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# **Development of Credit and Consumer Cooperation in the Agricultural Sector**

## **Introduction**

Development of agricultural cooperation in Ukraine is a complex phenomenon, conditioned by a specific social and economic situation in the agricultural sector. Development of cooperatives is possible when facilitation of this process became one of the elements of the agricultural policy. In order for cooperative movement to become efficient, able to realize its main goal (meeting the economic needs of agricultural producers by means of specific organization of their collective actions), it is necessary to use the experience of developed countries, taking into account Ukraine's economic, legislative, political, social and cultural specifics.

Today in Ukraine there is only one civil and economic system, which represents cooperative sector of the economy and facilitates country's economic development – it is the consumer cooperation. Consumer cooperatives may participate in the creation of agricultural service cooperatives, since they have the cooperative basis and are located mostly in rural areas. Furthermore, consumer cooperation has its own system of distribution and exchange, as well as professional staff. Consumer cooperation in Ukraine has a strong material and technical basis, which includes merchandise and food industries, storage and production activities; this cooperation is very close to owners of individual subsistence farms, small and medium agricultural enterprises. At the same time, development of these structures is constrained by limited access to financial resources, associated with various barriers. That's why there is an urgent need to study the development of credit cooperation, which allows to mobilize savings of cooperatives' members and loans for production purposes.

## Research Goals, Tasks, Objects and Methods

*Goal* of the research is related to the analysis of activities of credit unions in agriculture, as well as justification of methodological bases of improving the financial and credit provision of consumer cooperatives. Implementation of this goal is associated with the solution of the following *tasks*:

- study of the process of formation of credit cooperation concerning its conformity with the general principles of cooperative movement;
- assessment of the situation with financial services for consumer cooperatives, operating in rural areas;
- determination of the most efficient sources of financial provision of consumer cooperatives during transformation of economic relations;
- justification of the mechanism of attracting funds of credit unions in order to increase current assets of consumer cooperatives.

*Research object* includes credit unions, operating in the Ukrainian agricultural sector, particularly in order to provide financial services for consumer cooperatives. *The following methods were used in the research*: structural and logical, systemic analysis, statistical, normative, formalization, observation, etc.

## Formation of Credit Cooperation in Ukrainian Agricultural Sector

Credit cooperation is the most widespread form of cooperation in the world. Cooperative banks, savings and loans associations and credit cooperatives, credit unions and other cooperative financial institutions are not widely spread all over the world – they occupy leading positions and play an important role in the world's financial systems. First evidence on the creation of cooperatives with the goal of providing mutual loans date back to 1850s. At that time, due to acceleration of the industrial development, the problem of getting the necessary funds was faced not just by entrepreneurs, but also by other individuals and communities, united by production, professional or social interests, which could not arrange for bank loans.

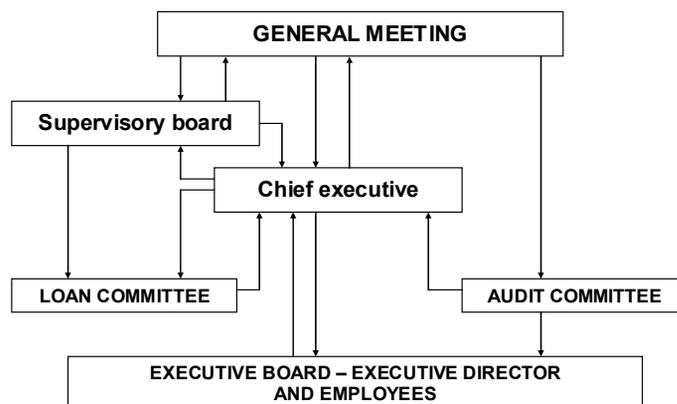
First credit unions appeared in Ukraine in 1869, and until 20th century they had approximately 3 million members. Today credit cooperation is not so widespread: out of 600 registered credit unions only 375 are functioning, and only 121 credit unions are members of the National association of credit unions of Ukraine. Credit union is a non-profit organization, founded by individuals on cooperative bases in order to meet the needs of its members for mutual loans and

provision of financial services through consolidation of contributions of credit unions' members.

Though according to current Ukrainian laws credit unions belong to civil organizations, by their nature they are a special form of financial cooperative, since principles of their activities correspond to general principles of cooperation: freedom of entry and exit; creation of the credit union based on the territorial bond; openness for new members, whose interests correspond to cooperative goals; self-sustainability and self-management; freedom of members to participate in any type of activity, including management; elections and periodic replacement of managerial bodies and their accountability to credit union members; impossibility of increasing the welfare of one member at the expense of other members; fair distribution of income between members depending on their participation in credit union activities; providing information to members on the cooperative's activities; provision of services mostly to members of cooperatives; cost minimization strategies.

Rural credit union is a voluntary organization of individuals and other organizations, who live (which are located) and/or conduct business in rural areas, with the goal of joint accumulation of funds and provision of loans based on the mutual assistance principles. The main directions of credit activities include providing loans to businesses (including farmers), as well as social crediting [Sabluk 2005, p. 638]. Management structure of a rural credit union is shown on Figure 1.

Management of cooperative is conducted by general meeting of its members, executive board (or by chief executive), supervisory board (audit committee). Executive board is an executive body of the credit union, and loan committee – as a consulting body. Management structure and its formation are determined by charter, taking into account the number of members and types of activities.



**Figure 1**  
Management Structure for a Rural Credit Union  
Source: Author's presentation.

Credit cooperation is able to concentrate country's internal financial resources and channel them to the development of consumer cooperation systems and, most of all, of their social basis – small producers and consumers. Besides, the idea of credit cooperation is very simple and understandable for the population. Today credit cooperation unites more than 1 million members of consumers' organizations and employs 123000 people. It covers more than 2000 consumers' organizations and 270 district and regional unions. Strong economic potential of consumers' cooperation is represented by more than 30000 sales units, 1500 processing units, 340 storage and sales facilities, as well as other objects. Gross turnover of main industries of consumers' cooperation amounts to more than 700 million EUR per year [Kyrylenko 2005, p. 167].

The field of consumer cooperation includes: consumer associations; other companies, organizations and institutions, founded by consumer associations and unions; joint enterprises, created by a group of unions. In order to perform certain functions, consumer associations may create internal departments. Comparison of production activities of agricultural and consumer cooperatives, as well as credit unions, is shown in Table 1.

**Table 1**

Comparison of Production Activities of Agricultural and Consumer Cooperatives, as Well as Credit Unions

Elements	Consumer Cooperatives	Agricultural Service Cooperatives	Credit Unions
1	2	3	4
<i>Social goals</i>	Meeting the needs of owners and their social protection	Economic self-protection of producers	Meeting the needs of members in mutual loans
<i>Economic goals</i>	Obtaining income from various types of activities, aimed at meeting the needs of consumer associations' members and non-members	Increase in members' income	Provision of financial services
<i>Charter</i>	Profit oriented organization.	Non-profit organization	Non-profit organization
<i>Organizational form</i>	Consumer cooperative	Service cooperative	Credit cooperative, public organization
<i>Management</i>	Nominally: democratic (one member – one vote). In practice: centralized management	Democratic (one member – one vote)	Democratic (one member – one vote)

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1	2	3	4
<i>Owners</i>	Nominally: all members, the number of members is not fixed. In practice: new members are not accepted	All members, the number of members is not fixed	All members
<i>Customers</i>	Various persons, who are consumers of goods/services, not necessarily owners	Only owner members	Union members
<i>Activities</i>	Provision of services to customers	Processing of raw materials	Provision of loans and deposit facilities
<i>Legislative regulation</i>	Consumer Cooperation Law	Agricultural Cooperation Law	Credit Unions Law
<i>Governmental support</i>	No incentives	Exemption from income tax, other incentives	Exemption from income tax

Source: Author's presentation.

Specific of credit unions include combinations of features of a public organization and a financial institution; their activities are aimed at small-scale borrower and minimization of financial risks [Borisova 2004, p. 24]. That's why, the positive aspect in creating the conditions for development of entrepreneurship is related to increasing the credit cooperation network through the development of credit unions. This way one could achieve diversification of the financial market, taking into account agricultural specifics. The main source of repaying the credit is associated with efficient production.

## **Assessment of the Situation with Financial Services for Consumer Cooperatives**

Financial provision is seen as the main precondition for financial and credit relations, aimed at provision of business activities with the necessary financial resources. Financial provision is closely related with the financial and productive potential of a company. Money income and funds form financial resources of businesses, which are divided into equity and borrowed capital. Financial provision means availability of financial resources for companies in order to finance current business activities, investment programs, personnel training activities, etc.

All financial structures of consumer cooperation have their own area of functioning, but they are closely interrelated by the common goal – income. That's why, it is not profitable for consumer cooperatives, which lack the necessary

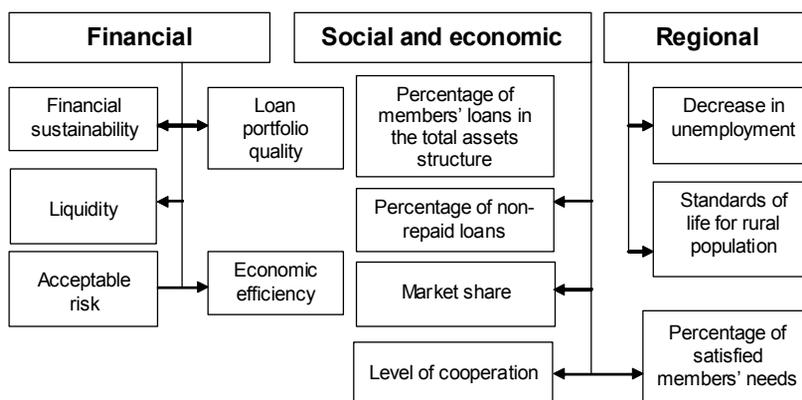
financial provision, to use services of other financial structures, since there is an outflow of own current assets, while the main goal of cooperatives (meeting the needs of their members) is not provided. So, there is the need for improvement of financial relations and market mechanism of consumer cooperation.

We believe that the most optimal form of credit cooperation in terms of consumer cooperation is associated with credit unions. This fact is stipulated by common elements in the goal and conditions of functioning of consumer cooperation, service enterprises and credit unions – consolidation of cooperatives' members contributions in order to conduct joint business.

The efficiency of credit unions is an economic category, which describes the performance of economic potential of these organizations. In order to evade bankruptcy, caused by instable financial market, credit cooperative should systematically monitor and plan its own activities.

The main goal of credit unions is related to increase in its capital, since it is the main source of funds. Capital is increased with new members or with the increase in equity of existing members. That's why a credit cooperative should organize its activities in such a way when many people would want to become its members.

Credit Union is a financial organization, but ways and directions of its operations are quite specific. That's why now all indicators of credit institutions efficiency may be used for assessing the credit union efficiency. Some problems in calculation of indicators is caused by the fact that credit unions do not have separate financial statements. That's why the proposed indicators may be used as internal and they should be calculated in the basis of accounting information (Figure 2).



**Figure 2**

The Structure of Indicators of Credit Unions' Efficiency

Source: Author's presentation.

While assessing the efficiency of sources of loan funds, one should take into account specifics of agriculture: the production process is longer compared with other branches, so the capital turnover is more slow; there is high uncertainty with forecasting of financial flows due to dependence on climate; loans efficiency is influenced by factors of macroeconomic instability [Nedyalkov 2002, p. 395]. So, creation of the mechanism of interaction of a credit union and consumer cooperatives should be started from the assessment of financial flows (determination the sources of funds, relation between consumption and accumulation processes) and selection of potential members of this process.

As a way of providing small loans, credit union may be viewed as an investor. The essence of investment activities of credit unions is related to a set of measures in the field of preparation and implementation of investment projects with social effects [Borisova 2001, p. 108]. So, formation of financial resources is seen as one of the most important task not just in the investment, but also of financial strategy of the consumer cooperation system, which would allow to provide necessary sources and funds, as well as financial sustainability in the consumer cooperation sector.

## **The Most Efficient Sources of Financial Provision of Consumer Cooperatives**

Demand of consumers' cooperatives is determined mainly by financial situation of the borrower, liquid collateral, etc. Analysis of these factors shows that consumer cooperatives are not attractive to banks as loans recipients: low credit quality, critical financial condition [Balanyuk 2004, p. 351]. Besides, because of low demand from the population, turnover of financial resources, invested in merchandise, is very slow. As a result, most sales costs are represented by interest payments.

When analyzing dynamics of sources of reproducing current and fixed assets in the consumer cooperatives sector, we see that bank loans do not play an important role in financing activities of consumer cooperatives (Table 2).

The largest percentage in sources of reproducing current and fixed assets belongs to the equity capital, which tends to increase. The positive aspect is seen in the decrease of accounts payable, but current liabilities increased during the year. Study of external financial sources of consumer cooperatives revealed the important role of credit unions in their financing. They are the mobilizers of dispersed financial resources, available in rural areas, and that's why at the beginning of their activities they are able to operate with limited loan capacity. Due

to adequate resource management and by attracting new members, they may increase their potential and widen their activities through balanced organization of financial activities.

**Table 2**

Sources of Reproducing Current and Fixed Assets for Consumer Cooperatives, 2005–2006

No	Indicators	Ukoopspilka in General			Including Sumy Region Consumer Cooperative Union		
		2005	2006	+/-	2005	2006	+/-
1	Equity capital, million EUR*	326,7	358,8	32,1	7,7	9,6	1,9
	As a percentage of assets	58,3	65,5	7,2	38,7	49,5	10,8
2	Accounts payable, million EUR*	125,9	73,3	-52,6	6,2	4,3	-1,9
	As a percentage of assets	22,5	13,4	-9,1	31,1	22,2	-8,9
3	Current liabilities, million EUR*	97,6	99,6	2,0	5,4	5,1	-0,3
	As a percentage of assets	17,4	18,2	0,8	27,1	26,3	-0,8
4	Bank loans, million EUR*	10,0	15,6	5,6	0,6	0,4	-0,2
	As a percentage of assets	1,8	2,8	1,0	3,0	2,1	-0,9
	Total assets, million EUR	560,2	547,4	-12,8	19,9	19,4	-0,5

\* Calculated with the exchange rate of 7,21 UAH/EUR

Source: [Plesha V., 2007, p. 30], own calculation and estimation.

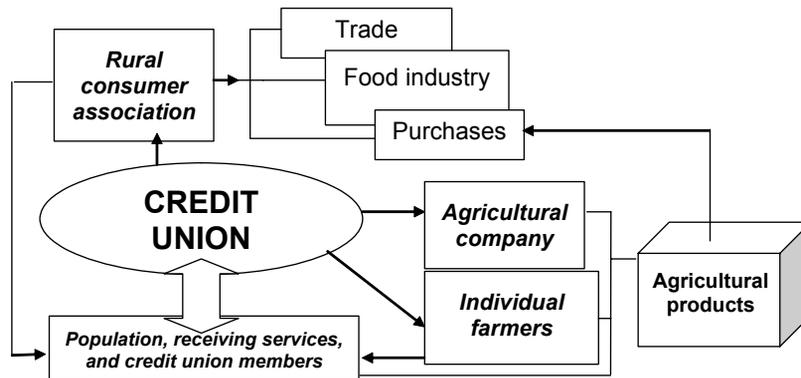
However, the use of credit unions' funds by consumer cooperatives should be preceded by staged efficiency assessment for loan funds. At the first stage, the periods of implementation of the credit process are determined. At the second stage, the loan amount is calculated. At the third stage, the optimal income flows are calculated. The loan efficiency is determined at the fourth stage. This issue is very important for borrowers, since there is a certain economic limit of business loans, beyond which the loan is not profitable. Interest payments should be compared with income, which may be obtained. In practice, the solution of this issue is not so simple. The reason is that the end result (income) is determined for the whole project, while the loan amount is just a part of financial provision.

Sustainable financial situations of enterprises in the market is largely determined by working capital utilization efficiency of each economic agent. Exchange processes, increase in accounts payable and receivable, bankruptcy threat are all results of deficit of working capital and its inefficient use. Main internal factors of financial stability include factors, which facilitate efficient use of funds (optimization of inventories and plant assets, acceleration of their turn-

over; balancing between necessary production assets and their sources, oriented at financial stability; organization of cash flows, which would provide excess of cash inflows over cash outflows; efficient use of profit). We believe that consumer loans influence not just on social security level, but also on the level of demand, trade and production.

## Mechanism of Attracting Funds of Credit Unions

Increase in efficiency of consumer cooperatives is possible due to implementation of the mechanism of interaction of these enterprises with population through creation of a credit union with the goal of providing loan funds to businesses (Figure 3).



**Figure 3**  
Attraction and Distribution of Credit Unions' Funds in Rural Areas  
Source: Author's presentation.

Attraction of credit unions' funds in order to replenish working capital of consumer cooperatives should be started from the assessment of financial flows (determining the sources of funds, relation between consumption and accumulation processes) and selection of potential members of this process. With positive dynamics of financial resources in a certain region, stakeholders, potential sources of cooperation and technical provision, one should develop technical and economic justification of credit unions' activities, calculating organizational costs, equity and its sources.

Credit union activities depend on various risks due to market changes in demand and supply. The most important is credit risk, related to inability of borrower to meet loan contract obligations. Factors, which increase credit risk, include: considerable amounts of loans to a small number of borrowers; liberal

credit policies; extending loans without necessary information; considerable loans to interrelated borrowers; economic and political instability. Factors, which decrease credit risk, include: conservative management policies; thorough loan approval procedures; determination of maximum allowable risk per one borrower; systematic monitoring. Due to funds, obtained from credit unions, consumer cooperatives have an additional source of working capital. At the same time, they should always determine the directions of efficient use of borrowed funds, calculating the efficiency of various activities.

## Conclusions

There are certain common features between consumer cooperatives and credit unions – these features are stipulated by the goal of creation, formation of own capital, but in terms of credit union owners are able to control activities of consumer organization and receive guaranteed income on invested capital. Besides, creation of the mechanism of interrelations of consumer organizations and credit unions in order to provide financial services, needed for their activities, would allow to analyze financial flows of a certain regions in terms of closed circle.

Provision of financial services for consumer cooperatives considerably depends on external financial sources, mobilization of which is limited by the lack of interest from the side of commercial banks, considerable monitoring costs and high risks, which make loans non-profitable. At the same time, lack of own current assets does not allow to conduct business and receive enough income for business enlargement, as well as creation of material incentives for workers and owners (members of consumer organization). The situation may be improved by means of developing the system of non-banking financial institutions and microloans.

One of the ways to solve the problem of providing financial services for consumer cooperatives includes usage of credit cooperation's funds. Credit cooperation allows to improve economic relations in rural areas, as well as the production ways in agriculture: productive factors and influence of property relations, exchange mechanism; it facilitates creation of new labor incentives, formation and stimulation of entrepreneurship in agriculture. Reproduction of financial mechanism through usage of credit unions' funds would allow to stimulate investments in rural areas. Credit unions are able to make a real contribution to resolving of production development issues, employment generation, social infrastructure development in rural areas.

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## ROZWÓJ KREDYTOWANIA I SPÓŁDZIELNIE KONSUMENCKIE W SEKTORZE ROLNICTWA

### Streszczenie

Celem opracowania jest analiza roli, jaką odgrywają spółdzielnie kredytowe w poprawie usług finansowych rolniczych spółdzielni konsumenckich. W celu utrzymania określonego poziomu kapitału obrotowego netto spółdzielnia konsumencka powinna brać udział w tworzeniu spółdzielni kredytowych, które pozwolą na: szybkie uzyskanie pożyczki, zróżnicowanie stopy oprocentowania oraz przedłużenie terminów płatności. W czasach uzależnienia jednostek od kredytów spółdzielnie kredytowe bazują na potrzebie skalkulowania wartości odsetek zarówno własnych, właścicieli, dłużników, jak i zarządu. Spółdzielnie kredytowe mogą być postrzegane jako finansowe jednostki pośredniczące, zapewniające finansowe i socjalne zabezpieczenie ich członkom pomimo wykorzystywania ich prywatnych oszczędności w celu zapewnienia źródeł kredytowania działalności produkcyjnej spółdzielni konsumenckich. System rolniczych spółdzielni kre-

dytowych w zakresie kredytowania rolnictwa pozwoli na zapewnienie ludności wiejskiej niezbędnych źródeł kredytowania i usług finansowych. Ponadto, może mieć wpływ na bezrobocie na obszarach wiejskich, rozszerzenie zakresu usług finansowych, wzrost stabilizacji finansowej, jak również na poziom zapotrzebowania na gospodarstwa rolnicze oraz na rozwój małej przedsiębiorczości. W ten sposób ułatwi to wzrost aktywności obszarów wiejskich.