

Islamic Cooperative Societies and the Efficiency of Financial Intermediation in Ife East Local Government, Osun State, Nigeria

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Abstract

The study investigated the relationship between cooperative societies and financial intermediation efficiency in Ife east local government, Osun State, Nigeria. The broad objective of this study is to examine the extent at which cooperative societies in Ife East Local Government achieved their financial intermediation role. The specific objectives are to examine the relationship between the total deposit and total credit of Munislam Welfare Fund cooperative society and to investigate the relationship between the total deposit and the total credit of Al-Irshad welfare fund cooperative society. The study used regression analysis method to achieve the stated objective. The data for this study was obtained from the annual financial report of the selected cooperative societies in Ife East Local Government, Osun state, Nigeria. It was revealed in Credit supply equation I that there was a positive correlation and significant relationship between the total deposit and total credit of Munislam Welfare Fund cooperative society. It was also discovered in Credit supply equation II that there was a positive correlation and significant relationship between the total deposit and total credit of Al-Irshad welfare fund cooperative society. The study recommends that Cooperative Societies should foster a higher level of liquidity in order to increase its ability to grant loans and advances to their members for productive purpose. The study also recommends that Cooperative societies should effectively utilize mobilized deposit in order to ensure the efficiency of financial intermediation.

Keywords: Islamic Cooperative Society, Financial Intermediation, Total Deposit, Total Credit.

JEL Classification: G2, G00, G3.

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Introduction

The history of cooperative societies in Nigeria can be traced back to the 16th century before the coming of the white men when indigenous cooperatives were in existence. Cooperative Society initially started as a rotating work association, this practice was later replaced with money due to the spreading of commercial transactions (contribution club). Gatawa and Aliero, (2015) concluded that from 1936- 1956, formal cooperatives have spread from the western to the eastern and northern parts of Nigeria, although it was not yet popularly recognized in the Northern part of the country. Marx and Seibel, (2012) revealed that

cooperative societies based on indigenous savings and credit associations were more effective in mobilizing personal savings and in terms of all other economic indicators than cooperatives without such basis. Ajani & Adebayo (2018) concluded that the non-Islamic nature of the conventional cooperatives and the need to improve economic activities in accordance with the Shari'ah law brought about the formation of Islamic cooperative societies (ICS).

The Islamic cooperative society began in the 1990s (Ajani, 2016) but started to proliferate in the year 2000s because of the impact of the Global Financial Meltdown (GFM) in favour of the Muslims (Abikan, 2011). The Islamic cooperative societies have grown such that there are many ICSs in Nigeria these days.

There is a limit to the amount of credit approve for individual member of the cooperative which may not be more than double of the member's contribution base on the cooperative rules and principles and the credit granted is mostly on short-term basis. At times, credit may not be granted to members due to insufficient liquidity which discouraged people and even leads to some members withdrawing from the cooperative. These invariably reduce the capital base of the cooperative; it makes cooperative members to see other financial intermediaries as source of adequate finance and makes it less efficient in delivering its financial intermediation role and also make people to still face the problem of funding project that will improve their standard of living.

The questions that were formulated to guide this study are (i) What is the significant relationship between the total deposit and total credit of Munislam Welfare Fund cooperative society? (ii) Is there any significant relationship between the total deposit and total credit of Al-Irshad welfare fund cooperative society? The broad objective of this study is to examine the extent at which cooperative societies in Ife East Local Government achieved their financial intermediation role. The specific objectives are to (i) Examine the relationship between the total deposit and total credit of Munislam Welfare Fund cooperative society (ii) Investigate the relationship between the total deposit and total credit of Al-Irshad welfare fund cooperative society. The hypotheses of this study were formulated in a null form (i) There is no significant relationship between the total deposit and total credit of Munislam Welfare Fund cooperative society (ii) There is no significant relationship between the total deposit and total credit of Al-Irshad Welfare Fund cooperative society.

This study is highly unique; it provides an analysis of cooperative societies and the efficiency of financial intermediation in Ife East Local Government, Osun State, Nigeria. The study shed light on the need to improve the performance of cooperative society's financial intermediation role. The findings of this study will encourage cooperative societies to develop strategies for better running of the cooperative. The study will also broaden people's knowledge on the efficiency of cooperative society as a non-bank financial intermediary that performs their financial intermediation role of mobilizing funds from the surplus units to the deficit units.

This study covers Ife East Local Government in Osun State, Nigeria. Among the major cooperative societies in Ife East Local Government are Munislam Welfare Fund Cooperative Society and Al-Irshad Welfare Fund Cooperative Society. This study takes two cooperative societies as representative sample out of cooperative societies in Ife East Local Government to determine their financial intermediation performance. The study investigates the financial intermediation role of Munislam and Al-Irshad welfare fund cooperative societies over the period of 2010-2020. The study covers the Concept of Cooperative Societies, Concept of Islamic Cooperative Society, Concept of financial intermediation, Concept of Efficiency, Transaction Cost Theory, Supply Leading Theory, Quantity Theory of Credit, and Demand Following Theory.

2. Literature Review

2.1. Concept of Cooperative Societies

Cooperative societies have been defined in different ways in literature and the definitions give same meaning. Lawal Oladejo (2013) opined that cooperative society is a business registered under the cooperative law and managed by the same law under which it is registered. Noibi (2012) suggested that, Cooperative Societies are private and non-profit making organization that accept deposit as savings from members and make loan from the savings accepted to the members in need of it. Epetimehin John (2011) concluded that, cooperative is a business owned and controlled by the people who use it.

Cooperatives can either be operated on conventional or on non-interest basis. Rasaki, Kamilu, Rukayatand Balkis (2018) concluded that, conventional cooperative society is based on a pure financial intermediation

model, where the society's profits are the margin between the interest earned by members from their savings on one hand and the interest from the funds advanced to members on the other, while non-interest or zero interest cooperatives are based on principles that prohibits interest earning, risk taking, sinful activities, gambling and speculative. It believes in trading based on real goods and services and a reward sharing contract. Cooperative societies' objective is not to maximize profit rather to maximize the benefit the members can derived from their transactions with the cooperative societies (Birchall, 2013).

Cooperative societies play an important role in an economy which cannot be over emphasized. Olesin in Oladejo (2013) opined that cooperative societies in Nigeria have fixed some financial challenges (such as poverty, high cost of living, low income, inflationary pressures and lack of access to credit) faced by low income earners for decades by providing credit to needy individuals from the resources pooled together by the collective efforts. It provides opportunities for various low income group of people both in rural and urban area. Lawal (2006) highlighted many benefits of cooperatives among which are the following;

1. Cooperatives give members opportunities to accumulate capital to finance their business from regular and continuing savings.
2. It undertakes business ventures and small scale enterprises financing thereby, contributes substantially to the commercial growth and economy development
3. It significantly contributes to the national output by way of considerable production of goods and services.
4. Enhancing workers empowerment: Being a member of a cooperative society, individuals, civil servants and other workers can now own houses, cars and other properties.
5. Members are encouraged to involve in an economic production and services that stimulate gross domestic product and national income by providing ready market for their products.
6. Employment opportunities are created either directly by the cooperative society or through members of the cooperative society.
7. Apart from assisting members to participate in international trade, cooperatives make it possible for Nigeria, through members representing the cooperatives at international level to sit among the community of nations.
8. The cooperative democratic principles and practices trained their leaders as good community leader.
9. The members' standard of living has been increased while their cost of living has reduced as well.

2.2. Islamic Cooperative Society

Ajani (2016), suggested that Islamic cooperative society (ICS) is a prototype of conventional cooperative society where Muslims come together to accomplish their individual and collective goals by pooling their resources together to fulfill their needs in line with Shari'ah principles. These principles according to Rasaki *et al* (2018) prohibit interest earning, risk taking, sinful activities, gambling and speculative but rather believe in trade premised on real goods and services and a reward sharing contract. These principles were concluded by Rasaki *et al* (2018) to have led to the creation of a separate financial system which entails: prohibition of interest (Riba), prohibition of speculations (mayseer), absence of uncertainty in commercial transactions (gharar) and all activities must be for legitimate purposes (halal). The sources of ICS's funds must be permissible by the Shari'ah principles (halal) and the funds must as well be expended on permissible ways and trades.

Ajani and Adebayo (2018) opined that the operation of every cooperative society in Nigeria (ICS inclusive) is established on the 1990 bye-law of Nigeria where the goals of the cooperative societies such as; to promote economy interest and performance of members through loan and necessary advice, to encourage members' spirit and practice of thrift, mutual help, self-help and so on, were spelt out. Islamic Cooperative Society members either new or old make deposit into savings funds, share funds and other special funds which form part of sources of funds to the cooperative society and are used by the cooperative as loan to members and as well as investing in lawful investments. The loan given to members are expected to be repaid in installment for a specified period of time without interest while the profits made on investments will be shared as dividend among the members at the annual general meeting (AGM) according to member's stake.

Ajani and Adebayo (2018) concluded that every cooperative society starts with zero capital and there is need for the society to look for ways of mobilizing funds and how to disburse the mobilized funds efficiently and lawfully. The following are the sources of funds for ICS;

1. **Share deposit:** This is the share capital of the ICS which is subscribed to by all the members. It is compulsory for all members to pay into this fund which will denote the member's stake in the ICS. Some ICS make it compulsory for all members to have same amount in this fund which could be paid at once or in installment while some ICS give their members the liberty to decide on the amount to be subscribed into the fund. This fund is used for business and investment and the profit realized is shared equally where members have equal stake or according to the member's stake at the AGM.
2. **Savings deposit:** This is fund contributed by members which is not compulsory as share capital but members make the payment because it determines their eligibility to loan and the amount of loan to be given to them. Individual member makes payment into this deposit based on their capability. Most ICS give twice the money contributed into savings deposit to members as loan and the loan is expected to be repaid in installment without interest.
3. **Entrance Fees:** These are non-refundable amount paid by new member(s) to join the cooperative legitimately and formally. It is the practice of the cooperative societies to give new member(s) registration form, pass-book, constitution, identification card etc. which are expected to be taken care of with the entrance fees.
4. **Fines and levies:** These are money collected from member who does not obey the rules of the cooperative. This is mostly from late coming members and also those who do not come for meeting. The amount of the fines and levies varies in the Islamic cooperative societies. Each fine has a fixed amount attached to it which is only adjustable by the general house.
5. **Special deposit:** Adebite and Tajudeen (2017) suggested that, it is a special savings of member for future needs which is collectable by the member on demand. Examples of this deposit are savings for children education, medical treatment, festival, hajj etc.
6. **Administrative charge:** This is a non-refundable compulsory equal amount paid by each member for administrative purpose of the cooperative per month. The money is used in managing the ICS. Some ICS collect it annually (by multiplying the monthly amount by twelve) while some collect it on monthly basis. This is necessary because the ICS cannot be managed with the shares and savings deposit without affecting the members' contribution which will lead to collapse of the cooperative.
7. **Sales of stationeries:** This is another source of funds to ICS through the sales of loan form or bond, pass-book, pay-in-slip etc. This fund is used to produce or get the old stationeries when exhausted.
8. **Profit from investment:** Another source of funds to ICS is the profit made from business and investment made by the cooperative.

ICSs give the funds mobilized to members as loans and also invest them in lawful ways. The investment could be in the form of musharak (active partnership), mudarabah (passive partnership), diminishing partnership, murabahah (sales contract at a profit mark-up), Ijarah (leasing) etc. However, loan and murabah (sales contract at a profit mark-up) are the most common ways the funds mobilized by Ife East Area Office ICSs were been expended.

2.3. Concept of financial intermediation

Researchers had defined financial intermediation differently with the same meaning. Andrew and Osuyi (2013) defined financial intermediation as the changing of collected or mobilized funds (deposits) liabilities into assets (credits) such as loans, overdraft, project finance etc. Adeyinka, Odi, Ebenehi, Ademola and James (2018), opined that financial intermediation is the process of collecting funds (money) which form liabilities for intermediary from people and lending such money which form assets for the intermediary to another set of people who need it for economic activities which will variably have a positive effect on the economy as a whole. OECD (2009) defined it as a financial institution which engages in financial transactions on behalf of lenders and savers in a financial market. Abel, Abamagal and Philipos (2019), argued that the intermediary assumes the risk of losing money on behalf of the savers by lending same to borrower when performing its function of an intermediary. According to Donald (2009), cooperative society is an important form of financial intermediary which provide financial services to their members. The source of this finance

providing to the members comes from the members' monthly contribution which could be in terms of savings or share. The accumulated funds from the members' savings and shares will be used to create credits such as loans, project financing which could be to finance the whole project or in partnership. Majority of cooperative societies give double of member's savings as loan when needed with assurance from other member(s) of the cooperative.

Mishkin and Eakins in John (2011) suggested that, financial intermediaries reduce transaction costs substantially. Cooperative societies as a financial intermediary also reduce the transaction cost of lending and borrowing money. Abelet *al.* (2019) suggested that, the most important economic function of financial intermediation is to boost mobilization of saving which must be accompanied by providing a safe place for both members and non-members savers and as well providing loan to its members which is regarded as an important tool to increase the earnings of third world population.

2.4. Concept of Efficiency

According to Sufian (2011) efficiency of a producer of output is defined as its ability to produce maximum possible output(s) with minimum possible inputs relative to its price, subject to resource constraints and operating environments. Phares (2016) supported that efficiency is achieved when output increase given the same level of inputs or the same level of output is achieved given reduction in level of inputs. Efficiency can be technical or allocative efficiency according to Coelli, Rao, Battese and Owusu (2014). Technical efficiency is defined as the ability to achieve a higher level of output given a similar level of inputs, (Ogunniyi, in Owusu 2014). Allocative efficiency (AE) occurs when input mix that allocates factors to their optimum value uses and introduces the opportunity cost of factor inputs to the measurement of productive efficiency is selected.

Phares (2016) concluded that maximum benefits to be derived by members are services provisions (loans and deposits mobilization) which are subject to resources available and given operating environments. The members' deposits (savings, special deposit, and shares) constitute the inputs while the credits (loans and project financing) constitute the output, following the intermediation approach of modeling inputs and output for efficiency analysis in the production process.

3. Methodology

The research design employed in this study is ex-post facto. Time Annual data on total deposit and total credit of Munislam and Al-Irshad welfare fund cooperative society for the period 2010- 2020 was sourced from their annual records. Research design provides the framework for finding solution to the problem under study. However, this chapter presents the Sources of data, Method of data analysis, Description of Research Variables, Model specification and Estimation Techniques. It also contains a detailed outline of systems of modelling equations that was used to achieve the objectives of this study. However, this work focuses on Cooperative Society and the efficiency of Financial Intermediation.

This study used secondary data obtained from the annual financial report given at the annual general meeting (AGM) of the selected cooperative societies in Ife East Local Government, Osun state, Nigeria. The data collected within the period of 2010 to 2020.

The study used regression analysis to analyze the data collected. The Statistical Package for Social Sciences (SPSS) version 21 was used to obtain the regression analysis results.

The study used total deposit as independent variable and total credit as dependent variable. The model for this study was presented using modified version of the econometric model as follow:

Credit Supply Equation 1

$$TC = f(TD)$$

The simple linear form is stated below:

$$TC = \beta_0 + \beta_1 TD + e_i \tag{1}$$

where:

TD=Total Deposit of Munislam welfare fund cooperative society

TC = Total Credits of Munislam welfare fund cooperative society
 e_i = Standard error

β_0 = Intercept parameter

β_1 = Regression Coefficient

Credit Supply Equation 2

$$TC^i = \beta^i_0 + \beta^i_1 TD^i + e^i_i \quad (2),$$

where:

TC^i = Total credit of Al-Irshad welfare fund cooperative society

β^i_0 = Intercept parameter

β^i_1 = Regression Coefficient

TD^i = Total deposit of Al-Irshad welfare fund cooperative society

e^i_i = Standard error

4. Results

Table 1. Total Deposit And Total Credit Of Munislam Welfare Fund Cooperative Society

| Years | Annual Deposit (N' Millions) | Annual Credit (N' Millions) |
|-------|------------------------------|-----------------------------|
| 2011 | 1620530 | 8500000 |
| 2012 | 1860200 | 10800000 |
| 2013 | 2960150 | 11903600 |
| 2014 | 3521550 | 14735000 |
| 2015 | 3061430 | 16600500 |
| 2016 | 2608680 | 18420000 |
| 2017 | 3467910 | 17170000 |
| 2018 | 4124270 | 22450000 |
| 2019 | 4599110 | 23735000 |
| 2020 | 2767990 | 26440000 |

Source: Munislam Welfare Fund Cooperative Society.

Table 2. Total Deposit and Total Credit Ofal-Irshad Welfare Fund Cooperative Society

| Years | Annual Deposit (N' Millions) | Annual Credit (N' Millions) |
|-------|------------------------------|-----------------------------|
| 2010 | 219400 | 180000 |
| 2011 | 645800 | 686000 |
| 2012 | 117190 | 1800000 |
| 2013 | 492650 | 1849635 |
| 2014 | 1004720 | 2711000 |
| 2015 | 1602610 | 2585000 |
| 2016 | 1426720 | 5515000 |
| 2017 | 2415200 | 5201700 |
| 2018 | 3516700 | 6500000 |
| 2019 | 3216750 | 3745000 |

Source: Al-Irshad Welfare Fund Cooperative Society.

Data Analysis

Credit Supply Equation I

$$TC = \beta_0 + \beta_1 TD + e_i \quad (3),$$

where:

TD = Total Deposit of Munislam welfare fund cooperative society

TC = Total Credits of Munislam welfare fund cooperative society

e_i = Standard error

β_0 = Intercept parameter

β_1 = Regression Coefficient

Table 3. Model Summary

| Model | R | R Square | Durbin-Watson |
|-------|-------------------|----------|---------------|
| 1 | .657 ^a | .431 | 1.020 |

Source: SPSS Data Analysis Result, 2022.

Table 4. Anova

| Model | Sum of Squares | Df | Sig. | |
|-------|----------------|---------------------|------|-------------------|
| 1 | Regression | 132933562844536.110 | 1 | .039 ^b |
| | Residual | 175184313684463.940 | 8 | |
| | Total | 308117876529000.100 | 9 | |

Source: SPSS Data Analysis Result (2022).

Table 5. Coefficients

| Model | | 95.0% Confidence Interval for B | | Collinearity Statistics | |
|-------|------------|---------------------------------|--------------|-------------------------|-------|
| | | Lower Bound | Upper Bound | Tolerance | VIF |
| 1 | (Constant) | -8025238.635 | 16740105.719 | | |
| | TD | .266 | 8.048 | 1.000 | 1.000 |

Source: SPSS Data Analysis Result (2022).

Credit Supply Equation 2

$$TC^i = \beta^i_0 + \beta^i_1 TD^i + e^i_t \quad (4)$$

where:

TC^i = Total credit of Al-Irshad welfare fund cooperative society

β^i_0 = Intercept parameter

β^i_1 = Regression Coefficient

TD^i = Total deposit of Al-Irshad welfare fund cooperative society

e^i_t = Standard error

Table 6. Model Summary

| Model | R | R Square | Durbin-Watson |
|-------|-------------------|----------|---------------|
| 1 | .805 ^a | .649 | 1.632 |

Source: SPSS Data Analysis Result (2022).

Table 7. Anova

| Model | Df | Sig. | |
|-------|------------|------|-------------------|
| 1 | Regression | 1 | .005 ^b |
| | Residual | 8 | |
| | Total | 9 | |

Source: SPSS Data Analysis Result (2022).

Table 8. Coefficients

| Model | | 95.0% Confidence Interval for B | | Collinearity Statistics | |
|-------|------------|---------------------------------|-------------|-------------------------|-------|
| | | Lower Bound | Upper Bound | Tolerance | VIF |
| 1 | (Constant) | -532979.514 | 2595690.713 | | |
| | TD | .558 | 2.233 | 1.000 | 1.000 |

Source: SPSS Data Analysis Result (2022).

Discussion of Findings

From the results of **Credit supply equation I**, the correlation coefficient (R) of 0.657 shows a positive correlation between dependent and independent variable.

The coefficient of determination (R-Squared) of 43.1% means that 43.1% variation in the dependent variable was well explained by the independent variable and 56.9% of the variation in the dependent variable is explained by the disturbance term or error term.

Confidence Interval of 95% means that the sample data of the model reflects the fraction of calculated confidence intervals that shows the true population.

The Durbin-Watson result of 1.020 is a number that tests for autocorrelation. The result reflected positive autocorrelation since the value of 1.020 is not up to 2.

The Collinearity Diagnostics result shows that Variance Inflation Factors (VIF) is 1.00. It means that the model does not require further investigations.

Testing for statistical significant at 5% (Credit supply equation 1).

Ho: $b\beta$

Ho: There is no significant relationship between Total Credit and Total deposit of Munislam Welfare Fund cooperative society.

Decision

t0.05 at (10 – 2) 8 degrees of freedom was statistically significant, P – value < 0.05; p - value = 0.039. H1 is accepted and Ho is rejected,

From the results of **Credit supply equation II**, the correlation coefficient (R) of 0.805 means that there was a positive correlation between dependent and independent variable.

The coefficient of determination (R-Squared) of 64.9% means that 64.9% variation in the dependent variable was well explained by the independent variable and 35.1% of the variation in the dependent variable was explained by the disturbance or error term.

Confidence interval of 95% means that the samples data of the model revealed the fraction of calculated confidence intervals that encompass the right population.

The Durbin-Watson result is 1.632, this indicated autocorrelation since the value of 1.632 is not up to 2.

Variance Inflation Factors (VIF) of 1.00 means that the model does not require further investigations.

Testing for statistical significant at 5% (Credit supply equation 1).

Ho: $b\beta$

Ho: There is no significant relationship between Total Credit and Total deposit of Al-Irshad Welfare Fund cooperative society.

Decision

t0.05 at (10 – 2) 8 degrees of freedom was statistically significant, P – value = 0.05. H1 is accepted, Ho is rejected.

Findings revealed that Munislam Welfare Fund cooperative society were able to perform their financial intermediation role to their cooperative members to a reasonable level i.e they are able to give adequate loans and advances to their members as the relationship between Total Credit and Total Deposit are statistically significant. The implication is that Munislam Welfare Fund cooperative society members can get loans and advances anytime they demand for it.

Findings revealed that Al-Irshad Welfare Fund cooperative society were not able to perform their financial intermediation role to their cooperative members adequately i.e they were not able to give adequate loans and advances to their members as the relationship between Total Credit and Total Deposit are statistically significant. The implication is that Al-Irshad Welfare Fund cooperative society members may not get loans and advances anytime they demand for it and also, credit availability is not at the peak.

Conclusion

The conclusions that can be drawn from the findings of this study is that Munislam and Al-Irshad Welfare Fund cooperative societies in Ife East Local Government contributes greatly to the mobilization of funds from the surplus spending Cooperative Members to the deficit spending Cooperative Members. Cooperative Credit/loan is still greatly improving the business activities and other necessities in Nigeria because of utilisation of the Cooperative loans by Cooperative Members.

Recommendations

Base on the objective and findings of this study, the study therefore recommends that:

1. Cooperative Societies should foster a higher level of liquidity in a bid to increase its ability to give out loans and advances to their members for productive purpose.
2. Cooperative societies should effectively utilize mobilized deposit in a bid to ensure the efficiency of financial intermediation.

Suggestions further studies

Further study may examine:

- i. Management of Asset and Liabilities of Cooperative Societies in Nigeria.
- ii. Influence of Liabilities on the Financial Performance of Cooperative Societies in Nigeria.
- iii. Cooperative Societies and the Efficiencies of Financial Intermediation in Nigeria

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