# Cooperative Microfinance: A New Option for Government & Development Organizations

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## Abstract

*The present study has been conducted to investigate the impact of Cooperative Microfinance Program (CMFP i-e Islamic Relief-Pakistan] on the standard of life of poor marginalized masses. Secondary, time series, ranging from 2002-2008 about the Disbursement of funds, number of beneficiaries [gender wise], financing methods have been taken from the reports of Islamic Relief. Numbers of beneficiaries, the volume of disbursement, recovery rate from disbursement, profitability and viability have been used as a proxy of well being of the poor masses and successful performance of IMFO respectively. Augmented Dickey Fuller (ADF) test [with and without trend] for checking the Stationary of data set has been used. The efficiency and performance of financial programs has been evaluated by using various financial ratios i-e Return on assets (ROA), Net return Margin (NRM) and Beneficiaries to Employee Ratio (BER). On the basis of RoA, NRM and OCL the financial performance of Islamic Relief Pakistan is much better than the conventionally largest NGO namely National Rural Support Program (NRSP). BER is used to measure the efficiency of the employees in reaching the beneficiaries. In this respect the performance of both of the organizations are approximately same. The study reveals that average total number of clients per year is 340 which increase with annual growth more than 250 %. Annual average disbursement (through Murabah'ah** Transactions) is Rs. 5,367,913 with an annual growth more than 690%. Findings of the study suggest that there is a great potential and greater chance of growth for Cooperative microfinance programs over here in Pakistan. Based upon the findings of the study the government should initiate a comprehensive Cooperative microfinance program to alleviate the absolute level of poverty and to improve the standard of life of extremely marginalized groups of the society.*

**Keywords:** *Micro-finance, Development, Government, Organizations*

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## Introduction

To alleviate poverty in most developing countries, financing small and micro enterprises is considered a "new paradigm" for bringing about Development and eradicating absolute poverty. Small enterprises have received growing attention at both national and international levels during the last decade.

A number of programs have been launched in different parts of the world by national and multinational organizations and institutions to empower and protect the poor. The most important of them is the provision of microfinance facility to non-bankable poor.

Micro financing is the provision of financial services to poor and low-income households without access to formal financial institutions (Conroy, 2003) Microfinance is described as banking for the poor. Microfinance programs provide Micro credit/loans, Micro savings, Micro insurance, training to group members and other financial services to low-income and poor people for use in small businesses.

In Cooperative Micro Financing we are essentially looking at a "double bottom line"— social gains and commercial success. Conventional Micro financing setup is somewhat also lying on the same concept however Cooperative financial system naturally focus on welfare aspect. The welfare may be in the form of no penalty in case of genuine late payment reason, risk sharing, profit sharing according to the percentage to support the ups and downs of business, asset based/backed transactions to overcome interest or riba, settlement in the form of goods; whether it be hardcore welfare aspects of qard-e-Hassan (interest free loan), sadaqah, zakah, Charity – have far more reaching and implicitly impacting positive role in each and every regard of life. Cooperative Microfinance Programs (CMFPs) are the new experiments in this field. The growing magnitude of these programs has attracted many countries of the world. CMPPs have a general acceptability in Muslim communities in particular, and non-Muslim communities in general since the principles of financing of these organizations are neither contradictory to the Islamic Shariah nor to any divine religion's principles or norms, values and traditions of any society.

Furthermore the profit and losses of business are shared by financer and investor, which protect the debtor and make him confident to invest freely in Shariah-based activities. Conventional micro finance Organizations (CnMPOs) do not provide credit to extremely poor and actual marginalized groups of the society because they are generally considered defaulter. While CMPOs facilitate such groups from Zakat and Waqf (Charity) funds. CMFPs can better serve the community and make sure the participation of all vulnerable groups. Islamic relief the popular NGO involved in Cooperative Micro financing programs over in Pakistan uses group lending methodology, where no physical collateral is required. Social pressure is used as an alternative to physical collateral.

Different studies have been conducted against CnMFPs and in favor of CMFPs. Due to lack of fund mobilization and the high administrative cost, most CnMFOs are not economically viable. Bennett (1998, p. 116) reports that administrative cost of five CMFOs in South Asia is in the range of 24 percent to more than 400 percent of per dollar lent. Reed and Befus (1994, p. 190) study five CnMFOs and find average return on assets for three of these to be below 2 percent, one at 3.5 percent and the other at 14.6 percent. The type of activity for which the funds are used may also be low productivity activities. Furthermore, CMFOs target women and some studies find that rate of return on credit given to women is low as they engage in relatively low productivity activities (Hossain 1987, Rahman and Khandker 1994). Osmani (1989) points out that one factor that forces some households out of microcredit schemes is that the resulting increase in the supply of output causes the rate of return on loans to be lower than its cost of borrowing.

Ditcher (1996), Hulme and Mosley (1996a), and Montgomery (1996) report that microfinance institutions do not serve the poorest who are either not given loans or drop out of the credit schemes.The declared objective of targeting women as recipients of funds is to empower them (Khandker 1998 and Rahman 1999). Khandker (1998), however, finds that financing women rarely empowers women. Rahman (1999) further reports that targeting the women as beneficiaries of credit by CMFOs creates tensions within the household and increases frustration and Violence in the family. Rahman (1996 a, b, 1999) discovers that the Grameen Bank borrowers often take loans from other sources to pay installments and are trapped in a spiraling debt cycle. Sadeq (2004) in Bangladesh on conventional CMFOs and Cooperative Micro finance he found that it was due to negative effects of social as well as economic nature of microfinance that attracted the critics to provide alternatives, which will be free from the negative effects. Some of them have come up with faith based micro financial services, and are categorized as Cooperative Microfinance Programs (CMFPs). They and their services are different from their counterparts in number of ways. First, the CMFOs provide micro financial products, which are free from interest. Their products are based on mark-up pricing, profit sharing and so on. Second, the IMFOs provide micro financial services to both men and women, without any differential treatment. Mannan (2007) in Bangladesh he found that CnMFPs are based on the implicit assumptions of social class conflict, so they tend to empower women, whereas CMFPs intends to empower family by ensuring joint liability of husband and wife in case of lending to family or groups of

families. Ahmad (2002) believes that Cooperative microfinance can provide greater benefit to clients through non-interest based financing ad reliance on funds from awqaf as a substitute to expensive external fund.
Majority of the authors have supported the idea of Cooperative microfinance on theoretical grounds. I have used quantitative data obtained from Islamic Relief. The establishment and existence is supported on the basis of the results obtained from the data set.

## Material and Methods

The present study has been conducted in the year 2009 to find out the impact of CMFP [Islamic Relief] on the standard of life of poor masses. Secondary, time series, monthly data ranging from 2002-2008 [72 observations] about the Disbursement of funds, number of beneficiaries [gender wise], financing methods of IMFO [Islamic relief, Rawalpindi office] has been taken from the reports of Islamic Relief. Number of benificieries, the volume of disbursement and recovery rate from disbursement have been used as a proxy of well being of the poor masses and successful performance of IMFOs respectively.

Augmented Dickey Fuller (ADF) test [with and without trend]for checking the stationarity of given data set has been used .Variables which were initially non-stationary at level form were converted into stationary variables after taking first difference .Akaike Information Criterion (AIC) has been used for taking optimal ADF lags. Descriptive Statistics for the centre and spread have been used. Percentage increase in number of clients [gender wise] and disbursements of funds is also calculated so as to find out the current position and future trends of this organization.

The efficiency and performance of financial institution is traditionally evaluated by using various financial ratios i-e Return on assets (ROA), Net return Margin (NRM) and Beneficiaries to Employee Ratio (BER), Operating cost as a percentage of loan disbursed (OCL). In order to analyze the performance and efficiency of IMFP [Islamic relief-Pakistan], we compare these financial ratios with NRSP a well established and largest conventional micro financing organization.

i). Return on Assets (ROA) = (Net Income/ Assets)*100

ii). Net Interest (Return) Margin (NIM) = [Total income from investment and interest-Total borrowing Cost (interest payments)/ Total Assets]*100

iii). Operating Costs as a Percentage of Loan Disbursed (OCL) = (Operating Costs/Loan Disbursed)*100

iv). Beneficiaries to Employee Ratio (BER) = Total Beneficiaries/Full-time Employees.

ROA is a measure of efficiency as it indicates how well the institution's assets (resources) are used to generate income. We instead use operating income to obtain the ROA. NIM indicates the efficiency of the intermediation of funds from different sources to users. Another measure of operating efficiency is the OCL. As in CMFPs advance small size of loans/funds, this ratio will be larger than conventional banks. Among different MFIs, however, if the field workers are efficient is covering a larger number of beneficiaries, this ratio will be lower. Finally, we use a measure that has relevance to the operations of MFIs in particular. BER is used to measure the efficiency of the employees in reaching the beneficiaries. Note, however, that while a large number of beneficiaries may increase the income per employee, it may also lead to lack of supervision and increase the default rate affecting income adversely.

### Description of variables

NMCs: total number of male clients

NFCs: total number of female clients

TNCs: Total no of clients

TD: Total Disbursement in tern of Rupees.

### Results and Discussion

The results of ADF test have been presented in table I and II. The Stationarity of the data has been checked by using this test. Table I shows the result of ADF test including intercept but no trend, while table II shows the result of ADF including both trend and intercept. Variables which were not stationary at level have been converted into stationary variables by taking first difference [I (1)]. The values in brackets are the optimal lags selected on the basis of AIC criterion. According to the result of table I all variables except TNCs and TD are stationary at level. These variables have been made stationary by taking first difference. Similarly all variables in table II are stationary except TNCs, which is then made stationary by taking first difference. Table III shows the descriptive statistics of all variables. Taking into consideration the results of table III we may find that average total number of clients per year is 340 which increase with annual growth, more than 250 %. Annual average disbursement (Murabah'ah Transactions) is Rs. 5,367,913 with an annual growth, more than 690%. Table IV represents annual percentage growth rate of clients and total disbursement of funds (Murabah'ah Transaction). Figure I and II show annual percentage growth rate of clients and funds respectively. These simple trend lines are used, so as to show the current position and future trend of the selected organization. Table five shows the efficiency and Profitabitly measures. On the basis of Return on Assets ( RoA), Net Return

Margin(NRM), Operating cost as a percentage of loan dispersed (OCL) the financial performance of Islamic Relief Pakistan is much better than the conventionally largest NGO namely National Rural Support Program (NRSP). BER is used to measure the efficiency of the employees in reaching the beneficiaries. In this respect the performance of both of the organizations are approximately the same.

Table I. ADF test result for Stationarity (including intercept but not trend)

| Variable | I(0) | | I(1) | | Results |
|---|---|---|---|---|---|
| | Test statistic | Critical value | Test statistic | Critical value | |
| NMCs | -4.047[0][1] | -3.526 | | | I(0) |
| NFCs | -6.560[0] | -3.526 | | | I(0) |
| TNCs | -2.09[2] | -3.526 | -10.580[1] | -3.526 | I(1) |
| TD | -1.78[2] | -3.526 | -9.520[1] | -3.526 | I(1) |

*(1)Figure in each square bracket beside each test statistics show optimal lags, selected by using minimum AIC criterion.*

Table II. ADF test result for Stationarity (including intercept but not trend)

| Variable | I(0) | | I(1) | | Results |
|---|---|---|---|---|---|
| | Test statistic | Critical value | Test statistic | Critical value | |
| NMCs | -7.670[0][1] | -4.090 | | | I(0) |
| NFCs | -7.97[0] | -4.090 | | | I(0) |
| TNCs | -3.82[2] | -4.090 | -10.550[1] | -3.090 | I(1) |
| TD | -7.47[0] | -4.090 | | | I(0) |

*(2)Figure in each square bracket beside each test statistics show optimal lags, selected by using minimum AIC criterion*

Table III. Descriptive statistics of Clients and annual Disbursement

| Statistics | Male Clients per year | Female Clients per year | No. of Clients per year | Total Disbursement per Year |
|---|---|---|---|---|
| | | | | |
| Mean | 301.83 | 37.5 | 339.33 | 5367913.33 |
| Standard Error | 43.96 | 5.16 | 48.4 | 1603684.30 |
| Median | 301 | 40 | 341 | 5762356.50 |
| Mode | #N/A | #N/A | #N/A | #N/A |
| Standard Deviation | 107.68 | 12.66 | 118.69 | 3928208.25 |
| Sample Variance | 11596.56 | 160.3 | 14089.06 | 1.54 |
| Kurtosis | 1.76 | -2.27 | 1.42 | -2.27 |
| Skewness | -0.98 | -0.35 | -0.92 | -0.14 |
| Range | 314 | 29 | 342 | 9134772 |
| Minimum | 114 | 21 | 135 | 777640 |
| Maximum | 428 | 50 | 477 | 9912412 |
| Sum | 1811 | 225 | 2036 | 32207480 |
| Count | 6 | 6 | 6 | 6 |

*Note: Descriptive statistics have been calculated on the basis of Annual reports of Islamic Relief (Pakistan)*

Table IV. Annual percentage growth rate of clients and disbursement

| Year | Anuul % increase in Male Clients | Annual % increase in Female clients | Annual %increase in clients | Annual % increase in total Disbursement |
|---|---|---|---|---|
| 2003 | 100 | 100 | 100 | 100 |
| 2004 | 250 | 119.0476 | 229.6296 | 147.8012 |
| 2005 | 258.7719 | 161.9048 | 243.7037 | 532.7589 |
| 2006 | 269.2982 | 219.0476 | 261.4815 | 949.2525 |
| 2007 | 335.0877 | 238.0952 | 320 | 1137.204 |
| 2008 | 375.4386 | 233.3333 | 353.3333 | 1274.679 |

Table V: Profitability and efficiency

| | Islamic Relief (IR) | NRSP |
|---|---|---|
| Return on asset (RoA) | 3.42 | 2.15 |
| Net return Margin (NRM) | 12.2 | 7.54 |
| Operating cost as % of the loan Disbursed (OCL) | 7.5 | 11.45 |
| Beneficiaries to employee ration (BER) | 170 | 172 |

Figure I. Annual percentage growth rate

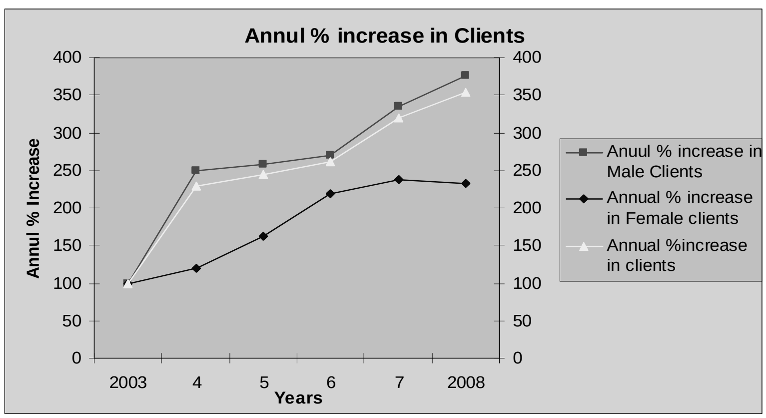
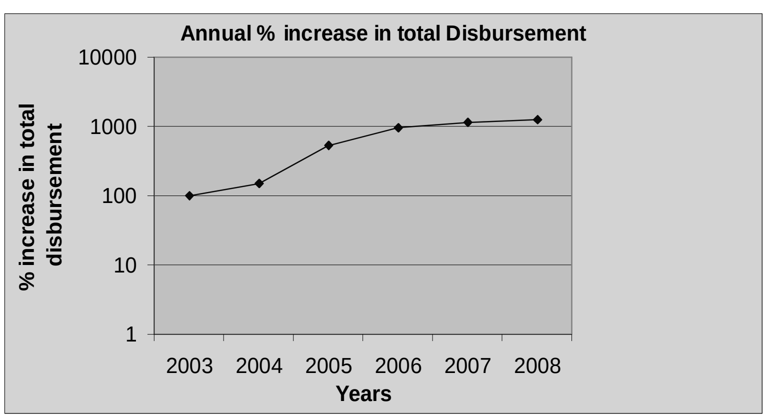



Figure II. Annual percentage growth rate of disbursement



## Conclusion and Recommendation

The facts and figures reveal that variables used, as a proxy of well being of the poor masses and successful performance of IMFP, show outstanding growth rates. This implies there is a great potential and higher chance of success for Cooperative microfinance organizations over here in Pakistan. Furthermore IMFPs have a general acceptability power in Muslim communities in particular, and non-Muslim communities in general because the principles of Micro financing of these organizations is neither contradictory to the Islamic shariah rules nor it is contradictory to any divine religion's principles or norms, or values and traditions of any other society. Based on the findings of the study the government should initiate a comprehensive Cooperative microfinance program to alleviate the absolute level of poverty and to improve the standard of life of extreme marginalized groups of the society.

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