

**A STUDY OF SEMI-FORMAL FINANCIAL INSTITUTIONS
(COOPERATIVE CREDIT)**

conducted for

State Bank Of Pakistan In Collaboration Of IDA

by

**MAZHAR – UL – HAQ
MUHAMMAD JAMEEL KHAN**

Executive Summary

Background

The State Bank of Pakistan entrusted a study of the Semi-Formal Financial Institutions (cooperative credit) in Punjab and AJK to Punjab Economic Research Institute to assess the financial and management performance of the Cooperative Societies.

The main objectives of the study were as follows:

- Assessment of the financial and management performance of the Agricultural Cooperative Societies.
- To verify the delivery of credit to the target group, i.e. members of the cooperative societies.
- Determining the prospects for strengthening capabilities of cooperatives in financial intermediation particularly in savings mobilization, disbursement of loans and recovery.
- To suggest policy actions required to improve the inter linkages in assessing performance of cooperative societies, Provincial Cooperative Banks and Provincial Cooperative Departments.

In this study we followed two approaches in assessing the performance of cooperative societies. Firstly, we got hold of official record. Secondly, we investigated the factual situation by contacting the cooperative societies members. We ended up getting conflicting evidence.

Sample Size

The sample size selected for the study comprised 175 cooperative societies (158 from Punjab and 17 from AJK), 55 bank branches (50 from the Punjab and 5 from AJK). In order to verify delivery to the target groups, 348 members of the agricultural cooperative societies, i.e. 306 from

Punjab and 42 from AJK were interviewed to collect requisite information. This study related to the year 1995-96.

Profile and Performance of Cooperative Societies

In Punjab, the average membership of cooperative societies was 33 with only a nominal membership of females. In AJK, the average membership was 13. The members who could read and write were 53.1% in Punjab and 58.4% in AJK. The average farm size of the loan beneficiaries was 11.5 acres in Punjab, while it was 5.53 acres in AJK. The average farm size of the members of the cooperative societies who were not availing credit facility was 7.48 acres in the Punjab and 7.15 acres in AJK.

In Punjab, the average working capital per cooperative society was Rs. 2.34 lacs, with 91.8% bank share. In AJK, the average working capital per cooperative society was only Rs. 0.84 lacs, with 95.9% bank share.

In Punjab, the average number of meetings convened by the general body of the cooperative society was 3.3. The meetings of management committee were also 3 during the survey year. The attendance in general body meeting was 43.5%. It was 72.9% in the case of meetings of the management committee. In AJK, the average number meetings of the general body and management committee were 1 and 2 respectively and attendance was 76% and 10% respectively.

During the survey year, the audit was done in the Punjab only once by sub-inspector of the Cooperative Department. In AJK, no audit of the sample cooperative societies had been carried out.

The number of short-term loans per cooperative ranged from 18 to 22 in Punjab covering only 27% of the members. In AJK the number of loans ranged from 15 to 20 covering 61.5% of the members. The average amount of loan advanced by the bank to the cooperative societies was Rs. 2.48 lacs. In Punjab, 56.2% of this loan was given in the "Rabi" season and 43.8% in the "Kharif" season. In case of AJK, the average amount lent by the Cooperative Bank to cooperative societies was Rs. 0.90 lacs. Out of this 59.8% was for the "Rabi" season and 40.2% for the "Kharif" season.

During 1993094 to 1995-96, the average amount of loan given per member of the cooperative society ranged from Rs. 6,129 to Rs. 7,521 in Punjab and Rs. 6,923 to Rs. 8,173 in AJK.

Fertilizer was the main input (70.1% of the total loan amount) followed by pesticide (27.8% of the total amount) for which credit was disbursed by the cooperative societies in Punjab. In AJK, the entire amount was disbursed as agriculture credit without specification of input.

The success of cooperative societies depends upon its recovery pattern. During 195-96, 87.9% and 76.1% of the borrowed amount by the cooperatives was repaid to the Cooperative Bank in Punjab and AJK respectively.

In Punjab the average income of a cooperative society was Rs. 7,517, while the average expenditure was Rs. 5,329. In AJK, the average income was Rs. 1,233, while expenditure was only Rs. 116. Thus cooperatives in both regions were making a nominal profit.

Profile and Performance of Cooperative Banks

During 1993-94 to 1995-96, the average number of cooperative societies covered by a bank branch in Punjab ranged from 151 to 184, and 97.8% of them were involved in short-term loans disbursement. In AJK, the coverage of cooperative societies by a bank branch ranged from 171 to 177.

During 1995-96, the average amount of short-term loan disbursed by the sample bank branches to cooperative societies in Punjab was Rs. 342.8 lacs, while such amount per cooperative and per loan was Rs. 1.86 lacs and Rs. 0.97 respectively. The average amount of medium-term loan disbursed was Rs. 0.58 lacs in 1995-96. In AJK, the average amount of loan disbursed by the bank branches to the cooperative societies was Rs. 75.49 lacs. Such amount per cooperative was Rs. 0.43 lacs.

During 1995-96, the average amount recovered by a bank branch in Punjab was a 78.2% of the amount advanced. In AJK, 55.6% of the loan amount was recovered by bank branches from cooperative societies in the same year.

In Punjab, the outstanding amount of defaulter cooperative societies was 5.8% of the borrowed amount, 7.4% of the recovered amount and 26.7% of outstanding amount of bank branches. In the case of AJK, such amount was 27% of borrowed amount, 48.5% of recovered amount and 42.3% of outstanding amount.

In Punjab, about 87.2% of the cooperative societies were working efficiently by making full payment, while the cooperative societies treated as defaulters were 5.9% in 1995-96. In case of AJK, 74.6% of the cooperatives were found making full payment, while 7.9% were treated as defaulters.

The average income of bank branches in Punjab was Rs. 46.98 lacs. The major portion i.e. 77.1% of the income was interest from cooperative loans in Punjab. In case of AJK, the average income of bank branches was Rs. 6.21 lacs, while the major contribution in income was of interest from cooperatives.

In Punjab, the average expenditure of the sample bank branches was Rs. 41.21 lacs. Interest paid on funds from Provincial Cooperative Bank was 53.9% of the total expenditure. In AJK, the average expenditure of the sample bank branches was Rs. 5.22 lacs, while the highest proportion, i.e. 77.3% of the expenditure was incurred on payment of interest on funds from the Federal Bank for Cooperatives.

In Punjab, the average profit of bank branches was 12.3% of their income. In case of AJK, such profit was 16% of the income of bank branches.

As per estimates of the Subsidy Dependence Index (SDI) which measures the percentage increase in the financial institution's average on-lending interest rate required to fully compensate for the elimination of subsidy, the Punjab Provincial Bank was heavily subsidy dependent. It would have to increase its on-lending interest rate to 25% instead of 14% at present to fully eliminate the subsidy as per 1994-95

By including the reserve requirement, the situation got worsened in the same year with SDI 120.4% in 1994-95. This indicates that the Punjab Provincial Cooperative Bank would have to increase on-lending interest rate in this year by 14.7%age points of adjusted rate, i.e. from 14% per annum to 29%, if the subsidy element in the interest rate is to be eliminated.

In 1995-96, SDI was the lowest (78.8%), which might be attributed to relatively better performance, specifically in the context of loan recovery of the bank. Thus the estimated on-lending interest rate to completely eliminate the subsidy element was 17.2%.

Member's Views Regarding Cooperative's Performance:

In Punjab only 3.9% of the sample societies were genuine. About 35.3% out of the sample societies were one man societies and 21.6% were fictitious societies, while 39.2% were family societies. In case of AJK, about all the sample societies were one man societies. In case of genuine societies all the sample members reported availing credit facilities, while in case of one man societies 16.7% of the members of the respective societies were availing group based credit in Punjab. Only 49.2% of the interviewed members of the family societies availed credit.

As far as utilization of the cooperative credit during 1995-96 is concerned, 24.2% and 23.8% of the loanees in Punjab and AJK respectively provided response in this regard. In Punjab, out of them, 60.4% reported making appropriated use of the cooperative credit for purchasing farm inputs, while the remaining 28% and 12.6% utilized this credit on other non-productive activities and other farm business respectively. In case of AJK, the utilization of such credit was generally made to construct houses, establish small business or shop in urban or rural localities or purchase of Suzuki Pickups.

Only one third and one fourth of the sample members of the cooperative societies in the case of Punjab and AJK respectively reported convening of general body meetings. Thus, the remaining members were deprived of the opportunity of expressing their credit requirements.

Only 31.4% of the sample members in Punjab has knowledge regarding Maximum Credit Limit (MCL) of their respective cooperative societies. In case of AJK, 6.9% of the sample members reported having knowledge regarding MCL of their respective societies.

Responding to the question that who brings inputs to the village for members, 74.8% of the sample members in Punjab pointed out that they had never seen input (fertilizer) brought into the village and distributed among the needy members. In case of AJK, 45.2% of the sample members provided negative response in this regard.

The sample members having knowledge regarding their rights and responsibilities were 22.2% in Punjab. In case of AJK, 32.4% of the sample members provided positive answer in this respect.

The awareness regarding right to vote was expressed by 35.6% and 38.2% of the sample members in Punjab and AJK respectively.

It can be concluded from the above mentioned situation that there is a need to activate the extension service of the Cooperative Department to educate the members regarding basic principles to avail group-based credit.

The main factor resulting in apparently efficient performance of the Cooperative Societies is the peculiar repayment strategy developed in both the study regions, i.e. Punjab as well as AJK. The cooperative societies loanees pay only the interest and 2% to 3% of the principle amount depending upon the repayment duration and the interest amount to the so called input dealers who would pay the principle amount of loan. Simultaneously, new pay order of loan is issued in the name of the agreed input dealer. This strategy is executed with the assistance of the front line worker of the Cooperative Department and apparently helps in presenting a better picture about the performance of the Cooperative Department. But in reality none or very few of the target group farmers may have been the beneficiary of the input supplies on credit for enhancement of agricultural productivity.

In Punjab about 74.8% and in AJK 45.2% of the sample members of the cooperative societies were not provided of inputs through cooperatives. This happened as the pay orders were generally converted to cash on payment of 5% of the amount indicated on the pay order to input dealers. Thus, the input dealers were having a thriving business without handling of inputs.

The Punjab Economic Research Institute in its report "Evaluation of Cooperative Credit Programme in Punjab", published in 1986, had suggested that transparency in the disbursement of loan to members of the cooperative societies was needed. This had not been done till the survey time for the study. This situation resulted in the creation of one man, fictitious and one family societies. To ensure disbursement of credit to the target group farmers transparency in loan sanctioning and disbursement is a must.

The emergence of one-man societies and one family societies along with the peculiar repayment strategy evolved is contributing to misuse of the credit specified for the group loaning. As the actual loan is received only for the first time and then adjustment of loans and new advances becomes a recurring feature giving a false impression of working of the cooperatives without physical benefits to the target groups. This malpractice could be avoided by increasing the gap between the repayment period and reissuing of loan.

Conclusions

Contradictory findings have emerged by analyzing field data collected from the record of the cooperative societies and the sample members of the cooperative societies. The assessment of performance of cooperatives working on the basis of loan disbursement pattern and beneficiaries of the credit reveals that 35.5% of the sample societies were one man societies and 21.6% were

fictitious societies and only one person was availing credit facilities from these cooperative societies, while 39.2% were family societies. Only 3.9% of the societies were found genuine.

Thus it can be concluded that the Cooperative Department as well as the bank branches were careless in scrutiny of credentials of the cooperative societies, whether they were genuine or not. This was contributing to the emergence of the following main problems which required attention of the policy makers:

- Emergence of one-man societies and family societies.
- Use of loan by individual which was specified for group lending.
- Use of agricultural loans for other purposes.
- Non-transparency of loan activities to the members of the cooperative societies.
- Unawareness of loanees even regarding loan issued against their names
- One man decisions instead of management committee decisions.
- Non-provision of farm inputs physically at village level.
- Development of a peculiar repayment strategy to show improved credit recovery.

Policy Implications

Keeping in view the above mentioned problems the following measures are suggested to improve the functioning of these institutions:

The audit and inspection of cooperative societies that is already done by the Cooperatives Department should be the responsibility of some independent agency. This would help in providing much needed feedback to the Cooperatives Department for improving the work of societies.

Old system of categorizing of cooperative societies should be reintroduced and our policy should focus on promoting efficient cooperatives rather than protecting sinking cooperatives.

Loaning and recovery should be the sole responsibility of the bank. However, last audit report of cooperative societies should be considered as an authentic indicator by the bank management before sanctioning of the loan to the cooperative societies.

Cooperatives Department should be entrusted responsibility of scrutinizing the particulars of members of the cooperative societies. The department should also work as trainer of the cooperative management and monitor audit objections settlement.

To avoid the peculiar loan repayment strategy, whereby cooperative societies loanees pay only the interest and 2%-3% of the principle amount, but simultaneously a new pay order is issued in the name of agreed input dealer without farmers actually having used the input in subsequent year, there must be a gap of 30 calendar days between loan repayment date and date of reissuing the loan. This will eliminate the fake book entry procedure which is being followed with the connivance of front line workers of the Cooperatives Department.

A legislative measure needs to be devised and strictly observed to have a check on exchanging of pay order for cash amount rather than purchase of inputs. Institutional arrangement needs to be devised to censure input provision at village level by the cooperative societies.

Non-transparency of loans sanctioned for group lending among loanees as well as members has resulted in creation of one-man societies and one family societies. For awareness of members regarding such sanctioned loans it is proposed that the Cooperative Bank branches should maintain savings account of all members of the cooperative societies. The loan amount for group lending on recommendations of the management committee of the respective cooperative should be transferred share-wise to the account of the individual loanee of the cooperative society. A letter indicating the amount of the matured loan along with share of the respective loanee should be issued by the bank for information of the loanees. A passbook should also be issued to the members for maintaining record of matured loans as well as savings. This would result in transparency of loans to every individual member and minimize chances of availing credit facilities by one individual office bearer or other factious members.

The bank branches of Cooperative Bank, whose functions have been restricted to the level of a chain between Provincial Cooperatives Bank and the Primary cooperatives, should be allowed to initiate all banking activities. A compulsory savings account for members of cooperative needs to be introduced like Grameen Bank in Bangladesh and Village Bank introduced by AKRSP in Northern Areas. Moreover, the management of the bank branches should motivate other farmers to participate in promoting banking activities of these banks to a successful level. Such measures may result in self-sufficiency and self-sustainability of the bank branches.

Lastly, it is felt that after having studied the defects and deficiencies of the cooperatives in the field, that a scientific, honest and bold approach is needed for improvement of cooperative's functioning so that cooperatives may be capable of development and saving the interest of the farming community in Pakistan. The government should privatize cooperative movement and let it grow at its own and provide it support and help through a non-lapsable Development Funds as has been done in India. For this a successful bank branch of a cooperative bank should be organized as a large-scale area cooperative. The Primary function of this branch should be promoting savings funds. Group loaning to farmers (5 to 10 members) on the basis of joint liabilities (a detailed working proposal can be submitted if desired) should be experimented for expansion of rural credit in that area. This would serve as a pilot project for group saving and group lending.