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## **Prospects of microlending economic entities of agricultural branch**

**Summary:** The article considers state and prospects of microlending economic entities of agricultural branch by credit cooperatives.

**Keywords:** microcredit, consumer cooperatives, credit cooperatives, credit, bank lending, tax burden, concessional loan

### **Introduction**

According to the requirements of the International Monetary Fund for the subjects of agricultural production, which is currently taxed by preferential terms, procedure of taxation will be changed. Cabinet of Ministers of Ukraine considers three variants for the taxation of agricultural producers, which provide following changes:

- for small and medium-sized agricultural enterprises under cultivation of which there are up to 10 thousand ha and average annual total revenue from sales of 50 million UAH, taxation by fixed agricultural tax and the VAT rate – 11% (input – 20% and output – 20%) are retained;
- the second variant assumes that 80% of the accumulated VAT remains in the possession of the payer, and 20% – is transferred to the budget;
- according to the third variant, agrarians voluntarily abandon the state support. Large-scale agricultural producers will be taxed under the general tax system. VAT is not compensated from the budget during export of grain and industrial crops. Small-scale producers, whose area of land do not exceed 10 thousand ha with an annual turnover of proceeds from the sale not more than 50 million UAH, will be taxed by single tax at a rate ranging from 0.3 to 1.0% of the normative value of the land.

Increase of tax burden on agrarians will take place using any variant of tax, and in return, increase of the cost of agricultural production, reduction of its competitiveness, flaw, own funds to cover the seasonal gap between the revenues from sales and production costs.

The production process in the agricultural sector of economy is accompanied by seasonality and time lag between the revenues from sales and costs of production. As a result of such a state there is a need for additional involvement of bank loans. The practice of lending domestic entities of agricultural production shows that they are mostly not covered by commercial banks as potential borrowers. It especially concerns

small-scale producers who can not compete on the market of credit services with economic entities of other sectors of the national economy. Owing to this situation, economic entities of the agricultural sector need government support. It should be noted that the level of support of economic entities of the agricultural sector in the EU varies considerably from state support for local agrarians. In particular, Greek agricultural producers receive about 700 euros per one hectare of land, in Bulgaria – 190, in Lithuania – 143, in Estonia – 112 euros, and in Ukraine – less than 20 euros. In addition, the EU agrarians can take credit at 3–5%<sup>1</sup>. Domestic agricultural producers can take credit at a rate of over 21% per annum. Under these conditions, provision of agricultural production entities with credit resources can take place due to the introduction of measures regarding their microlending through the network of credit agricultural cooperatives, creation of which is an urgent problem nowadays.

Analysis of recent researches and publications. Comprehensive parts of the genesis of agricultural cooperation, regional peculiarities of its functioning, issues of economic, organizational, legal regulation of agricultural credit cooperatives are studied in the works of foreign and local researchers. The contribution to the development of the theory of rural credit cooperative as microcredit institution was made by such foreign scholars as: F. Raiffeisen, H. Schulze-Delitzsch, D. Adams, D. Fitchett, J. Von Pischke, R. Levin, R. Fogel, D. Freshwater, R. Schmidt, M. Tuhan-Baranowski, A. Chayanov and N. Prizewinner in Economics in 2006 Muhammad Yunus.

Scientific papers of many local scientists, including M. Demyanenko, O. Gudz, T. Herasimova, A. Moroz, M. Malik, M. Savluk, P. Sabluk and others dedicated to studying multifaceted theoretical and practical issues of establishment and functioning of credit cooperatives.

However, up to date the program concerning the systematic approach and the scientific concept of development of agricultural credit cooperative in Ukraine, its governmental regulation and support are absent. Incompetence of studying the problem, its theoretical and practical significance for the national economy in general and the agricultural sector identified the need for this research.

### **Research purpose**

Scientific substantiation of theoretical and methodological positions and development of practical recommendations on credit cooperatives establishment and their functioning, in order to implement microlending of economic entities of agricultural branch.

### **Research methods**

The theoretical and methodological basis of investigation is the fundamental economic categories and laws, papers of classics of economy, works of modern domestic and foreign scientists, achievements of scientific and research institutes and educa-

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<sup>1</sup> S. Oliynyk: Farmers need support, Gazeta Ekspres 2014, 16–17 September (in Ukrainian).

tional institutions. General methodological basis is a comprehensive analysis, owing to which it became possible to combine different approaches, methods and techniques for achieving the goals and objectives of the research. In solving these tasks, the abstract-logical, economic and statistical, monographic research methods, and the expert evaluation method were used. Legislation and regulations, materials of the Ministry of Agrarian Policy and Food of Ukraine, of State Statistics serve as informational basis of research.

### Research results

Agricultural credit cooperative has a centuries-long history, according to the experience of countries with developed market relations. The first rural credit cooperative was established by pastor Raiffeisen in German village Heddersdo in the second half of the XIX century to ease the life of the rural poverty. Since that time, cooperation in Germany, France, the Netherlands, the United States and other developed countries become a basic form, combining agricultural producers to expand access to credit resources, needed material resources, the feasibility of agricultural products sale.

Formation of system of lending domestic agricultural economy took place in conditions of destructive events that led to the collapse of the existing systems of agricultural production maintenance, and financial and credit relationships. The state has nearly lost a regulatory role in the development of the industry, its central link – agricultural production.

Under the present conditions, governmental support of domestic agricultural producers lays in the cheapening of interest rates on loans. According to the Resolution of CMU<sup>2</sup> of 25.02.2000 No. 398 from 2000, along with the agrarian reform implementation, a mechanism of state support through the credit cheapening based on cheapening of interest rates for bank loans was implemented. Partial compensation of interest rates for economic entities of agricultural production through the budget funds, in its essence, is not market stock, because its basic principle is state regulation of functioning of financial services market. However, such compensation payments contributed to credit process unblock for the agricultural borrowers, and helped to involve them in credit resources.

Experience of the implementation of the mechanism of concessional lending showed some shortcomings, which was a prerequisite for its further improvement. According to Resolution of Cabinet of Ministers of Ukraine of 27.2001 by No 59 'On partial compensation of interest rate on commercial bank loans granted to agricultural producers and other enterprises agroindustrial complex', a differentiated approach to the size of partial compensation for agricultural producers – 70% was proposed, while for others

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<sup>2</sup> Постанова КМУ про додаткові заходи щодо кредитування комплексу сільськогосподарських робіт станом на 25.02.2000 No. 398 (Resolution of CMU on additional measures concerning lending agricultural activities complex for 25.02.2000 No. 398). *Ofitsiynyi visnyk Ukrainy* 2000, No. 6, p. 3–4. Retrived from [http://www.bank.gov.ua/Inf\\_mat/Of\\_Pov/2008/11.10.2008\\_319.htm](http://www.bank.gov.ua/Inf_mat/Of_Pov/2008/11.10.2008_319.htm) (in Ukrainian) [15.03.2015].

economic entities of agricultural production – up to 50% of discount rate of the National Bank of Ukraine, established on the date of the conclusion of the credit agreement<sup>3</sup>.

It is one of the prerequisites that bank loans don't cover a temporary break during the year between production costs and the proceeds from the sale of products connected with the growth of expenditures and balances of inventory items and needs further improvement. Mechanism of concessional lending of agrarians with compensation of lending rate of 50% at the expense of the budget funds with clearly established fixed rate of 17% proved its inability to positively affect the availability of credit resources for agrarians. It is clearly traced on the example of the economic entities of agricultural branch of Cherkasy region. Establishment of higher interest rates by banks, than it was provided in the memorandum, automatically deprived the borrowers of entitlement on compensation on cheapening of credits from the state.

Concessional lending of entities of agricultural production is influenced by macroeconomic factors, most significant of which are:

- the stability of the national currency;
- the degree of integration of the national economy in the world economy;
- general economic growth;
- state Regulation of food market;
- dependence on export potential;
- ensuring of price parity between agricultural and industrial products.

In the basis of concessional lending, a principle of access of economic entities of agricultural branch to cheap bank loans on the market of credit services is laid, since agrarians are not covered by commercial banks as potential borrowers as a result of specificity of production accompanied by a number of risks. In particular, due to the remoteness from local centers, banks are not interested in agricultural borrowers, especially in small-scale producers as in potential borrowers because the transaction costs for their service usually outweighs the potential benefit of the bank. Another factor that complicates the work of banks is the coinciding in time demand for credit by agricultural producers, especially during the crop production. Different terms of deposits involved, and loans provided, also complicate the work of banks: in crisis period. The population doesn't risk investing money for more than 1–3 months, and enterprises working in the agriculture, need a loan for a period of at least 6 months. The risks of commercial banks serving rural areas include insufficient of diversification of its loan portfolio, as a result of which the risks of their bankruptcy arise. Under such circumstances, commercial banks which hold a monopoly position on the market of credit services, authorized activity of which is the maximum profit, constantly improve interest rates on loans, and bank borrowings can use mostly highly profitable borrowers, whom level of profitability is far above the interest rates on bank loans. Such form of lending under the conditions of the economic crisis prevents access to credit resources of small-scale and low-profitable economic entities

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<sup>3</sup> Resolution of CMU on partial reimbursement of rate on commercial bank loans granted to agricultural producers and other enterprises of agroindustrial complex for 27.01.2001 No. 59. Ofitsiynyi visnyk Ukrainy 2001, No. 5, p. 41–42 (in Ukrainian).

of agricultural sector, which is the main obstacle concerning ensuring a continuous production process, prevention of the implementation of expanded reproduction.

The situation that occurred on the market of credit services concerning the provision of agricultural producers, especially small-scale, with credit resources, can take place due to the introduction of microlending through the established credit cooperatives. Due to the analysis of conducted researches, on Ukraine the credit cooperatives are absent of the reasons of absence of a state program on the development of microlending. Measures to provide purposeful state action for development of cooperation is not economically justified, the existing support mechanisms don't work.

In the conditions of competition with large-scale market integrators and absence of sufficient resource base, it is extremely difficult to develop credit cooperatives. However, with the support of state and local government, credit cooperatives could take a worthy place in the market of credit services. Practice shows that the government still underestimates the role of credit cooperatives and it has not decided how to incorporate them into the system of state support. Credit cooperatives are able to provide 'effect of scale' in the association of small producers, to interact with agricultural products customers and suppliers of resources and services for agriculture. A lot of researches in the field of microlending through credit cooperatives of agricultural producers indicate that some scholars identify their function to statutory activities of commercial banks. The fundamental difference between banks and credit cooperatives lays in its special relation to their capital and profit. Any commercial bank, private, joint-stock or mortgage, with government participation, making their operations, always strives to realize profit on capital as much as possible, with which it works. The main differences of agricultural credit cooperative from the bank are presented in (Table 1).

Thus, unlike commercial banks, credit cooperative is not rigidly focused on profit and it is created to meet the needs of their members-shareholders, that causes the methods of management, carrying on the business activities, distribution of income.

According to classics and cooperation, cooperative – is a commercial enterprise based on voluntary association of several persons, aimed not to maximize profits on capital spent, but its growth through joint management, labor income of its members and reduction of their costs. In addition to the cooperation, equally, characteristics of macro-financial enterprises inherent to credit cooperative. In the economic literature, the terms of microfinance institution, microfinancing, microlending are often used, though not always it means the same legal forms. In part, this situation is due to the fact that Ukraine doesn't have intergrated legal framework regulating microfinance activities.

Credit cooperatives, financial cooperation groups, mutual credit association, credit unions of citizens, associations of credit and financial initiatives, groups of the borrowers under the collective responsibility – this is not a complete list of the names of various forms of microfinance institutions found in the economic literature. When identifying distinguishing characteristics of microfinance institutions the following should be considered:

- special customer base has limited access to credit resources in the banking system. It presents a variety of populations (from successful small enterprises, small business owners and merchants to rural residents with low incomes);

**Table 1.** Differences of credit cooperative from commercial bank

Indices	Agricultural Credit Cooperative	Commercial bank
Purpose	Meeting the needs of cooperative members in the industrial loan	Income
Organizational form	Cooperative	Joint Stock Company, Corporation
Clients	Only members of the shareholders, mostly peasant farms and personal farms.	Any solvent clients
Management	According to the principle "one person – one vote"	According to the share in share capital, number of shares
Profit distribution	Contributions to the fund of financial cooperation	Dividends to shareholders
Sources of equity capital	Costs of sharers and savings of all cooperative members (including associate), revenues from their own activities	Contributions of shareholders in the share capital, income.
Basic warranty of creditworthiness	Confidence in personal characteristics of the borrower which ensure the effective and appropriate use of credit	Property
Vicarious liability for the obligations	Is an additional guarantee of solvency	–
Objectives of lending	Mainly for production purposes	It does not matter, for industrial and consumer needs
Services provided	Providing loans to members of the cooperative, deposits of savings of the cooperative members, payment and financial services, consulting	Loans of all kinds, the current account for individuals and businesses, other services (broader range of activity)
Taxation	Is taxed by personal income tax	Bank income tax
The level of transaction costs	Small, taking into consideration the availability of the cooperative for shareholders, including the territorial	Relatively high since it provides monitoring of loans, including travel of credit professionals to affiliates of commercial banks

- different legal forms;
- the volume of loans issued by macro-financial institutions ranging from micro to very large sizes (30 to 125 thousand Dollars depending on the country);
- formal and informal status;
- in spite of access to loans, microfinancial institutions serve important social support functions of poverty reduction and economic growth of the area;
- forms and functions significantly differ by countries, depending on their abundance, socio-economic development, poverty, availability of existing legislation.

Microfinancial institution – is the institution which provides entities of small entrepreneurship and individuals who have limited access to traditional banking services,

with financial and social services (including education and counseling) aimed, in terms of macroeconomic effect, at smoothing social tension in society, improving standard of living, providing employment, business development.

Agricultural credit cooperative is both agricultural cooperative and special micro-finance institution serving the interests of rural producers mainly in the sphere of production lending. The main goal of agricultural credit cooperative establishment is to provide access of its members to borrowing costs, primarily for agricultural production at the lowest possible price, as well as placing their surplus funds in the form of saving shares.

Features of agricultural production and the associated with them increased risk of non-repayment of loans, and the task of diversified rural economy necessitated the creation of financial and credit institutions focused on servicing the needs of the rural community, not just agricultural producers. In this regard, it seems necessary to introduce in the legal space a new concept of 'Rural Credit Cooperative' rather than 'Agricultural'.

In many countries of the world, the specific problems of small-scale rural loan were resolved through the establishment of cooperative credit institutions. By the size of equity capital and number of transactions, individual cooperative banks enter the top twenty commercial banks. These are: Dutch RABOBANK, German Reiffeisenbanken, French Credit Agricole, the US Farm Credit System, the distinctive feature of which is their cooperative origin, because they were established on the basis of credit cooperatives supported (Germany, Sweden) or initiated (USA, France, Japan) by the state.

The experience of the company and work of the system of cooperative banks in Western Europe countries and cooperative systems in the economies of Eastern Europe and Southeast Asia, which is developed, can be useful in our country, especially in the realm of financial support of working capital and in determining the legal and regulatory boundaries of activity of all microfinancial institutions of cooperative type.

The role of state in the development of credit cooperation is ambiguous. It can participate in the establishment of a system, from framework relations and control to direct funding of initial capital. Using the experience of the USA and Germany, from the budget of which a startup capital of the system of rural credit cooperatives was formed, as well as the recent example of Moldova, Bulgaria and Romania, where the state took loan in the World Bank in order to increase the working capital of credit cooperative.

There is no doubt that in the case of the loan from the state budget, it will be returned to the budget, as it was in the USA (government loan was paid in 20 years), pre-revolutionary Russia (by 1913 100% of the loans were issued from its own funds and deposits of shareholders), in South Korea volume of loans for 13 years increased in 4 times.

An important element of the cooperative system of lending of rural entrepreneurs is mechanisms of guarantee and loans provision. For example, the Lithuanian guarantee fund of agricultural loans (Zemes Ukio Paskolu Garantiju Fondas) with a capital of 1.8

million Euro was established in 1995 to provide guarantees for borrowers who are unable to provide mortgage. Analysis of the conducted research indicates the experience of Germany and the Netherlands which should be used. In these countries, a significant part of the capital of rural credit cooperatives is formed by attracting savings of local population and foreign private investments. To attract in the system of agricultural credit cooperative of Ukraine surplus funds from financial markets, the experience of the US Federal Corporation on funding farm loan can be used, which issues special bond that are guaranteed by the federal government. Another solution is to develop a mechanism by which involved funds are incoming not to the system of agricultural credit cooperative, but are accumulated in a special guarantee fund intended to issue guarantees to agricultural cooperatives with insufficient provision.

One of the promising directions of development of the system of credit cooperative is expanding loans of designated purpose. In Ukraine, the loans are available mainly for industrial purposes. The experience of Germany and Holland should be used, where loans provided for the needs of agriculture not exceed 5% of their total amount, and a territorial concept of rural district development is prevalent over the industrial.

It is hardly possible to transfer foreign experience by means of the formation of accumulation of shares. In the US Farm Credit System continuous accumulation of shares among clients are absent. In Germany and Holland, the size of the share is set the same for all members of the cooperative, and has a symbolic nature. The amount of received loan depends not on the size of the share but on the collateral value and the assessment of other guarantees provided under the provision of debt.

In prerevolutionary Russia the share was fixed. Cooperative members could form it in a few years since joining the cooperative. The maximum loan amount was equal to the size of the accumulated share. Conducted researches indicate the need for forming mandatory and saving shares, as well as an additional share in the event of cooperative loss.

There are a variety of variants in the sphere of distribution of income. In particular in the Netherlands, accumulated income is not applicable among the members of the cooperative, and is accumulated in a reserve fund, which is administered to increase its own capital and serve as a mean for covering possible losses or expanding services for the benefit of the cooperative members and the local community. This experience can be applied to the credit cooperatives which will be established in Ukraine. In addition, reserve requirements are performed. This is extremely important for local cooperatives – patronage payments should be sacrificed in behalf of the accumulation of own funds and fund expansion of financial cooperativeness.

## **Conclusions**

Establishment and successful functioning of credit cooperatives, its access to credit services market will enable agricultural producers to ensure regularity of circulation of production, increase of production volumes and realization of competitive agricultural products, their self-financed functioning and self-repayment, to ensure food security of the country.



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