

## DEVELOPMENTAL FACTORS OF AGRICULTURAL CONSUMER CREDIT COOPERATIVES AS AN ALTERNATIVE FINANCIAL INSTITUTE FOR RUSSIAN AGROINDUSTRIAL COMPLEX

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### Abstract

*The relevance of the work is stipulated by the need to study alternative financing instruments for the Russian agro-industrial complex whose products ensure the satisfaction of primary needs and national food security. The research aimed to study the potential of agricultural credit consumer cooperatives in the Russian economy as an institution of alternative financing and the sustainability of small business in agriculture. The authors of this article relied on a system-integrated approach, including statistical and comparative analysis, as well as case method and analogy method for identifying the determinants of the development of agricultural credit cooperation. The authors have revealed that the deterrent nature of the development of agricultural credit consumer cooperatives is determined by two groups of factors: exogenous (macroeconomic financial instability, lack of necessary institutional conditions, excessive requirements from the Bank of Russia) and endogenous (level of confidence of agricultural producers, lack of financial and digital literacy in rural areas). Agricultural credit cooperation can have real potential as an alternative source of financing in the field of small and medium-sized businesses in the agro-industrial complex with the support of this institution from the state and a high level of trust at the microlevel of rural territories.*

**Key words:** agricultural credit cooperation, agricultural consumer credit cooperative, factors, agro-industrial complex, credit

### INTRODUCTION

Amid the current endogenous and exogenous challenges, one of the priorities for the national economy and specifically the agro-industrial sector is national food security. The scope of this problem was expanded by the food Doctrine of 2020, which shifts the vector of key references from solely quantitative indicators toward transforming the structure of the consumer basket with an accent on the qualitative measures. This adds relevance to the fundamental problems of economic theory, namely: who should pursue these objectives with limited resources and what needs to be done. The above objectives call for a specific focus on the essential characteristics and developmental patterns of major subjects of production across the spectrum of operational forms, considering that the Russian economy is characterized,

firstly, by an uneven development profile as a result of the transformational processes in all forms of economic operations, both big and small. Secondly, a key factor of stability for small economic operations is the development of agricultural cooperation in the form of integrated structures of various typologies depending on the functions.

Despite the considerable interest in agriculture shown by government institutions and its outpacing growth compared to the overall GDP growth rate, the questions are still unresolved as to which institutional determinants shape the stability of development of various economic forms and which of them deter growth. Also, long-overlooked have been the issues of theoretical analysis of the transformation processes underway in the operational forms and economic relations in the Russian agro-industrial complex, the identification of

patterns and outlook in various economic operational forms and financial needs [11].

Historically in the Russian practice, of all types of agricultural cooperation (related to production, consumption, marketing, credit and processing), the production form has been the most advanced, as exemplified by kolkhoz operations, which lasted for almost half a century before the transition to market reforms in the 1990s. The subsequent transformation led to the recovery of agricultural credit cooperation (ACC), and many hopes were pinned to it in terms of financial support and development of small economic forms (SEF). The emergence of ACC was supported by a certain institutional framework, particularly Federal Law of the Russian Federation No. 193 "On Agricultural Cooperation" dated 08.12.1995 and the National Project for the Development of Russia's Agroindustrial Complex, which provided key references for the State Programme of Agricultural Development and Regulation of Agricultural Products, Commodities and Food Markets [13].

Late in 2019, pursuant to the requirements of Federal Law No. 193-FZ "On Agricultural Cooperation" dated 08.12.1995, the organisation Agrocontrol developed the Standards of Setting up and Operation of Agricultural Consumer Cooperatives, which particularly set forth the main principles of financial capital development at an agricultural cooperative [12]. The Standards were adopted by the Ministry of Agriculture of the Russian Federation and recommended for practical references.

Changes in the market of ACC require more detailed analysis, as shown further in this paper.

## **MATERIALS AND METHODS**

The methodological foundations in analyzing the issues of Russian cooperation were proposed by the prominent Russian scholars M. I. Tugan-Baranovskii [16] and A. V. Chaianov [3]. They, in turn, relied on the methods of comparative analysis of the first cooperative practices adopted by German agricultural producers. Chaianov used the

method of analogy in combination with analysis and synthesis to come up with the theory of cooperation development. Its major propositions mark the departure points in the development of modern cooperatives, including credit cooperatives [4].

One of the main inferences of Chaianov [3] that is still relevant for the current situation is as follows. Cooperation, irrespective of its forms, helps small economic operations maintain their independence and identity by integrating the advantages of major enterprise in attracting credit. A special highlight among the modern works is the paper co-authored by the researchers of the Central Economics and Mathematics Institute (CEMI) including V. E. Dementev, R. M. Kachalov, G. B. Kleiner, N.B. Nagrudnaia, R. I. Habibullin et al. These authors made a significant scholarly contribution to the development of the theoretical foundations of cooperation based on the analysis of successful regional cases of cooperation development as a form of collective economic operations, including the comparative analysis of their advantages and drawbacks [6].

We applied the methods of quantitative analysis to study the general trends of development of agricultural consumer credit cooperatives (ACCC). In analyzing their viability, an important tool is the case method to analyze best practices of economic operation and to establish the deterrents. The methods of historical and comparative analysis helped identify the specifics of modern cooperatives and the main determinants of their further development in the Russian economic system. The systems approach underlined all major inferences and hypotheses proposed by us in the analysis of quantitative indicators in the setting up, reorganizations and liquidations of ACCC.

## **RESULTS AND DISCUSSIONS**

### **ACCC as an institute to counter the problem of inadequate financial resources**

The organizational economic form of ACC is realized in ACCC, which emerge as voluntary organizations of individuals (and/or legal entities) existing and/or operating in rural

areas with the purpose of ensuring the financial requirements of their members. The main purpose of ACCC is mitigating financial deficits of agricultural producers by extending loans to the participants of the cooperatives from the established unit fund and other resources. Besides operating as a mutual fund, ACCC are also entitled to place idle resources in bank deposits or public securities to build up their reserves. Notwithstanding, they remain non-profit organizations as the generated income is used to increase the available funds of financial support for the participants of the cooperative. Their governance is regulated by federal laws and the organizational charter, while the key regulatory powers are administered by the Central Bank of the Russian Federation.

As of the beginning of 2020, according to the official statistics of the Central Bank, 653 ACCC are registered as operational in the State Register, 199 credit cooperatives are under reorganization and 2,007 ACCC are liquidated. Notably, the number of active ACCC declined by 9% in the single year compared to 717 ACCC as of the end of 2018. Meanwhile, the rate of discontinued ACCC rose by almost 10%. The numbers of ACCC

under reorganization were almost unchanged [14]. The figure of active credit cooperatives in agriculture includes 13.3% established between 1998-2002, 30% launched in 2004-2009 and more than 50% registered since 2010. Analysts attribute this growth from the early 2000s to the policies of big banks engaging with major ACCC and contributing to their unit capital as their associated participants and reinforcing their positions as credit organizations. [5]. However, the organizations set up between 2004 and 2009 proved the least viable, as the biggest proportion (75%) of now discontinued operations as of the beginning of 2020 is made up by those established exactly in this period. The majority (70%) of institutions currently under reorganization also fall within this bracket by the time of establishment. More than half (51%) of organizations set up between 2010 and 2015 (Table 1) have maintained their stability. One of the reasons behind their viability is the combination of exogenous (particularly, geopolitical changes) and endogenous factors (associated with changes in the domestic policies of the public institutions in the Russian Federation with regard to agricultural operations).

Table 1. Dynamics of ACCC in the Russian Federation

| Status               | Year of registration |      |           |      |           |      |                  |     | Total     |     |
|----------------------|----------------------|------|-----------|------|-----------|------|------------------|-----|-----------|-----|
|                      | 1997-2003            |      | 2004-2009 |      | 2010-2015 |      | August 2016-2020 |     | 1998-2020 |     |
|                      | Number               | %    | Number    | %    | Number    | %    | Number           | %   | Number    | %   |
| Active               | 91                   | 14.0 | 171       | 26.0 | 335       | 51.0 | 56               | 9.0 | 653       | 100 |
| Under reorganisation | 19                   | 10.0 | 144       | 72.4 | 27        | 13.6 | 9                | 5.0 | 199       | 100 |
| Liquidated           | 249                  | 12.4 | 1,501     | 75.0 | 242       | 12.0 | 15               | 0.6 | 2,007     | 100 |

Source: developed by the authors based on official data of the Central Bank [14].

### Exogenous factors influencing the development of ACCC

The deterred profile of ACCC development is due to two groups of factors, endogenous and exogenous. Exogenous factors include, first of all, the general financial turbulence in the global markets and, at the macro level, the national economy. The general consequence is that the interest rate is well above the average profitability rate of operations in the agricultural sector of the national economy. This results in the gradual squeezing of SEF

from the market, even as this segment specifically shapes competitiveness in developed market economies. In Russia, SEF have less chance of attracting cheap money from the primary lenders, despite certain steps of government institutions to provide funds on special terms. For example, Sberbank offers loans to individuals engaged in private subsistence farming; Rosselkhozbank provides loans for family farms. Interestingly, though, there is no official definition of a family farm. In practice, it refers mostly to

peasant (private) farms (PPF) engaging exclusively individual labour efforts of the owners. Moreover, the offerings of Rosselkhozbank for PPF and individual entrepreneurs for seasonal operations cautiously state that loans are subject to several types of guarantees, while interest rates on extended loans are set individually on a case-by-case basis depending on the product and loan term [9]. The list and criteria of such guarantees are not specified or available in the public domain for bank customers. Thus, agricultural producers at the micro level of individual rural localities cannot access reliable and comprehensive information via the Internet. Additionally, Rosselkhozbank runs the Farmers Loan co-programme with the Ministry of Agriculture to provide lending on special terms at an interest rate of 5% per annum. However, all such programmes usually envisage collateral requirements given the objective risks of agricultural operations. Such collateral is usually owners' private assets, including land plots and material facilities, such as agricultural equipment, real estate and government guarantees at the regional level.

In such circumstances, an economic interest in alternative lending to be provided by ACCC built on the principles of self-governance is logical. However, the analysis of official figures from the Central Bank, as shown above, does not yet confirm this interest in

practice. Interest rates on loans applying in consumer loan agreements signed by lenders with individuals (including family farms and individual entrepreneurs) depend not just on the term (under or over one year) but on the amount of the loan as well. For example, in 2019, 17.5% applied for a loan of up to 30 thousand roubles vs. 17.7% for the amount of up to 100 thousand roubles (Table 2). The rate of a long-term loan for a specific purpose extended by lenders to individuals (for more than one year) further depends on the loan amount. The cost of credit in micro-financing organizations (MFO), according to the Central Bank, is inversely related to the amount of the extended loan: 144.6% was the weighted average in 2019 for the term under one year, which is significantly higher than the rate for long-term loans. Another aspect is that the rates on long-term loans of more than 100 thousand roubles show a trend to the downside. Simultaneously, the cost of "short" money within 30 thousand roubles has been unstable over the last three years, fluctuating up and down. The reason behind the uneven dynamics is that such loan size is usually provided for essential needs (goods or services). Meanwhile, amounts over 100 thousand roubles for small PPF engaging family labour can be classified as innovation-related money used to arrange and support small business.

Table 2. Market averages for the full cost of consumer loans for individuals (% , round to one decimal place)

| Private financial institutions            | Unsecured consumer purpose loan (%)                                 |                  |   |                  |   |                  |
|---|---|------------------|---|------------------|---|------------------|
|   | 2017<br>(up to 100 thousand roubles/more than 100 thousand roubles) |                  | 2018<br>(up to 100 thousand roubles/more than 100 thousand roubles) |                  | 2019<br>(up to 100 thousand roubles/more than 100 thousand roubles) |                  |
|   | up to 1 year  | more than 1 year | up to 1 year  | more than 1 year | up to 1 year  | more than 1 year |
| credit institutions                       | 29.6/23.8   | 26.5/20.7        | 20.6/19.3   | 16.8/16.2        | 17.5/17.7   | 11.7/13.5        |
| microfinance organisations                | 140/35  | 56.5/33.5        | 148/31  | 54.7/32.2        | 144.6/38.5  | 57.7/32.5        |
| consumer credit cooperatives              | 53.7/23   | 45.5/31.4        | 54/24   | 43.5/26.4        | 57.7/23.8   | 40.8/25.2        |
| agricultural consumer credit cooperatives | 24.2/18.0   | 30.1/32.8        | 25.0/21.0   | 36.0/32.0        | 25.3/20.7   | 36.7/30.0        |

Source: developed by the authors based on [2].

Intriguingly, the market averages for the full cost of unsecured consumer loans for

individuals in ACCC are not only steadily high, but even exceeding the rates of credit institutions.

The exogenous deterring factors include the general institutional conditions of ACCC development: the lack of clear and transparent rules for their organization, as well as the lack of well-informed and competent approach in setting up their operation. A pending priority is to clarify the aspects of agricultural credit cooperatives in the regulatory framework, taking into account the specifics of agricultural economics and the current transformations of the organizational forms of economic operation. As shown above, the number of liquidated ACCC is 2.5 times the number of active ones. Moreover, there is no dedicated state programme for developing agricultural cooperation and thus no comprehensive approach to address the efficient development of ACCC. The main focus of the government bodies in recent years has been associated with the development and support of large economic operations, primarily agricultural holdings which show no interest in the development of credit cooperation. Meanwhile, government support of credit cooperation would provide additional opportunities for small operations in their adoption of new technologies to improve production efficiencies. For example, the modern trends in the development of precision farming require considerable amounts of investment, which becomes a deterrent in the development of PPF [7].

Besides, there is an obvious contradiction: in the absence of sufficient tools for the development of ACCC, there is excessive regulatory interference in credit cooperation. Particularly, the Central Bank requires that agricultural credit cooperatives comply with the same basic ratios and standards which govern the operations of self-regulated organizations [2].

The Central Bank also concedes that efficient interactions of credit cooperatives would require the development of an independent financial institution in the form of a banking cash desk to handle payments to credit cooperatives. The need in such an institute is driven by the current trends in financial

markets, specifically, the complete transition to electronic payments, while credit cooperatives still maintain cash payment systems. Another relevant priority is also the need to revise Federal Law of the Russian Federation No. 127-FZ "On Insolvency (Bankruptcy)" dated 26.10.2002. Specifically, an update is needed to clarify the exceptional powers of the general meeting of participants in a credit cooperative and the criteria of financial standing to declare bankruptcy. For now, ACCC face over-regulation and obstacles created by restrictions and standards defying the establishment of the much-needed conditions for their development as an independent financial institute. These contradictions can be viewed as deterrents, too.

Another consideration is that integration processes in rural localities are not only defined by external economic factors associated with the sanctions standoff of the West against the Russian economy but also by the changing trends in government policies with regard to the agro-industrial sector. This shows in the priority trends of the last five years, shifting from the import replacement policies to the export-oriented policies driven by the general developments of digitalisation. Another factor is the non-competitive stance of banks with regard to cooperative organizations and specifically ACCC. This is specifically felt in that banks are rather restrained when it comes to interacting with ACCC, as the latter fail to ensure proper state engagement and attract government guarantees.

#### **The influence of endogenous factors on the development of ACCC**

The main endogenous deterring factors include high transformation and transaction costs involved in the establishment of credit cooperatives as a result of not only inadequate institutional conditions but also the rural mentality. Such mentality is now particularly characterized by the tendency of lower confidence in ACCC as an alternative credit institution at the micro level in rural territories. This issue was a key topic of discussion at the Seventh All-Russian Convention of Agricultural Cooperatives

attended by us. The forum's resolution states that "despite the measures being taken to popularize the ideas of cooperation in the agricultural industry and despite government support measures, agricultural consumer cooperation is now nascent at best". The role of ACCC in "improving the income rates of rural families and entrepreneurs is still minor and hardly compares to what is achieved in traditional market economies" [10].

However, the shift in values among young entrepreneurs in agroindustrial production results in higher preference levels of younger generations for new technology and particularly IT as their trusted values. Certain impact is also felt from the general policy with regard to agricultural education in Russia, when not just the curriculum and specializations are cut down in agricultural universities but also an obvious deficit is felt among the graduates in terms of professional competences in ACC. Therefore, if the departure point is the observations repeatedly heard from Russian scholars that institutional development (specifically in financial institutions) is driven by the society's established value-related behaviours and behaviour references of the economically active population, it means that even in the mid-term, there will be an inevitable transition in the search for alternative sources, forms and mechanisms of funding toward digital financial instruments, as long as new Generation Z is raised in a different socio-technological culture [1, 15]. This applies to both urban and rural citizens. Hence the logical deterred development of ACCC based on collective interactions, which does not fit in the market psychology of the young generation nor the advanced development of new technology.

Currently, the debate is still on as to the financing of economic subjects in the agroindustrial complex and the main trends of development of ACCC as alternative financing institutions to support stable small business development and ensure national food security [8]. It is still up to discussion what motivates the development of this form of collective operation at the micro level in rural territories in the circumstances when the

main rules are established by government institutions at the macro level.

## CONCLUSIONS

Stable development of ACCC requires not only proper institutional conditions but also changes in the image of active ACCC or their rebranding. That said, it becomes obvious that the niche or functions of an alternative or complementary source of funding not yet fulfilled by ACCC could be absorbed by innovative financial instruments powered by digital technology. We believe there are sound prospects in this respect for the development of peer-to-peer lending in agriculture.

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