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RESEARCH ARTICLE

RETURN RATIO ASSESSMENT APPROACH TO FUNDS' MANAGEMENT: THE CASE OF COOPERATIVE BANK OF OROMIYA, HEAD OFFICE, ADDIS ABABA, ETHIOPIA

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ABSTRACT

The study was conducted to assess the return ratio approach to funds' management: The case of cooperative bank of oromiya, Head office, Addis Ababa, Ethiopia. The costs of sources of funds are cost paid by the bank for the funds that it deploys in its business. The cost of funds are one of the most important sign for a bank, since a lower cost will generate better returns when the funds are deployed in the form of short-term and long-term loans to the bank. The spread between the cost of funds and the return charged to loan and investment represents one of the main sources of profit for Cooperative Bank of Oromia (CBO). The increasing cost of funds of the bank is an indicator of unhealthy trends of the bank. Therefore, the bank should continually monitor the difference between the average costs of funds. If the bank is able to get lower cost of funds it may have an advantage that it can exploit by offering loan prices lower than its competitors. Funds management will be developed from three broad perspectives: Cost Approach, Integrated Approach, and Return Approach. To indicators of return approach to funds management includes: Return on Advance, Return on Investments and Return on Equity. The return approach performance was the explanatory variables that the CBO not satisfactory in managing its funds in case of cost and benefits perspectives.

1.1 INTRODUCTION

Cooperative banks play an important function in the economy of any country. They are the main intermediaries between those with excess money and those individuals and businesses with viable projects but requiring money for their investment. Cooperative Banks have at least the following functions: lending money, depositing money, transferring money locally or globally and working as paying agent. Cooperative banks are a recent phenomenon in the Ethiopian economy. They came into existence in 2005 when cooperative bank of oromiya was established.

Even though 'Cooperatives' are an age old concept of economic system and a movement of people in most of the countries in the world, it requires changes in system, structure, legislation etc., in accordance with the local situation to make the cooperatives vibrant. In turn, its members are benefited economically, socially and ethically. In the past, the Cooperative Banks have contributed significantly not only of their won growth but also to diversification of their activities other than meeting only consumption credit requirements of their members, the important role of cooperative bank in financing small traders, small businesses, and retail traders, house construction, car or vehicle purchase etc., was recognized all over the world. To analyze the costs of sources of funds of the bank, to identify the patterns of utilization of funds and return from deployment of fund and to evaluate the funds managers' practices binding for the mobilization and employment of funds.

1.2 STATEMENT OF THE PROBLEM

It is reported that the banking industry in Ethiopia has been experiencing a sea change during the last two decade due to the advent financial sector reforms in the form of new economic policy they brought in the banking industry and provided a new thrust on banking business. This is on the one side transformed the financial policy , regulations, service condition, customer service, focus, priorities and procedures of the banks and on the other brought new players into the field in the form of non- banking financial institutions (123).

Hence, funds management of the Cooperative Bank of Oromia, an important issue and their cost-benefit perspective is to be studied through cost approach, return approach and integrated approach Funds management of the CBO is an important issue and their return approach is to be studied with their impact on Return on Advance, Return on Investments and Return on Equity in CBO. In this context, the questions apt to arise are:

- Whether the funds management of the banks is in satisfactory manner in terms of return approach ratios?

To find out the answer to this question, an analytical study had to be undertaken. The results of such studies will help to find out the problem, difficulties, impacts etc., and to frame financial policies by the CBO for the benefits of the farmers, the community and other stakeholders (7, 8, 9, 10).

1.3 LITERATURE REVIEWS

Several individual researchers had studied a few facets of integrated approach of selected CBO in selected area. To know how far the ground is already prepared and to identify the gaps therein and to spell out the issues which need further intensive and comprehensive analysis, an attempt is made to review the related literature.

1.3.1 Vhokto Kumar Biswas (6) (2012) studied the term funds has many meanings; in narrow sense it means the accumulated sum of money of people while in broader sense, it refers to financial resources. It also means the working capital which is the excess of current assets over current liabilities. The most common usages of the term, funds refer to cash means working capital and financial resources. Working capital includes that part of total capital which is in use or carrying out the routine or regular business operations. The success and efficiency of an organization, to a large extent, depends upon the effective utilization and management of working capital.

1.3.2 Maheswari (5) (2012) pointed out that cooperative banks do need the measures for efficient management of funds like other financial institutions as they raise share capital, create reserve, mobilize deposits, borrow funds, recover loans lent and maintain adequate margin to meet the cost of management. The in-flow channels of funds do require their maintenance to meet the demand as and when it arises. The efficiency of management of funds can be judged meaningfully if one studies the relationship between the scale of operation i.e. inflow and out-flow of funds and cost of management.

1.3.3 Jyoti Gupta (4) (2012) expressed that the task force considers it necessary for the cooperative banks to devote adequate attention to maximizing their returns on every unit of resources through an effective funds management strategy and mechanism. For the purpose, institution specific investment policies need to be evolved taking into account, composition of funds, maturity pattern of assets and liabilities, availability of money market instruments, exposure limits and efficient monitoring and control mechanism.

1.4 OBJECTIVES OF THE STUDY

The specific objectives of the present study are:

1.To analyze the return approach in the CBO, and

2.To offer suitable suggestions for the development of the CBO.

1.5 METHOD OF DATA ANALYSIS AND INTERPRETATION

Mainly-analytical method has been followed for studying the return ratio of CBO of Ethiopia. The secondary data were collected from the profit and loss account and balance sheet for the selected CBO. The collected data were analyzed by trends, ratios, percentage, averages, and the results are presented by using tables. In addition the researcher will also employ descriptive data analysis is average. The analyzed data is presented using tables. Finally, taking analyzed information in to account, the inferences are drawn and recommendations will forwarded to fund manager of Bank.

1.6 SAMPLING DESIGN AND SAMPLING TECHNIQUES

The nature of the study is both qualitative and quantitative. The data that were obtained from the bank’s (balance sheet, profit or loss statement) and others can be expressed in amount will make this study quantitative and on contrary, the data that cannot be expressed in amount but in words made this study qualitative. Therefore, the study was return approach type of study. Purposive sampling was employed for the secondary data collection. Purposive sampling was used based on the ground that the fund’s managers knows more about funds management and its practices than other employees of the bank especially employees on funds management concern.

1.7 DATA SETS AND SOURCES

The study was based on audited data drawn from the annual reports of CBO for consecutive seven years. It covers a period of seven years from 2007-08 to 2013-14. Since, the sources and uses of funds as represented by various items such as liabilities and assets contained in balance sheets and interest cost, interest income, as a whole are drawn from Profit and loss statements accounts of the bank at head office level.

1.8 DATA COLLECTION TECHNIQUES

For collecting the required secondary data from the selected CBO, a comprehensive schedule was prepared and used. The schedule was pre-tested and finalized.

1.9 RESULTS AND DISCUSSION

1.9.1 Return on Loans and Advances

Return on the loans and advances portfolio provides the most profitable avenue for deployment of funds by a bank. This is a facility granted to a bank customer that allows the customer make use of banks funds which must be repaid with interest at an agreed period. The term loan refers to the amount borrowed by persons from the bank refers the nature of loan and the sum paid to the borrower. Thus, from the view point of borrower it is borrowing and from the view point of bank, it is lending. Loan may be regarded as credit granted where the money is disbursed and its recovery is made on a later date. Interest is charged on the loan at agreed rate and intervals of payment. There is a sense of debt in loan, whereas an advance is a facility being availed of by the borrower. However like loans, advances are also to be repaid. Thus a credit facility repayable in installments over a period is termed as loan while a credit facility repayable within one year may be known as advances. Cooperative bank of oromia lend money in four different ways: direct loans, cash credit, overdraft, and discounting of bills Return on loans and advances are components of return approach of the bank (11, 12).

Table 1.1 Return on Loans and Advances

(Br. in amount)

Year	Return on Loans and Advance	Credit Amount	Ratio
2007-2008	32,056,756	587,893,286	5.45
2008-2009	44,984,033	318,334,708	14.13
2009-2010	74,886,509	703,511,694	10.64
2010-2011	93,561,262.89	785,837,466	11.91
2011-2012	161,013,505.35	1,363,544,644	11.81
2012-2013	215,995,929	2,079,719,045	10.39
2013-2014	380,008,160	3,644,115,624	10.43
Average	**143,215,165**	**1,354,708,067**	**10.68**

Source: computed from audited financial statement of cooperative bank

Except 2007-08 all return on loans and advances are above 10 percent. Its average value is 10.68 percent from 2007-08 to 2013-14. It has 14.13% of maximum value and minimum value of 5.45%. So 10.68 percent is a financial asset of a bank arising from a direct or indirect loan and advance in seven years. The required level of return on loans and advance is between 10-14 percent. As a result of this cooperative bank of oromia did good performance regarding return on advance then it is satisfactory.

1.9.2 Return on Investment Ratio

Employment of bank funds in investments is intended to meet the requirements of statutory liquidity ratio. It measures the firm's efficiency in utilizing invested capital. In other words this ratio expresses bank’s ability to generate the required return (expected return) based on using and managing the invested resources by the members. Return on investment is a measure of profitability that indicates whether or not a bank is using its resources in an efficient manner. ROI is known as a profitability ratio, because it provides information about management's performance in using the resources to generate income. ROI is also used by bankers and business analysts to assess a bank use of resources and financial strength (11, 12).

The return on investment of cooperative bank of oromia which was invested on government, corporate security and bills was showing fluctuate increased during the study period from 2009-10 to 2013-14 and in 2007-08 to 2008-09 there is no return on investment. The average value of return on investment is 1.99 percent. In addition, ROI is limited by the fact that it focuses on one period of time and thus should be considered a short-term performance measure. Ignoring the long-term effects of investments can cause poor decision-making, so it is advisable to combine ROI with other measures of profitability and performance. Return on investment in cooperative bank oromia is not satisfactory when it evaluated with the standard optimum level of >3 percent.

Table 1.2 Return on Investment

(Br. in amount)

Year	Return	Investment	Ratio
2007-2008	0	207908522	0.00
2008-2009	0	203,477,138	0.00
2009-2010	12,969,200	432,309,019	2.99
2010-2011	6918946	230,631,564	3.00
2011-2012	10,911,004	576,620,892	1.89
2012-2013	22,469,085	1,112,304,492	2.02
2013-2014	33,778,861	839,903,292	4.02
Average	**17,409,419**	**565,874,400**	**1.99**

Source: computed from audited financial statement of the bank

The return on investment of cooperative bank of oromia which was invested on government, corporate security and bills was showing fluctuate increased during the study period from 2009-10 to 2013-14 and in 2007-08 to 2008-09 there is no return on investment. The average value of return on investment is 1.99 percent. In addition, ROI is limited by the fact that it focuses on one period of time and thus should be considered a short-term performance measure. Ignoring the long-term effects of investments can cause poor decision-making, so it is advisable to combine ROI with other measures of profitability and performance. Return on investment in cooperative bank oromia is not satisfactory when it evaluated with the standard optimum level of >3 percent.

1.9.3 Return on Owner's Equity Ratio

This ratio indicates profitability of a bank by comparing its net income to its average shareholders' equity. The return on equity ratio (ROE) measures how much the shareholders earned for their investment in the company. The higher the ratio percentage, the more efficient management is in utilizing its equity base and the better return is to members. The ROE ratio is an important measure of a company's earnings performance. The ROE tells common members how effectively their money is being employed. Peer Company, industry and overall market comparisons are appropriate. Financial analysts consider return on equity ratios in the 15-20 percent range as representing attractive levels of investment quality.

An increasing return on equity can suggest the bank is able to grow profits without adding new equity into the business, which dilutes the ownership share of existing shareholders. The higher a company's return on equity, the better management is at employing investors' capital to generate profits. The return on equity looks at the return on the shareholder's investment and thus from the shareholder's perspective, allows a comparison of investment in a bank's shares with other investment opportunities, while it can also provide a measure of the bank's riskiness (11, 12).

Table 1.3
Return on Equity
(Br. in amount)

Year	Net income	Average Owners Equity	Ratio
2007-2008	11754371	148330406	7.92
2008-2009	2499862	152370080	1.64
2009-2010	25096924	172706417	14.53
2010-2011	47272023	217419991	21.74
2011-2012	102018472	331525407	30.77
2012-2013	189261573	556602699	34.00
2013-2014	343798156	893183830	38.49
Average	**103100197**	**353162690**	**21.30**

Source: *computed from Audited financial statement of cooperative bank oromia*

The cooperative bank of oromia performed increased trend of return on equity the average value of seven years was 21.30 percent and it is not satisfactory when it is compared to the standard value of 15-20 percent. Unlike other return on investment ratios, ROE is a profitability ratio from the investor's point of view not the company. In other words, this ratio calculates how much money is made based on the members' investment in the bank, not the banks investment in assets or something else. That being said, members want to see a high return on equity ratio because this indicates that the bank is using its members' funds effectively. Many members also choose to calculate the return on equity at the beginning of a period and the end of a period to see the change in return. This helps track a banks progress and ability to maintain a positive earnings trend.

1.10 MAJOR FINDINGS

The present study, "Funds Management of Cooperative Bank of Oromia, Addis Ababa, Ethiopia: Return Ratio Assessment Approach "is an analytical one. The study was conducted in Ethiopia. The study was conducted in CBO, Head Office, Ethiopia. CBO was selected and secondary data were used for the analysis. A decadal period was covered by this (2007-08 to 2013-14).Statistical tools of statistical like average and ratio were used for analysis. The major findings and conclusion are presented in the following paragraphs.

Return on Loans and Advances (ROLA)

The Bank lends money in four different ways: direct loans, cash credit, overdraft, and discounting of bills. It is except 2007-08 all return on loans and advances are above 10 percent and its average value is 10.68 percent from 2008-2014. Return on loans and advances of the bank meets the optimum standard level of 10-14 percent which so satisfactory.

Return on Investment (ROI)

The return on investment of cooperative bank of oromia which was invested in government security and bills was increased during the study period from 2010-2014 but in 2007-08 to 2008-09 there no return on investment. The average value of return on investment is 1.99 percent and the optimum level of return on investment is >3 percent because of this the performance the bank was not satisfactory.

Return on Equity (ROE)

The ROE position the bank increased trend of return on equity. The average value of seven years was 21.30 percent and it is not satisfactory when it is compared to the standard value of (ROE) 15-20 percent. There is lack of management efficiency to utilize the resources contributed by members.

Table 1.4

Result of Return Ratio Assessment Approach

S. No	Name of the Ratios	Ratios Result	
		S	**NS**
Return Approach Ratios			
1.	Return on Loans and Advances	**S**	**-**
2.	Return on Investment	**-**	**NS**
3.	Return on Equity	**-**	**NS**
Total		**1**	**2**

S: Satisfactory NS: Not Satisfactory

1.11 CONCLUSIONS

Funds management is the coordination and control of all sources of funds in cooperative banks. Return on investment and Return on equity were an explanatory variable that the bank made not satisfactory performance except Return on loans and advances. If the bank concentrates to increase cost of deposits and speedy recovery of debts, it has good future both in increasing its own profitability and also can serve more efficiently. Hence, the overall performance of the CBO is not good. If the benefits are properly toiled and utilized it has a bright future both to the community and to the nation.

1.12 SUGGESSIONS

1. The management has to use the equity properly and realize the return for the members.

2. The bank has to increase interest bearing and increase non-interest bearing deposits which help the bank to stabilize its sources of funds.

3. In case of cooperative banks structure, management style of Board of Directors is mainly based on political influences involving presence of inefficiency in management decisions and lack of effective corporate governance.

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