



Microfinance Article Library

The Essential Triangle of Production (ETP). By Zvi Galor (March 2003).

Keywords:

Moshav, Co-operatives, mutual guarantee, Essential Triangle of Production.

Note:

In this brief article, the author examines the need for development organizations, to look beyond the simple provision of credit to the poor as part of poverty alleviation projects, and examine the triangular linkage credit has with the producer, and also factors like the supply of inputs and marketing. According to this theory, small business producers require credit to purchase their necessary inputs, and once this production is completed in an efficient manner, this is marketed so that the producer can repay the credit borrowed. Therefore, the essential triangle of production' (ETP) is composed of credit, supply of inputs, and marketing. This article describes the relationship between these three factors, and investigates how each can be targeted and used complementarily to achieve successful developmental objectives.

Countries:

Bangladesh, Israel

The Essential Triangle of Production (ETP) Zvi GALOR (March 2003)

1. The Guarantee.

Allocating loans is an activity which involves the transferring of money from an individual or an institution utilizing, generally, others' money, and for them it is in surplus, to where money is in shortage. Those who get the money, in a form of credit, are ready to pay for it a price, called in most cases interest. The problem of those who allocating credit is to how to guarantee that the credit would be reimbursed by the borrowers, including its own costs. Many commercial financial institutions apply a policy where borrowers supply guarantees of various sorts to the credit suppliers, in order to confirm to them that their credit would be returned.

2. The Mutual Guarantee

Poor people have difficulties providing sufficient and appropriate guarantees, and as a result, they have almost no access to formal forms of commercial credit. They also have difficulties providing an appropriate (in the eyes of the commercial finance suppliers) destination for this money, namely a business plan; a production project; a farm planning program; or any other income-generating project, capable of generating enough income to sustain itself and to be able to reimburse the credit. One solution is the mutual guarantee created among the poor. The Grameen Bank is famous enough for this policy.

The Moshav in Israel, based its economic activities on the mutual guarantee among all its members, to enable the availability of long and short term credit allocation deriving from external financial sources, since its foundation in 1920s. I still remember, many years ago, when serving as a treasurer of a young

Moshav, going to the bank, holding in my hand a long sheet containing all names of the 80 members of the Moshav and their signatures, the mutual guarantee of the members, to serve as part of the guarantees needed by the bank.

Mutual guarantee is, in some circumstances, a very useful means by which to obtain credit, especially for productive purposes. Mutual guarantees alone is however, in some cases, a short-sighted policy. A mutual guarantee should be part of a more comprehensive policy, which can be described as part of the Essential Triangle of Production (ETP).

3. The Essential Triangle of Production (ETP).

The Essential Triangle of Production is a must. It exists everywhere production is. What is it?

In order to produce, a producer needs credit. With this credit he is able to purchase the necessary inputs. He produces, utilizing the various factors of production, including the necessary know-how to enable him to produce in the most efficient way. The produce is marketed, and enables the producer to repay the credit borrowed. The ETP is composed of credit, supply of inputs, and marketing. The triangle should always be closed, to enable the project to succeed.

In the traditional set-up, the production is financed by credit allocated by the money-lender, who lends the money at the highest possible rate of interest. The supply of inputs is done by the private trader who sells these inputs at the highest possible cost. In many cases, and in many countries, the money-lender and the private trader are the same person. The produce, when production is done, is marketed by the middleman. The middleman pays to the producer, generally, the lowest possible price.

In many countries, the three functions are done by the same persons, and in most cases, not at all to the advantage of the producer. This enables the person who supplies the credit to guarantee its reimbursement.

Many developmental projects have ailed, since these projects neglected the existing of the ETP. They tended to provide credit, but neglected the other functions of the triangle, namely the production, the inputs and the marketing. The success of the Moshav for many years was due to the fact that it closed the triangle at the link of the angle between marketing and credit allocation. In the Moshav, the triangle was closed, but more than this, it belonged to the members of the Moshav.

The success of the triangle depends greatly in the fact that it belongs to its members. A possible way to generate this success is the cooperative way. The credit would be supplied through a savings and credit cooperative belonging to its members, the producers. The inputs would be supplied by a supply of inputs cooperative belonging to its members, the producers. The marketing would be done by a marketing cooperative belonging to its members, the producers. The producers are the owners of the three single purpose cooperatives, making practically one multipurpose cooperative.

4. The Other Guarantees.

I have mentioned that mutual guarantee was not enough to obtain credit, especially short term credit. The complementary part of the guarantees came from the linkage between the marketing of the production and the credit allocated to produce.

5. Concluding remarks

I feel that many governments, NGOs, and other credit organizations, including those supported by WOCCU, are dealing only with credit, and are not taking into consideration the other components of the triangle. EPT is essential to the success, but as well to the sustainable development of the poor.