

# Financial Stewardship of Cooperatives

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## Abstract

This paper aims to explore the concept of stewardship theory applied in the finances of cooperatives. It analyzed patterns between total receivables and gross income, total assets and net surplus, total equity and total assets, number of members and paid-up shares, and paid-up shares and retained earnings over a 7-year panel data of audited financial statements of 657 cooperatives in the seven (7) provinces of the Cordillera Administrative Region, Philippines. A curve estimate was used to interpret the cooperatives' commitment to stewardship theory as applied in their finances. The result reveals weaknesses in terms of the cooperatives' commitment to stewardship theory that could bring negative impact on their financial performance. The result brings practical implication which recommends that the cooperative leaders, members and employees must have greater commitment to financial stewardship.

## Financial Stewardship of Cooperatives

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**Abstract:** This paper envisages the concept of financial stewardship by integrating stewardship theory in the finances of cooperatives. It analyzes the relationships between total receivables and gross income, total assets and net surplus, total equity and total assets, number of members and paid-up shares, and paid-up shares and retained earnings. The study used a 7-year panel data of audited financial statements of 657 cooperatives in the seven (7) provinces in one region in the Philippines. A curve estimate was used to interpret the cooperatives' commitment to stewardship theory as applied in their finances. The result reveals weaknesses in terms of the cooperatives' commitment to stewardship theory that could bring negative impact on their financial performance. The result brings practical implication which recommends that the cooperative leaders, members and employees must have greater commitment to financial stewardship.

**Keywords:** Stewardship theory, Financial Stewardship, Cooperatives, Philippines

### 1. Introduction

Cooperatives are becoming strong force in today's society and they have demonstrated their contributions to sustainable and inclusive growth, social development. They are social institutions that are built collectively which are operated based on the principle of self-reliance and motivated by their shared goals. The members contributes their financial resources in the form of paid-up shares and they entrust their accumulated financial resources to their elected board of directors who will hire the management and staff to meet their common financial goals such as generating return from every business transaction and sustaining growth of assets and equity. In this sense, cooperatives establish a principal-steward relationship in which the members act as the principal and the leaders and the management and staff also acts as the stewards. Stewardship can also be developed as a culture in a cooperative because stewardship values can develop sustainable relationship with shareholders, employees, the community, suppliers and customers (Heuer, 2010).

The stewardship theory refers to the degree of relationship in which the principal extends trust to their stewards. The trust extended by the principal monitors the actions of the stewards whether it is aligned to the goals established (Van Slyke, 2006). In cooperatives, the board of directors and the management were entrusted with finances and assets and they have to mobilize these to meet the cooperative's financial goals specifically to maximize profitability and increase the members' wealth (Pandey, 2013; Cossin et al., 2015). The stewardship theory suggests that the stewards (i.e board of directors, managers) should act as responsibly to the assets they control (Cossin et al., 2015) and they should be motivated to work for the principal (i.e members) because their goals are aligned with the shared goals (Van Slyke, 2006). Moreover, the stewards are responsible and accountable to what they do thus, they have to carry out their tasks conscientiously (Menyah, 2013).

Stewardship theory in financial context assumes that the stewards (i.e. board of directors, managers) are responsible in ensuring that finances and assets are used wisely and funds are used in accordance with the shared goals. Stewardship theory has parallel objectives with financial decision-making because it serves as an essential qualitative characteristic that provides guideline for the management (Lennard, 2007). Stewardship theory can become an integral component for financial decision-making to pursue goals such as maximizing the wealth of the shareholders while considering societal contributions (Chen, 1975; McCuddy & Pirie 2007). Imperatively, the financial objectives of the cooperative should not be primarily shareholder-centered but they also have to serve the interest of other stakeholders, such as contributing to human progress and to the wellbeing of the environment and society (Chiu, 2012). In this sense, the management could not set aggressive financial goals at the expense of the members and other stakeholders. On the other hand, the members also expect a reasonable profitability and sustainable growth and eventually they would evaluate the financial results as a measure of the management's performance as stewards (Chen, 1975).

Stewardship of finances involves maximizing shareholders by embracing sound business practices (Olando et al., 2013). Merging stewardship with financial management promotes a value system where stewards act ethically and with high level of commitment in honouring their duties owed to the members and other stakeholders (Caldwell et al., 2008) as they pursue the cooperative's financial goals. As stewards, the board of directors and the management are responsible in ensuring that finances are used wisely and in accordance with the policies set by the collective general assembly. The board of directors and the management must formulate financial management decisions such as: 1) managing their receivables to increase their gross income; 2) utilize their assets to improve net surplus/income; 3) maintain growth in assets to benefit shareholders; 4) encourage their members to increase their paid-up shares; and 5) increase their retained earnings to improve the value of paid-up shares.

This paper aims to contribute to the validity of stewardship theory as applied among cooperatives. It explores stewardship of finances using financial indicators to assess the stewards (i.e board of directors and management) in fulfilling their commitment to the financial goals and responsibilities entrusted to them by the principal (i.e members).

## 2. Methods

### 2.1 Research Design and Sample

This paper utilized audited financial statements over a 7-year panel data from 2008 to 2014 that were submitted by the cooperatives in one region in the Philippines to the Cooperative Development Authority. The original number of reports submitted was 5,287 and because of missing data, 2,147 reports were removed from the study. There were 3,140 reports utilized as a sample data and majority of the reports were from multi-purpose cooperatives. The raw information was processed and organized to make curve estimation. The researcher generated the graph through the use of Statistical Package for the Social Sciences (SPSS) trial version which was analyzed and then different journals were used to support the analysis derived in the study.

### 2.2 The Curve Estimate

The study made use of curve estimates to plot the relationship of the financial indicators to understand the commitment of the stewards (i.e board of directors and management) to the stewardship theory. Specifically, linear, quadratic, and cubic were used to measure the correlation and to interpret behaviors of the cooperative's stewards.

## 2.3 Measurement of Variables

As a first measure, the stewards must reasonably earn from its operation. The cooperative's operation can be represented by the proxy variable total receivables since cooperatives would procure inventory and sell it on credit if they are in merchandising or grant loans if they are in credit line of business. Consequently, total receivables represent the fully rendered service of the cooperative to its members or non-member customers. The cooperative earnings from their operation can be represented by the variable gross income because it represents the amount generated by the cooperative from its business operation (i.e selling inventories or service on credit or issuing loans, which are represented by total receivables) and after deduction of cost of services (i.e cost of goods sold for merchandising, cost of services, etc.).

As a second measure, the stewards must be able to generate profit to improve the economic well-being and quality of life the members through greater dividend payments and patronage refunds. The net surplus/income can be used as a variable to represent that income that the cooperative have earned from itself (Chen, 1975) as a result of utilizing the assets of the cooperative. The net surplus/income generated represents the efficiency of the management to use available resources and their effectiveness in attaining their desired profitability.

As a third measure, the stewards must sustain growth of the cooperative. The growth in total assets indicates that the management was able to procure and generate greater resources to be utilized in generating profit to compensate the contributed capital of the members. The increase in total asset also means that the cooperative can cater greater services to the members, stakeholders, and the community.

As a fourth measure, the members support to their stewards can be indicated by their economic participation (Harun & Mahmood, 2012). Generally, the members would support and approve the management's activity through their paid-up shares. The members are interested in paying their subscribed share and the number of members is increasing when they can observe that the cooperative members' lives are improving (Sexton, 2001) and the shared goals of the cooperative is being met.

Lastly, the stewards must strive to make profit for the shareholders (Chen, 1975) and maximized the value of the shareholders. The retained earnings represent the net increment on the shareholder's equity as a result of operation and after deducting dividends (i.e interest on share capital and patronage refund). Greater retained means greater accrued value for the shareholders.

## 3. Results and Discussion

The results revealed positive relationship between: 1) receivables and gross income (*Linear* = 0.737, *Quadratic* = 0.743, *Cubic* = 0.743) ; 2) total asset and net income/surplus (*Linear* = 0.635, *Quadratic* = 0.836, *Cubic* = 0.857) ; 3) total equity/capital and total asset (*Linear* = 0.621, *Quadratic* = 0.640, *Cubic* = 0.644) ; 4) number of members and paid-up shares from members (*Linear* = 0.433, *Quadratic* = 0.470, *Cubic* = 0.511) ; and 5) paid-up shares from members and retained earnings (*Linear* = 0.779, *Quadratic* = 0.807, *Cubic* = 0.816) . The results of the analysis of the curve estimates revealed that financial variables such as receivables, total asset, total equity/capital, number of members and paid-up shares can influence the financial variables such as gross income, net income/surplus, total asset, paid-up shares from members, and retained earnings respectively. The results are shown in figure 2.

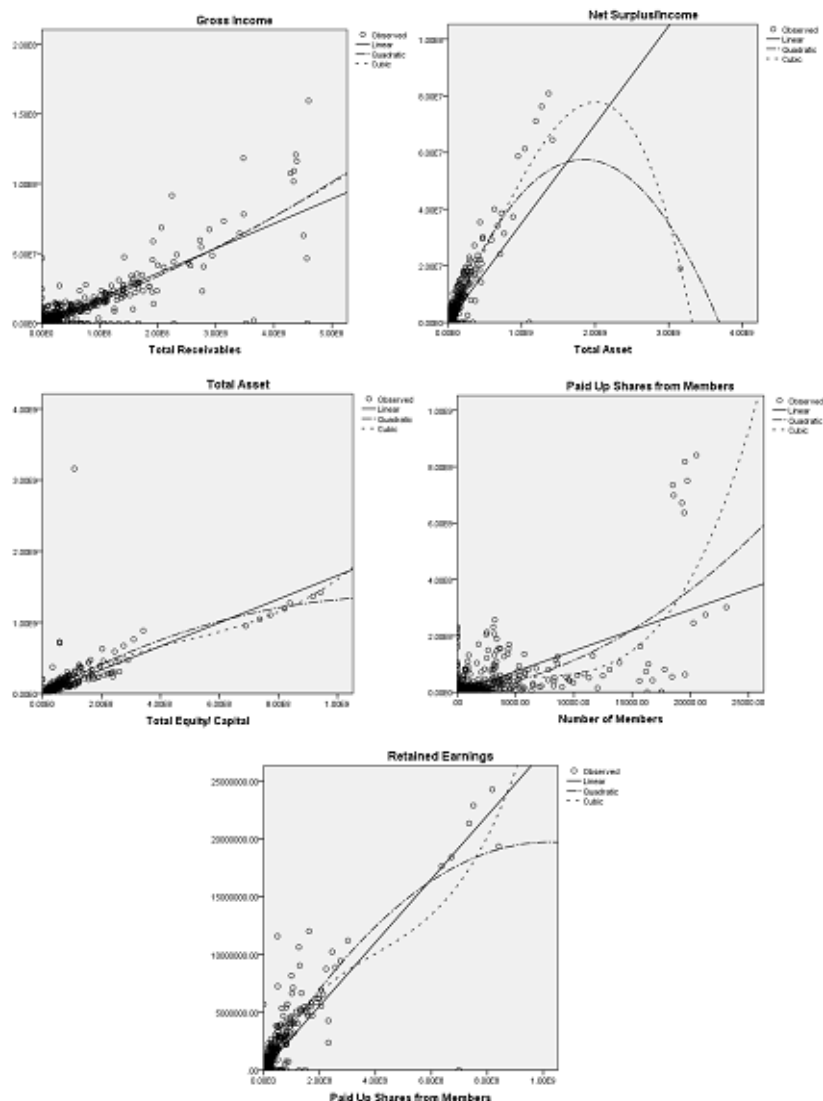


Figure 1. The Relationship of Financial Indicators as Observed Among Cooperatives (A: Total receivables and gross income; B: total asset and net surplus; C: Total asset and Total equity/capital; D: Paid up shares from members and number of members; and E: paid up shares from members and retained earnings)

Figure 1 presents that there were few observed cooperatives with high level of gross income and high level of receivables. Majority of the cooperative have low level of gross income and low level of receivables. This means that majority of the cooperatives tend to adopt a restrictive policy in terms of granting credit to their members which also leads to lower patronage of the members. As a result, the cooperatives operation is minimized that often results to low generation of income. This supports some literatures such as the findings of Ikechukwu and Nwakaego (2015) and Mbula et al. (2016) that receivables have a positive effect on firm's financial performance and profitability which means that when firms grant credit and implements good credit management strategy, the firms generate profit. In this case, most of the cooperatives have low level of gross income because they only grant low level of receivables. This may indicate that the cooperatives tend to limit selling their goods on credit or they restrict granting loans to their members resulting to lower patronage from members and as a result they would have low gross income. This could have happened because the

management could have been less innovative and they have strong risk aversion (Lyani Sindani et al., 2016) which hinders them from granting credit or loans to the cooperative members. Further, the result could also mean that the cooperatives were not efficient in the management of their cost of goods sold or cost of services which reduced their gross profit. This could have been also a result of weak implementation of credit risk management strategies that increased the cost of delinquent debt resulting to higher cost of services and lower gross income (Lyani Sindani et al., 2016). Also, the revenue or sales of the cooperatives could not yield reasonable margin or profitability where the cooperatives were not able to determine appropriate mark-ups or target sales to cover the cost of goods sold or cost of services.

As stewards, the board of directors and the management tend to restrict granting of credit or loans in which the principal (i.e members) could not maximize the benefit of availing the services from their cooperatives and the gross profit which can cover other expenses and which could increase the net surplus/ income of the cooperative becomes minimal. The stewards (i.e board of directors and management) may tend to discourage their members to patronize their cooperative because they tend to be restrictive in selling their goods in credit or in granting loans to their members. The result does not affirm what Attom (2016) had pointed out that the board of directors and the management can sell on credit or grant loans while ensuring liquidity because it can improve sales. Also, it does not affirm what Olando et al. (2013) had pointed out that loan disbursement can positively influence growth of cooperatives. In this sense, the cooperative stewards were not able to meet the cooperatives financial objective such as increasing the gross income by encouraging the members to avail of the credit services of the cooperatives.

On the cooperatives' net surplus/income and total asset, the result presents that there were only few cooperatives with high level of net surplus/income and total asset and most of the cooperatives have low level of net surplus/income and total asset. The result manifest that most of the cooperatives were not able to manage their resources effectively resulting to lower level of profitability that were generated from the utilization of the cooperatives assets. This relationship could be explained by the study of Nadeem, et al. (2015) and Burja (2011) stating that the financial performance of firms could be expressed through return generated from the management of available resources. Further, it can be observed that most cooperatives have low level of total assets that can be utilized to generate greater net surplus/ income. The result affirms the findings of Andarsari et al. (2016) that the size of cooperatives have significant positive effect on profitability. The result also indicates that the cooperatives were not able to use financial strategies such as using debt or capital to increase the cooperatives' assets which may enable them generate higher net surplus/income. The result does not conform to what Salawu (2009) had pointed out that firms can utilize debt or equity to increase their assets to generate greater profitability since it was found that there is positive correlation between profitability with short-term debt and equity. In this case, the stewards were not able to utilize effectively the cooperatives' assets to generate profitability. They maintained low level of assets which only yielded minimal profit/surplus. They were not able to procure more assets by implementing financial strategies such as using debt or equity to generate funds for procuring more assets.

In terms of total asset and total capital/equity, there were only few observed cooperatives with high level of total asset and total capital/equity and it can be observed that most of the cooperatives have low level of total asset and total capital/ equity indicating that most of the cooperatives have slow growth. The result may indicate that the cooperatives are not maximizing the use of the invested equity/capital of the members to procure more assets for the member-shareholders' benefit. The cooperatives may not have an optimal capital structure (utilizing debt and equity) for the total asset to increase (Basit & Hassan, 2017) and to improve their performance (Nadeem, et al., 2015). Further, the result manifests the proportion of assets being utilized to serve the member-shareholders is limited. As stewards, the board of directors and the management did not implement financial strategies to increase the cooperatives' assets for them to provide greater services to the members. For instance, they did not identify appropriate capital structure in order to accumulate greater funds for the cooperatives' assets to increase and for them to provide greater services to the members. Moreover, the members are not being encouraged to pay more capital for the cooperative to pool greater amount of funds for procurement of more assets that are needed by the members. Ideally, if members could reap greater benefits from their cooperative, it corresponds that they would contribute more

equity to manifest their support to their stewards. However, the result reveals that the members do not fully support their stewards and they are not willing to entrust their resources thus they tend to limit their capital contribution. The result may not adhere to the findings of Asratie (2014) that the members' perception on the economic benefits and asset creation must be maximized and enhanced since it also determines the contribution amount of the members.

In terms of paid-up shares from members and the number of members, it can be observed that there were few cooperatives whose members are paying high level of paid-up shares and most of the cooperatives have low level of paid-up shares in spite that they have increasing number of members. This means that the members are not willing to pay higher amount of equity/capital and they tend only to contribute limited amount because they are not confident to the management of their respective cooperatives. Most of the members would take seriously the payment of their subscribed share if they can observe increased benefits from their cooperatives such as greater dividends, higher profitability, growth in assets, and growth in equity. The board of directors and the management can attract members when the members feel financial security and growth. Further, when the members are involved in their cooperative, they become dedicated and they would participate (contribute capital) in the cooperative. Thus, the cooperative must encourage members' cooperation as owners and customers wherein the members support the cooperatives' management through capitalization and to benefit from the services offered by the cooperative (Soemodipoero, 2017). As stewards, the board of directors and the management are not fully committed to pursue the overall interest of the members which resulted to weak commitment of the members to pay their paid-up shares. The members may not fully support how the cooperatives are being run by their stewards thus they limit their investment to their cooperative. This could result to the cooperatives' difficulty in accumulating funds to support its procurement of assets and in sustaining business operation. This could hinder the cooperatives growth and longevity since members' participation is essential in an autonomous organization such as cooperatives.

In terms of retained earnings and total equity/capital, the result reveals that there were few cooperatives with high retained earnings and high level of total equity/capital and most of the cooperatives have low level of retained earnings and low level of total equity/capital. The result may indicate that the cooperatives cannot maintain high retained earnings because they lack effectiveness in their operation which affirms the findings of Chalomklang (2010) that low retained indicate lacking effectiveness in operation which causes loss or decrease in the capital. The low retained earnings could also hinder the growth of cooperatives since they were not able to generate additional source of financing that are internally generated. The cooperatives may lose opportunity to achieve growth because portions of the earnings of the cooperatives are not being utilized for reinvestment. The result does not adhere to what Thirumalaisamy (2013) have found that internally generated funds in the form of retained earnings have enormously contributed to financing growth of firms and it benefits existing shareholders from the earnings generated from the reinvested profit of the firm. Also, it negates what Andarsari et al. (2016) have stressed that retained earnings are the main reserve to be used when the company will make an investment for business development. As stewards, the board of directors and the management were not able to utilize a portion of the earnings of the cooperatives for reinvestment to accrue greater wealth for the members. Also, they were not able to create value to the shareholders in the form of book value because all of the profits were distributed as dividend or they were not able to generate profit to be reinvested. The result negates what Robb (2012) have pointed out that the management must create value for the shareholders so that when they move out from their cooperative, they could receive greater value.

#### 4. Conclusion

The result reveals positive correlation between: receivables and gross income; total asset and net income/surplus; total equity/capital and total asset; number of members and paid-up shares from members; and paid-up shares from members and retained earnings. The study stresses the importance of financial stewardship. The study found evidence that weak commitment to stewardship translates into poor financial performance such as low level of total receivables and gross income, low level of total assets and net surplus/income, low level of total assets and total equity/capital, low level of paid-up shares from members,

low level of retained earnings attributable to the paid-up shares from members. Financial stewardship also brings practical contribution to the development of cooperatives. The stewards should implement good credit policies to encourage the members to patronize their cooperatives and they should identify appropriate mark-ups and minimize cost of servicing credit for the cooperatives to have higher gross income. They should also implement financial strategies such as using debt or equity/capital to increase the cooperatives' assets and utilize these assets effectively to generate higher net surplus/income. They should also encourage members to contribute more capital by providing the members with better services and benefits such as greater dividends, higher profitability, growth in assets, and growth in equity value through increased retained earnings.

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