the conflict between owners and managers which SACCOs face (Fisher & Desrochers, 2002). As with any other type

of firm, two related issues are at stake: first the “expense preferences” issue, where the question is to verify that the choices made by the managers match the mission of the SACCO and not their personal interest; and second, the “entrenchment” issue where the managers make their choices based on securing their own permanence in the management structure (entrenchment theory). Fisher & Desrochers (2002) indicate that these two types of behaviors have opposite impacts on their risk of bankruptcy; expense preferences translate into lower efficiency and higher bankruptcy risk, while entrenchment theory generates risk-averse choices and lower bankruptcy risk.

Some SACCOs have experienced major crises, such as the more recent crises happening in countries like Benin, Morocco and Kenya; which clearly suggests the importance of controlling institutional development. Labie & Mersland (2011) define corporate governance as a system or set of mechanisms by which an organization is directed and controlled in order to reach its mission and objectives. SACCOs are usually characterized by multiple objectives and are therefore different not only in their organizational forms but also in terms of products, methodologies, social priorities and profit seeking behavior (Mersland & Storm, 2009; Odera, 2012).

SACCOs actively operating in Addis Ababa do play a paramount role in benefiting their members as sources of financing, safe custodians of hard-earned savings, augmenting members’ income through distributing dividends, investing in various alternatives, being a nucleus in establishment of major commercial banks, and improving the overall financial outreach. They are reliable partners for households at times when critically in financial trap whether to meet emergency needs or realize capital investment at family level for their members. They are preferred for their ease of access, lowest cost of borrowing, efficient processes and redistribution of income to its members. However, they do require support and revisiting of the way their governance processes are set and defined. Some governance issues are related to their nature of being member-owned and managed, limited resources and support to institutional capacity building, and ways of managing day-to-day affairs of the associations.

According to different document analysis and field experience results indicate that SACCOs in Ethiopia are entangled by the number of challenges that need to be addressed in order to enable them improve on soundness and stability, effectiveness and efficiency, governance, product diversity and integration to the formal financial system. The major challenges of primary SACCOs and union SACCOs include the following; weak governance, lack of awareness, and weak financial management system. (Kifle, 2015). Thus, this study will focus on making an in-depth analysis on the basic governance challenges SACCOs are currently facing in Addis Ababa.

1.4. Research questions

In order to achieve the above objectives of assessing corporate governance in the selected SACCOs, the following questions are employed as guidance.

1. How SACCO's comply with the existing legislation governing SACCO's?
2. What is the existing external governance practice in these SACCO's?
3. How are the internal governance processes of reporting, organization, and structure of the SACCO's?
4. What is the existing financial and ownership structure of the SACCO's?
5. What are the key elements of the article of formation?
6. How is the SACCOs board composition and its impact on Governance?
7. How does SACCOs perform financially and its linkage to governance?

1.5. Objectives of the Study

1.5.1. General Objective

The main objective of the study is to assess governance practices in Savings, Credit and Cooperative Societies (SACCO) in Addis Ababa.

1.5.2. Specific Objectives

Specifically, the study will attempt to:

- Assess external governance structure and practice of the SACCOs.
- Assess articles of formation for the SACCO's and compare among the SACCO's

- Identify the factors that affect good governance practice of the SACCOs and its impact.
- Review the financial Performance of SACCOs and its linkage to governance.
- Assess composition of SACCOs board members and its linkage to governance.
- Review internal corporate governance of the SACCO's

1.6. Significance of the Study

The study will provide adequate information for policy makers, for saving and credit societies, cooperative promoters', development workers and other stakeholders about the elements hindering good corporate governance in SACCOs and its impact on SACCOs operational success. This will enable them to design appropriate policies and procedures in the SACCOs for the successful achievement on organizational objectives and for the better contribution towards the government program of alleviating poverty in Ethiopia. The study, will also be used as a reference for those who are interested to make further study on the related issue.

1.7. Scope of the Study

The study targeted only in Saving and Credit Cooperatives Societies (SACCOs) operating in Addis Ababa city with special referencing of SACCOs in Ethiopian Electric Power Corporation (EEPCo), Ethiopian Airports Enterprise, & Catholic Relief Services.

1.8. Limitation of the study

Some of the limitations while conducting this research were limited access to data, decline to be part of the study as a SACCO, and limited data set to do further tests in assessing impact of variables. The management of Ethio Telecom Employees Saving and Credit Association was not willing to provide any information leading to exclusion in the study. The data provided from the sample SACCOs was limited only audited financial reports of two fiscal periods though the intent was to analyze data set of three years. This has impacted the study to further corroborate the impact of governance on financial performance with more robust statistical tests.

1.9. Structure of the study

The study is organized in to five chapters. Chapter one includes background of study, statement of the problem, objectives of study, research question, significances of the study, scope of the study and structure of the study. The second chapter is all about critical review of related literature, both empirical and theoretical. This part is part of researcher's investigation and past research in the field. The third chapter discuss research design and methodology, and discussion about study area. The fourth chapter is about discussion of research finding and Finally, chapter five presents conclusion, & recommendation.

CHAPTER TWO

2. LITERATURE REVIEW

This section reviews the literature related to influence of corporate governance and hindrance of poor corporate governance on overall performance of saving and credit associations. The literature will be based on the research paper objectives which include; governance and responsibility in credit and saving association, risk management and internal control systems, stake holders and social responsibility, business ethics, executives and non-executives recruitment, training, promotion, remuneration and committee composition in saving and credit association. This section also discusses the theory of corporate governance in different countries.

2.1. Historical development of Savings and Credit Cooperatives (SACCOs) in Ethiopia

The development and promotion of modern savings and credit cooperatives (SACCOs) in Ethiopia is not different from that of general cooperative promotion and development in the country. It was in 1960 for the first time in Ethiopia, during the imperial regime, the government issued a “Farm workers Cooperative Decree” that aimed at organizing the landless people in to agricultural cooperatives and the ministry of national community development was charged with the responsibility of ensuring systematic cooperative promotion and development.

Furthermore, in 1966, cooperative promotion No. 241/1966 was proclaimed to give basis for the promotion cooperatives and it was only after this proclamation that cooperatives began to emerge in the county. Establishment of SACCOs in Ethiopia started in the mid-1960 and the first one was pioneered by the employees of Ethiopian Airlines in 1964. From 1964-1973, there were 28 SACCOs and these societies formed their own national apex body known as Ethiopia Thrift and Cooperative Societies Ltd (ENTACCS). At that time the apex had 28 SACCO with 6,247 members and savings amounting to USD 627,752 and was also a member of the Africa Confederation of Cooperative Savings and Credit Association (ACCOSCA).

During the Dergue regime (1974 -1991), the different types of cooperative societies (agricultural cooperatives, handicrafts and small scale industry cooperatives, housing cooperatives, saving and credit cooperative and mining cooperatives) were organized, promoted, regulated and inspected by different Ministries and Institutions like Ministry of Agriculture, Ministry of Industry, Ministry of Housing and Urban Development, National Bank of Ethiopia and Ministry of Mines respectively.

Following the overthrow of the military government in 1991 with the adoption of economic reform program helped the organization, promotion and development of cooperative societies within the framework of the free market economy. The government provided a legal framework which is both comprehensive in many respects (including its ability to accommodate coops in various sectors/sub-sectors) and incorporates universally accepted principles of cooperatives including voluntary membership (Proclamation No. 147/1998 and amendment 402/2004). As a result, some improvements have been seen in that cooperatives started to distribute inputs, provide loan to their members, marketing their products in the domestic and foreign market, unions (secondary cooperatives) were formed, dividend payments were made by the unions as well as primary cooperatives. Both ADLI (the government's development program) and the Marketing Strategy explicitly envisage cooperatives to play a critical role in the development and poverty reduction efforts of the country (Ministry of Finance and Economic Development 2003; Ministry of Agriculture and Rural Development 2005).

In line with this a general legislation setting out the formal rules and procedures by which the development and activities of all types of co-operatives in the country are to be guided (Proclamation. No. 147/1998 and 402/2004) was issued. As such, it constitutes the incentive structure that shapes the behavior of cooperatives and their members. In response to the prevailing supportive government policy and commitment for the development of genuine cooperatives their number and diversity increased rapidly. Now a day, cooperatives is functioning through important sectors like saving and credit, coffee, beekeeping, seed multiplication, sugarcane, livestock, dairy, mining, marketing, consumer, fisheries and construction etc. Thus, cooperatives in Ethiopia are playing multi-functional roles in rural and urban areas.

2.2. Trends in number of SACCOs, membership and capital

Despite the ups and downs experienced, SACCO's movement in Ethiopia has registered numerical growth over the past decades both in terms of number, membership and capital. However, membership is still much smaller against the huge potential. The table below indicates that SACCOs have been constantly growing in terms of number, membership and capital mobilized over the period.

Table1. Trends in growth of SACCOs and capital

Year	No. of SACCOs	Membership	Capital (Birr)	Capital per member (Birr)
1991	495	119,799	78,772,710	658
1995	522	116,619	111,173,060	953
1999	716	156,938	174,577,503	1,110
2004	2,146	155,120	504,334,084	3,251
2006	5,437	381,212	994,960,169	2,610
2008	7,834	383,311	1,426,550,110	3,722
2012	10,270	910,275	1,206,319,160	1,325
2013	11,850	1,037,788	485,064,779	467
2014	14,453	1,736,122	5,126,912,681	2,953

Source: Wolday Amha (2003) and Federal Cooperative Agency (May 2014).

As can be noted from the above table 1, the number of SACCOs has increased by 84% between 2008 and 2014 from 7,834 to 14,453. Similarly, the aggregate membership has increased from 383 thousand to 1.7 million over the same period representing over and above four times increase. The capital of the society has also shown an increase of 259% over the same period.

2.3. Geographical distribution of Savings and Credit Cooperatives (SACCOs)

In the below table (table two) presented the distribution of SACCOs by region, their membership size and capital. The distribution of SACCOs among the regional states also presents sharp difference with Oromia and SNNP representing the highest numbers of SACCOs. Oromia represents the largest number of SACCOs with 5,334(36.9%), followed by SNNP with 3,473(24%), Amhara with 2,520(17%), Addis Ababa 1,705(11.8%), and Tigray with 834(5.8%)

SACCOs. The aggregate numbers of SACCOs in the rest of regional states constitutes the difference. In terms of number of membership, Oromia constitutes the largest number of members, followed by Addis Ababa, SNNP and Amhara in the order given.

Table2. Distribution of SACCOs by region

Region	No. of SACCOs	Membership			Membershi p Share (%)	Capital (Birr)	Capital Share (%)
		Male	Female	Total			
Oromia	5,334	432,709	250,576	683,285	39.38%	132,986,708	2.59%
SNNP	3,473	188,059	110,945	299,004	17.23%	112,780,258	2.20%
Amhara	2,520	139,218	71,699	210,017	12.10%	96,176,921	1.88%
Afar	120	1,033	4,249	5,282	0.30%	965,702	0.02%
Tigrai	834	112,318	76,086	188,404	10.86%	216,000,312	4.21%
Somali	166	1,796	5,953	7,749	0.45%	8,929,063	0.17%
Gambella	40	567	2,186	2,753	0.16%	379,239	0.01%
Benishangul Gumuz	44	432	1,126	1,558	0.09%	288,098	0.01%
Harare	66	1,116	1,746	2,862	0.16%	2,342,398	0.05%
Dire Dawa	151	55	3,365	3,420	0.20%	961,679	0.02%
Addis Ababa	1,705	182,582	148,306	330,888	19.07%	4,555,102,303	88.85%
Total	14,453	1,059,885	676,237	1,735,222	100.00%	5,126,912,681	100.00%

Source: Federal Cooperative Agency, May 2014.

2.4. The concept of corporate governance and its principles

The prominent definition of corporate governance of the Organization for Economic Cooperation and Development (OECD) is set as the system by which business corporations are directed and controlled (OECD, 1999). According to OECD, Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

Corporate governance mechanisms can be defined as the whole set of mechanisms which put pressure on the organizations and their managers in order to make sure that the decisions made match the mission of the organization. In the case of credit unions, because of the democratic

principle, the mission is defined by the members, who are also in charge of controlling the organization. This makes credit unions quite different from other microfinance organizations. (M. Labie and A. Périlleux,2008).

The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.” Good corporate governance therefore embodies both enterprise (performance) and accountability (conformance).” (Fin, 2004,). La Porta, Silanes and Shliefer (2000, 2002) view corporate governance as a set of mechanisms through which outside investors (shareholders) protect themselves from inside investors (managers). The Organization for Economic Cooperation and Development provides another perspective by stating that “corporate governance is the system by which business corporations are directed and controlled.

The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the Board, managers, shareholders and other stakeholders, and spells out the rules and procedure for making decisions on firms’ affairs. By doing this, it also provides the structures through which the company objectives are set, and the means of attaining those objectives and monitoring performance. The argument has been advanced time and time again that the governance structure of any entity affects the firm's ability to respond to external factors that have some bearing on its financial performance (Donaldson, 2003). In this regard, it has been noted that well governed firms largely perform better and that good corporate governance is of essence to firms’ financial performance and as well acceptance by the society.

The emphasis placed on the role of cooperatives in national development varies from one country to the other and from one environment to another. Due to the changing roles of government in cooperative development, necessitated by rapid globalization and liberalization, it has become absolutely necessary that countries keep track of these changes lest the pace of

cooperative development becomes hopelessly inconsistent with the rest of the sectors. In Ethiopia the role of Saving and Credit Associations in agricultural led strategy is the focus of the government to avail financial services to the rural which is inaccessible through conventional banks. In addition, the government also focused on Saving and Credit during the second transformation plan for the poor in the cities to access financial services through these cooperatives. Therefore, good corporate governance is of immense importance in the SACCOs to ensure that all stakeholders involved are addressed by these institutions. (Focus, 1997).

WOCCU (1999) has developed three governance principles, these are external governance, internal governance. External governance addresses the issues that credit unions face as participants in the financial market place. Financial institutions, regardless of structure, are expected to operate in a transparent manner, comply with regulatory and prudential standards and be held accountable to the public. The internal governance defines the responsibilities and accountability of the general assembly, the board of directors, management and the staff which includes creating good governance structure, check and balance in the actions of management and insuring accountability. Individual governance, confirms that credit union obtains and management who are able to fulfill the two previous obligations of external and internal governance through integrity, competence and commitment.

The OECD (2004) has established six principles of corporate governance. These are ensuring the basis for an effective corporate governance framework, the rights of shareholders and key ownership functions, the equitable treatment of shareholders, the role of stakeholders in corporate governance, disclosure and transparency, and responsibilities of the board. The corporate governance framework should; promote transparent and efficient markets, should protect and facilitate the exercise of shareholders' rights, should ensure the equitable treatment of all shareholders, including minority and foreign shareholders, should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises, should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company, and should ensure the strategic guidance of the

company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

The Basel committee on banking supervision has identified thirteen corporate governance principles for banks. These are related to board responsibilities, board qualification and composition, board structure and practices, senior management, group structures, risk management, compliance, internal audit, compensation, disclosure and transparency, and the role of supervisors. As to the Committee, the board has the responsibility of the organization strategy, financial soundness, governance structure and practice, and risk management & compliance obligation. Besides, the board should be comprised of individuals with a balance of skills diversity and expertise that collectively possess the necessary qualifications appropriate with the size, complexity and risk profile of the organization. Moreover, the board should define suitable governance structures and practices periodically reviewed for ongoing effectiveness. It stated also that senior management should have the required experience, competencies & integrity to manage the business. For the risk function to be vibrant, the organization should have an effective independent risk management function, with clear direction, sufficient height, independence, resources and access to the board. Risk has to be identified, monitored and controlled on an ongoing basis. There should be healthy communication within the organization regarding risk, through reporting to the board and senior management. To be compliant, the Committee stressed establishment of a compliance function and approval policies and processes for identifying, assessing, monitoring and reporting and advising on compliance risk. Further, the internal audit element provides independent assurance and support to the board and senior management in promoting an effective governance process and the long-term reliability of the organization. The accord also stated compensation as an element where remuneration systems is the crucial factor of the governance and incentive structure through which the board and senior management promote good performance. The Committee emphasized on governance to be adequately transparent to the board and its members. The last element is on supervisors to provide comprehensive evaluations and regular interaction with boards. (Basel Committee, 2015).

2.5. Stakeholders in Corporate Governance

Abdullah & Valentine (2009) indicate that a stakeholder can be defined as any group or individual who can affect or is affected by the achievement of the organization's objectives. Stakeholder theorists suggest that managers have a network of relationships to serve, which include the suppliers, employees and business partners. Sundaram & Inkpen (2004) contend that stakeholder theory attempts to address the group of stakeholder deserving and requiring management's attention. Freeman (1984) reveals that the network of relationships with many groups can affect decision making processes as stakeholder theory is concerned with the nature of these relationships in terms of both processes and outcomes for the firm and its stakeholders. Donaldson & Preston (1995) argue that this theory focuses on managerial decision making and interests of all stakeholders have intrinsic value, and no sets of interests is assumed to dominate the others.

2.6. Agency Problem and Agency Costs in Corporate Governance

Jensen and Meckling (1976) define the agency relationship as a contract under which one party (the principal) engages another party (the agent) to perform some service on their behalf. As part of this, the principal will delegate some decision-making authority to the agent. The agency problem derives from the owners (principals) not being able to run the business themselves and therefore having to rely on agents (management) to do so for them. This separation of ownership from management has been getting worse as the size of firms and appearance of institutional investors that are passive in the day to day activities of firms. The agency problem therefore arises if there is a breach of trust by directors by intentional action, omission, neglect or incompetence. These agency problems arise because of the impossibility of perfectly contracting for every possible action of an agent whose decisions affect both his own welfare and the welfare of the principal, Brennan (1995b). Arising from this problem is how to induce the agent to act in the best interests of the principal. Managers bear the entire cost of failing to pursue their own goals, but capture only a fraction of the benefits. Jensen and Meckling (1976)

argue that this inefficiency is reduced as managerial incentives to take value maximizing decisions are increased.

This breach may arise because the directors are pursuing their own interests rather than the shareholders' or because they have different attitudes to risk taking to the shareholders. For example, if managers hold none or very few of the equity shares of the company they work for, what is to stop them from working inefficiently, concentrating too much on achieving short term profits and hence maximizing their own interest not bothering to look for profitable new investment opportunities, or giving themselves high salaries and perks? One power that shareholders possess is the right to remove the directors from office. But shareholders have to take the initiative to do this and, in many companies, the shareholders lack the energy and organization to take such a step.

McColgan (2001) gave a very broader view of agency theory and corporate governance. The major interest of his research covered the area that where the interests of managers diverge from those of the interests of shareholders. He kept the view that the agency relationship and the agency cost which arises from these relationships. McColgan extended the work of Jensen and Meckling (1976) who defined the agency relationship as a type of contract in which the principal keeps the agent to carry out the services of the firm on his behalf. Similarly, Himmelberg, Hubbard and Palia. (1999), argued Jensen and Meckling (1976) by saying that principal agent problem is not similar in all firms rather they are different in different firms, different industries and also in different cultures. The governance should be designed according to the firm environment as one general mechanism can be more important for some firms and less important for other firms. Okeahalam and Akinboade (2003) conducted the review by studying a contribution on the corporate governance in Africa and said that the modern concepts of separation of management from the ownership make the corporate governance an important issue for research.

The interests of people who control the organizations are differing from those who invest in the company by external finance. Also the principal agent problem and the interest of shareholders can only be reduced through the effective corporate governance. Okeahalam and Akinboade

(2003) stated that the organization systems, practices, process and rules of governing institutions are concerned closely with the corporate governance so there is a need to find those relationships that regulate, create or determine the nature of relationship through those relationships. Farinha (2003) conducted the theoretical and empirical literature review to find out the true nature and consequences of corporate governance. The main focus of his literature was to find out the reasons of conflict between manager and shareholders in organizations with respect to ownership mechanism. He also tried to find out the link between the corporate governance and the value of the firm. Farinha (2003) argued that major problem in organization arises with the relationship of principal and agent relationships and a different approach of manager than the shareholders. The perspective of the manager remains with the limited cash-flows thus managers focus lies with the short term perspective on investment whereas shareholders stuck with the quick return of cash flows.

Risk preference is also a major source of conflict between the principal and the agent. Shareholders associated with the market risk and the risk of stock returns whereas managers always concerned with the company risk because their survival depends on the firm risk. The area of corporate governance is lacking with the external disciplining devices. The firms through the effective corporate governance can implement these devices which includes the composition of the board of directors, increase number of shareholders, maximize the inside ownership and by providing different financial policies and compensation packages.

According to Kaplan, agency costs arise largely from principals monitoring activities of agents, and may be viewed in monetary terms, resources consumed or time taken in monitoring. Costs are borne by the principal, but may be indirectly incurred as the agent spends time and resources on certain activities. Examples of these costs include: incentive schemes and remuneration packages for directors, costs of management providing annual report data such as committee activity and risk management analysis, and cost of principal reviewing this data, cost of meetings with financial analysts and principal shareholders, the cost of accepting higher risks than shareholders would like in the way in which the company operates, cost of monitoring behavior, such as by establishing management audit procedures and additional type of costs which is called residual loss. This is an additional type of agency cost and relates to directors furnishing

themselves with expensive cars and planes etc. These costs are above and beyond the remuneration package for the director, and are a direct loss to shareholders.

As with any other costs, agency problems will be captured by financial markets and reflected in a company's share price. Agency costs can be seen as the value loss to shareholders, arising from divergences of interests between shareholders and corporate managers. Jensen and Meckling (1976) defined agency costs as the sum of monitoring costs, bonding costs, and residual loss.

2.7. Composition of Board of Directors and Diversity:

It is a more than decade old that researchers began to look at how board diversity might enhance corporate governance and firm performance (Fields & Keys 2003). In probably the first research of its kind, Carter et al. (2003), in a study of Fortune1000 firms, find significant evidence of a positive relationship between board diversity, proxies by the percentage of women and/or minority races on boards of directors, and firm value, measured by Tobin's Q (Chung & Pruitt 1994). They also find that firms making commitment to increasing the number of women on boards also have more minorities on their boards and vice versa, and that the fraction of women and minority directors increases with firm size but decreases as the number of inside director's increases. Adams & Ferreira (2002), in using data from United States firms, found that gender diversity of corporate boards provides directors with more pay for performance incentives and that the boards meet more frequently. In terms of diversity, there is no proclamation that encourages private business to include minorities in their board rank in Ethiopia, there is however proclamation that encourages business to include women in their management as a minority. Hence it is difficult to find business with social responsibility of including minorities in their board rank.

In other western countries and Europe there is such policy that encourages companies to include minority. In relation with this by a study on Indian firms in US, Ramaswamy and Li (2001) find evidence that greater foreign directorship appears to be able to influence firms by discouraging unrelated diversification. Notwithstanding above, empirical studies on the relationship between board diversity and firm performance remain sparse to date. One explanation is insufficient development of testable theory. Hermalin and Weisbach (2001) comment that board specific

phenomena are not quite explained by principal-agent models and note that current theoretical framework including agency theory does not provide clear-cut prediction concerning the link between board diversity and firm value. On the other hand, firms have in recent years been increasingly pressured by institutional investors and shareholder activists to appoint directors with different backgrounds and expertise, under the assumption that greater diversity of the boards of directors should lead to less insular decision making processes and greater openness to change (Westphal & Milton 2000).

There are also strong conceptual and business propositions for diversity. A diverse workforce and diverse leadership within the firm can increase its competitiveness as a great variety of ideas and viewpoints are available for decision making, attract a larger base of shareholders and employees, and help retain existing as well as potentially gain new minority consumers (Cox 1993). Cox & Blake (1991) show how managing cultural diversity can create a competitive advantage for firms in six areas. These are cost, resource acquisition, marketing, creativity, problem solving, and organizational flexibility. Robinson & Dechant (1997) also present three business reasons for diversity. There are cost savings, winning competition and driving business growth. According to Robinson and Dechant (1997), in today's fast paced global market, diversity tends to encompass differences in gender, ethnicity, age, physical abilities, qualities, and sexual orientation, as well as differences in attitudes, perspectives and background.

In a report by the Conference Board, U.S. (Martino 1999) written with anecdotal evidence from some large corporations such as IBM, Ford Motor, Nortel, Lucent, Sara Lee, Texaco, and DuPont, diversity has been cited as an imperative for business success. The report cites the shift in labor market demographics, turnover rates, and the productivity gains of heterogeneous teams as primary drivers for diversity. The report also suggests that the truly diverse company is one that has minorities and women at every level of the workforce including the board of directors. With globalization bringing about diversity in clients, operations and market competition, it will be interesting to see how firms can respond to the challenge and more research on board diversity is needed in understanding how to establish a more effective and robust board. In another related work, the proportion of independent directors was found to have a significant positive relationship to firm performance (Weisbach, 1988). Firms with higher number of

independent directors are expected to pursue activities that would bring about low financial leverage with a high market value of equity (Baysinger and Butler, 1985).

In addition to Non-Executive independence, Jensen (1993) argues that separating CEO and chairman roles is in the shareholders' interest. Similarly, large firms that separate the two functions better with less probability of the director abusing power. Studies of the impact of boards/board effectiveness on corporate profitability and shareholder value have dominated corporate governance research in finance. These researchers focused on the influence of non-committees, have enhanced board effectiveness which in turn has added to shareholder value. For example, Dahya et al. (2002) investigated the relationship between top management turnover (a measure of board effectiveness) and financial performance (a measure of management effectiveness). Others have studied the appointment of non-executive directors and their role in monitoring company management, on behalf of shareholders (Bhagat and Black, 2002).

Research has considered whether there is a positive relationship between the number of non-executive directors (NEDs) and corporate financial performance, (Ferguson, Lennox and Taylor, 2005) concluded that generally showing that there is a positive relationship between the two. Researchers have also investigated the relationship between executive remuneration and financial performance (Jensen and Murphy, 1990). In a Nigerian study, Sanda et al. (2003) found that firm performance is positively related with small, as opposed to large boards. Since the duties of the Supervisory Committee are largely technical, it would be appropriate if at least one of the people elected to it has some finance experience or training. It is from whoever has some knowledge that the other members of the committee can be guided.

Independence of committees is also considered important for a board committee to be an effective monitor (Klein, 1998). John and Senbet (1998) report empirical evidence showing that the presence of monitoring committees (audit, nomination, and compensation committees) is positively related to factors associated with the benefits of monitoring. However, the presence of insiders in the compensation committees increases the probability of making decisions in favor of the CEO's interests (Newman and Mozes, 1999). Moreover, when the CEO sits on the nominating committee or when no nominating committee exists, firms appoint fewer

independent outside directors and more gray outsiders with conflicts of interest (Shivdasani and Yermack, 1999). In addition, the market's reaction to appointments of independent outside directors is more positive when the director's selection process is viewed as relatively independent of CEO involvement (Shivdasani and Yermack, 1999). Klein (2002) shows that independent audit committees reduce the likelihood of earnings management, thus improving transparency.

Finally, when the CEO serves on the nominating committee, the audit one is less likely to have a majority of independent directors (Klein, 2002). Corporate governance mechanisms assure investors in corporations that they will receive adequate returns on their investments (Shleifer and Vishny, 1997). Previous evidence suggests that corporate governance has a positive influence over firms' performance. A widely accepted statement is that good corporate governance results in a lower cost of capital. One explanation is that good corporate governance will lead to lower firm risk and subsequently to a lower cost of capital. The board of directors is assumed to have an influence on performance. The board is vested with responsibility for managing the firm and its activities. There is no agreement over whether a large or small board does this well. Yermack (1996) suggests that the smaller the board of directors the better the firm's performance. Yermack (1996) further argued that larger boards are found to be slow in decision making. The monitoring expenses and poor communication in a larger board has also been seen as a reason for the support of small board size (Jensen, 1993). However, there is another school of thought that believes that firms with larger board size have the ability to push the managers to pursue lower costs of debt and increase performance. Studies by Wen et al. (2002) and Abor (2007) both reported evidence in support of a positive relationship between board size and leverage. They argued that large boards with superior monitoring ability pursue higher leverage to raise the value of the firm.

2.8. Rewards and incentives:

One of the important thing is corporate governance in principal-agent relation in the structure of rewards and incentive to motivate directors to deliver short and long term wealth to shareholders and greater good to other stakeholders. In relation with this, Ari (2009) observes that institutions performance revolves around the relation employer-employee and job incentives to the employees. He argues that the agency problem and incentives are identified as macro-economic problems besides being microeconomic ones that affect performance in organizations. Thompson et al (2004), observes that company managers typically use an assortment of motivational techniques and rewards to enlist organization-wide commitment to executing the strategic plan. A director has to do more than just talk to everyone about how important new strategic practices and performance targets are to the organization's wellbeing.

Develtere and his associates (2008), observed that an important aspect of human resource management which needs special attention in co-operative organizations is the development of a reward system which will attract, retain, and motivate co-operative personnel, as well as provide training and promotional opportunities. Their findings reveal that Co-operative organizations in Asian and African countries have a poor reward system where directors and staff are not only poorly paid but are paid late. It is revealed that there are no provisions for rewarding superior performance or for a wage system based on merit and promotion criteria are based on seniority and length of service.

Thompson et al (2004), have found out that Financial incentives generally head the list of motivating tools for trying to gain whole hearted employee commitment to good strategy execution and operating excellence but they note that successful companies and managers normally make extensive use of such nonmonetary carrot-and-stick incentives as frequent words of praise, special recognition at company gatherings or in the company newsletter, more job security, simulative assignments, and opportunities to transfer to attractive locations, increased autonomy, and rapid promotion. Other motivational approaches to spur stronger employee commitment they note include: Providing attractive perks and fringe benefits, relying on promotion from within whenever possible, making sure that the ideas and suggestions of employees are valued and respected, creating a work atmosphere where there is genuine

sincerity, caring and mutual respect among workers and between management and employees, sharing information with employees about financial performance strategy, operational measures, market conditions and competitors' actions. In relation with Ethiopian government on credit association under credit and saving associations requires the appointment of the Chief Executive Officer (CEO) who is answerable to the Board of directors.

Burnes (2009) found out that employers and employees will increasingly come to look for new and more appropriate ways of rewarding and being rewarded. According to Chase et al (2006), when a comparison of common reward and incentive plans was made, it was found that merit pay and pay for knowledge are individual based and have the advantages of allowing management to target specific behavior and to easily evoke criteria over time, and allows management to target specific types of skills and personal growth respectively. They argue that profit sharing, gain sharing, lump sum bonuses and piece rates are applicable to groups and when applied have the advantages of tying business performance to employee rewards and allows management to target specific output goals. What is not clear is the effect of this motivational effort on performance of co-operatives.

2.9. Frequency of Board Meeting:

Vafeas (1999) finds that the annual number of board meeting increases following share price declines and operating performance of firms improves following years of increased board meetings. This suggests meeting frequency is an important dimension of an effective board. Lipton & Lorsch (1992) find that the most widely shared MAS Staff Paper No.29 March 2004 10 problem directors face is lack of time to carry out their duties, and that (Conger et al. 1998) board meeting time is an important resource in improving the effectiveness of a board. This frequency of board meeting should however tradeoff between costs and meaningful communications between board members during the meeting. Opposite to the view that frequency of board meeting increase performance and integration, an opposing view is raised by (Jensen, 1993), a problem that is a byproduct of the fact that CEOs almost always set the agenda for board meetings.

2.10. Board Committees (Nomination, Remuneration and Audit Committee) and their composition.

Board committees are an important component of the board structure in affecting firm performance. The areas considered important are the quality of financial reporting, director remuneration and appointment of directors (Spira & Bender 2004). Therefore, the Cadbury Committee (1992) recommended establishing oversight committees for remuneration of executive directors, the auditing of financial statements and appointment of directors, initiatives supported by agency theory, because independent monitoring alleviates agency problems. They considered board committees were an additional control mechanism that increased accountability and ensured the interests of the shareholders were safeguarded.

The establishment of board committees is expected to have a positive influence on the motivation of the directors and provide confidence in the financial reports of the firm. (Spira & Bender 2004) reported that the firms, which introduced board committees to the board structure, performed better than those without them, and showed a significant improvement in firm performance by firms which have introduced, nomination, audit and remuneration committees. Given the recommendation in the codes of practice, monitoring by board sub committees is expected to have a positive influence on firm performance. In Kenya a study conducted by Ademba (2010) reported that the FOSAs, which experienced frauds, were the same that neither had a signed code of ethics nor had established board audit committee.

2.11. Internal Control System and Governance

Whittington and Pany (2001) noted that the control environment sets the tone of the organization by influencing the control consciousness of people. They further assert that control environment is viewed as the foundation for all the other components of internal control. Control environment factors include; integrity and ethical values of personnel responsible for creating, administering, and monitoring the controls, commitment and competence of persons performing assigned duties, board of directors or audit committee's management philosophy and operating style. Whittington and Pany (2001) also believed that these factors set a basis upon which the other internal control components can be built. The two researchers asserted that control environment

provide a framework within which the other components operate. Internal control systems not only contribute to managerial effectiveness but are also important duties of boards of directors. Another thing to understand is that controlled environment supplements the other functions of internal control systems. It is the foundation for all the other components of internal control. It comprises of factors like integrity and ethical values of personnel tasked with creating, administering and monitoring the controls, commitment and competence of persons performing assigned duties, board of directors or audit committees, management philosophy and operating style and organizational structure. In addition to control environment, control activities refer to policies, procedures, and mechanisms put in place to ensure directives of the management are properly carried out. These appropriate and accurate documentation of policies and procedural guidelines helps to determine how the control activities are to be executed (Woolf, 1997).

Woolf stated that control activities are put in place by the management to make financial information authentic and reliable. For example, debtors cannot be written off without permission of finance director or any other person given authority to write off debts. Such control activities do not necessarily be in the nature of authorization. Further to this “Internal control also includes the program for preparing, verifying and distributing to the various levels of management those current reports and analysis that enable executives to maintain control over the variety of activities and functions that are performed in a large organization”. They mentioned internal control devices to include; use of budgetary techniques, employee training, and time studies, financial reporting among others. Morris (2011) believed that Enterprise Resource Planning systems provide a mechanism to deliver fast, accurate financial reporting with built in control activities that are designed to ensure the accuracy and reliability of the financial information being reported to shareholders. Ray and Pany (2001) also mentioned Control activities as another component of internal controls. They noted that control activities are policies and procedures that help ensure that management directives are carried out. Controls activities in an organization basically comprise; performance reviews (comparing actual performance with budgets, forecasts and prior period performance), information processing (necessary to check accuracy, completeness and authorization of transactions), physical controls (necessary to provide security over both records and other assets), and segregation of duties (where no one person should handle all aspects of a transaction from the beginning to the end).

2.12. Impact/effect of corporate governance on financial performance

According to Kennedy, Robert, Doreen, & Anthony (2011) study finding, there existed a relationship between financial reporting and financial performance of SACCO's at 5% level of significance. Management style also affected financial performance of SACCO's. There finding agreed with the stewardship theory which stipulates that a manager's objective is first to maximize the firm's performance because a manager's need of achievement and success are met when the firm is doing well (Coleman, 2008). The researchers conclude that the size of the board of directors affect financial performance. The study found out that there was a significant relationship between financial reporting and financial performance of SACCO's. SACCO's with more frequent financial reporting structures showed better financial performance. According to the study finding, there was a significant relationship between management style and financial performance of SACCO's. Participative management with democratic leadership enhanced the financial performance of SACCO's. The relationship between size of the board and financial performance was insignificant at 5% significance level. (Otieno, Mugo, Doreen, & Kimathi 2015).

2.13. Board Competency and Experience:

The level of expertise of board member's influences board effectiveness. For example, a qualified board of directors plays a key role in reducing agency costs by overseeing management's behavior. Likewise, board expertise and social networks provide a better governance mechanism for advising managers. Prior research concludes that qualified directors are more effective in board monitoring and encouraging higher levels of reporting quality. However, there is a controversy surrounding what constitutes a financial expert. Some studies suggest that directors who sit on several boards have developed reputation capital as experts (e.g., Fama and Jensen, 1983). Other studies, define a financial expert as a person who has relevant employment experience or professional certification in accounting and/or finance. For credit unions, the expertise of directors depends on the existence of sufficiently qualified board members who can be elected to the board. A concern arising from the governance structure of credit unions is that elected directors do not possess the required financial expertise to understand the financial conditions, risks and reporting of the credit union. Therefore, we argue that the financial expertise of each board member in the credit union contributes significantly to

effective monitoring and advising of managers; which in turn results in higher credit-union performance.

2.14. Board Independence

The issue of board independence revolves around Non-executive directors and this focuses on the issue of whether directors should be employees of or affiliated with the firm inside directors or outsiders has been well researched, no clear conclusion is reached. On the one hand, inside directors are more familiar with the firm's activities and they can act as monitors to top management if they perceive the opportunity to advance into positions held by incompetent executives. On the other hand, outside directors may act as "professional referees" to ensure that competition among insiders stimulates actions consistent with shareholder value maximization (Fama 1980). Fields & Keys (2003) conduct an extensive review of empirical research on outside directors and found overwhelming support from researchers (Brickley & James 1987; Weisbach 1988; Byrd & Hickman 1992; Brickley et al. 1994) who support the beneficial monitoring and advisory functions to firm shareholders. However, there appears no evidence that insider/outsider ratio is correlated with firm performance (Hermalin & Weisbach 2001) and that firms with more independent directors achieved improved firm profitability (Bhagat & Black 2002; Bhagat & Black 1999).

Baysinger & Butler (1985) advocate a mix of insiders and outsiders on the board and find empirical support that this approach enhances firm performance. Agrawal & Knoeber (1996) suggest that boards expanded for political reasons often result in too many outsiders on the board, which does not help performance. Carter et al. (2003) find evidence that the proportion of women and minorities on boards decreases when the number of inside directors on boards increases. Perhaps, one sensible approach is to assess the firm profile and the roles expected of the directors before deciding on the issue of outsider directors. Deli & Gillan (2000) find that firms with lower managerial ownership (of shares) and fewer growth opportunities are more likely to have independent and active audit committees. Klein (1998) examines board committees by classifying committees according to the two primary roles of directors: monitoring and decision-making (advising managers). She finds that firms increasing insider representation on committees associated with decision making e.g. finance and strategy committees have higher contemporaneous stock returns and return on investment. Like board size, empirical studies on outside directors is complicated by the endogeneity problem (Hermalin & Weisbach 2001). For example, Hermalin & Weisbach (1988) find that outside directors

are more likely to join a firm after poor performance, when firms leave product markets, or when a new CEO is chosen. Mak & Li (2001) find evidence that the proportion of outside directors of Singapore listed companies is negatively related to managerial ownership, government ownership and board size. It is felt that more research focusing on internal agency problems and inner working of the board will shed further insights on the use of outsider directors.

2.15. Risk management and corporate governance in saving and credit associations (SCA):

Good corporate governance practice gives a way to achieve the goal of reducing risks to the acceptable, manageable or eliminating risk if possible while delivering wealth and optimizing on performance at the same time (Vrajlal, 2006). Implementation of good governance according to Tandelilin (2007) is not only about better returns but also management of risks. This is because organizations can make financial losses if the risks are not well managed and they may even fail to achieve their objectives. Risk according to Deelchard and Padgett (2009) is the variability of returns that are associated with a certain asset and that must be minimized or else controlled. Risk is generally considered as the possibility of output that deviates from the expected and is usually negative outcomes that organizations need to look into. Spira (2003) pointed out that risk taking is important for every business, however cooperative financial institutions have higher exposure to credit risk and taking this credit risk is part of financial intermediation hence effective management by financial intermediaries is important to institutional viability and sustained growth. A study conducted by Okwee (2008) in Uganda revealed that 19.7% of the SCA had their portfolios being recovered as per agreed while the risk have their portfolios at risk of default.

Cooperative Associations change the available savings deposits into loans instantly, which have longer maturity transformation. Individual savings deposits are typically much smaller than an average loan and therefore requires multiple deposits to fund a single loan and these savings deposits are then changed by the societies with an absolute expectation of safety and repayment into credit risky loans to members. Most importantly, the loans advanced by these societies carry a fixed interest rate for their entire term, as opposed to those of commercial banks that can be adjusted at any time according to changes in market interest rates. Unfortunately, all these

financial transformations are quite risky (Bald, 2007). According to Brogi (2008) the governance system of financial intermediaries is more important because these institutions are mainly in the business of risk acceptance. However, many firms are yet to implement practices for better risk management (Kleffner *et al*, 2003). Tandelilin (2007) maintains that implementation of good corporate governance is not only concerned about better expected return but is also concerned about better managing of risk. The most important types of operational risk involve breakdowns in internal controls and corporate governance (Vrajlal, 2006). For instance, in a survey on the status of missing CSAs in Uganda, 23% of the CSAs collapse was explained by fraud and mismanagement by board executives and management (AMFIU report, 2007).

2.16. Summary of Literature and Research Gap

The issue of corporate governance is compounded by the absence of hard and fast rule in different countries of the world. In UK, corporate governance is ruled by the combined code which is the best practices. This is a principled based approach that requires listed companies to apply the code and explain the bit that they are not following. The cod of best practices is framework which include corporate governance, remuneration of board of directors, internal control, audit committee and non-executive directors. This code is developed over a period from early 1990's until early 2000 due to corporate failures in UK.

The other major corporate governance is the one followed US is issued through Sarbanes Oxley in 2002 after Enron failure. This code of governance is rules based. On other hand there is other source of corporate for other countries which is issued by Organization for Economic Cooperation and Development (OECD). Most countries developed either a principle based governance or ruled based governance and other countries combine both practices. In the case of Ethiopia, the corporate governance is at infant stage and the country has not developed its own corporate governance since, it has not adopted the IFRS requirements. Corporations and firms in concisely apply bits of corporate governance wherever convenient and wherever directors are aware of the benefit of good corporate governance to deliver shareholders wealth. There is the same practice for credit and saving association. This study therefore looks in the practices of corporate governance in Credit and Saving Association and try to determine how they are applying the practices.

2.17. Overview of Empirical Studies Conducted on Corporate Governance in SACCOs

Labie and Périlleux (2008) stated the need to conduct further studies in corporate governance of credit unions as a “promising field for research”. They stressed on the capability of cooperatives in providing good governance while experiencing growth maintaining their key essence. Four research areas has been highlighted in their study that focuses on understanding of what makes a credit union beyond legal titles, networking structures, relationship between governance and growth, and identifying suitable mechanisms based on the developmental state of credit unions. Though the concept of corporate governance has got prominence in profit making private entities, still a lot remains to be done in its implication on growth and performance of credit unions. This remains true in examining the inventory of researches done in Ethiopian context of both urban and rural SACCOs.

Among those limited researches conducted in Ethiopian SACCOs is the study made in East and West Gojjam RuSACCOs (Biruk, 2015). The study assessed rural saving and credit cooperatives financial performance, challenges and prospects in facilitating rural financing in East and West Gojjam Zones using WOCCU model with reference to PEARLS. The findings indicated that rural saving and credit cooperatives do lack healthy financial performance when compared with WOCCUs standards of excellence in protection, effective financial structure, asset quality, rates of returns & costs, liquidity and sign of growth with challenges of sustainability. Besides, serving as alternatives for filling the gap in financial intermediation, they do in fact contribute positively in service provision, awareness creation but lacks product mix and diversification. They are performing well in effective loan provision, efficient credit appraisal technique, stringent credit policy and acceptable interest rate on loan. However, they are also facing difficulties in meeting huge demand for loans, weak infrastructure, competition, lack of access to external funding, weak technical assistance from supervisory agencies, and inadequate staffing.

Mary (2014) in her research conducted in Kenyan Saving and Credit Cooperatives of Kakamega Municipality indicated that performance of most SACCOS have been deterred due to poor management, nepotism and embezzlement of funds. Despite the great potential of cooperative societies as agents for national development in the country, they have performed poorly. This poor performance is due to poor corporate governance practices by the management committees or other bodies entrusted with the responsibility of governing the cooperative. The study has identified two-

tier types of boards; the supervisory board and the management board. Yet, the board composition lacks gender balancing that men were the majority. Though the SACCOs do have various sub-committees, the importance of having an audit committee has been under emphasized in contrary to the SACCOs Societies Act of Kenya. She concluded her study suggesting for further research to assess the impact of corporate governance practices on financial performance of SACCOs.

Another study conducted on analyzing the effect of corporate governance on financial performance of SACCOs in Kenya revealed the strong relationship between financial reporting and financial performance of savings and credit cooperatives. Sacco's with more frequent financial reporting structures showed better financial performance. Besides it has identified the impact of management style on financial performance of savings and credit cooperatives. Participative management with democratic leadership enhanced the financial performance of Sacco's. On the other hand, size of the board has significant impact on financial performance. It emphasized the need for frequent and regular financial reporting and use participatory management style (Oriento et. al., 2015).

Further studies conducted on Kenyan SACCOs in Kericho Municipality (Mwangi et al, 2015) on effect of governance taken as an independent on financial performance as dependent variable. The study indicated that board of directors have great role they play in running of the SACCOs which include proper utilization of funds, proper supervision of management staff and the entire SACCOs and to ensure proper internal controls are in place. According to the study level of reporting does affect growth. As to the study, board of directors are elected by general assembly of members during financial statements are disclosed to members and entire public through the general meeting and publicized hence ensuring financial transparency. Board term runs for three years which is in compliance with the regulatory requirements of the supervisory agency. Corporate governance is strongly positively correlated with financial performance. Another study conducted on effect of governance on financial performance in SACCOs active in Kenya deduced that directors do affect the financial performance, involve in setting internal governance mechanisms, and periodic board monitoring affect financial performance (WAMBUA, 2011). The study recommends consideration to board size and composition including academic qualification. Besides, it stressed the need for SACCOs to conduct regular governance audits.

The research on corporate governance and performance of organizations revealed that large board size, board skill, management skill, longer serving CEOs, size of audit committee, audit committee

independence, foreign ownership, institutional ownership, dividend policy and annual general meeting are positively associated with the performance of organizations. Organizations are encouraged to adopt good corporate governance practices to improve their performance and also to protect the interest of the shareholders. Most importantly the regulatory authorities must ensure compliance with good governance and apply appropriate sanctions for non-compliance to help the growth and development of industries in the country (Mudashiru et al, 2014). It was discovered that the adoption of good corporate governance practices enhances transparency of company's operations, ensures accountability and improves firm's profitability. It also helps to protect the interest of the shareholders by aligning their interest with that of the managers. The annual reports and the financial statements of the companies are the main means of communication between the company and the stakeholders. Therefore, the sensitive role of the audit committee by ensuring that the financial statements show the true position of the company's performance cannot be over emphasized. The audit committee must be well constituted to increase its independence and with the right size.

The issue of capital adequacy has also been raised in studies conducted on SACCOs. Insolvency is a major risk to SACCO's hence a source of finance instability (MbuliKivuvo and Olweny,). Kenya's enhanced regulatory requirement has emphasized on capital adequacy requirements for SACCOs and developed financial reporting standard (CAMELS). They made analysis of SACCO financial statement to determine financial performance, predictor variable potency and models contribution to financial stability. The study advocates for regulators and policy makers in reshaping capital adequacy requirements and urges SACCOs to improve their liquidity, profitability, operating efficiency and total assets turnover to actively engage in business.

2.18. Conceptual Framework

Corporate governance mechanisms are divided into three major elements: external governance, internal governance and linkages between the external and internal categories.

External Corporate Governance

External corporate governance consists of legislation, capital markets, financial structure and ownership structures. Legislation determines the overall framework and rules the way business is done. It includes cooperative society's proclamations, securities market act, auditing act, competitive legislation among others. Legislation has a pivotal role in the control of a company as it incorporates

the rules governing management of a company mainly boards, disclosure requirements and others given its variations across business types and countries as well. Thus, we will have a look at the overall legislative framework for governing of cooperatives active in Ethiopia. The second element of external governance is of capital markets. The existence and functioning of capital markets greatly influences the form of corporate governance linked with source of financing as equity shares, debt financing or securities markets. Though Ethiopia has no functional and vibrant capital markets yet cooperatives have been involved in owning significant shares in various businesses including at banks. Thus, an effort will be made to highlight the role these cooperatives do have in the financial sector and investment activities they are involved in. The third element of the external governance focuses on the financial structure of cooperatives. This refers to share transferability, valuation of share values, and size of share ownership. Besides, debt financing as a source of financing for growth and leveraging for a cooperative is also a component. The last component of the external governance is the nature of ownership. It refers to ownership structure and concentration of shareholdings among members of a cooperative. It relates to the control exercised on the cooperative through the degree of ownership members do have in terms of shares owned. Though cooperatives do have one share-one vote kind of exercise, an attempt will be made on overall ownership attributes and its impact on cooperative governance and its performance.

Internal Governance

Internal governance includes the board and its practices, incentive schemes, reporting practices, hierarchy and organization, structure and corporate culture.

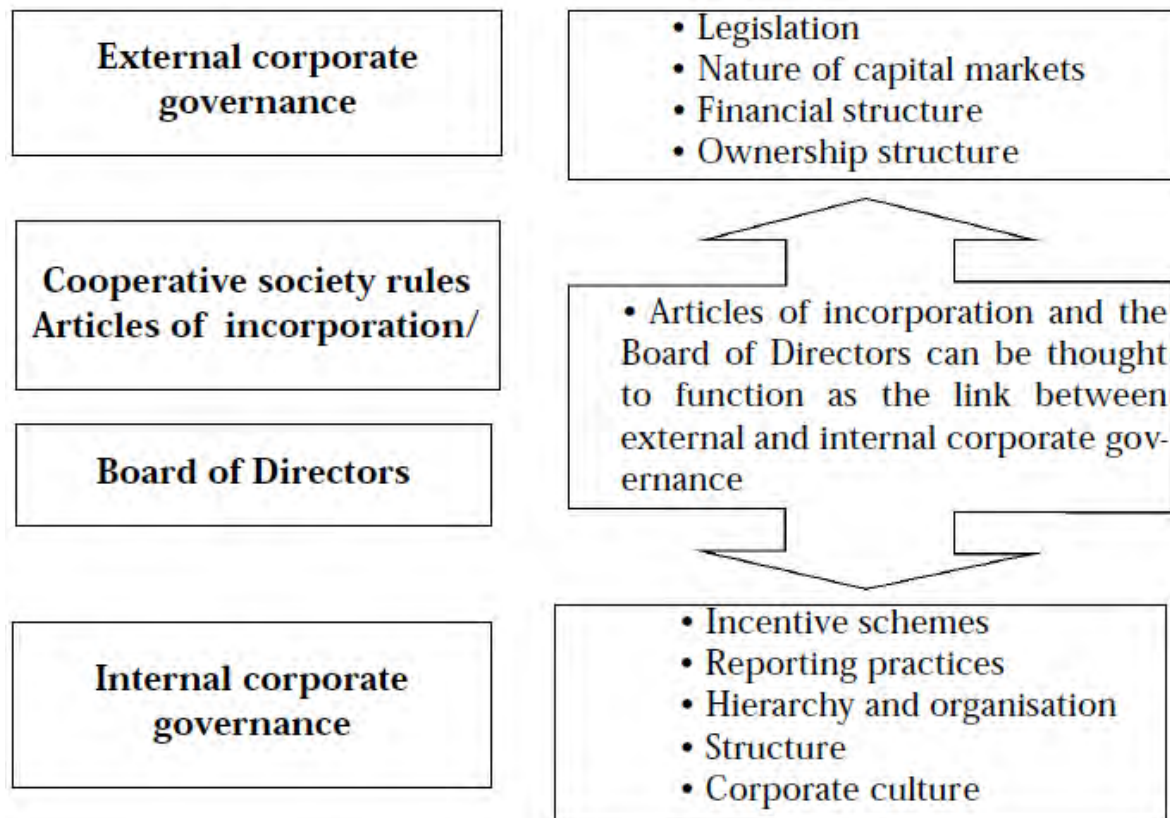
Composition of the Board and Its Practice

A model used in most cooperatives established by owner-members takes two forms of two-tier structure composed of supervisory board and a board of directors. The members do have representation at two levels. The supervisory board can be taken as a common body of the member-owners positioning itself and deciding on long-term issues and dedicating itself to advance decision of owners. Thus, clear definition of responsibilities, roles and tasks between management structures at supervisory board, board of directors and operational management should be clearly defined to get the best out of it to make value adding contributions. Yet, the other model of single board of directors which focuses on duties and responsibilities of board members including their familiarity with the business sector and its operation is also an alternative model. The other models include a mix of directors with operations management as a member, boards with inside and outside executive

directors. The key concern in a cooperative is establishing an effective and vibrant board of directors and clearly set expectations from the board in promoting overall goals of the cooperative benefiting member-owners. Besides, in compliance with the legal requirements stipulated, an option of including non-members in the board with adequate skill and expertise may be considered. In sum, a governance structure with member representation functions better when the cooperative is local and its operations are extension of its members' businesses. (Pellero, Confederation of Finnish Cooperatives, 2000).

While in deciding the composition of the board, members of a cooperative should emphasize on key attributes of board members and the board chairperson as well. There are cooperatives in which the seats on the supervisory board are divided on a party political basis. Whereas this does not make the members any less competent or biased in representing the owners' interests, it easily leads to the problem of outside interests conflicting with those of the owners. Finally, it is useful to remember that no organizational structure automatically guarantees good corporate governance. Neither does the cooperative form of enterprise make all cooperatives so similar that they would be justified in having the same system. Non-executive directors may have the tendency to strictly control its background interests.

Another important aspect of human resource management which needs special attention in cooperative organization is the development of a reward system which will attract, retain, and motivate cooperative personnel as well as providing training and promotional opportunities. (Develtere, 2008). Financial incentives generally head the list of motivating tools for trying to gain whole hearted employees commitment to good strategy execution and operating excellence but they note that successful companies and managers normally make extensive use of such nonmonetary carrot-and-stick incentives as frequent words of praise, special recognition at company gatherings or in the company newsletter. (Thompson et al, 2004)



PEARLS as a tool to measure financial performance of cooperatives

PEARLS deals with key elements of protection, effective financial structure, asset quality, rates of return and cost, liquidity, and sign of growth. Protection principle is to ensure that the financial institution provides depositors a safe place to save their money. Financial structure is the most important variable that affects growth, profitability and efficiency. Effective Financial Structure area of PEARLS emphasizes on an institution's sources of funds and its uses of funds. Asset quality is also the main variable that affects profitability. An excess of dodged or delayed repayment of loans have adverse effects on credit union earnings as those assets are not earning income. The intent of rates of return and costs is for an institution to: pay real rates of return on savings and shares, and charge rates on loans that recover all. Managing liquidity is an essential component of administering a savings institution. Signs of growth reflect member client satisfaction, appropriateness of product offerings and financial strength. (WOCCU, 2002).

CHAPTER THREE

3. RESEARCH DESIGN & METHODOLOGY

This chapter describes the methodology that was employed in order to undertake the research. It outlines research design, area of study, population of the study, sampling size, procedures, data sources, and data collection instruments.

3.1. Research Design

The study adopted descriptive research approach of both qualitative and quantitative through employing a questionnaire as a primary data source distributed to Board Members of the three Saving and Credit Cooperatives namely Ethiopian Electric Power Corporation (EEPCo), Ethiopian Airports Enterprise, and Catholic Relief Services functional in Addis Ababa taken as a case. Secondary data mainly of financial information was collected from SACCOs' charter and audited financial reports. The study aimed at assessing corporate governance practices and challenges at three of the sample Cooperatives including a brief overview of their financial performance.

3.2. Data Type and Source

To undertake this study, both primary and secondary data was collected. The primary sources of data were obtained from SACCO board members. Secondary sources of data include SACCO's audited financial report and Cooperative Charter of the SACCOs.

3.3. Data Collection Instruments

Primary data were collected with self-administered questionnaire that was completed by SACCO Board and Board sub-committee members. The questionnaire was designed to answer the specific objectives and research questions. The questionnaire has comprised both qualitative and quantitative questions. Secondary data were collected from SACCO's company charter and their audited financial reports.

3.4. Sampling Design and Sampling size

All SACCOs were population. The number of SACCOs were targeted study population. While making the SACCO board members as a sample framework and SACCO board members target respondents, purposive sampling technique were used. The majority (above 84%) have been members of the Cooperatives for over five years. Secondary data were also gathered from published materials and SACCO's annual reports for the two years' period of 2011 and 2012 as similar three years audited financial reports were not available.

3.5. Data Analysis Techniques

Data analyses were conducted for bringing order, structure and interpretation to the mass of collected data. The data input using questionnaire, and secondary sources were systematically organized in a manner to facilitate analysis. The data analyses involved preparation of the collected data - coding, editing and cleaning of data in readiness for processing using Statistical Package for Social Sciences (SPSS) Version-20 for Windows and descriptive data analysis were used. Though the intent was to do some statistical test on variables, limited data set and sample size taken constrained to performance further tests.

CHAPTER FOUR

4. Data Analysis Result and Discussion

This section of the paper presents and analyses the data collected from primary and secondary sources. The objective of the study was to assess governance practices in Saving and Credit Cooperatives (SACCO) in Addis Ababa taking the case of SACCO's of EEPCCO, Ethiopian Airports Enterprise, and CRS with relation to governance principles and standards and PEARLS financial performance monitoring tool of the World Council of Credit Unions (WOCCU).

4.1. Data Analysis Result and Discussion

Corporate governance practice of the above mentioned SACCO's were studied comparing against governance principles and basic governance mechanisms with a set conceptual framework for analysis focusing on internal governance, external governance, compliance with statutory requirements and functioning of the board within Cooperatives. Comparisons have also been made across the three SACCOs. A brief analysis of their financial performance using PEARLS as a tool has been made.

4.2. External Corporate Governance Practice

External corporate governance consists of legislation, capital markets, financial structure and ownership structures. Legislation determines the overall framework and rules the way business is run. It includes cooperative society's proclamations. Legislation has a pivotal role in the control of a company as it incorporates the rules governing management of a company mainly boards, disclosure requirements and others given its variations across business types and countries as well (WOCCU (2000)).

The study identified on ways of ownership in those Cooperatives indicated and found a mix of results that two of the SACCOs, Airports Enterprise and EEPCCo do issue shares of ownership whereas CRS has no such experience of defining ownership through issuance of shares to

members. As indicated on Table 3 below, Membership fees for registration are common in three of them. Further, according to cooperative societies proclamation number 147/1998, section 19; it gives the right to transfer shares of ownership to a legal heir though it lacks in two of the SACCOs, Ethiopian Airports Enterprise and Catholic Relief Services. Yet, though not transferable, members can keep their ownership even after leaving the organization at Ethiopian Airports Enterprise. In the case of CRS, membership is not totally transferable; leaving the organization for any reason results in instant termination of membership with the SACCO with the only refund of savings with accrued interest offset against loan balances with no claim for accumulated profit. Thus, still there are ambiguities and lack of clarity and consistency within the industry on defining ownership, transferability and liquidation of shares when a member joins and leaves the cooperatives.

Profit sharing schemes within the SACCOs has also been assessed. SACCOs do generate earnings and incur operational expenses resulting in a net income or loss. At times of good operational performance, they use the profits to pay dividends to members and retain part of it to capitalize the cooperative. The unique feature of cooperatives is that members do benefit from the profit sharing scheme though they pay interest as borrowers at the end of the day. The income generated will then be distributed back to them. However, as indicated below, it's mostly dependent on the amount of savings one has accumulated and equivalent to bank interest rate on savings. This greatly favors borrowers than savers. Besides, Cooperative Societies Proclamation No. 147/1998, section 16, states that any cooperative association should pay dividend from income to members after retaining 10% of the net income.

Table 3. Ownership, Transferability of Shares and Profit Sharing Scheme

		ORGANIZATION			Total
		CRS	Airports Enterprise	EEPCo	
Did SACCO ownership defined in the form of shares?	Yes	-	29.5%	29.5%	59.1%
	No	40.9%			40.9%
Total		40.9%	29.5%	29.5%	100%
Transfer of shares/ membership?	Transferable		2.3%	29.5%	31.8%
	Non-Transferable	40.9%	27.3%		68.2%
Total		40.9%	29.5%	29.5%	100%
Saving Interest Rate		36.4%	22.7%	27.3%	86.4%
If there is dividend payment to members, how is profit sharing scheme (dividend payment) set?	Amount of average saving ratio per member	2.3%	4.5%		6.8%
	Annualized saving amount	2.3%	2.3%	2.3%	6.9%
	Total	40.9%	29.5%	29.5%	100%

Source: Survey data (2016)

4.2.1. SACCO Board Composition, Educational Status and Professional Background

The Basel Committee on Banking Supervision identified in its corporate governance principles of board composition that the board should be comprised of individuals with a balance of skills diversity and expertise that collectively possess the necessary qualifications appropriate with the size, complexity and risk profile of the organization (Basel Committee 2015). Gender composition in the Board, internal audit and female CEO has positive impact on performance of financial institutions ((Mersland and Strøm, 2009).

Given the critical impact of board composition on governance and performance, the Study made analyses of board composition of the three SACCOs in terms of gender, educational status and professional background. As shown on Table 4, female members are better represented in CRS followed by Airports Enterprise. Yet, at EEPCo, it's below 20%. Overall, the representation of female members stood at 30% for three of the cooperatives. The trickledown effect has been seen in their presence within sub-committees of the Board. Most of the members of more than 68% are well experienced as they are within the age group of 40 and above. However, the presence of those below 30 years of age is minimal at 2.3%. Most of the committee members are from the support departments like finance, human resources and logistics. On the other hand, academic

qualification of the Board members seems astounding that more than 95% do have first degree of which around 30% did their second degrees particularly at CRS.

Table 4. Board Composition, Educational Status and Professional Background

		Organization			
		CRS	Airports	EEPCo	Total
Gender					
	Female	43.0%	33.0%	14.0%	30.0%
	Male	57.0%	67.0%	86.0%	70.0%
Total		100.0%	100.0%	100.0%	100.0%
Age Group					
	18-29	0.0%	2.3%		2.3%
	30-39	18.2%	6.8%	4.5%	29.5%
	40-49	15.9%	9.1%	13.6%	38.6%
	>50	6.8%	11.4%	11.4%	29.5%
Total		40.9%	29.5%	29.5%	100.0%
Professional Composition (Department working within the organization)					
	Technical or Program	18.2%	4.5%	2.3%	25.0%
	Support Services (like Finance, Log, HR)	22.7%	25.0%	27.3%	75.0%
Total		40.9%	29.5%	29.5%	100.0%
Educational Status					
	College Diploma	2.3%	2.3%		4.5%
	First Degree	18.2%	22.7%	25.0%	65.9%
	Second Degree and Above	20.5%	4.5%	4.5%	29.5%
Total		40.9%	29.5%	29.5%	100.0%
Educational field of study					
	Business and Finance	20.5%	22.7%	27.3%	70.5%
	Natural Sciences	4.5%	2.3%		6.8%
	Other Social Sciences	15.9%	4.5%	2.3%	22.7%
Total		40.9%	29.5%	29.5%	100.0%

Source: Survey Data (2016)

As indicated on Table 4 above, the educational background of the Board is of in areas of business and finance which positively contributes in managing the cooperatives given the line of business these cooperatives are engaged in. Others do have backgrounds in social as well as natural sciences. A study conducted in Kenyan SACCOs stressed same finding on gender representation in the Board. As to Mary (2014) the board composition lacks gender balancing that men were the majority.

4.2.2. Audit and Compliance with Statutory requirements and articles of incorporation.

According to corporate governance principles identified by the Basel committee on banking supervision, organization should have an effective independent risk management function, with clear direction, sufficient height, independence, resources and access to the board. Risk has to be identified, monitored and controlled on an ongoing basis. There also should be healthy communication within the organization regarding risk, through reporting to the board and senior management. To be compliant, the Committee stressed establishment of a compliance function and approval policies and processes for identifying, assessing, monitoring and reporting and advising on compliance risk. Further, the internal audit element provides independent assurance and support to the board and senior management in promoting an effective governance process and the long-term reliability of the organization. (Basel Committee 2015)

It is also indicated in cooperative societies proclamation number 147/1998, under section 36, regarding audit and control. It states that “The appropriate authority shall audit or causes to be audited by a person assigned by it, the accounts of any society at least once in a year.” The audit report shall be present to the general assembly, submitted to the office of the authority and accessible to members. Thus, the study has made a brief overview the regularity of annual audits and compliance to statutory requirements of supervisors. Yet, though there were efforts to have their annual returns audited, still there are gaps in conducting those audits in time and annually after closure of the fiscal period like in EEPCo. This may be attributed to the gaps in the supervisory agency to reach to all SACCOs in Addis Ababa as well as delay in preparation of the financial reports from the side of SACCOs. However, still it relies on the supervisory authority to ensure provision of annual audit service in time. Besides, retention and accessing of those audit reports was a concern in all of the SACCOs. A research conducted on Kenyan SACCOs indicated that financial reporting and disclosure impacts performance through ensuring financial transparency and building trust of members. Board term runs for three years which is in compliance with the regulatory requirements of the supervisory agency (Mwangi et al, 2015). Corporate governance is strongly positively correlated with financial performance.

Table 5. Audit and Compliance

Question	Response	ORGANIZATION			Total
		CRS	Airports Enterprise	EEPCo	
Did the SACCO undergo through annual audit every year	Yes	40.9%	29.5%	9.1%	79.5%
	No			20.5%	20.5%
Total		40.9%	29.5%	29.5%	100%
Based on prior audits and supervision activities of the Cooperative agency, to what extent does the SACCO comply with statutory and regulatory requirements for SACCO's?	Most Compliant	34.1%	18.2%		52.3%
	Moderately Compliant	6.8%	11.4%	29.5%	47.7%
Total		40.9%	29.5%	29.5%	100%
To what extent does the SACCO comply with its own articles of incorporation, internal policies and procedures?	Most Compliant	34.1%	18.2%	22.7%	75%
	Moderately Compliant	6.8%	11.4%	6.8%	25%
Total		40.9%	29.5%	29.5%	100%
Does the SACCO have its own recruited employees to handle the day to day operation?	Yes		29.5%	29.5	59.1%
	No	40.9%			40.9%
Total		40.9%	29.5%	29.5%	100%
Did you get any technical and supervisory support from the respective Cooperative Agency?	Yes	36.4%	27.3%	27.3%	90.9%
	No	4.5%	2.3%	2.3	9.1%
Total		40.9%	29.5%	29.5%	100%

Source: Survey Data (2016)

As indicated on Table 4.3, overall almost half of the respondent board members believe that they are moderately compliant with statutory requirements including the conditions of the supervisor. Specifically, majority of CRS Board members responded that they are most compliant to the regulatory requirements. Similarly, most of Board members of Ethiopian Airports Enterprise believe that they are most compliant with both statutory, and regulatory requirements and their articles of incorporation. Further, all respondents of EEPCo Boards recognize that they are moderately compliant with statutory, and regulatory requirements. Besides, while reviewing management letters of those audited financial reports, there were no material compliance matters reported accompanying those financial reports.

Board tenure is another area of compliance requirements per the Proclamation of Cooperatives No. 147/1998, section 23, service tenure of management committees is set for a period of three to six year. Hence, the practice is in line with the requirement where Board members do serve a maximum of two terms with three years per term. In short, a Board member cannot serve more than two terms. The selection has been done in the presence of a representative or delegate from the respective authority of cooperatives agency.

Given the large size of members and routine savings and loan transactions like in Ethiopian Airports Enterprise and EEPCo SACCOS, they require having independent full time employees. Both SACCOS at Airports Enterprise and EEPCo has recruited their own staff to handle the day to day operation. However, CRS has no permanent staff to handle those financial and administrative tasks. The task has been given to a permanent staff of the organization who is also member of the SACCO to work on part time basis. This may be attributed to small size members though the resources under the SACCO are significantly material. All of the SACCOS uses excel spreadsheet to monitor their financial activities. This requires support on the side of the supervisory agency to help them switch to a better application affordable to them. As it is indicated on Table 4.3, though most of the board members indicated that they are getting adequate technical and supervisory support, still there are members who believe that the Agency would rather contribute much better than what is currently doing to strengthen the industry. A study conducted on effect of governance on financial performance in SACCOS active in Kenya deduced that directors do affect the financial performance. The study recommends consideration to board size and composition including academic qualification. Besides, it stressed the need for SACCOS to conduct regular governance audits (Wambua, 2011). Board term is three years for SACCOS in Kenya (Mwangi et al, 2015).

4.3. Internal Governance Practice

The internal governance aspect of SACCOs refers to the internal policies, procedures and incentive schemes employed in conducting business of acceptance of saving deposits and provision of credit facilities to member-owners. The study has assessed how some of the processes have been taking place in those SACCOs.

4.3.1. Incentive Scheme for Board Members

Basel committee on banking supervision has identified corporate governance principle on compensation which states remuneration structure should support sound corporate governance and risk management. Incentive schemes influence the way through which the board and senior management promote good performance, take acceptable risk taking behavior and reinforce organizational operations and risk culture. Systemically important financial institutions should have a board compensation committee as an essential part of their governance structure and organization to oversee the compensation system's design and operation. The remuneration structure should be in line with the business and risk strategy, objectives, values and long-term interests of the SACCO'S. It should also incorporate measures to avoid conflicts of interest. Incentives entrenched within remuneration structures should not incentivize the board to take excessive risk.

The study identified whether there are incentive mechanisms in the SACCOs to motivate Board members. However, the result turned to be mixed. There is no incentive scheme for Board members of CRS Employees savings and credit association as a compensation for taking risk and oversight function of the Cooperative either in kind or in cash. However, Ethiopian Airports Enterprise and EEPCo SACCOs have incentive schemes for their Board members in the form of allowances. In all of the three SACCO's, there are no shares options as an incentive for Board members. Ethiopian Airports Enterprise Employees saving and credit association has both transport and airtime allowance incentive scheme for its Board members while EEPCo's Employees savings and credit association has only transport allowance scheme to their board members.

Table 6. Incentive Schemes for Board Members

Incentive to Board Members	YES			NO		
	CRS	Airports Ent.	EEPCo	CRS	Airports Ent.	EEPCo
Additional Shares	-	-	-	100%	100%	100%
Cash Payment	-	62%	-	100%	38%	100%
Transport Allowance	-	69%	100%	100%	31%	0%
Mobile/Airtime Allowance	-	92%	-	100%	8%	100%

Source: Survey Data (2016)

4.3.2. Credit Facilities, Saving Deposits and Investment Activities

Saving and Credit Cooperative do play a pivotal role as a financial intermediary and investment vehicle through channeling saving deposits to the economy while serving their members. According to the World Bank report of 2012, the gross savings rate was a mere 3.2 percent of GDP in the period between 2004 and 2010 which is by far behind from the Korean and Chinese experience of their growth periods which were beyond 25% of their GDP. It has stressed the need for domestic resources mobilization in the form of savings to expedite ambitious investment plans. Yet, besides the low financial penetration, persistent negative real interest rates affected the private savings rate further (the World Bank, 2012). Hence, SACCOS contribution in mobilizing core deposits to the economy is paramount. Further, SACCOS should also ensure safety of hard-earned savings of members through managing their risk exposure including credit risk.

Good corporate governance practice gives a way to achieve the goal of adequate risk management in maximizing opportunities while reducing risks of loss to the level tolerable while delivering wealth and optimizing on performance (Vrajlal, 2006). Implementation of good governance according to Tandelilin (2007) is not only about better returns but also management of risks. This is because organizations can make financial losses if the risks are not well managed leading to failure to achieve their objectives. Cooperative financial institutions are highly exposed to credit risk due to the peculiar financial intermediation role.

Cooperative Associations channel the available savings deposits to members in the form of loans. Individual savings deposits commonly termed as core deposits are typically much smaller than an average loan and therefore requires multiple deposits to fund a single loan and these savings deposits are then changed by the societies with an absolute expectation of safety and repayment into credit risky loans to members. Most importantly, the loans advanced by these societies carry a fixed interest rate for their entire term, as opposed to those of commercial banks that make adjustments at any time according to changes in market interest rates. Unfortunately, all these financial transformations are quite risky (Bald, 2007). According to Brogi (2008) the governance system of financial intermediaries is more important because these institutions are mainly in the business of risk acceptance. (Kleffner et al, 2003).

According to the audited financial document review and response of the three SACCO Board members, all the three SACCO's use banks to manage deposits collected from individual SACCO members. Savings are collected from members on payroll of their employer and remitted to the Saving Association each month. The savings collected are then deposited in a savings bank account opened in the name of the Cooperatives. Members savings that represent a lion's share of total liability of the cooperatives do earn an annual interest rate of 5% which is the risk free market rate offered in most commercial banks on saving accounts. However, the rate is not sufficient enough to maintain the real value of the savings compared to the higher inflation rate at present. While ease of accessing savings in time, it takes almost a week to get savings drawn. This seems extended for those members in urgent need for savings withdrawal and in comparison with simplicity in savings in a bank.

Table 7. Access to Savings

		Organization		
		CRS	Airports Enterprise	EEPCo
Time it takes to withdraw savings	1-2 days	5%	38%	23%
	3-4 days	6%	18%	27%
	One week	89%	44%	50%
	> One Week	-	-	-

Source: Survey Data (2016)

The loan portfolio taken as a productive asset of Cooperatives is another product besides savings offered to members. The loan terms include amount, repayment period, cost of borrowing as interest rate, purpose and collaterals attached with it to ensure timely repayment of the funds disbursed. SACCOs where this study has been undertaken have set maximum loan size, maximum period for repayment and interest rates the loan bears. However, it varies across SACCOs. The current maximum loan size given by Ethiopian Airports Enterprise Employees SACCO is ETB 130,000 with an amount equivalent to three months' salary with 8.5% interest due over the maximum loan repayment period of six years. The ceiling for loans EEPCo advances to members' amounts to ETB 150,000 with an interest rate of 8.5% payable over a maximum repayment period of six years. Thus, the terms on interest rate and maximum repayment period are same for Ethiopian Airports and EEPCo. Thus, while the income generated from one Birr in loans is below nine cents, savings per one Birr cost five cents remaining with an income of below four cents to cover operating expenses, dividends and capitalization, if not inflation as well.

The maximum loan size given by CRS Employees SACCO is 12-month salary which means the person with high amount of salary will access bigger loans than a member with lower salary. The saving rate on deposits is 5% while interest rate on loans is 6% which is much lower compared to the other two SACCO's and the maximum loan repayment period is four years. Thus, loans are cheaper at CRS than the two SACCOs. Yet, it greatly impacts financial sustainability of the SACCO and minimal dividend payout plan to encourage savers leading to real negative value on savings of depositors. Currently, risk-free market interest rate for saving deposits is 5% while average loan interest rate is around 14%, save microfinance institutions, which is subject to change with inflation rate, nature of business and time period for loan repayment. However, loan interest rate of the three SACCOs remains stagnant which doesn't consider at least yearly inflation and time value of money.

While thinking of governance in SACCOs, it is inevitable to think of prudent exercise in ensuring the health of their loan portfolio through designing various mechanisms to minimize risk of default and subsequent loan loss. Some of the mechanisms include reliance on members' savings, putting conditions on provident funds, personal guarantee, insurance coverage and linking repayments with monthly payroll of employees. According to the respondents all the

three SACCO's use individual members' saving as a collateral including personal guarantee for the loan.

With regard to managing risk to loan loss due to default in repayment of loans related to credit facilities given to SACCO members, both Ethiopian Airports Enterprise and EEPCo SACCOs have insurance coverage. CRS Employees SACCO depends on provident fund and personal guarantee within employees of the organization. Individual SACCO members of both CRS and Ethiopian Airports Enterprise can withdraw from their savings without impacting their membership. and the time it will take for them to receive the loan from their loan application date to disbursement is one week and from 1 day to a one-week time respectively. From the three SACCO board and committee members 87% of response the in the next table we can see that the time it will take for an individual SACCO member from loan application time to disbursement is 1-2 weeks' time whereas the rest of the average 13% respondent believe that it will take 3-4 weeks to receive a loan from loan application to disbursement.

Table 8. Loan Processing Time

		Organization			
		CRS	Airports Enterprise	EEPCo	Average
Time it takes to access loan from application to disbursement	1-2 Weeks	83%	85%	92%	87%
	3-4 Weeks	17%	15%	8%	13%
	5-6 Weeks	-	-	-	-
	> 6 weeks	-	-	-	-

Source: Survey Data (2016)

Almost all of the three SACCO's board and committee member's response, the major purpose of loan applications from individual SACCO members are for purchase of fixed assets like auto and mortgage, marriage, school fees, and medical.

Besides the central role of serving as custodian of savings and provider of credit facilities to members those SACCOs contribute as investment vehicles. Though their involvement in investment activities is still minimal, three of the SACCOs do have at least interments through equity ownership of various financial and non-financial ventures. Ethiopian Airports Enterprise SACCO has share ownership at Addis International bank and Addis Ababa Saving and Credit Cooperatives. Ethiopian Electric Power Cooperation Employees SACCO has also share

ownership at Zemen Bank including representation in the Board of the Bank as well as with Addis Ababa Saving and Credit Cooperatives. CRS Employees SACCO has share ownership at Addis Saving and Credit Cooperatives though the amount of share is insignificant. One deterring factor in investing in equity ownerships may be related to the process it takes to get consensus in collective decision of the Board and its members.

Even if the life blood of SACCOs as a source of funding comes from members' savings, they can have access to external funding in the form of debt financing. However, none of the three SACCOs do not involve in soliciting these funds. Some other sources are dividends from various investments and interest income from deposits in a bank. For instance, according to the audited financial statement, Ethiopian Airports Enterprise Employees SACCO and EEPCo Employees SACCO have funding source from bank loans, dividend income from share investment in a bank and Addis Ababa Saving and Credit Cooperatives, and from interest income on saving deposits. However, according to the audited financial report, CRS Employees SACCO's source of external funding is only interest income from saving deposits in a bank.

4.4 Financial Performance of Saving and Credit Cooperatives

Saving and Credit Cooperatives (SAACOs) do have dual mission of achieving financial sustainability while serving their members interests of ensuring as a safe custodian of savings deposits and dependable alternatives of availing credit facilities in demand. They should be able to ensure sound financial discipline not only to protect saving deposits but also to maintain its real value while covering its running costs from income generated from its diverse portfolio in the form of interest revenue or income. Thus, while discussing the issue of governance in these institutions, the bottom line of effective and efficient financial governance and risk management prevail forefront. Thus, the World Council of Credit Unions (WOCCU) has introduced financial monitoring tools to assess performance of credit unions with an acronym "PEARLS" in late 1990s focusing on five key areas requiring analysis of the financial position and operational results employing over forty ratios and percentages. This study focuses on a selective of key elements within each major category. It helps to make in-depth examination of cooperatives related to **Protection**, **Effective financial structure**, **Asset quality**, **Rates of return and cost**, **Liquidity** and **Signs of growth**. The PEARLS do serve as management tool to focus on sensitive

areas to find possible solutions, enhance standardization in financial ratios applicable for the industry for ease of comparability, create a room for ratings and rankings of these cooperatives with objectivity, and facilitate supervisory role (Richardson, 2002). This study has undergone a brief assessment of financial performance of the three Cooperatives, CRS, Airports Enterprise and EEPCo using PEARLS as a tool.

4.4.1 Protection

The strength of a cooperative in controlling loan losses arising from non-performing loans to a minimum, if not to zero level, is considered as a guard against risk to savings deposits given that loan portfolios are financed from members' deposits. Besides, keeping adequate provision for loan losses is considered as a reflection of having adequate protection to savings deposits. WOCCU has set a standard of having a full provision of an amount equivalent to substandard loans overdue more than a year and a 35% provision for loans overdue less than a year. As indicated on Table 3 of the PEARLS analysis, three of the SACCOs do not have provisions for loan losses. This implies that they do have a strong mechanism of ensuring full recovery of maturing loans in time with almost zero or negligible portfolio at risk. To the contrary, they may not also disclose substandard loans in tier reporting. However, still it is commendable to have some level of provision though their portfolio is current from prudence and wise risk management perspective

4.4.2 Effective Financial Structure

The effective financial structure assesses the composition of the financial position of the cooperatives as to resources and its sources. It's decisive in affecting potential for growth, income generating capacity and financial health of a given cooperative. It focuses on the level of investment in productive assets including the loan portfolio as a major income generating source and resources considered as unproductive. As to WOCCU, the share of net loan portfolio is expected to be 70-80% of total assets and liquid short term investments to be from 10-20% while the rest of around 5% on fixed assets considered as unproductive for SACCOs. Further, the source for funding is expected mainly from savings of members taking 70-80%; 10-20% of

member share capital and 10% to be from institutional capital accumulated as retained earnings from yearly income as capitalization.

The study revealed that two of the SACCOs, CRS and EEPCo, are not efficient in terms of converting the savings collected from members which is below the minimum standard of 70% mainly in fiscal year 2011. Ethiopian Airports Enterprise has performed well with the total share of loan portfolios from the total assets stood at around 88% on average over the two fiscal years of 2011 and 2012. This can be taken as a good performance given the 70-80% standard set by WOCCU. On the other hand, it indicates the peculiar nature of SACCOs to rely on members' savings as a reliable source of funding credit products. The total savings account over 90% of total assets for CRS and EEPCo whereas it's around 87% for Airports Enterprise. Neither of them utilized external avenues of funding to diversify their sources of financing. The other element of the financing structure is the share capital compared to total assets. Thus, it's only Airports Enterprise which has been able to raise a share capital of 2.5% of total assets. However, CRS and EEPCo do have below 1% of their total assets in the form of share capital. This implies that those SACCOs are not adequately capitalized though the industry standard is 10-20% of their total assets to be from equity contribution of members. Similarly, the institutional capital in the form of accumulated retained earnings stood at 4.5% and 2.3% for Airports Enterprise and CRS respectively though the expected figure was at around 10% of total assets. The issue of capital adequacy has also been raised in similar studies conducted on SACCOs operating in Kenya where regulatory requirement has emphasized on capital adequacy requirements for SACCOs (MbuliKivuvo and Olweny).

4.4.3 Asset Quality

Asset quality is measured through examining the risk exposure in the form of delinquency ratio from the overall loans disbursed. Besides, the share of non-earning assets from the total assets is taken as indicator for asset quality. Delinquency is a beast that erodes the total loan portfolio affecting income generating capacity of the asset. The standard of excellence is, as to WOCCU, to have a ratio below 5% of total loans, if not zero for delinquency. The same applies to keeping non-performing assets to be below 5% of total assets. Encouragingly, all of the SACCOs in the study do have no delinquency implying that their portfolio is so healthy. This may be attributed

to strong collateral mechanisms that they use to secure repayment of loans like linking directly to payroll, provident funds, member-borrower own savings and personal guarantees. The analysis of the SACCOs revealed that two of the Cooperatives do maintain the minimal level of non-performing assets except EEPCo which has a 5.4% in 2012. However, much of the funds raised from members have also been tied in the form of bank savings rather than disbursing to members in need of loans to generate additional income at a better rate.

Table 9. Financial Performance of SACCOs on Protection, Financial Structure, and Asset Quality

No.	PEARLS Ratios (Indicator)	Standards of Excellence (Goal)	June 30,2011			June 30,2012			Averages		
			CRS	Airports Ent.	EEPCo	CRS	Airports Ent.	EEPCo	CRS	Airports Ent.	EEPCo
Protection (P)											
1	Allowance for Loan Losses (Delinquency > 12 months)	100%	0%	0%	0%	0%	0%	0%	0%	0%	0%
2	Allowance for Loan Losses (Delinquency of 1-12 Months)	35%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Effective Financial Structure (E)											
1	Net Loans/Total Assets	70-80%	68.3%	90.2%	66.9%	69.8%	85.2%	70.6%	69.1%	87.7%	68.8%
2	Saving Deposits/Total Assets	70-80%	97.6%	87.3%	90.0%	96.4%	86.3%	92%	97.0%	86.8%	91.0%
3	External Credit/Total Assets	Max. 5%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
4	Member Share Capital/Total Assets	10-20%	0.1%	2.4%	0.0%	0.1%	2.6%	0%	0.1%	2.5%	0.0%
5	Institutional Capital/Total Assets	Min. 10%	2.2%	5.2%	-	2.4%	3.8%	-	2.3%	4.5%	-
Asset Quality (A)											
1	Total Loan Delinquency/Gross Loan Portfolio	< = 5%	0%	0%	0.0%	0%	0%	0%	0.0%	0.0%	0.0%
2	Non-Earning Assets/Total Assets	< = 5%	0%	0.14%	3.3%	0%	0.04%	5.4%	0.0%	0.1%	4.4%

Source: Audited Financial Reports of SACCOs (2011-2012)

4.4.4 Rates of Return and Costs

The rates of return and costs indicators monitor the return generated on each asset using various sources of assets. It helps to assess efficiency and effectiveness in deploying assets and looking for cheaper costs of funding. This indicator and its related ratios focus on measuring financial performance of the cooperatives in terms of income generating capacity and efficiency in managing operational costs in running activities. It assesses yield on various investments and costs related to financing, administrative costs and loan loss. Costs of financing include interest on savings mobilized, external borrowings, and dividends on members' shares. The standard of excellence for cooperatives has set below 5% of average total assets as administrative expense. Other costs of funding are set per the prevailing market rate for raising such funds.

The return on loan portfolio seems minimal for cooperatives as one birr advanced in loan generates less than six cents in 2011 and less than seven cents per birr given in loans. The maximum was for EEPCo generating seven cents per Birr in loan portfolio. Airports Enterprise generated five cents per Birr in loans. On the other hand, one birr in savings costs around five cents as interest expense. It's lower even for two of the SACCOs, Airports and EEPCo at 2.7% and 4.4% respectively. Besides, the operating expense is 5.2% for CRS and 4.4% of total assets for Airports. The real interest rate on savings is negative comparing the inflation rate of 20.8% during June 2012. Thus, the interest paid to depositors is not sufficient to maintain value of their deposits; only nominal figures. It seems that there is a need to pay better interest rates than currently offered to encourage more deposits though it has cost implication on the SACCOs. Dividend payments seem better at CRS with payouts five times the share capital. Yet, this is misleading that the level of capitalization is so minimal. Share capital has not been given due attention as a fallback at times of shocks and losses and as a source of funding investment opportunities. Efficiency in managing costs seems in line with the acceptable standard of around 5% as SACCOs incurred 5% (CRS), 4%(Airports Enterprise) and 4.5% (EEPCo). No loan loss was recognized in three of the SACCOs. Return on assets measured in terms of net income is minimal remaining at around 1%.

4.4.5 Liquidity

Liquidity refers to debt paying ability without converting non-current assets of maturing obligations. It is linked to meeting unlimited savings withdrawals of members in the cooperative at ease. It should be analyzed from dual perspectives of maintaining liquidity reserves while keeping minimal level of idle funds. The ideal target is to have at a minimum 15% of net current assets. The other two indicators are the ratio of total loans to total savings (expected to be 60-70%) and liquidity reserve against saving deposits to be at a minimum of 10%. However, the study identified that for one birr in savings, it's only below 3 cents in net current assets where as the standard is a minimum of 15 cents for a birr in savings. Further, more than 70% of the portfolio is financed from members' savings. Thus, three of the SACCOs need to work on optimal matching of current assets against current liabilities including savings.

4.4.6 Signs of Growth

The last element of the PEARLS measures growth trends in terms of outreach in members, portfolio of loans, savings mobilized, change in capital or equity and overall wealth maximization in overall growth of assets of the cooperative. The signs of growth are a manifestation of the extent of members' satisfaction and the cooperatives ability to attract non-members to join, suitability of credit and saving facilities availed, and operational as well as financial sustainability. Growth trends do measure and indicate the direction the cooperative is moving on. As shown on Table 11, all of the three cooperatives have a positive sign of growth of above 20% in loans advanced and savings mobilized compared to the preceding fiscal year of 2011 compared to 2012. The inflation reported as of June, 2012 was 20.8% (The World Bank, 2012). The growth of total assets is over 20% for the year 2012 which is almost equivalent to the level of inflation reported at 20.8% as of June, 2012. In reality, the real value of assets has no significant change though nominally it seems there is a positive trend. Similarly, the overall conclusion of the study conducted in rural saving and credit cooperatives in Ethiopia revealed that rural saving and credit cooperatives do lack healthy financial performance when compared with WOCCUs standards of excellence in protection, effective financial structure, asset quality, rates of returns and costs, liquidity and sign of growth with challenges of sustainability. They are also facing difficulties in meeting huge demand for loans, weak infrastructure, competition,

and lack of access to external funding, weak technical assistance from supervisory agencies, and inadequate staffing (Biruk, 2015). This highlights the need to conduct further studies in corporate governance of credit unions as a “promising field for research” to better understand the sector and contribute to the global knowledge base (Labie and Périlleux , 2008).

Table 10. Financial Performance of SACCOs on Return and Cost, Liability, and Signs of Growth

No.	PEARLS Ratios (Indicator)	Standards of Excellence (Goal)	June 30,2011			June 30,2012			Averages		
			CRS	Airports Ent.	EEPC o	CRS	Airports s Ent.	EEPC o	CRS	Airports Ent.	EEPCo
Rates of Return and Costs(R)											
		a rate covering all expenses + min. 10% of institutional capital)	5.9%	4.7%	6.5%	6.6%	5.8%	8%	6.2%	5.3%	7.3%
1	Net Loan Income/Average Net Loan Portfolio										
2	Interest on Savings Dep./Average Saving Deposits	Market Rates > Inflation	5%	3.7%	4.1%	4.8%	4.4%	5%	4.9%	4.1%	4.4%
3	Interest on External Credit/Average External Credit	Market Rates	-	-	-	-	-	-	-	-	-
4	Total Dividend on Shares/Average Member Shares	Market Rates >= Cost on Savings	520.9%	26.1%	-	-	24.7%	-	576%	25%	-
5	Total Operating Expenses/Average Total Assets	5%	5.2%	3.9%	4.2%	4.5%	4.6%	5%	5%	4%	4.5%
6	Total Loan Loss Provision /Average Total Assets	Depend on Loan Quality	-	-	-	-	-	-	-	-	-
7	Net Income/Average Total Assets	Linked to Instit. Capital	0.8%	0.9%	1%	0.92%	1.1%	1.4%	0.9%	1%	1.2%
Liquidity (L)											
		(Current Assets - Current Liabilities) / Savings									
1	Deposits	Min. 15%	2.3%	9%	5%	2.6%	7.1%	3.4%	2.5%	8.1%	4.2%
2	Loans Outstanding / Total Savings	60-70%	70%	93.2%	74%	72.4%	85%	78.2%	71.2%	89.1%	76.1%
3	Liquidity Reserve/Savings Deposits	10%	30.1%	4.8%	8%	29.2%	9.2%	6.2%	29.6%	7%	7.5%
Signs of Growth (S)											
1	Growth in Loans to Members	Depends on Loans	-	-	-	24.9%	39.1%	28.3%	24.9%	39.1%	28.3%
2	Growth in Savings Deposits	Depends on Savings	-	-	-	20.8%	45%	20%	20.8%	45%	20%
3	Growth in External Credit	Depends on Borrowings	-	-	-	-	-	-	-	-	-
4	Growth in Share Capital	Depends on Share Capital	-	-	-	11%	55.5%	-	11%	55.5%	-
5	Growth in Institutional Capital	Depends on Instit. Capital	-	-	-	37.1%	6.4%	-	37.1%	6.4%	-
6	Growth in Membership	> 12%	-	-	-	2%	3.5%	9.6%	2%	3.5%	9.6%
7	Growth in Total Assets	> inflation	-	-	-	22.3%	47.1%	21.5%	22.3%	47.1%	21.5%

Source: Audited Financial Reports of SACCOs (2011-2012)

CHAPTER FIVE

5. CONCLUSION AND RECOMMENDATION

5.1. Conclusion

The study on corporate governance in savings and credit associations(SACCOs) operating in Addis Ababa taking Ethiopian Airports Enterprise, Ethiopian Electric Power Cooperation (EEPCo), and Catholic Relief Services (CRS) employees SACCOs aimed at assessing governance practice in those associations. These include internal and external governance focusing on ownership, board composition and characteristics, compliance to statutory requirements, internal processes and a brief overview of financial performance.

Based on the study, there are no consistencies as to ownership within the SACCOs defined in the form of shares of ownership. One of the SACCOs does allow transferability while the rest do not permit transferability of ownership to others while leaving the SACCOs. Lack of clarity in ownership undermines the potential for SACCOs to raise equity capital to better improve capital adequacy position.

The Board size ranges from seven to nine members in these SACCOs with representation of female members though it is still around 30% compared to the share of their counterparts. The profile of boards in academic qualification and level of education is astounding given that majority of the members do have their first degrees of which 30% (like at CRS) with second degrees.

Ethiopian Airports Enterprise and EELPA employees SACCO do have a better performance in conducting periodic review meetings unlike at CRS where regular board meetings are rare. The three SACCO's board performance evaluation at board level periodic assessment and getting members' feedback is very minimal.

The Cooperative Agency is mandated in conducting periodic supervision and annual audit of those saving and credit cooperatives. Besides, it is expected to technically support those firms.

Yet, there are gaps in conducting regular timely annual audits in the SACCOs. Trainings related to governance and management of SACCOs was not adequately provided to board members.

Incentive schemes either in cash or in kind for board members seems poor mainly at CRS where there is no any incentive mechanism for members of the board. Unless members saving resource is wisely invested either in the form of loan portfolio or other investment alternatives, keeping in a bank saving deposit could not generate adequate income for the cooperatives to prosper and pay off better dividends to depositors.

The maximum loan size given by CRS Employees SACCO is 12-month salary which means the person with high amount of salary will access bigger loans than a member with lower salary. The saving rate on deposits is 5% while interest rate on loans is 6% which is much lower compared to the other two SACCO's which charge 8% on loans to members and the maximum loan repayment period is four years. Thus, loans are cheaper at CRS than the two SACCOs. Yet, it greatly impacts financial sustainability of the SACCO and minimal dividend payout plan to encourage savers leading to real negative value on savings of depositors. Loan interest rate of the three SACCOs remains stagnant which doesn't consider at least yearly inflation and time value of money. This may require revisiting the current cost of lending if the SACCOs are to be operationally and financially sustainable.

With regard to investment, Ethiopian Airports Enterprise and EEPCo Employees SACCO have share ownership at banks. CRS Employees SACCO has share ownership at Addis SACCO though the amount of share is insignificant.

The study has made a brief assessment of financial performance of SACCOs using PEARLS as a tool. Accordingly, three of the SACCOs do not have provisions for loan losses. This implies that they do have a strong mechanism of ensuring full recovery of maturing loans in time with almost zero or negligible portfolio at risk. To the contrary, they may not also disclose substandard loans in their reporting. However, still it is commendable to have some level of provision though their portfolio is current from prudence and wise risk management perspective.

5.2. Recommendation

The Role of SACCOs in improving the financial deepening of the Country in mobilizing savings and availing credit facilities to their members and to the economy is prevalent for decades. However, they are still in need of adequate support to improve their governance practices to achieve their objectives of advancing benefits of their members and paying active role in the developmental effort of the Country. To this end, the following points are identified and recommended.

- The level of capital in three of the SACCOs is minimal compared to the resources they mobilize in savings. Besides, the form of ownership is not consistent among those SACCOs. Thus, it requires clear definition of ownership within SACCOs beyond collection of membership fees at time of joining those SACCOs. This helps to improve capital adequacy position of the SACCOs that would help improve their outreach, impact and protection to member-owner depositors.
- Gaps in supportive supervision and timely annual audit of SACCOs by the Cooperatives Agency and lack of proper documentation of those audit reports in a way that creates accessibility to members has been identified. Thus, the supervising Agency should better meet its mandate of conducting timely annual audits on returns of SACCOs.
- Provision of trainings on governance and management to board members of SACCOs by the cooperative agency would enhance the SACCOs leadership that lead to improve performance. Thus, the Cooperatives Agency should conduct relevant trainings in governance, risk management, credit and savings and related topics with thorough needs assessment of SACCOs.
- SACCOs should strengthen sound financial discipline in optimal utilization of huge savings mobilized to productive loan portfolios and investment opportunities than keeping at a minimal bank deposit rate. The funds would generate better returns if deployed to loans and invested in better income generating ventures with prudent investment decisions.
- It's recommended for SACCOs management to revisit interest rates both on savings and loans to reflect administrative costs, cost of funding, inflation and elements of capitalization. Thus, the current interest rate on savings and loans should be adjusted in consultation with the general assembly.

- SACCOs need to make periodic revision of credit terms and conditions based on the nature of loan, period of repayment, purpose of the loan, and cost of lending aligned with changing market realities.
- Finally, conducting further and in-depth study on governance and management of SACCOs with broader perspective in cooperation between the supervising agency, academics and other stakeholders would further improve the knowledge base and influence policy making in the industry.

APPENDICES

Appendix 1. Survey Questionnaire

Questionnaire on Governance Practice in Ethiopian Airports Enterprise, Ethiopian Electric Power Cooperation (EEPCo), and Catholic Relief Services (CRS) Employees Saving and Credit Association.

The purpose of this research is to assess *Governance Practice in the above mentioned organizations*. Thus, this questionnaire is developed to collect relevant and adequate information to understand the current governance structure, practice, and identify gaps in Cooperatives so as to perform better and serve members expectations.

The questioner has five different blocks of questions:

- I. Biography of the respondents
- II. External Corporate Governance
- III. Compliance with statutory requirement & articles of incorporation
- IV. Board of Directors
- V. Internal Corporate Governance

I would like to confirm that this research is purely for academic purpose only and passed through the necessary approval from the above mentioned SACCO's. All information collected through this questioner will be kept confidential.

As your response to this questionnaire is very crucial for the reliability of information as a basis for outcomes of the study including further analyses, recommendations and conclusions, I am kindly requesting and greatly appreciate your unreserved support in sharing your hand-on information taking a few minutes from your invaluable time.

Thank you in advance for your willingness to be part of this study. Kindly let me know if you have any question or concern in the course of completing the questioner.

I. Biography of the respondents

- 1) Gender: Female Male
- 2) Age Group: 18-29 Years 30-39 Years 40-49 Years 50 Years & above
- 3) No. of years as a member of the SACCO?
0 – 2 Years 3 – 4 Years 5 -6 Years 6 Years & above
- 4) No. of years as a board member of the SACCO?
0 – 2 Years 3 – 4 Years 5 -6 Years 6 Years & above
- 5) Educational Status:
High School Complete College Diploma First Degree
Second Degree & above
- 6) Educational field of study:
Business and finance Natural Sciences Other Social Sciences
- 7) Department you are working within the organization:
Technical or program Support Services (like Finance, Log, HR)

II. External Corporate Governance

- 1) Did SACCO ownership defined in the form of shares?
Yes No
- 2) How do you manage ownership registration?
Share Issuance Membership fee at time of joining SACCO
- 3) Transfer of shares/ membership?
Transferable Non Transferable
- 4) Does the SACCO payout dividends to its members?
Yes No
- 5) If there is dividend payment to members, how is profit sharing scheme (dividend payment) set?
Saving interest rate Amount of average saving ratio per member
Annualized saving amount Year of membership Other

If your answer is other, please specify: _____

III. Compliance with Statutory requirement and articles of incorporation

- 1) Did the SACCO undergo through annual audit every year?
Yes No
- 2) Who conduct the annual audit?
External audit firm Cooperative agency auditors
- 3) Based on prior audits and supervision activities of the Cooperative agency, to what extent does the SACCO comply with statutory and regulatory requirements for SACCO's?
Most compliant Moderately compliant Material compliance gaps
Non-compliant
- 4) To what extent does the SACCO comply with its own articles of incorporation, internal policies and procedures?
Most compliant Moderately compliant Material compliance gaps
Non-compliant
- 5) Does the SACCO have its own recruited employees to handle the day to day operation?
Yes No
- 6) Do you use IT system/ accounting software or applications for finance including savings and loans management and related activities of the SACCO?
Yes No
- 7) Did you get any technical and supervisory support from the respective Cooperative Agency?
Yes No

IV. Board of Directors

1) How are boards of directors of the SACCO being appointed or elected?

Vote on general assembly meeting Vote on board meeting Other

If your answer is other, please explain below

2) Do you have regular board meeting? Yes No

3) If your answer to question #2 is yes, how frequent is the board meeting?

Monthly Quarterly Semi-annually Annually

4) Does the board have a charter as a term of reference to guide its activities?

Yes No

5) What is board member's tenure or service year limit in a term?

1 - 2 Years 3 - 4 Years 5 - 6 Years Above Six Years

6) Please select the sub committees you have within the board.

Loan Committee Audit Committee Finance Committee

Nomination Committee Governance Committee

Conduct, review, & ethics Committee Awareness Creation Other

If your answer is other, please explain below

7) How many are the numbers (size) of the board of directors of the SACCO?

Three Five Six Above six

8) What is the gender composition of the number of members of the board?

Number of Female Board Members _____

Number of Male Board Members _____

9) Has any training been provided to board members in the past one year related to SACCO management and governance?

Yes No

10) What communication channel is used by the board to communicate with SACCO members? Formal/ e-mail, invitation letter, text messages, notice board/

Informal/member to member communication/ Other

If your answer is other, please explain below

11) How is board performance evaluation conducted?

Based on annual reporting to the general assembly meeting

Periodic assessment at Board level meeting

Supervision conducted by Cooperatives Agency

Collection of individual members' feedback Other

If your answer is other, please explain below

V. Internal Governance

1) How old is the SACCO in service?

5 – 10 Years 11 – 15 Years 16 – 20 Years 21 – 25 Years

25 & above Years

2) Year of establishment of the SACCO _____

3) Is there any financial or non-financial allowance or incentive scheme to members of the board?

Yes No

4) If your answer to question # 3 is Yes, what is the form of incentive?

Additional shares Cash Payment Transport allowance

Mobile airtime Other

If your answer is other, please explain below

5) How are members saving managed?

Self-managed Financial Intermediary (e.g bank)

- 6) Did the SACCO involve in investment activities?
 Yes No
- 7) If your answer to question #6 is yes, on what type of investment the SACCO is involved?
 Ownership in banks and insurance shares Fixed or time deposit
 Ownership of shares in other non-financial companies Other investment avenues
 If your answer is other, please explain below

- 8) Does the SACCO have access to external funding source besides members' savings?
 Yes No
- 9) If your answer to question #8 is yes, what are those external funding sources for the SACCO?
 Bank Loan including microfinance NGO Support
 Dividend from Investment activities Interest income on savings deposits
- 10) What is the maximum loan size given to the SACCO members? _____
- 11) What is the minimum interest rate on saving? _____
- 12) What is the maximum interest rate on loan? _____
- 13) How long it will take to take loan from application to disbursement?
 1 – 2 weeks 3 – 4 weeks 5 – 6 weeks More than 6 weeks
- 14) Is there an option for members to withdraw from their savings anytime without losing (maintaining) their membership?
 Yes No
- 15) If your answer to question # 14 is yes, how long it will take to withdraw saving?
 1 – 2 days 3 – 4 days One week More than a week
- 16) What is the maximum period for loan repayment?
 Six months 6 months – 1 year 1 – 2 years More than 3 Years
- 17) Is there a collateral requirement for loans to members? Yes No

18) If your answer to question # 17 is yes, what are the collateral types?

Members own saving Personal Guarantee Provident Fund

Other collateral

If your answer is other, please explain below

19) How do you manage risk to loan loss due to default in repayment of loans related to credit facilities given to members?

Insurance coverage Saving & loan almost near

Provident Fund Associated Other risk handling mechanisms

20) What are the major purposes of loan requests members demand for?

Consumption Marriage

Fixed asset purchase School fees

Medical

Auto loans

Other

If your answer is other, please explain below

21) General comments and suggestions you may have related to policy and procedural interventions, ways, processes and systems you think would improve the SACCOs governance and management to deliver their major objectives of serving their members.

Thank you so much for your time and invaluable inputs!!!!!!

Appendix 2. PEARL Formula

The PEARLS Monitoring System Indicators and Goals

Area	No.	Indicator Description	Goal or Standard of Excellence	Formula
Protection (P)	1	Allowance for Loan Losses (Allowances required for loans delinquent over 12 months)	100%	Allowance for Loan Losses/Total Balance of Loans Delinquent over 12 Months
	2	Net Allowance for Loan Losses (Allowances required for loans delinquent less than 12 months)	35%	(Total Allowance for Loan Losses - Allowance for Loans Delinquent Over 12 Months)/(Current Loans +Delinquent Loans Less than 12 Months)
Effective Financial Structure (E)	1	Net Loans/Total Assets	70-80%	(Total Gross Loan Portfolio Outstanding - Total Allowance for Loan Losses)/Total Assets
	2	Saving Deposits/Total Assets	70-80%	Total Saving Deposits / Total Assets
	3	External Credit/Total Assets	Max. 5%	Borrowed Funds / Total Assets
	4	Member Share Capital/Total Assets	10-20%	Total Member Shares / Total Assets
	5	Institutional Capital/Total Assets	Min. 10%	Total Institutional Capital / Total Assets
Asset Quality (A)	1	Total Loan Delinquency/Gross Loan Portfolio	< = 5%	Total of all Delinquent Loans / Total Loan Portfolio
	2	Non-Earning Assets/Total Assets	< = 5%	Total Non-earning Assets /Total Assets

(Source: Richardson,2002)

The PEARLS Monitoring System Indicators and Goals

Area	No.	Indicator Description	Goal or Standard of Excellence	Formula
Rates of Return and Costs (R)	1	Net Loan Income/Average Net Loan Portfolio	Entrepreneurial Rate (a rate that covers all expenses + min. 10% of institutional capital)	Total Income from Loans / Average Net Loan Portfolio
	2	Interest on Saving Deposits/Average Saving Deposits	Market Rates > Inflation	Costs of Saving Deposits / Average Savings Deposits
	3	Total Interest Cost on External Credit/Average External Credit	Market Rates	Interest Paid on Borrowed Funds / Average Borrowed Funds
	4	Total Interest or Dividend Cost on Shares/Average Member Shares	Market Rates >= Cost on Savings (i.e., No. 2)	Dividend Paid on Member Shares/Average Member Shares
	5	Total Operating Expenses/Average Total Assets	5%	Total Operating Expenses (except loan losses)/Average Total Assets
	6	Total Loan Loss Provision Expense/Average Total Assets	Depend on Loan Portfolio Quality	Provision for Loan Losses / Average Total Assets
	7	Net Income/Average Total Assets	Linked to Institutional Capital	Net Income After Dividends / Average Total Assets
Liquidity (L)	1	(Current Assets - Current Liabilities) / Savings Deposits	Min. 15%	(Current Assets - Current Liabilities) / Savings Deposits
	2	Liquidity Reserve/Savings Deposits	10%	Total Liquidity Reserves / Total Savings Deposits
Signs of Growth (S)	1	Growth in Loans to Members	Depends on Change in Financial Structure	Current Loan Portfolio Balance / Loan Portfolio Balance of Last Year-end
	2	Growth in Savings Deposits	Depends on Change in Financial Structure	Total Current Savings Deposits / Total Savings Deposits as of the Last Year-end
	3	Growth in External Credit	Depends on Change in Financial Structure	Total Current Borrowed Funds / Total Borrowed Funds as of Last Year
	4	Growth in Share Capital	Depends on Change in Financial Structure	Total Current Member Shares / Total Member Shares as of Last Year-end
	5	Growth in Institutional Capital	Depends on Change in Financial Structure	Current Institutional Capital / Institutional Capital as of the Last Year-end
	6	Growth in Membership	> 12%	Current Number of Members / Number of Members as of Last Year-end
	7	Growth in Total Assets	> inflation	Total Assets / Total Assets as of the Last Year-end

(Source: Richardson,2002)

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