THE RELATIONSHIP BETWEEN BAD DEBT AND MICRO FINANCE INSTITUTION PERFORMANCE: (The Case of Addis Credit and Saving Institution's)

A Thesis Submitted to Addis Ababa University College of Business and Economics Department of Business Administration in Partial Fulfillment of the Requirements for Master's Program, in MBA Finance.

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Declaration

I the undersigned declare that the thesis entitled “The relationship between bad debt and micro finance institution performance: the Case of Addis credit and saving institution” is my original work. I have done this study independently with the guidance and support of my advisor Alem Hagos (Ph.D). Any other contributors and sources used for the study have been acknowledged. Moreover, this study has not been submitted for the honor of any degree or different projects.

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Statement of Certification

This is to certify that Natenael Geremew Beyene has carried out his research work on the topic entitled "The relationship between bad debt and micro finance institution performance: the Case of Addis credit and saving institution" is his original work and is submitted for examination with my approval as a university advisor.

Alem Hagos (Ph.D)	______________	______________
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This is to certify that the thesis entitled "The relationship between bad debt and micro finance institution performance: the Case of Addis credit and saving institution" is carried out by Natenael Geremew Beyene under the supervision of Alem Hagos (Ph.D) and submitted in partial fulfillment of the requirements for the degree of master of arts in MBA Finance complies with the regulations of the university and meets the accepted standards with respect to originality and quality.

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ABSTRACT

This study was undertaken with the objective of identifying the relationship between bad debt and micro finance institution. The study was based on Addis credit and saving institutions, within the period of 2013/14-2019/20, which are practicing micro-financing business at present. Bad debts are identified as one of the foremost factors affecting the profitability and survival of Addis credit and saving institution. Most financial institutions are unable to stay competitive within the unsettled financial sector/industry because of high default rate. Against this backdrop the study examined the relationship between bad debts and micro finance institution performance within the case of Addis credit and saving institution. Secondary data spanning the period of seven years (2013-2019) was sourced from the financial statements of Addis credit and saving institution. Descriptive statistics and Correlation Analysis was conducted to examine trends and relationships. The result is that Addis credit and saving institution are witnessing steady rise in their bad debt ratio (BD), which raises concern about their effectiveness in managing credit risk. The study also concludes that bad debts have negatively related with Addis credit and saving institutions performance. The study recommended that Addis credit and saving institution must take steps to reduce their bad debts since it affects their lending abilities and financial performance. Also, effort must be made by these institutions to empower their credit staff with the necessary skills and tools to enhance credit administration within the institution.

***Key words**: Bad Debt, Micro Finance institutions (MFIs), Addis credit and saving institution (ACSI), Return on its Assets, Return on its Equity, Lending potential.*

CHAPTER ONE

1. INTRODUCTION

Micro finance has been a hot issue over the last years, and is not without disadvantages there are many benefits and able to get a better life because of it. Financing limits many poor people around the world to improve their livelihood. MFIs help those people they are poor to get access for financial sources to cover their costs and to earn profit. It is hard for MFIs to achieve their goals if they are not performing well financially. Minimizing default debt (bad debt) is an important factor for firm’s performance. The study, therefore focus on the relationship between bad debt and micro finance institution performance the case of ACSIs.

This section gives a concise foundation of the relationship between bad debt and micro finance institution performance in the case of ACSIs. It additionally caught the background of the study, statement of the problem, objective of the study, research questions, Delimitation (scope) of the study, the limitation of the study, significance of the study and organization of the study.

1.1. Background of the study and organization

Poverty is the fundamental driver of worry in improving the financial status of developing countries. A microfinance establishment is an association that offers monetary administrations to low income populations. Practically all offer credits to their individuals, and many offer insurance, deposit and other services.

Microfinance is progressively being considered as one of the best devices of diminishing poverty by empowering microcredit to the financial poor. Microfinance plays a critical role in resolving any problems between (financial) institutions and the poor people of the country. Microfinance acquire financial assets from banks and other standard financial sectors and provide the vulnerable with financial and support services. Micro finance institutions (MFIs) are also a mixture of social and monetary consolidation components. With appropriations, a greater part of their company started (Armendáriz and Morduch, 2010).However, the industry has encountered a prominent move toward commercialization (Culletal, 2007; Mersland, 2009).

Microfinance refers pave the way to the poor and low-income people with no access to financial services through the ordinary formal financial sector the provision of different types of small-scale financial services. The administrations that offered by the MFIs are equivalent to that of regular monetary organizations offer to their customers however the scale and technique for administration conveyance is extraordinary (Ledgerwood, 1999).Microfinance is frequently characterized as monetary administrations for poor and low-income customers offered by various kinds of professional organization (Gateway, 2012).

Microfinance can be an amazing instrument against poverty, yet it is just when supply satisfies demand that the destitute individuals can discover out of poverty (Helms, 2006). The customers of microfinance are commonly independently employed, low-income business visionaries from both rustic and metropolitan regions. As referenced in the definition above from Gateway microfinance is given to poor and low-income customers, yet despite the fact that they are helpless for the most part not viewed as among the least privileged of the poor (Ledgerwood, 1999).

Microfinance is often provided to clients who are sellers, street vendors, small farmers, service providers, craftsmen, small producers and to other individuals or groups at the local levels of developing countries (Ledgerwood, 1999; Robinson, 2001). Majority of the customers are women, only 33 percent of all microfinance clients are men (CGAP, 2012). All though microfinance can be a powerful instrument against poverty is not always the answer. For people who are extremely poor and badly malnourished, ill, and without skills or employment opportunities there might be other kind of support that may work better (Helms, 2006; Robinson, 2001). Such people need food, shelter, medicines, skill training, and employments, and when they are ready to work microfinance might be the next step (Robinson,2001).

Bad debts affects negatively on financial institutions performance, though the financial institutions still makes huge profit from its operations and hence substantial increase in its investment rate over the years considered. This was thanks to the recapitalization exercise which has really increased its capital based to finance more investments. However, there's the necessity for financial institutions to monitor their loans so as not to incur huge bad debts as this will reduce the strength of the financial institutions within the period of post consolidation. Effective lending therefore requires the financial institutions to be proactive in handling financial proposals of would-be borrowers because the financial institutions controls a vital commodity-money- which if not carefully handled can impact negatively on the financial institution sector and at large can trigger the economy (Thomas ,2015).

Bad Debts adversely affected financial performance of economic institutions in terms of profitability, liquidity, and market appeal within the period into consideration. Among the components that represented the event of bad debts, it had been uncovered from the examination led that insufficient checking of debts was the foremost significant factor representing the occurrence of bad debts at the identical time as trading was found to be the arena with the best incidence of bad debts. It will be that the debts to the trading sector which is that the major lending activity of the institution is that the most exposed to credit risk as compared to other sectors. It’s therefore expected that management will adopt very effective risk mitigating measures during this sector to boost the health status recording bad debts (Asante, 2013)

The effect of the Bad debts as a significant cost of financial institution failure and poorly managed trading risk can quickly sink the financial institution; the oldest and largest explanation for financial institution failure remains debts that turn sour (Stallion,2004). High level of bad debts largely constitute to financial institution failures which might put a stop to further lending business relations by the affected financial institution, and adversely affect economic development. The effect of bad debts is devastating to an economy if not check as a multiple of failure financial institution can erode the boldness of the financial institution, this will have a negative implication on the entire establishment (Nwankwo, 1990).

There are various types of microfinance providers, they can be ranged from informal to formal (Ledgerwood, 1999). The level of reserve depends on the sophistication of the organizational structure and governance, but it also depends on the degree of oversight or supervision by governments (Helms,2006).

In Ethiopia MFIs is a 1990s phenomenon. The Microfinance proclamation in 1996 denoted the beginning of deposit taking MFIs in Ethiopia. The area has advanced from helpful direction to joining effort and suitability missions. The public authority's hand in the business is tremendous, going from stretching out institutional and portfolio supports to guaranteeing proprietorship in

MFIs. A study conducted by Wiedmaier et al. (2008) on admittance to fund in Ethiopia showed that government led MFIs have figured out how to accomplish high assistance outreach.

Addis credit and saving Institution establish as per the commercial code of Ethiopia and proclamation on 40/88 to provide financial and other related services within the boundaries of Addis Ababa city administration. It was established and registered as a micro finance institution on January 2000, with paid up of capital of birr 517,000,000. Owned by six shareholders namely: Addis Ababa City Administration, Addis Ababa Youth association, Addis Ababa women association, Addis Ababa Teacher's association, Karalo area peasant's association and one physician person

ACSI was established to achieve the following activities: To decrease poverty and unemployment that prevailing in A.A, Provision of suitable credit and saving service to many active poor as possible financial services ,Developing the culture of saving among the target group and the public as a whole ,Giving priority to women in the delivery of financial services and financial self-sufficiency. (Source: Addis credit and saving institution brushers)

It is highly unlikely to recuperate the total from the account holder when the debt turns out to be bad debt. It ought to be moved from the indebted person's record to the charge of a record called Bad Debts Account when an obligation is perceived as bad (Inanga et al, 2001).

According to Holden (1995), a debt is desirable when it falls within the operation area of the financial institution. A profitable debt or loan is that the one that may be repaid and wouldn't be detrimental to the expansion and development of the financial institution specifically but which might also promote the economic process and development of the community normally. Generally, debt/loan is desirable and suitable given that it's in accordance with the government directive and the financial institution policy. This was supported by Nwankwo (1991) who stated that effective lending is that which maximizes profitability, liquidity and security requirements of the financial institution and also the development of the economy.

1.2. Statement of the problem

Successful collection of debts, regardless of whether (business-to-business) or purchaser (obligations owed by people) requires tolerance and steadiness. The best debt collection has sharpened their abilities over years, realizing what techniques will in general push borrowers towards making installments. For new debt authorities they haven't yet had the opportunity to build up their assortment procedures, notwithstanding, there are some genuinely straightforward methodologies that can assist them with beginning (Nwankwo, 1990).

Practically in each working business debt assortment is a basic errand since they're one piece of the business scene. In the present intense economy, clients are additionally experiencing more difficulty than typical paying their debts (Asante, 2013)

Many studies have been conducted by using different methods and data from developed and developing countries to define the bad debts. The results of their studies provide bad debts contain a negative relation on the financial institutions profitability.

A debt becomes a bad debt the moment the debtor declares bankruptcy. When their cash inflows are substantially inadequate to cover their unpaid obligations, persons or companies declare bankruptcy. This helps them to legally accept their failure to comply with their unpaid debt obligations due to cash flow constraints. The bad debts incurred by bankruptcy, however, are not completely irrecoverable (Bloem and Gorter, 2001)

Beyond the question of financial institution profitability decisions to lend or to not lend financial institutions influences the economic development of its community. Because the lending process affects not only the financial institutions activity, but also the development process, risks should be avoided as much as possible. As a matter of fact, most financial institutions failures could also be traced to faulty policies in respect of loans and advances. The risk mostly ensues when debt become bad debt. The very nature of the financial business is so sensitive, because over half percent of their liability is deposits from depositors. Financial institutions use these deposits to get credit for their borrowers, which of course could be a revenue generating activity for many financial institutions. All the identical, beside other services, financial institutions should make credit for their customers to shape some cash, develop and endure hardened contest at the commercial center. Credits are shaping a more prominent segment of the general resources in monetary establishments. These assets generate huge interest income for financial institutions, which is to an outsized extent determines the financial performance of MFIs (Ledgerwood, 1999).

However, a portion of the advances generally fall into bad debt status and unfavorably influence the presentation of monetary establishments. Visible of the critical role financial institutions play in an economy, it's essential to spot problems that affect the performance of those institutions. This can be on the grounds that bad debt can influence the capacity of monetary foundations to assume their part in the improvement of the economy (Saunders and Cornett, 2005).

In addition to the above statement in process of resources allocation, financial institutions while making profits, encounter several risks. Nowadays, one in every of the foremost important risks is default risk, which results in increase in bad debts. The most important problems that country's financial institutions system face is increasing of financial institutions bad debts and consequently reduction of liquidity, disruption of resources allocation and eventually reduction of financial institutions profit (Ghasemi, 2010).

When the rate of bad debt increases, the financial institution ROA will decrease, meaning that the financial institution profitability will be lowered. Furthermore, the loans to deposits rate and the growth of GDP both have an impact on the financial institutions performance (Doa, Ngoa and Phunga, 2019).

Bad debt is a major cost of financial institutions failure and financial institutions derive most of their income from the interest they charge on debts they disburse which contribute to the profitability of these institutions. When such debts end up as bad debt, the financial strength of these institutions is affected. And also the effect of bad debt on financial institutions can be identified with a possible financial institutions failure, barrier to further lending, reduction in profit level and negative economic growth in the society (Stallion, 2004).

Bad debts are one among the determinant factors for the soundness of the financial institutions sector. At the identical time bad debt rate is that the most vital issue for financial institutions to survive. The issue of bad debts has, therefore, gained increasing attentions since the immediate consequence of huge amount of bad debts within the financial institutions system could be a cause of MFIs failure. It's accepted that the number or percentage of bad debts is usually related to financial institutions failures and financial crises in both developing and developed countries (Caprio and Klingebiel, 2002).

From the theoretical and empirical studies point of view bad debts negatively related with the performance (profitability and lending potential) of micro finance institution. Therefore, evaluating the relationship between bad debt and micro finance institution performance the case of Addis credit and saving institution is important. The performance of MFIs can be affected by different factors such as macroeconomic and regulatory factors. From those factors the strategic decision to minimize a debt become a bad debt, credit management and avoiding constraints on the achievement of its objective is the most crucial parts in these business activities.

Therefore, based on the above studies, there is no empirical research done in Ethiopia concerning the relationship between bad debts and micro finance institution performance in the case of ACSIs, which motivates the researcher in filling the gap by putting his contribution on the relationship between bad debts and micro finance institution performance in the case of Addis credit and saving institution (ACSI).

1.3. Research Questions

The following research question is answered at the end of the study.

- What is the relationship between bad debt and micro finance institution performance?

1.4. Objectives of the study

Micro finance institutions are a business enterprise aims at maximization of profit payment of Dividends to the shareholders and contributing its quota to the financial advancement of the country. The main objective of this research is to investigate the relationship between bad debt and micro finance institution performance in the case of ACSIs.

1.5. Research Hypothesis

The hypothesis is formed after the theoretical structure is endorsed or comes from prior literature and studies on the subject, so that the following research hypothesis is suggested in order to address research question and achieve the objective.

H1: There is a negative relationship between bad debts and Micro finance institution performance.

As per Thomas (2015),bad debts affects negatively on financial institutions performance, though the financial institutions still makes huge profit from its operations and hence substantial increase in its investment rate over the years considered. This was thanks to the recapitalization exercise which has really increased its capital based to finance more investments. However, there's the necessity for financial institutions to monitor their loans so as not to incur huge bad debts as this will reduce the strength of the financial institutions within the period of post consolidation. Effective lending therefore requires the financial institutions to be proactive in handling financial proposals of borrowers because the financial institutions controls a vital commodity money which if not carefully handled can impact negatively on the financial institution sector and at large can trigger the economy.

Bad Debts adversely affected financial performance of economic institutions in terms of profitability, liquidity, and market appeal within the period into consideration. Among the variables the represented the rate of bad debts, it had been uncovered from the study directed that insufficient checking of credits was the chief significant factor representing the occurrence of bad debts at the identical time as trading was found to be the arena with the best incidence of bad debts. It will be that the loans to the trading sector which is that the major lending activity of the institution is that the most exposed to credit risk as compared to other sectors. It's therefore expected that management will adopt very effective risk mitigating measures during this sector to boost the health status recording bad debts (Asante, 2013).

1.6. Significance of the study

These study deals with the relationship between bad debt and micro finance institution performance in the case of Addis credit and saving institution. The study is beneficial for different stakeholders such as for other microfinance institutions, future researchers and concerned bodies like government institutions including the controlling organ National Bank of Ethiopia. For MFIs managers, this study provides basic information about the relationship between bad debt and micro finance institution performance. For future researchers, provide basic information for further study in the sector by developing new hypotheses and design with new variables by using other performance measurements that are not included in this research.

Finally, the finding of the study is used as an input for the concerned bodies (regulator and policy makers) to forecast the overall wellbeing and trustworthiness of Addis credit and saving institution. Besides, it helps other researchers and other academic communities as a source of reference for those who want to make further study on the area subsequently.

1.7. Delimitation (Scope) and limitation of the study

1.7.1. Delimitation (Scope) of the study

The study took place in Addis Ababa city, the main office which is located in Arada sub city. This study concentrated only on Addis credit and saving institutions which have seven years (2013-2019) experience. Bad debts the independent variable and micro finance institutions performance the dependent variable used in this study. Secondary data were used for the study and obtained from official documentations (Financial statements, brochures, newspapers and internet publications, etc.) from ACSIs.

1.7.2. Limitation of the study

While doing this research, the researcher encounters various problems, from these problems the most dominant ones are it wouldn't easy to get all relevant information from the institutions. Budget problem and time constraints were other prominent factors that face the researcher while doing this paper. Due to COVID 19, the course Econometrics was not given properly, so the researcher was forced to teach himself using the internet and particularly how to use SPSS software was time taking. Beyond these and other constraints that could rise during the research, the researcher has tried his best to find comprehensive results which helped to address the objectives of the study. However, the above resistant factors make this study difficult; the researcher hopes that readers will get some valuable ideas from the outcome of this study.

1.8. Organization of the study

The entire research has been grouped into five chapters. The first chapter discusses on introduction of the study and the Background that would give a brief overview of Bad debts and micro finance institutions. The chapter also discusses on problem statement, relevant research questions, and objectives of the study, Hypothesis of the Research, significance, the Delimitation (scope), the expected limitation and the organization of the study as a whole. Chapter two shows an exhaustive literature review conducted on relevant studies. The review included both theoretical and empirical studies on the subject area. Chapter three describes the research methodology. It explains the research design, data collection instruments, population and sample used, the mode for collecting the data and the analysis of the data collected. Similarly, chapter four discussed on result and summary of the study. Based on the results the last chapter (chapter five) gives a brief conclusions and recommendations.

CHAPTER TWO

LITERATURE REVIEW

2. Introduction

The preceding chapter deals on the introductory part of the study i.e. the motive behind conducting this study. The purpose of this chapter is to review the existing literatures concerning on the area of the relationship between bad debt and micro finance institution performance. The current chapter has four sections and organized as follows. The first section presents the theoretical reviews on bad debts; it includes Definition and concepts, Causes (Factors) Accounting for Bad debt, Overview of Microfinance Institutions, Dimensions and Indicators of Financial performance of MFIs, Lending Potential. Second section similarly reviews different empirical results regarding the relationship between bad debt and micro finance institution performance. The third section presents chapter summary and knowledge gap that inspire this study. Finally, section four deals with conceptual framework showing the interaction of variables of this study.

2.1. Theoretical Review

A theoretical framework is group of related ideas that provides guidance to a research project or business undertaking. It permits analysts to test the theory and describe the results. In this section definition and concepts, Causes (Factors) accounting for Bad debt, overview of Microfinance institutions, dimensions and indicators of financial performance of MFIs and lending potential are discussed.

2.1.1. Definitions and concepts

Debt: Debt is an amount of cash borrowed by one party from another. Debt is employed by many firms and entities as a technique of constructing large purchases that they may not afford under normal conditions. A debt arrangement gives the borrowing party permission to borrow money under the condition that it's to be paid back at a later date, usually with interest (Chen, 2020).

Good Debt: Good debt is exemplified within the old saying it takes money to form money. In the event that the debt you are taking on assists you with getting pay and increment your total assets that may be considered positive. Whereas good debt takes the potential to extend a personality's net value, it's normally considered to be debt if you're borrowing money to buy depreciating assets (Smith, 2020).

Bad debt: A bad debt can be perceived as an advance which the leaser discovers troublesome or difficult to recuperate. For Financial institutions, bad debt refers to an amount of money given to a borrower, usually firms, which are difficult to recover for a variety of reasons, including business losses or bankruptcy. While there's no particular meaning of a bad debt, it is frequently summed up as follows: a debt that happens when a firm accepts that a borrower can't or reluctant to pay and subsequently the business won't ever have the option to recuperate the money owed (Ireland, 2005). That is a debt that can't be collected, or one whose collection would be inefficient to follow.

Doubt full debts: is an account receivable that may become a bad debt at some point within the future. It's going to not even be ready to specifically identify which open invoice to a customer could be so classified. In this case, create a reserve account (also referred to as a contra account) for assets that will eventually become bad debts, estimate the quantity of assets which will become bad debts in any given period, and build a credit to enter the quantity of the estimate during this reserve fund, which is thought because the remittance for dicey records. The charge inside the exchange is to the debt expense (Prosser, 2003).

Micro finance institution: Microfinance refers to a financial institution that gives the poor and low-income people with no access to financial services through the normal formal financial sector the availability of various sorts of small-scale financial services. The basic services that the MFIs provide are the identical that conventional financial institutions offer to their clients; the sole difference is that the scale and method of service delivery (Ledgerwood, 1999).

Inflation: inflation will be characterized as a supported or ceaseless ascent inside the overall record or, then again, as a maintained or constant fall inside the worth of money (Gehrig and Stenbacka, 2007).

Gross Domestic Product: GDP could be a measure of the income and expenditures of an economy. It's the whole worth of every last great and administrations delivered inside a rural in an extremely given timeframe (Joseph, Mabvure, 2012).

Lending interest rate: interest rate is that the value a borrower pays for the use of money they acquire from a moneylender/monetary foundations or charge paid on acquired resources. Premium is considered as "lease of cash" (Nguta & Huka, 2013).

The matching principle: It is the accounting principle that allows the expenditures incurred the same period during which the related profits are received to be earned. This principle acknowledges that corporations must incur costs in order to gain profits. Further, it ends up in a liability to look on the record for the tip of the accounting period. The matching principle is identified with the accumulation premise of bookkeeping and changing sections. On the off chance that a cost isn't straightforwardly attached to incomes, the cost ought to be accounted for on the explanation inside the bookkeeping time frame during which it terminates or is utilized up. If the longer-term benefit of a cost can't be resolved, it ought to be charged to discount right away (Prosser, 2003).

The objectivity principle: is the concept that the financial statements of a business entity are based on hard evidence (Prosser, 2003).

Financial Performance: According to Arthur et al (2013), the financial success of MFIs is the institution's ability to function successfully in the management of its capital and to achieve quantitative growth goals, profitability and sustainability.

2.1.2. Bad debt Estimation

The bad debts are discounted, which is really an abrogation of the debt to dispose of its consequences for the precision of the assertions. Just explicitly distinguished sums are discounted as bad debts. Paper of 'bad debt estimation', however, could be a logical inconsistency; it's basically gathered in two proper accounting rules (Prosser, 2003).

1. The matching principle, wherein revenues are perceived once procured yet not got, and expenses are perceived when brought about, yet not paid. This method of recording

matches income to the amount it absolutely was generated without counting on the particular timing of cash flows.

2. The objectivity principle, which says that the value of record things like the resources ought to mirror their normal feasible worth.

Matching concepts could be a generally accepted principle. The matching rule dictates that "Revenues must be allocated to the accounting period within which the products are sold or the services performed, and expenses must be assigned to the accounting period within which they're used to produce revenue. Under the strategy for recompense, bad debt misfortunes are coordinated against the business they help to produce. Under direct write-off, bad debts are sometimes recorded during a different accounting period from the one within which the sale takes place, the method therefore doesn't conform to the matching rule (Needles et al, 2007).

2.1.3. Bad debt and Doubtful Debt

As seen earlier in the definition and concept section, bad debt is the circumstance where a firm accepts that a borrower can't or reluctant to pay and the business will be not at any point to recuperate the cash owed (Ireland, 2005). A debt that isn't been gathered or one whose assortment would be uneconomical to seek after. Bad debt is objective while on the other hand Doubtful debt is subjective. Doubtful debt is the place where in a firm own creative mind figures a client will most likely be unable to settle their obligation that is owed.

Bad and doubtful debts share numerous comparable attributes, the sole genuine distinction being their degree of collectability. According to Prosser (2003), the last guideline is that any obligation more prominent than a half year should be painstakingly considered as a bad debt, however a debt can turn out to be 'awful' whenever inside its life cycle looking on the conditions, while obligations is ordered doubtful when an obligation is matured 90 days or more. Also, bad debts are for the most part the consequences of target proof, i.e. when there's verification or exhortation from an autonomous outsider in regards to the uncollectable debt, while doubtful debt are upheld abstract, however not completely discretionary, assessments.

2.1.4. Causes (Factors) Accounting for Bad debt

Some research findings and distribution show bad debt is brought about by helpless administration (Berger and Young, 1997). They contend that directors in most monetary organizations with the issue of bad debt don't rehearse satisfactory advance (credit) endorsing, observing and control. Credit culture is another factor which has been recognized by some examination discoveries as causes for bad debt. Sometimes borrowers decide to apply for loan without thinking enough about the future and what else they need to buy with their income. When this happens, a credit culture can develop where borrowers get rid of large loans not because it's financially informed do so but because they see others screw, this may end in bad debt.

International Bank for Reconstruction and Development policy research working paper on bad debt in geographical region revealed that prime records of bad debts are caused by adverse economic shocks not to mention high cost of capital and low interest margins (Fofack, 2005). Goldstein and Turner (1996) expressed that the development of bad debt is as a rule because of assortment of things, including monetary decline, macroeconomic unpredictability and terms of exchange decay, high financing cost and inordinate dependence on over expensive between bank borrowings, insider borrowing and moral hazard. Again, another publication identifies speculation: that is putting resources into high risk assets for procure high income and furthermore fake practices such propelling advances to ineligible people or advances without security or reference as some of the causes of bad debt. It additionally refers to inward reasons like work unsettling/lack and market disappointment as some of the variables representing bad debt. Outer variables like downturn inside the economy and common catastrophes/fiascos were additionally referred to by the indistinguishable distribution as some of the elements representing a debt become bad debt.

2.1.5. Factors leading to bad debt and causes affecting Micro financial institution performance

According to Ahmad (1997), some of the main factors that lead to bad debts are the unwilling in debt resettlement coupled with diversifying the funds by the creditors and deliberates lack of appropriate appraisal of the facility by the debt Officers. Kwakwa (2009) have indicated that debt facility granted to corporate firms tend to result in high debt default rate as real GDP falls, and that the decline in the local currency against the major foreign bureaux in the exchange rate, have a direct repercussion on the repayment ability of borrowers. Balogun and Alimi (1988) have also recognized that shortages of credit, delay in time of loan delivery, the prevailing high interest rate in a country, poor supervision by most regulators, non- profitability of enterprises and unnecessary government intervention are causes of bad debt affecting the financial institutions.

2.1.5.1. Inflation

Macroeconomic instability which is generally manifested by high rate of inflation also makes lending appraisal tougher for the institution, because the viability of potential borrowers depends upon unpredictable development within the overall rate of inflation. Moreover, asset prices are likely to be highly volatile under such conditions. Hence, the longer term real value of debt security is additionally very uncertain that financial institution does poorly both when product and asset price prudential policy, inflation accelerates unexpectedly, unemployment increases, and/or aggregate output and income decline unexpectedly. Unexpected accelerations in inflation adversely affect financial institution performance, by increasing the speed of debt default and decreasing financial institution profit (Martin, 1998, sited in W. N. Geletta, 2011).

Causes of bad debt extend from borrowers specific act to institution weak regulatory mechanism in advancing loans and monitoring procedures. Credit/loan contracts specify the number borrowed, the interest and non-price terms like collaterals, which constrain the borrower so as to cut back default. Because the terms of contract change the behavior of the borrower is probably going to change (Stiglitz 1990).

Gehrig and Stenbacka, (2007) stated that information sharing reduces adverse selection problems and thereby promotes financial stability; it is a borrower disciplining device and it reduces the informational rents that financial institution can extract within the framework of their established customer relationships.

Additionally, Barth, Lin, Lin & Song (2008) show that information exchange will help in minimizing lending corruption in financial institution by reducing information gap between consumers and lenders, improving the bribery control methods and reducing informational rent, and hence the bargaining power of lenders. Furthermore, Jentzsch (2008) clarify that sharing credit information between lenders increases competition and enhance access to finance. Credit information also acts as a borrower disciplining device, by cutting insolvent debtors removed from credit and eliminates or reduces the borrower's incentive to become over-indebted by drawing credit simultaneously from many institutions with none of them realizing it.

2.1.5.2. Gross Domestic Product

The performance of any kinds of lending is very associated with country's condition. Keeton and Morris (1987), who investigated the basic drivers of debt losses for a sample of nearly 2,500 US financial organizations for the amount 1979 to 1985 using simple linear regressions, had already demonstrated that local economic conditions explained the variation in debt losses recorded by financial institution.

Carey (1998) sited in Joseph, Mabvure T et al, (2012.p.474) also report similar results and suggests that the state of the economy is that the single most vital systematic factor influencing diversified debt portfolio loss rates. A powerful economic condition measured by GDP, as motivating factor to financial institution has statistically significant impact on issuance of more private credit to businesses. A powerful economic condition creates more demand for goods and services which cause more investment in several sectors hence increase the per capita income similarly because the savings, collectively these factors convince to financial institution to issue more private credit.

2.1.5.3. Deposit to Asset Ratio (DEPTA)

As the major source of external finance is deposits, deposit to asset ratio was used as an independent variable to examine the effect of deposit on profitability of ACSIs. Since the total debt of ACSIs composed of deposit and non -deposit liabilities, this variable intended to show the effect of deposit-financing and hence the non -deposit financing decision on profitability. Abbadi & Abu-Rub (2012) found Positive relationship between deposit to asset and profitability. Based on the nature of financial institutions operation and empirical evidences, in this study a positive relationship between deposit to asset ratio and profitability of MFIs were expected.

$$\text{DEPTA} = \frac{\text{Total deposit}}{\text{Total asset}}$$

2.1.5.4. Interest Rate

Lending Interest rate as a price of money reflects market data with respect to expected change in the buying influence of cash or future inflation (Ngugi, 2001). Monetary contraction and interest rate increase reduce spending directly; both also reduce spending indirectly by shrinking financial institution loan supply (Bernanke and Blinder, 1988). A large number of the bad debt were owing to moral hazard: the unfriendly motivators on monetary organization proprietors to receive rash loaning procedures, specifically insider loaning and loaning at high financing costs to borrowers in the most dangerous sections of credit markets. Financial institution lending rates are mostly seen as being rigid for the reason that they do not move in tandem with the markets. A number of explanations have been suggested to account for the rigidity in financial institution lending rates. On account of advances, the unbending nature has been because of the apportioning of credit to borrowers attributable to the way that there are issues of asymmetric information (Blinder and Stiglitz, 1983). Indeed, financial markets are not perfect; in the presence of adverse selection and moral hazard issues, financial institution are more likely to choose for credit rationing than to adjust their lending rates in a situation where there has been an upward adjustment of interest rates by the financial institution. It may also be possible that when large financial institution capture large market share, the impact of tight monetary policy on financial institution lending will be minimal.

Bloem and Gorter (2001) concurred that bad debts may impressively increase because of sudden changes in financing costs. They examined different global norms and practices on perceiving, esteeming and ensuing treatment of bad debts to resolve the issue from see purpose of controlling, the executives and decrease measures. An investigation led by Espinoza and Prasad (2010) zeroed in on macroeconomic and monetary organization explicit variables impacting bad debts and their belongings in monetary establishment System. After a comprehensive analysis, they found that higher interest rates increase bad debts but the relationship was not statistically significant. The interest rate affects the difficulty in servicing debt, in the case of floating rate loans. This implies that the effect of the interest rate should be positive, and as a result the increasing debt burden caused from rising interest rate payments should lead to a higher number of bad debts.

2.1.6. Overview of Microfinance Institutions

Micro Finance is that the provision of credit and other financial services to the poorest of the poor. Thus, it becomes customary to provide to their credit requirements for a holistic development of the state. In such an environment, MFIs and other similar lending agencies have evolved to supply micro credit for brief duration to the neediest group. The debts are mostly collateral free and provided at high rates of interest to hide the high operating costs of the institutions. Such institutions provide hopes of a poverty free nation to several (Brau & Woller, 2004, Morduch, 2000).

Microfinance refers it gives to the poor and low-income people with no access to financial services through the standard formal financial sector the availability of various varieties of small-scale financial services. The basic services that the MFIs provide are the identical that conventional financial institutions offer to their clients; the sole difference is that the scale and method of service delivery (Ledgerwood, 1999).The Micro Finance Institution is exclusive in nature because of its double bottom line objective of Outreach (reaching sizable amount of poor) and Sustainability (ability to hide costs and earn profits within the long run).

Microfinance is a strong instrument against poverty, but its only supply meets demand that the poor people can find their answer of poverty (Helms, 2006). There is a large growth within the microfinance institution for over a decade, but there's still an extended way to go, it only reaches little percentage of its potential market worldwide (Ledgerwood & White, 2006).

2.1.7. Dimensions and Indicators of Financial performance of MFIs

The financial execution of Microfinance foundations is of foremost significance within the microfinance sector furthermore because the countries within which they operate (porter, 2005). Measuring the financial performance doesn't only involve the sustainability of MFIs but also other aspects like the outreach especially if the MFIs major mission is reaching the poor of a rustic (Nelson, 2011).The performance of those institutions are often said to be multidimensional and has been grouped into four perspectives or dimensions by the International Journal of Management and Strategy (2011).

2.1.7.1. Portfolio Quality

The quality of the portfolio as described by Ahlin et al (2010) is that the asset level standard tests the performance of the primary significant asset, i.e. the MFI loan portfolio; it measures the portfolio standard whether it is good or poor, growing or decreasing.

2.1.7.2. Efficiency and productivity

The efficiency and productivity of MFIs is that the measure of how the institutions measures its operating costs in respect to the portfolio yield (MIX, 2005).Efficiency for a microfinance foundation moreover as other monetary establishments is inconceivably significant in light of the fact that it infers a reasonable or great utilization of information sources in like manner as yields and subsequently guarantees endurance of the organization (Nieto, 2006).The efficiency and productivity like other dimensions of MFI financial performance is measured by the utilization of ratio indicators. (Barres, Curran, Porter, 2005).

2.1.7.3. Sustainability

Arsyad (2005), in his study of the assessment of microfinance institutions performance indicated that sustainability is extremely essential within the operation of the MFI, however for this to occur loan rates must be sufficient to hide full cost of funding, administration cost similarly as operational costs. While one might believe that MFI sustainability has to do with marketing, this is not always the case since two-thirds of sustainable MFIs are either public banks, cooperatives or NGOs and not for profit organizations (Guntz, 2011). Microfinance sustainability could be a step towards profitability, they're both achieved when the institution offers better products, are ready to reduce their transaction costs and supply services that meet the requirements of clients, generating appropriate revenue and discovering new ways to fund unbanked families (CGAP, 2004).

2.1.7.4. Profitability

Profitability is a financial benefit that's realized when the revenues or the quantity of revenue generated from a commercial movement surpasses the costs, costs and assessments expected to support the action, Profitability in MFI is just the contrast between all out income and absolute expense (Arthur et al, 2013).Barres, Curran, Porter (2005), states that profitability and efficiency just like the other dimensions is measured by different indicators that include:

A. The Return on Asset (ROA)

ROA also called the Return on Investment (ROI) measures how the MFIs are dealing with its resources for boost its benefits. The ROA or ROI ought to be expanding as the following proportion demonstrates the establishments capacity to think of benefits from its ventures /assets (Iezza, 2010). Developed MFIs ought to produce positive profits from its resources. The profit from resources might be significant proportion in light of the fact that the proportion estimates the organizations capacity to live the ventures benefit producing capacity, it's determined as; total compensation after charges and before gifts/Average resources (Thomas, 2013). Yield on portfolio shows the MFI's capacity to get incomes from financing costs, expenses and commissions inside the gross credit portfolio. A diminishing pattern implies lower income inside the portfolio, either from an adjustment of portfolio organization, item estimating, or foreordained income in view of an increment inside the sum late (Dhan,2003). It's determined as; Interest, expenses, and commissions in advance portfolio/Average gross advance portfolio.

B. Return on Equity (ROE)

ROE could be a core measure of profitability. It’s a vital proportion to financial backers since it takes a gander at the re-visitation of the financial backers. ROE estimates MFI's ability to make equity through retained earnings. The commonly accepted perspective (the norm) is that the upper the share, the better because it shows that the corporate is using the investors’ money or donor funds to come up with income (Jorgensen, 2011). A mature MFI should generate a positive ROE. It’s measured / calculated as: net income after taxes and before donations/Average equity.

2.1.8. Lending Potential

Olokoyo (2011) was indicated that deposits form the major component of financial institution lending behavior as the lending rate of the financial institutions directly influences its lending patterns. Karimetal (2010) also acknowledges that reduction in financial institutions lending potential is other effects of bad debts. Again, financial institutions derive greater proportion of their income and returns from the activities of lending (Nguta & Huka, 2013). Therefore, proportionate amount of the revenue is lost whenever financial institutions experience bad debt through unpaid credit. Once income is lost in a fiscal year, the ability of the financial institution to grant loan to others would practically happen in the subsequent year. This situation might lead to the financial institution inability to grant loan or may not give the required amount sought.

2.2. Review of Related Empirical Studies

The previous section presented theories of bad debt focusing on definition, classification of debt and causes of bad debt. This section reviews the empirical studies on the effects of bad debt. There are a number studies that examined the effect of bad debt on the profitability and performance of financial institutions. The effects of bad debts studied by different scholars are reviewed in the following paragraphs.

2.2.1. Effects of Bad debt and doubtful debt on financial institution performance

As per Thomas (2015),bad and doubtful debts affects negatively on financial institutions performance, though the financial institutions still makes huge profit from its operations and hence substantial increase in its investment rate over the years considered. This was thanks to the recapitalization exercise which has really increased its capital based to finance more investments. However, there's the necessity for financial institutions to monitor their loans so as not to incur huge bad debts as this will reduce the strength of the financial institutions within the period of post consolidation. Effective lending therefore requires the financial institutions to be proactive in handling financial proposals of borrowers because the financial institutions controls a vital commodity money which if not carefully handled can impact negatively on the financial institution sector and at large can trigger the economy.

Asante (2013) inferred that Bad Debts unfavorably influenced monetary execution of financial organizations as far as benefit, liquidity, and market offer inside the period into thought. Among the elements the represented the occurrence of bad debts, it had been uncovered from the study directed that incapable checking of credits was the premier significant factor representing the rate of bad debts at the indistinguishable time as exchanging was found to be the arena with the best incidence of bad debts. It will be that the loans to the trading sector which is that the major lending activity of the institution is that the most exposed to credit risk as compared to other sectors. It’s therefore expected that management will adopt very effective risk mitigating measures during this sector to boost the health status recording bad debts.

2.2.2. Lending Potential and profitability

Amoako (2015), investigated that bad debt has significant negative effect on the lending potential of financial institution. Also, it had been discovered that though bad debts contain a negative effect on the banks profitability, the effect isn't significant and also, he discovered that the most causes of bad debts within the financial institutions are credit monitoring, poor appraisal system and ignorance on the part of borrowers to grasp the terms of credit facilities.

Bloem and Gorter (2001),concluded that even though bad debts tend to affect negatively all the Micro financial institutions, the effect is however felt more by those within the commercial and mortgage financing institutions which usually possess large chunk of credit facilities. This ultimately hampers the ability of these financial institutions in granting further loans to respective applicants. Large bad debts could lead to declining confidence level of both depositors and foreign investors who may adopt strange position against the institutions which might result in a negative signal and liquidity problems. Bad debts policy tends to reduce total loan portfolio of the financial institutions thus affecting the interest.

Stallion (2004) emphasized the effect of the bad debt as a major cost of financial institutions failure and positively stated that, financial institutions derive most of their income from the interest they charge on debts they disburse which contribute to the profitability of these institutions. When such debts end up as bad debt, the financial strength of these institutions is affected. He also concluded that the effect of bad debt on financial institutions can be identified with a possible financial institutions failure, barrier to further lending, reduction in profit level and negative economic growth in the society.

Nwankwo (1990) proposed that a high level of bad debts largely constituted weaknesses in microfinance institutions that would put a stop to the affected financial institutions' further lending of business relationships and adversely affect economic growth. If not checked because a number of failing financial institutions will erode the trust of public financial institutions, the effects of bad debts will be catastrophic for an economy; this would have a negative impact on the entire financial industry. He also summarized the effect of bad debt as there is high possibility of the financial institutions affected to liquidate, Slow business turnover as new lending cannot be made with payment of old loans and advances, Reduction in revenue earnings by war of interest and commission on turnover, monetary organizations powerlessness to serve various clients effectively is premise on restricted asset.

John (2018), concludes that bad debts has a significant relationship with the financial institutions' profitability and performance. This calls for the need to have an effective financial intermediation especially towards loan disbursement as private shareholding induces more bad debts to be manipulated by corrupt private owners. The study also shows that the ratio of return on assets in a financial institution will rise as the rate of bad debts will decrease. This calls for the caution of every lender or credit analyst to make only good loans. This can be achieved through giving utmost importance on the areas of poor management, lack of sound credit policy, inadequate credit analysis, and error emphasis on profitability at the expense of loan quality, fraudulent practices and unhealthy competition. The study also concludes that there is significant role of macroeconomic factors in determination of financial institutions performance with respect to bad debts and this implies that all challenges against the realization of macroeconomic objectives to be tackled.

Doa, Ngoa and Phunga (2019), concluded that when the rate of bad debt increases, the financial institution ROA will decrease, meaning that the financial institution profitability will be lowered. Furthermore, the research results have pointed out that in the case of Vietnam, the loans to deposits rate and the growth of GDP both have an impact on the financial institutions performance.

According to Lata (2014) bad debt in Bangladesh has become a problem that has significant negative impact on financial institution profitability. He posits that bad debts are a topic of great concern in Bangladesh. He states that for the last eight years, loan default as a percentage of outstanding loans in state owned commercial financial institution were 50 percent or above where private commercial financial institution and foreign commercial financial institution hold maximum 5 – 10 percent of the total. To this extent, financial institutions in Bangladesh have been given ultimatum to bring down their soaring bad debts to below 10 percent of their respective outstanding loans. The causes of bad debts are generally due to the lack of effective supervision and regulation by financial institutions, the lack of effective redress by lenders, the shortcomings of the legal infrastructure, and the lack of effective strategies for credit recovery.

Liu, Wu,Lin and Lu (2017), The study found that bad debts constituted one of the most influential factors affecting micro financial institutions performances; thus, When the proportion of bad debts among financial institution loans rose, if the government implemented financial reform, establishing a financial institution exit mechanism and legalizing mergers and acquisitions among financial institution, the loan problem could be controlled and prevented from worsening, and the emergence of systematic financial risk could be kept away. The requirements of the financial institution of International Settlements-Basel Accords and the domestic monitoring authorities regarding the capital adequacy ratio have significantly improved and enhanced the risk management of the banking sector. The study also concluded that, after comparing analyses of financial institution' profitability performances in the profitability stage to the results from the operating stage, it was found that financial institution profitability performances and their operating efficiency are not necessarily consistent, indicating that the traditional profitability model of earning the difference between deposits and loans was becoming less important to financial institutions, while the role of financial institutions investments, wealth management, and other financial products and services had increased. The study found that in time financial institution operating performances would enter a highly mature period of stability. In order to improve their profitability and competitiveness, financial institutions must proactively grow a variety of financial products and creative financial services, broadening their operating scale and scope. In cases where the design of financial products and services, such as the launch and sale of Target Redemption Forward products, crosses the technical banking boundary, the introduction of the leverage alternative for securitization of commodities and futures will enable financial institutions to face enormous challenges.

2.3. Chapter summary and knowledge gap

In this chapter the discussion was about the Theories essentially related to bad debts and other related empirical studies that determine the effect of bad debts on micro finance institution performance. From the theoretical and empirical studies point of view bad debts affect the performance of micro finance institution negatively. Therefore, evaluating the effects of Bad debt on the performance of Addis credit and saving institution is important. The performance of

MFIs can be affected by different factors such as macroeconomic and regulatory factors. From those factors the strategic decision to minimize a debt become a bad debt, credit management and avoiding constraints on the achievement of its objective is the most crucial parts in these business activities.

According to the empirical studies, there is no direct empirical literature which is related with the relationship between bad debt and microfinance institution performance in the case of Addis credit and saving institution. So far, as to the knowledge of the researcher, there is no study directly linked with it.

To this end, the researcher is very much interested to put his own contribution on the relationship between bad debt and microfinance institution performance in the case of Addis credit and saving institution.

2.4. Conceptual framework

Conceptual framework can be applied in showing the interaction of variables that is the dependent and independent variables.

Independent variable

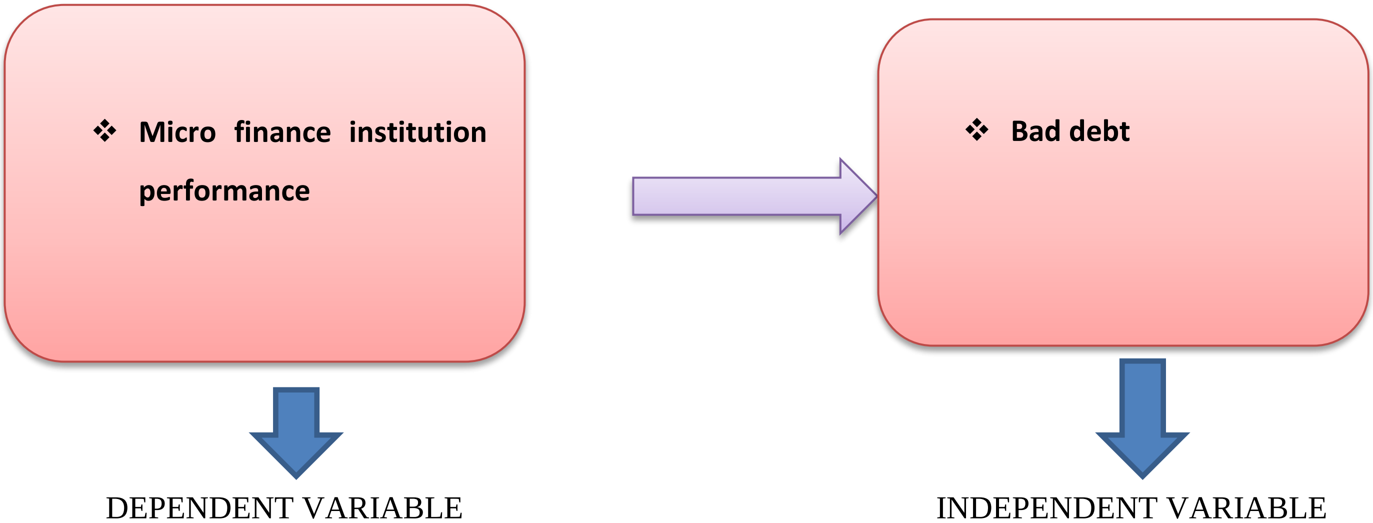
Independent variable is the variable that explains and affects other variables that are not independent (Sugiyono, 2014).

Dependent variable

The dependent variable is often referred to as the output variable and the affected variable. The dependent variable is the variable that is affected or resulted from independent variables (Mishra, 2010).

The figure below shows the conceptual framework of the study from the literature reviewed.

Figure 2.1: Conceptual framework of the study



CHAPTER THREE

3. REASEARCH METHODOLOGY AND DESIGN

3.2. Introduction

The preceding chapter discuses about both theoretical and empirical studies and it tried to give a brief summary of the chapter and dig out the gap in the existing knowledge. This chapter explains the research methodology and design that was used to conduct the research, techniques and data collection. It gives detail information about the techniques used in conducted research. The research methodology and Design section covers the research design, target population, source of data and data collection methods, sampling techniques and data analysis techniques.

To accomplish the research objectives a quantitative research method adopted. The purpose of using such approach is important to gather data that help the researcher to investigate the relationship between bad debt and microfinance institution performance, the case of ACSIs. To gather data on the relationship between bad debt and microfinance institution performance, it is obvious to use secondary data (audited financial statement of ACSIs). On the other hand, once data were found and accepted, data entry and process was made using SPSS software. Analysis of data was undertaken to show important relationships of variables in the study.

3.3. Research Design

According to C.R. Kothari (2004) a research design is the planning of activities for collection and analysis of data. In fact, the research design is the conceptual framework within which a certain study is conducted; it contains the plan for the collection, measurement and analysis of data. With the view to address the research objectives, in this study the researcher used quantitative method. This research paper is descriptive in nature since its purpose is to investigate the relationship between bad debt and micro finance institution performance in the case of Addis credit and saving institution. Secondary data were collected and analyze the relationship between bad debt and microfinance institution performance. The researcher also used correlational research technique in determining relationship between bad debts and microfinance institution performance. Secondary sources are used and different literatures and empirical studies were reviewed to gain insights and background information about the relationship between bad debt and microfinance institution performance.

3.4. Population and Sampling Design

The total population of the study is Addis Credit and Saving Institution head office. The sampling frame for drawing sample included Addis Credit and Saving Institution seven years working experience (i.e. from 2013 to 2019). Type of the target population was the credit officer and management staff of Addis credit and saving institution. Since the department has only 34 loan officer and 7 managers from the loan department. Sample is the portion of the study population and used when addressing the total population in the study is not possible. Different authors show that the need for considering different factors in deciding on the desired sample size. These factors include the availability of time and resources, homogeneity of the target population, the accuracy required and the aim of the research (Sarantakos 2005, sited in Wollela, 2008). According to Brooks (2008, p 105), while there is no definitive answer for an appropriate sample size for model specification, it should be noted that most testing procedures in econometrics rely on asymptotic theory. This theory says that as the sample size approaches to the population, the results from the sample estimates are more appropriate for generalizing to the general population. Thus in this case the sample size was almost equal to the population which enabled to make appropriate generalization to the overall population.

3.5. Data collection, Presentation and Analysis

3.5.1. Data Collection

Quantitative data collection methods are centered on the quantification of relationships between variables. The current study used only secondary data. In this study the researcher used firm-level data for Addis Credit and Saving Institution that operated during the 2013 to 2019 period. The firm-level data were obtained from the audited financial statement of Addis Credit and Saving Institution. Besides, related books, journals articles and various manuals also used as sources of Secondary data.

3.6. Data Analysis

The data collected were analyzed with the aid of Statistical Package for the Social Scientist (SPSS, version 23) descriptive and correlation analysis. Hence, inferences will be made from the data collection analysis.

3.7. Variable Presentation

This study used independent variables such as: Bad debt, while the dependent variable was micro finance institution performance (ROA). The variables descriptions are stated below.

3.7.1. Dependent Variable

MFIs performance (profitability) is the dependent variable in this study. MFIs performance in this study is measured by profitability (ROA).

3.7.1.1. The Return on Asset (ROA)

ROA also called the Return on Investment (ROI) measures how the MFIs are managing its assets to maximize its profits. The ROA or ROI ought to be expanding as the following proportion shows the foundations capacity to think of benefits from its speculations/resources (Iezza, 2010). Created MFIs ought to produce positive profits from its resources. The return on assets may be important ratio because the ratio measures the institutions ability to live the investments profit generating ability, it's calculated as; net income after taxes and before donations/Average assets (Thomas, 2013). Yield on portfolio demonstrates the MFI's capacity to get incomes from financing costs, expenses and commissions inside the gross advance portfolio. A diminishing pattern implies lower income inside the portfolio, either from an adjustment of portfolio creation, item estimating, or predetermined revenue because of an increase within the amount overdue (Dhan,2003). It's calculated as; Interest, fees, and commissions in loan portfolio/ Average gross loan portfolio.

$$ROA = \frac{\text{Net Income}}{\text{Total Asset}}$$

3.7.2. Independent Variables

The explanatory (independent) variables in this study are bad debt.

3.7.2.1. Bad debt

A bad debt can be perceived as an advance which the creditor discovers troublesome or difficult to recuperate. For Financial institutions, bad debt refers to an amount of money given to a borrower, usually firms, which are difficult to recover for a variety of reasons, including business losses or bankruptcy. While there's no particular meaning of an bad debt, it is frequently summed up as follows: a debt that happens when a firm accepts that an indebted person can't or reluctant to pay and along these lines the business won't ever have the option to recuperate the money owed. That is a debt that can't be collected, or one whose collection would be inefficient to follow (Ireland, 2005).

CHAPTER FOUR

4. Data Analysis, Results and Discussions

4.1. Introduction

This part presents the analysis, results and discussions of the study depend on the collected data. As discussed in the preceding chapter this study is aimed at exploring the relationship between bad debt and microfinance institution performance the case of Addis credit and saving institution. In case, the data for this study was drawn from the year 2013/14 to 2019/20. To this end, 7 years observations were analyzed to observe the relationship between bad debt and microfinance institution performance.

4.2. Description of data and data analysis techniques

The analysis is conducted with the aid of SPSS Statistical tools. The secondary data in the form of financial ratios and data was computed using Statistical Package for Social Scientist (SPSS version 23). The study has a general objective which is to examine the relationship between bad debt and microfinance institution performance of Addis credit and saving institutions. Out of this for the purposes of clarity of analysis, the analysis is conducted according to these objectives.

4.3. Data Analysis and Results

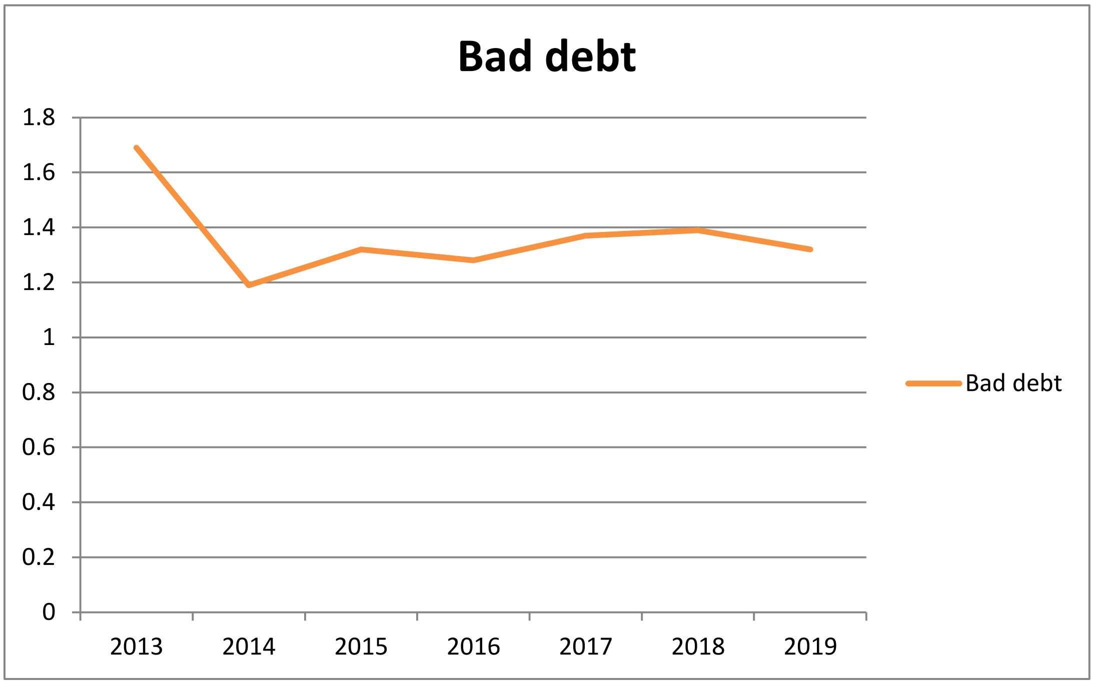
4.3.1. Analysis of the trend of Bad debts and ROA of ACSI during the past seven (7) years

One of the main issues affecting ACSIs in particular and the financial institutions in general is bad debt. Against this backdrop, the researcher sought to examine the relationship between bad debt and microfinance institution performance the case of ACSIs. The section begins by examining the descriptive statistics of Bad debts from 2013/14 to 2019/20.

4.3.1.1. Trend of Bad debt

The trend of Bad debt from 2013/14 to 2019/20 is depicted in Figure 4.1

Figure 4.1 Line Graphs showing the trend of bad debt of ACSI from 2013/14 to 2019/20



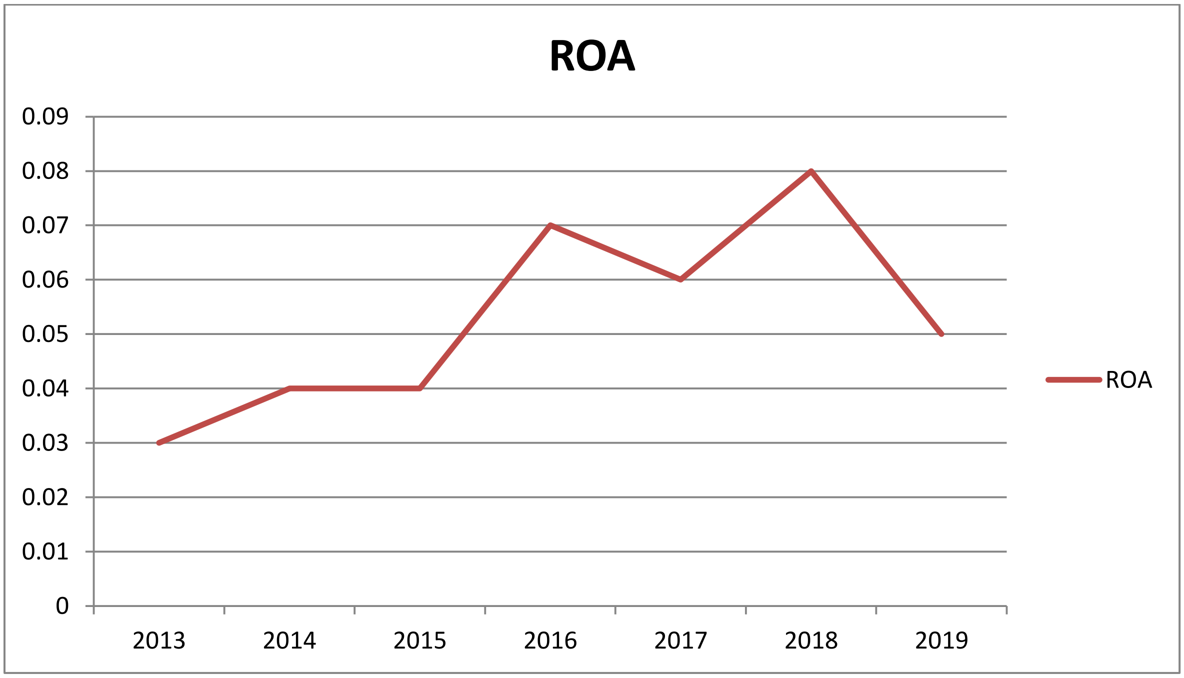
Source: ACSIs financial statments

The result in Figure 4.1 shows that Addis credit and saving institutions exhibits both an upward and down ward movements in their Bad debts since 2013/14. For instance, it can be observed that the Bad debt for ACSI increased by 1.69% in the year 2013/14 but has seen a steady fall from 2014/15 to 2019/20. The result implies that there is a need for ACSIs to take steps to improve their bad debts since it has implications on their profitability and survival. High bad debt means that the institutions will have to write off some of the debts as bad, leading to a reduction in profitability. Also, high percentages of bad debt imply that the institutions will not be in the position to lend more funds to borrowers.

4.3.1.2. Trend of ROA

The trend of ROA from 2013/14 to 2019/20 is depicted in Figure 4.2

Figure 4.2 Line Graphs showing the trend of ROA of ACSI from 2013/14 to 2019/20



Source: ACSIs financial statments

The result in Figure 4.2 shows that Addis credit and saving institutions exhibits both an upward and down ward movements in their ROA since 2013/14. For instance, it can be observed that the ROA for ACSI decreasing in the year 2013/14 but has seen a steady rise from 2014/15 to 2016/16 and also a steady decline in the year 2016/17 to 2017/18. The result implies that there is a need for ACSIs to take steps to improve their ROA.

4.4. Analysis of the relationship between bad debts and of ACSIs performance

The study examined the relationship between bad debts and ACSIs performance. ROA was designated as measure of profitability. The analysis is performed by examining the descriptive statistics of the variables and the correlation analysis.

4.4.1. Descriptive Statistics

This section presents the descriptive statistics of dependent and explanatory variables used in this study. The dependent variable was MFIs performance (ROA) that used to measure profit performance of ACSIs while explanatory variables are Bad debts. The summary of the descriptive statistics of bad debts and Return on Asset for ACSI is presented in Table 4.1.

Table 4.1.Summary of Descriptive Statistics

		Return on Asset	Bad Debt
N	Valid (N)	7	7
Mean		.0532	1.3657
Std. Deviation		.01779	.15715
Minimum		.03	1.19
Maximum		.08	1.69

Source: Researcher computation on SPSS software

In the descriptive analysis, the researcher computes the variables minimum, maximum, mean and standard deviation. The above descriptive analysis "N" indicates that the researcher used seven years data of respective variables.

As measured in the above table 4.1, the average value of ROA, a measure of profitability (dependent variable) which is measured by dividing Net Income by Total Asset of the institution has a mean value of 0.05. This result revealed that on average for every birr Addis credit and saving institution would generate a profit of 5 percent from its assets. The higher ROA shows that the company is more efficient in using its resources and reflects the ability of management to generate profits from their economic resources or assets. The maximum ROA was 0.08 and the minimum value was 0.03. This means Addis credit and saving institution earns highest profit of 0.08 cents income and the lowest profit Addis credit and saving institution earns 0.03 cents income for a single birr on their economic resources. The standard deviation 0.017.This shows the variation in the total assets of ACSIs in the study period.

The independent variable as shown in Table 4.1 provides a description of the bad debt rate of Addis credit and saving institutions. The result shows that the minimum Bad debt for the period (2013/14-2019/20) is 1.19% whiles the maximum bad debt for the same period is 1.69%. On average, the Bad debt for Addis credit and saving institutions is 1.37. With a standard deviation of 0.16, it can be concluded that the bad debt values of the ACSI do not deviate significantly from the mean (average). The result means that ACSI must improve its credit management effort in order to remove its Bad debts. The result implies that ACSIs should do more to cut their bad debts in order to make more profitable and competitive.

4.4.2. Correlation Coefficients Analysis

Correlation is a way to indicate the degree to which two or more variables are associated with or related to each other. The most widely used bi-variant correlation statistics is the Pearson product-movement coefficient, commonly called the Pearson correlation which is used in this study. Correlation coefficient between two variables ranges from +1 (i.e. perfect positive relationship) to -1 (i.e. perfect negative relationship). Sample size is the key element to determine whether or not the correlation coefficient is different from zero/statistically significant. Table 4.4 bellow shows correlation coefficient between dependent variables and independent variables

Table 4.2 Pearson's Moment Correlation Coefficients

		Return on Asset	Bad Debt
Return on Asset	Pearson Correlation	1	-.290
	Sig. (2-tailed)		.529
	N	7	7
Bad Debt	Pearson Correlation	-.290	1
	Sig. (2-tailed)	.529	
	N	7	7

Source: Researcher computation on SPSS software

As Brooks (2008), if it is stated that y and x are correlated, it means that y and x are being treated in a completely symmetrical way. Thus, it is not implied that changes in x cause changes in y, or indeed that changes in y cause changes in x rather, it is simply stated that there is evidence for a linear relationship between the two variables, and movements in the two are on average related to an extent given by the correlation coefficient.

According to the above table Bad debt is negatively correlated with ROA with the coefficient of -0.29 and the linear relationship between Bad debt and ROA is statistically different from zero/statistically significant. So that, we accept the research hypothesis there is a negative relationship between bad debts and Micro finance institution performance.

4.5. Summary of the result

This section presents the summary of the result obtained from the descriptive and correlation analysis the secondary data. The study examined the trend of bad debts and ROA for ACSIs and the relationship between bad debts and microfinance institutions performance the case of ACSIs.

From the analysis became clear ACSI are witnessing upward and downward trends in their bad debts and their ROA. The result implies that there is a need for ACSI to take steps to improve their bad debts since it has implications on their profitability and survival. High bad debt means that ACSIs will have to write off some of the debts as bad, leading to a reduction in profitability. Also, high percentages of bad debts imply that ACSIs will not be in the position to lend more funds to borrowers. This will affect the profitability of ACSIs since the institutions rely on interest income to generate profit and enhance their day-to-day operations. The implication of this finding shows that there is a negative relationship between bad debts and performance so that a rise in bad debts leads to a decline in the amount of funds available for disbursement as credit.

CHAPTER FIVE

5. Summary, Conclusion and Recommendation

The previous chapter presented the results and finding of the study while this chapter designed to provide a summary of the main findings obtained from the analysis. In addition, the chapter provides general conclusions of the study and recommendations based on the results and findings. Accordingly, this chapter is organized into three sub-sections. Section 5.1 presents the summary of key findings, section 5.2 presents the general conclusions of the study and section 5.3 presents the recommendations.

5.1. SUMMARY OF KEY FINDINGS

The study was conducted to ascertain the relationship between bad debts and microfinance institutions performance the case of Addis credit and saving institution. The research question what is the relationship between bad debts and microfinance institutions performance the case of ACSIs from 2013/14 to 2019/20 was examined in the study. For the purposes of clarity of presentation, the findings are presented under the research question.

5.1.1. The relationship between bad debt and MFIs performance (the case of ACSIs)

The analysis of the data revealed bad debts has a negative relationship with profitability (ROA) of ACSIs. The implication of this finding is that an increase in bad debts leads to a decrease in firm's profitability. The findings from the analysis show that ACSIs are experiencing both upward and downward trends in their bad debt and ROA. This means bad debts have been increasing and decreasing percentage wise over the seven years examined. Out of the seven years considered, ACSI recorded the highest rate of bad debt in 2013/14, raising concerns about the institutions ability to reduce its high default rate. The result implies that there is a need for ACSIs to take steps to improve their bad debts since it has implications on their profitability and survival. High bad debt means that the ACSIs will have to write off some of the debts as bad, leading to a reduction in profitability.

5.2. CONCLUSION

Bad debt can affect the ability of MFIs to play their role in economic development. The fast increase in bad debt not only increased MFIs vulnerability to further shocks but also limited their lending operations with broader repercussions for economic activity. The current study attempted to ascertain the relationship between bad debt and MFIs performance.Bad debts have been identified as one of the major factors affecting the profitability and survival of ACSIs. The study examined the relationship between bad debts and micro finance institutions performance the case of Addis credit and saving institution. Secondary data was used to meet the objectives of the study. The secondary data in the form of financial ratios spanning the period of seven years (2013/14-2019/20) was sourced from the financial report and annual report of ACSIs. Using Statistical Package for the Social Sciences (SPSS version 23) descriptive and correlation analysis were conducted to examine trends and relationships. The result found that the ACSIs are witnessing steady increase and decrease in their bad debt ratio, which raises concern about their effectiveness in managing credit risk. The study further found that there is a negative relationship between bad debts and micro finance institutions performance the case of Addis credit and saving institution.

5.3. RECOMMENDATIONS

Addis credit and saving institutions can generate more income to exhibit better performance in its financial statements through credit growth. However, there is a need to improve the quality of debts given to customers or debt clients so as to reduce the incidence of bad debts, thereby maximizing profit. Based on the findings from descriptive, correlation and the linear regression analysis and conclusion, the researcher forwarded the following recommendations.

- ❖ The study discovered that there is a negative relationship between bad debts and micro finance institutions performance which means increase in bad debts leads a decline in firm's performance so that to diminish the degree of bad debts, ACSIs must ensure that there is effective and efficient credit appraisal system in place. For instance, the institutions must critically examine the credit worthiness of customers using all possible means so as to ensure that bad debt is reduced to the barest minimum.
- ❖ Effective assessment of loan applicants coupled with an effective monitoring of loans and an effective loan recovery strategy. It is worth mentioning that credit is the backbone of financial institutions. Decision made can make or break the institutions; therefore, the right person should be recruited as credit manager.
- ❖ There should also be regular staff capacity building for credit managers and credit officer because credit managers and officers should be competent. So also to improve their skills on effective credit risk management in order to lower bad debts.

5.3.1. For Future Researchers

This study paper had put some ground work to explore the effect of bad debt on the performance of microfinance institutions the case of Addis credit and saving institution, by using bad debt, deposit to asset ratio, inflation rate and GDP growth rate, to measure their effects on ACSIs performance.

Further work is required to develop new hypotheses and design new variables by using other performance measurements and variables which were not included in this research work.

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APPENDIX

APPENDIX 1- Summery of SPSS out put

Correlation

		Return on Asset	Bad Debt
Return on Asset	Pearson Correlation	1	-.290
	Sig. (2-tailed)		.529
	N	7	7
Bad Debt	Pearson Correlation	-.290	1
	Sig. (2-tailed)	.529	
	N	7	7
	Sig. (2-tailed)	.542	.730
	N	7	7

APPENDIX 2- Summary study variable Data

Year	ROA	Bad debt
2013	0.03	1.69
2014	0.04	1.19
2015	0.04	1.32
2016	0.07	1.28
2017	0.06	1.37
2018	0.08	1.39
2019	0.05	1.32