FINANCIAL DUALISMS AND INVESTMENT RISK

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Abstract

Investment in less developed countries is allways the times with a higher risk than in economically high developed countries. Traditional systems meet up with modern technologies. It is not always possible to be successful in putting through these tendencies and at the some time a vital necessity is involved. Economic background, financial are included is available. Variability is evident mainly in cities and in the countryside. They meet and co-operate on different levels a complement each other in formal and informal financial systems. The article is a short analysis of the situation, concluding the cases in which the risks of appropriate investment can be higher and why?

Key words: Financial dualisms, rural economic background, urban economic background, risk Microfinancing, financial system, growthmania

INTRODUCTION

Financial System and Financial Dualisms

The financial system of most developing countries have the co-existence and operation side of a formal financial sector and an informal sector - which becomes financial dualism The formal sector would refer to an urban-oriented, institutional and organized system catering to the financial needs of the monetized, modern sector, which the informal sector, itself unorganized and non-institutional, would deal with the traditional, rural, subsistence (non- monetized) spheres of the economy. (Gernidis 1990)

The, interpenetration between the two sectors in terms of the operations and participants *"lenders – borrowers - savers"* involved, geographic location, the nature of activities also result is a sometimes substantial flow of funds – in both direction – between them.

The formal sector, two main cases may be distinguished.

- The first is that of a closely regulated financial sector and its dualism, where government control over and intervention in the activities of financial institutions
- The second is that of a more liberalized financial sector where financial institutions have greater in currying out their intermediation activities, and where market mechanisms are promoted.

Banks and other formal financial institutions are institutions that accept deposits and make loans. Included under the banks are firms such as commercial and investment banks, savings and loan associations, mutual savings banks, and credit unions. Banks are the financial intermediates that the average persons interact with most frequently. A person who needs a loan to buy a supplier needs for rural business, trades, artisans, venders, and subsystem small farms usually obtain it in a local bank.

The informal sector, one of the most striking features is the wide variety of links *"lenders – borrowers – savers"* ranking from simple credit arrangements to complex financial intermediation mechanisms. Three basic types of informal financial operations can generally be distinguished:

1. Individual money lenders
2. Associations (groups of individuals organized mutually)
3. partnerships firms

Tab.1: Informal savings – credit arrangement

	Types of links	Lenders	Borrowers
Individual money lenders	**Non-commercial arrangements**	- friends - neighbors - relatives	- small farmers - small businessmen - householders
	commercial credit arrangements		
	1. money-based	- professional money lenders - mobile bankers	- small farmers - small businessmen - households

		- private individuals from upper-income groups	-
	2. land-based	- land lords - farmer-money lenders	- tenants - small farmers
	3. communally based	- money lenders - agricultural input dealers - equipment suppliers (millers) - produce traders - itinerant traders - marker venders - storeowners	- small farmers - small businessmen - households
Associations	- **savings arrangements**	- fixed-fund associations - mutual aid associations - savings clubs	- small farmers - small businessmen - householders
	- **combined savings and credit arrangements**	- informal credit unions - informal savings and loan cooperatives - ROSCAs and variants	- small farmers - small businessmen - householders
Partnerships firms	- **financial intermediati ons**	- indigenous bakers - pawnbrokers - financial companies - investment companies - leasing companies - hire-purchases companies -	- small businessmen - householders

Source; Adapted from Germidis Dmitri: Interim Dualisms in the developing Countries 1990

Formal versus Informal Institution in the Field of Microfinancing

Human behavior reflects the efforts of the individual to adjust himself to his surroundings. Two characteristics seem to dominate the environment of the poor: small-scale ness and risk. **Rural economies are "penny economies"** in which almost everything is small-scale. Participants in this penny economy produce, exchange, buy and sell, save and borrow and earn money in extremely small quantities and amounts. The market is "atomized": rice is sold not in ba gs but in cigarette tins; bananas and carrots not in bunches or bundles, but by the piece; eggs and cigarettes are bought singly, and sugar is bought in lumps rather than by the kilo. People save in cents and dimes, not in dollars and women save in handfuls of rice kept back from daily meals. Hence, money transactions in this economy, although very frequent, are mini-sized, too; one does not borrow or lend for long, but for extremely short periods, and interest is calculated on a daily, weekly or monthly but seldom on an annual basis.

The mini-character of rural economies has its consequences for development strategies and intervention mechanisms. Viable financial intermediation in such an environment requires a low-cost institution, making a sufficiently large number of profitable mini-loans to cover overheads, the cost of capital accumulation and the risk of default.

The formal sector's superiority over the informal one is not in doubt when it comes to financing large-scale economic development and projects of national or regional importance. It can command much more capital and afford long-term loans. But the design and cost structure of most formal finance institutions are such, that they resemble the proverbial white elephant when they try to serve a penny economy rather than a dollar or maxi-economy. Transaction and management costs of banks, in particular, could threaten their survival, because the economy of low income rural households cannot generate sufficient business volume to sustain them (Bouman 1989).

Loans for micro-enterprises such as workshops to cast and polish (spare) parts of a pump-set, to make chalks for blackboards, to mould plastic bottles, caps and T-pieces for electrical conduits, credit for iron ploughs and sickles used in cane cultivation, small repairs of pump-sets, wells and irrigation pipelines, loans for starting a small shop, petty trade or a street stall for the sale of fruit, drinks and cane juice, the purchase of a bicycle, refrigerator or TV-set - all these are largely financed by the informal sector rather ten formal one.

Informal lenders usually operate as individuals (e.g., friends and relatives, rural moneylenders, agricultural input, dealers and produce traders, pawnbrokers, and urban curb market brokers) or as groups of individuals organized mutually – as in Rotating and Accumulating Savings and Credit associations (ROSCAs and ASCRAs). However, in some countries some informal lenders are organized as partnership firms (e.g., “indigenous banks” in India), or even as companies (e.g., those non-bank financial intermediaries such as informal finance, investment, leasing and hire-purchase companies, which are exempted, to a greater or lesser degree, from central bank controls and which partake of characteristics of the informal sector). Since informal lenders can be institutions, the dichotomy between institutional and non-institutional credit is misleading, the crucial characteristic being informality and flexibility of operations, which confers on the informal sector its comparative advantage over the formal sector in respect of lower transaction costs.

Africa is particularly noted for its proliferation of those groups that have saving and lending as a main or auxiliary activity, there are **two basic forms:**

1. Accumulating Savings and Credit Associations (ASCRA)
2. Rotating Savings and credit Associations (ROSCA)

The outstanding characteristics common of them are namely:

- participation is voluntary
- self-sufficiency, self-regulation, self-control institutions
- control by official authorities are not necessary
- proven penchant for increased formalization and bureaucracy
- short life cycle offers the perfect climate to enable regular adoption of the rotation of the fund
- priority is given to consensus, need, lottery or auction

There is the great difference between ROSCA and ASCRA…

- **The ROSCAs** each time savings are pooled and they are immediately distributed among members in rotation, until each has had his turn and then they come to their and. Its lifetime depends on the number of players and the periodically of contributors. In principle, each participant draws from the ROSCA as much as he puts into it.
- **The ASCRAs**, on the other hand, resembles the Credit Union. The pooled savings are kept in custody and accumulated for a specified time, at the end of which the savings are redistributed. The common period is here also one year, during which members may save to pay taxes and school fees or to meet the expenses of a recurring religions ceremony etc. Participants might also build up a fund to pay for emergencies, insurance, community development expenses or for joint investments.(Bouman 1994)

  ASCRAs are much larger than ROSCAs; membership may number several hundred, even a few thousand, while a ROSCA usually numbers between 12 and 50, depending whether meetings are monthly or weekly. A larger ROSCA would result in a longer cycle, with the opposite effect to its very purpose: accelerated access to capital or a commodity. The ROSCA loans are automatic and the group has to be kept small and localized, because much depends on mutual trust and knowledge of each other. In this respect, the ROSCA is like the credit cooperative of Raiffeisen, who also wanted to keep the cooperative small and localized because of the principle of unlimited liability.

ASCRAs versus ROSCAs

Why borrowers would prefer ASCRAs to ROSCAs¸
Both ASCRAs and ROSCAs lend. Each entrusts the borrower with resources in the present in exchange for a promise to return resources in the future. A borrower from ROSCAs, however, is more constrained than a borrower from an ASCRA for at least five reasons. First, all ROSCAs borrowers, except the first, must save before borrowing. Second, potential borrowers must find ROSCAs matching their cash flows. Third, ROSCAs loans are small and short, especially for those fall those late in the rotation. Fourth, it is not the borrower but the ROSCAs that fixes the number and the size of installments. Fifth, if the pot is allocated by lottery at each meeting, then the borrowers in a ROSCAs do not know when they will get their loans.

Relative to loans from ROSCAs, loans from ASCRAs are less constrained. Deposits are more flexible, loans are larger and longer, and the borrower chooses whether and when to ask for a loan. Perhaps most importantly, the Gambian ASCRA offers flexible repayment. In fact, as long as a borrower makes good progress in good faith, the Gambian ASCRA leaves the size and spacing of installments up to the borrower. This allows the borrower to make choices unfettered by rigid repayment schedules.

Gambian ASCRAs can offer this flexibility because their members have many nonfinancial interlink ages which eliminate most information asymmetries. When a family illness interrupts repayments, the reason is known, understood, and uncontested. The ASCRA can always punish deliberate delinquency by shunting more and tougher work on the group's common plot to the borrower or by excluding the defaulter from the group's non-financial activities.

Why borrowers use ROSCAs if they prefer ASCRAs*?* There are two reasons why a borrower would prefer an ASCRA but use a ROSCA. The first reason is the choice; saving is more important to some people at some times than is borrowing, and ROSCAs are better for saving than ASCRAs for at least three reasons. First, the mandatory contributions to ROSCAs provide a socially acceptable excuse for refusing to give cash to family and friends. Second, ROSCAs are well-suited to the cash flows of traders, providing a haven for cash and returning it in a usefully large sum. Third, contributions to ROSCAs are more liquid than deposits in an ASCRA because ASCRAs generally return deposits annually whereas ROSCAs rotate more frequently. The second reason is constraint; loans from ASCRAs may not be available in all amounts at all times to all people because the common funds used to make loans may be so small that the ASCRA must ration loans In addition, it costs more to participate in an ASCRA than in a ROSCA, and these costs may outweigh the benefits of access to better loans. The product of choice and constraint is a matching of those who have decided to borrow either with an ASCRA or with a ROSCA.

Urban and Rural Financial Environment

Financial market has another dualism, for example so-called "**Urban Sustainable financial environment"** and **"Rural financial environment"** As for countryside of less developed countries we can say term "**sustainable"** if only financial both financial environment are applied in double harness.

Urban Sustainable Financial Environment

Urban sustainable financial environment, (how is it in the developed country) has the role of financial intermediation and maintaining the health of local economics of less developed countries. But a the typical microfinance clients are low income persons that do not have access to urban financial institutions there risk ness of rural's borrower due to the lack of credit history, lack of adequate collateral, uncertainty about entrepreneurial ability and repayment capacity linked to market constrain, deficiency in the legal system in case of loan delinquency etc. The urban financial environment in less developed countries has a tendency to change its activity and its financial services towards "a Growthmania".

What is growthmania? The regime of growthmania is one of the features of the modern world. Economic growth is currently the major goal namely of state economics and, of course, of Third World countries. Population growth is no longer a major goal for most countries, and in fact a slowing of demographic growth. Economic growth is held to be the cure for poverty, unemployment, dept repayment, inflation, balance of payment deficit, pollution, depletion, the population explosion, crime, divorce and drug addition and the summum bonum. This is "Growthmania!
(Kirby 1999).

World leaders seek growth above all else. Growthmania is many times irresponsible especially to rural areas in the less developed countries. The danger of this is child of Growthmania - money fetishism. Simple commodity production, the sequence **of C-M-C´ (commodity – money – other commodity)**, as simple commodity production gave way to capitalist circulation the sequence shifted to **M-C-M´.**

Money fetishism and Growthmania are alive and well in a world in which banks in wealthy countries make loans to poorer countries, and the debtor countries cannot make the repayment, the banks simply make new loans to enable the repayment of interest on loans, and thereby avoid taking a loss on the debt. The result is that somehow real growth in the debtor countries will also snowball. The paper economy offers more scope for growth than the real economy, than the production of commodities, than the eradication stubborn poverty in the less developed countries. Accounts, investments bankers and tax lawyers make more money then engineers because manipulating abstract symbols is easer than rearranging concrete materials into more useful structures. **M-M´ replaces M-C-M´** (Kirby 1999). The poor rural areas can not obtain loans. For a microfinance activity absolutely close off accepting informal finance institution.

Rural Financing Environment

Credit, savings and mineralizing of risks of investments dominated the rural financing above all Microfinancing debate, and only recently that savings have come to the international discourse and have been recognized as a service to which poor people need access. This is a part of a wider appreciation of the needs of poor people for a range of financial services extending from savings, insurance, and money transmission, to products which will enable them to deal with the medical emergencies or build their small farms, houses etc. The broader view of the financial service needs of poor people, which he identifies of the microfinance that of micro-enterprise development is still overarching. Social capital is the networks, norms and trust that facilitate co-ordination and co-operation for mutual benefit. (Johnson 1998) The Rural financing system is a field for informal voluntary financial activities namely of microfinance and micro-enterprises, create competitive environment. Informal finance institutions bring bag formal finance institution and its microfinance activities which will have to determinant forces on the finance market in the rural areas in the less developed countries and it will be limited operation of ten situations. Many times, in the complex situation analysis of the state and corresponding guaranties, the generally imported projects can be successful and vice versa, they can as a feedback influences the financial system and recover it.

CONCLUSIONS

The relatively lowest risk in the investment of financial sources arises in the situation were the financial system is complex and contains both, formal and informal financial system. The informal part takes more in rural needs and creeps in with them. It exploits traditional family relations, and natural initiative form below so it can decrease entrepreneurial risks. Formal financial system is not only connected with cities and towns, due to the informal very initiative financial system competition, but operates in the rural area as well. The financial sources are lower in price than usually in those places were the competition of informal financial institutions is not working properly.

An urban and rural economic background is then complemented. In the country microeconomic activities develop in natural ways, which corresponds to the needs of dynamic development of given states. Easily they accept modern financial technologies. This development has been effective against any usury, and dangerous speculations of various middlemen and mediators. From the macroeconomic point of view such a background breaks down the tendencies of growth-mania. From the entrepreneurial and investment point of view there exists an assumption of a relatively low risk. It is obvious that each investment project is in a way an original and therefore it is apparent and necessary to elaborate complex studies and analyzes of an appropriate project. In the country there are more or less active but very formal financial institutions, corporations and individuals without any innovative influence in the formal institutions, then the financial means are procurable for the country development stagnates. Some professional characterize this situation as a come-back into the end of 19th century, the usury growths wild. Urban economic background with minimum linkage with the country has its financial sources too expansive, hardly available and so the major financial institutions have a tendency to a feature, called growth-mania and money fetishism. Such a background has been usually very risky in the investment activities. The risk is usually increased by a social discontent of inhabitants. I would like to stress the fact, that what is generally valid is not necessarily true in individual

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5