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Leveraging on Rural Cooperatives in Informal Sector Financing for Economic Growth

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Abstract

This paper focuses on the finance function as it relates to economic growth and development in rural economies against the backdrop of the imperatives of inclusive growth and the underlying expected roles of small and medium enterprises that are generally seen as engines of growth. An attempt has herein been made to see why the experience in Nigeria of direct intervention through microcredit schemes have failed and which calls for a rethink and the proposition of the need to leverage on rural cooperatives for informal sector financing. This has herein been reinforced by putting forward a reasonable scholastic view of the advantages of rural informal cooperatives over the formal ones with the conclusion that over time if the rural informal cooperatives are supported to stabilize, they will on their own transform into formidable formal institutions without any coercion.

Keywords: Rural informal cooperatives, Inclusive growth, Small and Medium Enterprises

Leveraging on rural cooperatives in informal sector financing for economic growth: A scholar's perspective.

1.0 Introduction:

Characteristically, every national economy comprises of the formal business sector and the informal business sector and in this, even the developed economies of Europe and America are not exempted though this characterization is more pronounced in the continents of Africa, Asia and Latin America that are considered as emerging continents. The developed nations of Europe and America have been able to integrate what would have been a clearly defined informal business sector more into the formal system in a higher degree though not absolutely. In most African countries also, there exists financial market dualism which explains the existence of an unorganized informal financial services sector along side with the more formal financial services sector of banks, insurance companies, finance houses and other non-bank financial institutions.

In Africa and in Nigeria in particular, the bulk of businesses are in the category of cottage, small and medium scale enterprises with no formal structure of management and this category of ventures employ about 52% of the population. One of the peculiar features of these businesses is that they are initiated with little capital often sourced from family and friends and household savings. It is imperative to state that in Nigeria, household savings is often not enough considering the fact that the real per capita income is low due to gross inequality in income distribution accentuated by the high level of corruption among government officials and major private sector business players.

Entrepreneurs in the informal business sector have over the years suffered as a result of inaccessibility to credit which is considered as a critical factor needed for business success. The inaccessibility to enough credit has significantly affected the performance of small and medium scale enterprises in the informal sector and limited their productivity as well as their potential for expansion.

Learning from the experience and success story of Asian countries like India, Malaysia, Taiwan and China that have transformed their previously depressed economies to enviable ones through small and medium scale enterprises considered to be engines of growth and in recognition of the inherent potentials of the businesses in the informal sector to contribute to economic growth through the production of goods and services as well as reduce unemployment, the federal government of Nigeria had at different times have taken steps to enhance the Small and Medium Enterprises (SMEs) sub-sector.

In recognition of the importance of SMEs to economic growth, a review of the Industry Policy Document prepared by the General Babangida administration was carried out in year 2001 by the Obasanjo administration with the following policy objectives:

a. Increase in the role of private sector in SME promotion and development.

b. Promote entrepreneurship and trade skills development

c. Increase the utilization of local raw materials, technology and competences to enhance value addition.

d. Achieve self sufficiency in intermediate and consumer goods.

e. Increase the competitiveness of SME products in domestic and export markets

f. Promote modernization, collective efficiency and linkages of industrial production

g. Modernize traditional industries and crafts

h. Create employment opportunities and sustainable livelihood

i. Promote rural development and dispersal of industries

At different periods also government at the federal level had conceived and implemented institutional credit interventions through the setting up of Nigerian Agricultural Cooperative Bank, Family Economic Advancement Programme, People's Bank of Nigeria, Community banks, National Poverty Eradication Programme etc as basic microcredit intervention activities but with little success.

The rationale for government involvement in microcredit schemes is seen as imperative by Calomiris and Himmelberg (1993) when the following conditions subsist;

a. When an enterprise has the capacity to save foreign exchange and as such ease balance of payment constraints on other growth sectors.

b. When there is a sharp difference between the private benefit and social benefit derivable from the proposed enterprise.

c. When the risk component of the intended business is high.

d. When new industries are faced with huge start-up costs.

e. When information problems discourage lending to small scale enterprises.

However, in Nigeria government direct interventions in this regard has not yielded much success and the reasons for the failure of these interventions are not far-fetched. Essentially, these interventions could not achieve much because it was supply driven and there was not enough technical back-up for users of microcredit.

Be that as it may, it is instructive also to emphasize that considering the amount of financial resources needed to fill the funding gap between what is needed by businesses in the informal sector and what is made available by the government, other organizations such as rural community cooperatives in different forms and shades have been put in place by different groups. These cooperatives exist as either gender based cooperatives, commodity based cooperatives, vocationally based cooperatives, faith-based cooperatives, ethnic based cooperatives, job based cooperatives etc.

Rural financial or credit cooperative societies are mostly informal self-help associations that have evolved traditional savings and credit schemes to meet the credit requirements of their members. This type of arrangement is common in every nook and cranny of Nigeria but especially among the rural populace with members holding meetings and making cash collections and disbursement weekly, fortnightly, or monthly as the case may be. This arrangement has popularized peer group lending where the premise for giving credit to an individual is based on societal and communal mutual trust.

Cooperatives by their nature are well adapted to engender growth in rural economies and even the larger society. According to Gertler (2001) cooperatives being community based organizations and rooted in democracy due to the participatory involvement of members are well suited as catalysts for economic development. Cooperatives according to Gibson (2005) play increasingly and important roles globally in poverty reduction through job creation.

The advantage of rural informal cooperatives over the formal one is that decisions taken at the rural level endeavours to balance the profitability need of the cooperative society with the social welfare needs of its constituent members. Essentially, cooperatives engender economies of scale and scope thus enhancing the bargaining power of the members and thus providing social protection.

In agreement with the view of other scholars, Somavia (2002) posits that it accords members opportunity, protection and empowerment which are pre-requisites for uplifting men from abject poverty. In the view of Heneham (1997) also, cooperatives help in improving risk management mechanisms and as such keep markets efficient. Cooperatives promote the ideals of social inclusion in the economic affairs of the society.

The aim of this write-up is to take a stand against the backdrop of the debate on what approach is best suited to correct the deficiency in the supply of credit to the informal sector in emerging economies and what the challenges are as well as the inherent benefits of surmounting such challenges in order to drive inclusive economic growth even more when it is obvious that the formal financial sector has underperformed. As such this is a position paper based on real world economic principles.

2.0 Informal sector business financing and economic growth nexus: A review of literature.

The role of proper financing in catalyzing growth cannot be over-emphasized. In line with the proposition expanded as the Harrod-Domar model which has further been improved on in the neoclassical growth model, the size of the capital stock represented as (K) is critical in stimulating economic growth. This is from the understanding of the economics of capital-output ratio.

Most small and medium scale enterprises owners, source funds for the acquisition of capital goods form the informal financial sector. There is no gainsaying that for an economy to experience growth, new investments that are net additions to the capital stock is germane. Funds for these net additions in the form of national savings are largely domiciled in the informal sector in a developing country like Nigeria.

Ordinarily, if the capital-ouput ratio is denoted as K and if we assume that the national saving ratio (S) is a fixed proportion of national output (Y) and naturally total new investment is determined by the level of total savings, we can construct the following simple model of economic growth. Savings S is some proportion of (s) of national income (Y) such that we have the simple equation:

$S = sY$

Net investment (I) is defined as the change in the capital stock (K) and can be represented by ΔK Such that:

$I = \Delta K$

But because the total capital stock K bears a direct relationship to total national income or output Y as expressed by the capital-output ratio, K, it follows that;

$K/Y = k$

$\Delta K/\Delta Y = k$

$\Delta K = K\Delta Y$

Finally, because net savings S must equal net investment I, we can write S=I

The expectation of growth to be driven by the private sector will be a mirage if funding is inadequate. It is instructive to say that private sector growth for sustainable poverty reduction through wealth creation is more feasible through the enhancement of the capacity of small and medium scale enterprises because as they are presently in Nigeria this category of enterprises suffer from low productivity. Hitherto, the weak investment climate in Nigeria which is tied to poor infrastructure and poor business environment has made the formal business sector to underperform.

Funds are needed for business expansion and value addition, acquisition of capital goods and the financing of industrial clusters thus taking advantage of agglomeration externalities. A report by the World Bank (2011) identified the lack of sufficient funds as a major constraint for SMEs due to the underdevelopment of long-term financing instruments in Africa. Many times, small businesses are excluded from benefiting from capital market operations. Hence to address this challenge, it is imperative to have a robust agenda for innovative financing that will guarantee financial inclusion and this is what cooperative societies can undertake and especially rural community cooperatives.

Lemo (2006) affirmed that the launch of the Microfinance Policy, regulatory and Supervisory Framework in Nigeria was to make sure that financial services reach more than 80million Nigerians that are un-served by commercial banks and other formal institutions especially those considered to be economically active poor and low income households.

According to Ojo (2010) supply side interventions to develop an economy will fail if real incomes especially among rural households and the urban poor who are mainly in the informal sector do not stimulate demand conditions in the local economy that can lead to increase sale of goods ad services in the economy.

Diverse studies on microfinance have come up with reports of the inherent and actual benefits of the approach to funding human focused development. For example, Chirwa, Peter, Lucy and Evious (1999) in their study posited that microfinance has positive effects on incomes and poverty reduction. Gallardo, Bikki and William (2005) also reported that microfinance is a commercially viable approach to funding development though in driving the methodology suggested, there is a critical need for qualified personnel to drive the process in developing economies.

3.0 Cooperatives and the informal business sector in Nigeria

Informal businesses are common in Nigeria due to the hectic business registration and operational obstacles often put on the way of prospective entrepreneurs. Consequently, their status makes them quite unfit to access credit from banks as business entities. Expectedly, in Nigeria cooperative societies in different forms and shades as a type of micro-credit arrangement have risen up to the challenge. The peculiar features of their type of finance arrangement are:

a. There is no need for asset based collateral

b. Loans value are relatively small

c. Their operational procedures are usually simple.

Generally, the goals of microcredit include:

a. To scale up productivity among the user group

b. To engender poverty reduction

c. To improve household welfare

d. To enhance the quality of life in rural areas and as such promote the development of rural areas.

Cooperatives naturally provide an organizational framework that helps members to undertake tasks that enhance their productive capacity. This is done by encouraging a culture of saving that eventually translates to capital formation. The peculiarities of cooperatives in terms of their dual nature as both an economic and social organization makes them potentially suited as an agent to jumpstart and sustain local economic transformation.

However, hitherto in Nigeria according to Ojo (2010) credit as a proportion of gross domestic product (GDP) has been a meager 24% compared to an average of 57% in Sub-Saharan Africa and 120 % in developed economies. Also, microcredit as a proportion of total credit has been 0.9% compared to about 20% in South Africa.

4.0 A comparison of Informal Cooperative Financing and Formal Microcredit Financing.

The idea of microcredit or microfinance is not new in Nigeria either in its informal or formal form. As a matter of fact, the federal government made efforts at promoting the concept of microcredit for development by introducing rural banking programme and by allowing concessionary interest rate regimes. Microfinance is often targeted at people in the informal sector who have not benefited from lending by conventional commercial banking institutions. Report has it that only about 35% of the economically active population of Nigeria is served by the formal financial system while the remaining 65% lack access to financial services. This gap has however been filled by local money lenders, non-governmental organizations and local cooperative societies.

The interesting thing about it is that both the informal cooperative societies and formal microcredit institutions are expected to serve low income earners such as farmers, traders, tailors, weavers, entrepreneurs involved in agro-processing, women engaged in handicraft, young school leavers who lack collateral that is usually required by commercial banking institutions as a pre-condition for accessing credit. A distinguishing feature of the formal microcredit cum cooperative institutions is that they are often required to register with sub-national agencies of government while rural cooperatives do not register with any agency of government and are such less complex in their operations.

It is instructive to state also that rural cooperative societies are more adapted to addressing the key issues in the supply of agricultural credit as it concerns the cost of credit, the timeliness of credit especially for resource-poor farmers and the operational procedure that makes it easy to repay what was borrowed. This is usually facilitated by the process of cross-guarantee often put in place by participating members.

Also, the cost of running rural cooperative societies are quite insignificant because in many cases members are readily available to run errands for the society at no cost to the cooperative. In formal microcredit institutions however, the operational cost is often significant and may affect the fortune and performance of the society if it is not well managed.

In addition, the fact that rural cooperative societies from the Nigerian experience are engaged not only in giving production credit but also consumption credit makes it reasonable to suggest that leveraging on such cooperatives for informal sector financing is of essence if the government is to be able to achieve the goal of mass social and economic transformation as spelt out in the Nigeria transformation by the Jonathan administration.

However, the lack of capacity in terms of human and technical capacity in many microfinance institutions must be addressed to enhance the performance and sustainability of new credit initiatives in Nigeria.

In agreement with the view of Ahmad (2005) that cooperative societies are partly private and partly public but different from both private and public enterprises, they ought to play an increasing role as an alternative and countervailing power to both big businesses and the supposedly big government.

5.0 Concluding Remarks

It is instructive at this stage to douse the fear of possible macroeconomic distortions if rural informal cooperatives are encouraged to thrive because whether we like it or not in Nigeria, these informal institutions have come to stay and deliberate attempts should be made to support them and propped up with time to metamorphose into formal institutions which they will gladly do without coercion as long as the inherent benefits there-from are obvious and will be for the common good. It must be appreciated that different people are at different stages of economic well being and for every person within the country to be enabled to have access cum opportunity of maximizing their inherent potential, rural cooperatives can readily make this achievable.

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