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Providing Loans for Agricultural Cooperatives in Ukraine

Introduction

The establishment of financial and credit relations, the foundation of institutions and organizations for providing the agricultural sector and rural population with a financial service is a slow process in Ukraine. In practice, only banks are able to offer credit facilities to agricultural borrowers, cooperatives in particular. Non-banking credit system hardly ever works, though the conception of development of agricultural cooperation in rural areas still exists [Conception 2009]. The experience of economically developed countries convinces that loan facilities of the commercial banks and cooperative credit institutions for agricultural borrowers are not different in their principal approaches as to the stages and assessment of creditworthiness. The differences in the cost of borrowing and credit facilities exist in the terms of credit agreements. That's why standard procedures of loan provision for agricultural borrowers adapted to the modern Ukrainian economic conditions should be examined on the example of banking service as the most developed and regulated.

Being an economic phenomena, the agricultural cooperation is set up under the scheme, when the individual producers unite in producing agricultural commodity and serving their own business (supplying the material and technical means, processing and selling the agricultural products, providing financial and credit services etc.) on the basis of the principles of mutual support and assistance, self-management, self-help and self-control. The development of agricultural cooperation carries out the two main functions – economic and social. This is a wide social movement, which is constantly developing, going through the different phases and according to them and the stage of its development taking the organization forms. Combining an owner and a customer of the enterprise in one person may characterize the agricultural cooperative as a loan consumer. The main direction of cooperative activities includes meeting primarily the interests of their founders, but not making their own profit, which determines the peculi-

arities of the establishment of credit relations of agricultural cooperatives with credit institutions.

Research Goals, Tasks, Objects and Methods

Goal of the research is related to the analysis of crediting agricultural cooperatives in Ukraine as well as finding the way of its improving. Implementation of this goal is associated with the solution of the following *tasks*:

- study of the peculiarities of credit rating of agricultural cooperatives and their classification as borrowers;
- determination of the directions of development of the agricultural cooperatives credit system and measures to improve their competitiveness;
- justification of the organizational elements of microcrediting and finding the way of improving agricultural cooperatives crediting.

Research object includes organizational and economic principles of agricultural cooperatives crediting in the context of transformational processes in the agricultural sector. *The following methods were used in the research*: analytical, statistical, normative, formalization, observation etc.

Peculiarities of crediting agricultural cooperatives

The parameters of loan provision for agricultural cooperatives (the amount of a loan, the cost of borrowing, the terms, the specific orientation and the form of credit) are determined by the objective common factors of external macroeconomic environment, the form of credit institution and the peculiarities of cooperatives as borrowers.

The system of credit rating of agricultural cooperatives in Ukraine needs improvement, which is connected with:

1. The absence of the only method of credit rating of agricultural cooperatives. The study of comparison efficiency of management of different organizational and legal forms of enterprises in the agricultural sector is conducted by using the same normative and legal basis, economic and mathematical methods without taking into account the individual forms of management.

2. Another reason for the absence of information about credit rating and state of crediting the agricultural cooperatives is their division into service and production ones. In Ukraine the majority of agricultural cooperatives are production (76%). According to the information of the Ministry of Agrarian Policy in 2007 there were 37.2% – multi-functional, 33.3% – service, 22.1% – storage; 5.2% – sales, 2.2% – other cooperatives.

The Ukrainian production and service cooperatives are different borrowers and their loan provision should be provided with the consideration of the given peculiarities (Table 1).

Table 1
Classification of Agricultural Cooperatives as Borrowers

Elements	Characteristics
Level of unity	1. Primary production cooperatives 2. Primary service cooperatives 3. Unity of existing legal persons
Form of unity	1. Rural individuals 2. Farmers 3. Production cooperatives and enterprises 4. Mixed
Credit history	1. Heirs of credit history (former collective farms) 2. Without credit history (newly-established)
Goal of creation	1. To produce and obtain income (production cooperatives) 2. To get sales and financial service, service of resource supplies (service cooperatives)
Charter	1. Enterprise (production cooperatives) 2. Non-profit organization (service cooperatives)
Formalization of unity	1. Registered as a legal person 2. Conduct joint business, but not registered as a legal person

Source: Author's presentation.

The division of cooperatives into service and production isn't a simple classification. The differences in the way of crediting exist at the legislative level. So, the Degree of the Cabinet of Ukraine "About the additional measures to provide a complex of agricultural work with bank loan" [Degree 2000], which introduced the partial compensation of loan rate of credits that are given to agricultural producers (borrowers) to do the work in the field, anticipated firstly that the commercial banks had to grant a loan only to this category of producers as well as cooperatives, if they guaranteed to repay the bank loan. Besides, it was anticipated that agricultural producers might use bank charges for paying the service of insurance companies and notary public, provided while making a credit agreement.

When viewing a cooperative as an attractive borrower and setting the cost of borrowing, the credit institution takes into account the possibility for cooperatives to obtain the state compensation of the rate of interest. Besides, the absence of government compensation of the rate of interest not only pushes up the cost of borrowing. It declines the financial and economic indicators of agricultural enterprises. And on the contrary, an increase in the budgetary compensation for

repaying the rate of interest influences positively the financial indicators of the enterprises (Figure 1). Though the dependence between the cost of budgetary compensation and profitability of agricultural producers isn't direct, since the financial results are influenced by a plenty of external factors (petrol and fertilize prices, changes in taxation of agricultural sector, price instability of the agricultural produce, national and climatic factors etc.), there is a common tendency for the profitability of agricultural enterprises because of an increase in the budgetary compensation.

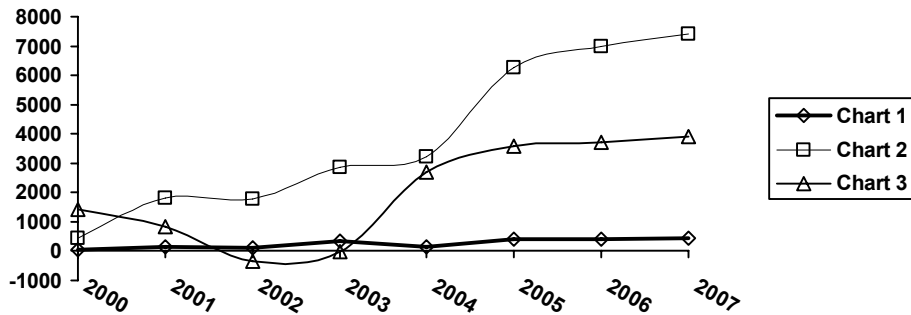


Chart 1: Transferred from the budget to the partial compensation of loan rate, million UAH*

Chart 2: Soft loans, granted to agricultural enterprises, million UAH*

Chart 3: Net income, loss of agricultural enterprises, million UAH*

* Exchange rate was 7,23 UAH/EUR in 2007

Figure 1

Comparative Chart of Indicators of Preferential Loans and Financial Performances of Agricultural Producers

Source: According to the information given by the State Committee of Statistic, the Ministry of Agrarian Policy of Ukraine and National Bank of Ukraine.

3. One more peculiarity of the Ukrainian agricultural cooperatives as borrowers is disagreement as to their unprofitable nature at the legislative level. By some legal enactments the Ukrainian cooperatives are divided into profitable (production) and unprofitable (service) [Law of Ukraine 2007], and the others, in particular, in the issues concerning taxation such a division isn't provided for, though there isn't a direct denial that service cooperatives would be given the possibility of receiving non-profit status [Law of Ukraine 1997]. The fundamental principle of cooperatives activity – unprofitability as the main principle for financial planning of income and expenditure is not supported entirely by the legislation. But, in fact, if cooperative acts on the other principles, it doesn't carry out properly its social and economic function. In practice, service cooperatives, being “de jure” – enterprises for making profit, don't always long for it. Even for production cooperatives obtaining income is not the main goal of creation.

The reason is that such characteristic of a borrower as unprofitability usually equates to ineffective activity and is connected with a high credit risk. And loan provision for undermanaged enterprises is prohibited by legislation.

However, non-profit status for cooperatives is fundamental and system-making. Combining an owner and a customer of the enterprise in one person stipulates special characteristics of agricultural cooperatives as a credit consumer [Plesha 2007]. Non-profit status is not simply well-grounded but indispensable if cooperatives are considered to be extended business of their members – owners in order to conduct effective and profitable work of these farms but not to obtain and increase their own income.

Such characteristic as profitability enables production cooperatives to apply to a bank with an application for credit. In order to take out a loan, non-profit service cooperative has to give a source of repaying loan and paying for the rate of interest within special current and capital expenditure, not within income as it's classically predicted in business-planning. Business-planning for service cooperative is the system of well-organised activities aimed to gain the goal for which credit is taken out.

Directions of the Development of Agricultural Cooperatives Loan Provision

Analysis of present-date organizational and economic state of agricultural crediting in Ukraine, in particular crediting agricultural cooperatives has shown that the existing system of credit provision doesn't meet their needs. If bank loans are available for production cooperatives, percentage of service cooperatives in loan portfolio is very low. The main directions in solving the problems of proper loan facilities for agricultural cooperatives are:

- improvement of mechanism of financial and credit provision management at a state level to increase creditworthiness of agricultural cooperatives;
- creation of ramified and multi-stage credit infrastructure;
- development of the new forms of small loans provision which would stimulate an increase in creditworthiness of agricultural cooperatives.

Favourable and necessary conditions should be provided by proper state mechanism, represented by the system of macro- and microeconomic instruments. Macroeconomic instruments (supply of loans and demand for loan, registration rate, price policy in the market of agricultural produce, energy resources and other resources, which are necessary for work of agricultural sector, taxes, subsidization etc.) are influenced greatly by state regulation of finance and credit sphere [Sabluk 2005].

In order to increase creditworthiness of agricultural cooperatives, the main efforts on macrolevel should be made in two complementary directions (Figure 2):

- measures for improvement of loan service mechanism, that creates institutional conditions for increasing the amount of credit loans in agricultural sector;
- measures for upgrading agricultural cooperatives efficiency.

Besides the development of credit infrastructure, the system of centralized rating of borrowers, the creation of a network of loan history bureaus with the state support should promote an increase in loan availability. It might reduce bank expenditure on credit rating of cooperatives and enable to avoid credit risk, which would help to reduce the cost of borrowing [Batrak 2006].

Also we suggest that production and service cooperatives should be provided with financial statements which would take into account their special status. Creation of state institutions and promotion of creation and development of non-state institutions with guarantee of loans will allow to solve the problem of absence of liquid collateral in cooperatives. Nowadays high financial indicators of cooperatives activity is not plausible argument for obtaining credit without any guarantee or collateral. It is necessary for the development of appropriate infrastructure at a state level to create appropriate legislative basis of guarantee and insurance of agricultural loans [Kudinov 2006].

The usage of non-traditional methods of crediting: factoring operations, forfeiting and financial leasing must increase cooperatives competition in case of financial instability of their major fraction that prevents from drawing on the external financial resources (traditional bank loans). Creation of proper normative and legal basis as to the methodological provision of these operations will enable banks to use widely these forms of crediting for cooperatives with instable financial indicators of creditworthiness and which don't have any huge mortgage.

Organizational and Practical Principles of Small Loans Provision

In existing financial mechanism of crediting agricultural sector, there is much disagreement between real need, demand for loans and supply of loans. The factors of increasing loan provision for agricultural cooperatives must be the goal-directed activity of banks aimed for implementation of small loans system. At the same time the problems in banking system, connected with the world financial and economic crisis and termination of loan provision for natural and legal persons are not the subject of this investigation.

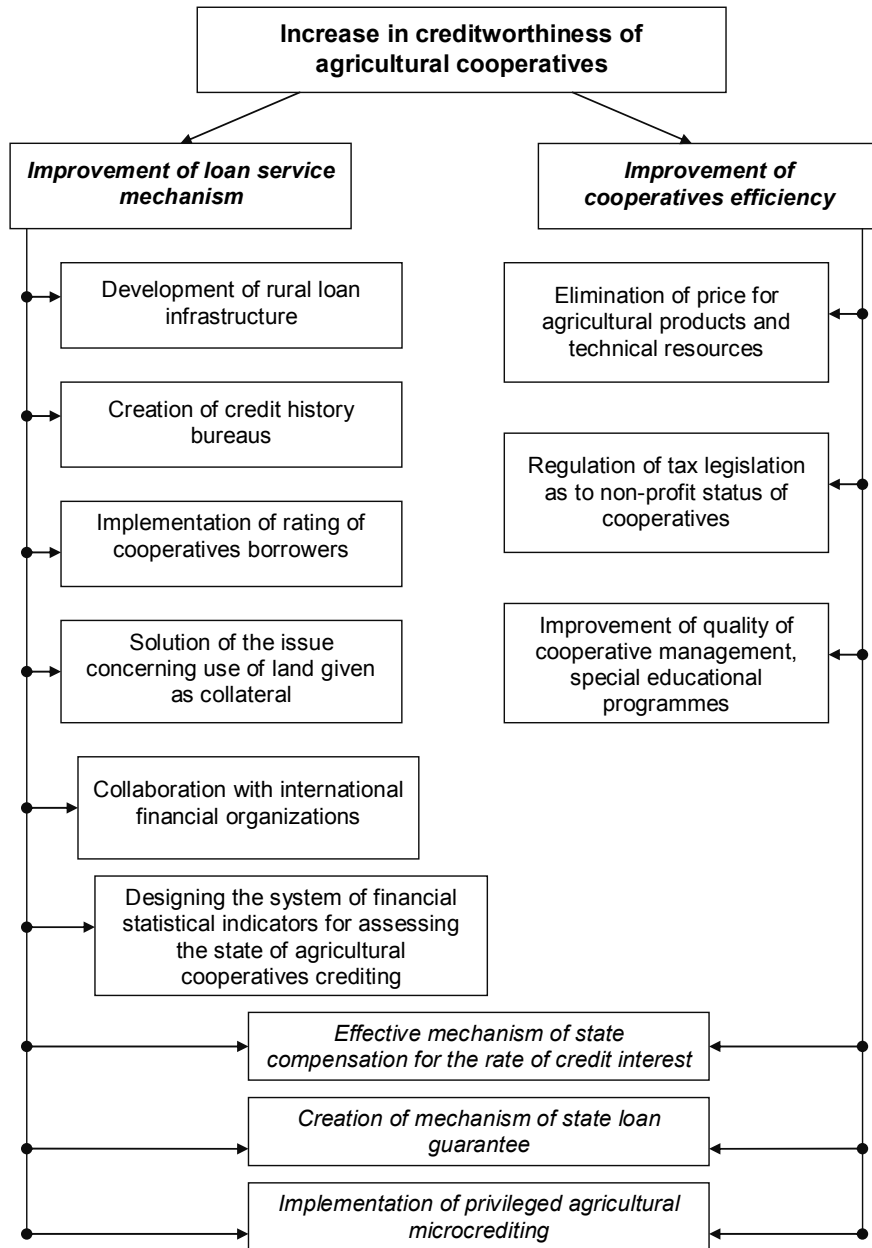


Figure 2
 The Main Measures for Increasing Creditworthiness of Agricultural Cooperatives
 Source: Author's presentation.

Study of the practice of implementation of small loans provision programme for agricultural enterprises in ProCredit Bank by October 2008 allows to distinguish some positive aspects which microloans have:

1. The largest percentage of repaid small loans belongs to the loan portfolio. If the average indicator of agricultural loan repayment is 80–90%, small loans are repaid by 99.4%.
2. Small loans allow to diversify loan risks.
3. While increasing the amount of small loans, the total profitability of operations is improving and they are likely to give banks the same return as big loans.

Regardless of persuasive advantages, the system of small loans provision in agricultural sector hardly ever works in practice. Banks don't pick out borrowers from the agricultural microloan provision into individual task group. The general requirements are imposed on them as to collateral and financial rating which they don't meet in full.

Since 2005 on the whole territory of Ukraine there is a special programme for the small-scale agricultural borrowers IPC GmbH "Agro+", which was developed specially for the Ukrainian conditions on the basis of German credit technology. The programme has significant differences in the issues about credit analysis, mortgage and credit management in comparison with ordinary ones. Among the banks it is ProCredit Bank which works on the similar technology. As practice has shown, there are some obvious shortcomings which need remedying.

ProCredit Bank offers agricultural borrowers the following credit products: AgroExpress, AgroBusiness and bank lines. More and more small-scale borrowers are applying for credit, among which the main borrowers are farmers, companies, production cooperatives. There are few service cooperatives among them because the scheme works on the principle of profitability, and service cooperatives are unprofitable. The important factor, besides unprofitability, which makes agricultural service cooperatives unattractive borrowers, is their small number. So, it's necessary to create perspective schemes of loan service management, aimed to remedy negative factors which prevent from expanding the range of borrowers by means of service cooperatives. The world experience shows that just service sector of agricultural service cooperation is the most attractive borrower in agricultural sector because of a fast turnover. Bank faces smaller risk by providing loan service for joint group of borrowers on the cooperative basis because of an increase in personal responsibility of each owner.

In existing ProCredit Bank regulation at the moment of investigation private firms, physical persons, engaged in cattle-breeding, plant-growing and processing their own agricultural produce belonged to the task group of enterprises,

which claimed on agricultural loans. Enterprises (as legal persons) must be registered in accordance to the current legislation; they are farms, private firms, co-operatives, joint stock companies and others.

Maximum allowable numbers of permanent workers on the farm shouldn't amount to more than 200 persons, taking account of connected companies – 300 persons. Minimum amount of such loan is 200 dollars USA (or equivalent in other currency). Maximum amount of loan is established by the separate orders of bank directors. Small loans are considered to be loans up to 10 thousand dollars USA per a borrower.

Credit terms depend on the work schedule of agricultural enterprises, capital movement and financial needs of enterprise. Maximum term of agricultural small loans, given in accordance with the Programme was determined by the following parameters: for increasing current assets – 12 months, for buying fixed assets – 24 months. Loan coverage depends on the form of credit (Table 2).

Table 2
Agricultural Loan Provision

Form of loan	Collateral coverage	Guarantee
AgroExpress to 1000 dollars USA	Without coverage	Of physical person
	100% goods and chattels (the principal of loan with accrued charges)	Without guarantee
AgroExpress 1001–5000 dollars USA	50% bank debt (the principal of loan with accrued charges)	Of physical person
	100% goods and chattels (the principal of loan with accrued charges)	Without guarantee
AgroBusiness	100% bank debt (the principal of loan with accrued charges)	Of legal or physical person

Source: ProCredit Bank regulation of loans provision for agricultural enterprises.

Among different kinds of property within collateral, proportions and discount on collateral cost are allowed (Table 3). Increase in part of any kind of collateral is allowable under the agreement on the appropriate decision of credit committee. The proposed discount is minimum; if collateral is rare machinery, equipment and other property, which are difficult to sell at market prices, discount may be bigger than the pointed one in the Table 3.

In order to reduce credit risk, secured loan is possible. In each particular case it is necessary to take into account all groups of risk connected with each certain borrower: used technology, the climatic conditions of certain region, availability of agricultural machinery and its state, balance structure of enterprise and its income, availability of collateral and its state.

Table 3

Allowable proportions of different types of property within collateral and discount on collateral cost (in %)

Provision components	Fraction in total collateral for loans		Discount for loans	
	Up to 5000 dollars USA	5001 dollars USA and over	Up to 5000 dollars USA	5001 dollars USA and over
Carrier equipment	100	100	10–30	30–50
Agricultural machinery	100	100	20–30	20–50
Business equipment and unit	100	70	30	30–50
Animals	100	70	30–50	40–50
Personal property	100	50	30	30–50
Goods, complete produce	70	50	50	50
Future yield	–	10	–	50
Real estate	–	100	–	30–50

Source: ProCredit Bank regulation of loans provision for agricultural enterprises.

The pointed credit procedures are used to the borrowers who have reliable financial indicators, and the basis for payment of the main financial ratios (liquidity, profitability, turnover, financial leverage) is the following basic date: total assets, spare cash, material assets, accounts receivable and payable, the share own capital, sales and the amount of profit).

All these procedures are not adapted to service cooperatives, which are considered to be unattractive borrowers, because some changes in current procedures of assessment and monitoring should be made for their convenience.

Conclusions

The necessity for improving loan provision for agricultural cooperatives in Ukraine arises in the creation of conditions for proper credit management with the goal of negotiating a loan and securing the performance of contract on the negotiated terms by means of consecutive adherence to the established loan procedures.

In order to improve loans provision for agricultural borrowers and impose small loans provision for agricultural cooperatives bank should do the following:

1. In order to push prices for loan resources lower, reduce loan risks and lower operational expenditures on implementation of small loans provision programme, banks should take part in servicing proper international banks lines.

2. Banks should intensify differentiation of credit terms for agricultural borrowers in accordance with relative amount of financial indicators to definite normative amount. This may be accompanied by additional requirements under the credit terms as to monitoring in the case of availability of insufficient typical indicators, as it would occur to service cooperatives. This fact would contribute to agricultural cooperatives' taking special measures for improvement of financial state and raise it to necessary normative amounts and with the help of bank consultants – creditor.

3. In order to provide the proposed group of borrowers with loan resources at a bank level, there is the need for creation of a mechanism for stimulating establishment of service cooperatives and improving their financial indicators when granting small loans. In particular, it is necessary to expand the use of “loan range” as means of loan repayment guarantee.

4. In order to increase creditworthiness it's necessary to improve mechanism of repaying loans and rate of interest. With taking into account seasonal specifics of agricultural production, mechanism of one-off repayment on loans and interest at the end of the term is the most attractive. In this case the source of repayment is profit obtained from a sold harvest. Mechanism of repaying loan and rate of interest would be more economical at using annuity scheme. The positive aspect is that cooperative doesn't have to extract once a great amount of money to repay credit and rate of interest. But in this case it is necessary to receive income, the amount of which should secure performance of given liabilities. Also the usage of monthly repayment mechanism stipulates an increase in financial planning and financial discipline level, but on the other hand is less risky in comparison with a mechanism of one-off repayment on loan and rate of interest. The majority of produce cooperatives use mechanism of one-off repayment on loans and rate of interest at end of the term.

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Dostęp do pożyczek spółdzielni rolniczych na Ukrainie

Streszczenie

W opracowaniu przedstawiono propozycję poprawy dostępu do pożyczek dla spółdzielni rolniczych na Ukrainie. Warunki otrzymania pożyczek nie pozwalają na spełnienie zapotrzebowania na te źródła finansowania spółdzielni. W funkcjonujących mechanizmach finansowych określone świadczenia są zróżnicowane i odpowiadają na zapotrzebowanie na kapitał tylko współczesnym formom prawnym jednostek gospodarczych. Spółdzielnie rolnicze odróżniają się od innych pożyczkobiorców przyjętymi zasadami finansowania. W spółdzielniach, które zajmują się produkcją bądź usługami w aspekcie pozyskiwania pożyczek, odnotowano zarówno cechy wspólne, jak i elementy różnicujące. W artykule przedstawiono klasyfikację spółdzielni rolniczych na Ukrainie w ujęciu pożyczkobiorców. Określono, że głównym czynnikiem pozwalającym na zwiększenie dostępności do pożyczek dla spółdzielni rolniczych powinno być ukierunkowane działanie banków, przyczyniające się do wdrożenia systemu małych pożyczek rolniczych, który pozwoliłby na spełnienie wymagań stawianych przez banki (ocena zdolności kredytowej oraz biznes planu, który brany jest pod uwagę w sytuacji spółdzielni jako pożyczkobiorcy).