

# The future of co-operatives in a growing Europe

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d'Economia Social i  
Cooperativa





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## PREFACE

For nearly a decade now the Research Committee of the International Cooperative Alliance's European Section has been organising research conferences on an annual basis: Tartu, Estonia (1996); Bertinoro, Italy (1997); Cork, Ireland (1998); Berlin, Germany (1999); Oslo, Norway (2000); Gavle, Sweden (2001); and Naoussa, Greece (2002)<sup>1</sup>. These conferences attract around a hundred social scientists from Europe and elsewhere in the world specialised in cooperative issues.

In May 2004 the scientific event was organised for the first time in Spain by two research bodies: the Research Institute for Social and Co-operative Economy of the University of Valencia (IUDESCOOP) and CIRIEC-España. The town of Segorbe provided the venue for the conference.

The slogan of this conference was "*The Future of Cooperatives in a Growing Europe*". The process of innovation and adaptation that cooperatives have undergone in the last decade was mainly brought about by greater economic integration resulting from organisational changes made at the heart of "traditional" cooperatives. The creation of new cooperative enterprises as a result of the EU's social agenda and the recognition of the social role of cooperatives have played an equally important part. The enlargement of the EU has opened up a host of new opportunities and generated new demands of cooperative enterprises and the cooperative movement as a whole. In the immediate future, this latest expansion requires a thorough process of adaptation on the part of cooperatives in the accession countries. From a wider perspective, however, it represents the starting point for a new raft of major changes at the core of the EU. These changes will in all likelihood extend to the accession countries.

The principal aim of this International Research Conference consists of calling together the researchers community of several countries, as well as professionals and anyone who is interested, to analyse and discuss the main challenges and opportunities facing cooperatives in the new context of an enlarged European Union.

Official conference website: <http://www.uv.es/iudescoop/ICA-2004>

The present volume comprises a selection of the papers presented at the conference, chosen by the Conference's Research Committee. All the papers included in this volume have been refereed by an Evaluation Committee integrated by:

- Rafael CHAVES, Director of Institute IUDESCOOP of the University of Valencia, Spain.

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1. Proceedings papers from the conference were recently published in a book: Karafolas, S.; Spear, R. & Stryjan, Y. eds.: (2004): *Local Society and the Global Economy: The Role of the Cooperatives*. Hellin Publications: Greece. 2004

- José Luis MONZÓN, President of CIRIEC-España and senior lecturer at the University of Valencia, Spain.
- Yohanan STRYJAN, ICA Research Committee and Södertörns högskola, Sweden.
- Roger SPEAR, ICA Research Committee and the Open University, United Kingdom.
- Simeon KARAFOLAS, Institute of Technological Education (TEI), Eastern Macedonia, Greece.
- Elena MELIA, CEGEA, Polytechnic University of Valencia, Spain.
- Aitziber MUGARRA, University of Deusto, Spain.
- Donal McKILLOP, School of Management and Economics, Queen's University Belfast, United Kingdom.
- Joachim EWERT, University of Stellenbosch, South Africa.

The broad range of issues covered by these research papers –many of them of exceptionally high quality– reveals the depth of research being conducted on the cooperative movement and the social economy.

The texts have been organised into 10 different thematic areas:

- Part 1. CREDIT UNIONS. Section coordinated by Donal Mc Killop
- Part 2. WINE AND OLIVE OIL COOPERATIVES. Section coordinated by Joachim Ewert
- Part 3. COOPERATIVE GOVERNANCE AND WORKER COOPERATIVES
- Part 4. PATHS IN INNOVATION, EDUCATION AND COOPERATIVE DEVELOPMENT SYSTEMS
- Part 5. COOPERATIVES AND SOCIAL ENTERPRISES
- Part 6. MERGERS AND DEMUTUALIZATION
- Part 7. COOPERATIVE PRINCIPLES
- Part 8. COOPERATIVES, LAW AND PUBLIC POLICY
- Part 9. COOPERATIVES AND WOMEN
- Part 10. HISTORICAL PERSPECTIVES

Last, we would like to express our gratitude to the Government of the Autonomous Region of Valencia - Directorate General for Labour and Occupational Health and Safety (Generalitat Valenciana) for helping to finance both the publication of this book and the organisation of the conference. Our thanks also go to the Spanish Social Economy Confederation (CEPES) and the Valencia Confederation of Cooperatives.

Finally, we would like to acknowledge and express our sincere gratitude to Ana Ramón Sierra for her diligence and perseverance in collating and processing all the texts in this book.

We sincerely hope that readers will find the texts stimulating, particularly in terms of their contribution to the research debate.

The Conference's Research Committee  
Valencia, spring 2005



## **CIRIEC-España**

The Spanish branch of CIRIEC was founded as an association in 1986. Its head office is based at the University of Valencia. It is a full member of CIRIEC-International (International Centre of Research and Information on the Public and Cooperative Economy), an international scientific nongovernmental organisation founded in 1947, whose objectives are to promote scientific research and to disseminate information and scientific work focusing on sectors and activities that aim to provide services of general interest: the economic policy of governments, public services, public companies, social economy organisations such as cooperatives, employee-owned companies, friendly societies and associations. Another of CIRIEC's objectives is to provide a link between professionals in these sectors and scientists to enable information to be exchanged as part of a mutually enriching process.

CIRIEC's goals are to help researchers organise their work on the social economy, promote working teams, stimulate areas of knowledge focusing on the social economy and, as a consequence, create strong links between the University and this sector.

<http://www.ciriec.es>

## **IUDESCOOP**

The Research Institute for Social and Co-operative Economy of the University of Valencia is a research centre specialized in the field of social and cooperative economy, in the widest sense of the term. It is an independent centre within the University of Valencia.

<http://www.uv.es/iudescoop>

## **The ICA Committee on Co-operative Research**

It is a thematic committee of the International Co-operative Alliance. The members of the Committee form a network of individual researchers from over 20 countries in Europe, Asia and America.

The Committee is a bridge between academic research and the co-operative world. It aims at strengthening activities and making the work of researchers more visible, particularly to ordinary managers and co-operators. Questions concerning education, social audit, co-op principles, developing co-operative advantage and the emergence of new wave co-operatives have all been reviewed from both a practical and theoretical stance.

<http://www.ica.coop/ica/ica/sb/research.html>





# THE FUTURE OF THE COOPERATIVE MOVEMENT IN THE BUILDING OF EUROPE

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## 1. EUROPEAN COOPERATIVES AND THE SOCIAL ECONOMY AS A NEW CONCEPTUAL FRAMEWORK

In November 1986, a European Conference on “The Cooperative, Mutual and Associative Economy. Contribution to the Building of Europe” was held at the European Economic and Social Committee (EESC) headquarters in Brussels. The organisers were, on the one hand, the Coordinating Committee of European Cooperative Organisations (CCACE) and other social economy associations<sup>1</sup> and, on the other, the EESC, the European Commission and the European Council. The purpose was none other, as announced by the title, than to examine the contribution of cooperatives, mutuals and associations to the building of Europe, the response they could provide to the challenges facing what was then the European Community (EC) and the demands of these organisations concerning the various EC policies.

Some of this conference’s analyses and conclusions concerning the contributions and challenges of the cooperative sector could be a useful starting point, although we believe that two observations should first be made. Firstly, it should be recognised that the EC, now the European Union (EU) is a living social institution that has made great strides in its integration and enlargement since then and continues to do so. Secondly, we should note that over these years a number of important changes of different types have taken place, which entitle us to speak of a new conceptual, institutional, social and economic framework.

The cooperatives of Europe have a long, deep-rooted tradition with a history that dates back over a century and a half, although they have evolved differently in different places. It may be asserted, as we shall see later, that they have become an important

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1. International Association of Mutual Insurance Companies, International Association of Mutual Societies and the French National Liaison Committee for Mutual, Corporative and Associative Activities.

social and economic factor throughout most of Europe in most sectors, so their contribution to the building of Europe to date is fairly obvious.

Another aspect that should not be forgotten is that cooperatives, due to their internal coherence with their values and principles, particularly solidarity as the most genuinely cooperative value and their well-known open-doors or voluntary membership principle, are social institutions which are very much identified with the processes of European integration and enlargement.

During the last two decades of the 20<sup>th</sup> century, “social economy” found favour in economics literature as a term to define companies and private organisations that, based on the principles of solidarity and assisting their members, are governed by economic democracy practices, placing people before capital. Although, even today, there is no sufficiently precise or fully accepted definition of this sector, there is at least a general acceptance of its being formed around four associative formulas – cooperatives, mutual societies, associations and foundations – without detriment to the possible inclusion or recognition of other forms under this heading.

However, it is important to note that the cooperative movement, as an unequivocal element of the associative sector, is clearly identified by its values and principles as a component of the social economy; indeed, given its long tradition and social weight, it is probably the most representative part of what is called the market social economy. It is not by chance, therefore, that the European Conference organised by the EESC in 1986 should have brought together the three main families in the social economy – cooperatives, mutual societies and associations – that years later were grouped under this name.

The reason for our drawing attention to this phenomenon is not because of any merely academic or theoretical interest in the examination of business formulas with such a long tradition as that of the cooperatives, but because of the importance and recognition that they have gained, politically and socially, in recent years. The best example of this is that European Conferences have already been convened by the Commission using the term “Social Economy”. From the first (held in Paris in 1989) to the eighth (in Salamanca in 2002<sup>2</sup>), they have highlighted the social and economic relevance of what is also called the third sector (Defourny 1992) and the need to implement access routes that will allow it to play a greater part, since it represents an option which is differentiated from the public sector and traditional capitalist companies and contributes to greater social cohesion.

The increasing interest in this type of enterprise has arisen because they provide a response to social demands that are not adequately satisfied either by the public sector or by other private initiative companies. Willi Croll, Chairman of the General Confederation of Agricultural Co-operatives in the European Union (COGECA), speaking at the EESC Conference (Croll 1987), reminded us that, historically,

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2. I Paris (1989), II Rome (1990), III Lisbon (1992), IV Brussels (1993), V Seville (1995), VI Birmingham (1998), VII Gavle (2001), VIII Salamanca (2002).

cooperatives were considered the “daughters of necessity”. Even then it was observed that the implementation of particular European policies requires the employment of formulas that imply a greater degree of social commitment and a greater rôle for society, which can only be guaranteed by cooperatives and other associative forms, as organisations that foster participation.

In the 1980s, certain European Parliament Resolutions resulting from well-known reports demanding that the cooperatives play a greater rôle in carrying out various European policies were already moving in this direction. Examples are those arising out of the Mihr report in 1983, the Avgerinos report in 1987, which pointed to the contribution of the cooperative movement to regional development, the Trevelli report in 1988 on the rôle of the cooperative movement in development policies and, finally, the Ramaekers report. This led to the Communication from the Commission to the Council on “Businesses in the “Economie Sociale” sector: Europe’s frontier-free market” of 18 December 1989 and to the creation of a Social Economy Unit in EC Directorate General XXIII, which, to all intents and purposes, can be considered a formal acceptance by the European institutions of the social economy revolving around cooperatives, mutuals, associations and foundations.

An important landmark on the path of recognition is the publication of the Commission Decision of 13 March 1998 setting up the European Commission’s Consultative Committee of Cooperatives, Mutuals Associations and Foundations (CCCMF), whereby this sector became fully integrated into the European institutions.

## **2. FROM THE EUROPEAN COMMUNITY OF THE EIGHTIES TO THE EUROPEAN UNION OF THE 21<sup>ST</sup> CENTURY. INSTITUTIONAL AND POLITICAL FRAMEWORK**

Since the eighties, the Community’s general institutional and political framework has seen significant changes, many of which, such as those concerning European integration and enlargement, are still underway. Some of the most significant events of the past twenty-five years, in general and for cooperatives, have been:

- 1981 Greece joins the European Community (second enlargement).
- 1986 Spain and Portugal join the EC (third enlargement).
- 1987 Single European Act comes into force.
- 1992 Signing of the Treaty of Maastricht. The European Council approves the creation of the European Union (EU) and the Economic and Monetary Union (EMU).
- 1993 The Single Market is created.
- 1995 Austria, Finland and Sweden join the EU (fourth enlargement).
- 1999 EMU. The single currency is launched, with a fixed rate of exchange for euro area currencies against the euro, and brought into circulation in 2002.
- 2002 The Treaty of Amsterdam is signed, increasing the powers of the European Parliament.

- 2003 The draft constitution for the European Union is presented, with institutional reforms to come into force in 2009.
- 2003 Publication in the Official Journal of the EU of Council Regulation (EC) n° 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE)
- 2004 10 states join the EU (Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Slovakia, Slovenia, Poland) (fifth enlargement).

The fact that most EU states joined the EMU meant not only that the euro became the single currency for the countries in what is known as the Eurozone but also that they became committed to the Stability and Growth Pact, which sets out a series of macroeconomic conditions that must be met, including low inflation and reducing deficits to a maximum of 3% of GDP in order to promote slow but sustainable growth. The pact determines the extension of a strong budgetary discipline which obviously involves a tight rein on public spending, together with labour market reforms directed at making employment contracts more flexible to enable companies to be more competitive, despite the risk of undesirable effects such as less stability and job losses in some sectors and areas and a possible reduction in welfare cover (Juliá, Marí, 1998).

Enlargement from EU15 to EU25 represents the greatest quantitative and qualitative changes in the social and economic order of all the enlargements to date. Surface area and population have increased by almost a third, as the population has risen from 380 million to almost 456 million and the surface area to almost 3 million sq km, whereas the growth in GDP is barely 6%. The per capita GDP of most of the new member countries is below 10,000 euros (Latvia, Lithuania, Estonia, Slovakia, Poland, Hungary), which is half that of the EU15. The unemployment rate in some of these countries is over double that of the EU15 (Slovakia 19.7%, Poland 18.6%).

In addition, it is also highly likely that Bulgaria and Rumania will join in 2007, Turkey is already a candidate for accession and several Balkan countries have begun to request negotiations.

There is an obvious need to address the problems of integrating less developed economies with higher unemployment rates and fewer social security benefits, in the above-mentioned context of budget constraints that places limitations on public spending and makes it difficult not just to address them but to obtain the necessary budget increases for community policies that contribute to greater social and territorial cohesion.

Take for instance the longest-standing community policy, which even today still has the largest budget, the Common Agricultural Policy (CAP). It is being discussed in a budget freeze, due not only to the commitment to greater budgetary balance, as mentioned above, but also to international agreements under the auspices of the World Trade Organization (WTO) that force agricultural subsidies, especially those directly related to production (known as amber and blue boxes) to be reduced gradually. This is the background to the accession of the 10 new countries, which, for European agriculture, will mean a 30% rise in usable agricultural land and a

staggering 58% rise in the number of farmers. It is clearly impossible for the need to develop and restructure agriculture in these countries to be addressed adequately in the present budgetary context. Indeed, although it is inevitable in the light of this situation, these countries are understandably uneasy over the medium term CAP reform, approved on 26 June 2003, which entails significant cuts in direct subsidies and will be applied to farmers progressively up to 2012.

Cooperatives and other forms of social economy organisations already play a significant role in Eastern European countries and although in general, as with the rest of their economy, they are less developed than those of the EU15, they are considered a fundamental part of the integration process, for their contribution to local and regional development and greater social cohesion, as highlighted at the first European Conference on the Social Economy in Central and Eastern Europe, held in Prague in 2002 and sponsored by the Czech government and the Commission. This will be followed by the Cracow Conference in October 2004, organised by the Polish government and the European Commission. The issues to be addressed will include the strengthening of ties between the social economies of East and West, adaptation of the legal framework, the creation of a social economy development fund, access to European Structural Funds for the East's social economy, rural and local development, etc.

Finally, Council Regulation (EC) n° 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society has appeared after several years' wait, fulfilling the Council's undertaking to these organisations. This regulation may be considered the most important innovation in the EU's institutional framework for cooperatives and opens up new opportunities for them to develop in a borderless economy.

With respect to this legislative innovation, it should be noted that at the 1986 European Conference, mentioned above, some distinguished participants (Croll, 1987; Munkner, 1987) indicated that there was no clear will in the sector to bring about legislative harmonisation or even a European Statute. It is therefore interesting to see how the attitude of the European cooperative movement changed significantly with the passage of time, in the light of economic and social change and progress in the EU integration process, and in the nineties began to call insistently for a European statute for cooperatives similar to that which existed for European companies.

The SCE statute should be regarded as an historic turning point for European cooperatives as, by regulating the sector at EU level, it enables them to operate throughout the European Union. It signals a commitment to facilitating transnational or cross-border activities, which in recent years, in the present market context, cooperative organisations had been demanding with great insistence.

The serious difficulties which arose in enacting these regulations are undeniable. Consider for example the different ways in which the Member States regulate cooperatives: some have no specific regulations and rely on custom or commercial case law (the United Kingdom, Denmark, Ireland), others do have special regulations but these lie within the framework of general regulations (Netherlands, Belgium) and finally there are those that have their own regulatory framework with specific laws

on cooperatives (Germany, France, Spain, Greece, Finland, Italy, Austria, Luxemburg, Portugal and Sweden).

All this meant that it was essential to try to establish common denominators, with particular attention to safeguarding aspects that are vital to cooperative identity such as company control by user partners through a democratic decision making process or the generation of indivisible assets, by introducing concepts and practices that are permitted in the regulations of some States. Hence the continuous references throughout the SCE Regulation to the provisions of the member States' legislation (limited plural vote, sector assemblies, etc.). It should be noted that the Statute upholds the principle of obligatory compliance with the national legislation of the member State in which the SCE has its head office, which is where it acquires legal personality and must be registered (articles 11, 17, 18).

The SCE Statute tries not to interfere with national legislation, imposing no conditions so each sovereign State may develop and revise its legislation freely (Minondo 2002), although undoubtedly it can and should serve as a guide as this will facilitate the future application of this cross-border European regulation. We believe that this Regulation is destined to provide a legal framework for the creation of new cooperatives and the conversion of a cooperative into an SCE (art. 35), as well as for mergers of cooperatives from different States with the simultaneous creation of an SCE, an issue which it addresses thoroughly in a considerable number of its articles, no less than 16 (art.19 to art.34) out of a total of only 80.

### **3. THE SOCIAL AND ECONOMIC FRAMEWORK. GLOBALISATION, A NEW SCENARIO FOR EUROPEAN COOPERATIVES**

The considerable socio-economic changes seen over recent years must of necessity be addressed, as they are shaping the social and economic framework in which all activities must be conducted. A major factor is the well-known phenomenon of globalisation which, like it or not, is present at all levels, particularly in geographic areas that have traditionally had a greater tendency to exchanges and have become the major markets for goods and services.

Globalisation is understood to mean greater interaction in all economic activities, crossing national borders, with freer, easier and faster access to markets and a greater integration of the world economy (Barea 2002). In fact, it is usually identified with very similar terms which have become popular in economics writing and everyday language such as liberalisation, multilateralism or internationalisation. Globalisation offers both threats and opportunities depending, to a greater or lesser extent, on how it is managed (Stiglitz 2003).

Although there is nothing new about this process, it has certainly become more significant and relevant, socially and economically, and continues to grow, favoured by international agreements seeking greater market liberalisation, despite some distortions that benefit of more developed countries, as some countries complain.

In addition, advances in sectors such as communications, in particular information and transport technologies, have contributed even further to the spread and power of globalisation.

This has led to the growth of global companies with world-wide strategies and to the significant development of free trade, with world trade growth rates rising faster than GDP. International trade in goods and services in particular has grown much faster than GDP, increasing by a factor of 16 in contrast to only 5.5 for GDP (Barea 2002).

The importance of these processes in the European area is particularly significant. This is undoubtedly the leading market nowadays for transnational exchanges and has one of the most open economies in the world, as witnessed by the high ratio of imports and exports to GDP in many of the member States (Germany 69%, Spain 60%, the United Kingdom 57%, France 51%, for instance) (Barea 2002).

Income per inhabitant in the less advanced developing countries has converged but the difference in income per inhabitant between the richest and the poorest countries has increased.

Furthermore, it is also true that there is a greater sensitivity towards defending the cultural values of local identity, protecting the environment and more sustainable production methods, together with an increased concern over food risks stemming from rapid international media dissemination of the latest food scandals. In fact, a large part of society views the globalisation process with well-founded concern, in the belief that it may end up imposing single cultural models, progressively eliminating local ones, and promote widespread use of intensive production methods to increase productivity and profitability, in the light of increasing competition, without the necessary precautions to safeguard against any possible, as yet unknown consequences of this behaviour for food safety and biodiversity.

The controversy surrounding the issue of the market for transgenic products (genetically modified organisms) in Europe, which is being approached with caution by the authorities as a result of public concern, is just one example. Another is Agenda 2000's bid for a European model of multifunctional agriculture, as reflected in the new CAP, which attempts to view agriculture not merely as a productive activity but to take into account that it also performs other functions which have enormous social value, such as conserving the environment and the landscape, contributing to rural development and maintaining the population in these areas, with a clear commitment to the land. These considerations all serve to legitimise agricultural subsidies, without contravening international agreements, moreover, since the subsidies are geared to developing these other functions and are unrelated to productive capacity, as the grounds on which they are based are that these functions can be considered public goods that are not paid for, or not adequately paid for, by the market (Juliá, Marí 2002).

It is true that fortunately we are still far from having eradicated the local characteristics of our different regions and inhabitants, an indisputable part of our cultural heritage and values and of great importance for all economic players, in particular for those such as cooperatives that are basically community-based companies



committed to the people and the area of which they are a part. In fact, it is evident that in many parts of rural Europe, cooperatives are the main nucleus of economic activity, generating and distributing wealth among the local population.

Cooperatives and other forms of social economy organisation can help to minimise the above-mentioned risks stemming from the globalisation process. As they develop and extend their sphere of action while retaining their values and principles, they will be in a position to act as bridges between the local and the global and become agents of what has been termed “glocalisation” (Jeantet 2003).

Nonetheless, one of the greatest risks of the globalisation process, which increasingly leads companies to channel their efforts into becoming more competitive to achieve greater market dominance, is that it may also have the undesirable effect of destroying jobs and becoming a factor that upsets the social equilibrium. Given this situation, it is therefore relevant to ask whether the cooperatives can provide an answer and what they should do in this direction (Jeantet 2003).

It must be remembered that, as the President of ICA-Europe said at the Bologna Conference on Entrepreneurship and Cooperatives in Europe 2000, some of the greatest challenges facing the EU are unemployment, with 18 million jobless, and enlargement (Hillbörn 1999). The Chairman of CIRIEC has also made similar comments, stating that the far-reaching changes which have shaken the foundations of the Welfare State in the EU over the last 20 years have generated a crisis of confidence in the system’s traditional institutions, which for three decades of the 20<sup>th</sup> century, after the Second World War, managed to respond satisfactorily to the economic and social challenges of the time (Monzón, 2003).

This distrust and this incapacity to find appropriate answers to the new challenges of the global economy legitimate concern over the new role of cooperatives and the social economy in the consolidation of the welfare society. The main problems to be dealt with, given their social importance, are unemployment, social exclusion and new social needs.

To conclude this section, we would point out that the last Communication of the Commission to the Council, the European Parliament and the EESC, dated 23<sup>rd</sup> February 2003 on the promotion of cooperative enterprises in Europe, after noting that cooperatives are not sufficiently well-known nor is their potential exploited, and that their image should be improved, introduces among its objectives a recognition of the increasingly significant and positive rôle that cooperatives play as a means of attending to a large number of community objectives in areas such as employment policy, social integration and regional and rural development. In the Commission’s opinion, this tendency should be maintained and the presence of cooperatives in the different programmes and policies of the community should be exploited and promoted.

#### 4. STATISTICS ON COOPERATIVES IN EUROPE. A MAJOR SOCIAL AND ECONOMIC FACTOR

Cooperative enterprises in the EU15 are a major economic and social factor. In 1996 they numbered 132,462, employed approximately 2,300,000 people and had a total of 83.5 million members, accounting for 22.4% of the total population.

According to data from a recent EUROSTAT study (2001) on several European countries (Denmark, Spain, France, Italy, Portugal, Finland, Sweden and Switzerland), cooperatives make up about 1% of total companies except where the percentage is higher: 1.71% in Denmark and 2.69% in Sweden. They employ almost 4% of the total workforce, with turnover figures as a proportion of the economy of each country ranging from 1.39% for Portugal to 9.27% in Denmark.

Their presence in the different EU countries varies greatly, as does the degree of development of their cooperative sector (Table 1). In countries where cooperatives have reached a higher level of business development, such as Denmark, Germany, Netherlands and the United Kingdom, they are far larger than the average European cooperative, in terms of both the number of employees and the number of members.

However, it may be noted that efficient business size is one of the objectives pursued by EU cooperatives and the signs are that this has been achieved in part, as the average number of members per cooperative in EU12 rose from 518 in 1990 to 638 in 1996 and the average number of employees increased from 17 to 18.

At this point, we would like to draw attention to the difficulties researchers experience in obtaining data on the cooperative sector. It is evident that the data sources for the 1990, 1996 and 1998 studies are different (table 1), which creates some discordances in the analysis and has lead us to work with average data in order to reduce any differences in criteria inherent in the available data.

We would, therefore, argue for the need for an organisation to undertake an on-going compilation of statistics on the cooperative sector at European level, which would undoubtedly benefit the sector. The Commission's Communication to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions on the promotion of cooperatives in Europe of February 2004 recognises the need to use satellite accounting techniques to collect and analyse statistical data on cooperatives and that these techniques should be used by National Statistics Institutes.

**TABLE 1.**  
**GROWTH IN THE NUMBER OF COOPERATIVES, MEMBERS, AND EMPLOYEES IN EUROPEAN**  
**UNION COUNTRIES 1990-1998**

	1990			1996			1998	
	No. of cooperatives	No. of members	No. of employees	No. of cooperatives	No. of members	No. of employees	No. of cooperatives	No. of employees
Belgium	2.450	1.623.330	34.113	1.553	3.597.862	19.441	n/a	n/a
Denmark	899	1.348.774	58.920	1.445	1.392.244	68.092	8.883	63.893
Germany	8.770	15.236.000	483.038	10.320	22.322.050	492.711	n/a	n/a
Greece (1st tier)	7.446	982.897	12.474	6.970	1.043.381	12.054	n/a	n/a
Spain	9.941	2.583.459	181.548	23.481	4.336.502	423.066	21.595	210.263
France	24.415	14.228.755	403.973	23.573	17.485.573	315.157	22.147	163.203
Ireland	713	1.276.044	19.645	723	2.123.576	2.394	n/a	n/a
Italy	38.194	5.798.209	245.802	39.625	7.624.430	486.209	4.651	121.894
Luxembourg	17	23.400	1.500	63	17.627	458	n/a	n/a
Netherlands	4.106	n/a	84.169	735	856.446	100.811	n/a	n/a
Portugal	1.569	590.279	35.480	2.966	2.134.670	44.637	2.355	33.133
United Kingdom	5.218	10.041.191	181.357	2.191	9.547.707	97.954	n/a	n/a
TOTAL EU-12	103.738	53.732.338	1.742.019	113.645	72.482.068	2.062.984	n/a	n/a
TOTAL EU-12	n/a	n/a	n/a	132.462	83.557.698	2.300.191	n/a	n/a

Source: Own elaboration using data for 1990 from "Le secteur coopératif, mutualiste et associatif dans l'Union Européenne" European Commission, 1997; data for 1996 from "Statistics and Information on European Cooperatives", ICA, 1998; data for 1998 from "A Pilot Study on Cooperatives, Mutuals, Associations and Foundations", 2001, EUROSTAT.

By sectors of activity (Table 2), agriculture is the sector with the largest number of cooperatives (35%), followed by workers' cooperatives (20%); these percentages correspond to the cooperative presence in the primary and secondary sectors. The tertiary sector therefore accounts for the remaining 45%, with a notable percentage of credit unions (8%).

However, despite their lower number, credit unions and consumer cooperatives have the greatest number of members, 42% and 40% of the total respectively, with an average of 3,200 members in credit unions and 7,300 in consumer cooperatives.

In relation to their ability to generate employment, it is interesting to note that 50% of cooperative employees belong to workers' or agricultural cooperatives. This is due not so much to the average number of workers employed per cooperative, but to the greater number of cooperatives in both of these sectors, as in both cases a large percentage are of limited size, especially in the case of workers' coops.

An analysis of the cooperatives by sector for the period 1990-1996 (Tables 2 and 3) reveals a reduction in the number of enterprises in the agricultural and credit sectors, which fell from 42% and 11% respectively of the total number of cooperatives in 1990 to 35 and 8% respectively in 1996. This is largely a consequence of the concentration which is a driving force in both sectors, since the reduction in the number of enterprises is accompanied by an increase in average size, both in the number of members per cooperative (which has doubled in the agricultural sector) and in employees.

**TABLE 2.**  
**COOPERATIVES, MEMBERS AND EMPLOYEES IN THE EUROPEAN UNION BY SECTOR OF ACTIVITY, 1996**

1996	Agricultural	Workers'	Banking	Insurance	Consumer	Other	Total
N° cooperatives	46.534	27.073	10.855	135	3.518	44.347	132.462
N° members	10.629.616	854.078	35.696.375	n/a	25.834.946	10.542.683	83.557.698
N° employees	596.026	582.399	440.974	40.601	255.200	384.991	2.300.191
% cooperatives	35,1%	20,4%	8,2%	0,1%	2,7%	33,5%	100,0%
% members	12,7%	1,0%	42,7%	n/a	30,9%	12,6%	100,0%
% employees	25,9%	25,3%	19,2%	1,8%	11,1%	16,7%	100,0%
N° members/coop	228,4	31,5	3.288,5	n/a	7.343,6	237,7	630,8
N° employees/coop	12,8	21,5	40,6	30,7	72,5	8,7	17,4

Source: Own elaboration based on "Statistics and Information on European Cooperatives", ICA, 1998.

**TABLE 3.**  
**COOPERATIVES, MEMBERS AND EMPLOYEES IN THE EUROPEAN UNION BY SECTOR OF ACTIVITY, 1990**

	Agriculture	Banking	Construction	Commerce	Insurance	Others	Total
Nº cooperatives	44.260	12.088	33.239	6.760	251	7.140	103.738
Nº members	4.084.906	28.694.982	1.150.275	9.309.537	6.000.000	4.492.638	53.732.338
Nº employees	374.992	401.610	338.047	409.533	19.301	199.536	1.743.019
% cooperatives	42,7%	11,7%	32,0%	6,5%	0,2%	6,9%	100,0%
% members	7,6%	53,4%	2,1%	17,3%	11,2%	8,4%	100,0%
% employees	21,5%	23,0%	19,4%	23,5%	1,1%	11,4%	100,0%
Nº members/coop	92	2.374	35	1.377	23.904	629	518
Nº employees/coop	8	33	10	61	77	28	17

Source: Own elaboration based on "Le secteur coopératif, mutualiste et associatif dans l'Union Européenne" European Commission, 1997.

Thus, the reason for the current growth and importance of European cooperatives in both sectors (agricultural and credit) is to be found in their business development: the key has been concentration, be it through the creation of cooperative groups, second tier cooperatives, mergers or structures based on partnership with other types of business organisations, which has made them much more competitive.

Agricultural cooperatives are a well-established tradition in the EU farming world. Their influence in their sector is far higher than that of cooperatives in other sectors such as banking or health. Indeed, their products account for over 60% of Europe's agricultural output, rising in some countries to percentages in excess of 90% in certain cases such as pork and milk in Denmark or milk and cut flowers in the Netherlands.

Workers' cooperatives, the second most common cooperative formula in the EU, generate 25% of the total number of jobs in cooperatives. They are particularly significant in two Member States, Spain and Italy, which have 48% and 33% respectively of this type of company. Their capacity to generate employment is proportionately the reverse, as Italian cooperatives, which are smaller in number (33%), employ the highest number of workers (40%) whereas the Spanish employ 33%, an indication of their smaller business size.

The banking sector is the third largest in terms of number of enterprises and (according to 1996 data) accounts for 8.2% of European cooperatives and 42% of members. These cooperatives are becoming increasingly significant in the financial system in which they operate, as shown by the growth in value of their consolidated balance sheets for the period 1990-1995 (in the member states for which data are available) and their market share, with the exception of German cooperatives.

The member States that are joining the EU in the latest enlargement, in May this year, have a cooperative tradition dating back 150 years in some cases. Sometimes, especially during the transition to a free market model, their cooperatives have wrongly been considered state collectives. There are over 20,000 cooperatives in these countries, with around 10 million members and almost 460,000 employees. On joining the EU they will account for 14% of the total number of cooperatives, 10% of the members and 16% of the employees.

The sectors where cooperatives are most in evidence are agriculture, at 38% of the total number of cooperatives and housing, 26%, while workers' cooperatives are in third place, at 15%.

Their role in the economic activity of these countries is undisputed, as shown by data such as the market share of agricultural cooperatives in countries like the Czech Republic (65%) or the fact that 40% of cultivated land in Hungary is linked to these organisations. Housing cooperatives are very important in the construction sector in several countries, such as Poland (in Warsaw, 77% of new housing has been built by cooperatives), Slovakia, where they have built 23%, and the Czech Republic, where their market share is 45%. Finally, consumer cooperatives also have a major presence, with market shares of 13.5% in Estonia, 6% in Lithuania and in Poland and 4.1% in Slovakia (ICA, 1998).



**TABLE 4.**  
**NUMBER OF COOPERATIVES AND MEMBERS IN CENTRAL AND EASTERN EUROPEAN COUNTRIES JOINING THE**  
**EUROPEAN UNION ENLARGEMENT**

	Agricultural		Workers'		Banking/ Credit Unions		Housing		Consumer		Total	
	Nº of coops	Nº of memb.	Nº of coops	Nº of memb.	Nº of coops	Nº of memb.	Nº of coops	Nº of memb.	Nº of coops	Nº of memb.	Nº of coops	Nº of memb.
Cyprus	36 5,2%	15.727 3,1%	11 1,6%	2.026 0,4%	477 69,1%	420.057 81,5%	1 0,1%	5.581 1,1%	127 18,4%	69.880 13,6%	690 100%	515.352 100%
Slovakia	757 68,3%	126.000 16,1%	179 16,2%	17.562 2,2%			130 11,7%	98.387 12,6%	40 3,6%	220.604 28,2%	1.108 100%	782.966 100%
Slovenia	109 62,6%	20.354 9,2%			63 35,6%	200.000 90,8%					174 100%	220.354 100%
Estonia									30 100%	53.528 100%	30 100%	53.528 100%
Hungary	1.345 38,5%	300.000 10,1%	606 17,3%		226 6,5%	1.800.000 60,7%	1.060 30,3%	304.000 10,3%	260 7,4%	559.000 18,9%	3.497 100%	2.983.000 100%
Latvia	1 1%		48 49%						49 50%	305.400 100%	98 100%	305.400 100%
Lithuania									99 100%	246.300 100%	99 100%	246.300 100%
Malta	14 70%	3.401 87,1%									20 100%	3.906 100%
Poland	4.938 35,9%	630.000 24,4%	2.073 15,1%		1.649 12%	1.954.638 75,6%	3.930 28,5%		413 3%		13.774 100%	2.584.638 100%
Czech Republic	1.081 49,5%	85.000 6,2%	428 19,6%	34.834 2,5%	27 1,2%	10.500 0,8%	578 26,5%	671.482 48,6%	70 3,2%	579.767 42%	2.185 100%	1.381.583 100%
Total	8.259	1.168.156	3.334	52.396	1.965	3.965.138	5.698	403.058	961	1.964.599	21.675	9.057.027

Source: Original work based on "Statistics and Information on European Cooperatives", ICA, 1998.

## 5. BY WAY OF A CONCLUSION

Cooperatives have made very significant contributions to the social and economic development of Europe in recent decades, as is shown by their social and business evolution over the period. They are a major presence in many sectors, such as agriculture, banking and retailing, and in certain sectors and regions constitute a far more active instrument of job creation than capital-based companies. They are also appearing with great vigour in sectors that respond to major social demands, such as education, health, services to households and other social services.

They are part of what is called the social economy, with which they are clearly identified, alongside other types of business and organisation such as mutuals or foundations. All of these share and are sustained by values such as solidarity and mutual assistance and all of them place people before capital. Nonetheless, the fact that the term 'social economy' is still not a sufficiently precise concept means that it is open to some people using it in a very wide sense in terms of its content, leading to a risk of confusion when forms such as cooperatives, which are fully identified with its values and principles, are grouped with other, very diverse types, leading to possible assimilation and problems of image.

Progress must be made, therefore, on defining the social economy more precisely, or at least clearly delimiting the formulas that comprise it. If this is not done, any possible prestige, given the institutional recognition of this sector due to the social interest of its components, could drift into a process of social delegitimation, as the sector as a whole would lack the well-defined social values that distinguish it from other business models and justify the call to give it a greater part in the various social policies.

At an institutional level, the progress made by cooperatives and the social economy has certainly been outstanding in recent years. Notable examples are the Communication from the Commission to the Council of 1989 on "Businesses in the "Economie Sociale" sector: Europe's frontier-free market", which signalled a recognition by the European authorities of their social and economic importance and an interest in the social economy being given a greater rôle in implementing European policies, and the publication of the Statute of the SCE, which makes it possible to create transnational European cooperatives. More recently, the latest Communication from the Commission, in February 2004, on "the promotion of co-operative societies in Europe" clearly favours the cooperative model and makes it better known at all levels. It argues for improving the regulatory framework and for greater participation by the cooperatives in the main EU policies (agriculture, rural and regional development, job creation) and makes particular reference to the rôle they can play in facilitating the integration of the new members joining the EU.

However, the opportunity to include an express mention of promoting cooperatives in the new European Constitution, in the same way as it appears in the constitutions of certain EU member states (Spain, Italy and Portugal), should not be missed. This is still at draft bill stage but the text made known to date, despite its length, does not expressly mention cooperatives in this way.

Globalisation, in the sense of a greater opening of markets and interaction of regional economies, is an inevitable process. Rather than making many people uneasy, it can and should provoke a response to the risks and opportunities that may stem from it, attempting to achieve a globalisation with a human face (Stiglitz, 2003). From this point of view cooperatives, with their particular governance based on the priority of people over capital and their nature as community-oriented companies, can diminish the risks of loss of local identity and delocalisation of economic activity and can prevent due attention to the social needs of citizens from being neglected.

Equally, cooperatives can contribute to a more harmonious and balanced economic development that counts on people, envisages commitment to the area and, above all, does not widen the wealth gap between developed and developing countries, as has occurred to date.

Cooperatives can help to create the globalisation with a human face to which Stiglitz refers in *Globalisation and its Discontents* and to make the new term 'glocalisation' a reality, acting as a bridge between the local and the global, as Jeantet indicates.

However, the contributions that cooperatives can and should stand for in this context, both in Europe and the world, require a greater knowledge of their reality and identity and of how they work and are governed. It must be said that the actions proposed in the communication of the Commission of February 2004, mentioned above, are very much to the point and it is well worth highlighting some of them here.

They include measures to improve knowledge of the cooperative model so that both governments and economic sectors are aware of the potential of this formula. Among others, conferences and seminars, research studies and creating networks are mentioned. For this to be effective, the quantity and quality of the available information on the cooperative sector must be improved. Actions to develop and perfect data bases are therefore proposed, making them uniform and involving not only official statistics bodies but also academic institutions and the cooperative sector itself. The communication expressly mentions the possibility of using methods such as satellite accounts.

It highlights the importance of increasing the information on the cooperative model in business studies curricula in both secondary and university education, again mentioning steps in this direction leading to education curricula fostering participation in cooperatives, as well as transnational networks of specialists that can be useful in developing good practices in innovative sectors.

In this respect, the ICA's Scientific Committees, and CIRIEC also, can play an important part, as the participants in these prominent, privileged forums are researchers in this field from the major European academic institutions. The work done to date by these organisations should therefore be the first to be considered, compiling the various studies already available on these subjects and taking these as a starting point. Some national studies have already been conducted with satellite accounting methods, in research work which, moreover, had European funding (Barea, Monzón, 1995), and these are undoubtedly a good example.

Use should also be made of the existing vehicles of scientific communication, such as the superb journals that have already gained widespread recognition among the academic community. Certain journals that specialise in the social and cooperative economy, for instance, are already indexed in some of the main international scientific data bases (Econlit and IBSS ).

There are networks of centres and institutes that research the social and cooperative economy and are present in the greatest network of the information society, internet (redenuies.org, unircoop.org, etc.). This helps to make the cooperative movement more visible, better known and increasingly recognised. Here again the ICA and CIRIEC must be mentioned, as their membership includes many of these institutions. They should act as catalysts for these activities as, indeed, they are already doing.

Another point of particular interest is the need to improve the regulatory framework and to develop it in relation to the effective implementation of the SCE statutes, naturally always respecting the cooperative values and principles contained in the ICA Statement on the Cooperative Identity. The communication considers that common rules should be adopted throughout Europe as soon as possible.

It signals that action must be taken to make the most of the special contribution that cooperatives can make in the fields of agricultural policy, enlargement, rural development, job creation and attending to the new demands of society. However, we must not turn a blind eye to the fact that for this contribution to be effective, cooperatives must adopt the necessary business strategies to enable them to compete in the market place, which in many cases requires them to undertake resizing to achieve greater business concentration, as is being done by their competitors, particularly in sectors such as agri-food, banking and distribution. Although there are other specialised sectors offering specific activities where smaller units can operate, these will undoubtedly have to operate within the framework of networks to increase their efficiency and give them a more effective market presence.

The importance that the commission places on maintaining continuous close ties with the organisations that represent the cooperative sector should also be highlighted. It also recognises that the representation tasks performed at European level by national and sector federations are adequate and specifically mentions ICA Europe and the CCACE as the most representative organisations.

Finally, we would like to point out that now, more than ever, cooperatives are destined to be a key element that dynamises true, sustainable social and economic development with greater social and geographical cohesion, due to their particular characteristics, and that is something that a fairer, more equitable society cannot forego.

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# ANECOOP: DEVELOPMENT OF COOPERATIVE GROUPS

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## 1. INTRODUCTION

The following presentation has been divided into three parts:

- Firstly, we will make an introduction about Anecoop,
- Secondly, we will make an explanation about the Anecoop Group and,
- Finally, we will focus on the Anecoop Business Group.

## 2. ANECOOP, S.COOP.

What is Anecoop?

Anecoop is a Second-Tier Agricultural Co-operative made up of 98 co-operatives located all over Spain.

It was founded in 1975 by a group of 31 co-operatives from Valencia and Castellon.

This season we have commercialised nearly 600.000 Tm. of produce and we have had a turnover of approx. 400 million euros.

Anecoop is Spanish market leader in the sale of fresh fruit and vegetables and one of the leading European suppliers of fresh produce.

Along these 28 years, Anecoop has been grouping up co-operatives all over Spain. Some of these co-operatives are 80 and even 100 years old.

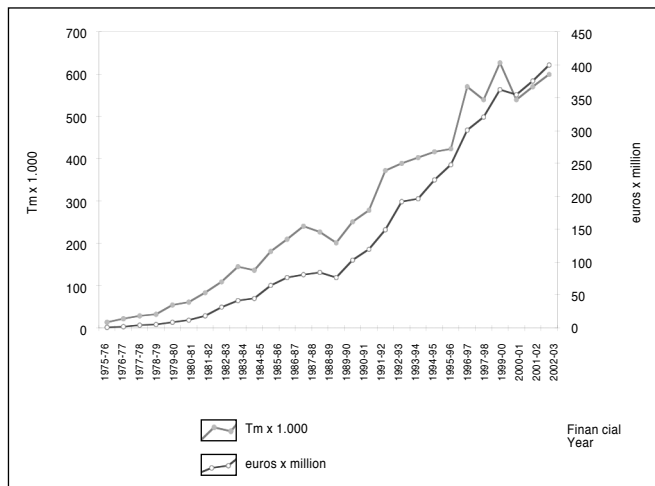
Since Anecoop was founded, its major goals have been:

- **To steadily consolidate** co-operatives supplying produce
- **To diversify the offer**, both by increasing the variety of produce marketed and by extending the product seasons. The latter had previously been limited to what could be produced locally during each season by the first-tier co-operatives.

- As a consequence of the above mentioned, **to gain bargaining power** when dealing with large-scale distribution chains.
- **To strengthen co-operatives** from the business and the economic point of view, by adopting measures to complement and promote both their produce and the use of resources.

Presently, we keep working on these goals.

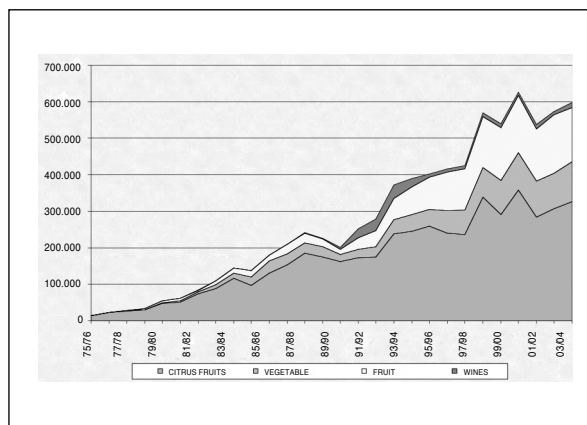
**GRAPH 1.**  
**SALES DEVELOPMENT (SEASON 03/04)**



According to graph nr. 1, sales development in metric tonnes and Euros has increased since Anecoop's foundation, except for those seasons in which we had problems due to a freeze, hailstone or less production due to very dry weather.

As Anecoop was founded by citrus growers, in the early times it only commercialised citrus fruit, mainly in the Old Eastern Countries. Progressively, with the admission of new co-operative members Anecoop increased the variety of products as well as the production and commercialisation calendar. Nowadays, we market not only citrus fruit (which represents 50% of our sales) but also fruit, vegetables and wine all year round. Graph 2.

**GRAPH 2.**  
**DEVELOPMENT PRODUCT GROUPS MARKETED (SEASON 03/04)**



As you can see in graphs 1 and 2, thanks to its wide range of products Anecoop is able to offer produce to consumers all year round, from September to August.

This fact implies having a professional, hard-working sales team the whole year.

**CHART 1**  
**PRODUCTS AND PERIODS OF COMMERCIALISATION (I)**

<b>Citrus Fruit and Fruit Marketed - Season 03/04 (Tn)</b>		
Satsumas	25.135	September to December
Clementines	94167	September to February
Other Mandarines	29.443	November to June
Oranges	155.449	October to August
Lemons	19.300	October to July
Grapefruit	3.557	October to June
Large Strawberries	11.505	January to June
Medlars	1.043	April to June
Stone Fruit	15.810	April to September
Pome Fruit	920	May to August
Watermelons	88.278	April to November
Melons	11.280	April to October
Grapes	3.159	June to December
Kakis	8.652	September to December
Other Fruit	2.219	April to June

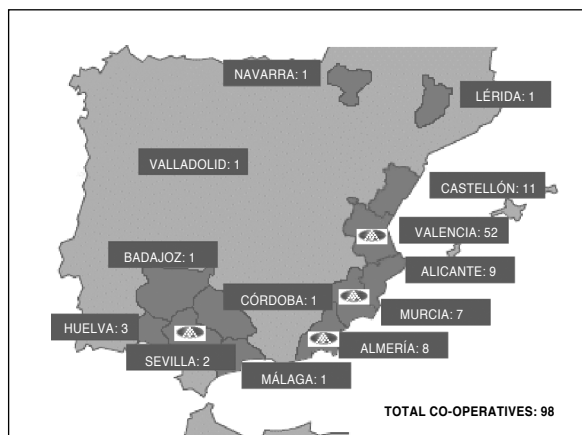
**CHART 2**  
**PRODUCTS AND PERIODS OF COMMERCIALISATION (II)**

<b>Vegetables Marketed - Season 03/04 (Tn)</b>		
Peppers	14.240	October to September
Tomatoes	26.714	October to September
Cucumbers	13.741	October to September
Cabbages	17.497	November to October
Courgette	9.729	October to September
Lettuces	8.769	October to September
Onions	1.024	October to September
Aubergine	3.139	October to September
Potatoes	1.514	February to July
Fennel	1.032	October to May
Celery	870	October to May
Artichokes	1.033	October to May
Asparagus	124	February to July
Other vegetables	5.674	October to September
<b>Wine Marketed - Season 03/04 (HL.)</b>		
Wines/Grape Juice	174.771	September to August

Most of the vegetables are grown in greenhouses in the Almeria area.

Since its foundation, Anecoop's idea was to overcome geographical limitations on quantity and diversity.

**GRAPH 3.**  
**GEOGRAPHICAL DISTRIBUTION OF MEMBER CO-OPERATIVES**



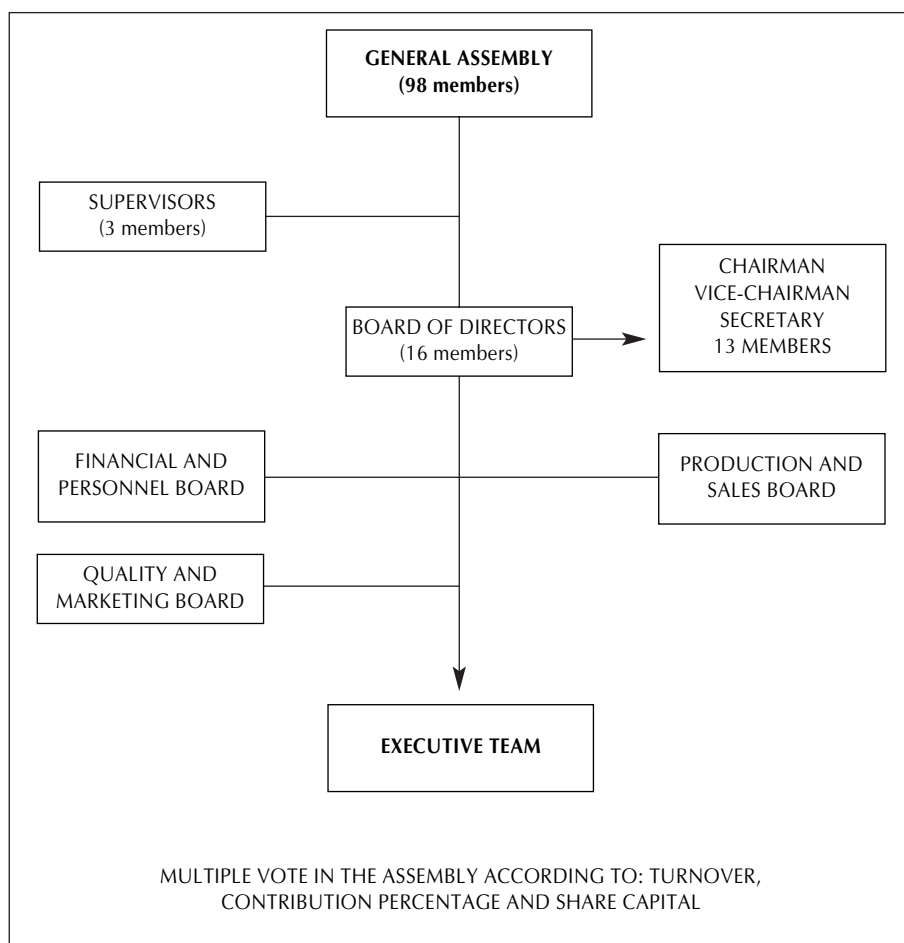
Anecoop is made up of nearly 100 First-Tier Agricultural Co-operatives all over Spain. Three of them (located in Badajoz, Navarra and Lerida) are also Second-Tier co-operatives that group more than 90 small First-Tier co-operatives.

Most of Anecoop's member co-operatives are located in the main farming areas around Spain, especially along the Mediterranean Coast. Graph 3.

Anecoop is made up of nearly 100 First-Tier Agricultural Co-operatives all over Spain. Three of them (located in Badajoz, Navarra and Lerida) are also Second-Tier co-operatives that group more than 90 small First-Tier co-operatives.

Most of Anecoop's member co-operatives are located in the main farming areas around Spain, especially along the Mediterranean Coast. Graph 3.

**GRAPH 4.**  
**GOVERNING BODIES: FLOWCHART**



Anecoop's governing bodies are the same as those of an ordinary co-operative: General Assembly, Board of Directors and Executive Team.

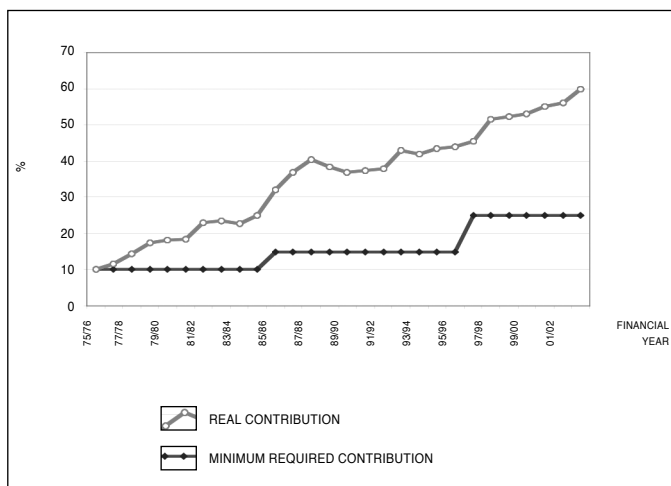
Each co-operative has one representative in the General Assembly. Also, they have a variable number of votes, according to the sale volume through Anecoop, percentage of their sales commercialised by Anecoop and Share Capital.

16 representatives from the member co-operatives make up the Board of Directors. These representatives are elected in the General Assembly. The Chairman, Vice-Chairman and Secretary are elected from among its members.

3 Supervisors also elected in the General Assembly are present in the Board of Directors, but not as full members, as they have no vote. Graph 4.

Co-operative members are required a minimum produce contribution (25%) to become and remain a member of Anecoop. Real contribution is much higher than the minimum required. Graph 5.

**GRAPH 5.**  
**PRODUCE CONTRIBUTION (SEASON 03/04)**



### 3. THE ANECOOP GROUP

Anecoop also provides additional services to its co-operatives: commercialisation, logistic services, processing industry, quality systems, development of new products and varieties, etc.

These services are provided to our clients and co-operatives through our supply networks and sales structure, made up of six companies in Spain and ten subsidiaries abroad. These sixteen companies, together with Anecoop, make up the Anecoop Group.

One of Anecoop's objectives from the very beginning was to set up its own sales network, to create the closest possible relationship between producers and distributors so as to ensure that the requirements, needs and wishes of distributors and consumers reach producers as quickly and as direct as possible and vice – versa.

We have ten subsidiaries situated in areas that are of importance to the international fresh fruit and vegetable market. They are located in France, United Kingdom, Holland, Germany, The Czech Republic and Poland.

We also have sales offices located at the heart of Spain's main farming areas: Valencia, (headquarters), Almería, Murcia and Sevilla.

Their function is, on the one hand, to keep direct contact with growers and on the other hand, to keep partners and producers in touch with Anecoop's production, supply and marketing strategies, as well as customer's needs and demands.

Six companies plus Anecoop make up the Anecoop Group in Spain:

**GRAPH 6.  
OUR STRUCTURE (I)**



Agriconsa manufactures processed products from fresh fruit and vegetable produce (mandarins, oranges, artichokes, pears and peppers). It also produces preserved vegetables and orange and mandarin juices.

Servicom, Despachos Fruteros and Citruship provide logistic services to our customers, co-operatives and general market.

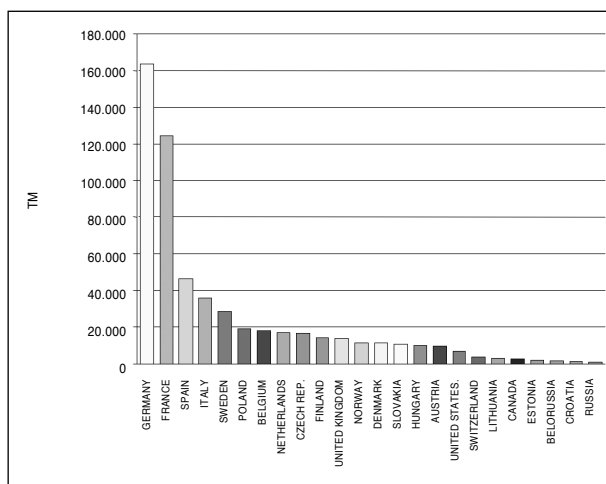
The aim of Producciones Nature, located in Andalucia, is to grow and take care of Anecoop's own produce.

Finally, through Fundación Anecoop we provide ongoing training both to our staff and to the member co-operatives, as well as doing research into and developing new products and varieties. One of the most emblematic and well-known cases is the case of the Bouquet Seedless Watermelon, which leads Europe's Seedless Watermelon market in sales, thus turning Anecoop into the biggest producer of this variety of Watermelon.

Anecoop markets produce in over forty countries, the E.U. being the main destination of our products. Within the E.U., Germany, France and Spain are our principal clients.

Until 1990, Anecoop was not allowed to commercialise produce in the domestic market, only co-operatives could deal with local buyers. This is one of the reasons why in Graph Nr. 7, Spain is in the third position in volume of produce commercialised.

**GRAPH 7.**  
**EXPORT COUNTRIES (CAMPAIGN 03 / 04)**



Due to the consolidation of large-scale distribution chains in Spain, it became more difficult for the co-operatives to meet their demands. As a consequence of this, Anecoop was authorised to sell in the domestic market.

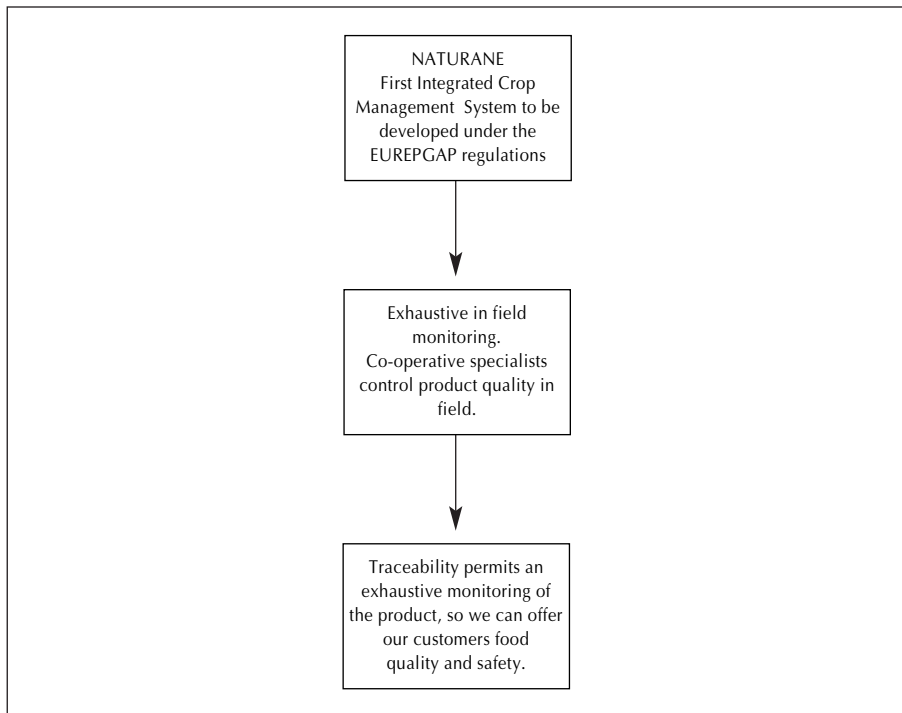


The key to Anecoop's relationship with its co-operatives is commercialisation and the development of quality systems adapted to their needs. These systems comply with the strictest quality standards established by the different acknowledged international organisations. According to its quality policy, Anecoop developed the *naturane* label in 1998.

*naturane*, (Graph nr. 8) is the label given to all the products (fruit and vegetables) treated with Anecoop's Integrated Crop Management System.

Integrated Crop Management is a farming system based on respect for nature and caring for the environment. Anecoop's quality and production departments have produced a field or work book (the *naturane* book) to collect information on each product. All the treatments to which the crop is subjected are recorded in the books.

**GRAPH 8.**  
**QUALITY IS OUR PRIDE**



*naturane* has 18 different protocols developed and standardised by EUREP GAP for several products. We are expecting 3 more approvals in the short term.

Some of Anecoop's hazards and challenges for the future are:

## **Hazards**

1. Development of Large Scale Distribution Chains. The number of large-scale distribution chains is decreasing and they are growing in size and power. At the same time, the number of suppliers is increasing, therefore we have more competition.
2. Pressure from substitute products manufactured by multinationals, especially dairies, pastry, etc.
3. Competition from third countries with cheaper labour. This, together with globalisation and market liberalisation will generate a different, more competitive market.
4. Company image and competition. The management system developed by the co-operatives is not as aggressive as our competitors' from the private sector.

## **Challenges**

1. To obtain a feasible dimension of productive structures. A major feature of Mediterranean Agriculture is "minifundismo", or the division of crop-producing land into small plots.
2. To increase company culture in order to improve management. We need to incorporate young professional staff in our co-operatives, placing special emphasis in our know-how.
3. To adapt and promote consumer products. We have to adequate our products to our customer's needs and requirements. Also, we should do more advertising and promotional campaigns. Regarding this, we collaborate arm in arm with the large-scale distribution chains in the development of relevant national and international marketing campaigns. Anecoop is not only a member, but also collaborates with other organisations such as Fundación Sabor y Salud, 5 al día, Intercitrus and the Kaki and Medlar D.O.'s. In the last three organisations we have participated in their generic product advertising campaigns of citrus fruit, Kaki and Medlar, respectively.
4. To improve the social and corporate image of the co-operatives. Anecoop has to strengthen the image of its member co-operatives, giving a social and at the same time business-like image.

## **4. THE BUSINESS GROUP**

One of the major decisions that came out of the Strategic Conference held in 2001, in which more than two thousand people from the different co-operatives

(Board of Directors and staff) as well as Anecoop's Board of Directors, Executive Team and staff took part, was the creation of the Business Group.

Anecoop realised that if it wanted to set its position in the different markets, it needed co-operatives with a larger structure and a standardised management system. It was difficult to integrate different co-operatives within the same area, so Anecoop thought of an intermediate solution: the creation of the Business Group.

This is not a definitive solution, but it will help us strengthen both the company and the co-operatives that integrate the Business Group, hoping that in the long term some of them will merge.

The Business Group is expected to become a unique operative structure, with diversity and social independence. Its members may preserve their social independence, and at the same time, build up a sole business entity together with Anecoop.

The Business Group was founded in October 2003, and it is integrated by 12 cooperatives: Agrícola San José (Alcácer, Valencia), Cooperativa Agrícola de Altea (Altea, Alicante), Coop. Agrícola del Marquesado de Llombay (Llombay, Valencia), Consorcio Cooperativo de L'Horta (Torrente, Valencia), Cheste Agraria (Cheste, Valencia), Ejidoluz (El Ejido, Almería), Fruitvall Consorcio Cooperativo (Llutxent, Valencia), Vinícola San Pedro Apóstol (Godella, Valencia) Agrícola San Isidro Labrador (Picassent, Valencia) Cooperativa Vitivinícola de La Pobla del Duc (Pobla del Duc, Valencia), Cooperativa Agrícola Valenciana La Constancia (Pobla de Vallbona, Valencia) and Anecoop itself as head of the Group.

The main goals of the Group are:

- Improve co-operative management
- Optimisation of any resources within our reach
- Search of synergies
- Improvement of final results
- Strengthening of our member co-operatives
- Company homogenisation

Anecoop works together with these twelve co-operatives in the development of different action plans to reach these goals.

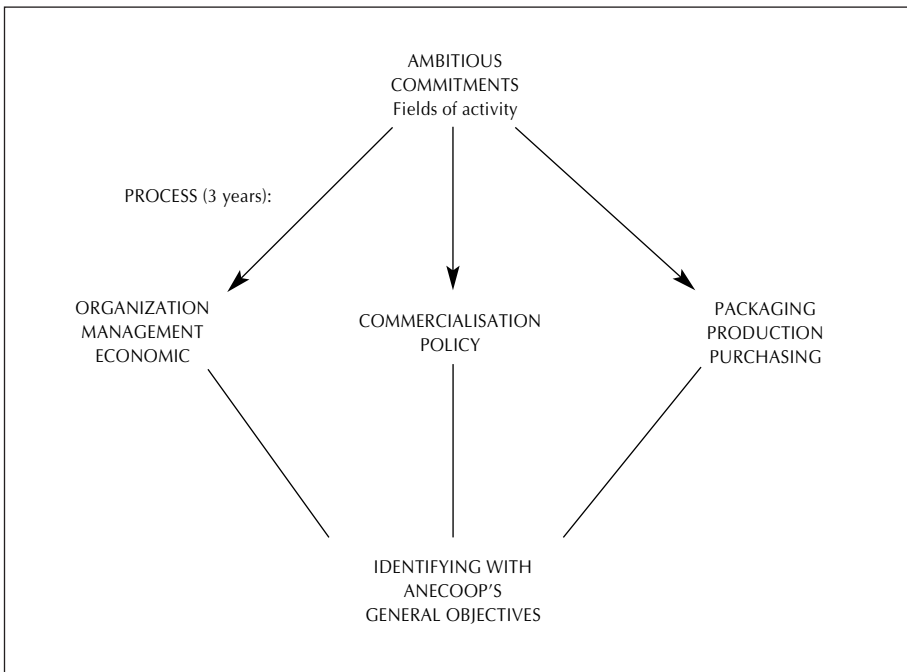
Minimum necessary requirements to become member of the B. G. are:

- Acceptance, through written agreement, of any basic objectives established by the Business Group
- To provide real information:
  - \* Organisational and management systems
  - \* Financial and economic variables
  - \* Cash management sheet
- Social and economic feasibility

- Suitable production and packaging structures
- Traceability and naturane or any other certification
- Integration of commercial policies
- Establishment of a homogeneous classification, packaging and payment (to co-operative members) system.
- Development of strategic projects in common regarding production, packaging, etc.

All Anecoop member co-operatives were invited to take part in the B. G., except for the wine co-operatives. Only 16 of the 103 co-operatives invited initiated the process to become members of the B.G. Of those 16 co-operatives, only 12 met all the necessary requirements. Anecoop hopes that the remaining 4 will soon comply with all the requirements to join the B.G..

**GRAPH 9.  
THE BUSINESS GROUP**



It has been established a 3-year period to reach the proposed aims. Initially, the Group has focused on three fields of activity:

- Organisation, management and economic
- Commercialisation policy and,
- Packing, production and purchasing

Any action taken must identity with Anecoop's general objectives and with the B. G. Internal Regulations Document.



**PART 1**  
**CREDIT UNIONS**





# THE WORLD PROFILE OF FINANCIAL SERVICES COOPERATIVES: AN APPROXIMATION BASED ON THE RELATIONSHIPS WITH THEIR REPRESENTATIVE BODIES

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## 1. INTRODUCTION

The increase of internationalization, the adoption of new communication and information technologies, and the processes of deregulation are provoking a higher level of complexity of financial institutions. Commercial banks receive much more attention as subject of research, especially from the financial perspective. Research centers, professional associations, central banks, government bodies and private companies produce numerous studies each year. These focus in different issues, among them: efficiency, performance, risks management, and governance commercial banking. At the academic level and in North America, the Financial Institutions Center at the University of Wharton, in the United States of America (USA), stands out. It produces a substantial number of studies, which are used by the Sloan Observatory whose role is to advise the government on political decisions related to financial issues. In Canada several initiatives exist: the National Research Program in Financial Services and Public Policy at the Schulich Business School; the Financial Services Management Chair at the University of Quebec in Montreal (UQAM); and the Banking Management Research Group at the University of Sherbrooke.

In Europe, there are numerous observatories in the financial services knowledge area. Among them: (a) the European Savings Observatory an initiative of the French Association of Financial Management in 1999; (b) the Corporate Credit Observatory and the Credit and Indebtedness Observatory funded by the Government of Belgium; (c) the Electronic Payment Systems Observatory of the European Central Bank; and (d) the Finance Observatory and its foundation, created by the Charles-Leopold Mayer Foundation in 1996 for the progress of man with the objective to promote within the financial sector the search for a common good.

This deployment is far from being reached by financial services cooperatives (FSC)<sup>1</sup> in spite of being a key entity within the banking systems in a multitude of countries. Their study does not matter much thus making it the “great unknown” not only for researchers specialized in financial studies, but also for the governmental organizations. This situation has important implications for the development of the cooperative movement, in general, and of financial services, in particular. Any type of promotion and/or development initiative, at the national and international level, has been based on a basic knowledge of the target agents. In the case of the FSC, the nonexistence of international multidisciplinary research and the quantitative and qualitative international databases implies that any attempt to acquire knowledge of the sector will only be partial. On the one hand, the studies and reports on the situation of the cooperative movement around the world offer a vision of the FSC based on some successful experiences, fundamentally in the industrialized countries. On the other hand, the quantification of the financial cooperative sector is carried out based on data originating from the world representative bodies of the FSC with the limitation that this implies when integrating only a part of the total existing entities. This lack of information, common to all sectors, has been considered by the United Nations as a key factor for improvement that will allow the creation of a framework to support the development of the cooperative movement (United Nations, 2001).

For this reason, the objective of this study is to show the existing knowledge of FSC at the world level through the analysis of research carried out in the last thirty years and the study of their representative bodies at the international level. In order to achieve this, in the first case, we have been checking different databases in the area of business administration and economic issues, the publications of university centers specialized in cooperatives, in general, and in financial services in particular, and the research results of the various organizations specialized in the financial sector. In the second case, we have analyzed the representative bodies of the FSC, four worldwide and five supranational, in terms of activities, geographical implementation and available data to try to build a profile of the sector.

We must highlight that this work is framed inside the research on the state of the art of the FSC around the world carried out by the Desjardins Center for Studies in Management of Financial Services Cooperatives at the HEC Montréal (Canada). In this sense, it is necessary to point out that the work is preliminary and not exclusive as the consequence of the methodology used. The results are limited by the databases and internet sources used and the information contained in them.

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1. In spite of the fact that FSC includes the entities of the insurance sector, in this study they are not considered..

## **2. FINANCIAL SERVICES COOPERATIVES KNOWLEDGE: AN APPROXIMATION THROUGH THE RESEARCH CARRIED OUT IN THE LAST THIRTY YEARS**

In the last thirty years, the international financial system suffered from an evolution that was difficult to anticipate. The research advanced in the same measure though not in a homogeneous way for all sector entities. In spite of the fact that the FSC are part of the banking sector in most of the countries of the Organization for Economic Co-operation and Development (OECD), awareness of them is minimal. In fact, a review of approximately five hundred scientific journals in the business and economic areas during the last thirty years shows that FSC related articles represent slightly over 10% of the total number of commercial banking publications, indicated by the data in Table I.

It is necessary to highlight that in spite of the dominance of commercial banking publications, their growth rate has been half that of the rate obtained for FSC. The rising interest of researchers as well as a greater scientific journal editorial openness could explain the fact that 60% of the published articles about FSC from 1975 to 2004 have been written in the last ten years.

With respect to the analyzed articles, we can highlight and comment on some aspects. In the first place, journals specialized in economic and financial issues capture the greatest number of articles followed, in reduced measure, by those focused on management and marketing. The *Revue d'Économie Financière*, the *Journal of Finance*, the *Journal of Banking and Finance*, the *Applied Economics* journal, and the *International Journal of Bank Marketing* account for 25% of the total FSC articles. We need to emphasize that in the case of the first two journals, special issues have contributed notably to the increase in knowledge of the financial cooperative sector.

**TABLE 1.**  
**FSC RESEARCH AROUND THE WORLD**

Breakdown of the articles published in scientific journals over time						
	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999	2000-2004
FSC Articles	13	22	15	17	42	67
Commercial banks articles	84	89	145	165	261	337
Total	97	111	160	182	303	404

**Breakdown of the FSC publications by types and regions**

	Africa	Asia	Caribbean	Europe	Latin America	North America	South Pacific
Books	0	1	0	28	28	93	0
Book chapters	3	3	0	15	12	4	2
Case studies	0	0	0	0	0	9	0
Conferences	0	0	0	6	7	0	0
Doctoral and master thesis	0	0	0	2	2	7	0
Journal articles	4	14	0	70	19	94	21
Working papers	7	5	0	8	15	13	0
Total	14	23	0	129	83	220	23

Source: Generated by authors.

In the second place, the geographical area as object of the FSC articles covers only eighteen countries. USA, Australia, Canada, Germany and United Kingdom account for almost 60% of the publications with a clear hegemony of the first; a consequence of, among other things, the availability for free of the complete financial data of all FSC.

In the third place, in relation with the topics studied, scale and scope economies are a perennial subject for the researchers. Their analysis can be carried out on individual basis on: a part of the sector (Kohers & Mullis, 1998), the FSC affiliated to a representative body (McKillop, Ferguson & Nesbitt, 1995), or the entities in a territory (Crapp, 1983; Murray & White, 1983); as well as on merged entities comparing the results before and after the integration (Ralston, Wright & Garden, 2001). From the business point of view, the financial aspects have the greatest interest, emphasizing the following: financial monitoring models (Desai, Crook & Overstreet; Tan & Dihadjo, 2001); financial performance (McKillop, Glass & Ferguson, 2002; Pille & Paradi, 2002; Westhey & Shaffer, 1999); and financial management (Emmons & Schmid, 2002; Ralston & Wright, 2003; Reichert & Rubens, 1994).

The decision making processes (Smith, 1984), the common bond effect on different aspects of the FSC organization (Bunt, Chiesa & Keating, 1989; Frame, Karels & McClatchey, 2003; Leggett & Strand, 2002), governance (Davis, 2001), and growth strategies (Pleshko & Souiden, 2003; Podding, Laudi & Varmaz, 2003) are the topics discussed. From a marketing point of view, service quality and its relationship to financial performance (Duncan & Elliott, 2002) and to employee satisfaction (Allred, 2001), as well as the comparison of service quality among different banking institutions, including FSC, represent the aspects on which research is conducted. Finally, employees' influence on customer-orientation (White & Kleiner, 2001), and the relationship among human resource practices, trust-in-management and organizational commitment (Whitener, 2001) are the topics dealt within human resources management.

But the knowledge of the state of FSC in research terms requires a wider analysis of the publications to provide us with more qualitative contributions and not only quantitative - focus of the articles obtained from the analysis of the international scientific journals reviewed. For this reason, we have carried out a review of various sources, namely: the bibliographical banks of various entities; studies from the university units specialized in cooperatives, in general, and in FSC, in particular; the available information from representative bodies; and some scientific journals specialized in cooperatives but not indexed in the databases used<sup>2</sup>.

In spite of the fact that the new analysis triples the number of countries with FSC data, strong imbalances continue to exist among the different regions as shown in Table I. The knowledge of the cooperative financial sector is nill in the Caribbean and quite weak in Africa, Asia and the South Pacific in comparison to the rest of the

2. ABI/Inform, EconLit, Emerald Intelligence, Erudit, JSTOR Business and Erudit.

regions. It is necessary to highlight that an important part of the African and Asian publications are produced by Development International Desjardins (DID) and by the World Council of Credit Unions (WOCCU). These two entities together with the Cooperative German Confederation (DGRV) contribute significantly to the increase in FSC knowledge in the Latin American environment.

On the other hand, in North America, specialized university centers stand out as strong supporters of the development of the FSC knowledge. In effect, the Chair of Caisses Populaires Acadiennes en Études Coopératives at the University of Moncton and the Institute for Cooperative Studies at the University of Victoria generate various publications, working papers, case studies, and books on Canadian FSC. In addition, the Filene Research Institute is the distributor and promoter of a considerable part of the research carried out in USA. This entity publishes the results of the research carried out by the Center for Credit Unions Research at the University of Wisconsin.

Taking it all into account, the information obtained is a minimal part of a puzzle. Furthermore, the lack of homogeneous knowledge about a part of the sector is a consequence of the scarcity of transversal studies. The works reviewed follow three trends. In the first place, we find that the research focused on measuring the financial performance of FSC in North America, Europe and Asia through Data Envelopment Analysis (DEA) (Fischer, 2002). In the second place, we come across the analysis carried out on the evolution of the FSC movements, based on a set of specific factors, in the USA, Great Britain, Ireland and New Zealand (Sibbald, Fergusson & McKillop, 2002). In third place, we consider the research comparing the specific legal framework, the structure, and the concentration of FSC in Latin America (Arzbach & Durán, 2003a and b, 2002 and 2001; Carella, Hernández & Lion Pi, 2003; Mateu Gordon, 2001) and Europe (Dalmaz, 2002; Di Salvo, 2002; Palomo Zurdo, 1995).

Finally, we need to highlight that in 1998 the first FSC international profile was published by the Desjardins Centre for Studies in Management of Financial Services Cooperatives, previously known as the Management Center of Cooperatives, at HEC Montréal. Based on the information of different organizations and on 45 questionnaires received, of a total of 350 sent out to FSC groups and representative bodies, it quantified the world sector on seven basic variables (members, clients, credit unions, deposit, loans, assets and reserves) and it described briefly 67 financial cooperative groups and/or national representative associations (Côté, Vézina & Tétrault, 1998). As can be seen from the data contained in Table II, there is a considerable difference in the dimension determined by the study and the data from the international representative bodies. Though the two sources do not take into account a multitude of FSC movements, the review of the base-entities used by the profile allows us to conclude that the discrepancy could be due to the duplication of data of some systems - considered both individually as well as a part of a representative organization - and to the inclusion of FSC auxiliary entities.

TABLE 2. THE FSC IN FIGURES

Continent	N. FSC	N. Members	Savings	Loans	Assets
Desjardins Centre for Studies in Management of Financial Services Cooperatives, 1996					
Africa	26.839	9.905.680	5.179.247.746	2.239.397.991	6.303.866.063
America	18.860	89.578.616	385.090.984.064	319.568.304.014	466.182.340.179
Asia	155.514	153.943.797	2.161.333.829.578	1.362.163.672.327	2.493.448.759.805
Europe	14.638	42.052.065	1.624.755.325	1.303.173.772	2.609.680.131
South Pacific	557	3.641.040	11.688.525.394	10.396.084.670	13.440.176.735
Total	216.408	299.121.198	2.564.917.342.107	1.695.665.632.774	2.981.984.822.913
WOCCU, 2000					
Africa	3.267	2.135.463	525.944.752	457.562.549	552.093.788
America	13.122	89.054.027	426.450.042.228	341.249.976.782	490.941.610.959
Asia	14.338	8.801.241	23.640.768.722	15.539.472.540	25.751.945.555
Europe	5.899	5.028.677	6.894.374.925	5.317.995.941	8.280.405.838
South Pacific	290	3.242.411	8.816.515.610	8.721.906.785	10.701.234.165
Total	36.916	108.261.819	466.327.646.237	371.286.914.597	536.227.290.305
World figures (WOCCU + EACB), 2000					
EACB	3.389	3.636.025	1.433.213.000.000	1.382.999.000.000	2.526.915.000.000
Total	40.305	111.897.844	1.899.540.646.237	1.754.285.914.597	3.063.142.290.305

Source: Generated by authors on Côté, Vézina & Tétrault (1998), WOCCU (2001) and statistics from EACB available in its website.

### **3. THE WORLD AND SUPRANATIONAL FINANCIAL SERVICES COOPERATIVES REPRESENTATIVE BODIES: A CONFIGURATION STUDY**

Representative bodies of financial services cooperatives exist to meet the needs of the base-entities in terms of advocacy and development. The relationship between both groups of organizations varies between countries and regions depending on the structure of the system, the dimensions of the sector, the legal framework, the membership system and the variety of services offered.

The affiliation of the FSC to representative bodies can be accomplished in cooperative or sector-based entities. In the first case, we found two: The International Confederation of Agricultural Credit (CICA), and the World Savings Banks Institute (WSBI). The CICA is constituted by the organizations that finance the agricultural sector – including: public banks, commercial banks, foundations and FSC. Members can also be organizations whose objective is the development or study of agricultural credit. Of the total number of entities affiliated to the CICA, 58% are FSC, it is necessary to point out that 38% come from Crédit Agricole and Crédit Mutuel in France. In the case of WSBI, it affiliates different types of saving entities, among these are the French saving banks converted to cooperative status in 1999 as a result of the new regulation (Moreau & Boukhorssa, 2002). The presence of the FSC is very small, only five entities of a total of 117 are affiliated. As a result of the lack of specialization of these two entities, and the fact that FSC are affiliated to other cooperative representative bodies, we are not considering them in this study.



**TABLE 3.**  
**THE MEMBERSHIP CHARACTERISTICS OF FSC REPRESENTATIVE BODIES**

Name	Geographical area	Membership typology	Full members	
			Profile	Conditions
Asian Confederation of Credit Unions (ACCU)	Asia	– Full – Associate – Supporting	Associations, federations and credit unions	2,000 individual members or 2% of country's population
Caribbean Confederation of Credit Unions (CCCCU)	Caribbean	– Full – Associate	National credit union associations	---
European Association of Co-operative Banks (EACB)	Europe	– Full	Cooperative banking groups	---
International Co-operative Banking Association (ICBA)	Worldwide	– Full	National and international cooperative bodies interested in banking issues	Affiliated to International Co-operative Alliance (ICA)
International Confederation of the Popular Banks (CIBP)	Worldwide	– Full	Banking institutions (coop and non coop)	Encourage the development of SME
International Raiffeisen Union (IRU)	Worldwide	– Full – Associate	National cooperative organizations	Based on Raiffeisen principles
Latin-American Confederation of Credit Unions (COLAC)	Latin America	– Full – Associate	National credit union associations	One full member per country
Unico Banking Group (UNICO)	Europe	– Full – Associate	Cooperative banks or banking units of the cooperative groups	---
World Council of Credit Unions (WOCCU)	Worldwide	– Full – Associate – Supporting	Regional and national credit union associations	---

Source: Generated by authors.

In the case of the FSC representative bodies of cooperative character, we detected nine with international character: four at the global and five at the supranational level as shown in Table III. The first aspect to analyze to obtain the world profile of FSC is the type of membership. The representative bodies have three types of members – although, depending on the entity different names are used: (a) Full members, national or regional representative bodies of FSC, national cooperative banks, and/or FSC; (b) Associate members, cooperative representative bodies, financial and non-financial, that want to support the development of FSC; and (c) Supporting members, FSC or individuals that want to participate in specific projects. As can be seen in

Table III, the full member option is the most widely used by the organizations. The combination full and associated members is used by the CCCU and COLAC, from the supranational perspective, and by IRU from the world perspective, although, in this last entity, the supporting members include the associate member concept. Finally, the combination full, associate, and supporting is used by WOCCU and ACCU. This member diversity - especially referring to associate and supporting members - encourages the inter-cooperation between the cooperative representative bodies of FSC and those entities and/or individuals that are linked or implicated in their development.

We would like to highlight the nature of the full members. From the perspective of the world organizations, WOCCU affiliates as full members national and regional FSC associations. The adhesion in the ICBA is open to any national and international cooperatives bodies interested in banking issues but it must be affiliated to International Cooperative Alliance (ICA). IRU integrates national cooperative organizations that are based on the Raiffeisen principles. The affiliation to the CIBP is free for all banking institutions, cooperative and non-cooperative, that encourage the development of the SME.

In the case of the supranational representative bodies, differences also exist. CCCU and COLAC only admit as full members the representative national bodies of FSC; in the case of COLAC, it is more restrictive affiliating only one full member per country. ACCU is more open because it admits associations, federations, as well as FSC but that they must have at least 2.000 individual members or to group 2% of the country's population. The European organizations only affiliate cooperative banking groups, EACB, or cooperative banks or banking units of a cooperative group, UNICO.

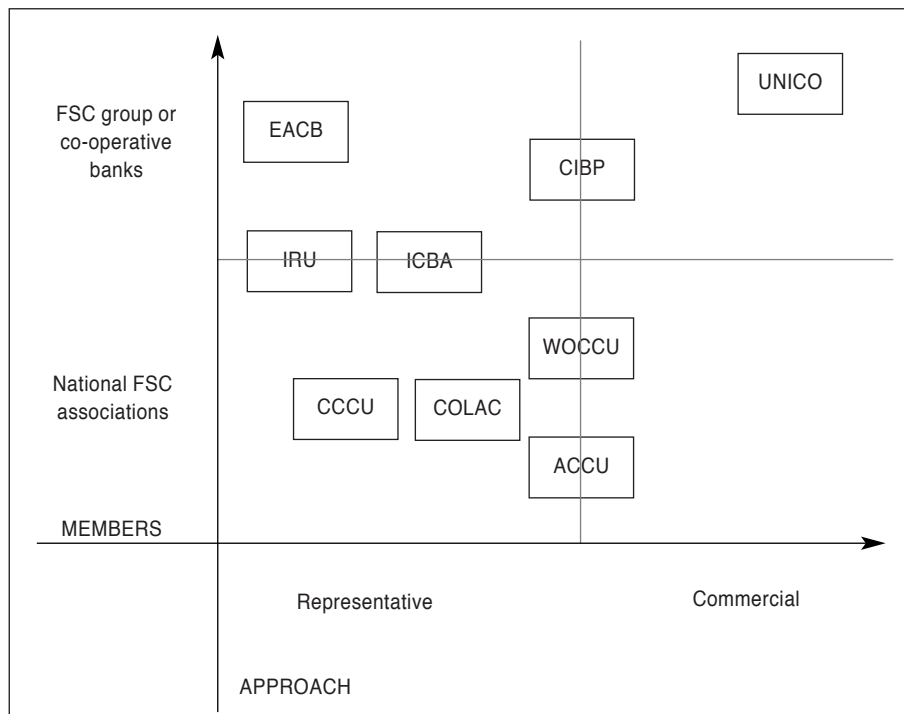
Excluding the institutional representation lobby, carried out by all of the national and supranational bodies, the variety of the rest of activities, captured in Table IV, gives us an idea of the needs of the affiliated FSC. The development of banking and financial products and services is only offered by CIBP and WOCCU, and adapted to the needs of the specific members: the commercial relationships of the SME, in the first case, and the financial profitability, the development of the FSC, and the remittances transfers, in the second case. These two organizations are also the only ones that carry out training and research activities. In the first case, it is achieved through seminars without a temporal continuity, while the research is carried out through working groups on products and financial services. In the case of WOCCU, the training is centered in two programs: National Credit Union Development Education Program, organised by the National Credit Union Foundation (NCUF), and Young Credit Union People Scholarship Program (WYCUP) in both cases aimed at members of FSC.

All representative bodies, except CIBP, have publications and information exchange activities. The seminar is the tool of choice for ICBA and IRU; additionally in the latter case, it generates internal newsletters and activity reports. On the other hand, WOCCU has a Leadership Institute as the forum of information exchange. From the publications point of view, this entity is more advanced, publishing technical guides,

working papers, monographs, books, and the magazine Credit Union World. In the case of ICBA and IRU their publications are the International Co-operative Banking Association Journal, published once per year, and more recently the ICBA Bulletin for the ICBA and the magazine IRU Courier, for the latter.

The supranational bodies are more advanced in the area of providing services for their members. ACCU, CCCU and COLAC offer their affiliates technical assistance on banking and financial issues. UNICO offers three types of special services: UniCash (International Cash Management), Unico Car Lease, and Unico Lease Network. Except for EACB, all the bodies have training programs, provided through foundations or institutes created by them. In addition, in the case of ACCU and CCCU, research activity is also carried out by their foundations or training institutes. ACCU has even created an institute specifically dedicated to this activity: the Asian leaders and managers institute for credit unions (ALMI). With respect to publications, COLAC is the only body with multiple publications, including the Magazine COLAC.

**GRAPHIC 1.**  
**THE CLASSIFICATION OF FSC REPRESENTATION BODIES**



Source: Generated by authors.

Taking into consideration only full members and the activities developed by each organization, we can categorize the different organizations as shown in Graphic I. In this way, we can determine that UNICO has the greater entrepreneurial perspective - perhaps due to the banking character of its members. At the opposite end, we can see IRU and ICBA with the most significant representative role.

The geographical presence of the world representative bodies depends on the reference territory, as shown in Table V. On the one hand, we find the two regions without supranational representative associations: Africa and the South Pacific. In the first case, one fifth of the countries do not have FSC national bodies. Of all the known national organizations, only half are affiliated to any world entity with ICBA being the one that has the greatest number of members - 43%. In contrast with the other regions, the number of entities with multiple affiliations to international organizations is reduced to only three: the Savings and Credit Cooperatives League of South Africa (SACCOL), the Kenya Union of Savings & Credit Cooperatives (KUSCCO), and the Popular Bank Group from Morocco. In the South Pacific region, the Australian and New Zealand entities are affiliated to WOCCU; Fiji and New Guinea do not have international representation.

TABLE 4. THE ACTIVITIES OF THE FSC REPRESENTATIVE BODIES

Org.	Products/services banking/ financial	Training	Research	Divulge/exchange of information	Publications
<b>WORLD BODIES</b>					
<b>CIBP</b>	<ul style="list-style-type: none"> <li>- Client Groupe International : commercial and banking accompaniment in the cross-border activities</li> <li>- Mutual funds: Euroaction emerging (2000) and Euroaction Smallmidcap (2003)</li> <li>- TIPA: international mass payment cross-border processing to SME</li> <li>- B.P. Invest Consult GmbH: accompany, support and advise the customers of the CIBP member banks in their projects abroad.</li> </ul>	International seminars: 1995, 1996, 1998 and 2003	Banking products and services research groups	---	---
<b>ICBA</b>	---	---	---	Seminars inside General Assembly of ICA	<ul style="list-style-type: none"> <li>- International Co-operative Banking Association Journal</li> <li>- ICBA Bulletin</li> </ul>
<b>IRU</b>	---	---	---	<ul style="list-style-type: none"> <li>- International seminars</li> <li>- Circular letters</li> <li>- Reports of activity</li> </ul>	<ul style="list-style-type: none"> <li>IRU Courier Journal, three times par year in four languages: English, French, Spanish and German</li> </ul>
<b>WOCCU</b>	<ul style="list-style-type: none"> <li>- Financial performance monitoring system (PEARLS)</li> <li>- Technical assistance programs on USAID : savings mobilization, rural finance, financial performance monitoring</li> <li>- Products and services development: International Remittance Network (IRnet)</li> </ul>	<ul style="list-style-type: none"> <li>- National Credit Union Development Education Program organized by National Credit Union Foundation</li> <li>- Young Credit Union People Scholarship Program (WYCUP)</li> </ul>	<ul style="list-style-type: none"> <li>- Financial performance monitoring</li> <li>- Rural finance</li> <li>- Remittances</li> <li>- Development credit unions</li> </ul>	<ul style="list-style-type: none"> <li>- WOCCU's Leadership Institute</li> </ul>	<ul style="list-style-type: none"> <li>- Credit Union World</li> <li>- Books</li> <li>- Monographs</li> <li>- Working paper</li> <li>- Technical Guides</li> </ul>

Org.	Products/services banking/ financial	Training	Research	Divulge/exchange of information	Publications
SUPRANATIONAL BODIES					
ACCU	Technical assistance in micro financial development and products	Asian Credit Unions Institute (ACUI): advance Training on CU Management, microfinance and Microenterprise Development, and training on CU Organization and Management	Research through the Asian Leaders/managers Institute for Credit Unions (ALMI)	- Electronic Forum - Asian Credit Union Forum	- Annual reports
CCCU	Technical assistance	Development Foundation of the CCCU	Cooperative development through the Development Foundation	Benchmarking	N/a
COLAC	Technical assistance: credit scoring, specialized credit unit, balanced score card, financial network and central bodies, risk management, monitoring and financial discipline	FECOLAC	Operations, financial, accounting, legal and risk management aspects	Documentation centers	- COLAC Journal - Annual reports - Documents - Books - Newsletters
EACB	---	---	---	---	Documents from others entities
UNICO	- UniCash: International Cash Management - Unico Car Lease - Unico Lease Network	Unico Banking Institute: corporate finance, English, international trade and banking issues	---	News from other institutions	---

Source: Developed by authors from website of each FSC representative bodies.

**TABLE 5.**  
**THE GEOGRAPHICAL PRESENCE OF THE FSC REPRESENTATIVE BODIES**

	Africa	America	Asia	Europe	South Pacific
Number of countries analyzed	38	43	24	30	4
Number of countries without affiliation to international representative bodies	19	8	9	10	2
Number of known national representative bodies	38	76	37	68	4
<b>National representative bodies affiliation (full members) in the FSC international representative bodies</b>					
CIBP	1	2	1	8	0
ICBA	10	17	1	18	0
IRU	2	7	18	29	0
WOCCU	4	13	0	4	2
ACCU	—	—	15	—	—
CCCU	—	17	—	—	—
COLAC	—	12	—	—	—
EACB	—	—	—	29	—
UNICO	—	—	—	6	—

Source: Generated by authors.

This situation is completely different for the rest of the large regions. In Asia, the affiliation of the FSC national bodies is almost complete. Those entities not affiliated to ACCU, are affiliated to IRU and, to a lesser degree to CIBP. Only the Sanasa Federation of Thrift and Credit Cooperatives (FTCCS) from Sri Lanka has a double affiliation to ACCU and IRU. On the other hand, Europe is the territory with the greatest number of multiple affiliations, both among the regional organizations themselves, Unico and EACB, as well as among the worldwide entities. IRU is the world association with the greatest number of affiliates, followed by EACB, CIBP, and WOCCU, this latter one with only four full members.

In America, FSC have national representative bodies in all countries. The integration of these in the various international bodies differs depending on the part of the area. The Caribbean region has the CCCU, with an exclusive affiliation of its members and without duplication in multiple international organizations. At the opposite end, we find the case of Latin American area where 60% of all the full members are affiliated to different international associations; an interesting aspect because COLAC is a member of IRU and WOCCU.

This implementation of the FSC representative bodies does not allow us to obtain sector quantification. From the global perspective only WOCCU has available basic information. The FSC dimensions offered by this entity includes both data from

national affiliates as well as representative entities from Asia, the Caribbean, and Latin America given their affiliation as associated members, and in which WOCCU does not have direct full members. In spite of this grouping, the data is incomplete due to the fact that a multitude of national movements are not taken into consideration, especially in Africa and Europe. In the latter, the EACB information allows us to complement the world data thus providing some new figures for the sector, as shown in Table II.

#### **4. WHAT IS THE WORLD PROFILE OF FINANCIAL SERVICES COOPERATIVES?**

Having completed the analysis, the answer to this question is that we do not have a complete international profile. On the one hand, the financial institutions' academic literature is heavily focused on commercial banks ignoring FSC, even though they are part of the banking system. A review of the known publications offers us a limited panorama on FSC reality for several reasons: (a) the research only covers 35% of a total of 139 countries analyzed; (b) the different temporal perspectives used; and (c) the difference in content and approach used. With relation to this last point, it must be emphasized that a concentration on different topics is produced, such as differentiation between cooperatives and commercial banks in terms of efficiency, banking practices, market position, adequacy of the cooperative nature in the financial market, description of the systems and structures of FSC, relationship between entity and member, demutualization and local development as evolutionary trends; and the efficiency of FSC entities. These topics were studied from a theoretical and an empirical perspective, and from a local as well as national point of view - and in some cases, supranational. At the root of this situation we find the absence of specific data bases with qualitative and quantitative content.

Nor does the analysis of the international representative bodies allow us to obtain a world profile of FSC. Heterogeneity is the common aspect for each of the analyzed representative bodies. The diversity of the FSC affiliated implies the integration and therefore the dissemination of confusing information about the sector formed by different agents: FSC systems, cooperative banks, non-financial cooperative entities, and individuals. In terms of activities, representation and information exchange are carried out by all organizations while training is the competency of supranational representative organizations through their specific units. The geographical presence of worldwide representative bodies, 65% of the countries analyzed, depends on their historical origins and their area of influence, as well as the implementation of its regional and/or national affiliates.

The alarming difference among attempts to determine the dimension of the sector in terms of basic variables (entities, members, deposits, loans, and assets) reveals the urgent need to undertake some kind of effective initiative to allow us to understand the FSC at a global level not only from a quantitative perspective, but also a qualitative



perspective within a context where growing competitiveness and internationalization demand rapid progress in their knowledge.

Finally, we must highlight that the absence of knowledge about FSC has a set of negative effects not only for the sector itself, but also for the agents that have a relationship to it: researchers, regulatory institutions, control units of financial entities, and government agencies. The lack of accurate information reduces considerably the interest, and therefore, the development possibilities of the sector which puts a distance between the cooperative movement, political power, and researchers. In this sense, it is necessary to point out the importance of the legal and institutional measures put in place by the public agents have in determining the role of FSC in the market. This is, among others, one of the key factors that could explain the different levels of evolution of the movement around the world; consequence, in some cases, of the failure to adapt existing legal and institutional framework, specific and banking, to FSC.

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# WHY DO AGRICULTURAL CREDIT COOPERATIVES MERGE? THE PORTUGUESE EXPERIENCE

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## **1. INTRODUCTION**

From their origins in the 16th century, the Portuguese Agricultural Credit Cooperatives (ACCs) have played a significant role in the national banking system. However, until 1976, the ACCs had a reduced role in Portuguese banking activity, with a share of only 1% of total deposits and credit. Moreover, with the democratization of the country, consequence of the carnation revolution in 25<sup>th</sup> April of 1974, ACCs were considered in the framework of a financing strategy for the development of the agricultural sector. So, during the 80's the ACCs activity showed a spectacular energy, expressed by annual growth rates for deposits and credits of, on average, 40 per cent and 32 per cent, respectively. Nowadays, they are the second largest national banking network with a standalone brand, with 400,000 members, almost 600 branches and over 1.5 million customers.

In general terms, the ACCs are governed by the Portuguese legislation on cooperatives and in their banking activity they are subject to regulations similar to those applied to the banking system as whole. Over the last decade, ACCs have experienced increased difficulties in attracting enough equity leading them to adopt a process of economic and financial restructuring. The most visible aspect of this process has been an intensive wave of mergers: between 1993 and 2002, 64 mergers involving 143 ACCs took place (almost 70% of the ones in 1993), with some ACCs being involved in more than one merger.

The main aims of the paper are (a) to analyze the economic motivations that have led the ACCs to merge, and (b) to evaluate the ex-post merger impact on their economic

performance<sup>1</sup>. To achieve this purpose, the remainder of this paper consists of three sections. Section 2 provides a brief description of the characteristics of the ACCs. Section 3 describes the model, sample and results. Section 4 offers some concluding remarks.

## 2. THE CHARACTERISTICS OF PORTUGUESE AGRICULTURAL CREDIT COOPERATIVES

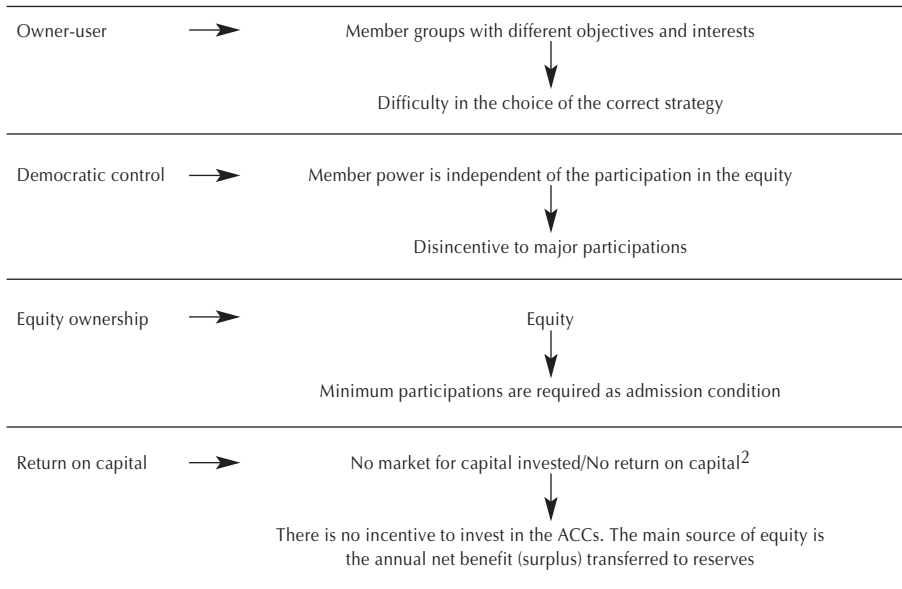
Like other cooperative organizations, Portuguese ACCs are organized following the traditional cooperative structure with open membership, democratic control and restricted residual claims. A recent work on the theory of cooperatives (Cook and Iliopoulos, 2001) suggests the existence of transaction costs generated by a set of vaguely defined property rights linked to the appliance of the traditional cooperative principles, namely free-rider, horizon, portfolio, control problems and influence costs.

The free rider problem occurs when individuals who did not fully invest in developing the gains may realize gains from co-operative action, whether those are new(er) members (internal free rider) or non-members (external free rider). The horizon problem results from residual claims that do not extend as far as the economic life of the underlying asset, which causes disincentives for co-operative members to invest in long term, higher-risk projects. Like the horizon problem, the portfolio problem stems from the restricted nature of the equity in the cooperative. As a result, the organization's investment portfolio may not reflect the interests or risk attitudes of any given investor/member, because members cannot withdraw and reallocate their investments. In sum, the property rights allocation within the traditional cooperative structure does not provide members with the necessary incentives to invest (Cook and Iliopoulos, 2001), causing negative consequences in the capital structure. Figure 1 is a description of the consequences/effects of the "cooperative nature" on the financial structure of ACCs.

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1. In contrast with the retail and investment banking sectors, where the motivations and economic consequences of mergers have been the object of enormous research (Focarelli et al., 1998), in the agricultural credit unions this research is scarce or almost null.

**FIGURE 1.**  
**COOPERATIVE PRINCIPLES AND FINANCIAL STRUCTURE OF ACCS**



Additionally, the activity of ACCs, both in deposits and credit, is essentially centered in the rural sector, suffering the risk of specialization. After Portugal joined the European Union, in 1986, the Portuguese agriculture witnessed economic erosion, negatively conditioning the profitability of the financial institutions more directly involved in agriculture ventures.

Like many other cooperatives, the ACCs increasingly face survival challenges related to financial issues linked with equity capital. During the nineties of the last century the solution adopted by them to overcome this constraint<sup>3</sup> was based in an intense process of mergers, supported by specific legislation for this purpose. In the next section the merging activity of Portuguese ACCs is modeled.

2. Portuguese law requires the net benefits to be transferred into reserves, with no return on the invested equity capital, which constitutes a disincentive to invest in the ACC, therefore originating that the participation on the equity has as exclusively aim the benefit of the services, i.e., mainly credit, of the organization.

3. An alternative solution to this problem is the creation of "category B shares" with a limited annual remuneration and a no active power in the governance of the organization (Tremblay, 2001).

### 3. MODEL, SAMPLE AND RESULTS

#### 3.1. Model

The empirical literature suggests that bank mergers and acquisitions are a mean for banks to achieve productive efficiency, to benefit from new business opportunities and for managers to value their utility function. However, in the long term, the driving force is to boost X-efficiency. Nevertheless, the studies are not always conclusive, especially when dealing with cost efficiency improvements (Akhavain et al., 1997; Berger et al, 1999, 2000; Berger and Humphrey, 1997; Dermine, 1999; Pilloff and Santomero, 1998). Improvements in performance are expected to occur only in mergers between banks of the same size (Vennet, 1996); efficiency gains are also found in mergers between small banks operating in the same markets (Resti, 1997), thus confirming that economies of scale are realistic only at the local level and for small size organisations.

The need for merger is felt more intensely by ACCs than in the rest of the banking system given the restrictions to organic growth<sup>4</sup> and the lack of funding (equity). Thus, ACCs have difficulties in increasing their scale of production, even if scale economies are present, consequently resulting in high levels of productive inefficiency, caused by an excess of capacity that compromises their survival. As the main source of equity is the net benefit (surplus), which is totally transferred to the reserves, the leverage problem is self-sustained.

To better understand the inherent factors leading to mergers, a questionnaire<sup>5</sup> was sent to the merged ACCs. This questionnaire allowed us to realize that size is a fundamental issue. The small ACCs suffer growth difficulties that prevented them to reach a minimum efficient size, that would allow them, for example, to support technology investments and to recruit qualified staff. On the other hand, the larger ACCs face several difficulties in the areas of operational costs and risk credit management. Moreover, ACCs have not been able to meet the requirements of the Bank of Portugal<sup>6</sup>, especially the solvency ratio, driving the ACCs that face recurrent problems in this area to search for a partner that could provide a solution to their difficulties.

With these considerations in mind, we try to capture the motivations for a merger, using a model that includes the following explicative variables<sup>7</sup>:

- The size ( $X_1$ ), measured by the total assets of the ACC.

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4. The activity of each ACC is restricted to the county (*concelho*) where is located, i.e., the ACCs are regional organizations and their product markets are limited.

5. This questionnaire, via normal mail, was directed to the ACC managers. The rate of response was 35%. For more details see Cabo (2003).

6. Portuguese central bank, that regulates the banking activity in Portugal.

7. Which values are quantified in the financial statements, or annual reports.



- The management of the credit risk reflected by the variables: bad loans ( $X_2$ ), measured by bad loans as percentage of gross credit; deposits to credit ratio ( $X_3$ ), quantified by the total deposits converted into credit granted; and provisions to credit ratio ( $X_4$ ), given by the relation between total provisions and credit granted<sup>8</sup>.
- To catch the possible existence of scale economies and to cut off operational costs, the variables labor costs ( $X_5$ ) and other administrative costs ( $X_6$ ), both as a function of total assets.
- As profitability measures the financial margin ( $X_7$ )<sup>9</sup>, as a function of total assets and return on assets<sup>10</sup> ( $X_8$ ) measured after taxes.
- Finally solvency ( $X_9$ ), measured by the ratio equity to total liabilities, trying to capture the aim of ACCs to fulfill the Bank of Portugal requirements.

Hence, we estimate a multinomial logit of the following form in which we characterize the incorporating, incorporated and integrated ACCs:

$$\text{Prob}(Y_i = 0, 1, 2, 3) = F(X_1, X_2, X_3, X_4, X_5, X_6, X_7, X_8, X_9) \quad (1)$$

The multinomial logit is used when the dependent variable takes on more than two discrete outcomes. In this case it assumes values of 0, 1, 2 or 3 if the ACC decides not to merge, to actively instigate a merger (incorporating), to be a merger target (incorporated), or to merge on a relatively equal basis by mutual accord (integration). The value of each event in the  $t$  period will be determined according to the behavior of the ACC in the  $t+1$  period.

Additionally, the variable 'year', an annual trend to track structural changes, such as technological progress, is incorporated in the model. Multiple equations are estimated jointly in order to make efficient use of the information available (Greene, 2000), and the coefficients for each possible outcome are to be interpreted with respect to a reference group, in our case ACCs that were not involved in any deal in any particular year (value 0 of the dependent variable).

To evaluate the consequences of a merger operation on ACC performance, we used a linear regression relating the ACC performance and the merger operations, creating three dummy variables (Merge0, Merge1, and Merge2) to reflect the time gap between the actual moment and the merger moment.

8. The most correct measure of this ratio would be, without a doubt, expressed in relation to a bad loan or to the gross credit, however, omissions verified in some observations in bad loan data disabled their use - in the years 1995 and 1997 and for about 25 ACCs, it only had bad loan value in percentage. The use of the credit granted value is justified by the high correlation between this ratio and the one presented by gross credit (> 92%), in the cases there it was possible to calculate both.

9. The financial margin reflects the remuneration of the financial intermediation function.

10. The non-inclusion of return on equity is justified by the existence of ACCs with negative equity. Moreover, the cooperatives' goal is to not remunerate the capital invested by the members.

The variable Merge0 assumes the value of 1 in the year of merger, while the variable Merge1 assumes the value of 1 in the first 2 years after the merger and the variable Merge2 will take the value of 1 in the following years (year  $\geq 3$  post merger). The variable Merge0 should measure one-off charges taken at the moment of the transaction; the variable Merge1 measures the short term adjustments made by ACCs post transaction, as restructuring. Finally, the variable Merge2 shows the medium-long term effects of mergers.

As indicators of performance ( $Y_{i,t}$ ) we used the exogenous variables in model (1), in order to check the consistency of the results with the motivations.

$$Y_{i,t} = \alpha_0 + \alpha_1 \text{ Merge0} + \alpha_2 \text{ Merge1} + \alpha_3 \text{ Merge2} + \kappa_1 \text{ Yeart} + \varepsilon_{i,t} \quad (2)$$

Since our goal is to analyze, by contra pointing, the situation of not to merge, i. e., to compare the ex-post merger results with those if this situation had not occurred, we computed a *pro forma* balance sheet, by consolidating the 1995-2001 balance sheets and considered them as one ACC before merging.

### 3.2. Sample

The analysis addresses the 1995-2001 period. Data refers to the end of the year and are deflected at 1995 prices. The balance sheet data was collected from the ACCs annual reports and information on the number and type of mergers from “Diário da República”<sup>11</sup>. We excluded from the sample data 3 ACCs that failed in the years 1999 and 2000, plus 26 ACCs in 1998, because of data missing from their annual financial reports.

At the end of this process we had a pool of 1,043 observations from 7 years of unbalanced allocation: a) 942 observations corresponding to ACCs not involved in any kind of merger; b) 37 corresponding to ACCs participating actively in a merger as incorporator; c) 42 as incorporated; and d) 22 ACCs participating in a merger by integration. Summary statistics for our sample are reported in Table 1, where ACCs behavior is presented according to the role they took in each type of deal.

On average, over the 1995-2001 period, the ACCs of the sample that were not involved in any merger had 33.747 million euros of total assets; bad loans were approximately 11.28 per cent of the total loans; return on assets, 1.05% and solvency, 6.64%. The financial margin was 3.88% of the total assets and labor and administrative costs were 1.33 % and 1.95% of the total assets, respectively.

Incorporating ACCs held, on average, 47.684 million euros of total assets; bad loans of 9.91% of the total loans; return on assets of 1.60% and solvency of 4.61%. Labor and other administrative costs were 1.23% and 1.94 % of the total assets

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11. Official legislative journal of the Portuguese government.

respectively. Incorporated ACCs had different characteristics: they are small (12.237 million euros) with many bad loans (21.29% of the total loans); negative return on assets (-2.02%) and solvency (-5.54%); and high labor and administrative costs (1.60 % and 2.42 % of the total assets).

Finally, the ACCs participating in mergers by integration held, on average, 17.139 million euros of total assets; bad loans of 25.78 per cent of total loans; negative return on assets (-4.32 per cent) and solvency (-8.18 per cent). Labor and administrative costs were 1.59 % and 1.48 % of the total assets.

**TABLE 1.**  
**SUMMARY STATISTICS: THE ACCS SAMPLE**

**EVENT 0**

	# Observations	Average	Median	Standard Deviation	Max	Min
Total assets (millions of euros)	942	33.747	23.772	34.346	244.639	847
Bad loans	942	0.1128	0.0905	0.0868	0.7046	0.0000
Deposits/Credit granted	942	0.5326	0.5270	0.1601	1.0271	0.1201
Provisions/Credit	942	0.1055	0.0738	0.1208	1.5138	0.0106
Financial margin	942	0.0388	0.0379	0.0209	0.5402	-0.0791
Labor costs	942	0.0133	0.0123	0.0089	0.2173	0.0034
Other administrative costs	942	0.0195	0.0191	0.0169	0.4128	0.0025
Return on assets	942	0.0105	0.0121	0.0234	0.1651	-0.2332
Solvency	942	0.0664	0.0741	0.1018	1.0831	-0.4423

**EVENT 1**

	# Observations	Average	Median	Standard Deviation	Max	Min
Total assets (millions of euros)	37	47.684	31.441	49.535	274.745	6.168
Bad loans	37	0.0991	0.0709	0.0816	0.3746	0.0134
Deposits/Credit granted	37	0.5351	0.5621	0.1337	0.8030	0.1840
Provisions/Credit	37	0.1069	0.0649	0.1100	0.5709	0.0140
Financial margin	37	0.0352	0.0373	0.0106	0.0530	0.0011
Labor costs	37	0.0123	0.0112	0.0034	0.0206	0.0049
Other administrative costs	37	0.0194	0.0200	0.0068	0.0363	0.0033
Return on assets	37	0.0160	0.0155	0.0154	0.0783	-0.0180
Solvency	37	0.0461	0.0620	0.1047	0.2171	-0.3860

## EVENT 2

	# Observations	Average	Median	Standard Deviation	Max	Min
Total assets (millions of euros)	42	12.237	7.837	11.926	69.647	3.085
Bad loans	42	0.2129	0.1765	0.1536	0.7254	0.0120
Deposits/Credit granted	42	0.4910	0.4939	0.1773	0.9125	0.1588
Provisions/Credit	42	0.2545	0.1600	0.3358	1.9380	0.0129
Financial margin	42	0.0318	0.0326	0.0221	0.0675	-0.0674
Labor costs	42	0.0160	0.0151	0.0056	0.0343	0.0083
Other administrative costs	42	0.0242	0.0236	0.0096	0.0670	0.0082
Return on assets	42	-0.0202	0.0031	0.0623	0.0733	-0.2387
Solvency	42	-0.0554	-0.0388	0.1298	0.0980	-0.4173

## EVENT 3

	# Observations	Average	Median	Standard Deviation	Max	Min
Total assets (millions of euros)	22	17.139	10.183	22.611	111.290	1.964
Bad loans	22	0.2578	0.2448	0.1577	0.5508	0.0223
Deposits/Credit granted	22	0.4126	0.3712	0.1450	0.6880	0.1197
Provisions/Credit	22	0.2710	0.1749	0.3062	1.1212	0.0211
Financial margin	22	0.0216	0.0297	0.0256	0.0669	-0.0225
Labor costs	22	0.0159	0.0158	0.0039	0.0221	0.0075
Other administrative costs	22	0.0148	0.0110	0.0091	0.0331	0.0044
Return on assets	22	-0.0432	-0.0134	0.0840	0.0295	-0.3070
Solvency	22	-0.0818	-0.0296	0.1561	0.1218	-0.3944

### 3.3. Results

Table 2 reports the results of model (1) estimation. For each event, the coefficients reported in the table measure the impact of each variable on the probability of each event with respect to the baseline case (no mergers in the following year): they are to be interpreted as affecting the odds ratio.

**TABLE 2.**  
**DETERMINANTS OF THE ACCS MERGER DECISION**

Variables	ACC Incorporator (Y=1)	ACC Incorporated (Y=2)	ACC Merged (Y=3)
Constant	-2.5604 (0.9195)	-3.6457 * (1.0396) *	2.1924 (1.7872)
Total Assets (X <sub>1</sub> )	0.0077 (0.0040) ***	- 0.0993 * (0.0213) *	-0.0238 (0.0167)
Bad Loans (X <sub>2</sub> )	-8.1558 (4.3908) ***	9.6034 (2.9061) *	4.6144 (3.4810)
Deposits/ Credit (X <sub>3</sub> )	0.5557 (1.2656)	0.5949 (1.3700)	-1.8768 (2.1949)
Provisions/Credit (X <sub>4</sub> )	4.7387 (2.7006) ***	-2.9963 (1.7264) ***	-3.9904 (2.1351) ***
Labor Costs (X <sub>5</sub> )	-76.0730 (66.1826)	-15.4622 (46.5476)	-133.9884 (67.4391) **
Administrative Costs (X <sub>6</sub> )	80.3960 (37.5753) **	44.6626 (26.1352) ***	117.2172 (43.9486) *
Financial Margin (X <sub>7</sub> )	-23.4418 (16.3589)	-24.5452 (13.3467) ***	4.2596 (17.2221)
Return on Assets (X <sub>8</sub> )	10.6687 (8.6687)	-5.0052 (5.5497)	-19.4975 (7.5072) *
Solvency (X <sub>9</sub> )	2.6186 (2.3871)	-1.8103 (1.0055) ***	-4.6988 (2.2501) **
Year (X <sub>10</sub> )	-0.2512 (0.1274) **	0.3167 (0.1196) *	-2.7875 (0.8436) *
Chi-squared (degrees of freedom)		202.98 (30)	
Significance level		0.000	

1. Standard deviation in parenthesis

2. \*, \*\*, \*\*\*: Significance level of 1%, 5% and 10% respectively

Table 3 contains a summary of the signal, expected and observed, and significance associated to the parameters of the model.

**TABLE 3.**  
**SIGNAL AND SIGNIFICANCE OF THE PARAMETERS OF THE MULTINOMIAL LOGIT MODEL**

	Incorporating		Incorporated		Integration	
	Expected	Observed	Expected	Observed	Expected	Observed
Size ( $X_1$ )	+	+	-	-	-	(1)
Bad loans ( $X_2$ )	-	-	+	+	+	(1)
Credit/deposits ( $X_3$ )	+/-	(1)	+/-	(1)	+/-	(1)
Provisions/Credit ( $X_4$ )	+	+	-	-	-	-
Labor costs ( $X_5$ )	+/-	(1)	+/-	(1)	+/-	-
Administrative costs ( $X_6$ )	+/-	+	+	+	+	+
Financial margin ( $X_7$ )	+/-	(1)	-	-	-	(1)
Return on assets ( $X_8$ )	+/-	(1)	-	(1)	-	-
Solvency ( $X_9$ )	+	(1)	-	-	-	-

1. - - - Statistically not significant

The size ( $X_1$ ) affects positively the probability of being an incorporator, while impacting negatively on the probability of being incorporated, as expected. The difficulties of growth which the small ACCs face make them attractive targets for incorporation into a bigger ACC and thus, presumably, more capable.

In credit management area ( $X_2$ ,  $X_3$  and  $X_4$ ) we can see that mergers seek efficiency gains through the dissemination of incorporator's superior capacity in credit management throughout the organization. The bad loans ratio affects negatively the probability of an ACC being an incorporator and positively the probability of being incorporated. The provisions to credit ratio influences positively the probability of an ACC being incorporator and negatively the probability of it being incorporated. Thus, this confirms the hypothesis that an incorporator ACC holds a better credit provision and that the merger extends that practice to the incorporated ACC. The variable credit to deposits ratio does not influence the probability of an ACC participating in any kind of merger operation<sup>12</sup>.

Regarding the operational costs, labor costs ( $X_5$ ) do not exercise any influence over the probability of an ACC being either an incorporator or incorporated, indicating, however, that they affect negatively the probability of an ACC participating in integration. This result is in harmony with the merger purpose hypothesis of internal restructuring and the resulting viability of specialized departments and investment in

12. Considering the ambiguity of the strategies used by the ACCs managers in this field, this non-influence, up to certain point, was expected.

qualified labor. On the other hand, the variable administrative costs exercise a positive influence over the probability of an ACC becoming an incorporator, incorporated or integrated. The purpose of cost cut-offs (at this level) is valid for all partners involved.

Concerning profitability, the variable financial margin ( $X_7$ ), as expected, affects negatively the probability that an ACC will be incorporated. The evolution of the financial margin experienced in the agricultural credit and bank sector in general, in recent years, as witness a decreasing rate, partially due to a decline of interest rates, a break of spreads and a credit seek contraction. Thus, difficulties are especially felt by ACCs with larger deficiencies in the credit management area.

Relative to return on assets ( $X_8$ ), do not influence the probability of an ACC to participate in incorporations; however, this proved to affect negatively the probability of an ACC being involved in an incorporation. In this way, the hypothesis of merger to explore profit inefficiencies through the transfer of higher management capabilities of an ACC incorporator to the incorporated, as reported by Focarelli et al. (1998) for the Italian banks, was not confirmed.

Finally, and as expected, since a significant part of the mergers was driven by the needs to accomplish Bank of Portugal requirements, the solvency ( $X_9$ ) influenced, in a negative way the probability of an ACC being incorporated or participating in a merger by integration.

Once having identified the factors inherent in an ACC merger, it is important to evaluate their results and analyze their effects on the performance of the ACCs involved. Table 4 reports the outcome of the model (2) estimation.

**TABLE 4 .**  
**EX-POST MERGER IMPACT ON THE ACCS PERFORMANCE**

Xs / Ys	Constant	Merge 0 (year 0)	Merge 1 (year 1 and 2)	Merge 2 (year ≥ 3)	Year (Prob)	F Statistic	R <sup>2</sup>
Total Assets	26.8958 * (2.8868)	21.6604 * (5.2438)	20.6360 * (4.0540)	25.5200 * (4.1597)	1.7247 * (0.6596)	23.38 (0.000)	0.0887
Bad Loans	0.1563 * (0.0059)	0.0354 * (0.0110)	0.0225 *** (0.0086)	0.0095 (0.0088)	-0.0127 * (0.0014)	33.46 (0.000)	0.1230
Deposits/ Credit	0.4267 * (0.0121)	-0.0196 (0.0224)	-0.0381 ** (0.0173)	-0.0172 (0.0178)	0.0281 * (0.0028)	35.89 (0.000)	0.1300
Provisions/ Credit	0.1476 * (0.0164)	0.0318 (0.0227)	0.0360 (0.0180)	0.0273 (0.0185)	-0.0100 * (0.0037)	6.02 (0.000)	0.0245
Labor Costs	0.0139 * (0.0003)	0.0004 (0.0006)	0.0010 ** (0.0004)	0.0016 * (0.0005)	-0.0004 * (0.0001)	12.02 (0.000)	0.0477
Administra-tive Costs	0.0073 * (0.0002)	0.0006 (0.0005)	0.0006 *** (0.0004)	0.0001 (0.0004)	0.0002 * (0.0001)	6.29 (0.000)	0.0256
Financial Margin	0.1212 * (0.0106)	-0.0139 ** (0.0072)	-0.0071 (0.0058)	-0.0039 (0.0039)	-0.0154 * (0.0020)	145.47 (0.000)	0.3776
Return on Assets	0.0067 * (0.0016)	-0.0004 (0.0030)	-0.0029 (0.0023)	-0.0035 (0.0023)	0.0011 * (0.0004)	3.58 (0.006)	0.0147
Solvency	0.0123 (0.0082)	-0.0681 * (0.0138)	-0.0799 * (0.0107)	-0.0668 * (0.0110)	0.0165 * (0.0019)	54.49 (0.000)	0.1849

1. Standard deviation in parenthesis;

2. \*, \*\*, \*\*\*: Significance level of 1%, 5% e 10% respectively.

The results show that ACCs involved in the merging activity present a positive variation of size immediately after the merger occurs, in line with the purpose to overcoming the growth difficulties of smaller size ACCs. However, these results do not provide any evidence that might confirm the aim of cost reduction, from a more efficient use of production factors, namely by obtaining efficiency gains in the credit management area. The merged ACCs suffered a positive variation in relation to bad loans starting from the moment of the merger and maintaining in the following two years.

The deposit to credit ratio experienced a negative variation in the first two years after the merger. This result can be explained by the reduced knowledge of customers' portfolio on the part of the ex-post merger management team or even the existence of diseconomies at the management level, motivated by an increase in scale operations. This raises the hypothesis that mergers create an excessive size, which disables or obstructs the knowledge and weakens the relationship between ACCs and the local community, a competitive advantage that is fundamental to ACCs. In the provision ratio no significant differences between merged ACCs and the remaining ACCs were found in the period subsequent to the merger.



Regarding the evolution of the operation costs we have no evidence of cost cut-offs. Administrative costs confirm the expectations of the merge, that is, they only vary positively in the first two years after the merger, probably, justified by the merger itself. Moreover the merged ACCs felt a positive variation in labor costs starting from the first year after the merger, which denotes a deficiency in the employment of this factor. Labor market rigidity and ACCs policy of “no firings” can justify this result; however, the continuing growth in the number of workers, after the merger operation, shows that other steps should be taken to rationalize this factor.

The evolution of the profitability is incipient. In the return on assets no significant differences between merged ACCs and non-merged ACCs were verified. The financial margin experienced a negative variation in the merger year zero, which can be explained to some extent by the negative evolution verified in the variable bad loans in that year.

The effects on the solvency remains negative in the period after a merger, which seems to be inconsistent with the assumption that the merger was based on the aim of meeting Bank of Portugal requirements.

## 4. CONCLUSIONS

Our analysis led to the conclusion that compared to ACCs that did not engage in a merger process, the incorporating ACCs were larger and held a better credit management, having a smaller bad loans ratio and better credit provision. They were, however, struggling with problems at the administrative costs level, expressed by a heavier cost structure. Incorporated ACCs were smaller, faced difficulties in reaching a minimum efficient scale and held a weaker credit management. Moreover, they have a heavier administrative costs structure, like incorporator ACCs, and leverage problems (smaller financial margin and solvency ratio). The integrated ACCs held a heavy administrative costs structure but in the other operational costs component – labor costs – they maintained a lighter structure. They were also struggling with solvency and profitability issues.

Regarding the mergers impact on the ACCs performance, they were unable to exploit, in general terms, the resultant merger benefits as intended. We find no evidence of credit management efficiency gains or of a more efficient use of productive factors through the exploitation of eventual scale economies. This outcome is not unexpected, considering that ACCs are, more and more, inserted in competitive markets and therefore their ability to act is limited to the cost side, and as mentioned in 3.1, bank M&A empirical evidence is not conclusive regarding ex-post merger efficiency-X cost improvements.

ACCs are complex units as far as decision-making process and control are concerned, where members play a crucial role, and not only with respect to equity. Assuming that various structural changes have impact on the intensity of application of cooperative principles and contribute to its identity crisis, “it should be noted that

in a world in which individuals are defined by their interests, it is not obvious that cooperative distinction can be recognized and appreciated. The size of local cooperatives also raises the issue of collective action, to the extent it is necessary to take into account the quasi-public nature. To this we must add that the specific mission of cooperative banks in western countries is no longer defined by the situations of abuse or absence of services, which characterized the initial conditions. Members now experience their relationship with their cooperative in a highly evolved competition environment offering choices as much at the individual levels as at the level of collective action" (Trembley, 2001: 10). In this context, two issues are of particular importance for future research: (1) the members behavior must be better understood, in a dynamic of which can range from a strengthening of the cooperative identity to a complete loss of identity in the event of demutualization; and (2) better perception of the ACCs internal bargaining process among stakeholders (members and managers) in an external environment characterized by the intensity of competitive forces, banking deregulation, internationalization and solvency of demand.

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# THE ROLE OF CREDIT COOPERATIVES IN REGIONAL DEVELOPMENT. A STUDY FOR THE SPANISH REGIONS

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## 1. INTRODUCTION

The cooperative character endows to credit cooperatives of a wider role in regional development than to the rest of credit and deposit institutions. This role acts, at least, by three different ways: facilitating the creation of physical capital, of human capital and of social capital.

First, as they are credit institutions with a strong regional introduction, they avoid the drains of financial resources toward other regions. In this way, they favour the financing of local activity and they participate, therefore, in the creation of physical capital. On the other hand, they intervene in regional development facilitating the improvement of the productive factors, as labour, by the formation, due to the application of the Principle of Formation and Cooperative Promotion. Also, the practice of the Interco-operation and the diffusion of the principles and cooperative values allow the creation of companies and social nets. Both are a key element in the formation of the social capital.

In this work we will try the verification of these previous affirmations for the Spanish autonomous regions. For this purpose, we propose a model of panel data of fixed effects that will be presented in the third section. Previously, we have made a review of the most significant literature, so much from the point of view of the development models as much of the empiric applications of such theories. This document will be closed with a section in which we will discuss the results of the model and we will conclude.

## 2. ANTECEDENTS OF THE STUDY AND REVIEW OF THE LITERATURE

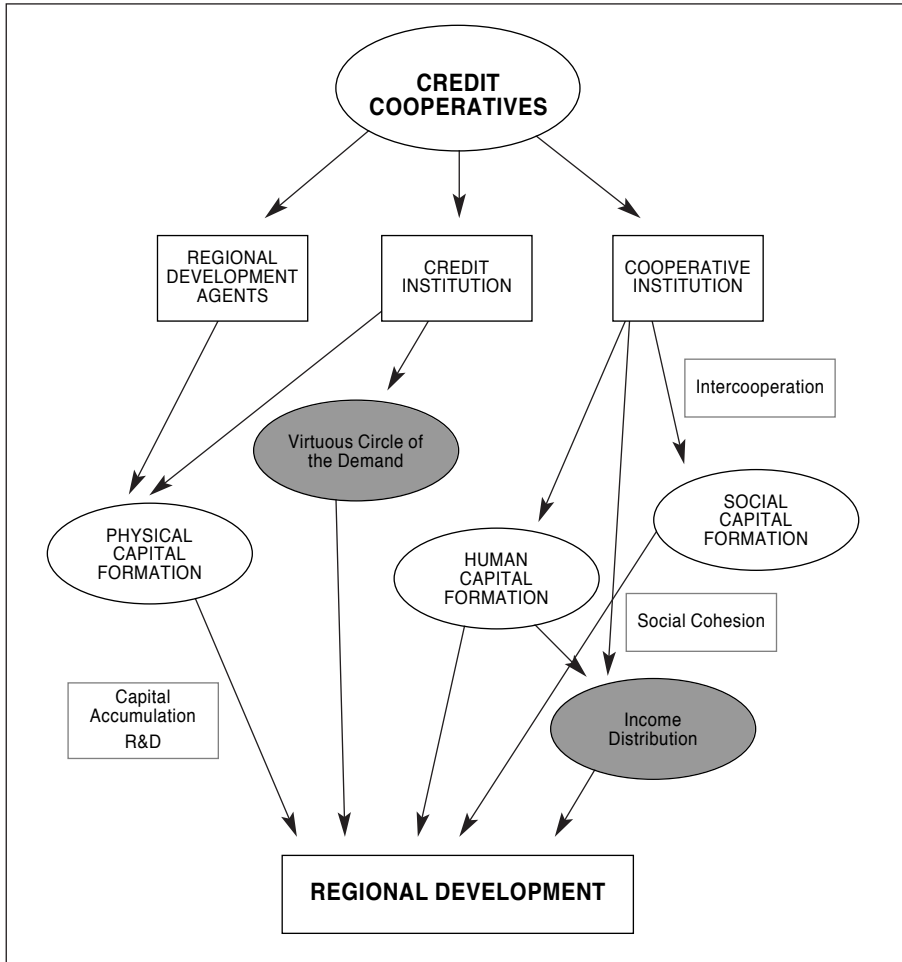
The present work starts from the concern for regional development and the role that cooperatives, in general, and credit cooperatives, particularly, have in it. We believe that cooperatives, by the application of cooperative principles, serve better than the rest of juridical forms to the instrumental objectives of the policies of local-endogenous development (Carrasco, 1999 and Carrasco and Pardo, 1999).

There are many documents in the European Union ambit, where it is recognised the important role of cooperatives in development. For example, the Recommendation of the International Office of Work on the promotion of the cooperatives (2002) or the Decision 2002/177/CE of the Council that marks the guidelines for the employment policies of the states members. More recently, the Communication of the Commission to the Council, to the European Parliament, to the European Economic and Social Committee and the Committee of the Regions on development of the cooperatives in Europe (2004), take up these subjects.

On the other hand, the advances in the theory of the economic growth over the last years allow to reopen and to complete the works previously mentioned. This way, in addition to traditional factors of the economic growth as stock of capital, human capital, fiscal policies, income distribution or economic globalisation, today many authors consider social capital or relational capital (Barro, 2003; Galindo, 2003).

Incorporating this new factor of growth to the previous analyses, we find that cooperatives in general, and those of credit in particular, intervene in the economic development of their regions through three different ways: the formation of physical capital, of human capital and of social capital, as it is appreciated in the following outline.

## CREDIT COOPERATIVES AND REGIONAL DEVELOPMENT



### *a) The creation of physical capital*

Today it exists a relative consent among economists in the sense that the development of the financial system is important for the economic long-term growth. The role of financial system in economic growth is essential, because it allows the flow of surplus from the savers toward the deficit expense units. The financial institutions are indispensable in this transfer, due to the transformation of the assets that they do, and their adaptation to the conditions demanded, as well by the units with excess, as well for the investors. This way, they promote saving and investment. The efficiency of this system will be bigger as bigger is the volume of resources than it is able to

direct toward the productive investment and as much those resources are adapted to the individual preferences, because the volume of saving of the community will also be determined by the effectiveness of it. Equally, it can be verified that the degree of development of the financial system is related positively with the rate of growth of the economy<sup>1</sup>.

On the other hand, the traditional theories of development, remind us that the accumulation of capital (physical) is an indispensable factor in the promotion and acceleration of the economic growth. From a Schumpeterian perspective (Schumpeter, 1911), the incorporation of innovations in the productive process is key for the growth. For that, the behaviour of both, innovative manager's and financial markets are essential<sup>2</sup>. The modern theories of growth (among them the neoclassical models of the exogenous growth, the post-Keynesian theories of growth or the models of endogenous growth) also stress the importance of the formation of physical capital in the growth of western economies. To this role, some theories of the endogenous growth (as those of Grossman and Helpman or Aghion and Howitt) add the importance that companies' investment in R+D has in technological progress. (Escot and Galindo, 2001).

From the empiric point of view, they have been carried out interesting works since the decade of the seventy's, such us those of Goldsmith (1969), McKinnon (1973) and Shaw (1973) for small samples of countries. They have results that supported the idea that the best financial structuring in an economy, accelerates its growth. Recent developments, among those they highlight Ross Levine's works (1996), present growth models in which financial intermediation affects the rate of growth (endogenous) of long term GDP per capita. So that, policies of repression to the financial system, or excessive intervention and control in their functions have noxious effects in long term.

In this line, the works of King and Levine (1993), Levine and Zervos (1998), Rajan and Zingales (1998), affirm that there exists intrinsic relationships between financial intermediation and productivity. And, given that, as it is known, productivity variations impact in long term level of economic development and in the rate of GDP growth,

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1. Empiric evidence, that illustrates the evolution of the GDP of a wide group of economies along the XX century and the explanation of the factors that have affected to its path of growth, has allowed their characterization in a series of *Stylised Facts*. Among them it stands out the important role of saving and investment in the growth of GDP. For modern growth theories, the investment, and more concretely the accumulation of the capital (so much physical as human) is the essential variable to explain growth. For a good synthesis of some *stylised facts* of growth and main growth theories as classic, neoclassical and those of endogenous growth, see Escot, L. and Galindo, M.A. (2001). The main growth theories from Keynes are summarised in Galindo, M.A. and Malgesini, G. (1994), and there is an empiric demonstration for the Spanish regions in Alvarez, A. and Galindo, M.A. (2004).

2. Those positions have not been free from critic, because some economists (Robinson, 1952) assumed that the development of the financial system was the result of economic growth or that it accompanied to the economic growth, but difficultly it could be one of its determinants. Later, Goldsmith (1969) wrote about the difficulty of settling down with security the sense of the causation, this is to say, to decide if financial factors are responsible for the acceleration of economic development or if financial development is the consequence of economic growth, whose origin should be looked for in another item.



it is possible to maintain that the sustained economic development is not only a product of the combination of the managerial activity and investment in tangible and intangible capital, but also of the financial intermediation.

By means of the application of statistical techniques to a wide group of countries, the mentioned authors conclude that it exists a clear positive correlation between the speed of the economic growth and 1) the size of the financial system, measured, for example, for their liquid assets; 2) the proportion of credit granted by the private banks, in front of that granted by the central bank; and 3) the proportion of credit granted to the private sector in front of the credit granted to the public sector.

In referring to the size of the financial system, measured by the relationship between the public's liquid assets and the GDP, Levine (1997) suggests that if you increase the size of the financial sector, it will be an important positive effect in the economic growth: "in outline, it could be eliminated a third of the gap among the countries that grow faster and those whose growth is slower, by the increasing of the size of financial intermediation sector of these last countries from its medium value until the medium value corresponding to the countries of quicker growth".

So that, the majority of the theories of economic growth justify the important role that credit and deposit institutions have in growth, so much in a direct way, by means of their contribution to the formation of physical capital as in a more indirect way, by the support to the technical progress and the improvement of the productivity<sup>3</sup>.

But, in despite of the positive aspects, it is also necessary to consider that the mobilization of resources (essence of the financial activity) could have a negative effect in certain areas. If financing is directed towards more active regions focusing on more profitable investments, it can hinder the financing of less dynamic regions activities, depressing them due to the depriving of this fundamental growth factor, and limiting, therefore, their development possibilities.

Local credit institutions, or those of regional installation, would palliate this problem, because they channel financial resources of the area toward investment projects in the same one. More concretely, the credit cooperatives, due to their cooperative character, have a special vocation of service to the partner (Ferguson and McKillop, 1997:2), paying special attention to their financial necessities<sup>4</sup>. So, if they are very established in a certain geographical space, this vocation of service will have positive repercussions on the region, and they would constitute one of her development pillars.

Credit cooperatives cannot only carry out the role of agent or promoter of development by means of the exercise of the financial activity, but they can also

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3. Levine (1996) assures that a growing volume of works (so much theoretical as empiric) tends to push, even the sceptics, toward the belief that the development of financial institutions and markets are a determinant of the economic growth, more than an accompaniment or a passive answer to this growth.

4. Such a vocation of service to the partner is specially important in the case of cooperatives associated to credit cooperatives, because as this juridical form have not an easy access to the big markets of capitals (as shared companies have) their financing possibilities depends on the own funds and on credits.

make a significant role by implementing concrete projects, alone or in collaboration with other institutions or organisms. In countries as France, United Kingdom or Italy, they are earning importance actions as the stimulus of investment funds or mutualities to the encouragement of cooperative form. In others, as Holland, it is prominent the role of credit cooperatives in the support to scientific and research activity. As mentioned above, according to some theories of endogenous growth, the investment in R&D generates technical progress, which is necessary to stimulate growth.

#### *b) The creation of human and social capital*

A second group of theories of endogenous growth add to physical capital, human capital (education and sanity) as explanatory factors of growth (among others see Escot and Galindo, 2001 and Galindo and Malgesini, 1994). Applying those theories, credit cooperatives would have a second way of influence in the development of regions; in this case not as credit or deposit institution, but as cooperative society, by the application of the formation and cooperative promotion principle. Thereway, more fits to the formation funds and more efficiency in their employment, more growth of the area of influence of the cooperative credit institution. A better-formed population allows, among other things, an improvement of income distribution, as Stylized Facts prove, it is also a growth factor.

Apart from human capital as factor of growth, some theories have incorporated recently a new element, denominated *social capital* (also known as relational capital in some ambits). This one supplements to human capital, because its essence is the relationships among individuals<sup>5</sup>. More concretely, following Woolcock (2001), the social capital has to do with the norms and nets that facilitate the collective action. It is centred in structural and relationship aspects. So that, the improvement of the social relationships it is a fundamental component of the goals and means of development.

In fact, Woolcock and Narayan (2000) affirm that communities that have a wide and diverse range of social nets and civic associations are better prepared to face up the adversity, to solve conflicts and to take advantage of new opportunities. For this reason, social capital is related positively with development. This way, the increase of the quantity and density of social groups has positive effects in community well being. The economic development, following Granovetter (1995, cit. in Woolcock and Narayan), is produced according to a mechanism that allows people to exploit

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5. For a deep treatment of this growth factor, see, for example, the writings of M. Woolcock, D. Narayan, P. Adler, S. W. Kwon, C. Grootaert, inside the series of works that the World Bank has open under the initiative of Social Capital. In Alvarez, A. and Castaño, M.S. (2004) we can see the estimation of a model of economic growth including social capital as productive factor, for the countries of the European Union.

the advantages of belonging to a reduced community, and so, acquiring dexterities and resources to participate in nets that overcome their communities.

The role of the credit cooperatives in the employment generation does not finish with the mission of formation or canalisation of funds. It can also be played in an indirect way, through the inter-cooperation and the development of this managerial form; or in the same way, collaborating in the formation of nets of companies. Also the invigoration of cooperative principles and values facilitate the contact and the cooperation among agents, which redounds in the formation of individuals' nets and so on of social capital.

Credit cooperatives can also promote initiatives whose motivation is not economic but social, and in definitive, they redound in an improvement of many people quality of life. In this sense, the president of the Movement of Caisses Desjardins of Canada, affirm that the success of the institution is not due to the luck or to the obsession for the benefit or for the power [but] to people's pride, its trust in themselves and its strong social conscience [as well as] cooperative nature of the project that was in its base" (Béland, 1993).

### **3. METHODOLOGICAL SPECIFICATIONS OF THE MODEL. DATA, ECONOMETRIC ESTIMATION AND RESULTS**

With regard to theoretical and empiric models that have been referred in previous section, we have thought about three-departure hypothesis:

1. Financial activity of credit cooperatives favours the long term economic growth
2. Credit cooperatives also facilitate growth through the formation of human capital
3. Credit cooperatives intervene in economic growth by means of the creation of social capital

To check if those hypothesis are fulfilled or not, we have outlined a data panel model of fixed effects. It is sought to verify if the role that credit cooperatives play in each one of the Spanish regions, by facilitating the creation of physical, human and social capital, rebounds in their long-term development, through the increment of the GDP per capita. The equation would have this expression:

$$\Delta \text{GDPpc}_{it} = \alpha_i + \sum_{j=0}^s \varphi_j \Delta \text{CKF}_{p,i,t-s} + \sum_{j=0}^s \delta_j \Delta \text{CKH}_{i,t-h} + \sum_{j=0}^s \gamma_j \Delta \text{CKS}_{i,t-h} + \varepsilon_{it} \quad (1)$$

$$\varphi_j \begin{cases} j \cdot \varphi & 0 \leq j \leq h \\ (s-j)\varphi & h+1 \leq j \leq s \end{cases} \quad \delta_j \begin{cases} (h+1-j)\varphi & 0 \leq j \leq h \\ 0 & j > h \end{cases}$$

$$\gamma_j \begin{cases} (h+1-j)\gamma & 0 \leq j \leq h \\ 0 & j > h \end{cases}$$

where:

1.  $\Delta \text{GDPpc}_{it}$  = GDP per capita rate of growth in constant Euros, Base 95, of region "i" at the moment "t". Source: INE
2.  $\Delta \text{CKFpc}_{j,i,t-h}$  = Rate of variation of the variable or financial ratio "j" measured in terms per capita. It relates credit cooperatives with the creation of physical capital in the region "i" in time period "t-h". Source: UNACC, INE. As credit cooperatives are institutions with a strong regional installation, avoid the transfers of financial resources toward other regions, so they favour the creation of physical capital. The ratios and variables used are the following ones:
  - a) Debt / Assets: this ratio would be related positively with growth, because it indicates the financing of public deficit that credit cooperatives do, and so on, their collaboration in the implementation of expansive fiscal policy, that according to Keynesian and endogenous growth models, it favours economic growth. However, this financing to public activity can produce a crowding-out effect on private activity. Rural credit cooperatives usually hold public debt of their own autonomous communities or local corporations of their environment.
  - b) Credit / Deposit: it measures the relationship among the quantity of savings that the institution captures and the financing that it facilitates through the credit. This ratio will have a positive relationship with rent and its growth, because bigger the ratio, bigger efficiency of the institution in the canalisation of savings toward productive activities.
  - c) Credit / Assets: small and medium sized companies that generate more stable long term employment, are financed mainly through credit, due to

their difficulties to have access to other markets (even if they are not cooperative). For that reason, this ratio would be related positively with economic growth.

- d) Resources borrowed from financial system / Resources lent to the financial system: the relationship will also be positive, and if it is sorter than one, it would mean that the institution is dawning financing from inter-bank market to be lent in the region. It has been an habitual practise of credit cooperatives during a lot of time, the placing of excessive liquidity in inter-bank market, looking for profitability in periods of high interest rates (Carrasco and Congo, 1998).
3.  $\Delta CKHpcj,i,t-h$  = Rate of variation of human capital creation variable, measured by the number of the credit cooperatives' workers in relation with region i inhabitants, in time period " t-h ". The relationship of the number of workers with GDP generation also has to be positive; not only because of salary generation, but also by the formation of human capital that has spillover effects. According to endogenous growth theories, this is positive for economic growth. Credit cooperatives, in the development of the formation principle, should have a prominent role in this sense. Source: UNACC, INE
4.  $\Delta CKSpcj,i,t-h$  = Rate of variation of the variable creation of social capital in the region " i " in time period " t-h ". This variable has been calculated using the procedure of main components. The objective has been to obtain a single component from the variables "number of associates by type (cooperative, physical person and juridical person) divided by the population of the region "i". These variables should also have a positive relationship with GDP, because they are a proxy variable of social capital, that measures, among other things, the relationships among individuals and the formation of human nets, which nets can support the activities of people, that it is, also according to the most recent theories, a growth factor. Source: UNACC, INE

To achieve the planned goal, we have used a panel data, formed by the 13 peninsular Autonomous Communities with presence of cooperatives of credit (Andalusia, Aragon, Asturias, Castilla-La Mancha, Castilla-León, Catalonia, Comunidad Valenciana, Extremadura, Galicia, Community of Madrid, Murcia, Navarre and the Basque Country) for the period among the years 1993 and 2002. In the analysis, we have adopted the following general specification of panel data:

$$Y_{it} = \alpha_{it} + \sum \beta_{kit} X_{kit} + U_{it}$$

where i denotes the regions and t the time periods. The panel model selected is a fixed effects one, because it explains better the impact of credit cooperatives on the growth rate of the GDP pm per capita of each one of our Spanish regions in the last years.

This method implies that when the hypothesis of global homogeneity is rejected for panel data, the OLS common coefficient estimators are inconsistent. One of the most common options used in the economic literature to introduce the differences among regions, through variations in the intercept parameters of a typical OLS, is the Model of Fix Effects.

The most obvious generalization of the model with intercept and constant slope parameters for a panel data, is to introduce dummy variables to incorporate the effects of omitted variables that are specified to the individual units of cross section, but remain constant during the time, and the effects that are specified at each time period but are similar through the different cross section units. For example, if we suppose that there are not specified effects at the time ( $\lambda_t=0$ ), the model is:

$$Y_{it} = \alpha_i^* + X'_{it}\beta + \varepsilon_{it}$$

that corresponds to a covariance model. In this model,  $\varepsilon_{it}$  represents the effects of omitted variables that are particular as cross section units as considered time periods. It is suppose that  $\varepsilon_{it} \sim N(0, \sigma^2_\varepsilon)$ . The rest of parameters and variables of the model are:

- $\alpha_i^*$  : is a constant term that gathers the specific effects of i-sm region. It is constant during the period.
- $\beta$  : is a k vector of coefficients  $k \times 1$  that includes the effects of k exogenous variables.
- $X_{it}$  : is the matrix of the k exogenous variables that changes for each individual and during the time.

The estimator of  $\beta$  to be used in this model is:

$$\hat{\beta}_{CV} = \left[ \sum_{i=1}^N \sum_{t=1}^T (x_{it} - \bar{x}_i) (x_{it} - \bar{x}_i)' \right]^{-1} \left[ \sum_{i=1}^N \sum_{t=1}^T (x_{it} - \bar{x}_i) (y_{it} - \bar{y}_i)' \right]$$

$$\hat{\alpha}_i^* = \bar{y}_i - \bar{x}_i \hat{\beta}_{CV}$$

When the number of dummy variables is very high to reflect the specific effects of each cross section unit, doing too big and complex the matrix to be inverted, it is possible to use a transformation of the model to calculate  $\hat{\beta}$  without necessity to include such kind of variables. It is only necessary to calculate the averages  $\bar{x}_i$  and  $\bar{y}_i$ , separately for each cross-section unit. Later we will calculate  $(x_{it} - \bar{x}_i)$  e  $(y_{it} - \bar{y}_i)$ , and then it will apply OLS to the transformed model. The expression of the model is:

$$(y_{it} - \bar{y}_i) = (x_{it} - \bar{x}_i)' \beta + (\varepsilon_{it} - \bar{\varepsilon}_i)$$

This process is equivalent to multiply  $Q = I_T - 1/T \mathbf{i}_T \mathbf{i}_T'$  for the equation  $Y_{it} = \mathbf{i}_T \alpha_i^* + X'_{it} \beta + \varepsilon_{it}$ , where  $\mathbf{i}_T$  is a vector of ones, so:

$$\hat{\beta}_{CV} = \hat{\beta}_W = \left[ \sum_{i=1}^N X'_i Q X_i \right]^{-1} \left[ \sum_{i=1}^N X'_i Q Y_i \right]$$

The model proposed, expressed by the equation (1), has been estimated under different specifications, till we have arrived to a equation that collects better the long-term effect of credit cooperative in the growth of the Spanish regions. The estimation of the proposed model by the equation (1) presents some problems that it has been necessary to confront. First problem is the existence of multicollinearity among the explanatory variables. The correlation among the exogenous variables is picked up in table1:

**TABLE 1.**  
**CORRELATIONS OF THE EXOGENOUS VARIABLES OF MODEL (1)**

	$\Delta(\text{Debt}/\text{Assets})$	$\Delta(\text{Credit}/\text{Assets})$	$\Delta(\text{Credit}/\text{Deposit})$	$\Delta \text{Resources borrowed to FS}$	$\Delta \text{Resources lent from FS}$	$\Delta \text{CKSpC}$	$\Delta \text{CKHpc}$
$\Delta \text{Debt}/\text{Assets}$	Pearson Correlation Sig. (bilateral) N	1 , 156	<b>0,240(**)</b> 0,003 156	0,088 0,275 156	-0,048 0,554 156	-0,027 0,736 156	0,010 0,905 156
$\Delta \text{Credit}/\text{Assets}$	Pearson Correlation Sig. (bilateral) N	<b>0,240(**)</b> , 156	<b>0,446(**)</b> 0,000 156	-0,100 0,212 156	-0,081 0,312 156	-0,046 0,569 156	-0,064 0,430 156
$\Delta \text{Credit}/\text{Deposit}$	Pearson Correlation Sig. (bilateral) N	<b>0,446(**)</b> 0,000 156	1 , 156	-0,071 0,379 156	-0,037 0,644 156	<b>0,168(*)</b> 0,036 156	0,073 0,368 156
$\Delta \text{Resources borrowed to FS}$	Pearson Correlation Sig. (bilateral) N	-0,048 0,554 156	-0,100 0,212 156	-0,071 0,379 156	1 , 156	<b>0,916(**)</b> 0,000 156	0,138 0,085 156
$\Delta \text{Resources lent from FS}$	Pearson Correlation Sig. (bilateral) N	-0,027 0,736 156	-0,081 0,312 156	-0,037 0,644 156	1 , 156	0,031 0,702 156	0,139 0,083 156
$\Delta \text{CKSpC}$	Pearson Correlation Sig. (bilateral) N	-0,003 0,971 156	-0,046 0,569 156	<b>0,168(*)</b> 0,036 156	0,038 0,641 156	1 , 156	<b>0,240(**)</b> 0,003 156
$\Delta \text{CKHpc}$	Pearson Correlation Sig. (bilateral) N	0,010 0,905 156	-0,064 0,430 156	0,073 0,368 156	0,138 0,085 156	<b>0,240(**)</b> 0,003 156	1 , 156

\* Correlation is significant at the 0,05 level (bilateral).

\*\* Correlation is significant at the 0,01 level (bilateral).



The changes that we have done to model (1), to mitigate this problem, have been the grouping of the four variables and financial ratios into two variables that have the property of collecting the information of all these and not to present correlation among them. The new expression of the model is:

$$\Delta \text{GDPpc}_{it} = \alpha_i + \sum_{j=0}^s \beta_j \Delta \text{CKF}_{1,i,t-s} + \sum_{j=0}^s \eta_j \Delta \text{CKF}_{2,i,t-s} + \sum_{j=0}^s \gamma_j \Delta \text{CKS}_{it-s} + \delta \Delta \text{CKH}_{it} \varepsilon_{it} \quad (2)$$

$$\beta_j \begin{cases} j \cdot \beta & 0 \leq j \leq h \\ (s-j)\beta & h+1 \leq j \leq s \end{cases}$$

$$\eta_j \begin{cases} j \cdot \eta & 0 \leq j \leq h \\ (s-j)\eta & h+1 \leq j \leq s \end{cases}$$

$$\delta_j \begin{cases} (h+1-j)\delta & 0 \leq j \leq h \\ 0 & j > h \end{cases}$$

$$\Delta \text{CKF}_{1,i,t} = \mu_1 \left( \frac{\Delta (\text{Crédit} / \text{Asset})_{i,t} - E(\Delta (\text{Crédit} / \text{Asset})_{i,t})}{\bar{S}_{\Delta} (\text{Crédit} / \text{Asset})_{i,t}} \right) + \mu_2 \left( \frac{\Delta (\text{Crédit} / \text{Deposit})_{i,t} - E(\Delta (\text{Crédit} / \text{Deposit})_{i,t})}{\bar{S}_{\Delta} (\text{Crédit} / \text{Deposit})_{i,t}} \right)$$

$$\Delta \text{CKF}_{2,i,t} = \varphi_1 \left( \frac{\Delta (\text{Resources borrowed to FS})_{i,t} - E(\Delta (\text{Resources borrowed to FS})_{i,t})}{\bar{S}_{\Delta} (\text{Resources borrowed to FS})_{i,t}} \right) + \varphi_2 \left( \frac{\Delta (\text{Resources lent from FS})_{i,t} - E(\Delta (\text{Resources lent from FS})_{i,t})}{\bar{S}_{\Delta} (\text{Resources lent from FS})_{i,t}} \right)$$

where:

- $E(\Delta(\text{Credit} / \text{Asset})_{i,t})$  = Average of the rate of variation of the Credit / Asset ratio.
- $E(\Delta(\text{Credit} / \text{Deposit})_{i,t})$  = Average of the rate of variation of the Credit / Deposit ratio.
- $E(\Delta(\text{Re sources borrowed from FS})_{i,t})$  = Average of the rate of variation of variable "sources borrowed to financial system".
- $E(\Delta(\text{Re sources lent from FS})_{i,t})$  = Average of rate of variation of variable "sources lent to financial system".
- $\bar{S}_{\Delta(x)_{i,t}}$  = Standard deviation that corresponds to ratio or financial variable X.

The following step has been to estimate equation (2) with different retards for the explanatory variables in order to finding that structure of distributed retards that better would collect the long term effect on the growth of the GDP per period. To select the equation with the best explanatory capacity of the model, we have followed the approaches of Akaike and Schwarz.

Finally, the equation selected is the following one:

$$\Delta \text{GDPpc}_{it} = \alpha_i + \sum_{j=0}^s \beta_j \Delta \text{CKF}_{1,i,t-s} + \sum_{j=0}^s \mu_j \Delta \text{CKF}_{2,i,t-s} + \sum_{j=0}^s \gamma_j \Delta \text{CKS}_{it-s} + \delta \Delta \text{CKH}_{it} \varepsilon_{it} \quad (3)$$

$$\beta_j \begin{cases} j \cdot \beta & 0 \leq j \leq h \quad \forall h = 3 \\ (s - j)\beta & h + 1 \leq j \leq s \end{cases} \quad \mu_j \begin{cases} j \cdot \mu & 0 \leq j \leq h \quad \forall h = 3 \\ (s - j)\mu & h + 1 \leq j \leq s \end{cases}$$

$$\gamma_j \begin{cases} (h + 1 - j)\gamma & 0 \leq j \leq h \quad \forall h = 2 \\ 0 & j > h \end{cases}$$

The results of the estimation of equation (3), for GLS (Cross Section Weights), with correction of the heteroskedasticity for the method of White, are picked up in table 2. The model, in principle, also presented an error term that was not white noise, so it has been necessary to correct it, as it is appreciate in the table 2. Possibly, the existence of serial autocorrelation is due to the problem of simultaneity between production growth and the explanatory variables as Goldsmith pointed it (1969).

**TABLE 2.**  
**ESTIMATION OF EQUATION N° 3**

Dependent Variable: DGDPPc Method: GLS (Cross Section Weights) Sample: 1996 2002 Included observations: 7 Number of cross-sections used: 13 Total panel (balanced) observations: 78 Convergence achieved after 6 iterations White Heteroskedasticity-Consistent Standard Errors & Covariance				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
CKF <sub>1</sub>	0.001762	5.14E-05	34.29385	0.0000
CKF <sub>2</sub>	0.001176	0.000111	10.56850	0.0000
CKS	0.001155	8.31E-05	13.88968	0.0000
DCKH	57.69106	0.850442	67.83653	0.0000
AR(1)	0.449679	0.119170	3.773425	0.0004
Fixed Effects				
AND	0.025386	0.007010	3.621497	0.0006
ARA	0.016766	0.007642	2.193890	0.0321
AST	0.022017	0.006098	3.610655	0.0006
CLM	0.010974	0.022512	0.487471	0.6277
CLE	0.028992	0.000174	166.8833	0.0000
CAT	0.018437	0.006026	3.059751	0.0033
VAL	0.015721	0.014519	1.082791	0.2832
EXT	0.031167	0.004367	7.137230	0.0000
GAL	0.027158	0.006635	4.093111	0.0001
MAD	0.027058	0.023569	1.148009	0.2555
MUR	0.019615	0.020493	0.957159	0.3423
NAV	0.009336	0.012772	0.730968	0.4676
PV	0.037827	0.011116	3.402980	0.0012
<b>Weighted Statistics</b>				
R-squared		0.996205	Mean dependent var	0.088106
Adjusted R-squared		0.995129	S.D. dependent var	0.209048
S.E. of regression		0.014589	Sum squared resid	0.012771
F-statistic		926.4369	Durbin-Watson stat	2.135919
Prob(F-statistic)		0.000000		
<b>Unweighted Statistics</b>				
R-squared		0.312359	Mean dependent var	0.027584
Adjusted R-squared		0.117527	S.D. dependent var	0.015530
S.E. of regression		0.014589	Sum squared resid	0.012771
Durbin-Watson stat		2.028319		

The coefficients of the explanatory variables obtained in equation (3), make evident the positive influence of the role played by credit cooperatives in the development of the Spanish regions, in the last few years. The equation also picks up the different behaviour of following regions: Castilla-La Mancha (CLM), Comunidad Valenciana (VAL), Comunidad de Madrid (MAD), Región de Murcia (MUR) y Comunidad Foral de Navarra (NAV). In order to show more clearly the differences between these communities and those presenting a normal behaviour, we have estimate again the equation 3 for the two groups of regions. In table 3, we have the results of the equation applied to the group of regions that have had a similar behaviour in period 1995-2004. They are confirmed the results before achieved.

We have estimate the model also for the group of non-significant regions, but the results are not satisfactory, because the causes that make them having a differential behaviour are characteristic of each one, as we will see in next section.

**TABLE 3.**  
**ESTIMATION OF EQUATION 3 FOR THE SIGNIFICANT REGIONS**

Dependent Variable: DGDPPc Method: GLS (Cross Section Weights) Sample: 1996 2002 Included observations: 7 Number of cross-sections used: 8 Total panel (balanced) observations: 48 Convergence achieved after 12 iterations				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
CKF1	0.001767	0.000162	10.88763	0.0000
CKF2	0.001165	0.000333	3.502517	0.0013
CKS	0.001142	0.000261	4.379678	0.0001
DCKH	57.69749	5.538561	10.41742	0.0000
AR(1)	0.403607	0.178180	2.265165	0.0298
Fixed Effects				
AND	0.025744	0.008273	3.112009	0.0037
ARA	0.017461	0.008843	1.974584	0.0562
AST	0.022253	0.007786	2.858166	0.0071
CLE	0.028992	0.000620	46.76842	0.0000
CAT	0.018991	0.007788	2.438585	0.0200
EXT	0.031631	0.006520	4.851613	0.0000
GAL	0.027737	0.008400	3.301845	0.0022
PV	0.037663	0.010335	3.644429	0.0009
<b>Weighted Statistics</b>				
R-squared		0.997588	Mean dependent var	0.098889
Adjusted R-squared		0.996761	S.D. dependent var	0.196101
S.E. of regression		0.011161	Sum squared resid	0.004360
F-statistic	1206.244		Durbin-Watson stat	2.055332
Prob(F-statistic)		0.000000		
<b>Unweighted Statistics</b>				
R-squared		0.454757	Mean dependent var	0.029332
Adjusted R-squared		0.267816	S.D. dependent var	0.013043
S.E. of regression		0.011161	Sum squared resid	0.004360
Durbin-Watson stat		1.740743		

The results of the model, with its structure of multipliers, following equation 3 are:

$$\begin{aligned}\Delta \text{GDPCpc}_{it} = & \alpha_i + 0,00176\Delta \text{CKF}_{1,i,t-1} + 0,00352\Delta \text{CKF}_{1,i,t-2} + \\ & + 0,00529\Delta \text{CKF}_{1,i,t-3} + 0,00118\Delta \text{CKF}_{2,i,t-1} + 0,00235\Delta \text{CKF}_{2,i,t-2} + \\ & + 0,00353\Delta \text{CKF}_{2,i,t-3} + 0,00231\Delta \text{CKS}_{i,t} + 0,00115\Delta \text{CKS}_{i,t-1} + \\ & + 57,69106\Delta \text{CKH}_{i,t} + 0,44968\varepsilon_{t-1}\end{aligned}$$

Finally, results of the model, with its structure of multipliers, considering only the significant autonomous communities, following equation 3 are:

$$\begin{aligned}\Delta \text{GDPCpc}_{it} = & \alpha_i + 0,00177\Delta \text{CKF}_{1,i,t-1} + 0,00353\Delta \text{CKF}_{1,i,t-2} + \\ & + 0,00530\Delta \text{CKF}_{1,i,t-3} + 0,00117\Delta \text{CKF}_{2,i,t-1} + 0,00233\Delta \text{CKF}_{2,i,t-2} + \\ & + 0,00350\Delta \text{CKF}_{2,i,t-3} + 0,00228\Delta \text{CKS}_{i,t} + 0,00114\Delta \text{CKS}_{i,t-1} + \\ & + 57,69749\Delta \text{CKH}_{i,t} + 0,403611\varepsilon_{t-1}\end{aligned}$$

#### 4. DISCUSSION OF THE RESULTS AND CONCLUSIONS

As it has been exposed in section two of this work, the main difference between credit cooperatives and the rest of credit and deposit institutions is the fact of being cooperative societies, that endows them of a wider dimension than the strictly economic one, and it places them in a privileged place to participate in the promotion of the economic development, because they are companies that respond both, to managerial and social interests.

Cooperation is an essential ingredient to build a development model based on the mobilization of local forces and the optimization of the endogenous potential of growth. So, credit cooperatives must have a triple mission in development: first, as credit institutions of great territorial installation, they avoid the flows of financial funds toward other areas, and they assure their reinvestment in the own region, stimulating this way the virtuous circle of the demand in that region. Other way, as cooperative societies, in the developing of formation principle, they allow the improvement of local human capital, which in turn, redounds in an improvement of GDP distribution; so, they propitiate the development of the region. In addition, by the application of inter-cooperation principle, they foment other types of cooperative societies that can be important, both, by their possible economic impact, as well as their social impact, so they favour the formation of social capital, which it is also considered as a factor of development.

The results obtained by the model confirm those ideas, demonstrating a long-term positive relationship, firstly between the considered financial variables and growth. Also it is confirmed that credit cooperatives rebound in growth by the formation

of the human capital, although it is necessary to say that it is very little the information that it can provide to us the variable used, since it only makes reference to the number of employees, and it doesn't consider the possible effects spill-over of human capital in growth that will be generated by the earnings of qualification, derived of the application of the Education, Formation and Cooperative Promotion Fund, in the formation of the labour. As it doesn't exist public information of the use of the mentioned funds, it is difficult to infer more conclusions in this respect from the model, but it could be considered that the impact could be bigger.

It is also confirmed the existence of a positive effect of credit cooperatives in growth by the formation of the social capital. But, equally, as it is difficult to consider the effect of the application of the so-called Fund in the creation of social nets and therefore of social capital, it leads us to suppose that the impact that collects the coefficient is shorter than the real one.

Secondly, conclusions on economic policy that we can obtain are coherent with that declared by the European Commission: the cooperative form (and in particular the credit cooperation) serves very well to the objective of economic growth, so that, it is necessary to foment it.

Thirdly, looking to the autonomous communities, it is first of all remarkable, the exceptional impact of credit cooperatives in the development of Basque Country (PV), what is derived from its high fixed coefficient. That is due to the great cooperative tradition and the deep installation of credit cooperatives. More concretely, we can remark about one of their unequalled credit institutions, the *Caja Laboral Popular* that for its inter-cooperative policy, it has instruments as a Central Fund of Inter-cooperation (to finance projects of preferable interest for the cooperatives of the group that individually they cannot develop) or the society *MCC Inversiones*, whose purpose is the promotion of companies by financial participations (capital participations, guaranties, lends, etc.) to support new activities and projects of development of the associate cooperatives. Also, they highlight the societies of the group dedicated to the research, as *Ikerlan*, *Ideko* or *MTC*. On the other hand, the participation of the *Caja Laboral Popular* in the development is increased not only with their formative actions, carried out with its Formation and Promotion Fund, but also with those that it plays through the holding *MCC* in an indirect way. To attend to formation necessities, the corporation has created numerous centres, as *Eskola Politeknikoa José M<sup>a</sup> Arrizmendarrieta*, *E.T.E.O.*, *Irakasle Eskola*, *Mondragón Unibertsitatea*, *Iraunkor*, *Sailoan*, *Diara*, *School of Hostalería of Oñati*, *Goier*, *Europace* or *Alecop*<sup>6</sup>.

Over and above that, we can remark that the three autonomous communities with bigger fixed coefficient, Basque Country (PV), Extremadura (EXT) and Castilla-León (CLE), have the common trait of having a long and wide tradition on credit

6. See more information about MCC, for example in Ormazabal, P. (2003); Errasti, A.M; Heras,I; Bakaikoa, B and Elgoibar, P. (2002), Clamp, C.A. (2000), or Bakaikoa, B; Errasti, A. and Begiristain, A. (2004)

cooperativism. Apart of those three communities, there are two more communities that share this characteristic, Navarra and Comunidad Valenciana. Both of them have been taken out of the model because of their non-significativity. This fact, means that they are not behaving as the rest of communities in the studied period of time. In fact, by different causes, they have had a decrease in the financial ratios the last few years, what could explain this behaviour.

Despite this decrement, Navarra, that is the second Spanish autonomous community with bigger GDP per capita, has a relation between credits concede by credit cooperatives and GDP per person, near to this one of Basque Country. In both cases, this proportion is meaningfully bigger to the averaged one, as it occurs with the number of workers. The ability to associate people by credit cooperatives in this region is also exceptional (see those variables and their relation with GDP in charts of the appendix).

On the other hand, in Comunidad Valenciana case, in the period of time studied, they have lived some joining processes that have promote some adjustments in all the variables considered. That, probably hinders the real importance of credit cooperatives, as it is demonstrate by the significant presence of local cooperative credit institutions, with a consequent high number of branch offices and employees, and a extraordinary ability to associate people. Consequently, they are more active than the average of credit cooperative conceding credits. (See figures of the appendix)

So, the movements, some times erratic, that have taken place in credit cooperatives of this last two communities in the studied period of time, doesn't permit us to appreciate, in the model, the true role of credit cooperatives in the development of both regions, which unit cooperative tradition and a wide introduction of credit cooperativism. Even considering that, we could conclude that credit cooperatives have a bigger role in the economic development of the autonomous region which they belong, when there are a wide tradition on credit cooperativism. Of course, this would be a very interesting hypothesis to be developed in another work.

Murcia (MUR) is another community with atypical behaviour in the model. In this case, it is owing to an extraordinary increment of credits concede by credit cooperatives in the last years of the considered period; despite that, credit cooperatives of this region have a low importance in their local credit system, as it can be inferred from the little presence (measured by number of branches), the short ability to associate people and the volume of credits concede. Madrid (MAD) joins as well the group of atypical regions, what is also due to the low importance of credit cooperatives in its regional credit system. Castilla-La Mancha (CLM) is as well an atypical community, but in this case, by reason of its very blocked credit cooperative system, whose financial and social ratios rate of growth have been negative in last few years. It shows up the high number of branches, workers and associates per inhabitant that evidence an important presence in the region. Nevertheless, their financial activity is proportionally lower, even though it is upper than the national average. (See figures of the annexe).



Finally, the resting autonomous communities, Andalucía (AND), Aragón (ARAG), Asturias (AST), Cataluña (CAT) and Galicia (GAL) that have a normal behaviour into the model, share the trait of having a relative importance on the agrarian sector. So, even when there are three types of credit cooperatives, we can conclude saying that Spanish credit cooperative system is mainly rural, with the exception of the named Basque Country. Not in vane, the autonomous communities taken out of the model at its first step because of the non existence of credit cooperatives, or its low relevance, are those with lowest participation on the final agrarian production of the country.

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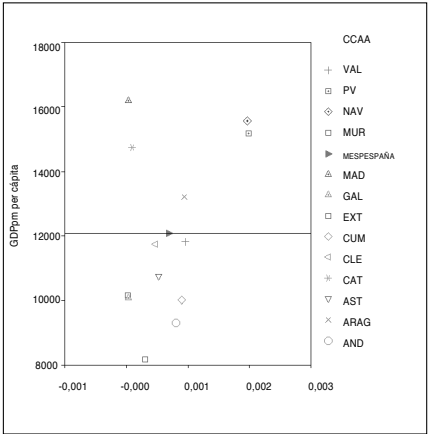
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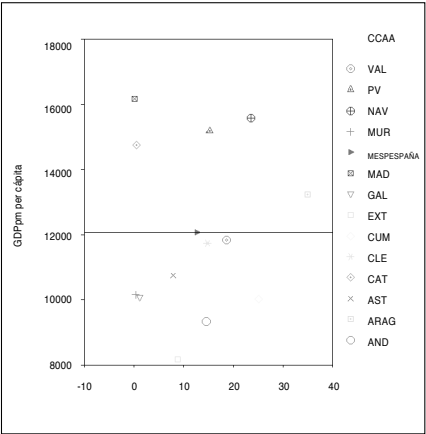
APPENDIX

**FIGURE 1.**  
**Relation between credit and growth**



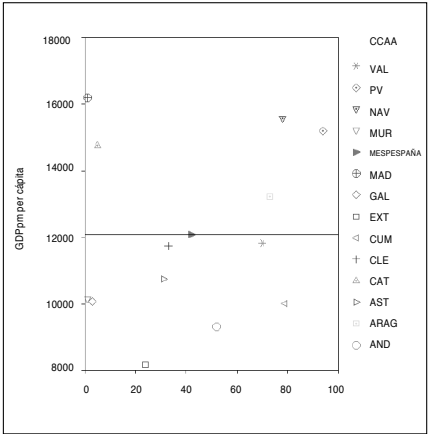
Average of credit concede by inhabitant.

**FIGURE 2.**  
**Relation between the number of branches offices and growth**



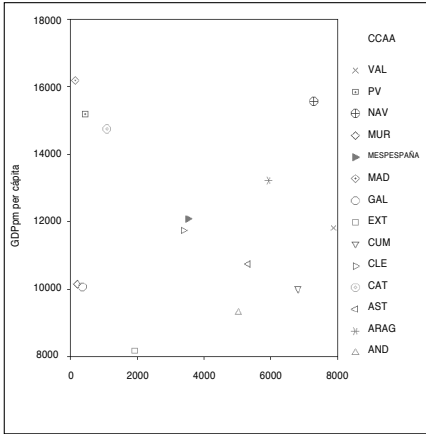
Average of branches offices (10<sup>5</sup> Habitants).

**FIGURE 3.**  
**Relation between number of workers and growth**



Average of workers by 10<sup>5</sup> inhabitants.

**Figure 4.**  
**Relation between number of associates and growth**



Average of associates by 10<sup>5</sup> inhabitants.

# ISSUES OF SUSTAINABLE DEVELOPMENT IN A TRANSITIONAL CREDIT UNION SYSTEM: REFINING THE UK RESEARCH AGENDA

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## 1. INTRODUCTION

The issue of 'sustainable development' of UK credit unions has been in sharp focus recently, partly as a response to the slow growth of credit unions and also as a result of the Government's concern about addressing financial exclusion in UK society through a greater involvement of credit unions. That 'sustainable development' is a core issue can be evidenced from the recent debate concerning a shift from an 'old' credit union development model to a 'new', more commercially driven, model of credit union development. Some commentators see this debate as a fundamental one regarding the very purpose and role of credit unions (Fuller and Jonas 2002). Thus, for proponents of the 'old' credit union model it is the social values of community self-help that make credit unions distinctive and a shift towards a 'new' more business orientated model is seen as a denial of the credit union ethos. Equally, opinion abounds about the failure of '*socially committed but financially weak credit unions*,' (see for example, Jones 2000) to create sustainable financial services for members and potential members. With recent changes in the regulatory context of UK credit unions it is clear that a process of transformation is now underway, and that the dominant perspective of creating more commercially driven and financially viable credit unions is driving the movement, hopefully, to a more sustainable future.

This paper examines some key forces of transformation affecting the UK credit union movement in the process of evolving to the 'new' credit union development model. Recent legislative changes have created a '*proportionate regulatory regime for credit unions*' (Strachan (2001), Director of the FSA's Deposit Takers Division,) where greater attention is paid to the risks of credit union activities and their likely impact on the safety, soundness and vitality of the movement. This new regulatory regime is

likely to increase consumer confidence in the movement, and has the potential to allow many credit unions a period of sustained growth. However, many smaller credit unions (especially those heavily reliant on part-time volunteers with limited expertise) will find it difficult to comply with the new regulatory requirements. The predicted affect of this new regulatory regime therefore is for increased merger activity, especially amongst small community based credit unions. This paper considers in some detail the new regulatory regime and its attendant potential for increased merger activity. Given the ongoing transformation of UK credit unions to a 'new' model of credit union development, the main focus of our paper is also to consider both theoretical and methodological issues concerning the identification of 'best practice' within UK credit unions. Obviously, 'best practice' provides a measure against which to evaluate what is meant by more business orientated credit unions. Similarly, looking at increased merger activity will also help identify more precisely what the 'new' business orientated model of credit union development should consists of. Our paper aims to make a contribution to the future research agenda in respect of UK credit unions to ensure that 'best practice' is well defined and grounded in empirical evidence. Our paper not only considers the 'structural' and 'agency' traditions in credit union research, but evaluates both quantitative and qualitative methodologies as part of a concern to ensure that proposed future research on the transition process within UK credit unions takes a more holistic and interdisciplinary approach.

Documenting 'best practice' in the early stages of transformation can, we believe, positively impact upon the sustainable development of the UK credit union system by illuminating the opportunities and difficulties associated with restructuring through mergers and the drive towards a new model of credit union development. In particular, our paper attempts to build upon the recent empirical work undertaken by Jones in 2000 on sustainable credit union development and in 2001 on the development of rural credit unions where the 'new' model of credit union development is articulated and justified in a UK context. By further examining what is meant by 'best practice' through our proposals for a mix of quantitative and qualitative methodologies, we hope to contribute further to the interdisciplinary interpretation of the new model of credit union development.

## 2. UNFULFILLED POTENTIAL OF CREDIT UNIONS

Despite having shown great promise, UK credit unions have not yet achieved notable success. In the forward to Jones (2000), Mervyn Pedelty (Chief Executive of the Co-operative Bank) maintains that, *'despite continuous growth they still fail to achieve the impact that many involved with the sector have been hoping for and predicting for years.'* The extent of this unfulfilled promise within the credit union system in the UK is proclaimed in more robust terms by Donnelly (2002)

*Credit Unions in England, Scotland and Wales<sup>1</sup> have received millions of pounds in state aid as part of a governmental initiative in the area of social inclusion. Yet little has been achieved except to make it harder for credit unions to develop within these countries.*

The shortcomings of the UK sector, which is dominated by small community based credit unions, are made stark when counter posed against a growing awareness - not least in Government circles - about the significant and growing problem of financial exclusion in the UK. It is estimated that around 1.5 million (7%) households in Britain lack access to any financial products. Additionally a further 4.4 million (20%) are on the margins of financial services and usually have little more than a bank account. Between a quarter and a third of people in the UK have no savings. (Kempson and Whyley, 1999) The reality of struggling for financial survival amongst the less well off is well illustrated in the study conducted in Liverpool by Jones (2002). The naked exploitation of many unscrupulous lenders offering very high interest loans for small amounts or overly expensive goods shows that in the UK there is a built in 'poverty penalty' simple for being poor.

In the study conducted by Jones amongst Liverpool's poor, the reported lack of awareness of credit unions by respondents shows the gap between what credit unions can potentially do and what is actually achieved in disadvantaged areas throughout the UK. Donnelly (2002) is scathing about the poor performance of UK credit unions and criticises weak community credit unions for failures in addressing the problems of financial exclusion. He also is vocal in condemning the 'social engineering' approach taken by the Government and UK local authorities in trying to develop credit unions in deprived areas by underwriting credit union development through subvention and grants. He questions the wisdom of seeing credit unions as a major policy instrument that can alleviate poverty. Donnelly also notes that the strongest segment of the UK credit union movement is employer based credit unions.

A profile of UK credit unions is detailed in Table 1. This table presents an overview of the size as measured by members and assets and the age of credit unions at UK level and separately for Northern Ireland, Scotland and England & Wales. In addition an attempt has been to match credit unions by their postcodes to deprivation measures at ward level. It should, be noted that consistently defined data on deprivation for the UK as a whole is not available. An index of deprivation is available at electoral ward level but the regions of the UK utilise marginally different common denominators making inter regional comparisons somewhat problematic. However, two of the main

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1. The focus of this paper is UK wide. Correctly, Donnelly makes a distinction between the constituent countries of the UK as credit union development differs between them. In omitting mention of Northern Ireland there is also a recognition that credit union development is much healthier there than elsewhere in the UK. UK credit union trade associations, as pointed out by Donnelly, are fragmented along country lines and this adds to a lack of strategic coherence within the overall UK credit union movement.

determinants of deprivation, low income households as a proportion of electoral ward level population<sup>2</sup> and the percentage of the population in the electoral ward in low employment (ie forced exclusion from the world of work either through unemployment, sickness or disability)<sup>3</sup> are consistently treated between regions<sup>4</sup>. These two components were employed to gauge the degree of poverty/deprivation in an area and consequently to control for 'environmental' differences in the economic profile from which individual credit unions draw their members. In general terms the measures of deprivation revealed that approximately 69 percent of credit unions were located in areas of medium to high deprivation. For example, the location of credit unions ranged from being in an electoral ward where only 2.7% of the population are in receipt of benefits to being in a ward where 74.3% were on benefit. The two measures of deprivation are strongly positively correlated (0.84), however, the income measure identifies a greater proportion of credit unions to be located in areas of high deprivation relative to the employment measure. The comparative proportions are 34 percent compared to 25 percent. There are also some regional variations in deprivation. The sharpest distinction is between England and Wales, where the majority of credit unions are located in areas of high deprivation, and Scotland where the majority are situated in areas of low deprivation. Again the two measures offer a slightly different picture when it comes to a regional analysis. The most obvious difference being with respect to credit unions located in Northern Ireland. The income measure classifies approximately 50 percent of credit unions as being based in areas of high deprivation compared to 30 percent when the employment measure is used.

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2. The calculation of low income households is dependent upon factors such as the number of adults and children in income support households; the number of adults and children in income based job seekers allowance households; the number of adults and children in disability working allowance households; and non-earning, non-income support pensioner and disabled council tax benefit recipients.

3. The calculation of low employment is determined by the unemployment claimant count for those aged 16 to 59; new deal participants not included in the unemployment claimant count; incapacity benefit recipients aged 16 to 59; severe disablement allowance recipients aged 16 to 59; and those out of work but in government training employment schemes.

4. The deprivation components, at electoral ward level, were obtained from the relevant government department in each of the regions. Credit union postcodes were then employed in a manual matching of the deprivation measures to the individual credit unions in the sample.



**TABLE 1.**  
**MEAN SIZE, GROWTH, AGE AND SUSTAINABLE INDICATORS FOR UK AND REGIONAL CREDIT UNIONS AT DIFFERENT**  
**LEVELS OF LOW INCOME, IN 2000**

	UK 25 – 40%				ENGLAND & WALES 25 – 40%				SCOTLAND 25 – 40%				NORTHERN IRELAND 25 – 40%			
	< 25%	Low	Medium	High	< 25%	Low	Medium	High	< 25%	Low	Medium	High	< 25%	Low	Medium	High
<b>Number of credit unions</b>		159	215	192		61	123	140		55	26	9		43	66	43
<b>% of Benefit claimants</b>		%	%	%		%	%	%		%	%	%		%	%	%
Mean	18.01	32.22	49.71	49.33	18.33	32.55	49.93	41.96	17.17	29.49	41.96	50.64	18.62	32.67	50.64	50.64
Min	2.70	25.05	40.01	40.01	5.91	25.18	40.01	40.87	2.7	25.43	40.87	40.6	7.72	25.05	40.6	40.6
Max	25.00	40.00	74.27	74.27	24.99	39.97	74.27	43.86	24.97	38.29	43.86	67.00	25.00	40.00	67.00	67.00
Std Dev	5.35	4.48	7.82	7.60	5.24	4.27	7.60	1.08	5.79	3.62	1.08	8.56	4.86	4.84	8.56	8.56
<b>Total Assets</b>		£	£	£	£	£	£	£	£	£	£	£	£	£	£	£
Mean size	540,498	1,252,984	797,738	250,943	302,271	192,739	250,943	402,840	479,551	1,632,935	402,840	2,660,656	956,402	3,079,218	42,824	42,824
Min size	1,618	267	1,804	1,804	1,618	267	1,804	1,804	8,894	11,371	76,882	41,957	41,957	45,504	45,504	45,504
Max size	5,195,663	37,893,205	11,215,231	5,559,428	3,622,231	7,478,367	5,559,428	1,054,731	5,195,663	17,283,037	1,054,731	11,215,231	3,729,613	37,893,205	11,215,231	11,215,231
Std Dev	908,758	3,809,163	1,786,270	714,731	608,109	733,477	714,731	372,216	1,066,776	4,063,728	372,216	2,814,118	922,452	5,902,360	2,814,118	2,814,118
<b>Total Members</b>		No.	No.	No.	No.	No.	No.	No.	No.	No.	No.	No.	No.	No.	No.	No.
Mean	764	1,248	983	544	421	367	544	952	1,003	2,043	952	2,420	945	2,576	2,420	2,420
Min	22	5	32	32	22	5	32	277	56	87	277	127	75	97	127	127
Max	7,246	23,332	10,085	8,631	3,543	6,659	8,631	2,292	7,246	14,303	2,292	10,085	3,939	23,332	10,085	10,085
Std Dev	1,067	2,656	1,564	1,027	589	724	1,027	693	1,468	3,698	693	2,186	858	3,670	2,186	2,186
<b>Age</b>		Years	Years	Years	Years	Years	Years	Years	Years	Years	Years	Years	Years	Years	Years	Years
Mean	13.75	15.21	14.68	11.11	12.27	11.23	11.11	14.01	11.45	11.12	14.01	26.45	18.80	24.23	26.45	26.45
Min	6.00	6.25	6.31	6.31	6.46	6.49	6.31	9.79	6.34	6.66	9.79	6.75	6.00	6.25	6.75	6.75
Max	35.97	40.24	36.41	21.02	21.07	21.31	21.02	21.07	21.07	20.78	21.07	36.41	35.97	40.24	36.41	36.41
Std dev	7.89	9.48	8.24	3.29	4.81	2.33	3.29	5.26	4.61	3.80	5.26	9.12	11.72	11.71	9.12	9.12

The continued and deepening problem of financial exclusion prompted the UK Government to set up a Treasury Taskforce in July 1998 to investigate ways of widening the range of credit union services provided to members in order to encourage expansion of the sector. The main recommendations of the taskforce were to: permit credit unions to borrow from authorised institutions; allow interest-bearing (share) accounts and additional basic services and charge fees; make the common bond requirements more flexible; remove the current 5,000 membership limit; and extend repayment periods for loans. These recommendations were accepted and came into force in the form of legislative changes to the Credit Unions Act 1979 contained in Schedule 18 of the Financial Services and Markets Act 2000.

### 3. REGULATORY CHANGES

On the 1st December 2001 the Registry of Friendly Societies ceased to exist and the Financial Services Authority (FSA) took over the Registrar's powers for credit unions. Since the 1st July 2002 the FSA has had the full range of powers and tools of the Financial Services and Markets Act to apply to the regulation and supervision of credit unions. Credit unions are expected to be fully compliant with the FSA's Rules and maintain at least the minimum prudential standards laid down.

The Financial Services and Markets Act introduced a new process following the registration of a credit union. The Act gives a credit union authorisation to undertake deposit-taking business, but there are 2 variations of this deposit taking permission, namely, Version 1 requirements and Version 2 requirements. The Version 2 credit union type can lend larger amounts and for longer periods relative to the former and can offer a wider range of ancillary services. Version 2 credit unions also face much stiffer capital, liquidity and supervision requirements and are required to have a financial risk management policy setting out how they handle interest rate and funding risk. The FSA's new regime for credit unions also extends to credit union members' funds now being protected by the Financial Services Compensation Scheme. Under the rules of the scheme eligible depositors receive 100% of the first £2,000; 90% of the next £33,000 with the maximum amount payable under the scheme to an individual depositor being £31,700.<sup>5</sup>

Many smaller credit unions (especially those heavily reliant on part-time volunteers with limited expertise) will find it difficult to comply with the new regulatory framework. It is clear that the FSA does not view its brief to support unviable credit unions and as, stated earlier, there is likely to be a wave of often 'forced' mergers as weaker credit unions strive to survive the rigorous of this new regulatory framework.

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5. The first credit union to 'benefit' from the scheme is Thameswood credit union located in south-east London. It has 883 members and it was closed by the FSA in September 2002 as it was discovered to be heading for insolvency, see Walne (2002).

#### 4. REFINING THE UK RESEARCH AGENDA

Assessing whether UK credit unions will enter a more pronounced period of 'sustainable development' given both the changes in their regulatory framework and as a consequence of the predicted wave of (forced) mergers, requires both a quantitative and qualitative research methodology. There is now scope to refine the UK research agenda to better define credit union 'best practice' in a period of transition where credit unions are engaging in a more business orientated model of credit union development. Ideally, the most productive research methodology should comprise a mix of both quantitative and qualitative approaches. Also, researching this issue should entail a holistic approach involving interdisciplinary dimensions. However, before considering an ideal research approach and the range of methodologies that exist for assessing 'best practice' in credit unions, our initial focus will concentrate upon an historical appreciation of wider credit union research, particularly the distinction between 'structural' and 'agency' research perspectives.

The structural research agenda, which is largely American in origin, highlights an important conflict of interest that arises between members in determining the policies of a credit union. Emmons and Schmid (1999) describe this structural research approach as one that

*focuses on the legal structure of credit unions  
as consumer-owned cooperatives and  
explores how credit unions produce and  
distribute financial services.*

There is a long tradition of a structural approach in credit union research, particularly in the US but also more recently, for example, in the UK and Australia. Early theoretical research on U.S. credit unions in the structural tradition includes Taylor (1971), Flannery (1974), Smith, Cargill, and Meyer (1981), and Smith (1984). Membership bias is an important subset of research in the structural tradition, and this includes US research by Patin and McNiel (1991), Smith (1986) and again more recently in the UK by McKillop and Ferguson (1998). Further recent examples of the structural approach in credit union research can be seen in studies of member incentives by Besley, Coate, and Loury (1993), Hart and Moore (1996, 1998), Banerjee, Besley, and Guinnane (1994), Emmons and Mueller (1998), and Davis (1998). Additional recent empirical work in the structural tradition examines the operating efficiency of credit unions and this includes Fried, Lovell, and Vanden Eeckaut (1993) and Fried, Lovell, and Yaisawarng (1998) in the US, McKillop, Glass and Ferguson (2002) in the UK, Worthington (1998) and Esho (2001) for Australian credit unions and Pille and Paradi (2002) for Canadian credit unions.

Turning to the agency perspective in credit union research, the focus of an agency approach is identified by Emmons and Schmid (1999) as

*the important yet largely extralegal and unregulated relationship between the management of a credit union and its members and sponsor(s).*

Compared to stakeholder-owned financial institutions, credit unions have comparatively weak governance structures. This, in turn, can lead to the potential for managerial agency problems, where a credit union's management becomes, according to Emmons and Schmid, *the de facto residual claimant to the institution's surplus*. Removed from the discipline of institutional takeover and operating within relatively weak governance structures may lead credit union managers to favour their own interests as reflected in pay offs such as a large salary, or non wage benefits such as a luxurious office, generous travel allowances etc,. Given this perspective, Emmons and Schmid make the point that

*Agency problems may be of the first order of importance in credit union management and performance*

The agency research perspective is well developed in the US and recent work on agency theory includes Akella and Greenbaum (1988), Mester (1989, 1991), Keating and Keating (1992), and Schmid (1997). Recent research work in other countries utilising an agency perspective includes McKillop and Hickson (1995) in the UK.

Returning to our central concern of UK credit unions in a period of transition and the attendant concern to identify appropriate quantitative methodologies to assess 'best practice' in credit unions we should examine a number of these drawn from the structural tradition within credit union research. The first of these, the PEARLS performance measures are well known and used extensively in developed credit union systems. This is a financial performance monitoring system designed to offer management guidance for credit unions and other savings institutions.<sup>6</sup> WOCCU (2002) in guidance notes states that PEARLS can be used to compare and rank institutions. PEARLS encompasses 44 quantitative financial indicators across six general areas of operation

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6. This system builds upon CAMEL ratings of the financial safety and soundness of financial institutions. CAMEL is an acronym for five performance dimensions used to evaluate credit unions: capital adequacy, asset quality, management, earnings and liquidity management. Camel ratings vary from a high of 1 (sound in almost every respect) to a low of 5 (basically insolvent and unlikely to survive more than 12 months).

**TABLE 2.**  
**QUANTITATIVE FINANCIAL INDICATORS PEARLS**

PEARL Category	No. ratios in category (No. of key ratios)	Examples of key ratios
Protection	6 (2)	P1: Allowance for loan losses greater than 12 months
Effective financial structure	9 (4)	E1: Net Loans/total assets (suggested norm 70%-80%)
Asset quality	3 (2)	A2: Non-earning assets/total assets (suggested norm £ 5%)
Rates of return and cost	12 (3)	R9: Total operating expenses/average total assets (suggested norm 5%)
Liquidity	3 (1)	L1: (investments + liquid assets – payables)/savings (minimum 15%)
Signs of growth	11(1)	S11: Growth in total assets

Of the 44 ratios which constitute the PEARLS monitoring system some 13 are identified as being viewed as more important than the remaining ratios.<sup>7</sup> Other methodologies may offer a more robust mechanism for identifying ‘best practice’ and these are now considered.

One such methodology is that of the non-parametric techniques Data Envelopment Analysis (DEA). This technique has grown in popularity and Pilli and Paradi (2001) explain its antecedents and the power of DEA as a research methodology,

*DEA was developed from a multi-disciplinary effort by engineers, managers and economists and has seen enormous growth during the past two decades. DEA has been characterised as a new way to organise and visualise performance data in organisations. Scientifically speaking, DEA is a non-parametric, fractional linear programming technique that results in a best practice frontier constructed from the best performing units in the sample. Moreover, DEA provides efficiency ratings for the inefficient units as well as indicators of potential improvement opportunities for such units. For cases where there are a sufficient number of operating units, decision making units (DMU), DEA offers a method of analysis that accommodates multiple inputs and outputs at the same time and is units invariant.*

7. WOCCU (2002) provide a commentary on the respective ratios and suggest which ones should receive the most attention from financial institutions. The number of ‘important’ ratios in each of the categories is highlighted in parentheses.

Data Envelopment Analysis (DEA) is therefore a sophisticated quantitative approach that can be used to create efficiency measures for credit unions in order to identify and rank strong performing and weaker credit unions. This particular approach has proven itself to be both a theoretically sound framework for performance measurement and an acceptable method by those being measured. DEA has many advantages over traditional methods based upon performance ratios, and activity based measurements. The benefits that DEA provides are that it does not require weights to be determined in combining ratios for ranking of Credit Unions, it provides peer groups (relatively efficient Credit Unions) that inefficient units can compare themselves to in order to improve their management practices, and it also provides the amounts by which inputs should be reduced or outputs might be increased, in order to become efficient. The regulator can use DEA as one simple all encompassing measures to monitor change and the relative efficiency of individual credit unions.

A competing methodology which provides a single measure of the relative performance of individual credit unions is the parametric stochastic frontier approach. In this instance the performance of individual credit unions are assessed relative to an empirically constructed frontier. This approach can also be adapted to gauge the extent to which the environment within which a credit union operates impacts upon that credit unions relative efficiency. The methodology also permits each credit union to be placed in a similar operating environment and thus determine how much of a credit union's inefficiency is due solely to managerial performance within the credit union. As with DEA this methodology provides peer groups (relatively efficient Credit Unions) that inefficient units can compare themselves to in order to improve their management practices, and it also provides the amounts by which inputs should be reduced or outputs might be increased, in order to become efficient. The regulator can also use these parametric efficiency measures to monitor change and the relative efficiency of individual credit unions.

Assuming that the environment affects the efficiency with which a production process is operated the parametric approach can be detailed more formally as follows. Assuming a stochastic translog (TL) cost frontier format so that the model can be written, for  $i = 1, \dots, I$  credit unions and  $t = 1, \dots, T$  periods, as

$$\ln C_{it} = TL(y_{it}, w_{it}, t; \beta) + v_{it} + u_{it}. \quad (1)$$

In (1),  $C_{it}$  denotes the variable costs incurred by producer  $i$  in period  $t$ ,  $w_{it}$  are the exogenous input prices, and  $y_{it}$  are the outputs produced by the credit union. The deterministic part of the stochastic cost frontier model (1) is given by the first term on the right-hand of (1). In this term, the inclusion of  $t$  in  $TL(\cdot)$  accounts for technological progress, while  $\beta$  is the vector of parameters to be estimated.

In the composed error term  $\varepsilon_{it} = v_{it} + u_{it}$ , the effects of random shocks on producer  $i$  are captured via the two-sided random-noise component  $v_{it}$ , while the one-sided error component  $u_{it} \geq 0$  reflects cost inefficiency. The  $v_{it}$  are assumed to be independently and identically distributed as  $N(0, \sigma)$ . The  $u_{it}$  are defined so as to embody the assumption that environmental conditions influence a credit union's

cost inefficiency. Hence the cost inefficiency term is made an explicit function of a vector of environmental variables  $z_{it}$ .

Earlier it was stated that the most productive research methodology should comprise a mix of both quantitative and qualitative approaches. Before progressing to a discussion of this, it is necessary to first consider qualitative research in its own right and assess its strengths and weaknesses. The strengths of qualitative research relate to its depth, openness and the avoidance of pre judgements. It is generally accepted that it is possible to understand phenomena at a deeper level through qualitative research than say relying on the standardised questionnaire beloved of a quantitative methodology. Qualitative research affords the opportunity to generate new theories and recognise phenomena ignored by previous research and literature. Above all, qualitative research helps others see the world view of those studied – *their* categories, rather than imposing categories it simulates their experience of the world. Given the voluntary, member based nature of credit unions it is important to capture this dimension in the research agenda of transition. Attempts to avoid pre-judgements, (although we always make judgements, for instance choice of one location or group over another is a judgement) therefore the research goal is more of a quest that tries to capture what is happening without being judgmental; to present people on their own terms, and to try to represent them from their own perspectives. Jones (2002) study of access to credit by Liverpool's poor and the case study of Derry credit unions by Heenan, and McLaughlin (2002) both provide recent studies of relevance to UK credit unions which employ a strong qualitative approach.

The weaknesses of qualitative research are well known. Generally research utilising a qualitative methodology involves small sample sizes and fewer people are studied. As a consequence of this, it is less easy to generalise the results of the research. It is also far more difficult using a qualitative methodology to aggregate data and make systematic comparisons. Qualitative research is heavily dependent upon the researchers' personal attributes and skills in conducting the research. Finally, the *hawthorne effect*, where participation in a setting always changes the social situation is a further well known negative dimension.

## 5. BEYOND PEARLS

As previously indicated, researching 'best practice' in the transition of UK credit unions to a more business orientated model of credit union development should, in our opinion, entail the use of either a parametric or non-parametric frontier approach. In keeping with our plea for a mix of appropriate quantitative and qualitative research in order to produce a more holistic interpretation, researching the development and performance of credit unions should also entail examination of the fine detail their actual operation through focussed, qualitative case studies. Whilst the parametric or non-parametric frontier approach provides data on a range of efficiency measures it does not capture the complexity of credit union operations, nor can it provide a full

explanation of differential performance. For example parametric or non-parametric frontier approaches do not easily capture the full complexities of credit unions operations. For example the different governance structures of individual credit unions or the different characteristics of the membership mix. Table 1 clearly highlights that credit unions draw their members from varied socio-economic groups and there is anecdotal evidence for credit unions in both Scotland and Northern Ireland that those credit unions which have prospered over the last thirty years are those which have had a common bond which captured both a low income and middle income membership which enables the credit union to generate a healthy balance between saving members and borrowing members.

Lydia Plackett from the UK trade body ABCUL highlights the need for further research in the UK and emphasized the central place of the economic and competitive environment in which credit unions operate and develop, their organization and management, the role of government in credit union development, the fundamentals of credit union purpose including extant models of development, the common bond and a greater understanding of 'community' all as issues requiring further study. These issues should be reflected in the future research agenda. In keeping with previous empirical work, exploring these issues will also entail interpretative research techniques based upon in depth case studies.

A case study approach can allow deeper analysis of the strengths and weaknesses of particular credit union operational and development strategies and can help uncover results that will be instructive for weaker credit unions by more accurately highlighting 'best practice' in the sector.

In terms of conducting plausible research the following specification represents our minimum specification. The case study analysis should extend to fifteen credit unions where six credit unions are to be chosen from those identified as strong performing (group (a)) identified earlier through either the parametric or non-parametric frontier approaches. This is a key credit union group in that it is this category that contains role model credit unions. These six credit unions will be differentiated in terms of their asset base (small, medium or large credit unions, with two credit unions considered in each of these categories) and their geographic location (located in Northern Ireland, Scotland, England or Wales, with at least one credit union considered in each location). For comparator purposes the other nine case studies should consider three average performing credit unions (group (b)), three marginally performing credit unions (group (c)), and three weakly performing credit unions (group (d)). In each case a small, medium and large credit union will be considered with emphasis also placed on achieving as much regional diversity as possible.<sup>8</sup>

The case studies would involve a mix of action research, participant observation, semi-structured interviews plus desk-based research. The semi-structured interviews

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8. A random approach will be employed, subject to satisfying the previously mentioned criteria, to choose credit unions for case based study.



should be carried out independently with the following (i) key representatives on the credit union board, the Chair and Treasurer (ii) the credit union manager (iii) representatives at local authority/development agency level with a brief/interest in credit union development. The desk-based research will, for example, consider material detailing the socio-economic profile of the area in which the credit union draws its members as well as business planning material and related information relevant to the research agenda spelt out by Plackett (2002) and itemized earlier.

The start point for each case study is the economic and social profile of area in which the credit union's common bond is based and this should include consideration of the population profile, the ethnicity and religious profile and an assessment of the extent of poverty and social exclusion. Additionally, the employment profile should be considered along with extant community development policies and any local initiatives for tackling social exclusion. The nature of the common bond and the membership mix of the credit union also require to be examined.

How well a credit union fulfils its membership growth opportunities will be an important component of each case study. Competitive comparisons should be made with other local financial services providers and the efficacy of the credit unions marketing efforts should also be considered. This would entail detailed examination of product and service offerings along with the strategies employed for membership growth based upon, for example, employment, housing associations or other distinct potential membership elements within the common bond area. How the credit union undertakes its promotional work, the extent to which the 'membership market' has been segmented in terms of say youth, retired or unemployed potential members could be considered. In terms of product offerings, detailed consideration should similarly be given to the credit unions objectives for share deposits and withdrawals, loan repayments and loan interest and loan take up.

By linking the results of the parametric or non-parametric frontier approaches to focused case studies of credit union that excel within their geographical location and asset size base should reveal useful results. This weight of our research approach stresses the ingredients of best practice rather than searching for the reasons for credit union failure, and to this extent can offer 'role model' credit unions for others to emulate.

## 6. CONCLUSIONS

The benefits for the UK credit union movement in bringing to bear a research armoury that better defines 'best practice' in credit union operations is an important issue at this stage of credit union development in the UK. This paper has explored some of the existing perspectives in credit union research and has highlighted strengths and weaknesses of particular quantitative methodologies. The quantitative methodology that appears most suited to the research needs of the UK movement, given the objective of more rigorously defining 'best practice', is a frontier approach (either parametric

or non-parametric). We have been at pains throughout to stress that only a mixed methodology will best serve the research agenda of defining best practice, and therefore equal weight must be given to the employment of a qualitative methodology. To this end we have mapped out the minimum requirements for a series of linked empirical case studies and how credit unions would be selected for study. The detail of the scope of the case studies has also been provided to illustrate how the qualitative dimension can add to a richer picture by stressing important positive attributes of 'best practice'.

Hopefully refining the UK credit union research agenda will aid in the production of some positive evidence that the announcements of the UK movements possible demise are perhaps premature. Preliminary findings reported by Plackett (2002) for instance indicated a more hopeful future than that reported by many other commentators,

*Having investigated [elements of credit union development and organisation] the writer concludes that credit unions can survive in the twenty-first century and even move from the margins to the mainstream of financial services provision*

Refining the research agenda and obtaining better research results on what constitutes 'best practice' and what constitutes a 'role model' UK credit union will support or deny this assertion.

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# DEVELOPMENT AND PROSPECTS OF A NEW COOPERATIVE CREDIT SYSTEM: THE GREEK CASE

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## 1. INTRODUCTION

The Greek co-operative credit system was initiated at the beginning of '90's under the new legislative frame which describes the creation and function of co-operative credit institutions. Till 1992, three credit co-operatives were created under the Law on civil co-operatives without having the status of credit institution. With the new legislation, co-operative credit institutions are divided into two categories:

- credit co-operatives which are not banking institutions and they can not offer banking services (only limited economic help to their members); their aim is to collect the requested capital in order to become co-operative banks,
- co-operative banks which can offer all banking services. Their creation results after the accomplishment of the principal request, the collect of minimum capital.

The credit co-operative system includes 15 co-operative banks and 14 credit co-operatives. Despite their big number, these institutions have a very limited part of the Greek banking system because of endogenous difficulties of development of the system and increased competitiveness of the Greek banking market. The development of the Greek co-operative credit system is characterized by the autonomy of institutions and a non homogenous development influenced by the policy of these institutions. Prospects of the system are limited due to its capacities of development.

Development and prospects of the Greek co-operative system are examined in the following sections: legislation, autonomous and non homogenous development, prospects of development, conclusions.

## 2. THE LEGISLATION

The legislative framework that permitted the creation of the Greek credit cooperative system is provided by the Law 2076/1992 for the credit institutions and the Act 2258/1993 of the Governor of the Bank of Greece ("Definition of the framework of function and supervision of credit institutions under the form of credit cooperative of the Law 1667/1986") (Karafolas, 1997). While the Law 2076/1992 acknowledged the possibility of existence of co-operative banks in Greece, the framework of their operations was mainly defined with the Act 2258/1993. The main characteristics of the creation and function of co-operative banks are:

- Co-operative banks can exercise all banking services except the underwriting ones.
- They can transact exclusively with their members, other credit institutions and the Greek State. Transactions with non members are permitted only under the participation of a member in them. These transactions are referred essentially to deposits in which a member can have a common deposit account with a non member.
- Co-operative banks are subject to the same supervision and regulation imposed by the Bank of Greece, as any other bank. On the contrary, the credit co-operatives are subject to the supervision of the Ministry of National Economy and Finance.
- The share capital requested for the foundation of a co-operative bank depends on the bank's geographical expansion:
  1. 1,76 million euros for a co-operative bank having members and branches in only one prefecture (Greece is divided to 52 prefectures); prefectures of Attiki and Thessalonica are not included in this rule.
  2. 5,87 million euros for a co-operative bank with members and branches in the bordering prefectures as well or in the same administrative region (Greece is divided in 13 regions).
  3. 11,74 million euro for a co-operative bank expanded allover Greece or having the head office in Attiki or Thessalonica.

The minimum requested capital augmented by the Bank of Greece in 2001 with the Act 2471/10.4.2001 of the Governor of the Bank of Greece ("Definition of the minimum share capital of credit institutions"). The demanded capital is now for each of the three categories respectively, 6 million euros, 10 million euros and 18 million euros.



### **3. AN AUTONOMOUS AND NON HOMOGENOUS DEVELOPMENT**

#### **3.1. Local credit institutions**

The Greek credit co-operative system is characterized by an autonomous development of its institutions based on local credit institutions. At its first stage the system constituted only credit co-operatives that had to accomplish the condition of the minimum capital. Number of them succeeded their transformation to a bank. By the end of 2003, 15 co-operative banks and 14 credit co-operatives were registered, table 1. Among the co-operative banks only two, Pagritia Co-operative Bank and Co-operative Bank of Chania have branches in more than one prefecture, table 2.

The Greek system did not consider the existence of regional co-operative banks, as in the case of France (Guichon, 1988 and Palomo Zurdo, 1997) or Germany (Aschhoff and Henningsen, 1996 and Palomo Zurdo, 1997). The legislation does not presuppose the existence of a central co-operative bank as it is the case of numerous credit co-operative systems in Europe (Palomo Zurdo, 1997). The idea of a central co-operative bank has been discussed because of the weaknesses in the development of the system, and especially for most of the participant institutions. A form of a central co-operative bank took place in 2001.

#### **3.2. Non homogenous development**

Since 1993 the strong interest in the creation of a credit co-operative has resulted to the creation of 31 credit co-operatives in 30 towns; these institutions were added to three credit co-operatives that had already existed under the Law 1667/1986 on "Urban Co-operatives" (Karafolas, 1997). Some reasons expressed the need of the credit co-operative system:

- Offer of better banking terms such as lower credit interest and higher deposit interest
- Effort to eliminate usury
- Collection and use of the local savings in the department
- Development of the local economy and society

Initiatives were taken principally by local organizations and particularly the local chambers of commerce and industry. Members are mainly merchants, professionals and owners of small industries. The participation of farmers is very limited because of the involvement of the Agricultural Bank of Greece in agricultural businesses (Karafolas, 1997).

The strong interest in the credit co-operative system did not have the results expected by all participants. More than half of the credit co-operatives were not

transformed in co-operative banks because they did not succeed in collecting the requested capital for a co-operative bank. Only a small number, of the existing co-operative banks, has an important growth beyond their prefectures' limits. Three categories of institutions can be distinguished within the system in connection with their development:

1. The co-operative banks that managed the higher growth, Pagritia Co-operative Bank, Co-operative Bank of Chania, Co-operative Bank of Dodekanisou and Co-operative Bank of Lamia.
2. The other co-operative banks that accomplished their transformation to a bank.
3. The credit co-operatives that did not collect the demanded capital.

In order to compare the development of co-operative banks, we examined:

- The banks' activities, including balance sheet elements and the geographic expansion,
- the interest showed by the local population in the co-operative banks.

On table 2 we present elements of balance sheets of the 15 co-operative banks, while on table 3 we present elements connected to the expansion of the bank. On both tables the non homogenous development appears clearly. Activities and branches are concentrated on three banks, Pagritia (mainly), Chania and Dodekanisou that in 2002 held 65,7% of assets of co-operative banks, 67,9% of deposits, 66,1% of loans, 57,9% of equity capital and 66% of branches. The Co-operative bank of Lamia presents a particularity. This institution was the pioneer of the system as it is the oldest co-operative credit institution in Greece, created on 1911 as a co-operative of technicians and workers of Lamia. But problems on bank's activities resulted to the intervention of the Bank of Greece, (Palamiotis 2000); the consequence was the loss of confidence towards the bank and therefore decline of activities. The Co-operative Bank of Lamia remains the second numerous co-operative bank having more than 15.000 members, despite its problems.

Beyond the bank's activities, Pagritia has the largest number of branches and it is one of the two co-operative banks (the other being the Co-operative Bank of Chania) having branches in more than one prefectures.

Three main reasons can explain the predominance of the co-operative banks of Pagritia, Chania and Dodekanisou:

1. A strong spirit of co-operation due to a healthy co-operative development, on the islands of Creta and Dodekanisa. Greek co-operative movement, related to agricultural area mainly, was often criticized for inefficiency because of political interventions (Kamenidis, 1991 and Klimis, 1991). These problems provoked the loss of confidence on the part of the population towards the co-operative movement. In the cases of Creta and Dodekanisa a healthy co-operative

organization in navigation along with the creation of shipment co-operatives led to the success of the co-operative banks as well.

2. The confidence to the pioneers who had the initiative for the creation of credit co-operative institution. The confidence towards the Board of Directors and even the president, conducted an important part of the population to participate in the creation of the credit co-operative.
3. The expansion policy followed, especially by the Pagritia and in a lower level by the Chania and Dodekanisou. Other co-operatives had a conservative expansion policy. In the case of Pagritia the expansion policy was related to the creation of peripheral councils which had a role of motivating the local population; the council could suggest the creation of a branch as well.

The local economic situation may have a positive influence in some cases such as in the Co-operative Bank of Dodekanisou and the Co-operative Bank of Lesvou (that has established 6 branches). Using the aggregate "Deposits per Habitant", (in 15 prefectures where a co-operative bank functions), table 4, it appears that co-operative banks with an extensive policy are in prefectures with higher level of savings. Nevertheless, the influence of local economic situation must not be generalized, since differences of savings are not very important, in comparison to the average of 15 prefectures, (with the exception of Dodekanisou and Lesvou); furthermore, in some cases, co-operative banks that belong to departments with higher level of savings have a low expansion (example of the Co-operative Bank of Ioannina).

The participation of the local community can give a clear view on the development of a co-operative bank and how strong the bank's involvement in the local society and economy is. We created two graphs:

1. For the first, (population's participation in the co-operative bank), we used two elements, actions held per member and part of the local population who are members of the co-operative bank. Thus, we can observe if an important part of residents has a strong participation in the co-operative bank. The best result is obtained by Pagritia, graph 1, followed by Chania and Dodekanisou. The case of Lamia is an exception related to its long existence.
2. The second graph shows the bank's involvement in the local economy measured by two elements: deposits in the bank as part of deposits in the department and part of the population who are members of the co-operative bank. Pagritia has the most important involvement, (this result is partly overestimated because of its expansion to other departments too), followed by Lamia, Chania and Dodekanisou, graph 2. The involvement of the other co-operative banks is very limited, between 1% and 2% approximately. This result shows the difficulties that co-operative banks have to face in the local economy because of the strong competition of the other nation wide banks.

### 3.3. Different stages of growth

Ferguson and McKillop (1997) described three stages of growth for credit unions which are: nascent, transition and mature. A summary table of the described stages is given at Ferguson, McKillop and Sibbald (2002).

We can have a comparison with the Greek case by examining the following areas:

1. Asset size,
2. regulations,
3. common bond,
4. product diversifications,
5. voluntarism,
6. sponsorship from the credit union movement,
7. professionalism,
8. development of computerization system,
9. economic targets and targets of growth,
10. central services,
11. organization.

Component of the stage	Co-operative bank	Credit co-operative
Asset size	Large : Pagritia Medium: Chania, Dodekanisou Small : all others	Small : alls
Management	Professionalisation	Voluntarism
Product	Shift towards product diversification	Single collect of capital and informal loans to members
Central services	Under development with the help of Panellinia	Non authorized for banking services
Help from the Credit Union movement	Only under the specific help of Panellinia Bank	Important for offer services and capital collect
Computerized system	Yes	Exists but limited
Economic targets	Yes	Main target: collect the demanded capital
Common bond	Exists	Exists

Somme comments on the findings.

A distinction has to be made between a co-operative bank and a credit co-operative one since only the first can offer banking services; the credit co-operative targeting on the collection of the demanded capital in order to become a co-operative bank.

- The asset size is small in comparison to nation wide banks. Pagritia, mainly, can be an exception. Limitations due to offer of services only to members and limitations on the geographic expansion are the main reason for the stage of growth.
- Co-operative banks now use professionals for the management of the bank. The participation of the bank's members in the Board of Directors does not prevent the professional management of the bank. Problems arisen in the bank's management, (as in the case of the Co-operative Bank of Lamia but for other credit co-operatives and co-operative banks as well), and the need for growth of the bank resulted in the acceleration of professionalism and the limitation of voluntarism (which is still important to credit co-operatives).
- Even if loans and deposits remain the strongest part of banking activities, diversification of products, as money transfer, credit cards, stock market services, constitute the targets of all co-operative banks. The support of a central wide co-operative bank seems imperative for most of the banks to develop central services that, otherwise, could not be offered or would be very expensive for the clients.
- The credit union movement has an important involvement in credit co-operatives. Within co-operative banks it is limited to actions related to training programs for the staff, representation to national authorities as the Bank of Greece and related ministries.
- One characteristic of the Greek co-operative credit system was the involvement of the State and the European Union by financing projects related to the creation and development of credit co-operatives; by this program, 23 credit co-operatives had been financed (50% of the proposed budget) for activities related to computerization, diffusion of the cooperative idea, equipment, building transformations, preparation of business plan (Karafolas, 2002).

## **4. PROSPECTS OF DEVELOPMENT**

### **4.1. Cooperative banks in the Greek banking market**

In spite of the big number of cooperative banks, 15 cooperative banks against 24 credit institutions of nation wide, co-operative banks have a limited part in the Greek banking market in regard to banking network, personnel and balance sheet element.

By the end of 2002, 15 co-operative banks had a network of 76 branches and outlets while 24 non co-operative credit institutions had in total 3.184 branches and outlets, table 5, which is about 133 branches and outlets per bank against 5 branches and outlets per a co-operative bank. An analogous result appears for the personnel since co-operative banks had 566 employees against 59.772 for the other banks.

An analogous image appears on balance sheet elements, table 6. Co-operative banks have a very limited part of the market which does not correspond to the number of institutions. Part of assets and deposits of co-operative banks in total assets and deposits are only 0,5%; for loans this part is only 0,8%. The Pagritia Co-operative Bank has only the 19<sup>th</sup> place within Greek credit institutions and the Cooperative Bank of Chania the 22<sup>th</sup> place, table 7.

The nature of co-operative banks is on the basis of this limited part in the Greek banking market. Some main reasons can be mentioned to explain it: restrictions of capital, restrictions of areas and clients, restrictions of services.

- Restrictions of capital: Credit co-operatives (and co-operative banks) were created with a strong sense of democracy regarding the management and co-operative capital possession. Independently of capital possession, at the General Assembly each member has one vote. Furthermore the possession of co-operative capital can not surpass a limit designed by every credit co-operative. The main reason is to avoid the control over the credit co-operative institution by one person or a small group of members. Such a philosophy prevents investors from investing important amounts. Consequently, people of the same prefecture participated with a small amount covering a minimum of the co-operative capital. The result is the rather limited amount of actions held by every member and therefore the limited capital of the bank.
- Restrictions of areas: According to the legislation, a co-operative bank can have members and network in one prefecture or in bordering prefectures or it can be a nation wide bank. In every case the requested capital differs. Within 15 co-operative banks, 13 have banking networks and members-clients exclusively in one prefecture. Consequently, the bank's clientele is limited to the prefecture; that implies the limited growth of the bank. The Pagritia Co-operative Bank and the Co-operative Bank of Chania present a diversification to the general rule; however, their network is expanded only on the Island of Crete, which is divided into 4 prefectures, and Athens.
- The limited network results to a higher cost of transaction for services to other departments, in comparison to banks with national and international banking network. Consequently, the co-operative bank is obliged to limit the services offered to the clientele mostly to deposits and loans. Even so, these two services are limited too. Because of the limited clientele, deposits are limited and therefore loans are limited too, despite the fact that some Greek co-operative banks use the co-operative capital for granting loans, table 2. The inability to offer services or to offer them with higher cost, such as management of available funds, capital transfer abroad, clearing of checks, underwriting, create unfavorable conditions to the growth of co-operative banks.

## 4.2. The creation of a nation wide organization

The creation of the Panellinia Bank targeted at the development of those services which can not be offered or are very costly for the bank's clients. Its intervention could be in several levels with the offer of:

- a nation wide network,
- central services with an acceptable cost,
- sufficient capital to satisfy the loan demand.

Its creation had been discussed from the first steps of the credit co-operative system. The creation of the Union of Co-operative Banks of Greece aimed at playing the role of a central co-operative bank by its gradual transformation to a bank.

In order to satisfy these needs, the Panellinia Bank has been created by 14 co-operative banks (with the exception of the Co-operative Bank of Ioannina) and 15 credit co-operatives (Panellinia Bank, 2004 and Union of Co-operative Banks of Greece, 2001).

According to its status, the Panellinia Bank is a stock company, "Societe Anonyme", according to the Laws 2076/92 and 2396/96 and the relative Acts of the Governor of the Bank of Greece. It is not a co-operative bank. The bank was established with the amount of 11,74 million euros, the minimum capital requested for the creation of a nation wide bank (Journal of the Government, 2001).

The bank can exercise all banking services. Nevertheless, one of the major purposes of the bank is to support, improve and expand the transactions of local co-operative banks and help in the development and proliferation of co-operative credit in Greece. The status of the bank anticipates the following activities to realize these targets, (Journal of the Government 2001):

- The exercise of internal audit to co-operative banks, if they wish to, and after the authorization of the Bank of Greece.
- The transfer of know how to co-operative banks.
- The function of branches in all towns where a co-operative credit exists, after an agreement between the Panellinia Bank and the credit co-operative.
- The support and provision of any appropriate help to credit co-operatives in order to become co-operative banks.
- The development and support of computerization systems for co-operative banks.
- The application of training programs for the employees of co-operative banks and credit co-operatives.
- The management of the available funds of co-operative banks and credit co-operatives.

- The development of new banking products for the co-operative banks.
- The exercise of import-export related banking services and other services related to the foreign activities for the benefit of clients of co-operative banks. The creation and function of the Panellinia Bank corresponds to the nature and function of central co-operative banks at European co-operative banking systems described by Palomo Zurdo (1997). The author concluded by the following characteristics of central co-operative banks:
- The central co-operative bank appears to be the achievement inherent to the development process of the system.
- Central co-operative banks are not credit co-operative societies but stock societies (usually limited companies) whose share holders are, mainly, the credit co-operative societies which make up every respective co-operative banking system. Among their shareholders, they are usually co-operatives from other sectors of activity.
- Central co-operative banks can resolve needs of local co-operative banks related to certain activities for which a central operation and the achievement of a critical mass to operate (with enough profit margins in the financial markets) are necessities. Such activities are those concerning clearing and means of payment, activities within national and international financial markets, institutional and corporate banking, specialized and advising services (such as international trade operations, stock in companies etc.).
- The guideline for the functioning of this institution is the principle of subsidiariness to meet certain operative needs.
- The existence of the central co-operative bank allows an access to companies and markets which local co-operative banks could not easily reach by themselves.
- The central co-operative bank does not harm the operating and decision making independence of local co-operative banks.

#### **4.3. The insufficiency of the nation wide effort and the changes in the Greek banking market**

The involvement of the Panellinia Bank in services offered by credit cooperative institutions may help them to improve their function; nevertheless, the positive influence will be limited because of the formation of the cooperative credit system its self and the changes that took place in the Greek banking system and the Greek economy during the last decade.

The character of the credit co-operative system, based on the participation of local communities, presents an important obstacle to its development even with the



collaboration of the Panellinia Bank. Every co-operative bank has its own Board of Directors and General Assembly who decide on the bank's policy. Independently the professionalization of bank's management, this character favors rather a conservative than an extensive policy. Due to capital restrictions, loans or investments of big amounts can not be considered. Such amounts can easily be offered by nation wide banks. Risks can not be undertaken by the manager of the co-operative bank because a failure could have disastrous results for the bank given its small magnitude. Therefore these banks remain small banks with a limited part in the Greek banking market.

The Greek banking market faced main changes in the decade of '90s characterized by a strong concentration based on some private banks (Maliara, 2000). In 2002, six banks had more than 81% of the assets of the banking market in Greece, table 7. This concentration exacerbated the growth of new banks including co-operative banks.

During the second half of the decade of '90s, the Greek economy was characterized by a strong fall of inflation. The rate of inflation fell from 20% at the beginning of '90s to an average, during the last 3 years, of 3,5%. The consequence was the analogous fall of interest rates. But, high interest rates on loans had been a main reason for the creation of co-operative banks. Small enterprises, mainly commercial, had great difficulties in suffering such expensive loans. The creation of credit co-operatives institutions, that could offer less expensive loans, seemed an alternative solution. This main problem has no more the same significance and probably it will not either in the next years because of Greece's participation in the Economic and Monetary Union that demands a strict monetary policy. This environment, (contrary to the one at the beginning of '90s) is rather hostile towards the considerable growth of the credit co-operative system.

## 5. CONCLUSION

The Greek co-operative credit system, initiated at the beginning of '90's, is characterized by an autonomous and non homogenous development. Three categories can be distinguished: banks with an extension to several departments having the biggest growth, other co-operative banks limited to one department, and credit co-operatives that are not banking institutions and must collect the demanded capital in order to become a bank. The formation of the system is based on local credit institutions with no regional co-operative credit institutions. Since 2001, a banking institution, formed by co-operative banks, has a role of a central co-operative bank without being a co-operative credit institution; a principal aim of the bank is to help co-operative banks and credit co-operatives by offering appropriate services. Co-operative banks in Greece introduced a professionalisation of the management and try to have banking services more than loans and deposits being at a stage of transitory banks. The local

character of co-operative credit institutions and the restrictions that derive such as capital and clients restrictions, prevent banks' growth. The strong concentration of the Greek banking system and the economic changes, especially the considerable fall of interest rates, put further limits on this growth. Co-operative credit institutions, influenced by all the above reasons, will follow a limited penetration of the banking system.

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**TABLE 1.**  
**GREEK CO-OPERATIVE BANKS AND CREDIT CO-OPERATIVES, END 2003**

	<b>Co-operative banks</b>	<b>Credit co-operatives</b>
1	Ahaiki	Arkadias
2	Chania	Artas
3	Dramas	Athinon
4	Dodekanisou	Etoloakarnanias
5	Evrou	Hermes
6	Evoias	Kilkis
7	Ioanninon	Larissas
8	Karditsas	Megaridos
9	Korinthias	Magnisias
10	Kozanis	Serron
11	Lamia	Thesprotias
12	Lesvou-Limnou	Thessalonikis
13	Pagritia	Viotias
14	Pierias	Xanthis
15	Trikalon	

Source: Co-operative banks and credit co-operatives .

**TABLE 2.**  
**CO-OPERATIVE BANKS: BALANCE SHEET ELEMENTS, END OF 2002**  
**(IN .000 EUROS)**

Co-operative bank	Assets	Deposits	Loans	Equity Capital	Profits (*)
Pagritia	394.831	302.947	312.503	78.726	8.261
Chania	116.830	83.471	83.405	27.986	1.680
Dodekanisou	96.927	76.937	80.940	17.920	1.393
Ahaiki	58.116	33.018	47.519	23.427	1.679
Lamia	57.493	38.721	62.385	16.806	603
Evoias	34.088	27.399	24.885	5.759	939
Lesvou-Limnou	27.902	21.884	18.195	5.569	537
Trikalon	26.978	19.234	19.354	6.298	811
Ioanninon	25.200	17.957	20.495	6.776	244
Evrou	22.977	18.139	15.497	4.626	324
Karditsas	19.668	12.909	10.231	6.074	521
Dramas	12.405	7.828	7.369	4.245	340
Kozanis	12.369	8.263	6.644	3.999	10
Pierias	11.459	8.429	5.420	2.931	7
Korinthias	8.851	4.949	6.583	3.666	264
Total	926.094	682.084	721.426	214.808	17.614

(\*) Profits before taxes.

Source: Co-operative banks, Balance sheet and Income statement of 2002.

**TABLE 2A.**  
**CO-OPERATIVE BANKS: BALANCE SHEET ELEMENTS, END OF 2002: PART OF**  
**TOTAL (IN %)**

Co-operative bank	Assets	Deposits	Loans	Equity Capital	Profits (*)
Pagritia	42,6%	44,4%	43,3%	36,6%	46,9%
Chania	12,6%	12,2%	11,6%	13,0%	9,5%
Dodekanisou	10,5%	11,3%	11,2%	8,3%	7,9%
Ahaiki	6,3%	4,8%	6,6%	10,9%	9,5%
Lamia	6,2%	5,7%	8,6%	7,8%	3,4%
Evoias	3,7%	4,0%	3,4%	2,7%	5,3%
Lesvou-Limnou	3,0%	3,2%	2,5%	2,6%	3,1%
Trikalon	2,9%	2,8%	2,7%	2,9%	4,6%
Ioanninon	2,7%	2,6%	2,8%	3,2%	1,4%
Evrou	2,5%	2,7%	2,1%	2,2%	1,8%
Karditsas	2,1%	1,9%	1,4%	2,8%	3,0%
Dramas	1,3%	1,1%	1,0%	2,0%	1,9%
Kozanis	1,3%	1,2%	0,9%	1,9%	0,1%
Pierias	1,2%	1,2%	0,8%	1,4%	0,0%
Korinthias	1,0%	0,7%	0,9%	1,7%	1,5%
Total	100,0%	100,0%	100,0%	100,0%	100,0%

**TABLE 3.**  
**YEARS OF FUNCTION AND EXPANSION OF CO-OPERATIVE BANKS**

Co-operative bank	Years of function	Members	Branches	Departments of implantation
Pagritia	10	27.934	30	5
Chania	9	8.792	12	4
Dodekanisou	9	8.456	11	1
Ahaiki	10	5.179	4	1
Lamia	10	15.200	3	1
Evoias	5	2.295	2	1
Lesvou-Limnou	5	2.000	6	1
Trikalon	6	2.851	2	1
Ioanninon	10	4.512	2	1
Evrou	7	2.310	2	1
Karditsas	6	2.370	1	1
Dramas	5	2.225	1	1
Kozanis	4	1.347	1	1
Pierias	5	1.549	1	1
Korinthias	6	1.455	2	1
Total		88.475	80	

Source: Co-operative banks .

**TABLE 4.**  
**DEPOSITS PER HABITANT IN PREFECTURES WITH A CO-OPERATIVE BANK**  
**(IN EUROS)**

<b>Prefecture</b>	<b>Deposits</b>
Dodekanisou . . . . .	10.730
Lesvou-Limnou . . . . .	8.150
Ioannina . . . . .	7.354
Chania . . . . .	7.191
Irakleion (1) . . . . .	7.151
Evrou . . . . .	7.004
Dramas . . . . .	6.976
Ahaia (2) . . . . .	6.736
Total of involved prefectures . . . . .	6.702
Evoias . . . . .	6.661
Korinthias . . . . .	6.429
Kozani . . . . .	5.975
Viotias (3) . . . . .	5.773
Pierias . . . . .	5.228
Trikala . . . . .	5.182
Karditsa . . . . .	3.646

Source: Bank of Greece, Department of Economic Studies

Notes: (1), (2), (3): Where Pagritia Co-op. bank, Ahaiki co-op. bank and Lamia co-op. bank function respectively



**TABLE 5.**  
**CREDIT INSTITUTIONS IN GREECE: NETWORK AND PERSONNEL,**  
**END OF 2002**

<b>Institutions</b>	<b>Branches</b>	<b>Outlets</b>	<b>Total</b>	<b>Personnel</b>
Credit Institutions	3.018	166	3.184	59.772
Cooperative banks	67	9	76	566
Bank of Greece	28		28	3.069
<b>Total</b>	<b>3.113</b>	<b>175</b>	<b>3.288</b>	<b>63.407</b>

Source: Hellenic Bank Association, 2003, Greek Banking System Data.

**TABLE 6.**  
**BALANCE SHEET ELEMENTS OF CREDIT INSTITUTIONS IN GREECE,**  
**END OF 2002 (MILLION EUROS)**

<b>Institutions</b>	<b>Assets</b>	<b>Deposits</b>	<b>Loans</b>
Credit Institutions	142.606	112.603	70.666
Cooperative banks	906	669	675
Specialized banks	35.325	28.105	16.915
Coop. banks / Total	0,5%	0,5%	0,8%
<b>Total</b>	<b>178.837</b>	<b>141.377</b>	<b>88.256</b>

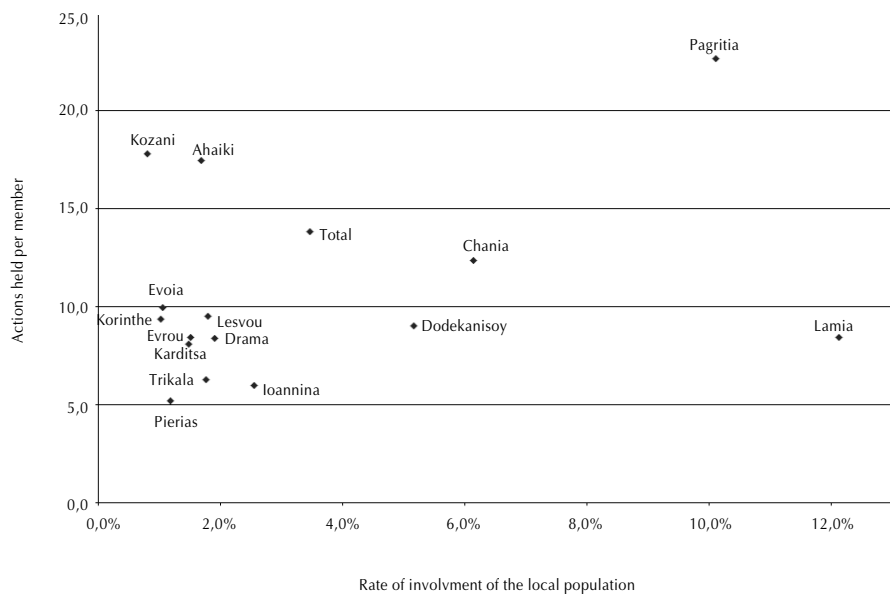
Source: Hellenic Bank Association, 2003, Greek Banking System Data

**TABLE 7.**  
**RANK OF CREDIT INSTITUTIONS IN GREECE, BALANCE SHEET ELEMENTS,**  
**END OF 2002 (MILLION EUROS)**

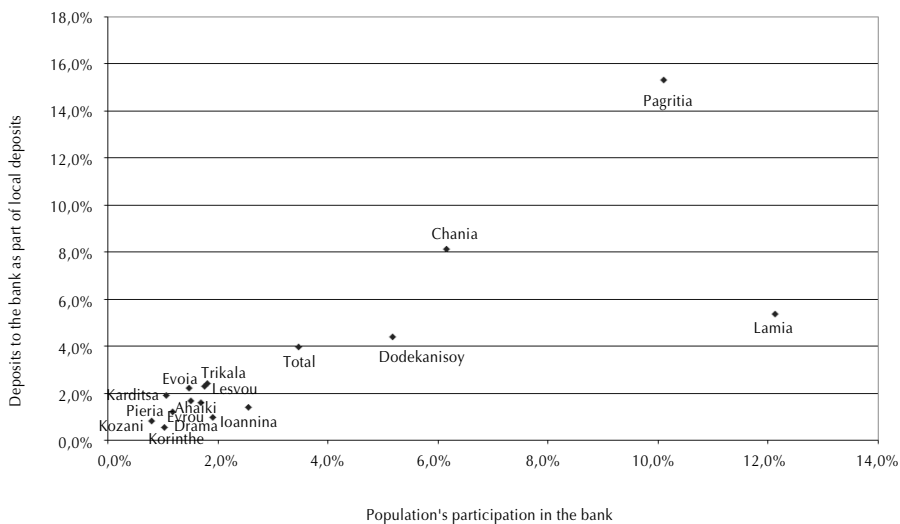
<b>Institution</b>	<b>Assets</b>	<b>Deposits</b>	<b>Loans</b>
National Bank of Greece	49.161	41.446	17.310
Alpha	27.264	21.327	15.467
Eurobank	23.366	16.636	12.532
Agricultural bank	16.801	14.971	11.107
Commercial	16.448	13.152	9.792
Pireaus	12.528	9.463	6.928
Postal Savings Bank	10.604	8.939	1.451
Deposits & Loans Fund	5.079	3.951	3.085
General	2.853	2.267	1.984
ETBA	2.737	186	1.209
Egnatia	2.444	2.097	1.651
Laiki	1.789	1.349	1.186
Attikis	1.715	1.387	1.067
Aspis	1.612	1.241	1.057
Novabank	1.227	994	421
FBB	601	250	502
Probank	493	412	231
Omega	460	318	225
<b>Pagritia</b>	<b>395</b>	<b>303</b>	<b>306</b>
Marfin	268	219	94
Unit bank	167	9	157
<b>Chania</b>	<b>117</b>	<b>83</b>	<b>80</b>
Investment Bank	106	18	38
<b>Panellinia Bank</b>	<b>105</b>	<b>58</b>	<b>64</b>
Investment Bank of Greece	102	18	23
Dodekanisou	97	77	79
Ahaiki	58	33	46
Lamia	57	39	45
Evoias	34	27	24
Lesvou	28	22	18
Trikalon	27	19	19
Ioanninon	25	18	19
Evrou	23	18	15
Dramas	12	8	7
Kozanis	12	8	7
Pierias	11	8	5
Korinthias	9	5	6

Source: Hellenic Bank Association, 2003, Greek Banking System Data.

**GRAPH 1.**  
**POPULATION'S INVOLVMENT TO THE COOPERATIVE BANK**



**GRAPH 2.**  
**INVOLVMENT OF THE COOPERATIVE BANK IN THE LOCAL ECONOMY**



# THE ROLE AND PERSPECTIVES OF CREDIT COOPERATIVES - CREDIT UNIONS - IN LITHUANIAN FINANCIAL SECTOR JOINING EUROPEAN UNION

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## **1. INTRODUCTION**

European integration process and consolidation of financial markets forces financial institutions, acting in the financial sector to review their strategies and policies and to adjust to changing environment. The requirements to increase market value, expansion of European Union, influences financial institutions to review their role in the financial sector and to react to the processes of increasing competition orientating to the strengthening of the commercial advantages better than to provision of universal banking services.

In Lithuanian financial sector nearby commercial banks there are active cooperative financial institutions – credit unions, which provide services to their members – a community of people. Credit unions orientate to specific segment of market – mainly individual persons with low and medium income, farmers, small and medium businesses - which is not so important for commercial banks, orientating more towards commercial sector.

Though credit unions still have a very small market share (0,55 percent in assets), growth rates of credit unions assets, members deposits and loans are 4-5 times higher than commercial banks sector. This is one of the proves that credit unions are important financial institutions, especially in regions, where they are founded by communities of people having common interest – farmers, employees of the same factory, students – or people living in the same area to serve their financial needs.

A niche appeared for credit unions when after privatization commercial banks, seeking to improve efficiency of activities, closed their branches in the small towns

and villages. In most cases people were left with no access to financial services and the state economy was left with fewer possibilities to collect financial resources (deposits) from rural areas. As non profit organizations, which main goal is to provide useful financial services to their members, credit unions began to found their own branches in the small towns providing people and small and medium businesses necessary financial services.

The enlargement of European Union and the globalization, consolidation processes in the financial sector not only opens new possibilities for the development of credit unions, but also raises new threats and questions of the perspectives of these cooperative financial institutions.

A problem of survival credit unions faced in the process of Lithuanian integration to European Union. According to European Directives, because of small share capital, credit unions could not receive credit institution status and might have been limited to take deposits. Considering the examples of credit cooperatives systems in the other European Countries – Ireland, Great Britain – an exemption for credit union sector was made with a condition that Central Credit Union, which ensures stability and liquidity of the network is founded.

At the moment the European enlargement processes and new requirements for the institutions of financial sector raises new discussions of the perspectives of credit unions sector in Lithuania.

The main goal of this paper is to discuss changes in credit unions activities caused by Eurointegrational processes and to point out major preconditions for credit unions development in Lithuanian financial sector considering the analysis of the role and impact of credit unions sector in Lithuanian retail banking market and the role of cooperative banking systems in the other European countries.

## **2. CREDIT UNIONS DEVELOPMENT IN LITHUANIA**

The movement of the Lithuanian credit unions started its first activities in 1995 and has reached significant results at the present. There are 58 credit unions in Lithuania having more than 35 600 members and 39 449 million Euro in assets in March 2004 (Lithuanian Central Bank, 2004). Credit unions provide saving services and loans for farmers and the other people who have poor access to bank services as well as small and medium business enterprises. 49 credit unions are joined in Lithuanian Central Credit Union which ensures stability and liquidity of the network, acts as clearing center for Lithuanian credit unions (Lithuanian Central Credit Union, 2004).

## **3. HISTORY IN BRIEF**

Created with the pooled savings of common people the first Lithuanian credit union ("Taupmenu skolinimosi bendrove" - savings borrowing society) was established in 1871.

During 50 years credit unions (they were mainly called credit co-operatives at that time) movement spread throughout the country. There were 417 “people banks” in 1928. With the increasing need for more effective members’ services, credit unions started their consolidation so that in 1939 there were 310 active credit unions with 119 000 members and assets of 85 million Litas (at that time 1 Litas was worth 10 present-day Litas, which today has a value of 3,45 Litas for 1 EUR), - with a 37% market share of deposits and 37,5% of loans. The World War II and the postwar regime terminated the existence of the movement (Terleckas, 2000).

During the period of the Soviet regime credit co-operatives were replaced by “savisalpos kasos” (“self-help credit unions”) which were created by employees and usually based on small mandatory payroll deductions which were pooled and lent to employees on rotating basis. No interest was paid or charged, so in result it was a forced savings scheme that provided periodic access to accumulated personal savings. Due to the fact that there was no market economy, mainly the means lent from “savisalpos kasa” were deposited at the State Savings Bank.

In 1994 Canadian International Development Agency, Open Society Fund - Lithuania, Lithuanians in Canada with the help of Développement International Desjardins started a three year project to help Lithuanians to have access to alternative financial institutions - credit unions. After less than one year of project activity (in February 1995) the Parliament of Lithuania working closely with DID and WOCCU credit unions projects passed a Law on Credit Unions.

## **4. ORGANIZATIONAL STRUCTURE OF CREDIT UNIONS’ MOVEMENT**

### **4.1. Credit unions and Association Lithuanian Credit Unions**

Organizational structure of the movement of credit unions in Lithuania consists of overall credit unions network including branches, Association of Lithuanian Credit Unions, and Lithuanian Central Credit Union.

A credit union (“kredito unija” - in the Lithuanian language) may be established by at least 50 natural persons of the Republic of Lithuania.

A minimum share capital of credit union cannot be less than 15 000 LTL (~4,344 EUR) and the minimum share of a member is 100 LTL (~29 EUR).

Membership in the credit unions is based on the following criteria:

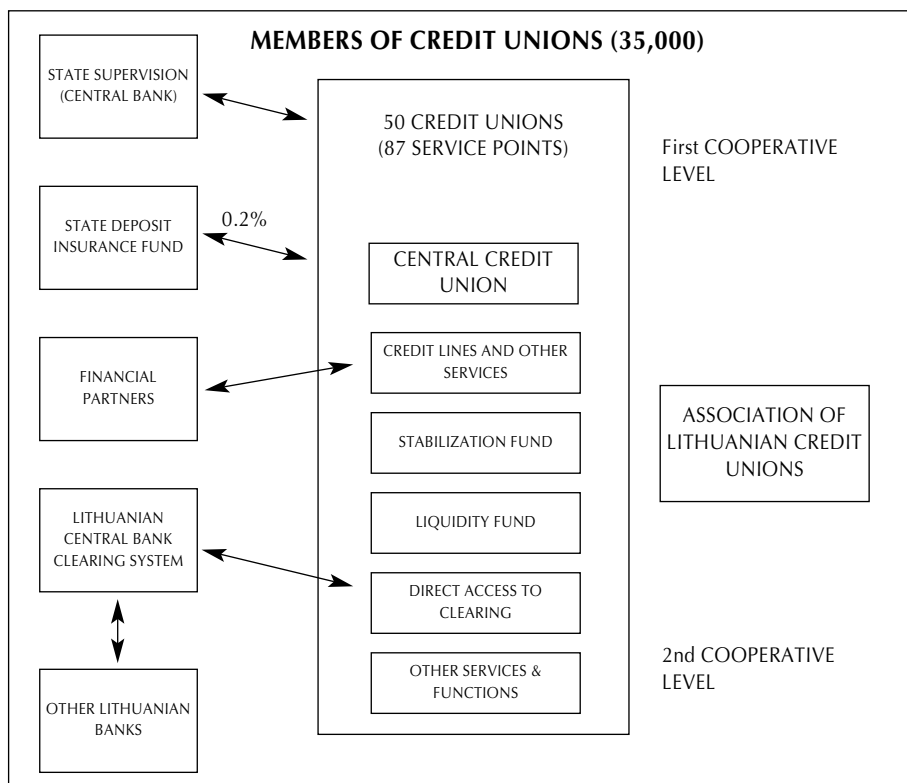
- Employment at the same enterprise or institution;
- Membership in the same professional group;
- Belonging to a certain formal registered association;
- Residing at the same location: township or village (Amendment Law on the Lithuanian credit unions..., 2000).

Credit unions are established on a voluntary basis. A license to perform operations of saving and issuing loans for the members is done by Central Bank of Lithuania. Supervision of Lithuanian credit unions is performed by Central Bank of Lithuania, as well as for the other credit institutions in Lithuania (commercial banks). Deposits of credit unions members are insured by state deposit insurance system.

At the very beginning credit unions have had a clear idea that the help of international projects and donors is not durable and the movement has to become self-sustainable. The first step was made in 1997 when Association of Lithuanian Credit Unions was founded by 11 credit unions established with the help of DID project.

Until the establishment of Lithuanian Central Credit Union, Association used to provide all necessary services to credit unions - marketing, training, computerization, assistance in licensing, consultations, lobbying, credit lines and credit unions' liquidity management, monitoring. After some time it became clear that financial services have to be provided by a separate central financial facility and first steps to create it were taken. Lithuanian Central Credit Union was founded in 2002.

**FIGURE 1.**  
**STRUCTURE OF LITHUANIAN CREDIT UNIONS MOVEMENT (2004 04 30)**





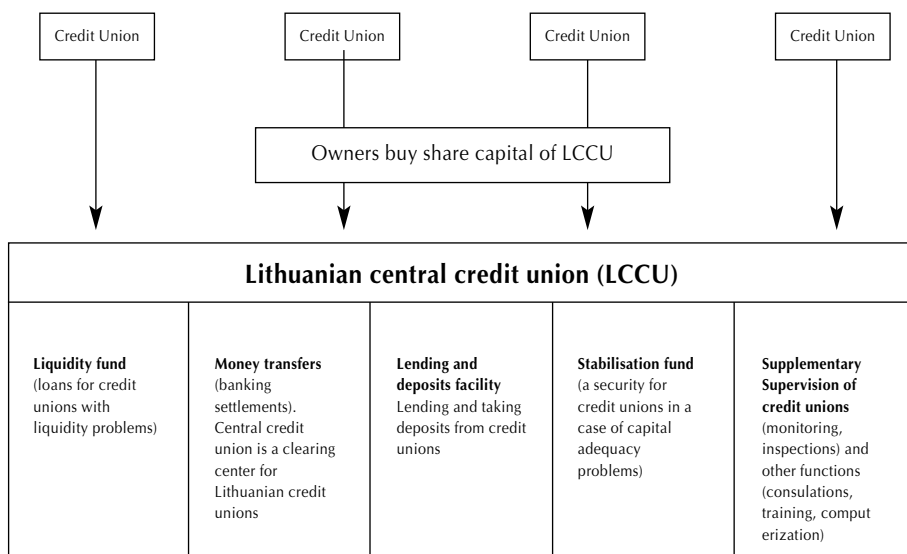
#### **4.2. Lithuanian Central Credit Union**

Activities of Lithuanian Central Credit Union are based on cooperative principles. All Lithuanian credit unions may become members of Lithuanian Central Credit Union, which can make use of its services and will accept corresponding responsibilities.

The largest part of Lithuanian Central Credit Union share capital is owned by the Government of the Republic of Lithuania. The initial capital owned by the Government of the Republic of Lithuania was 5,300,000 Litas. The amount of the capital shares of the other credit unions is 1,000 Litas. During the first year of Lithuanian central credit union activities, credit unions bought out from Lithuanian Government shares for 1 000 000 litas. (1 LTL = 3,4524 EURO). In the long term share capital should be bought out from Lithuanian Government. Though the Lithuanian Government owns the largest part of the share capital, it does not have exclusive right of vote. Lithuanian Central Credit Union is governed by cooperative principle: one member - one vote.

Governing bodies of Central Credit Union are elected representatives from credit unions and work on voluntary basis. Services of Central Credit Union are directed to improve the economic and social being of credit unions members by ensuring safety and stability of credit unions. The surplus arising out of the operations of Central Credit Union after ensuring appropriate reserve levels belongs to and benefits all members with no member or group of members benefiting to the detriment of others.

**FIGURE 2.**  
**MAIN FUNCTIONS OF LITHUANIAN CENTRAL CREDIT UNION**



*Main functions of Lithuanian Central Credit Union are as follows:.*

1. The Stabilization Fund with the purpose of providing assistance to the credit unions having solvency problems is set up within the Central Credit Union.
2. The Liquidity Fund is a guarantee of liquidity and restoration of solvency of credit unions, which will ensure the credibility and safety of the credit union system.
3. Clearing Center to enhance settlements within credit unions system though credit unions only system.
4. Supervisory and control function ensures sound and safe operations of credit unions.
5. Administration of credit lines, deposits and other financial services.

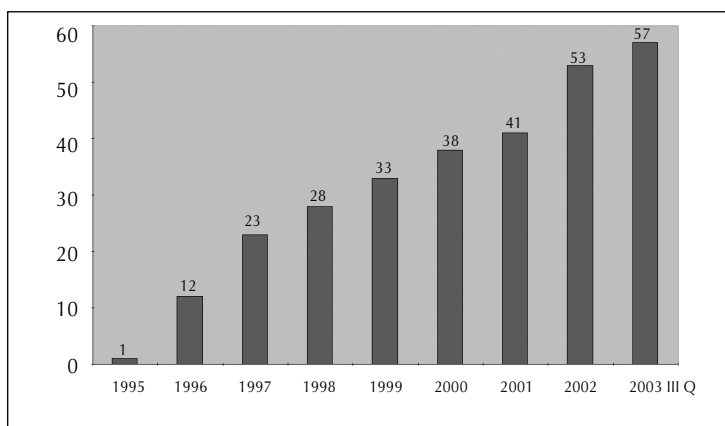
Central Credit Union is also promoting education of the members, elected officers, employees of the credit union network in Lithuania by organizing seminars, training programs, providing educational material to credit unions and credit union members, by organizing radio, TV broadcasts, publishing articles on the use of cooperation and democracy, raising awareness in finance and economy, providing the information on credit union members rights and responsibilities.

## 5. OVERVIEW OF CREDIT UNIONS' ACTIVITIES

From the start of the activities of credit unions in 1995, credit unions have shown very impressive growth results. Credit union growth has fastened even more after the second edition of the Law on Credit Unions was passed by Lithuanian Parliament in 2000.

### 5.1. Number of credit unions

**FIGURE 3.**  
**NUMBER OF CREDIT UNIONS IN LITHUANIA 1995- 2003 III Q**



Source: Lithuanian Central Bank.

In average each year 6 credit unions received licenses. In year 2002 the growth of the number of credit unions was very high. The main reason for that is the closing of Lithuanian Savings Bank branches in rural areas. This caused the great demand for financial services in rural areas.

### 5.2. Membership growth in credit unions

Credit union membership growth has significantly increased during the year 2001 and 2002 mainly because of the decrease in minimal membership share from 300 LTL to 100 LTL according to the new edition of Law on Credit Unions.

Credit unions members are mostly individual persons (98 percent). Until the second edition of the Law on Credit Unions legal persons had no rights to become credit unions members. Now enterprises owned by credit unions members can also join credit unions. Credit unions serve only small and medium enterprises, which employ not more than 49 people annually.

All members in credit unions are divided in two groups: members and associated members. Associated members do not have a right to vote during the Annual General Members Assembly, so they can not influence credit unions governance but may use all the services of credit unions.

**FIGURE 3B.**  
**TOTAL MEMBERSHIP AND AVERAGE MEMBERSHIP IN CREDIT UNIONS**  
**MEMBERS OF ASSOCIATION LITHUANIAN CREDIT UNIONS**

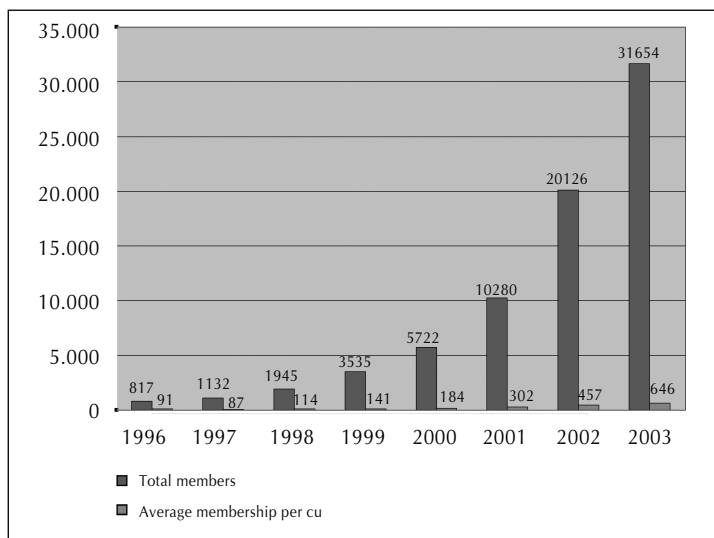
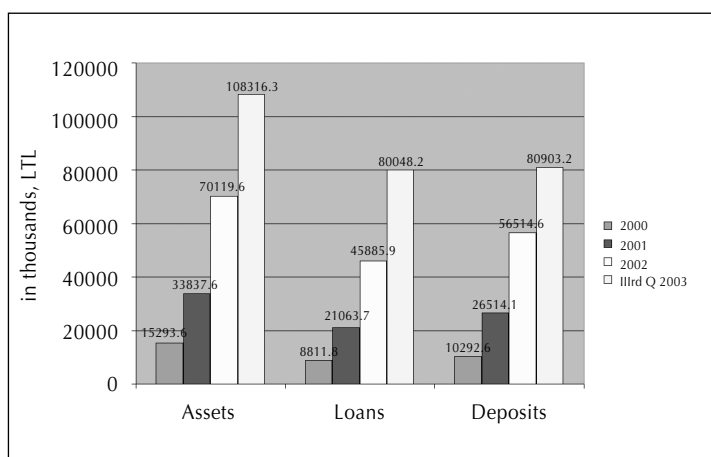


Figure 3b shows annual membership growth: total in the whole credit unions system and in average per one credit union. Membership growth in credit unions increased after year 2000, when the new amendments for Law of Credit Unions were made. They extended credit unions membership criteria and also introduced a concept of associated members.

### 5.3. Assets, loans and deposits dynamics in credit unions

1<sup>st</sup> of October total assets of 57 credit unions operating in Lithuania made 108 316 thousand Litass (1 LTL = 3,4524 Euro) (Figure 4).

**FIGURE 4.**  
**THE DYNAMICS OF CREDIT UNIONS ASSETS, LOANS AND DEPOSITS**  
**GROWTH YEAR 2000-2003**



Loans to credit unions members made the major part of credit unions assets. Total loan portfolio reached 80 042 thousand Litass. Members deposits made major part of credit unions liabilities (78 201 thousands Litass).

Average assets growth in credit unions during the last five years exceeds 100 %. The large part of all assets is invested to loans in credit unions, for example, 73 % of all assets at the end of III Q 2003 were invested in loans to credit union members. The part of granted loans in total assets is increasing from 1997. In 1997 all loans made up 42 percent of all credit union assets.

In peak periods - spring and summer when farmers and small businesses begin major activities credit unions start to lack resources for loans granting. At this moment extra credit lines from Lithuanian Central Credit Union are used to increase assets size and financing capacities of credit unions.

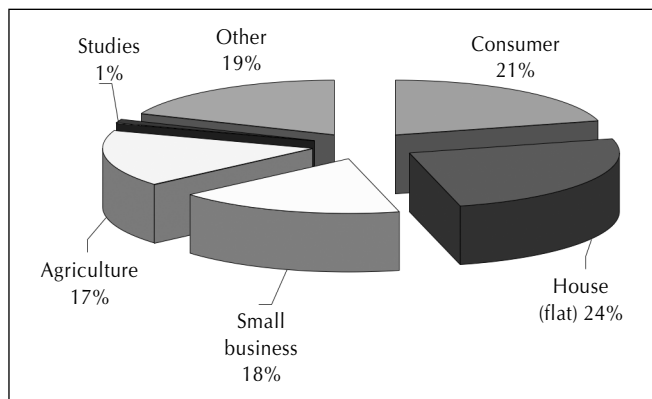
### 5.4. Services in credit unions

Lithuanian credit unions provide saving services and loan products to members also make transfer payment. Saving products are - current account, savings account,

children savings account, retirement savings account, also short term and long term deposits.

In addition, credit unions give loans to their members. Most popular loans types are business loan, consumer loan, and agricultural loans.

**FIGURE 5.**  
**CREDIT UNIONS LOANS BY PURPOSE 31ST OF DECEMBER, 2003**

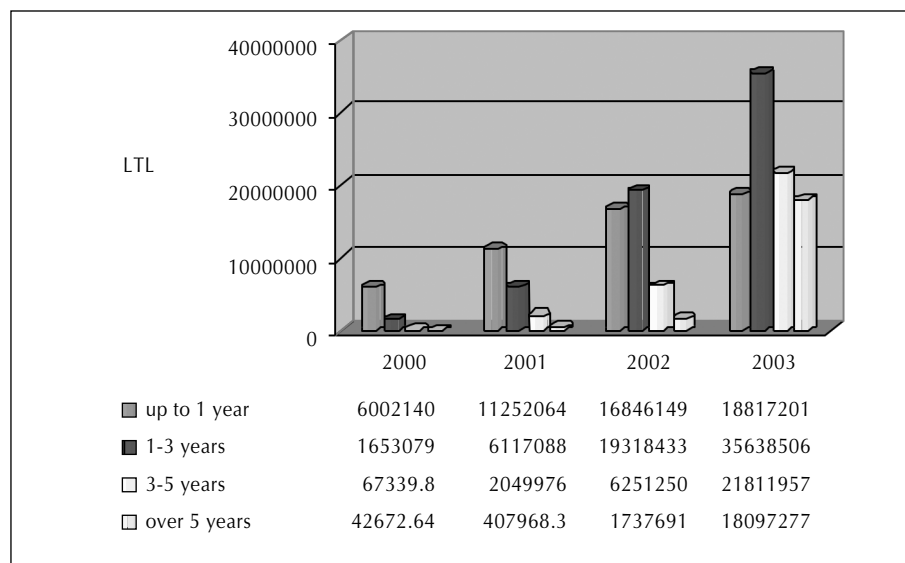


From the start of 2002 credit unions began granting mortgage (house (flat)) loans. Their part in the total portfolio has increased sharply from that time and now makes 24 percent of the total loan portfolio.

Changing economic environment, increase in GDP, total income has cause changes in the structure of credit unions loans terms. Part of long term loans has increased sharply from year 2002. The foundation of Lithuanian Central Credit Union and availability to use long term funds to finance long term loans has cause that loans over 5 years make up 22,5 percent of the total loan portfolio.

Credit unions also collect taxes for commodity enterprises, such as electricity, gas, water. A member in a credit union can also make different payments for goods, services or receive money from other persons.

**FIGURE 6.**  
**ALCU (ASSOCIATION LITHUANIAN CREDIT UNIONS) CREDIT UNIONS**  
**LOANS BY TERM 2000-2003**



In most part credit unions serve individual persons. Savings of business enterprises and loans to enterprises make not more than 2 percent the whole credit unions savings and loan portfolio.

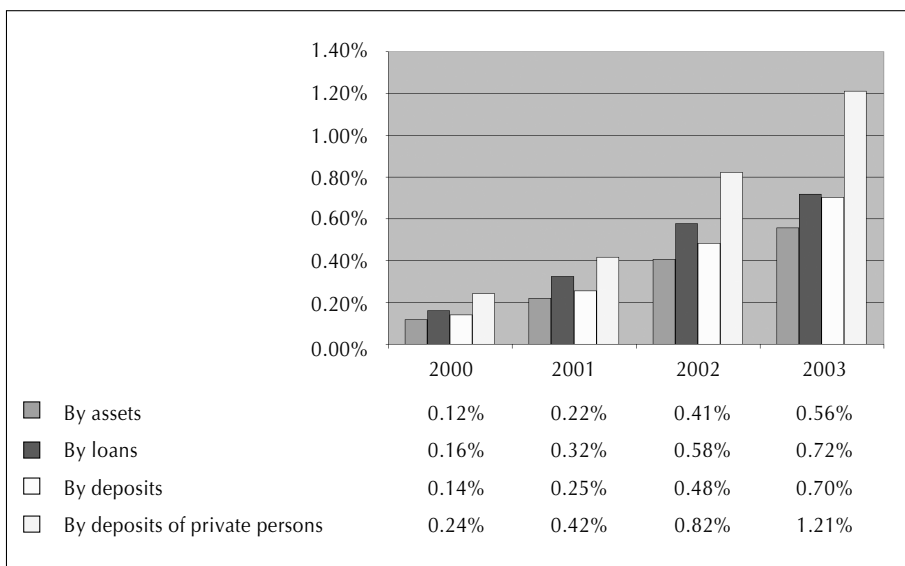
### 5.5. Credit unions market share

Though market share of credit unions is still very small (0,546 percent of the total banking assets in Lithuania), it is increasing sharply – e.g. on January, 2000 it was only 0,09 percent.

Assuming that deposits of private persons make up 98 percent of total deposits in credit unions, we calculated market share of credit unions by deposits of private persons. As we see this market share at the end of 2003 made up 1,21 percent.

The explanation for increase in market share is 4-5 times higher credit unions growth rates than comparing with banking sector (bank assets during year until IV quarter of 2003 grew by 22 percent, credit unions – 91,8 percent, bank loans by 40,2 percent, credit unions – 2,1 times). (Central bank of Lithuania, 2003/III quarter).

**FIGURE 7.**  
**CREDIT UNIONS MARKET SHARE**



## 6. CREDIT UNIONS DEVELOPMENT IN REGIONS OF LITHUANIA

After privatization, major part of Lithuanian commercial banks, seeking for better work efficiency, closed their branches in regions. To the niche that opened in Lithuanian retail market after that, credit unions began to penetrate.



**TABLE 1.**  
**CHANGES IN THE HANSA –LTB BRANCHES NETWORK STRUCTURE IN 1997 – 2002 AND THEIR INFLUENCE TO THE**  
**FOUNDATION OF NEW CREDIT UNIONS AND CREDIT UNIONS BRANCHES**

	Hansa – LTB branches in towns and villages				New credit unions or branches of credit unions during 2002 01 01 – 2003 02 28
	1-10 thousands inhabitants	10-30 thousands inhabitants	> 30 thousands inhabitants		
	1997	2002	1997	2002	
Pasvalys district	8	1*	-	-	2
Rokiškis district	6	0	1	1	1
Panevėžio district	5	0	-	3	5
Biržai district	5	0	1	-	2
Kupiškis district	10	1*	-	-	1
Šiauliai district	3	0	1	1	0
Akmėnės district	5	0	1	-	2
Joniškis district	4	0	1	-	0
Kelmė district	4	0	1	-	0
Pakruojis district	6	1*	-	-	3
Radviliškis district	7	0	3	2	1

Previous research of the authors (Levišauskaitė, Kaupelytė, 2003) show that restructuring processes in Lithuanian banking sector have positively influenced activities of Lithuanian credit unions so far. At the end of 2000, when Hansa-LTB close more than 200 bank branches, credit unions started to fill in the new niche in the market. On 31<sup>st</sup> of December, 2002 11 new credit unions started their activities in the place of former Hansa-LTB branches (Table 1). 11 more credit unions opened 24 their own branches in the places of former branches of Hansa – LTB (this makes 17,5 per cent of total number of all closed branches). At the end of 2003 there were 37 credit unions branches in former places of Hansa-LTB branches. Together with new credit unions founded it makes 24 percent of total number of all closed branches. This process is about to continue.

Analyzing the results presented in Table 1, we see that branches of Hansa-LTB were closed in all towns and villages which have less than 10 000 inhabitants. Out of 11 districts, only in 3 districts banks branches were left in towns, where there are less than 10 000 inhabitants, though at the same time we have to mention, that these towns are centers of the district.

The privatization of Hansa-LTB and closing of branches in the regions had a large impact on credit unions expansion in Lithuania in the year 2001 – 2002. The changes in the whole structure of Hansa-LTB branches network have heavily decreased the opportunities of inhabitants in those regions to use financial services. This made a great demand for credit unions services. A presumption could be made that in the near future the demand for financial services in the places where branches of Hansa-LTB were closed could still remain high. This situation opens new opportunities for the development of credit unions. Successful credit unions development in the regions testifies that credit unions services are needed.

Recent positive changes in credit union sector were influenced by opening for credit unions activities – not only improvement of economic environment, but also decreased credit unions member share from 300 LTL down to 100 LTL, valid Deposit and Investments insurance, also positive conditions for membership development.

Despite of the fact that credit unions develop fast, their market share is still small. The development level of Lithuanian credit unions one should compare with credit unions in other countries of European Union and countries candidates to European Union. As previous surveys of the author's show, (Levišauskaitė, Kaupelytė, 2003), e.g. in Ireland out of 1000 inhabitants 552 are credit unions members, credit unions take 6,5 percent of market share by assets.

**TABLE 2.**  
**COMPARATIVE ANALYSIS OF CREDIT UNIONS INDICATORS IN IRELAND,**  
**POLAND AND LITHUANIA FOR 31ST OF DECEMBER, 2001**

	Ireland (year 1999 )	Lithuania	Poland
<b>Relative indicators per 1000 inhabitants:</b>			
Members / 1 000 inhabitants	552	0,003	0,01
Assets, LTL/1 000 inhabitants	3963261	9,7	31,2
Total amount of members deposits, LTL / 1000 inhabitants	3369832	5,90	25,89
Total amount of loans, LTL / 1 000 inhabitants	2496274	6,00	22,50
<b>Relative indicators per 1 member of credit unions:</b>			
Assets, LTL /per 1 member	7173	3.145	3.056
Total amount of loans, LTL / per 1 member	6099	1.922	2.206
Total amount of deposits, LTL / 1 member	4517	1.958	2.536
<b>General indicators:</b>			
Average membership in a credit unions	3873	262	704
Market share (comparing by assets), %	6,5	0,22	4,30

After comparative analysis we see, that credit unions in Lithuania and in Poland (in comparing relative indicators per 1 member) are quite well developed, even in comparison to credit unions in Ireland. But credit unions of Poland and Lithuania have a very small penetration level – because of this reason, absolute outreach development indicators, such as total number of members, total assets, and market share, are small. By the development level, credit unions in Lithuania may be assigned to “transition” organizations. In order to reach the highest (“mature”) level, credit unions should have large asset size, deregulation, loose common bond, competitive environment, electronic technology environment, professional management, well developed central services, diversification of products and services, products and services based on market rate structures, rigorous financial management of operations. (Ferguson, McKillop, 1997).

Considering credit unions growth potential in Lithuania and other European countries, one may conclude, that credit unions growth, orientating to retail banking service sector is important, as one of the components diversifying Lithuanian financial sector which is dominated mainly by banks and insurance companies.

## 7. FUTURE PERSPECTIVES FOR CREDIT UNIONS' DEVELOPMENT

The attempt to evaluate nearest perspectives of Lithuanian credit unions makes us take into the consideration the first three years (till 2006), when Lithuania is supposed to become a member of European Union. During this period the formation process of Lithuanian financial system should be over. For credit unions this period is especially important, while during this period main players and their interest fields in the Lithuanian retail banking market will be identified.

Credit unions, as players of European retail banking markets are forced to review their strategies to the changing environment. New products and retail distribution channels appear in financial sector. New requirements are raised due to consolidation and concentration processes that have already began. Seeking for efficiency, commercial banks close their branches all through the Europe – at the same time credit unions in Ireland, Poland expand their network, acting according to their philosophy – to provide necessary services for their members and, as cooperative institutions, keeping low profit margins.

People, using financial services in various regions in Lithuania were directly influenced by the changes in national and international financial markets. After privatization, starting with 2001, the major retail bank Hansa-LTB closed its branches in rural areas leaving people living there with no access to financial services.

After closing branches of Hansa-LTB a niche appeared for Lithuanian credit unions. The experience of the changes in credit union sector in 2002 shows that the need for credit unions services rapidly grew in the places of former branches of Hansa-LTB. In these areas new credit unions were founded or old credit unions open their own branches. Expansion of credit unions activities in the place of former branches of Hansa-LTB should remain the main strategic direction for further credit union development.

After closing of branches of Hansa-LTB, as the results of the research show, most regions were left without primary financial services. People living in rural areas must be provided with pensions, salaries, possibilities to make payments for public utilities, as well as to be able to save and receive credits. Credit unions in Lithuania should be ready to provide these services to the retail sector.

The development of new financial services that would comply with the changing needs in the regions should be the other priority of credit unions development in Lithuanian regions. As economy in all the districts in Lithuania will further develop by influence of integration to European Union, the need for new financial services, such as new credit forms, transfer payments will appear. Credit unions should be ready to supply this demand.

Credit unions in Lithuania should expand their activities in retail banking not only working with individual persons. Till 2003 credit unions mostly were dealing with individual persons, because high requirements are applied for legal entities, trying to become credit unions' members. Most of them are starting and developing their businesses in the districts. Credit unions should be ready to provide financial services

to small legal entities in the regions, as it is very necessary for them to have financial services close to their business place.

Integration to the European Union opens new possibilities for farmers and entrepreneurs to receive funding from Structural funds of the European Union. Credit unions could be the institutions, which could provide small businesses in the districts with consultations on the development of the investment projects to receive funds. Today credit unions in Lithuania are still too small to provide financial support for businesses themselves (average assets of a credit union aren't more a little bit more than 2 billion Litas). As credit unions grow bigger, they will be ready to finance large-scale investment projects.

As Lithuania integrates to the European Union and the whole structure of the economy changes, credit unions have to implement new, modern technologies in transfers of payments, introducing payment cards. The implementation of new technologies should become easier as Lithuanian Central Credit Union started its activities at the end of 2002.

As competition in the banking sector gets stronger, credit unions should pay attention to the risk management and creation of information systems that would enable to recognize and manage risk. This would help to ensure stability and image of the whole credit unions system, which are extremely important in developing retail banking services.

Analysis of the experience of other European countries, such as Poland and Ireland leads to prediction, that the rapid growth of Lithuanian credit unions should become more slower and stabilize in a certain period of time. We could predict, that in 5 years, when Lithuanian credit unions will enter their third stage of development, the growth rate will remain in the level of 40–30 per cent.

Having a broad customer service network in Lithuanian regions, credit unions may become vital financial institutions not only in retail market, but also in the whole financial system, as they provide savings and other financial services to individual and legal subjects in all the regions.

## **8. CONCLUSIONS**

- Credit unions movement is a good example of cooperative financial institutions in Lithuania. Credit unions while uniting their members provide necessary financial services to people with poor access to bank services, especially in rural areas. Credit union services in most cases are cheaper and more effective. The rapid growth of credit unions proves that credit unions are needed in Lithuania. For small loans financing in most cases credit unions are the only one alternative.
- Credit unions' centralization and completely standardized operations create favorable conditions for coordinated development of credit unions. Competitors (Lithuanian banks) have more experience and are able to offer more financial

services, they dictate interests rate while credit unions today have 0.56 % of market in the banking sector and their development is more complicated, needs a lot of resources both human, financial and technical.

- There is a big space for creating and introducing new financial services for credit unions' members and spread already existing into financial market as e-banking, derivatives, brokerage, insurance, long termed crediting, house financing, leasing services, travel check service, operations in foreign currencies. At present the need for such kind of services among credit unions members isn't high, though considering the development of the economy of the country, one may predict the increasing demand for such kind of services in the future.
- Raising financial resources, investments as state programs, the European Union programs, credit lines from international funds may increase credit unions activities and maintain its services to an ever-expanding network.
- Close up of local banks' branches in small towns enables to create new credit unions, immobilizing savings and offering loan services (agricultural, consumer, small business loans). Credit unions have possibilities to compete with banks in the credit market segment for small business loans in the small and middle towns.
- It is obvious that the movement of credit unions is obtaining trust and financial impact to state economy, mostly in rural areas and are ready to take up the challenges of the future in present rapidly changing environment and integration to the European Union.

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# **CO-OPERATIVE BANKS' ROLE IN RURAL HOUSEHOLDS' FINANCIAL ASSISTANCE (POLAND'S CASE)**

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## **1. INTRODUCTION**

New finance tools and new institutions are necessary to overcome low efficiency of agriculture and barriers of rural development. The improvement in financing will help in farms competitiveness and rural population income growth.

The most important element in rural areas financing system is co-operative banks sector. It results not only from co-operative banks placing in rural environment but also from their experience in agriculture financial assistance and established position in local environment.

The paper is prepared drawing from a rural households survey as well as on co-operative banks' research. The aim of the survey carried out in 2002–2003 on the sample of 621 rural households in Lublin region was to investigate both rural households incomes and the social situation as well as the problems of rural society financing.

An author focuses on the role of co-operative banks as financing institutions servicing rural households. Elaboration does not include Co-operative Savings–Credit Accounts (SKOK) activities which are not strictly banks (according to polish legislation), but render services on rural areas behalf.

## **2. CO-OPERATIVE BANKS ROLE IN RURAL AREAS DEVELOPMENT**

The development of rural areas in Poland demands servicing institutions to support the process of multifunctional country development as well as to undertake activities regarding both initiation and coordination of development process, advisory services and help in financing activities.

Co-operative banks play a major role in the above mentioned process. Co-operative banks are natural partners for local society because they are acquainted with the problems and the needs of local people. It is the mission of co-operative banks to

meet the needs of local societies. They can influence the savings ratio by rural population, the level and dynamics of farms and entities investment, their development, the possibility to carry an efficient settlement of accounts, as well as make it possible for rural population to participate in financial assistance market.

Financial assistance of co-operative bank gives warrants for money not to flow beyond the boundaries of region regarding the golden role of cooperativeness - "local money for the local needs" (Kołodziej, 2000: 110).

Co-operative bank ensures both the opportunity for the owners and clients to have an impact on its functioning. Co-operative independence makes it possible to create targets by its members to realize their businesses but the results bring collective as well as individual profits (Tomczak, 1999: 30).

### **3. LEGAL ASPECTS OF CO-OPERATIVE BANKS FUNCTIONING IN POLAND**

In Poland there is a legal obligation – act from 2000 for cooperative banks activity which is an amendment in banking regulation to the act from 1994 regarding changes in polish economic and banking system. The new bank regulation implemented two – grades organizational structure instead of the old one, three – grades one. Co-operative banks are obliged to associate in one of three functioning associating banks. The new regulations allow banks to associate voluntarily in one of chosen associating banks. The territorial area of their activity increased as well as the range of services on the agreement of associating bank (Olko-Bagieńska, 2001: 7).

These acts can influence the more complexity of rendered services thus improving economic-financial co-operative banks situation. Activity of banks on territorial area increased and now includes administrative districts. It means that banks can serve the entities and subjects from the region where bank runs activity. But bank regulation allows on the agreement of associating bank to widen the activity territorial areas and also serves neighboring administrative districts. Big banks with capital over 1 ml Euro can run activity in the whole region.

The new Co-operative Bank Act was amended so as to implement capital levels. Banks must increase their own capitals to the level – 0,5 ml Euro to the end of 2005 and to the end of 2010 - 1ml Euro. The new regulations demands concerning minimal own capitals were enforced by restructuring processes within banks sector. At the beginning of 1999 there were 1190 co-operative banks in Poland, now – 603. The share of co-operative banks in polish market is still increasing, they act effectively. According to Polish Central Bank, both earning capacity of co-operative banks as well as credit portfolio quality are much higher than in commercial banks and cost much lower.

## 4. RESEARCH METHODOLOGY

In 2002 one carried investigations on rural household of Lublin region<sup>1</sup>. Lublin region is situated in the East part of Poland. Lublin - the capital of region is 160 km far from Warsaw.

The expert method was used to do research in four administrative districts: two of them situated close to the border; Biała Podlaska, Tomaszów Lubelski and two ones being under strong influence of province capital: Lubartów, Kraśnik. In every administrative district three communes were chosen purposefully to do survey regarding their size. Communes sizes were stated basing upon criteria like follows:

- Commune income level per 1 inhabitant (in zloty)
- Commune own income share in total commune income (in %)
- Total commune population

Both rural households and villages were chosen of fate. Survey was carried in three villages in every commune. The surveyed rural households population was 621.

The surveyed households were inhabited by 2630 persons and 20% of inhabitants from chosen villages were surveyed. Regarding chosen communes inhabitants – they constitute 4,4%.

The survey were continued in 2003 when the areas of three communes from Biłgoraj district (south-west Lublin region) were included in survey. It is the most dynamic area of Lublin region characterizing with high development level as well as activity of economic entities, off-government organizations, social ones and local societies. The inquires concerned also 13 co-operative banks presidents in surveyed communes. These banks serve 63 communes in Lublin region what gives 30% of all Lublin region communes and also 3 communes beyond Lublin region.

## 5. INCOME SITUATION OF LUBLIN REGION RURAL HOUSEHOLDS

Adoption of market economy rules had the great impact on rural households functioning. High unemployment levels in the countryside, the lack of government social care as well as real incomes drop made country inhabitants find in difficult situation. Lublin region is rural one but in deep recession. According to Eurostat data, this region is the poorest one in Poland, where the development level is 26% of the mean EU level<sup>2</sup>.

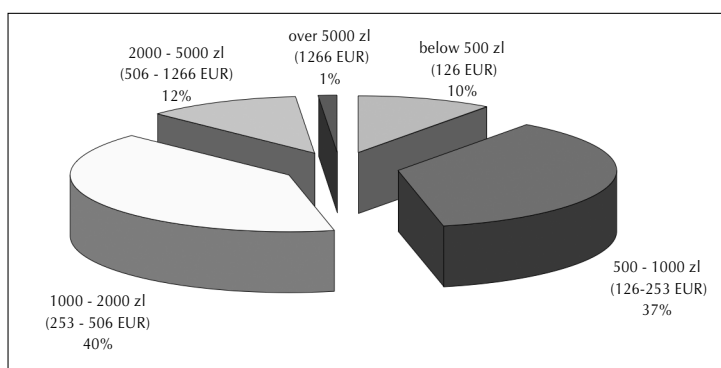
1. Within KBN (Polish Research Committee) research projects titled "The role of entities, institutions and local societies in equitable development of country and agriculture" (6POGR13321)..

2. Comparing to the richest Mazovian region, what gained level 53% of average Gross Domestic Product level per 1 EU inhabitant (Mierosławska, 2001: 3)..

According to research carried by us, average of household's monthly income was 1349,4 zloty (368 EUR) last year. It gives 81% of average value in region. Average monthly money income per 1 household in Lublin region was 1670,6 zloty (455 EUR).

There is great share of households with low incomes. Average monthly incomes of 47% of families were lower than 1000 zlotys (253 EUR), thus half of the households have incomes lower than average monthly income in the poorest Lubartów district (figure 1).

**FIGURE 1.**  
**RURAL HOUSEHOLDS STRUCTURE REGARDING GAINED INCOMES**



Source: Own elaboration basing on questionnaires

Carried investigations show that the majority of rural households live from pensions and rents (table 1). Over 33% of rural households pensions or rents are the base source of income<sup>3</sup>. In 2002 off-farm employment was the most important income source for 28% of households (29,3% in 2001).

3. Rural household main income source is the one what supplies the majority of financial means.

**TABLE 1.**  
**RURAL HOUSEHOLDS STRUCTURE REGARDING DOMINATING INCOME**  
**SOURCE**

Dominating income source	Households number		Share%	
	2001	2002	2001	2002
Off farm employment	182	174	29,3	28,0
Own activity	27	30	4,3	4,8
Farms product sale	141	142	22,7	22,9
Pensions or rents	208	208	33,5	33,5
Others (unemployment and social benefits, seasonal work)	24	30	3,9	4,8
Lack of dominating income source	39	37	6,3	6,0

Source: Own elaboration basing on questionnaires

From among 621 investigated households - 418 of them run farms - it is 67,3% of total population. Selling of agricultural products is dominant source of income (in 2002) for only 23% of rural households. Over 2/3 of rural farms show other sources of incomes. Pensions, unemployment and social benefits are very important incomes sources for farmers. The growing number of households without any permanent source of income being on the relief fund is very distressing.

The surveyed households were inhabited by 2630 persons. Grown ups were 72,3% of surveyed population. Professional status of grown up family members is submitted below (table 2).

**TABLE 2.**  
**PROFESSIONAL STATUS OF GROWN UP FAMILY MEMBERS.**

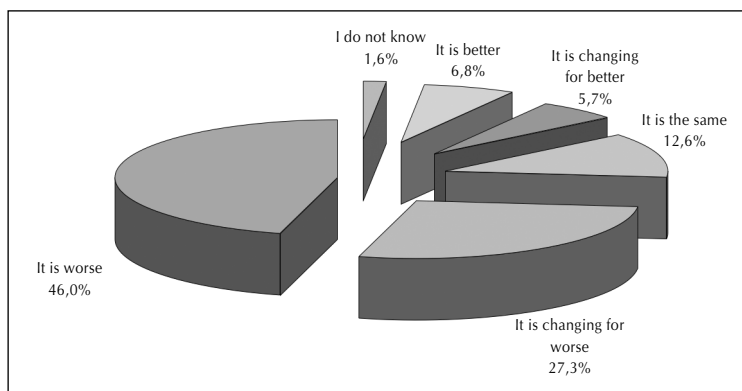
<b>Specification</b>	<b>Professional status (grown ups number)</b>	<b>Professional status (in % of grown ups)</b>
Employed	354	18,6
Entrepreneur	31	1,6
Unemployed	221	11,6
Working at home	67	3,5
Student	185	9,7
Pensioner, retired	598	31,4
Handicapped	6	0,3
Soldier	11	0,6
Farmer	423	22,2
Woman at maternity leave	7	0,4
Together	1903	100,0

Source: Own elaboration basing on questionnaires .

There is the highest share of pensioners, retired workers (almost 1/3 of surveyed group) and farmers (22,2%) among 1903 of grown ups. Employed people constitute 18,6% of grown ups population. Unemployed are 11,6% - great share. Entrepreneurs constitute nearly 1,6% of surveyed grown ups.

The economic situation of polish rural households has changed very much in transformation stage. Very few households feel real improvement but in the majority of them financial situation is not satisfying. 73,3% of households show worse or changing for worse situation comparing to the one before 1989 (figure 2).

**FIGURE 2.**  
**PRESENT FAMILY FINANCIAL SITUATION IN COMPARISON TO THE ONE**  
**BEFORE 1989**

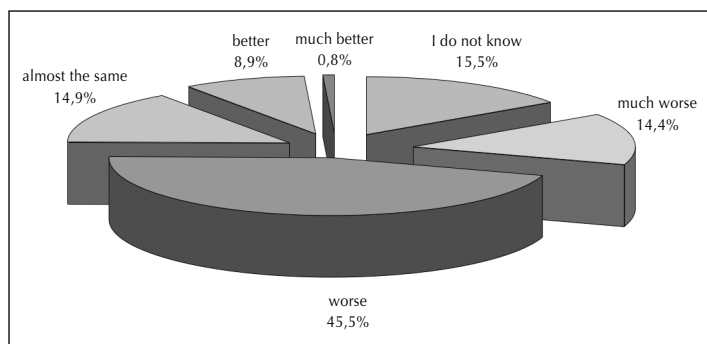


Source: Own elaboration basing on questionnaires.

Only 12,5% estimates situation to be better or changing for better and the same percent stated that nothing has changed.

Prognosis given by inquired people regarding future family income and financial situation are rather pessimistic. About 60% estimate the situation is going to be much worse or worse in the following 5 years<sup>4</sup> and 15% - think that situation is not going to change. Only about 10% are optimistic (figure 3).

**FIGURE 3.**  
**FAMILY FINANCIAL SITUATION IN THE NEAREST 5 YEARS**



Source: Own elaboration basing on questionnaires.

4. Percentage of given answers is 97,4%

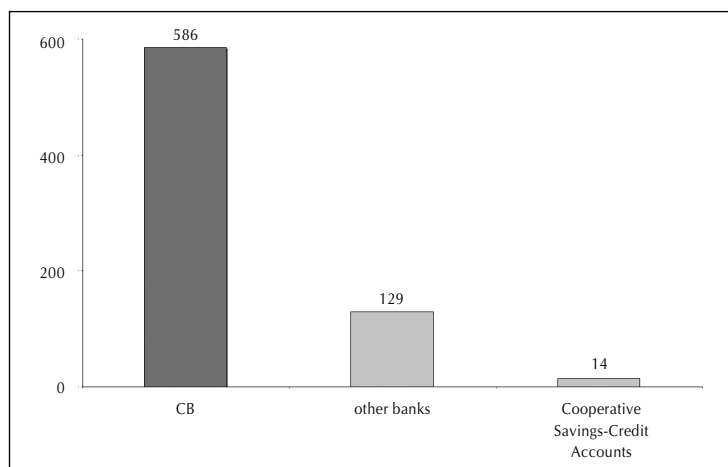
In such a situation the most important problems to solve are: decrease of unemployment rate, creating possibilities for people to start business activity and creating additional sources of income. To achieve these it is necessary to create business activity.

Respondents were asked about their business activity plans during next 3 years. Only 4,2% of inquired people decided to start business activity but 88,4% of respondents are not going to run their own business. According to respondents' opinion there are three barriers to start business activity: lack of own financial means (486), high risk (335), and the lack of efficient financial assistance with cheap credits (287).

## 6. THE POSITION OF COOPERATIVE BANKS ON RURAL HOUSEHOLDS MARKET

Carried survey shows strong advantage of cooperative banks comparing to commercial banks in communes area. Answering a question about bank assistance of people, enterprises in the area of communes and districts, inquired people mentioned 12 banks among 70 functioning in Poland and Co-operative Savings–Credit Accounts (SKOK). Respondents pointed to co-operative banks 586 times. Other banks gained only 129 indications (figure 4).

**FIGURE 4.**  
**RURAL HOUSEHOLDS KNOW-HOW ABOUT BANKS SERVICING THEIR**  
**COMMUNE (INDICATIONS NUMBER)**



Source: Own elaboration basing on questionnaires.

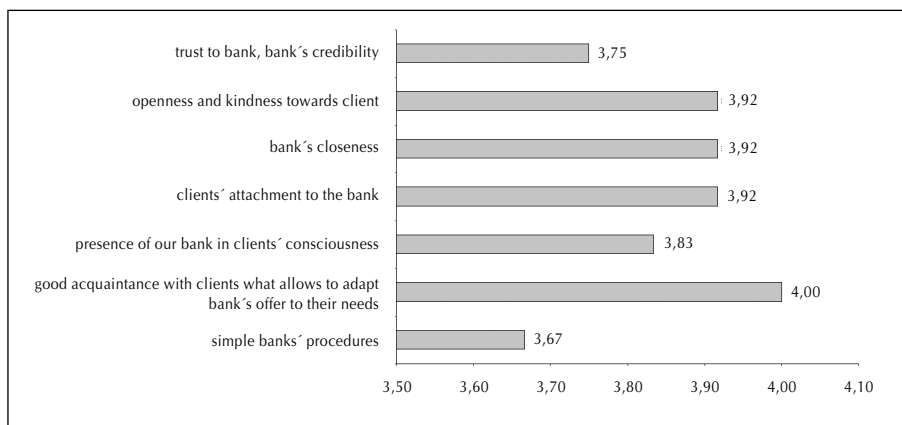


As far as bank assistance in districts concerned, the situation is quite different. PKO BP S.A. – one of the biggest polish retail bank is for people of the greatest importance (258 indications). Co-operative banks – the second position with 227 indications.

Co-operative banks' competitive position is very strong especially at rural markets. The local and niche character of co-operative banks allows them to make the quick decisions at low risk and gather local savings as well as to cooperate with territorial self- governments (Lepczyński, 2002: 23).

Inquiring the banks' managers I asked a question about the most important competitive factors of co-operative banks. In the opinion of banks' management it results from good acquaintance with clients (figure 5) what makes it easier for them to adapt services to the demands of clients expectations. This factor gained mark – 4 in scale from 4 (strongly yes) to 1 (strongly no). Apart from the above, the important factors are; kindness towards client, close bank situating and the clients' attachment to the bank ( 3,92).

**FIGURE 5.**  
**APPROACH OF BANKS PRESIDENTS TOWARDS CO-OPERATIVE BANKS**  
**COMPETITIVE ADVANTAGES**



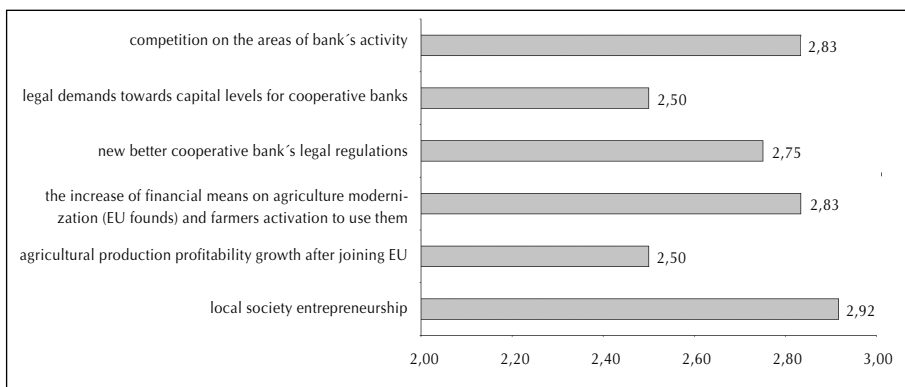
Source: Own elaboration basing on questionnaires.

Banks' managers were asked about pointing the factors stimulating co-operative banks activity. The answers are showed on figure 6.

Entrepreneurial activity of local society is the most important factor influencing development of banks according to banks' management – mark 2, 92 in scale from 4 (great influence) to 0 (the lack of influence). Competitive entities existence in the

area of co-operative banks activity is of great meaning for their development (mark 2,83). Competition is not considered to be an impediment for banks but as incentive to work better.

**FIGURE 6.**  
**THE FACTORS STIMULATING CO-OPERATIVE BANKS ACTIVITY**

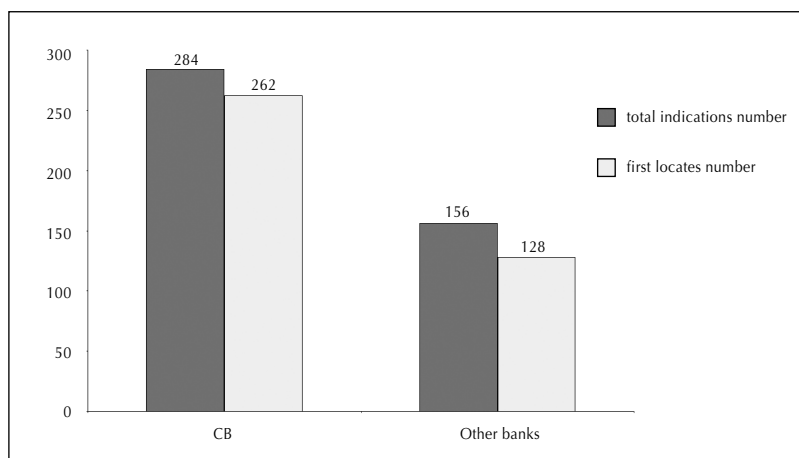


Source: Own elaboration basing on questionnaires.

## 6. THE SAVINGS OF RURAL HOUSEHOLDS

In the opinion of 81,1% of inquired people current incomes of their families are too low to have savings but 21% of rural households declare to have savings. It means that 2% of rural households have savings although they showed the lack of saving up opportunities. Country inhabitants specific feature of character is to make economies although the existing economic conditions are the barrier to save money. They emphasize difficult situation of polish country in the aspect of low incomes from production and the lack of complex state policy towards rural areas.

**FIGURE 7.**  
**THE KINDS OF BANKS ASSISTANCE – BANK ACCOUNT, LOCATES**



Source: Own elaboration basing on questionnaires.

More than a half of households declaring savings locate money in bank. Respondents were asked to point banks where they locate money with indication on bank of the greatest meaning<sup>5</sup>. 87,8% of inquired population pointed to 1 bank. Results show that co-operative banks are leaders on rural areas of Lublin region and they were mentioned 284 times (262 times first position). Commercial banks gained 156 indications (figure 7).

The greatest percent of rural households have savings in a range from 1000 to 2000 zlotys (253-506 EUR) and from 2000 to 5000 zlotys (506-1266 EUR) – table 3.

5. Percentage of given answers is 63,4%

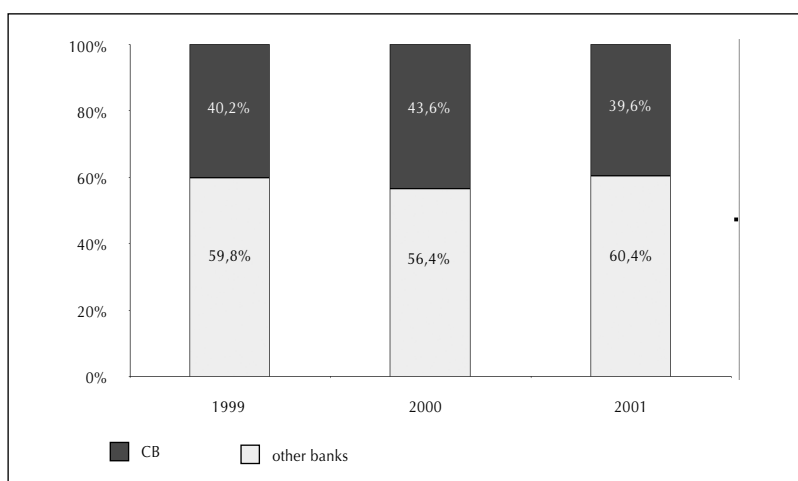
**TABLE 3.**  
**RURAL HOUSEHOLDS ANNUAL AVERAGE SAVINGS LOCATED IN BANK IN**  
**1999-2001 (ZŁOTY, EUR)**

Savings amount	1999	2000	2001
below 500 zł (126 EUR)	3,5%	3,1%	3,4%
500-1000 zł (126-253 EUR)	4,0%	3,4%	2,9%
1000-2000 zł (253-506 EUR)	4,3%	5,3%	5,0%
2000-5000 zł (506-1266 EUR)	5,0%	4,2%	4,7%
5000-10000 zł (1266-2532 EUR)	2,4%	2,6%	2,4%
over 10000 zł (powyżej 2532 EUR)	0,5%	0,3%	0,6%
	19,8%	18,8%	19,0%

Source: Own elaboration basing on questionnaires .

In 2001 5% of households population had savings in a range from 1000 to 2000 zlotys (253-506 EUR) and 4,7% from 2000 to 5000 zlotys (506-1266 EUR). 6,3% of households had savings below the level 1000 zlotys (253 EUR) and 3% of them with savings over 5000 zlotys (1266 EUR).

**FIGURE 8.**  
**THE SHARE OF CO-OPERATIVE BANKS IN RURAL HOUSEHOLDS DEPOSITS IN**  
**1999-2001**



Source: Own elaboration basing on questionnaires.

The majority of savings rural households locate in co-operative banks first of all because they are close to the place of residence. In 2001 rural households located over 60% of savings in co-operative banks (figure 8).

## 8. CO-OPERATIVE BANKS AS CREDITORS OF RURAL HOUSEHOLDS

Rural households far more often run into debts in co-operative banks than in other ones. Within 1999-2001, 218 of households ran into debts in co-operative banks. All the other banks were mentioned 124 times. Every year the number of rural households running into debts is growing. In 1999, 36,1% of rural households showed debts and in 2001 the rate of indebted farms increased to 37,5% of rural population (table 4). There are many reasons for above mentioned situation. More and more families want to raise their consumption level. The number of households taking investment credits and credits for current needs is still growing.

**TABLE 4.**  
**RURAL HOUSEHOLDS ANNUAL AVERAGE INDEBTEDNESS IN BANK**  
**IN 1999-2001 (ZLOTY, EUR)**

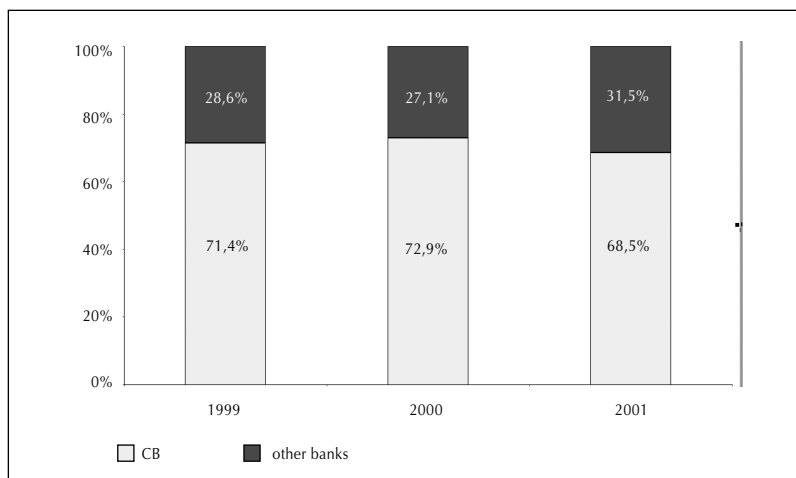
Indebtedness amount	1999	2000	2001
below 500 zł (126 EUR)	2,3%	1,8%	2,3%
500-1000 zł (126-253 EUR)	7,9%	6,0%	6,1%
1000-2000 zł (253-506 EUR)	8,1%	8,2%	8,9%
2000-5000 zł (506-1266 EUR)	8,7%	9,7%	10,1%
5000-10000 zł (1266-2532 EUR)	4,5%	5,3%	4,7%
over 10000 zł (powyżej 2532 EUR)	4,7%	5,3%	5,5%
	36,1%	36,2%	37,5%

Source: Own elaboration basing on questionnaires.

In 2001, indebtedness amounts of the greatest number of households (10%) were from 2000 to 5000 zlotys (506-1266 EUR), 8,9% of indebted households – from 1000 to 2000 zlotys (253-506 EUR). The number of households with indebtedness over 10 000 zlotys (2532 EUR) is still growing.

Rural households indebtedness amounts in co-operative banks were over 71% in 1999 and 73% in 2000 (figure 9).

**FIGURE 9.**  
**CO-OPERATIVE BANKS SHARE IN RURAL HOUSEHOLDS INDEBTEDNESS**  
**IN 1999-2001**

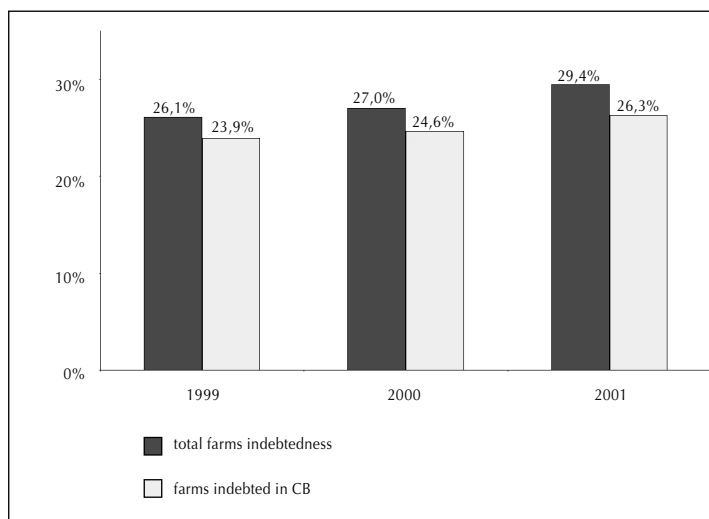


Source: Own elaboration basing on questionnaires .

In 2001, indebtedness share decreased to 68,5%. It results from households activity in searching financial middlemen which offer better credit conditions. In the opinion of inquired banks' managers, the clients very rarely give up co-operative banks services. Sometimes they do it but it results from aggressive other banks policy and very often they come back again.

Among all investigated rural households, 418 of them run agricultural farms what is 67,3% of population. The majority of investigated agricultural farms gained preferential credits subsidized by Agency for Restructuring and Modernization of Agriculture (ARiMR). In investigated period the number of farms which gained preferential credits has been systematically growing (figure 10).

**FIGURE 10.**  
**AGRICULTURAL FARMS PREFERENTIAL CREDITS SHARE**



Source: Own elaboration basing on questionnaires .

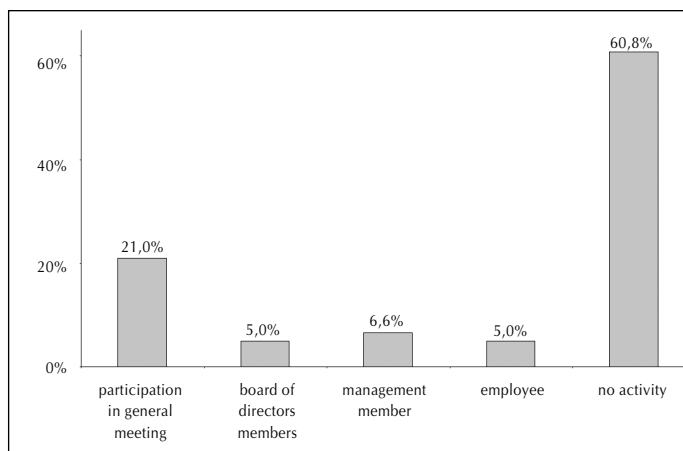
In 2001 over 29% of all farms had preferential credits and 26,3% took credits from cooperative banks. Only 3% of farms gained credits from other banks. In investigated period, 3% of farms ran into debts on commercial conditions. Farms having preferential credits used to gain commercial ones to finish investment.

## **8. RURAL HOUSEHOLD AND MEMBERSHIP IN CO-OPERATIVE BANK**

Over 29% of respondents are the members of co-operative banks. Only 10,5% (19 indications) of bank members see profits from bank membership; lower provisions, easier access to credits.

Banks' managers mean polish legislation discriminates self-governments. Bank is not allowed to use privileges like: advantageous credits, rates and locates towards its members. Very few banks pay dividends. Making banks analysis in 1999-2002 - only two of them paid dividends. The majority of banks used profits to strengthen their own capitals. The only advantages are simple procedures, lower provisions, easier access to preferential credits.

**FIGURE 11.**  
**ENGAGEMENT OF CO-OPERATIVE BANK MEMBERS IN ITS PROBLEMS**



Source: Own elaboration basing on questionnaires .

Co-operative banks' members are not enough active, they do not participate in representing bodies. 60,8% of members are not interested in bank's problems, 21% participate in general meetings, 5% are the members of bank board (figure 11).

Above graph illustrates the problem of co-operative movement in our country – broken organizational and social relationships between co-operative and members (Maliszewski, 1997). Broken relations between member and co-operative leads to lack of loyalty towards bank. 37% of co-operative bank members were serviced by other banks. The important reasons were: the seller's suggestion, while buying consumer goods on credits, simple procedures and low provisions.

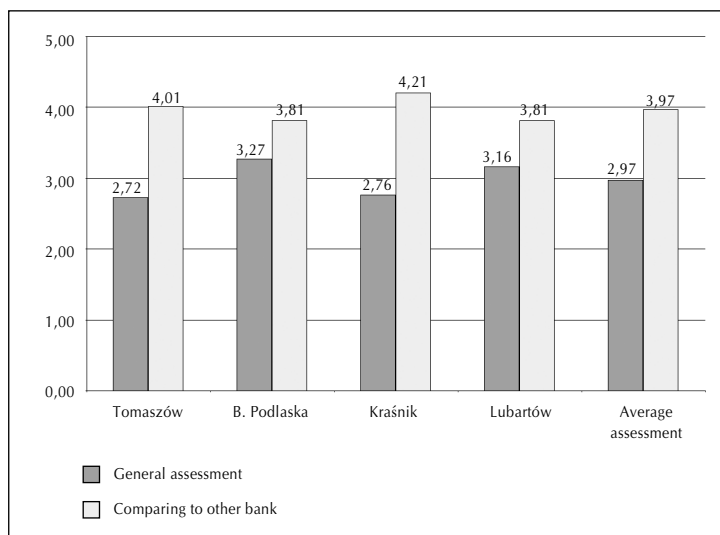
Keeping shares in co-operative banks is by no means in bank chosen by rural households to save money or take credits what shows the weak relations between banks and their members.

## 9. ASSESSMENT OF CO-OPERATIVE BANKS BY RURAL HOUSEHOLDS

Taking into account respondents' opinion about banks in local environment in scale from 1 (very bad) to 5 (very good), co-operative banks – note 3 with satisfactory opinion. In comparison to other banks, co-operative banks gained much higher note - 4 (figure 12).



**FIGURE 12.**  
**ASSESSMENT OF CO-OPERATIVE BANK ACTIVITY BY LOCAL SOCIETY**

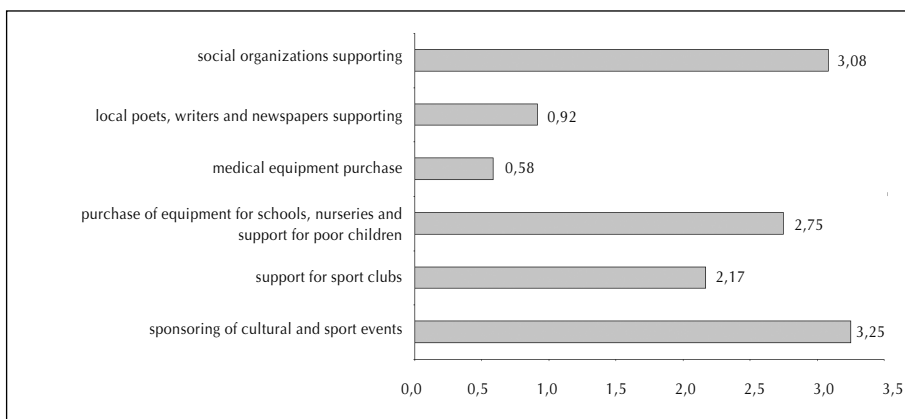


Source: Own elaboration basing on questionnaires .

Co-operative banks in many communes are the only financial institutions servicing local society. It allows them to keep great share in the market. But co-operative banks want to be competitive so their offer is going to be more and more interesting for people regarding both cost and quality. Clients notice these changes for better and give good marks for co-operative banks.

Rural households' representatives were asked about co-operative banks activity on behalf of local society and 601 respondents answered that question. The majority answers were negative. Very few ones sentenced that banks make any activity on behalf of local society. Banks activities pointed by people are; cultural and sport events sponsoring, help for schools and nurseries, financing sport clubs and social organizations. Co-operative banks undertake many kinds of social activity in local environment (figure13).

**FIGURE 13.**  
**CO-OPERATIVE BANKS ACTIVITY ON BEHALF OF LOCAL SOCIETY**



Source: Own elaboration basing on questionnaires.

According to banks' managers most often banks sponsor cultural and sport events – mark 3,25 in scale from 4 (very often) to 0 (no), they support social organizations – mark 3,08; schools, nurseries and poor children – mark 2,75.

Banks do not treat these kinds of activity as marketing promotion. One can talk rather about patronage activity bound up with cooperatives' social activity on behalf of its members as well as local environment. An idea is that banks should act stronger in environment through dissemination of information about undertaken activities to have positive image in local environment. Knowledge of banks activity in local environment influences the opinion of co-operative banks given by present and potential clients.

## CONCLUSIONS

1. The most important element of rural areas financial service is the co-operative banking sector. It results from banks situating in rural environment and experiences in agriculture servicing.
2. Co-operative banks play a major role for the population generally in rural areas as well as servicing enterprises in rural areas.
3. Rural households in the main deposit their savings in co-operative banks. They are also the most important creditors. Approximately 70% of rural households' indebtedness in the investigative period was in cooperative banks.

4. Preferential credits subsidized by the Agency for Restructuring and Modernization of Agriculture (ARiMR) are the main instruments for giving financial support for investments in agriculture. From among farms taking preferential credits, about 91% of them took credits from cooperative banks.
5. Both organizational and social relations were broken between co-operative bank and its members. This impacts on the level of activity as well as on the level of loyalty for bank services.
6. Cooperative bank assistance in the local environment was estimated by respondents. Compared to other banks, cooperative banks are regarded much more highly with an average score of about 4.

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# **AIMING FOR LESS FINANCIAL EXCLUSION VIA NEW REGULATIONS FOR UK CREDIT UNIONS: COST EFFICIENCY ANALYSES HIGHLIGHTS POSSIBLE BENEFITS AND DANGERS**

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## **1. INTRODUCTION**

Credit unions are not-for-profit, member-owned, voluntary, democratic, financial institutions that provide financial services to their members.<sup>1</sup> As such they are value-driven and committed to serving the financial services needs of their membership base, which is likely to include disadvantaged communities and individuals, many of whom have been abandoned by mainstream banking. Credit unions have a distinct social philosophy. They provide open membership, democratic control and consider that education has a role in meeting their social objectives. Economically they aim to make a surplus part of which is returned to members in the form of a limited return on their share capital. Many credit unions also use part of their surplus to support social, cultural and charitable events in the locality from which they draw their members.

The first UK credit union was established in Northern Ireland in 1960. At the end of 2001 there were some 180 credit unions operating in Northern Ireland with assets of £525 million and a membership of 336,000. The latter membership equates to

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1. Over 118 million people in 79 nations now belong to a credit union and, in aggregate terms, the assets of credit unions worldwide are calculated at \$676 billion (World Council of Credit Unions, 2002).

approximately 26 percent of the adult population of Northern Ireland. In Great Britain the first credit union was established in 1964, however, it was not until the passage of the 1979 Credit Unions Act that the movement in Great Britain gained positive impetus. (The 1979 Act was introduced to bring legislation in Great Britain into line with that provided for credit unions in Northern Ireland by the relevant subsection of the Industrial and Provident Act, passed in 1969.) At the end of 2001 there were 676 credit unions in operation in Great Britain, but they controlled only £266 million in assets and had a total membership of 362,000. Less than 0.5 percent of the adult population in Great Britain are members of a credit union. The later introduction of credit unions and the differing legislative environments are a part explanation for the much slower development of the credit union movement in Great Britain relative to that in Northern Ireland.<sup>2</sup>

In response to the sluggish development of the movement in Great Britain the Government set up a Treasury Taskforce in July 1998. Its remit was to investigate ways of widening the range of credit union services provided to credit union members and to encourage expansion of the sector. Recommendations emanating from the taskforce included: permit credit unions to borrow from authorised institutions; allow interest-bearing (share) accounts and additional basic services for which they can charge fees; make the common bond requirements more flexible; remove the current membership limit; and extend repayment periods for loans. Many of these recommendations came into force in the form of legislative changes to the Credit Unions Act 1979 contained in Schedule 18 of the Financial Services and Markets Act 2000.

As part of the restructuring of the sector, the governance of credit union regulation was transferred from the Registry of Friendly Societies to the Financial Services Authority (FSA). The FSA, from as early 1999, had begun to supply regulatory and other services under contract to the Registry of Friendly Societies. At the start of July 2002 they took over complete regulatory control with the new environment described by (Strachan (2001), Director of the FSA's Deposit Takers Division,) as a "*proportionate regulatory regime for credit unions*". Emphasis is placed upon the assessment of the risk of individual credit union activities, as well as the overall safety, soundness and viability of the credit union movement.

In the creation of this new environment for credit unions, the government has a number of general objectives. These include improving governance within the sector; increasing consumer confidence in the credit union movement; enabling the provision of a wider range of financial services; encouraging the expansion of credit unions; and ensuring credit unions become more effective as vehicles in the fight against financial exclusion. Many commentators, however, have argued that smaller credit unions may find it difficult to comply with the new regulations. Donnelly (2002) suggests

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2. The relatively poor performance of the credit union movement in Great Britain should not, however be allowed to mask the fact that in certain areas significant credit union penetration has occurred. The most notable example is in the West of Scotland. The latter is generally accounted for by the fact that this is where emigrants from Ireland, with their experience of Irish credit union development, tended to settle (see, Donnelly et al. (1999)).

that after July 2002 mergers between credit unions will become essential as the burden of complying with FSA regulation will be too great for many managers and directors. The credit unions most likely to become involved in 'forced' merger activity will be those smaller credit unions which have been established in deprived inner-city areas and housing estates with the help of professional development workers, and which currently remain dependent on external assistance and financial support. Therefore if mergers result in the closure of outlets in the more deprived areas this will have detrimental consequences for the provision of financial services to those in areas of most need and will be a retrograde step in the fight against financial exclusion.

Although credit unions share a common co-operative philosophy differences are also apparent. The age profile ranges from new formations to those established in the 1960s. Credit unions may also be affiliated to different trade associations. Currently there are five trade associations each having a different ethos with respect to credit union development. Some trade associations take the view that member credit unions should concentrate upon achieving significant critical mass which is then expected to result in the generation of business efficiency and scale economies. In contrast, there are other trade associations where the primary focus is on community development, self-help and small units. The common bond, from which credit unions draw their members, can also differ and is classified as associational, residential, occupational or living and working in an area. Credit unions also differ in terms of the economic status of their members. The historical philosophy of the movement suggests that credit unions should be more successful in areas of deprivation as unlike other financial institutions their primary purpose is to provide banking facilities using self-help principles to those who may otherwise be characterized as financially excluded. Against this viewpoint others have advocated a mixed income membership for credit unions suggesting that a low income and middle income membership base enables the credit union to generate a healthy balance between saving members and borrowing members which may be critical in the success of the credit union (McKillop and Wilson, (2003)).

Against the backdrop of a changing regulatory regime and a movement which varies across a range of factors, this study seeks to evaluate the performance of UK credit unions between 1991 and 2001. A stochastic frontier cost function is specified with its unknown parameters being estimated using a maximum likelihood procedure and the cost efficiency (inefficiency) of individual credit unions being measured relative to the estimated frontier. The analysis also explores how a credit union's cost inefficiency in its own environmental situation compares with its cost inefficiency in a situation where all credit unions are assumed to face identical environmental conditions. This comparison enables estimation of the extent to which less favourable environmental conditions, such as the deprivation of the area in which the credit union is located, influences a credit union's cost inefficiency. In addition, the measurement of a credit union's cost inefficiency in the most favourable environmental situation results in an implicit measure of managerial performance net of any less favourable environmental conditions.

The format of the paper is as follows. In the next section the methodology is outlined. The stochastic cost frontier upon which the empirical analysis is based is detailed, as is the manner in which the cost inefficiency of credit union  $i$  in time period  $t$  is determined. Two approaches to modelling environmental influences are also detailed. Section 3 describes the data set. Information is provided on overall input cost as well as output quantities. Factors that may influence the operating environment are also discussed with descriptive statistics provided. Empirical results for the sample period (1991-2001) are discussed in Section 4. Concluding comments are presented in Section 5.

## 2. METHODOLOGY

To investigate the impact of differing operating environments on UK credit union performance the study uses a stochastic cost frontier analysis. Notation-wise, a credit union is viewed as using variable inputs  $x = (x_1, \dots, x_n)$  at exogenous prices  $w = (w_1, \dots, w_n)$  to produce largely demand-driven variable outputs  $y = (y_1, \dots, y_m)$  in an operating environment characterised by the variables  $z = (z_1, \dots, z_K)$ . It is assumed that, in response to the increasingly competitive environment in which credit unions operate, each credit union attempts to produce its outputs  $y$  in environment  $z$  at minimum cost, but optimising success is not guaranteed. The analysis thus permits both failure to optimise and different degrees of such failure in credit union behaviour. It also permits some credit unions to have more favourable operating environments than others. In addition, the analysis recognises that random shocks outside the control of a credit union can also affect cost.

Given that different credit unions may experience different environmental conditions, the analysis investigates how a credit union's cost inefficiency, in its own environmental situation, compares with its cost inefficiency in a situation where all credit unions are assumed to face identical environmental conditions. In the empirical analysis, the latter (empirically-constructed) situation is taken as the most favourable operating environment in the sample. The foregoing comparison will thus yield a measure of how a less favourable operating environment impacts on a credit union's cost inefficiency. Also, by measuring a credit union's cost inefficiency in the most favourable environmental scenario, this can be interpreted as a measure of its managerial performance net of any less favourable environmental conditions (but within the context of its own random shock or 'luck' scenario). To the extent that it can be assumed that the set of environmental variables used in the empirical analysis corresponds to all the major environmental influences on credit union performance, then this measure can be viewed as providing useful insights into managerial performance in equivalent environments, given unique luck scenarios.

To investigate managerial performance in equivalent environments, the study adapts the Coelli et al (1999) methodology for the stochastic production frontier case to the current stochastic cost frontier case. This methodology highlights that, in



examining the impact of environmental factors on producer performance, different approaches may be taken to modelling environmental influences. One approach is to assume that environmental factors influence the efficiency with which the production process is operated rather than the production process itself. An alternative approach is to assume the opposite. The study uses both approaches, each of these is outlined below.

### 2.1. Environment affects the efficiency with which a production process is operated ('type one' model)

To model this approach, we assume a stochastic translog (TL) cost frontier format so that the model can be written, for  $i = 1, \dots, I$  credit unions and  $t = 1, \dots, T$  periods, as

$$\ln C_{it} = TL(y_{it}, w_{it}, t; \beta) + v_{it} + u_{it} \quad (1)$$

In (1),  $C_{it}$  denotes the variable costs incurred by producer  $i$  in period  $t$ . The deterministic part of the stochastic cost frontier model (1) is given by the first term on the right-hand of (1). In this term, the inclusion of  $t$  in  $TL(\cdot)$  accounts for technological progress, while  $\beta$  is the vector of parameters to be estimated.

In the composed error term  $\varepsilon_{it} = v_{it} + u_{it}$ , the effects of random shocks on producer  $i$  are captured via the two-sided random-noise component  $v_{it}$ , while the one-sided error component  $u_{it} \geq 0$  reflects cost inefficiency. The  $v_{it}$  are assumed to be independently and identically distributed as  $N(0, \sigma_v^2)$ . The  $u_{it}$  are defined so as to embody the assumption that environmental conditions influence a credit union's cost inefficiency. Hence the cost inefficiency term is made an explicit function of a vector of environmental variables  $z_{it}$ . Following Battese and Coelli (1995), this is done by specifying that the  $u_{it}$  are independently (but not identically) distributed as non-negative truncations of a general normal distribution of the form:

$$N(m_{it}, \sigma_u^2) \text{ or } N\left[\delta_0 + \sum_{k=1}^K \delta_k z_{k,it}, \sigma_u^2\right], \quad (2)$$

Where  $\delta_0$  and the  $\delta_k$  are parameters to be estimated. If desired, a trend variable can be incorporated in  $m_{it}$  in (2) to capture (linearly) time-varying cost inefficiency.

The estimates of the unknown parameters (the  $\beta$ s the  $\delta$ s and the variance parameters  $\sigma_v^2$  and  $\sigma_u^2$ ) in (1) and (2) are obtained simultaneously via maximum likelihood estimation. The likelihood function and its partial derivatives with respect to the parameters of the model are obtained from Battese and Coelli (1993), remembering that for the cost case here  $\varepsilon_{it} = v_{it} + u_{it}$  (not  $\varepsilon_{it} = v_{it} - u_{it}$  as in the production case). The likelihood function is expressed in terms of the variance parameters  $\sigma_\varepsilon^2 = \sigma_v^2 + \sigma_u^2$  and  $\gamma = \sigma_u^2 / \sigma_\varepsilon^2$  where the value of the  $\gamma$  lies between zero and one.

The cost efficiency ( $CE_{it}$ ) of credit union  $i$  at time  $t$  is defined as the ratio of stochastic frontier minimum cost (with  $u_{it} = 0$ ) to observed cost and is measured by separating the inefficiency component from the composed error term. Adapting Battese and Coelli (1993) for the cost case, a predictor for cost efficiency (the inverse of cost inefficiency) is defined by the conditional expectation of  $\exp(-u_{it})$ , given  $\varepsilon_{it} = v_{it} + u_{it}$  (see Kumbhakar and Lovell (2000), chapters four and seven). The expression is given by

$$CE_{it} = E \left[ \exp(-u_{it}) | \varepsilon_{it} \right] \\ = \left\{ \exp \left[ -\mu_{it} + 1/2 \sigma^2 \right] \right\} \cdot \left\{ \phi \left[ \mu_{it} / \sigma^* - \sigma^* \right] / \phi \left[ \mu_{it} / \sigma^* \right] \right\}, \quad (3)$$

Where  $\sigma(\cdot)$  denotes the distribution function of the standard normal random variable,

$$\mu_{it} = (1 - \gamma) \left[ \delta_0 + \sum_{k=1}^K \delta_k z_{k,it} \right] - \gamma \varepsilon_{it}, \text{ and } \sigma^2 = \gamma(1 - \gamma)\sigma^2$$

Thus, by replacing the unknown parameters in (3) with their maximum likelihood estimates, a predictor for the cost efficiency (and inversely the cost inefficiency) of credit union  $i$  in period  $t$  is obtained. Note that while cost inefficiency embodies both technical inefficiencies from using too much inputs to produce outputs and allocative inefficiencies due to non-optimal input usage given input prices, the study is only concerned with obtaining producer-specific estimates of cost inefficiency (rather than with decomposing these estimates).

The cost efficiencies (and inversely cost inefficiencies) yielded by (3) are gross measures in that they include the influence of environmental factors. To obtain net cost efficiency measures, which are net or exclusive of environmental factors, the

$$\sum_{k=1}^K \delta_k z_{k,it}$$

in (3) are replaced by min

$$\left[ \sum_{k=1}^K \delta_k z_{k,it} \right]$$

and the cost efficiency predictions are then re-computed. As in the Coelli et al (1999) methodology, these adjusted predictions can now be interpreted as net efficiency scores since they provide predictions of efficiency levels when all credit unions face equivalent environmental conditions (namely, the most favourable).

## 2.2. Environment influences the production process itself ('type two' model)

The foregoing approach assumes that environmental conditions influence a credit union's cost inefficiency, which means that the elements of  $z$  are incorporated in the one-sided error component (as is done in (2) above). An alternative approach, as noted in Coelli et al (1999), is to assume that the elements of  $z$  influence the production process itself rather than the efficiency with which the process is operated. For example, assuming that the  $K$  environmental variables affect the (log) cost frontier in a log-linear fashion, the alternative approach yields a modified version of equation (1) as given by

$$\ln C_{it} = TL(y_{it}, w_{it}, t; \beta) + \sum_{k=1}^K \theta \ln z_{k,it} + v_{it} + u_{it} \quad (4)$$

Where  $\theta_k$  are parameters to be estimated, the  $v_{it}$  are distributed as before, but now it is assumed that the  $u_{it} \geq 0$  are distributed independently of the  $v_{it}$  with a half-normal distribution (as given by the upper half of the  $N(0, \sigma_u^2)$  distribution). Maximum likelihood estimation then yields estimates of the unknown parameters (the  $\beta$ s the  $\theta$ s and the variance parameters  $\sigma_v^2$  and  $\sigma_u^2$ ) required to compute the producer-specific predictors of cost efficiency ( $CE_{it}$ ).

When  $CE_{it} = E[\exp(-u_{it}) | \epsilon_{it}]$  is used to generate predictors of cost efficiency relative to the alternative stochastic cost frontier model defined in (4), the cost efficiency (and inversely cost inefficiency) measures will now (in contrast to those generated relative to (1) and (2) above) be *net* measures which are exclusive of environmental influences. Using the Coelli et al (1999) methodology for the cost case, gross efficiency measures (which are inclusive of environmental influences) for this alternative approach can be obtained by re-evaluating the cost efficiency predictors with

$$\sum_{k=1}^K \theta \ln z_{k,it}$$

replaced by min

$$\left[ \sum_{k=1}^K \theta \ln z_{k,it} \right]$$

This means that these (gross) cost efficiencies of credit unions are obtained in a scenario where all producers face the same (most favourable) operating environment.

Since the TL(.) parts of (1) and (4) are identical, we can now write out the full form of (4), numbered as (4'), and demonstrate how the first approach differs from this. Before doing this we need to note how input prices are handled in the empirical analysis. UK credit unions are self-help, co-operative financial institutions that depend to a varying degree upon volunteer labour and subsidized premises and equipment. Thus while implicitly they face different exogenous input prices, the inadequate, incomplete data availability for these prices does not permit one to obtain reliable actual or estimated input prices. As a consequence, the form of (4) used in the empirical analysis is given by

$$I_n C_{it} = \beta_0 + \sum_m \beta_m \ln y_{m,it} + 1/2 \sum_m \sum_l \beta_{ml} \ln y_{m,it} \ln y_{l,it} + \beta_t t + 1/2 \beta_{tt} t^2 + \sum_m \beta_{mt} \ln y_{m,it} t + \sum_k \theta_k \ln z_{k,it} + v_{it} + u_{it} \quad (4')$$

Where as noted in Baumol et al (1988, chapter 15) the  $\beta$ 's are taken to be unspecified functions of the input prices  $w_{it}$ . It can now be seen that the empirical form of the earlier 'environment influences cost inefficiency' approach is obtained by dropping the  $\ln z_k$  terms from (4') and redefining  $u_{it}$  to be as in (2) above. In the empirical analysis, the usual symmetry parameter restrictions are imposed prior to estimation. The other regularity conditions (nondecreasing in outputs and rightward skew of the residuals) are checked after estimation.

We now have two possible approaches to modelling environmental factors when measuring cost inefficiency, but which is preferable? As Kumbhakar and Lovell (2000) note, the answer is not obvious in many cases. Coelli et al (1999) suggest turning to the data for guidance. This involves constructing an artificial nested model that not only incorporates the K environmental variables as factors explaining cost inefficiency (as in (2) above), but also incorporates these variables as a characteristic of the production process (as in (4) above). Likelihood ratio tests can then be used to test the null hypothesis associated with (in turn) each approach against the alternative hypothesis associated with the artificial nested model.

### 3. DATA DESCRIPTION

The database, for the most part, is constructed from financial information published by UK credit unions in their Annual Returns.<sup>3</sup> Over the period under investigation

3. Data for credit unions in Great Britain was obtained in computer-based format from the Registry of Friendly Societies. Data for credit unions in Northern Ireland is not as yet available in computerised format. Information for credit unions in Northern Ireland was obtained by photocopying the AR25 returns made by individual credit unions to the Registry of Friendly Societies, Belfast and the researchers then creating their own database from this paper-based information source.

(1991 to 2001) there have been a significant number of new credit union formations as well as a number of liquidations. Consequently for many credit unions information is not available for each time period resulting in the analysis being conducted within an unbalanced panel framework. In addition, credit unions registered for less than three years were removed from the panel of observations because information on aspects of their operation is for many not yet complete.<sup>4</sup> The pooled sample upon which the analysis is based is 6,636 observations which, for example, encompasses 398 credit unions in 1991 and 680 credit unions in 2001.<sup>5</sup>

An 'intermediation approach' is employed in the classification of outputs and associated input cost. Berger and Humphrey (1997) argue that the intermediation approach is preferable when the overall efficiency of a financial institution is being assessed as opposed to efficiency at say branch level. A three output mix is specified loans  $y_1$ , shares,  $y_2$  and investment funds  $y_3$ .<sup>6</sup> Variable costs,  $C$ , is defined as the sum of non-interest expense plus interest expense.<sup>7</sup> In Table 1 summary information is presented for each variable for 2001.

**TABLE 1.**  
**SUMMARY STATISTICS, (END SEPTEMBER 2001)**

Variables	Mean	Median	Standard Deviation	Minimum	Maximum
Loans, $y_1$	£789,419	£2,607,484	£88,908	£499	£38,422,665
Shares, $y_2$ ,	£926,350	£2,854,992	£122,819	£977	£43,366,050
Investments, $y_3$ ,	£273,045	£841,282	£42,233	£391	£12,657,058
Variable costs, $C$	£76,613	£249,956	£11,547	£1,518	£4,445,803

Deflated to 1991 values.

4. Removal of these credit unions from the data set is consistent with efficiency type analyses of credit unions in other countries. For example, Fried and Lovell (1993, 1994) in removing credit unions from their study of US credit unions emphasised that not all US credit unions provide complete, consistent and believable information.

5. The data set also includes 449 credit unions in 1992; 504 (1993); 561 (1994); 611 (1995); 651 (1996); 687 (1997); 698 (1998); 697 (1999) and 689 (2000).

6. Investment funds include funds held on deposit with banks, building societies and other credit unions.

7. Variable cost includes: (i) salaries, wages and national insurance; repairs and renewals; printing stationery and advertising; loan and share insurance; general insurance; bank charges and audit fees; conference/convention expenses; regional committee/chapter expenses; and promotion and training expenses (ii) dividends payable to shareholders; interest payable on secured and unsecured loans; loans written off as bad debts; movements in the provision for doubtful debts; taxation; depreciation of fixed assets.

### 3.1. The different environmental conditions facing credit unions

Credit unions may experience different environmental conditions and this analysis assesses how a credit union's cost inefficiency in its own environment compares with its cost inefficiency where all credit unions are assumed to face the same environmental conditions. To do this the analysis needs to incorporate the main environmental variables influencing credit union performance. In attempting this, the study complements other methodologies which have been used to explore the manner in which operational characteristics impact upon credit union performance. For example, McKillop et al. (2002) for UK credit unions, Worthington (1998) and Esho (2001) for Australian credit unions, Fried et al. (1993, 1994) and Goddard et al. (2002) for US credit unions and Pille and Paradi (2002) for Canadian credit unions..

Credit unions draw their membership from a pre-designated common bond. The centrality of the common bond to credit unions was summarised by Burger and Dacin (1991)

*"It is a multifaceted concept, interpreted tightly or loosely depending on the nature of the social, political, and economic environment. Common bond has been a strength of credit unions and also their Achilles' heel. It has aided the founding of thousands of credit unions, but over emphasis on common bond and disagreement over interpretation have also made it a weakness."*

In the UK the common bond can be associational, residential, occupational or living and working in an area. Black and Duggar (1981) provide an information argument to justify the common bond stating that it reduces the cost of gathering credit information and, in consequence, minimises the exposure of individual credit unions to bad debt losses. If this viewpoint is accepted workplace based credit unions may be at an advantage relative to associational and community credit unions as the majority of their members are in employment with loans outstanding invariably repaid through a direct pay-roll reduction mechanism, (see Ferguson and McKillop (1997)). Out of the 680 credit unions in operation in 2001 some 79, are classified as workplace based credit unions. A dummy variable is employed to control for this differential environment between credit unions.

Information is also available on the trade associations to which individual credit unions are affiliated. At present five different trade associations are in operation within the UK. These are the Irish League of Credit Unions (ILCU); the Ulster Federation of Credit Unions (UFCU); the Association of British Credit Unions (ABCUL); the Scottish League of Credit Unions (SLCU); and the Association of Independent Credit Unions (AICU). These trade bodies differ in terms of their ethos but also in terms of the range of services provided to member credit unions. In this respect the most sophisticated is the ILCU which was established in 1960 and offers a central financial service providing loans and stand-by facilities to member credit unions. It also provides insurance cover and since 1989 has operated a saving protection scheme which

safeguards individual members' savings. The ILCU also provides formal training for credit union officers and supplies an extensive range of educational promotional material.

In terms of service provision to members, ABCUL is next in standing. Services provided include the training of credit union volunteers and directors plus offering an advice service to member credit unions. Unlike the ILCU a safety protection scheme for member credit unions was not on offer until 2002 when the FSA took over complete regulatory control of credit unions in Great Britain and required that the Financial Services Compensation Scheme be extended to credit union members' funds. The UFCU is also a relatively active trade body with a significant number of affiliated members although services provided are essentially advisory in nature. The UFCU draws its member credit unions exclusively from Northern Ireland. It was established in 1995 with previously many of its member credit unions being affiliated to the British based National Federation of Credit Unions.<sup>8, 9</sup> The remaining trade associations are recently established, they have few member credit unions and merely offer an advisory service to affiliates. Dummy variables are utilized to reflect the different operating environment created by the differential service provided by the trade bodies. Four designations are controlled for (i) affiliated to the ILCU of which there were 104 credit unions in 2001; (ii) ABCUL affiliates, 369 (2001); (iii) UFCU affiliates, 51 (2001); and (iv) others which covers SLCU, AICU and those credit unions which are not affiliated to any trade body, 156 (2001).

Barron et al. (1994) argues that organisations as they age have an increasing vulnerability to competition from newcomers. Old age is equated with a loss of agility and responsiveness, so that, with ageing, more market opportunities are missed. There is of course an alternative viewpoint, which would contend that older and probably larger organisations have significant advantages over their younger and perhaps smaller counterparts. These advantages centre on being more aware of the market in which they operate, being able to avail of economies of scale in product provision and through a period of establishment being more likely to exercise both economic and political power. To control for the extent to which age and size impact upon the environmental situation, the number of years that the credit union has been in existence and the membership size of the credit union are employed as environmental factors. As of end 2001 the average age of credit unions in the sample is 14 years with a standard deviation of 9 years, with the minimum age 4 years, and the maximum 41 years. In terms of member numbers, the average credit union had 994 members with a standard deviation of 1,970, a minimum of 58, and a maximum of 23,905.

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8 . The NFCU is no longer in operation with, in Great Britain, the majority of its credit unions having transferred to either ABCUL or the SLCU.

9. UFCU member credit unions are not part of the savings protection scheme operated by the FSA for credit unions in Great Britain nor is it part of the scheme administered by the ILCU for credit unions in Ireland. This has necessitated the UFCU establishing a private deposit insurance mechanism. This scheme is, however, in its infancy having been established at the end of 2002.

Credit unions draw their members from pre-determined geographical areas. The historical philosophy of the movement suggests that credit unions should be more successful in areas of deprivation as unlike other financial institutions they are not-for-profit and a primary purpose is to provide banking facilities using self-help principles to those who have difficulty attaining them elsewhere namely, the financially excluded. Set against this argument a number of commentators have advocated a mixed income membership mix for credit unions suggesting that this will result in them becoming more stable and better able to serve the needs of the financially excluded (see McArthur et al. (1993), Rossiter (1997) and McKillop and Wilson (2003)).

Consistently defined data on deprivation for the UK as a whole is not available. An index of deprivation is available at electoral ward level but the regions of the UK utilise marginally different common denominators making inter regional comparisons somewhat problematic. However, two of the main determinants of deprivation, low income households as a proportion of electoral ward level population<sup>10</sup> and the percentage of the population in the electoral ward in low employment (ie forced exclusion from the world of work either through unemployment, sickness or disability)<sup>11</sup> are consistently treated between regions<sup>12</sup>. These two components were employed to gauge the degree of poverty/deprivation in an area and consequently to control for 'environmental' differences in the economic profile from which individual credit unions draw their members<sup>13</sup>. In general terms the measures of deprivation revealed that approximately 69 percent of credit unions were located in areas of medium to high deprivation. For example, the location of credit unions ranged from being in an electoral ward where only 2.7% of the population are in receipt of benefits to being in a ward where 74.3% were on benefit. The two measures of deprivation are strongly positively correlated (0.84), however, the income measure identifies a greater proportion of credit unions to be located in areas of high deprivation relative to the employment measure. The comparative proportions are 34 percent compared to 25 percent. There are also some regional variations in deprivation. The sharpest distinction is between England and Wales, where the majority of credit unions are located in areas of high deprivation, and Scotland where the majority are situated in areas of low deprivation. Again the two measures offer a slightly different picture when it comes to a regional analysis. The most obvious difference being with respect

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10. The calculation of low income households is dependent upon factors such as the number of adults and children in income support households; the number of adults and children in income based job seekers allowance households; the number of adults and children in disability working allowance households; and non-earning, non-income support pensioner and disabled council tax benefit recipients.

11. The calculation of low employment is determined by the unemployment claimant count for those aged 16 to 59; new deal participants not included in the unemployment claimant count; incapacity benefit recipients aged 16 to 59; severe disablement allowance recipients aged 16 to 59; and those out of work but in government training employment schemes.

12. The deprivation components, at electoral ward level, were obtained from the relevant government department in each of the regions. Credit union postcodes were then employed in a manual matching of the deprivation measures to the individual credit unions in the sample.

13. Due to the high correlation between the two deprivation components the empirical analysis utilises only one measure although findings when the models are re-estimated using the alternative measure are also noted.



to credit unions located in Northern Ireland. The income measure classifies approximately 50 percent of credit unions as being based in areas of high deprivation compared to 30 percent when the employment measure is used.

In the introductory comments it was highlighted that the credit union movement in Northern Ireland is more developed than elsewhere in the UK. Legislative differences were identified as one reason for the differential development as well as earlier establishment and the movement being fostered through the parish system. Legislative differences still remain. For example, a credit union legislative review is currently underway in Northern Ireland. Its aim is to update legislation in Northern Ireland to bring it in line with recent changes in Great Britain under the Financial Services and Markets Act (2000) and changes in the Republic of Ireland due to the Credit Union Act of 1997. Other differences in the treatment of credit unions across regions are also apparent. For example, many local authorities in Great Britain have in the past provided support to community based credit unions.<sup>14</sup> A review of this policy was undertaken by the Scottish Executive Central Research Unit (2000) for Scottish credit unions. It concluded that the policy was untenable and that *"few of this type of start-up credit union become self-sustaining."* Support by the Scottish Executive for credit unions has in recent times become more measured, being targeted at larger credit unions as well as being employed as an inducement to encourage certain smaller community based credit unions to consider merging their operations. In recognition of the different regional environments under which credit unions operate a dummy variable is employed to distinguish between credit unions located in Northern Ireland, Scotland, and England & Wales.

Finally all monetary data is deflated to a common year (1991) using the UK consumer price index. In addition, where appropriate, variables are normalised at their respective means calculated over all periods in the sample.

## 4. EMPIRICAL RESULTS

A maximum likelihood procedure is utilised to obtain parameter estimates for each of the stochastic cost frontier models. The estimated coefficients are presented in Table 2. The estimates pertain to the basic stochastic translog cost frontier model without environmental factors (column 2); the stochastic translog cost frontier model assuming that the environment affects the efficiency with which a production process is operated ('type one' model, column 3); the stochastic translog cost frontier model under the assumption that the environment influences the production process itself ('type two' model, column 4); and an artificial nested model which permits the environment to have both 'type one' and 'type two' effects (column 5). The latter is employed to determine whether the 'type one' or 'type two' model is the preferential approach.

14. Support varies but can include some or all of the following: training, education, small grants and the provision of facilities.

**TABLE 2.**  
**ALTERNATIVE STOCHASTIC TRANSLOG COST FRONTIER MODELS\***

TABLE 2 (PART ONE)				
	Basic translog model	'type one' model	'type two' model	Nested model
$\alpha_0$	0.308 (10.56)	0.373 (14.72)	0.095 (2.62)	0.121 (3.47)
$\ln y_1$	0.540 (10.55)	0.505 (10.07)	0.588 (7.80)	0.529 (7.01)
$\ln y_2$	0.388 (6.10)	0.487 (7.90)	0.342 (5.41)	0.399 (7.09)
$\ln y_3$	0.127 (6.67)	0.126 (7.33)	0.109 (5.76)	0.092 (6.04)
$t$	0.122 (7.90)	0.124 (8.41)	0.094 (6.31)	0.090 (5.93)
$t^2$	-0.064 (-3.91)	-0.100 (-7.32)	-0.041 (-2.45)	-0.084 (-6.06)
$\ln y_1 \ln y_1$	0.001 (0.03)	-0.003 (-0.14)	-0.020 (-1.10)	-0.005 (-0.28)
$\ln y_1 \ln y_2$	0.076 (3.17)	0.114 (5.63)	0.039 (1.51)	0.087 (4.44)
$\ln y_1 \ln y_3$	-0.014 (-0.73)	-0.013 (-0.63)	0.006 (0.32)	-0.002 (-0.09)
$\ln y_2 \ln y_2$	0.016 (3.24)	0.015 (3.45)	0.014 (2.90)	0.009 (2.34)
$\ln y_2 \ln y_3$	-1.042 (-18.21)	-1.022 (-18.91)	-1.042 (-18.29)	-1.056 (-22.29)
$\ln y_3 \ln y_3$	0.418 (14.67)	0.397 (14.60)	0.431 (15.30)	0.420 (17.65)
$\ln y_1 t$	0.019 (5.72)	-0.024 (-0.73)	0.048 (1.54)	-0.020 (-0.65)
$\ln y_2 t$	0.048 (1.06)	0.061 (1.43)	0.028 (0.66)	0.071 (1.77)
$\ln y_3 t$	-0.068 (-4.19)	-0.069 (-4.81)	-0.061 (-3.89)	-0.064 (-4.91)
TABLE 2 (PART TWO)				
	Basic translog model	'type one' model	'type two' model	Nested model
Membership Size			0.253 (15.48)	0.261 (16.56)
Age	-	-	0.140 (13.00)	0.287 (24.35)
Reg: Eng & Wales	-	-	0.004 (0.22)	0.018 (0.79)
Reg: NI	-	-	0.163 (3.09)	0.274 (6.08)
Employee Bond	-	-	-0.072 (-3.06)	-0.189 (-8.39)
ABCUL	-	-	0.109 (7.56)	0.094 (4.68)
ILCU	-	-	-0.038 (-0.73)	-0.164 (-4.13)
UFCU	-	-	-0.077 (-1.95)	0.026 (0.63)
Depriv. (income)	-	-	0.020 (1.58)	0.021 (1.41)
$d_0$	-21.45(-5.56)	-3.29 (-16.69)	-20.74 (-8.53)	-2.580 (-17.00)
Membership Size		-0.735 (-24.58)		-0.606 (-15.66)
Age	-	-0.806 (-17.87)	-	-1.249 (-29.23)
Reg: Eng & Wales	-	0.478 (6.24)	-	-0.096 (-1.37)
Reg: NI	-	-4.629 (-36.88)	-	-2.942 (-7.53)
Employee Bond	-	-2.011 (-28.69)	-	-1.681 (-15.06)
ABCUL	-	0.412 (7.69)	-	-0.034 (-0.64)
ILCU	-	2.344 (15.91)	-	1.148 (23.35)
UFCU	-	-0.831 (-6.726)	-	-0.922 (-4.23)
Depriv. (income)	-	0.461 (7.57)	-	0.367 (6.81)
$s^2$	0.696 (6.01)	1.352 (19.48)	6.50 (9.18)	1.049 (26.51)
$g$	0.980 (298.19)	0.929 (213.18)	0.981 (420.51)	0.928 (309.99)
L. L. Function	- 4,722.84	- 4,383.64	- 4,428.26	- 3,921.02
Number of obs.	6,635	6,635	6,635	6,635
Degrees of freedom	6,621	6,621	6,621	6,611
LR test	898.56	1,576.97	995.01	2,010.44

\*t-values in parentheses.

To be an adequate representation of the underlying technology the estimated cost function must be monotonically non-decreasing in output. For this condition to hold, at the sample mean of the variables, it is necessary that  $b_m \geq 0$ . The parameter estimates detailed in Table 2 (part one) for each model indicates that this is the case.

For the respective models the null hypothesis of no cost inefficiency (or of  $g = 0$ , implying that the one-sided error component makes no contribution to the composed error term) can be tested. To do this we follow the Coelli (1995) procedure which suggests that the one-sided generalised likelihood ratio test should be performed when maximum likelihood estimation is involved. Critical values for this test are obtained from Table 1 of Kodde and Palm (1986). For each model the null hypothesis of no cost inefficiency is rejected (see bottom row of Table 2 (part two)). For the cost efficiency (inefficiency) estimates to be meaningful the residuals from the respective models should also be positively skewed. Again this condition is satisfied.

From Table 2 (part two) it can also be observed that the estimates of  $g$  are close to one although significantly different from one. This suggests that the vast majority of residual variation is due to the cost inefficiency effect  $u_{it}$  and that the random error component  $v_{it}$  is relatively small. In the context of the 'type two' model, where the computed efficiency measures are net measures, that are exclusive of environmental influences, the  $g$  estimate can be interpreted as highlighting the presence of managerial inefficiency.

Log likelihood values are reported in Table 2 (part two) for the basic translog model, which does not incorporate environmental variables, and for the 'type one' and 'type two' models that do include environmental influences. Likelihood ratio tests are employed to determine whether the basic translog model can be rejected in favour of the other two models. In both cases the null (basic translog model) is rejected which emphasises that environmental variables cannot be neglected without introducing a bias in the estimation of cost functions.

A non-nested testing procedure, again based upon the likelihood values reported in Table 2 (part two), is employed in an attempt to discern between the 'type one' and 'type two' approaches to the modelling of environmental influences. This involves constructing an artificial nested model, which not only incorporates the environmental variables as factors explaining cost efficiency, but also incorporates these variables as a characteristic of the production process (see Table 2 (column 5). Likelihood ratio tests of the null hypotheses associated with the 'type one' and the 'type two' models against the alternative nested model are unable to distinguish between the two models as both the 'type one' null hypothesis and the 'type two' null hypothesis are both rejected. Consequently it cannot be argued that one approach provides a better fit to the sample data than the other.<sup>15</sup> The discussion and analysis in the paper is therefore based upon both approaches to the modelling of environmental factors.

15. Coelli et al (1999) note that without guidance from the data the ex ante selection of one model type over the other is a difficult task. It could, however, be argued that the 'type one' model is to be preferred as the estimated frontier represents the lower boundary of the cost possibility set, irrespective of environmental issues.

#### 4.1. Environmental Influences (the ‘type one’ model)

Table 2 (part two), documents the role and significance of the environmental variables. In the case of the ‘type one’ model, which assumes that the environment affects the efficiency with which a production process is operated, a positive relationship suggests that the environmental variable has a detrimental impact on **cost efficiency** while negative coefficients imply that the effect is beneficial. The majority of the coefficient estimates prove to be negative and significant. For example, the environmental variable representing membership size is negative, which indicates that an increase in a credit union’s membership base is likely to have a beneficial impact on cost efficiency. McKillop et al (2002), who derived radial and non-radial efficiency measures for large UK credit unions also found, in a follow up Tobit analysis, that *“larger credit unions are more efficient than their smaller counterparts”*. A similar result was found for US credit unions by Fried et al. (1993) and for Australian credit unions by Worthington (1998) although Esho (2001), again for Australian credit unions, found cost efficiency to be negatively correlated with total assets.<sup>16,17</sup>

The age variable is also negative and significant implying that older credit unions are more cost efficient than younger credit unions. This finding lends support to the view that older and larger organisations have advantages over their younger and smaller counterparts. In the case of the UK credit unions, in their early years, rely much more heavily on volunteer labour and donated premises and equipment than their more established counterparts and thus face lower costs in absolute terms. Consequently the finding that older credit unions are more cost efficient emphasises that with longer establishment comes greater levels of financial expertise, market knowledge and ability to capture members, thus enabling the more cost effective provision of financial services.

The dummy variable distinguishing credit union region of origin suggests that English and Welsh credit unions are less cost efficient than Scottish credit unions which in turn are less cost efficient than those in Northern Ireland. The superior cost efficiency of credit unions in Northern Ireland is primarily due to an historically more conducive legislative environment in conjunction with a parish infrastructure which provided suitable community based common bonds upon which credit unions could be grafted. The cost efficiency advantage that Scottish credit unions enjoy relative to those in England and Wales may also relate to historical factors, notably the role played by emigrants from Ireland who with their knowledge of the Irish movement were instrumental in the establishment and operation of many credit unions in the West

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16. Efficiency studies based on other financial institutions yield no consistent picture as to the relationship between size and efficiency. Hermlin and Wallace (1994) and Kaparakis et al (1994) found a significant negative relationship; Berger et al (1993) and Berger and Mester (1997) found a positive relationship; and Aly et al (1990), Berger and Hannan (1998), Cebenoyan et al (1993), Mester (1993,1996), and Pi and Timme (1993) found an insignificant relationship.

17. The parameter estimates in Table 2 (part one) can be used to determine whether UK credit unions are subject to increasing, decreasing or constant returns to scale. At the expansion point, for each of the models, increasing returns to scale pertain. This finding of increasing returns to scale is consistent with larger credit unions being identified as more cost efficient.

of Scotland, (see, Donnelly et al. (1999)).

The dummy variable differentiating credit unions by common bond type indicates that an employee bond is commensurate with superior cost efficiency relative to either a community or associational common bond. The information advantage, conferred by a tight and well-defined common bond, is instrumental in the creation of the cost efficiency advantage of employee-based credit unions:

*“A key function of financial intermediaries is to overcome adverse selection and moral hazard problems associated with direct lending. A tightly enforced common bond restriction may reduce information problems in lending, due to the close association between lenders and members, and therefore lead to greater efficiency. Since common bond restrictions are most tightly enforced in private industrial CUs and most loosely enforced in community CUs, efficiency is expected to be higher in industrial based CUs” (Esho, 2001).*

Dummy variables were also employed to reflect the fact that credit unions may choose to be affiliated to different trade associations. Four environmental situations were identified – affiliation to the ILCU, ABCUL, UFCU and ‘others’, which covers SLCU and AICU and credit unions which are independent. The dummy variable distinguishing between trade bodies identified ILCU affiliates to be less cost efficient than the omitted group ‘others’ as indeed are ABCUL credit unions although the differential in the latter case is not as pronounced. The ILCU and ABCUL are viewed as sister organizations, both are affiliated to the World Council of Credit Unions (WOCCU) and both play an active and significant role in the development, training, administration and supervision of their member credit unions. To finance activities both the ILCU and ABCUL levy an annual fee on member credit unions with the amount determined by membership size. The ILCU also operates a savings protection scheme financed through an annual levy upon member credit unions. These fee based *compulsory* services provided by the ILCU and to a lesser extent ABCUL result in higher input costs. McKillop et al (2002) in their analysis of large UK credit unions

*“.... although such services reduce the risks inherent in the operation of ILCU affiliated credit unions they also appear to impact adversely upon efficiency.”*

ABCUL over the course of the last five years has faced defections particularly to the SLCU. Some of these defections have been due to disagreement with the business philosophy adopted by ABCUL while others have occurred because members have felt that the services provided by ABCUL do not match fees charged. Similar disquiet has recently emerged within the ILCU with twenty of the larger credit unions threatening to break away and form their own trade association. One of the main complaints of this latter group is that the compulsory insurance provided by the ILCU’s own assurance company is too expensive. The fact that ILCU and ABCUL members have relatively lower cost efficiency levels offers some support to the course of action being pursued by the break away groups.

UFCU member credit unions are highlighted as being more cost efficient than the omitted group 'others'. The UFCU provides advice, information and assistance to credit unions both prior to establishment and after formation. Its structure is much simpler than that of the ILCU or ABCUL, with a single committee responsible for all its functions and it is only now considering the adoption of a privately administered savings protection scheme. The basic and sparse service provided to UFCU member credit unions may have cost efficiency advantages but this should be balanced against the added risks associated with membership of this trade body.

The deprivation measure, utilised to gauge the economic standing of the pool from which individual credit unions draw their members, is that of low income. The positive coefficient estimate indicates that cost inefficiency rises with the degree of deprivation. This suggests that the more cost efficient credit unions are to be found in areas subject to lower degrees of deprivation. (Reworking the analysis with low employment used as an alternate measure of deprivation provided a similar finding, the resultant coefficient estimate and associated t-statistic were respectively 0.589 and (12.62)). This is a finding of some importance. It suggests that credit unions which draw their membership from a common bond which captures both a low income and middle income membership have superior levels of cost efficiency to those credit unions which are focused primarily upon the financially excluded. This finding lends support to Jones (2002) who articulated a new model of development for credit unions in Great Britain. In this model credit unions are viewed as first and foremost a business structured around a wide membership base. They must have adequate reserves and offer competitive interest rates on savings and charge near market rates on loans and should not be dependent on external subsidy.<sup>18</sup> Jones argues that

*"Overall, this new approach introduces a rigour, discipline and technical expertise into credit union development that has been lacking within the British movement in the past."*

Underlying this new approach is the view that the needs of the poor and financially excluded are likely to be best served within sound and prospering credit unions which serve a wider cross-section of society and not just those on low-incomes who have limited access to mainstream financial providers.

#### **4.2. Environmental Influences (the 'type two' model)**

Table 2 (part two) provides a profile of the role and significance of the environmental variables for the 'type two' model. In this case a positive coefficient

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18. ABCUL is currently undertaking a credit union strengthening project in the West Midlands based on this model and the PEARLS monitoring system. PEARLS encompasses 44 quantitative financial indicators across six general areas of operation (Protection, Effective financial structure, Asset quality, Rates of return and cost, Liquidity, and Signs of growth).

suggests that an increase in the environmental variable is **cost** increasing while a negative relationship indicates that an increase in the environmental variable results in a cost decline. Both membership size and age have positive and significant coefficient estimates indicating that older and larger credit unions face a higher cost regime than their smaller and younger counterparts. This is expected in that older and larger credit unions are more likely to face additional financial costs relating to the acquisition of premises and equipment and the hiring of paid employees. However, it was previously noted that larger and older credit unions are more cost efficient. This emphasises that with size comes scale efficiency advantages and with age comes experience and market knowledge advantages, which in each case more than compensates for the higher cost regimes.

The dummy variable distinguishing between the region of origin suggests that while there is no significant cost differential between those credit unions in England and Wales and those in Scotland, credit unions in Northern Ireland do face a higher cost regime than their counterparts in Scotland. This is an expected finding because the longer established and more developed nature of the movement in Northern Ireland has enabled many credit unions to increasingly replace volunteers with paid employees. Furthermore, credit unions in Northern Ireland do not receive the same level of subsidies and grants as their counterparts in Great Britain. Faced with this cost disadvantage, the fact that Northern Ireland credit unions were earlier identified as more cost efficient can be firmly ascribed to the historically more conducive legislative environment within which credit unions in Northern Ireland have operated.

The negative coefficient on the dummy variable distinguishing credit unions based on an employee common bond indicates that these credit unions face a lower cost regime. This may be accounted for by the fact that credit unions structured around a tightly defined common bond such as an employer would be expected to have information advantages over credit unions that have, for example, a geographical common bond. In addition, employer focused credit unions will also be subject to lower levels of loan risk as members' salaries are, in many instances, channelled through the credit union which again should translate into lower costs.

The dummy variable distinguishing between trade bodies is positive and significant for ABCUL member credit unions, negative and significant for credit unions affiliated to the UFCU and insignificant in the case of ILCU credit unions. In broad terms these results are consistent with those described for the 'type one' model and in general are reflective of differences in service provision and the associated charge structure adhered to by the respective trade associations. More particularly, ABCUL member credit unions face higher costs than the omitted group 'others' and in the previous analysis they were identified as being less cost efficient than 'others'. UFCU credit unions, in contrast, face lower costs and were previously identified as more cost efficient than 'others'.

The reported coefficient estimate on the income measure is positive and significant suggesting that credit unions based in areas of high deprivation face higher operational costs. (Reworking the analysis with low employment used as an alternate measure of deprivation provided a similar finding, the resultant coefficient estimate and

associated t-statistic were respectively 0.020 and (1.77)). This finding, which is consistent with the earlier result that credit unions located in areas of higher deprivation are subject to lower levels of cost efficiency, may be due to two factors. In the first instance bad debt write-offs may be higher for these credit unions in that the low income status of the membership may lead to an increased difficulty in making loan repayments. Secondly, credit unions, which draw their membership from areas of high deprivation, are likely to be net borrowers requiring the credit union to access funds from sources other than from its members. In the UK these additional funds are obtained either from net saver credit unions or from other financial institutions. In both cases the resultant marginal cost of funds will be higher than those generated internally.

### **4.3. Net and gross cost efficiency measures**

In Table 3 cost efficiency measures, net and gross, are presented for the 'type one' and the 'type two' models. Differences between the gross and net cost efficiency measures for a specific credit union can be viewed as the contribution that the environmental variables make to the inefficiency of the credit union in question.

The efficiency estimates obtained from the estimation of the 'type one' model (the environment affects the efficiency with which a production process is operated) are gross measures with adjustments then made to obtain the corresponding net efficiency scores. This contrasts with the 'type two' approach (the environment influences the production process itself) where the initial measures were net in form with adjustments carried out to determine the gross equivalents. The first point to note from Table 3 is the consistency in the gross efficiency estimates for both of the models. For example, for the period as a whole, 1991-2001, gross efficiency, estimated utilising the 'type one' approach, is on average 0.6882 (mean value) 0.7609 (median value) compared to 0.6596 (mean value) 0.6952 (median value) for the 'type two' model. These gross efficiency estimates suggest that there is a relatively high degree of inefficiency within the UK credit union movement which might be expected given that credit unions, based on clearly defined and non-overlapping common bonds, are not in competition with each other for market share nor for that matter are they in competition with mainstream financial organisations. In terms of comparative work on UK credit unions McKillop et al. (2002) computed input cost efficiency measures for three input output mixes. The resultant geometric mean efficiency scores were 0.7506, 0.5971 and 0.6121 and are broadly in line with the results of this current study, supporting the contention that there is considerable scope for efficiency gains.

Differences between the net and gross measures are apparent for both models but are much more pronounced under the 'type one' approach. For example, the ratio of net/gross for the period as a whole (1991-2001) is on average, 1.4530 (mean value) 1.3142 (median value) when the environment explains inefficiencies compared to 1.1250 (mean value) 1.1152 (median value) with the environmental variables in



the frontier. In the case of the 'type two' model the net/gross ratio has remained relatively stable over the period whereas for the 'type one' model there is some evidence of a decline in the net/gross differential (1991: 1.5389 (mean value), 1.3120 (median value); 2001: 1.4115 (mean value), 1.2844 (median value)). If the future is one where credit unions merge and become larger, potentially draw from more than one common bond pool and perhaps embrace members from a wider socio-economic spectrum, the identified net/gross differential should reduce.

Assuming that the main environmental variables have been accounted for, the net efficiency measure may be interpreted as a measure of managerial performance. Under the 'type two' model there is significant evidence of managerial under-performance. The situation improves on consideration of the 'type one' model although again considerable scope for improvement is apparent. The volunteer nature of credit unions, at board level as well as at varying levels in front office positions and back office administration, may provide a partial explanation for the marked under-performance of credit union management. Agency issues may also be pertinent as an explanation for managerial under-performance in that the one-member-one-vote system may result in ineffective monitoring of managerial actions and performance. In an analysis of US credit unions Karels and McClatchey (1999) state

*"Externally, mutuals lack much of the outside monitoring found in stock institutions because ownership shares are not transferable to those wishing to exercise control over management."*

From Table 3 there is also some evidence of a marginal improvement in efficiency over the period. The average improvement ranges from two percent to six percent for 'type one' measures and between one and two percent for the efficiency aggregates obtained from the 'type two' model. As the UK movement has matured, there have been gradual relaxations of the legislative requirements under which credit unions operate. The latest changes enacted under the Financial Services and Markets Act 2000 have occurred too late to impact upon the current study, however, earlier amendments, enacted in January 1996 in the Deregulation and Contracting Out Act, will have had some impact. Most notable of these amendments were increases in loan and shareholding limits, an extension of the loan repayment period and a relaxation of the common bond to encompass employees or residents in a locality. As these changes permit credit unions to raise more funds from a wider membership base and make greater volume and longer maturity loans, the identified improvement in efficiency would be expected.

**TABLE 3.**  
**GROSS AND NET COST EFFICIENCY MEASURES, 1991 TO 2001**

		'type one' (net measures)	'type one' (gross measures)	net/gross	'type two' (net measures)	'type two' (gross measures)	net/gross
1991	Mean	0.9333	0.6498	1.5389	0.7295	0.6305	1.1570
	Median	0.9336	0.7622	1.3120	0.7699	0.6813	1.1301
	S.dev	0.0160	0.2530		0.1543	0.1606	
	Min	0.8739	0.0144		0.0583	0.0456	
	Max	0.9620	0.9439		0.9343	0.8516	
1992	Mean	0.9477	0.6630	1.5083	0.7394	0.6585	1.1229
	Median	0.9482	0.7584	1.3186	0.7709	0.7003	1.1008
	S.dev	0.0172	0.2396		0.1400	0.1453	
	Min	0.7021	0.0298		0.1027	0.0634	
	Max	0.9709	1.0000		1.0000	0.9309	
1993	Mean	0.9356	0.6607	1.5135	0.7390	0.6533	1.1312
	Median	0.9353	0.7458	1.3408	0.7694	0.6904	1.1144
	S.dev	0.0151	0.2301		0.1318	0.1395	
	Min	0.8501	0.0238		0.0759	0.0630	
	Max	0.9642	0.9656		1.0000	0.8649	
1994	Mean	0.9481	0.6688	1.4952	0.7372	0.6530	1.1289
	Median	0.9481	0.7558	1.3231	0.7704	0.6922	1.1130
	S.dev	0.0191	0.2288		0.1413	0.1484	
	Min	0.6268	0.0204		0.1059	0.0849	
	Max	0.9716	1.0000		1.0000	0.8645	
1995	Mean	0.9458	0.6685	1.4959	0.7321	0.6475	1.1307
	Median	0.9451	0.7489	1.3353	0.7654	0.6823	1.1218
	S.dev	0.0118	0.2239		0.1376	0.1456	
	Min	0.8976	0.0325		0.1195	0.0905	
	Max	0.9700	1.0000		0.9554	0.8833	
1996	Mean	0.9335	0.6887	1.4520	0.7465	0.6629	1.1261
	Median	0.9332	0.7553	1.3240	0.7793	0.6974	1.1174
	S.dev	0.0142	0.2089		0.1306	0.1385	
	Min	0.8514	0.0606		0.1200	0.0980	
	Max	0.9629	0.9409		0.9373	0.8597	
1997	Mean	0.9393	0.6982	1.4323	0.7509	0.6670	1.1258
	Median	0.9387	0.7600	1.3158	0.7815	0.6955	1.1237
	S.dev	0.0130	0.2005		0.1248	0.1318	
	Min	0.8608	0.0142		0.0449	0.0421	
	Max	0.9660	0.9583		0.9580	0.8569	
1998	Mean	0.9409	0.7022	1.4240	0.7514	0.6670	1.1266
	Median	0.9403	0.7571	1.3209	0.7768	0.6940	1.1193
	S.dev	0.0118	0.1895		0.1173	0.1233	
	Min	0.9029	0.0727		0.1019	0.0923	
	Max	0.9663	0.9494		0.9197	0.8733	
1999	Mean	0.9410	0.7176	1.3935	0.7556	0.6711	1.1258
	Median	0.9414	0.7665	1.3046	0.7792	0.6923	1.1254
	S.dev	0.0120	0.1707		0.1146	0.1183	
	Min	0.8725	0.0490		0.0942	0.0791	
	Max	0.9660	0.9591		0.9408	0.9127	
2000	Mean	0.9527	0.7059	1.4166	0.7382	0.6583	1.1213
	Median	0.9531	0.7676	1.3028	0.7786	0.6947	1.1208
	S.dev	0.0093	0.1930		0.1440	0.1478	
	Min	0.9165	0.0375		0.0763	0.0681	
	Max	0.9718	0.9502		0.9376	0.9309	
2001	Mean	0.9527	0.7085	1.4115	0.7339	0.6558	1.1191
	Median	0.9537	0.7786	1.2844	0.7813	0.7023	1.1125
	S.dev	0.0093	0.2018		0.1553	0.1590	
	Min	0.9151	0.0513		0.0679	0.0332	
	Max	0.9713	0.9313		0.9255	0.8783	
91-01	Mean	0.9431	0.6882	1.4530	0.7421	0.6596	1.1250
	Median	0.9444	0.7609	1.3142	0.7753	0.6952	1.1152
	S.dev	0.0150	0.2111		0.1353	0.1412	
	Min	0.6268	0.0142		0.0449	0.0332	
	Max	0.9718	1.0000		1.0000	0.9309	

Earlier in the discussion it was noted that we were unable to discriminate between the 'type one' and the 'type two' approaches. Having made this point the analysis to date indicates that both approaches yield similar results with respect to the direction of influence of the environmental conditions. In addition there is also a similarity in the magnitude of the efficiency estimates, particularly the gross measures, as well as the direction of change of the respective measures over time. To reinforce this contention a pair-wise correlation analysis between the efficiency estimates obtained from the two approaches is detailed in Table 4. As can be seen the correlation coefficients suggest that the various procedures employed in the computation of cost efficiency scores yield measures which, to a lesser or greater extent, are positively correlated. Therefore, it can reasonably be argued that the respective models provide a consistency in any relative assessment of credit union efficiency.

**TABLE 4.**  
**CORRELATION MATRIX OF GROSS AND NET COST EFFICIENCY MEASURES**

	'type one' (net )	'type one' (gross)	'type two' (net)	'type two' (gross)
'type one' (net)	1	0.2886	0.1176	0.1251
'type one' (gross)		1	0.8042	0.8725
'type two' (net)			1	0.9532
'type two' (gross)				1

## 5. CONCLUDING COMMENTS

As member-owned, not-for-profit financial institutions, credit unions are an important instrument of public policy, particularly in providing measures to counter financial and social exclusion. To facilitate this role, credit unions have been subject to a series of enabling legislative amendments throughout the course of the 1990s. This process concluded with the changes contained in Schedule 18 of the Financial Services and Markets Act 2000. It is anticipated that this restructured legislative environment will act as a catalyst for change. In particular, there is likely to be a decline in credit union numbers but those that remain, it is forecast, will be much larger and more professionally-managed.

Against the backdrop that UK credit unions face a period of change this paper has sought to explore the cost efficiency of credit unions over the period 1991-2001. On the grounds that credit unions can be expected to experience different environmental influences, the analysis also examined how a credit union's cost inefficiency in its own environment compared with its cost inefficiency in a situation where all credit unions were subject to identical environmental conditions.

The analysis revealed that, on average, there are high levels of cost inefficiency within the UK credit union movement when compared with best practice performance within the sector. Over the period the magnitude of average gross inefficiency was of the order of 30 percent. When credit unions were placed on identical and favourable environments it transpired that the actual environment, within which individual credit unions operate, accounted for a significant share of the documented inefficiency. In this instance the two models utilised in this study offered a somewhat divergent picture with the environment, on average, accounting for between 25 percent and 8 percent inefficiency.

On the assumption that the main environmental variables have been accounted for, net efficiency measures provide an implicit measure of managerial performance. Under the 'type two' model there was significant evidence of managerial under-performance (22 percent (median value) for the period 1991-2001). The situation improved in the case of the 'type one' model (6 percent (median value) for the period 1991-2001) although even this level underlines a need for improvement. From a theoretical perspective, managerial inefficiency is of no surprise as the decentralised voting structure, based upon one-member-one vote, provides those that organise and run the credit union with significantly greater autonomy than 'managers' in market based organisations. In addition many credit unions, particularly in Great Britain, are small in scale and volunteer based, within such organisations wide variation in managerial efficiency can be expected to exist.

The main insights from the directional analysis of environmental conditions were that larger credit unions are more cost efficient, as are credit unions which do not draw their membership exclusively from areas of high deprivation, as are also credit unions structured around an occupational common bond. These directional influences can be viewed as offering some encouragement to the thrust of the FSA's new policy regime for credit unions, which commentators expect will result in mergers leading to a smaller number of larger credit unions. Our study reveals larger credit unions to be more cost efficient. If these mergers also result in individual credit unions being able to draw their members from a wider socio-economic mix through, for example, amalgamating the common bonds of employer and community based credit unions this will also be beneficial as credit unions which do not draw their members exclusively from areas of high deprivation are more cost efficient. Drawing upon these results it can be conjectured that the 'new model' credit unions, which emerge in the coming years, may be more cost efficient enabling the provision of more cost effective services to members including those members who might otherwise be characterized as financially excluded. However, a cautionary note must also be made. As stressed, our results have highlighted that the least cost efficient credit unions are those based in areas of greatest deprivation. If mergers succeed in encompassing these credit unions within larger ones then the needs of the financially excluded will be better served. If these credit unions do not merge but face closure or, as a consequence of a merger, those outlets serving the more deprived areas are abandoned as part of a streamlining and centralization process this will have

detrimental consequences for the provision of financial services to those in areas of most need. Therefore it is important that the FSA in its drive to create larger self-sustaining credit unions keeps careful watch to ensure that the 'new model' credit unions have as part of their constituency those members which if it were not for credit unions would be classified as financially excluded.

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# **CONCENTRATION PHENOMENON AS A GROWTH STRATEGY IN THE CO-OPERATIVE BANK SYSTEM: THE CASE OF SPANISH RURAL SAVINGS BANKS**

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## **1. INTRODUCTION**

Credit co-operatives are financial entities which have traditionally dealt with financing an important group of entities within the social economy. They have also been the motor for the co-operative sector in general and particularly for the agrarian sector. Such is the situation that occasionally the role played by credit co-operatives within their area of influence has exceeded the financial framework.

The co-operative credit system is well established in Europe. We cannot forget that the roots of this system are to be found there, where it was first developed and at presents it represents a vital and dynamic reality.

As a consequence of the liberalisation phenomenon experienced within the European Union, there is high competitiveness in the banking sector. In order to confront this competitiveness, credit co-operatives have opted for integration strategies and intercooperation between entities in order to operate in the financial market, without losing the competitive advantage of personalization, the key to their functioning, and combining universal banking and specialised banking principles.

A co-operative banking Group is an organised whole, interrelated, co-ordinated and formed by credit co-operative partnerships and other legal entities, which act under common and mutual principles. They adjust their behaviour to the policy of the banking group, which is based on the establishment of common guidelines and on respect for independence of decision by member entities of the group. (Palomo, 1995).

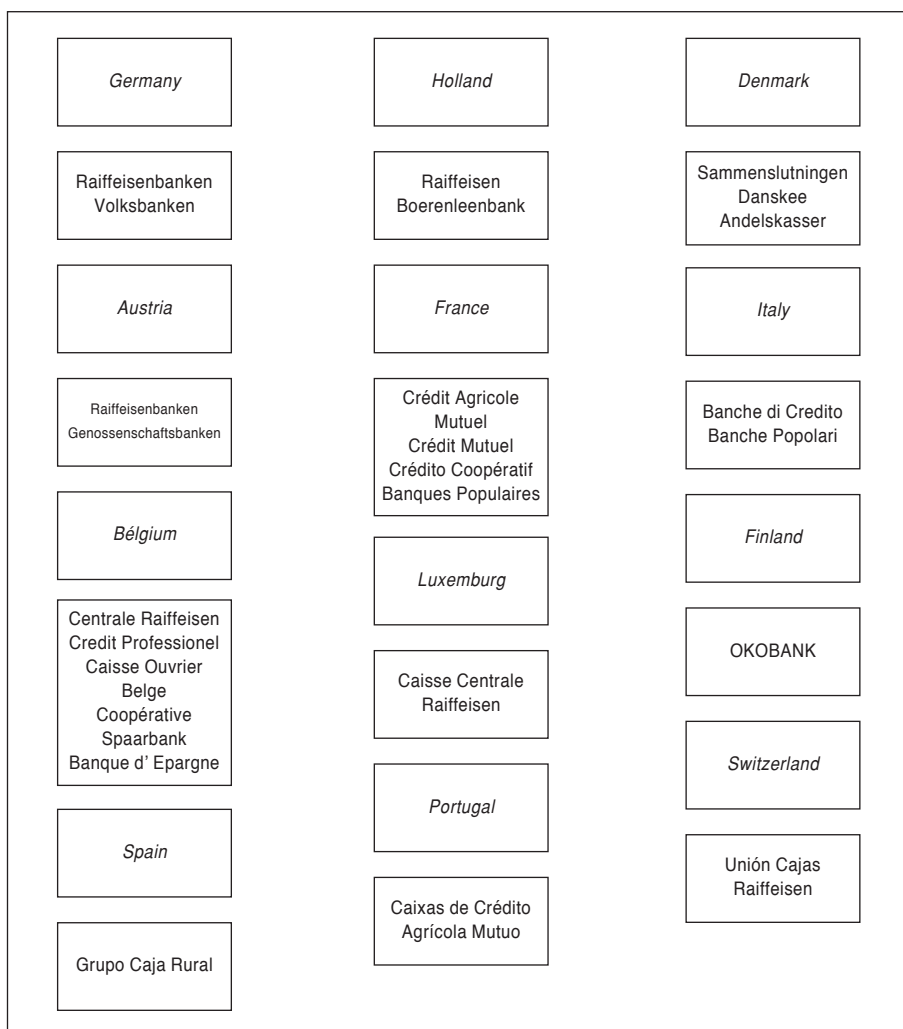
The co-operative bank, as a financial intermediary, competes in market conditions with any class of bank. The companies which constitute it base their activity on co-operative principles, democratic management and orientate their activity towards customers and partners.

Banking activity requires a certain dimension which makes commercialisation of a group of products and services viable, which in turn require operative and advanced technical means in accordance with the level of customer demand.

## 2. THE MAIN EUROPEAN CO-OPERATIVE BANKING GROUPS

In the majority of European countries, including Spain, the co-operative banking groups established are comparable to other financial groups. The level of development of each is not homogenous, since some have a greater tradition and others, as in the case of Spain, have been established more recently. The co-operative system has been developed fundamentally in France, Holland, Finland and Germany. Figure 1 includes some of the main European banking groups.

**FIGURE 1.**  
**EUROPEAN BANKING GROUPS**



The co-operative bank is represented through various organisations among which we can highlight; the “Groupement”, established in 1970, the “International Raiffeisen Union” (IRU), established in 1968, the “World Council of Credit Unions” (WOCCU), founded in 1970, and the “Confederaciones Internacionales del Crédito Agrario y del Crédito Popular” (CICA y CICP), the first credit co-operative was established in 1950.

The “Groupement”, whose statistical figures for the most important member organisations are presented in detail in Table 1, dated 31 December 2002, is one of the most important representative organisations of the Economic and Monetary Union. Its basic mission is to promote the common interests of its members and to do so; it analyses the financial and monetary problems which affect co-operative banks, applies community programs for financing different sectors, such as agriculture, fisheries, traditional customers of co-operative banks, exercises a representative function and defends the group’s interests within a framework of the European financial area.

The co-operative bank model has 3,700 local and regional banks, more than 51,300 branches, 37 million partners, almost 106 million customers, 572,000 employees and a 17% market share of deposits.

In some countries the co-operative bank has achieved clearly a significant market share of deposits and credits, such as Holland with 40.0 and 30.0% respectively, Finland with 32.7 and 32.0%, Austria with 31.3 and 27.4%, France with 39.1 and 40.0%, Italy with 28.5 and 22.3% and Germany with 18.8 and 11.3%. In other countries, like Spain, the relevance of the co-operative bank is much less, 5.0% market share for deposits and 5.1% for credits (Table 1).

The two countries which have the greatest concentration of European co-operative entities are Germany and France. Germany, in fact, has the greatest number of co-operative banks, 1,489, which comprise 40% of the members of the European banking co-operative, 28% of the customers, 31% of the branches of the employees. Its balance represents 20% of the consolidated total, while customers deposits and credits are 26 and 23% respectively.

With regards to France, its 122 co-operative banks comprise 28% of the branches 37% of the partners, 33% of the customers and generate 35% of the employees. Its balance is 41% of the consolidated total, whereas deposits are 32% and credits 35%.

Spain, with a basis of 84 co-operatives, covers only 8.5% of the branches, 4% of the partners, 8% of the customers and 2.8% of the employees. While, its consolidated balance is 1.7% of the total, deposits comprise 2.7% and credits 2.4% of the European banking co-operative. Obviously, the significance of this in absolute and relative terms is not so important, but they are entities which have an important role in the rural area and which are gradually becoming more secure, expanding there activity to new and different sectors, which are not so traditional.

Spanish rural saving banks, professional saving banks and the general savings banks are all members of the “Union Nacional de Cooperativas de Crédito” (UNACC)

which is committed to its institutional representation on a national and international level. The UNACC is a fully recognised member of the “Grupo Europeo de Bancos Cooperativos” (European Group of Banking Co-operatives).

The European co-operative banking systems, with the exception of Greece, Ireland and the United Kingdom, have a central co-operative bank which has a pyramid structure. In Spain that central co-operative bank is the “Banco Cooperativo Español”, 85% of its capital in proportion to assets is owned by member rural savings banks.

### **3. THE CO-OPERATIVE CREDIT SYSTEM IN SPAIN**

There are three entities which make up the finance system in Spain, banks, which are legally established as a limited company, savings banks which are foundations and credit co-operatives which are legally established as co-operative companies. The latter are the least significant with regards to importance per institution, but they have achieved a greater increase in their activity, taking market share from the banks.

Credit co-operatives in Spain have achieved the level of activity of their European homologues, but the process of bank homogenisation means that they act more frequently in sectors which are complementary to the traditional sectors. We cannot forget that their origins can be found in the agricultural unions in rural areas and guilds in the service and industrial sectors.

Tables 2 and 3 show how the relative importance of credit co-operatives (Table 2) and savings banks gradually increases the total consolidated balance, in contrast to the decrease of banks, for the economic periods from 1995 to 2002. The growth of the balance in credit co-operatives is also seen to be higher than that of the banks for the whole period (Table 3) and the savings banks in some periods.

**TABLE 1.**  
**THE “GROUPEMENT”. STATISTICS FOR MEMBER ORGANIZATIONS (31-12-02)**

Member Organisations	Regional and local banks	Bank Branches	Partners	Customers (1)	Employees	Consolidated Balance	Deposits millions of euros	Credits in millions of euros	Market share deposits	Market share credits
<b>Belgium</b> Credit Professionnel	n/a	n/a	n/a	16,643	74	2,250	450	1,480	n/a	n/a
<b>Denmark</b> Sammenlutningen Danske Andelskasser (b)	37	80	55,000	110,000	480	1,070	850	660	1.00	1.00
<b>Germany</b> Deutsche Genossenschaftsbank	1,499	15,866	15,184,846	30,000,000	169,000	560,336	396,655	340,682	18.80	11.30
<b>Ireland</b> ACCBANK (b)	1	47	n/a	150,000	624	3,314	2,165	2,319	2.00	1.50
Irish League of Credit Unions (a)	n/a	534	2,066,631	2,066,631	1,700	4,301	3,657	2,709	6.5	6.90
<b>Spain</b> Unión Nacional Cooperativas de Crédito	84	4,331	1,492,601	8,670,007	16,402	49,419	41,438	35,344	5.00	5.10
<b>France</b> Credit Agricole	45	7,232	5,600,000	16,100,000	102,259	580,795	270,164	273,212	20.60	16.30
Credit Mutuel	18	4,749	5,600,000	13,200,000	54,306	347,481	146,021	143,521	12.20	15.60
Banques Populaires	25	2,724	2,400,000	3,700,000	39,200	220,744	83,500	101,800	3.80	7.60
Credit Coopératif	34	242	140,000	267,500	2,724	9,011	4,287	5,847	0.50	0.50
<b>Greece</b> Association of Co-operative Banks of Greece	15	72	114,670	114,670	568	926	682	721	0.60	0.80
<b>Italy</b> Ato. Nazionale fra le Banche Popolari	92	7,020	1,130,000	7,500,000	50,500	362,800	211,700	171,300	20.95	16.91
FEDERCAFFE	461	3,206	648,140	1,205,138	24,420	95,842	76,339	57,097	7.50	5.40
<b>Luxembourg</b> Caisse Centrale Raiffeisen	35	71	4,765	116,000	419	2,958	2,677	1,447	10.00	10.00
<b>Netherlands</b> RABOBANK	349	1,918	1,108,000	9,100,000	59,096	374,720	171,632	225,252	40.00	30.00
<b>Austria</b> Österreichische Raiffeisenbanken	602	1,655	1,694,411	3,600,000	28,404	114,200	68,041	72,856	25.50	22.10
Österreichischer Genossenschaftsverband (b)	70	594	650,000	700,000	5,044	29,359	16,413	14,658	5.80	5.30
<b>Portugal</b> FENACAM (b)	132	592	300,000	1,600,000	3,670	7,501	6,477	5,020	5.00	3.00
<b>Finland</b> OKO BANK	244	692	1,042,000	3,023,000	8,937	31,625	19,932	24,319	32.70	32.00
Landshypotek (a)	10	10	69,216	69,216	107	3,787	n/a	3,602	n/a	n/a
<b>United Kingdom</b> The Co-operative Bank	n/a	133	n/a	2,230,000	4,247	13,264	10,537	6,694	2.00	2.00
<b>TOTAL UE15</b>	<b>3,743</b>	<b>51,318</b>	<b>37,237,717</b>	<b>105,660,805</b>	<b>572,181</b>	<b>2,815,703</b>	<b>1,513,317</b>	<b>1,490,540</b>		

Source: Review Banca Cooperativa. UNACC, 2003. Monetary figures in millions of euros (a) Figures for 2000. (b) Figures for 2001 (1): Estimation. (n/a): Not available

**TABLE 2.**  
**DEPOSIT ENTITIES. RELATIVE IMPORTANCE PER INSTITUTION**

<b>Institutions</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
Credit Co-op Savings Banks	3.2 33.6	3.4 34.7	3.5 34.9	3.6 36.5	3.6 37.2	3.7 38.5	3.9 39.5	4.1 41.3
Banks	63.2	61.9	61.6	59.9	59.2	57.8	56.6	54.6
<b>Total System's Assets</b>	<b>722,543</b>	<b>758,934</b>	<b>811,090</b>	<b>859,314</b>	<b>949,320</b>	<b>1,056,977</b>	<b>1,148,815</b>	<b>1,213,887</b>

Source: UNACC, several years and drawn up by author. Data of total assets in millions of euros

**TABLE 3.**  
**DEPOSIT ENTITIES. GROWTH OF BALANCE (%)**

<b>Institutions</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
Credit Co-operatives	16.1	11.0	9.9	11.3	10.5	13.8	16.3	9.4
Savings Banks	9.3	8.7	7.7	12.6	12.7	15.3	11.2	10.8
Banks	7.7	3.1	6.1	4.6	9.1	8.7	6.5	1.9

Source: UNACC, several years and drawn up by author

The specialisation which characterises credit co-op movement in Spain is apparent in the type of entities it is made up of. There are three types; rural savings banks, popular savings banks and professional savings banks, depending on whether the principal orientation of activity is directed towards one particular sector or another. Rural savings banks have been closely linked to the agricultural sector, although they are expanding their activities to other sectors.

Table 4 shows the evolution of the number of operative entities of credit co-op movement in Spain for the period 1989-2002. It shows the decrease in the number of entities due to the fact that they have quitted their activity in some cases and due to integration processes in other cases. It also points out the importance of the rural savings banks in the whole of the credit co-operative sector, which at present represents 93% of entities.

The drop in three number of co-operatives, which is 24% (27 entities), is more pronounced in popular and professional savings banks, since they have been practically reduced to a third part, decreasing to 65% (11 entities), than in the rural savings banks with 17% reduction (16 entities).

As the credit co-operatives have emerged from the agricultural and guild associations, it is logical to think that they have been created in those areas that have traditionally been noted for agriculture and industry. Therefore, in Table 5 we can appreciate the distribution of rural savings banks in Spain per Autonomous Community and the total number of credit co-operatives, as well as the number of active branches. Although the number of entities decreases, the number of branches increases and, in fact, there has been an increase of 471 branches of rural savings banks and 530 credit co-operatives in the four year period of 1999 – 2002. Credit co-operatives are consistent with the need to expand in order to be able to access the market and increase their business level.

The Autonomous Communities most noted for their agricultural sector are those where a greater number of rural savings banks are found. The Valencian Community, 47% of the entities and 18% of the branches and Andalusia with 13% of the entities and 25% of the branches (data from 2002, Table 5). These Communities are also the most important with regard to business volume. Rural savings banks present a greater territorial presence in the number of entities as well as the number of branches, and can be found in almost all the Autonomous Communities except for Catalunya, La Rioja and Madrid. However, popular and professional savings banks are only found in three Autonomous Communities; Catalunya, the Basque Country and Madrid, with the greatest number in the Basque Country.

The dimension of the branches (business volume) is not very high, but high fragmentation, to a certain extent, guarantees their continuity, since their extensive network of branches established in rural areas gives them a competitive advantage, and at the same time serves as an entry barrier for their main competitors.

For a long time Credit Co-operatives have been linked to their area of origin, in such a way that a mutual recognition of partner and customer has been established, typical of these entities. At present, the territorial principle, according to which Credit Co-operatives only open branches in their region of origin, local or provincial, is

losing relevance. In the process of homologation with other banking entities, the Credit Co-operatives are expanding to other regions and other fields of action, opening branches in areas that are not in their region of origin, at the same time as initiating fusion and concentration processes which are clearly in tune with the rest of the banking system.

In this context, the following events have taken place in the Valencian Community as well as in Andalusia; in 2000 the fusion of two of the most important credit co-operatives in Andalusia, from the provinces of Almería and Málaga, the “Caja Rural de Almería y Málaga”, and which was later named “Caja Rural Intermediterránea”, in 2001, the fusion of another two Andalusian rural savings banks from Seville and Huelva, creating the “Caja Rural del Sur” and in 2002 in the Valencian Community, the fusion of three of the most important rural savings banks, which brought about the creation of the “Caja Rural del Mediterráneo”. These three rural savings banks hold the first three positions in the assets ranking, and between them have a third of the average total assets of all rural savings banks in 2002.

The expansion of the number of branches is parallel to the expansion of the number of employees, Table 6, with 19% growth. Although there is an increase in the ratio of employees per branch, which is 3.5 (2002), this value is a long way from the average ratio of banks which is 7 employees per branch and that of savings banks which is 5. Along with the increase in the number of branches and the need to adapt to new technologies, there has also been an increase in the number of cash points, 1000 of which have been installed in the last four years, which has meant a 45% growth,. The number of partners has also increased to 19%, more than in 1999, as well as the number of customers to 15%, more than a million, with an average of 1,900 customers per branch.

With regards to the principal magnitudes of rural savings banks in Spain (see Table 7), all items have increased during the four year period which this study covers 1999-2000, average own resources at 19%, being 3,110 million euros on 31 December 2002, customer debits at 44%, and a balance of 32,221 million euros on 31 December, average total resources at 43% and customer credits 60%, the respective balance of both of 33,616 million euros and 28,247 million euros on the 31 December 2002. The average total assets increased by 45% and profits at 11%, with respective balances of 37,111 and 303 million euros.

Based on the list of ratios given in Table 8, growth in business volume of rural savings bank is apparent. It is expressed according to credits given and deposits received per employee as well as per branch. Credit given and deposits received per employee are on average 2,442 and 2,526 thousand euros respectively and per branch 9,249 and 9,567 thousand euros, in 2002. However, the net profit per employee has decreased, as well as the net profit of external resources, which is at approximately 1%. The transformation ratio, measured as a percentage of external resources, which are transformed into investment, is greater than 96%, while own resources compared to external resources do not reach 10%.

Finally, Table 8 also shows in detail the level of efficiency obtained by these banking entities. An entity will be more efficient according to whether it produces more

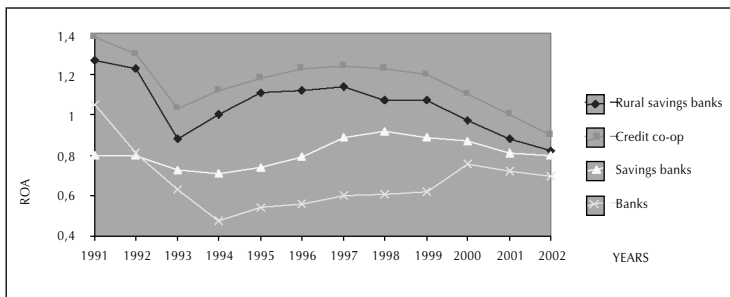


output by using the same or less resources. The Bank of Spain considers that banking efficiency can be expressed through an indicator, calculated as the coefficient between exploitation expenses (personal expenses, administration expenses and depreciation expenses, and reorganisation of assets) and the ordinary margin. The bank output will be on a level with the ordinary margin generated by the activity carried out and input will be the exploitation expenses calculated.

The reduction in the value of the exploitation expenses/ordinary margin ratio is positive, since it reflects an increase of the ordinary margin above that brought about by exploitation expenses, or rather a more efficient use of operating costs in obtaining the ordinary margin. For this reason, the level of efficiency expressed in table 8 indicates a certain stability of values, since, although the value of the ratio experienced a slight improvement in the preceding years, the ratio continues to be around 62%. This figure is very similar to that of the savings banks because the indicator of its efficiency in the tax year 2002 was 63%, but it is lower than that of banks.

It does not seem that high exploitation expenses of credit co-operatives (Tables 9 to 12 expressed as average total assets), caused by a more personal treatment and greater quality of attention, is a competitive disadvantage in contrast to other banking entities. It is, in fact, thanks to this that higher ordinary margins are obtained. All this leads to the fact that the evolution of the ratio of return on assets (ROA) is more favourable. (Figure 2)

**FIGURE 2.**  
**RATIO OF RETURN ON ASSETS**



**TABLE 4.**  
**EVOLUTION OF CREDIT COOPERATIVES IN SPAIN. NUMBER OF ENTITIES**

Entity	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Rural Savings Banks	94	90	89	85	83	82	82	86	86	85	84	82	81	78
Popular and Professional Savings Banks	17	17	17	17	16	16	13	9	9	9	8	7	7	6
Credit Co-operatives	111	107	106	102	99	98	95	95	95	94	92	89	88	84

Source: UNACC, several years and drawn up by author.

**TABLE 5.**  
**DISTRIBUTION OF CREDIT CO-OPERATIVES PER AUTONOMOUS COMMUNITY IN SPAIN**

	Rural Savings Banks						Total number of Credit Co-operatives					
	1999			2001			1999			2001		
	R.S.	Br.	R.S.	Br.	R.S.	Br.	C.C.	Br.	C.C.	Br.	C.C.	Br.
Andalucía	12	862	11	889	10	922	12	865	11	892	10	926
Aragón	5	403	5	408	4	400	5	404	5	409	4	412
Asturias	2	84	2	87	2	91	2	86	2	89	2	93
Baleares	1	17	1	20	1	22	1	18	1	21	1	23
Canarias	2	82	2	96	2	100	2	84	2	98	2	102
Cantabria	0	5	0	6	0	6	0	6	0	7	0	7
Castilla-La Mancha	8	432	8	428	8	429	8	432	8	428	8	430
Castilla y León	7	366	7	373	7	386	7	382	7	398	7	423
Cataluña	2	93	2	106	2	121	5	105	5	118	5	134
Extremadura	2	101	2	108	2	119	2	101	2	108	2	119
Galicia	1	34	1	34	1	40	1	34	1	34	1	40
Madrid	0	20	0	28	0	40	3	33	3	36	2	48
Murcia	1	193	1	209	1	228	1	194	1	210	1	229
Navarra	1	116	1	116	1	116	1	161	1	160	1	160
País Vasco	1	54	1	59	1	71	3	246	3	253	3	270
La Rioja	0	15	0	19	0	27	0	23	0	30	0	38
C. Valenciana	39	625	38	654	39	705	39	627	38	656	39	707
Total	84	3,502	82	3,640	81	3,823	92	3,801	89	3,947	88	4,161
											84	4,331

Source: UNACC, several years and drawn up by author. R.S: Rural Savings Banks; C.C.: Credit Co-operative; Br: Branches.

**TABLE 6.**  
**OPERATIVE DATA OF RURAL SAVINGS BANKS IN SPAIN**

	Nº Rural Savings Banks	Nº branches	Nº employees	Employees/ Branch	Partners	Nº cash points	Nº customers	Customers/ Branch
1999	84	3,502	11,735	3.35	1,178,013	2,265	6,539,848	1,867
2000	82	3,640	12,291	3.38	1,327,151	2,558	6,780,003	1,863
2001	81	3,823	13,208	3.45	1,341,974	2,915	7,098,556	1,857
2002	78	3,973	14,003	3.52	1,398,970	3,302	7,545,984	1,899

Source: UNACC, several years and drawn up by author.

**TABLE 7.**  
**MAIN MAGNITUDES OF RURAL SAVINGS BANKS IN SPAIN**

	Own resources	Own average resources	Customers Debits	Average total resources	Credits/ customers	Obligations and participation	Total Assets	Average Total Assets	Profit
1999	2,034,955	2,603,362	22,333,952	23,519,629	17,702,739	755,568	26,884,125	25,630,305	274,789
2000	2,348,250	2,429,304	25,033,257	25,591,756	20,822,550	849,415	30,072,924	28,331,576	276,079
2001	2,638,269	2,744,482	29,034,823	30,924,899	24,158,414	1,072,967	34,956,776	32,855,699	289,478
2002	3,025,280	3,109,699	32,220,625	33,616,267	28,247,309	1,179,391	38,465,248	37,111,045	303,830

Source: UNACC, several years. Data in thousands of euros.

**TABLE 8.**  
**PRINCIPAL RATIOS OF RURAL SAVINGS BANKS IN SPAIN**

	OR / ER (%)	Investment / ER (%)	NP / Employee	ER / Employee	ER/Branch	Investment / Employee	Investment / Branch	Personal expense / Employee	Efficiency (%)
1999	9.93	94.59	27.90	2,030.88	7,399.01	1,921.04	6,998.85	34.45	62.07
2000	9.90	95.10	27.24	2,229.17	8,170.05	2,119.92	7,769.66	35.71	60.96
2001	9.52	92.94	25.99	2,414.04	9,030.16	2,243.71	8,393.01	37.26	60.78
2002	9.81	96.67	24.91	2,526.38	9,567.70	2,442.29	9,249.25	38.51	62.24

Source: UNACC, several years. Data in thousands of euros. O.R.: Own Resources; E.R: External Resources; N.P: Net Profit.

**TABLE 9.**  
**ACCOUNT OF RESULTS OF RURAL SAVINGS BANKS IN SPAIN**

	Finance products		Finance costs		Broking margin		Service products		Ordinary margin		Exploitation expenses		Exploitation margin		Profit	
	Total	s/ ATA	Total	s/ ATA	Total	s/ ATA	Total	s/ ATA	Total	s/ ATA	Total	s/ ATA	Total	s/ ATA	Total	Total
1999	1,334,018	5.20	391,878	1.53	942,141	3.68	129,650	0.51	1,084,130	4.23	690,755	2.70	398,603	1.56	274,789	
2000	1,557,425	5.50	525,708	1.86	1,031,717	3.64	155,346	0.55	1,185,990	4.19	748,286	2.64	442,615	1.56	276,079	
2001	1,907,862	5.81	721,880	2.20	1,185,982	3.61	181,358	0.55	1,358,897	4.14	846,595	2.58	517,392	1.57	289,478	
2002	1,924,835	5.19	643,450	1.73	1,281,385	3.45	216,328	0.58	1,484,418	4.00	943,310	2.54	547,008	1.47	303,830	

Source: Boletín Económico del Banco España (Official Economy Bulletin from the Bank of Spain), several years, and drawn up by author. Data in thousands of euros. A.T.A.: Average total assets.

**TABLE 10.**  
**ACCOUNT OF RESULTS OF CREDIT CO-OPERATIVES IN SPAIN**

	Finance products		Finance costs		Broking margin		Service products		Ordinary Margin		Exploitation expenses		Exploitation Margin		Profit	
	Total	s/ ATA	Total	s/ ATA	Total	s/ ATA	Total	s/ ATA	Total	s/ ATA	Total	s/ ATA	Total	s/ ATA	Total	Total
1999	1,637,313	5.08	498,095	1.54	1,139,218	3.53	233,782	0.73	1,373,000	4.26	845,852	2.63	527,148	1.63	386,385	
2000	1,949,984	5.37	698,214	1.92	1,251,770	3.45	233,445	0.64	1,485,215	4.09	899,252	2.48	585,963	1.61	394,066	
2001	2,396,329	5.70	959,137	2.30	1,437,192	3.40	240,808	0.60	1,678,000	4.00	1,013,517	2.40	664,483	1.60	404,603	
2002	2,394,599	5.00	851,315	1.80	1,543,284	3.20	258,992	-0.10	1,802,276	3.80	1,114,454	2.40	687,822	1.40	408,558	

Source: Boletín Económico del Banco España (Official Economy Bulletin from the bank of Spain), several years, and drawn up by author. Data in thousands of euros.  
A.T.A.: Average total assets.

**TABLE 11.**  
**ACCOUNT OF RESULTS OF SAVINGS BANKS IN SPAIN**

	Finance products		Finance costs		Broking margin		Service products		Ordinary margin		Exploitation expenses		Exploitation margin		Profit	
	Total	s/ ATA	Total	s/ ATA	Total	s/ ATA	Total	s/ ATA	Total	s/ ATA	Total	s/ ATA	Total	s/ ATA	Total	Total
1999	15,824,252	4.78	6,604,762	2.86	9,219,490	2.79	2,892,286	0.87	12,111,776	3.66	7,474,150	2.26	4,637,626	1.40	3,004,754	
2000	19,223,565	5.17	9,210,132	2.48	10,013,433	2.69	2,932,572	0.79	12,946,005	3.48	8,016,750	2.16	4,929,255	1.32	3,330,893	
2001	22,943,896	5.41	11,626,886	2.71	11,317,010	2.70	2,949,274	0.75	14,266,284	3.45	8,725,547	2.16	5,540,737	1.29	3,500,745	
2002	22,441,220	4.73	10,512,190	2.21	11,929,030	2.52	2,792,481	0.60	14,721,511	3.12	9,321,430	2.01	5,400,081	1.11	3,667,461	

Source: Boletín Económico del Banco España (Official Economy Bulletin from the Bank of Spain), several years, and drawn up by author. Data in thousands of euros.  
A.T.A.: Average total assets.

**TABLE 12.**  
**ACCOUNT OF RESULTS OF BANKS IN SPAIN**

	Finance products		Finance costs		Broking margin		Service products		Ordinary margin		Exploitation expenses		Exploitation margin		Profit	
	Total	s/ ATA	Total	s/ ATA	Total	s/ ATA	Total	s/ ATA	Total	s/ ATA	Total	s/ ATA	Total	s/ ATA	Total	Total
1999	25,278,444	4.75	15,397,600	2.86	10,180,844	1.89	4,693,118	0.87	14,873,962	2.76	9,891,794	1.84	4,982,168	0.92	3,570,306	
2000	31,136,352	5.38	20,172,418	3.49	10,963,933	1.90	5,720,842	0.99	16,684,775	2.89	10,209,807	1.77	6,474,968	1.12	4,631,351	
2001	36,765,858	5.87	21,677,557	3.51	15,088,301	2.36	4,857,650	0.82	19,945,951	3.18	10,592,748	1.74	9,353,203	1.44	4,735,861	
2002	30,413,183	4.73	16,203,869	2.51	14,209,314	2.22	4,933,342	0.7	19,142,656	3.01	10,524,446	1.70	8,618,210	1.31	4,870,173	

Source: Boletín Económico del Banco España (Official Economy Bulletin from the Bank of Spain), several years, and drawn up by author. Data in thousands of euros.  
A.T.A.: Average total assets.

#### 4. THE RURAL SAVINGS BANK GROUP IN SPAIN

The finance Group “Caja Rural” (Rural savings Bank) was created in Spain in 1989 by 24 rural savings banks. The aim was to establish strong links between credit co-operatives, allowing for an improvement in the structures, the running and organization of the banking system.

At present Spanish rural savings banks form a co-operative banking system which is formed as a model of a federate bank similar to other European systems. From the time it was established until now the intercooperation strategy has become consolidated. At this moment, there is no question that Group Caja Rural in Spain is one of the most important Spanish banking groups.

Thanks to the Group, entities work through mixed organizational formulas, keeping individual structures for traditional business and developing the federate banking model at a Group level. The basic characteristics of this model of federate bank are based on fulfilling principles of decentralization, subsidiarity, solidarity, intercooperation and territoriality.

Credit co-operative partnerships which are the basis of European co-operative banking systems participate in the decision making of central co-operative banks through their representatives. To be exact, in Spain, rural savings bank own 85% of the share capital of the Banco Cooperativo Español, SA (BCE) (Spanish Co-operative Bank) in proportion to the its volume of assets. The remaining 15% belongs to the Deutsche Genossenschaftsbank (DG Bank), the German central co-operative bank.

Central co-operative banks in the main developed countries are partnerships through shares, which have are legally established as mainly limited companies, whose shareholders are credit co-operatives which form each respective system of co-operative banking.

On the other hand, European co-operative banking systems consist of specialised institutions which offer centralised banking and parabanking services to credit co-operatives, such as insurance, funds management, infrastructure and logistics as well as centralised processing of information. Thanks to economies of scale in the management of a volume of operations, this permits the profitability of such processes and a decrease in the excess of cost of offering these services individually. The “Banco Cooperativo Español” offers centralised banking services to entities of the Group. In some way a combination of representative functions and other operative functions is established with a greater technological component.

The “Banco Cooperativo Español” was created in 1990, joining to the above mentioned Group. Two other companies also joined “Seguros RGA” and “Rural Servicios Informáticos” (RSI), both established in 1986. Although the “Banco Cooperativo Español” follows the same line as its European homologues, it stands out among them for its youth and the fact that part of its share capital belongs to a central entity of another nationality.

The institutional framework of the group is the following:



- 1) The “Asociación Española de Cajas Rurales” (AECR), constitutes the instrument for co-ordinating and representing the Group which rural savings banks are linked to. Through this association the Group fixes its objectives, strategies and exact lines of action.
- 2) The “Banco Cooperativo Español” , (BCE) as mentioned above, is the banking centre for member rural savings banks. It co-ordinates the financial policies of the rural savings banks, acts as an agent in some operations and supplies specific financial services.
- 3) “Rural Servicios Informáticos” (RSI) is the company in charge of defining and establishing an automatized system for dealing with information. It has one central office for IT services for all entities.
- 4) “Seguros RGA” is the insurance entity for all the rural savings banks. It was created with the aim of expanding the range of products offered by these entities and introduced them into the field of insurance.

The “Banco Cooperativo Español” joined the “UNICO Banking Group” in 1998. This Group was created in 1977 and is made up of the central entities of the most important european banking groups. The members of this group, whose legal set up is as an “Agrupación de Interés Económico” (Group of Economic Interests), are the DG Bank (Germany), the Raiffeisen Zentralbank (RZB) (Austria), the Group KBC for banking and insurance (Belgium), the OKOBANK (Finland), the Caisse Nationale de Crédit Agricole (CNCA) (France), the RABOBANK (Holland), the Union Suiza de Banks Raiffeisen (Switzerland) and the Istituto di Credito delle Banche di Crédito Cooperativo (Italy). Its aim is to achieve international co-operation of the european co-operative bank.

The “Group Caja Rural” includes 96% of the Spanish rural savings banks. Only three entities (rural savings banks) have not joined the Group. The popular and professional savings banks operate without any stable relationship with each other or with the system of rural savings banks.

Therefore, in Spain there are two types of associations between credit co-operatives, as previously studied. On the one hand, the “Unión Nacional de Cooperativas de Crédito” (UNACC), created in 1969 which is the father organization of the sector, around which the rural savings banks, the popular savings banks and the professional savings form a federate structure, that is to say, all credit co-operatives. And on the other hand, the “Asociación Española de Cajas Rurales” (AECR), created in 1989 as a private association which acts as a constitutional framework for associated rural savings banks.

Table 13 gives a detailed evolution of the principal magnitudes of “Group Caja Rural” in the last five years, as well as the relative importance which it has had in all credit co-operatives. The fact that the number of entities which belong to the group decreases is due to fusion processes and absorption which the sector has experienced in this period. However, the volume of business has grown and the

Group's balance of total assets on the 31 December 2002 is 36,986 million euros, 58% higher than at the start of the period studied. The customer credits or credit investment rises to 27,366 million euros, almost doubling the figure in 1998, while the total for deposits achieved is 31,028 million euros, a growth of 61%. Subscribed capital is also double and reserves have increased by 67%. Profits alone at 16%.

The group concentrates 96% total assets of rural savings banks from credits and deposits, 98% subscribed capital and 92% reserves, also representing 95% total profit. With regards to credit co-operatives, rural savings banks and popular and professional savings banks as a whole, the volume of activity of the Group is 75% total assets and deposits, 77% credit, 67% capital, 70% reserves and 71% profit.

For more detailed information of the evolution of balance and an account of the Group's results for the five year period 1998-2002, see Table 14 for assets and liabilities broken down into the main items it covers and Table 15 for an account of the results.

**TABLE 13.**  
**EVOLUTION OF "GROUP CAJA RURAL". RELATIVE IMPORTANCE IN CREDIT CO-OP MOVEMENT IN SPAIN**

	1998	Δ	1999	Δ	2000	Δ	2001	Δ	2002
Nº entities	83		81		79		77		75
Total assets	23,364,448		25,890,132		28,901,479		33,340,484		36,986,187
% s/ Rural Savings Banks	95.6	10.8	96.3	11.6	96.1	15.4	95.4	10.9	96.2
% s/ Credit Co-operatives	75.6		74.1		74.4		73.8		74.8
Total Credits	14,119,018		17,173,885		20,210,698		23,343,037		27,365,825
% s/ Rural Savings Banks	95.5	21.6	97.0	17.7	97.1	15.5	96.6	17.2	96.9
% s/ Credit Co-operatives	76.4		77.8		77.8		77.0		77.4
Total Deposits	19,286,382		21,560,281		24,121,018		27,692,418		31,028,267
% s/ Rural Savings Banks	95.8	11.8	96.5	11.9	96.2	14.8	94.9	12.0	95.9
% s/ Credit Co-operatives	76.5		76.7		74.8		73.7		74.9
Subscribed Capital	341,735		389,126		480,263		524,046		676,606
% s/ Rural Savings Banks	96.0	13.9	97.8	23.4	98.1	9.1	94.3	29.1	98.5
% s/ Credit Co-operatives	62.0		62.6		64.9		62.6		66.7
Reserves	1,288,173		1,496,175		1,715,835		1,929,080		2,148,892
% s/ Rural Savings Banks	90.6	16.1	91.4	14.7	92.2	12.8	92.6	11.4	91.9
% s/ Credit Co-operatives	67.9		68.9		69.9		70.4		70.4
Profits	249,660		264,416		264,553		277,194		289,527
% s/ Rural Savings Banks		5.9	96.2	0.0	95.8	4.8	95.8	4.4	95.3
% s/ Credit Co-operatives	69.0		68.4		67.1		68.5		70.9

Source: UNACC, several years and drawn up by author. Data in thousands of euros.

**TABLE 14.**  
**"GROUP CAJA RURAL". EVOLUTION OF BALANCE**

ASSETS	1998	1999	2000	2001	2002
1. Cash and deposits in central banks	470,496	582,848	472,775	977,524	576,523
2. State Debts	1,947,285	2,286,187	2,117,629	1,892,102	1,747,557
3. Credit entities	5,241,258	4,044,317	4,092,392	4,644,314	4,696,337
4. Customer credits	14,119,018	17,173,885	20,210,698	23,343,037	27,365,825
5. Bonds and other values at fixed interest	420,949	433,997	485,183	643,934	690,047
6. Shares and other securities at variable interest	108,675	132,801	159,400	147,013	113,154
7. Holdings	149,508	139,044	132,726	183,971	274,353
8. Holdings in group's companies	5,331	11,057	40,058	64,597	50,654
9. Immaterial assets	8,258	11,572	10,519	10,943	18,262
10. Material assets	566,550	600,129	645,124	709,330	818,655
11. Expenditure pending contributions	6	0	0	275	191
12. Own contributions	234	22	201	74	0
13. Other assets	131,327	264,635	284,478	467,872	393,607
14. Periodisation accounts	195,551	209,638	245,219	235,006	241,022
15. Losses from financial period	0	0	5,077	492	0
<b>LIABILITIES</b>					
1. Credit entities	1,706,730	1,395,392	1,402,485	1,726,766	1,663,846
2. Customer debts	19,286,382	21,560,281	24,121,018	27,692,418	31,028,267
4. Other liabilities	78,618	305,924	366,033	498,002	450,028
5. Periodization accounts	143,305	142,517	183,851	220,478	233,095
6. Provisions for risks and expenses	167,027	218,808	211,160	225,298	210,277
6. A. Funds for general banking risks	66,346	72,197	73,867	76,546	90,573
7. Financial year profits	249,660	264,416	269,630	277,686	289,527
8. Subordinate liabilities	4,580	13,579	50,546	148,706	148,501
9. Subscribed capital	341,735	389,126	480,263	524,046	676,606
11. Reserves	1,288,173	1,496,175	1,715,835	1,929,080	2,148,892
12. Revaluation reserves	30,237	31,717	26,791	26,535	51,144
Results from previous financial years	30	0	0	- 5,077	- 5,569
Total Assets- Liabilities	23,364,448	25,890,132	28,901,479	33,340,484	36,986,187

Source: UNACC, several years and drawn up by author. Data in thousands of euros.

TABLE 15.  
“GROUP CAJA RURAL”. EVOLUTION OF THE RESULTS ACCOUNT

ASSETS	1998	1999	2000	2001	2002
1. Interests and assimilated profits	1,381,619	1,028,1206	1,494,354	1,822,541	1,850,366
2. Interests and assimilable charges	- 527,022	- 375,560	- 503,466	- 685,608	- 614,706
3. Profit from the portfolio of variable interests	4,640	5,606	6,081	7,737	8,950
A) Broking margin	859,237	911,252	996,969	1,145,670	1,244,610
4. Perceived commissions	135,366	158,167	190,901	221,481	264,166
5. Paid commissions	- 30,573	- 34,609	- 42,061	- 45,821	- 53,473
6. Results from financial operations	19,365	11,894	- 3,431	- 11,613	- 12,736
B) Ordinary margin	983,394	1,046,704	1,142,378	1,308,717	1,442,567
7. Other exploitation products	4,399	5,203	4,886	4,974	5,878
8. General administration costs	560,450	- 592,242	- 642,837	- 726,267	- 811,581
9. Repayment and reorganisation of assets	- 50,605	- 58,603	- 63,182	- 67,403	- 73,997
10. Other exploitation charges	- 20,026	- 22,360	- 23,853	- 26,943	- 32,738
C) Exploitation margin	356,713	378,702	417,392	493,078	530,129
15. Repayment and provisions for insolvency (net)	- 58,893	- 28,468	- 103,650	- 156,078	- 183,263
16. Reorganisation of financial immobilisation (net)	186	- 15,842	- 17,266	- 14,816	- 15,844
17. Endowment to funds for banking risks	- 7,416	- 2,599	- 397	- 2,072	- 14,036
18. Outstanding profits	46,332	44,255	68,085	69,291	85,592
19. Outstanding losses	38,483	- 61,280	- 59,274	- 70,525	- 74,383
D) Result before tax	298,439	314,768	304,890	318,878	328,195
20. Profit tax	- 48,778	- 50,351	- 40,336	- 41,676	- 38,658
21. Other taxes	0	- 1	- 1	- 8	- 10
E) Result of the financial year	249,660	264,416	264,553	277,194	289,527

Source: UNACC, several years and drawn up by author. Data in thousands of euros.

## 5. CONCLUSIONS

The Spanish financial system, as in the majority of developed countries is made up of banks, savings banks and credit co-operatives. The latter, which are legally established as a co-operative society, are classified according to traditional specialisation as in rural savings banks, popular and professional savings banks. The rural savings banks are more established at all levels in Spain, territorial presence, number of entities and volume of business

In this way, in practically all European countries, co-operative credit societies have evolved towards a system which is comparable to other financial groups. The co-operative bank model has 3,700 local and regional banks, more than 51,300 branches, 37 million partners, almost 106 million customers, 572,000 employees and a 17% market share of deposits.

Spanish credit co-operatives do not achieve the market share of other countries, where this system is very important, such as in Germany, France, Finland or Holland, with figures of 19, 21, 32 and 40 % of the market of deposits, in fact, they only reach 5%. This percentage in itself, which is not very significant quantitatively, is of particular importance as it grows every year, winning the market share from the rest of the financial entities which they are in competition with, banks and savings banks.

The search for an optimum dimension permits the reduction of costs and the improvement of benefits, based on a better use of human resources and infrastructure, to be exact, a more efficient allocation of inputs. En la búsqueda de esta dimensión óptima son importantes los fenómenos de asociación y fusión.

In Spain alone rural savings banks have constituted a co-operative banking system. The "Grupo Caja Rural" carries out coordination between the entities which have adopted this system of federate banking. This Group presents traits common to its European homologues, although it has not reached such a strong level of cohesion as in other countries such as France and Holland

The creation of "Group Caja Rural" in 1989, which 96% of rural savings banks belong to, has meant the greatest commitment to the integration of Spanish credit co-operatives in the face of the challenges of economic globalisation and the great changes in the national and international financial system. The Group carries out the task of co-ordinating individual interests and common interests, which makes the Group more aware. The running of this Group is through a vertebrate structure, in co-ordination and representation aspects as well as in operative functions.

The Spanish co-operative banking system materialised through the "Group Caja Rural" and is similar to that of the principal European co-operative banking systems. The functions of co-ordination and representation correspond to the "Asociación Española de Cajas Rurales" and the operative functions to the "Banco Cooperativo Español" and other specialised entities which offer central banking services such as insurances and informatics.

The effectiveness of the system of association is apparent in the yearly increase of its market share. Therefore, the balance has grown around 12% a year in the last

five years, a figure which is higher than that of the banks and in line with the savings banks. With regards to broking activity the total amount of credit investment given has increased on average by 17% yearly in the said period and deposits achieved by 13%, while profit is somewhat less at 4%.

The main European co-operative groups, are linked to the financial Group UNICO, the top exponent of the European co-operative banking system. Group Caja Rural through the Banco Cooperativo Español (Spanish Co-operative Bank), where it owns 85% of the share capital, is among these groups.

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# **THE COLLAPSE OF THE CZECH CREDIT CO-OPERATIVES - LACK OF CONFIDENCE (CASE STUDY FROM THE PERIOD 1990 - 2004)**

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## **1. INTRODUCTION**

Co-operatives should be considered as special organizations aimed to satisfy economic and/or social and cultural needs and wants of their members. The co-operative movement can be presented as a traditional practical application of solidarity ideas based on ethical principles. The International Co-operative Alliance (ICA) approved in 1995 the following internationally agreed co-operative principles: voluntary and open membership, democratic control, economic participation, autonomy and sovereignty, education and instruction of its own members and of the public, co-operation between co-operatives, and responsibility for the state of society. The co-operatives should strive for the permanently sustainable development of society. The old traditions of co-operatives are also based on ethical values like integrity, openness, social responsibility and care for others. The ethical aspect of the co-operative ideas was well emphasised by the prominent French theoretician of the co-operative movement Charles Gide (1847 - 1932) who formulated twelve principles (virtues) by means of which the co-operative movement was to enrich the mankind.

Unfortunately the actual practice in some renewed co-operatives in post-communist countries with the occurring transformation process is different. Such a development has affected the re-introduced Czech credit co-operatives. The aim of this paper is to make a short reflection to their present problems connected with ethics.

## **2. CO-OPERATIVES IN THE CZECH LANDS**

Credit co-operatives cannot be separated from the context of the whole co-operative movement and from its history. Furthermore the development of financial co-operatives in the Czech territory also should be considered in a broader context in view of simultaneous similar development - especially in neighbouring Austria and Germany. Surprisingly already in 1845 - just one year after the founding of the

historically first co-operative at Rochdale in England - the first co-operative in the European continent was a credit coop build up by Samuel Jurkovič at Sobotistě in the actual territory of Slovakia (then part of Hungary).

In the history of the co-operative movement the credit co-operatives in Central Europe were among the most successful and highly respected financial institutions offering services in the most remote localities with a perfect know how of local conditions and also with a considerable social impact and moral influence. In Europe they were spreading since the second half of the 19-th century. The names of at least two pioneers of credit co-operatives should be mentioned: *Friedrich Wilhelm Raiffeisen* and *Franz Hermann Schulze - Delitzsch*. Mutual loan associations were a particularly important part of the whole co-operative system. They collected savings from farmers and other less well-off classes of the population and on the other hand they extended credits on easier terms than banks of the local money lenders practising usury. Their role was not only economic but also social and cultural one.

Many examples can be given including the **kampelichkas in Bohemia** named after their pioneer *F. C. Kampelík* (1805 - 1872). These co-operatives applied the principles introduced by Raiffeisen. Their role was to provide credits to the poorer social classes - especially in the countryside - under interesting conditions (low interests rate etc.) and to collect the savings. But their role was not only of economic character. Kampelichkas also encouraged and financially supported building of new schools, sport centres and libraries and organising various cultural and education activities. A high respect and moral credit - characteristic for them - was covering all typical properties of ethical behavior: integrity, fairness, fair play, participation on common prosperity, truthfulness, honesty, credibility, orderliness, trust and - first of all - human solidarity of the co-operatives members. As to the Czech towns the co-operative saving banks based on principles of Schulze - Delitzsch as well as private banks predominated. Many of these saving organisations were oriented to specific clients (small and medium entrepreneurs, civic loan offices, former members of the Czechoslovak legions from the World War I etc.).

Generally speaking in the period between World Wars I and II following types of popular banking institutes operated in Czechoslovakia:

- saving banks,
- civic and tradesman loan offices of the Schulze-Delitzsch type,
- district agricultural loan offices,
- credit co-operatives of the Raiffeisen type,
- credit co-operatives in Slovakia.

Nevertheless the most popular type of co-operatives **in Czechoslovakia until WW II** were agricultural credit co-operatives.

During the World War II the tradition was interrupted by the German nazi occupation. The activities of the co-operatives were subordinated to the nazi control.

**After the WW II** the co-operatives in general were returning to the pre-war conditions in the connection with the reconstruction of the national economy. In October 1945 all banks and insurance companies were nationalised but the structure and owners relations in popular banking remained preserved. Several following years were dedicated to disputes concerning the future structure of the whole monetary system.

In February 1948 when the complete take of political power opened the way to realise the suggestions earlier promoted by the Communist party the process of transition from the capitalism to the socialism started. The private sector was nationalised and substantial changes concerned also the co-operative movement. Many types of co-operatives were liquidated and the remaining co-operatives had to integrate the small private producers, farmers and tradesmen. This process was called as a "socialisation".

The centralisation in popular banking was one of many features of a general control centralisation which took place in the whole economic life and interfered also other areas of social life. This made it possible to exclude political adversaries from their former - not rarely dominating - leading positions in monetary institutes. A simplification of the monetary system structure was related also with the transition to directive planning of the Soviet model what needed to concentrate financial means in hands of the headquarters and to distribute them in accordance with given targets of economic policy.

Organising centralisation in popular banking was realised in two steps. In 1948 institutes were established in domiciles of districts with the denomination of District saving banks and loan offices, in other towns with the denomination Saving banks and loan offices and in smaller municipalities with the denomination Loan office - *kampelichka*. These three types were considered as co-operatives but in fact the first two types represented hybrid formations because half number of their leading members and supervision councils were named by state organs in districts and municipalities. Also the way of voting was changed in accordance with the principle one member - one vote. After this reorganisation popular banking had to focus activities mainly to gather deposits (with a state guaranty) and furthermore to afford credits, especially for operative purposes of smaller enterprises and for mortgage credits. At the end of the year 1951 altogether 4264 institutes with 227 branch offices operated in popular banking; from this number 717 institutes and almost all branch offices were classified in the category denominated as saving banks and loan offices.

The second step was effected to the 1st January 1953 when the monopoly of state saving banks was introduced. Incidentally this reorganisation was realised in the time when after several years of the transition process the Soviet model of control, planning and national economy functioning was completely adopted.

Finally it is necessary to emphasize that under the communist system in Czechoslovakia the whole co-operative sector was subordinated to the central planned economy system and to a delimitation of tasks between co-operatives and the state sector. All economic activities were under a strong political control of the leading communist party. On the contrary to other socialist countries only four types of co-operatives were admitted at that time in Czechoslovakia: agricultural, consumers,

production and housing co-operatives. As to the credit co-operatives their activities in Czechoslovakia were stopped and their network was integrated with state saving banks.

In the contrary to the situation of popular banking system in Czechoslovakia, the system of credit cooperatives in some other socialist countries at that period survived. In Poland because of a still strong private agricultural sector credit cooperatives continued especially in rural areas to help local population (in 1966 altogether 2.8 millions of members were registered in 1638 credit and saving cooperatives). Also in Bulgaria, Hungary and Roumania credit cooperatives existed, mostly under the umbrella of consumer cooperatives.

**After the velvet revolution in November 1989** a transformation process started replacing previous centrally planned economics by the free market economy. Besides purely economic problems also deep changes in political and social structure occurred. The transformation process has been realized in both state and co-operative sectors of the previous national economy system. Common trends occurring in all post-communist countries of Central and Eastern Europe have not erased differentiating of national trajectories in any country.

The fast large-scale privatization with a significant role of the voucher (coupon) elements concerned only the state owned enterprises. The existing co-operatives had to be transformed in accordance with the new transformation co-operative law whereas their activities had to be subordinated to the new commercial law. In accordance with them the co-operatives in the Czech Republic should be considered as entrepreneurial subjects based on the private ownership of their members. All their activities are to be conformed to the internationally acknowledged democratic co-operative principles. The new commercial law has acknowledged to the Czech co-operatives the same position and the same operating possibilities as to other economic bodies on the national economic scene.

The transformation process in the co-operative movement - which survived the socialist period - had its own ethical problems and dilemmas. These problems can be described as underestimated solidarity, preference of special interests of smaller groups of members, efforts to maximise profit without any regard to the social responsibility, manipulated members' opinion, neglected education problems in the new social climate etc.

Further factors decreasing the propensity to cooperate have been marked by Y. Stryjan (1994d):

- 1) A traditional tendency to await government initiatives.
- 2) Lack of trust between agents. Besides old times legacy (such as the chasm between "old" and "new" farmers), it also reflects the fact that some agents actually can gain more by interacting with government organs, than by interacting with each other.
- 3) An activity hostile government attitude to all forms of cooperation, especially in agriculture (cf. Stryjan, 1992).

- 4) Major agents are incapacitated, or lack local commitment. External owners may (and for good reasons) have an ambivalent attitude towards the local community.
- 5) Best talents, and would-be social entrepreneurs migrate from the countryside to where the opportunities are.

### **3. SPECIFIC PROBLEMS IN THE RENAISSANCE OF THE CZECH CREDIT CO-OPERATIVES**

When after 1989 new political and economic changes in the Czech Republic occurred an attempt has been realised to restore traditional useful and successful credit co-operatives movement (completely liquidated after 1948). The demands for the re-introduction of the credit co-operatives into the financial system in the country were expressed early after the changes but the first legislation did not take credit co-operatives into account. There were various pros and cons to restore credit co-operatives besides the existing banking institutions, the main objection consisted in the private banks and their fear from a potential concurrence. It was only after the visit of the World Council of Credit Unions representatives in the Czech Republic and their meeting with representatives of the Czech co-operative movement and with the banking committee of the Czech Parliament in 1993 when an initiative group was established. This group included the representatives of all political parties and its goal was to put through an appropriate legislation for credit co-operatives. The renaissance of the *kampelichkas* network besides the existing banking institutions has been made possible by the Credit and Saving Co-operatives Act No. 87/1995 Coll. (valid from January 1, 1996).

It is not the aim of this article to completely describe this Act but some of its basic regulations should be mentioned to understand the later arising problems. The Act No. 87/1995 has a liaison with the previous Commercial Law where the chapter II about co-operatives had been approved as a compromise. Accordingly to the new law the foundation of any new credit co-operative needed the minimum of 30 founding members with the minimum capital of 100000 Kc (Czech crowns). Besides other functions the credit co-operatives have been authorised to accept savings from individual members and from jurist persons and to afford credits. Credit co-operatives have to establish democratic organs for their management including the control commission as well as a special commission for affording credits. The controlling role of the state has been determined by establishing a special authority for co-operative credit bank surveillance. Also a special fund for savings assuring has been established. There were various shortcomings in the Act that made it possible to credit co-operatives to found their own "daughter companies" or other societies for entrepreneurial activities. In fact in a relatively near future this appeared as one of the most serious sources of the collapse of many credit co-operatives.

In the early 1996, a Union of Czech and Moravian Credit Co-operatives was established as a voluntary interest-based organization without any formal link with the top Czech co-operative organ (DACR = Co-operative Association of the Czech Republic). The official title of the Union has been changed several times, the goal was to lobby and protect the interests of the credit and saving co-operatives. On January 1, 1997, in accordance with the law the State established a special authority for co-operative credit bank surveillance. Its mission was to improve the credibility of co-operative banking in the public and to prevent the credit co-operatives from going bankrupt.

At the same time also the Foundation for Support and Growth of Credit and Saving Co-operatives was established. Its task was to prepare a system of education, to gather contacts abroad and to draft specific materials for the cooperatives themselves. The Foundation was dissolved at the end of 1998 as a result of a controversy with the above mentioned Union. The reason of this controversy consisted in the different issues of understanding, concepts and future of the credit co-operatives in the Czech Republic. Original misunderstandings had an unfortunate influence on the further development and final collapse of many credit co-operatives.

Based on the Act No. 87/1995 Coll. a rapid growth of credit co-operatives “kampelichkas” has started - both in their quantity and in the number of members. Lot of people - especially in the countryside - entered them thanks to the image of kampelichkas before WWII believing that their style of work would be very similar. Unfortunately in the process of the renaissance of the Czech credit co-operative movement new deformations have occurred and co-operative ideas have been misused for personal profits and aims. The fundamental co-operative principles like mutual solidarity of members, democratic management and control have been completely neglected and violated. Extremely negative experiences in some credit co-operatives have awoken a wave of mistrust to the credit co-operative movement as a whole, especially after 1999. In many cases the state authorities dealing with criminal affairs had to be engaged because the membership savings (mostly coming from small savers) have been either endangered or even completely lost after *tunnelling* realised by their irresponsible or criminal management. This happened because of a lack of know how in the banking operations or because of a violation of the respective law and of co-operative statutes. Also a control from both the membership and the top co-operative and state organs was not satisfactory. It appeared that the members did not know the existing laws and their own rights and duties. Many people joined the new credit co-operatives just with a dream of getting high interests from their saved money. In a naïve trust they were expecting a high level of banking ethics as before WW II. This trust has been strongly shocked. Despite the immediate engagement of police and justice state organs many members had considerable financial losses and the population in a very short time lost any confidence in the new kampelichkas as it can be demonstrated by Table 1 (e.g. drastic decrease in the only year 2001!).

**TABLE 1.**  
**DEVELOPMENT OF CREDIT CO-OPERATIVES IN THE CZECH REPUBLIC**  
**IN THE PERIOD 1996 - 2004**

Year*	Number of credit coops	Number of members
1996	52	10500
1997	70	25533
1998	75	62300
1999	110	125000
2000	88	111740
2001	45	10876
2002	46	14200
2003	42	11174
2004**	36	?

\* the situation in any year is given to the December 31.

\*\* official data for 2004 not yet published.

Of course not all kámpelichkas lost their original image and confidence of clients. This can be shown by the following comparison of two different credit co-operatives (one successful, the other collapsing). The successful credit co-operative has been working in a relatively small territory, in an agreeable environment. Both official representatives and clients knew each other, they have been affording credits for short term investments keeping all classic rules of solidarity. On the other hand the collapsing credit co-operative was operating in the whole territory of the state. Its founders did not know the members; they asked their own agents to get new members promising them high interests. Individual members did not know at all their representatives, they believed only in the apparent luxury equipment of many new territorial branches without any knowledge about long term credits granted for dubious investments. To their great surprise the credit co-operative went bankrupt.

In spite of initial enthusiasm credit co-operatives mostly have been not successful and many of them go bankrupt. In such a situation new changes in the respective laws have been accepted by the Parliament as the Act No.100/2000 Coll. The new Act has made the regulations of the previous Act more severe. It has enlarged competencies and responsibilities of the elected organs of credit co-operatives, it has improved the role of state surveillance organs and - above all - it has forbidden any founding of "daughter companies" and any participation on entrepreneurial activities.

The actual problems in the Czech credit co-operatives movement have to be considered and solved not only as pure problems of law and justice but also as problems of co-operative principles and of business ethics. Let us only remind the main principles applied in founding the original kampflichkas:

- territorial limit (usually only one village or municipality or parochial district),
- voluntary work of the representatives (only the accountants and cashiers were paid for their work),
- solidarian unlimited liability with all the personal propriety,
- low interest rate for all the members,
- short term credits granted,
- inadmissible use of bills of exchange for a credit,
- using profits for reserve funds and partially also for publicly useful purposes,
- the moral influence of co-operatives.

The comparison of the original kampflichkas with present credit cooperatives is presented in Table 2.



**TABLE 2.**  
**COMPARISON OF ORIGINAL KAMPELICHKAS WITH PRESENT CREDIT**  
**CO-OPERATIVES UNDER COLLAPSE**

Original Kampelichkas	Present Credit Co-operatives under Collapse
they were a movement .....	they cannot be considered as a movement
mostly in the countryside .....	mostly in towns
territorial limit .....	various territorial range of activities (including the whole republic)
small number of members .....	large number of members
the members knew each other .....	the members do not know each other
unlimited liability .....	limited liability
mutual trust .....	mutual mistrust
aim: to improve conditions for credits .....	unsatisfactory motivation for members
motivation: no more dependence on banks .....	motivation: promising high interest from savings
a good legislative frame .....	defects in laws, lack of a special law on small banks, tunneling
effective system of control from members .....	bad control from members as well as from the Authority for Co-operative Credit Bank Surveillance
low costs for administration .....	high costs for administrative works incl. luxurious buildings and advertising
voluntary functionaries .....	paid functionaries
pride to serve voluntarily for kampelichkas .....	lack of interest for unpaid voluntary functions
moral authority of kampelichkas .....	no moral authority of credit co-operatives
high credit in the population .....	despite ethical codes a mistrust of the population
support to solidarity ideas .....	solidarity ideas discredited
social and cultural role in the countryside .....	neither social nor cultural role

In accordance with negative experiences it is possible to find a positive solution. **What to recommend as a way out?** First of all it is necessary to maintain actual laws and co-operative principles, to control activities of the management at any level, to realise a perfect work of the supervising state organs. Management of any co-operative should be perfectly and professionally prepared for the special work in co-operatives, also the active involvement of all members is needed. The same ethical banking principles should be applied in the credit co-ops as in the whole banking sector: trustfulness and transparency, justice, moral responsibility, professionalism and competency, service to clients, cautiousness, legality and excellency in work (effort to achieve optimum quality of services).

## 4. CONCLUSION

Ethics has to be considered as an inseparable part of economics as well as a precondition of both economic and political stability of the democratic society.

The existing Czech credit co-operatives should maintain all usual ethical banking principles as well as other ethical standards and measures used in the economic life. They should try also to follow the old traditions and to use very positive experiences of the Czech co-ops from the history. Negative experiences connected with the renaissance of the *kampelichkas* can serve as a warning and as a memento for any future co-operative development. Nevertheless a further positive (but probably very slow) development of Czech credit co-operatives - based on the return to the positive tradition of original *kampelichkas* - still can be expected. The credit co-operatives should be founded by the real members and for their own needs. In other words, "the future of cooperation as a movement hinges on its ability to reframe its mission: from merely trying to subsist on the leftovers of a problematic past, to shaping the ground for an organizational future" (Y.Stryjan - Z.Linhart, 1997).

New possibilities for the further development of the Czech credit co-operatives hopefully have been just open by the recent entry of the Czech Republic with the European Union on May 1, 2004. More intensive contacts of the Czech co-operative movement can be expected with those European countries where the development of co-operative movement has been never interrupted nor violated by any totalitarian régime. Nevertheless EU legislation demanding higher basic capital for any credit co-operative will need some restructuring of several still existing small Czech credit co-operatives which have proved their fidelity to the original solidarity ideas and co-operative principles and have been able to overcome any crisis of the renewed system of *kampelichkas*. Unfortunately to my deep regret these EU demands - not taking into consideration historical roots and development - can lead to liquidation of the small credit co-ops or to their fusion with the big ones. Therefore the future of the Czech credit co-operatives and their role in the financial market are not yet clear.... Let us believe that in the future Europe **the real solidarity idea** will serve as **one of priorities values** of credit co-operatives as well as of the whole co-operative movement.

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# CREDIT UNION SUPERVISORY COMMITTEES IN THE REPUBLIC OF IRELAND: A DISTINCTIVE GOVERNANCE APPROACH

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## 1. INTRODUCTION

The credit union supervisory committee, as a model of internal auditing, is very much invisible within corporate governance research, where the focus is almost entirely on its corporate counterpart, the audit committee. Thus, best practice is based almost entirely on audit committee experience. This is despite the existence of over 40,000 successful credit unions worldwide, safeguarding US\$600 billion in member savings, the majority of which adopt an acceptable alternative to audit committees in the form of a specially appointed supervisory committee.

In the Republic of Ireland (RoI), there are over 400 credit unions with 7 billion euros in member savings, and all credit unions are required by legislation to elect from their membership a supervisory committee charged with *'the general duty of overseeing the performance by the directors of their functions'* (Credit Union Act 1997, S.58 (1)). The Irish Financial Services Regulatory Authority (IFSRA), the new body responsible for the regulation of all financial institutions in the Republic of Ireland, including credit unions, has expressed the view that credit union supervisory committees should develop along the lines of the audit committee model. With the abundance of research and best practice guidelines on audit committees, compared with little or no research on supervisory committees, this is not surprising. In corporate companies, the audit committee operates as a sub-committee of the board. In this respect, the board can exercise some control over the audit committee and can decide who its members are. The members of the audit committee, as non-executive directors can also participate in corporate decision-making. The audit committee model has not prevented recent corporate losses (such as those in Barings, Enron, AIB/First Maryland). Some observers (Spira, 1999; Collier, 1997) cite its lack of independence as a key factor in the weaknesses of these committees. Therefore, audit committee and corporate governance literature may well benefit from the perspective of the alternative model

provided by the supervisory committee, which has independence as a key characteristic.

This paper explores the role of the supervisory committee in credit union governance and the structure of supervision, oversight and regulation within the Irish credit union movement. It reports the findings of a survey of credit union supervisory committees and qualitative interviews with key players in credit union supervision in Ireland, including the regulators of the credit union movement. A profile of the composition, activities and skills levels of supervisory committees is examined. A detailed discussion on the issue of independence is also presented. It is hoped that this paper will be a useful starting point for further research into the Supervisory Committee model of internal auditing.

## 2. WHAT IS THE SUPERVISORY COMMITTEE?

The supervisory committee is a statutory committee in Irish credit unions, established by the Credit Union Act (Republic of Ireland) 1997. It is elected from among the members of the credit union, by the members of the credit union and is responsible to the members of the credit union. The committee consists of three or five members, all of whom work in a voluntary capacity. The primary function of the committee is to oversee the performance of the credit union directors. The Supervisory Committee normally attends all board meetings but does not participate in decision-making. Thus, its independence from the board is secured.

Supervisory committees came into being at an early stage in credit union development, as early as the Raiffeisen movement of the late 1800s<sup>1</sup>. Possibly one of the reasons Irish credit unions adopted the idea of a supervisory committee was because the agricultural credit societies and village banks failed in the early 1900s partly as a result of 'inadequate control procedures' (Quinn, 1999:13). It seems credit unions were intent not to repeat the same mistakes.

The supervisory committee, as an independent entity, seems to be the most popular model of internal auditing used in credit union movements<sup>2</sup>. As indicated earlier the credit union supervisory committee model does not appear to have played any role in the development of corporate governance theory or practice. Even within credit union circles, there is little focus on supervisory committees. However, within the corporate sector, audit committees are now seen as a key ingredient in a good corporate governance structure. A number of corporate governance guidelines and

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1. The original legal framework for credit unions, the Cooperative law (1868,1871) paragraph 38 (I) stated 'It is the task of the Supervisory Board (Verwaltungsrat, Aufsichtsrat) to supervise the Executive Board (Vorstand) in their management in all branches of the administration...' (cited in Raiffeisen, 1970:55)

2. The Canadian credit union movement has adopted the corporate model of the audit committee which operates as a sub-committee of the board rather than as an independent entity.

codes such as those produced by Cadbury (1992), Higgs (2003) and Smith (2003) have increasingly focused on strengthening the role of the audit committee. The Irish Companies (Auditing and Accounting) Bill (2003) requires all public companies (whether listed or not) and all large private companies to have an audit committee (Devlin, 2003:25). Much of the corporate governance literature also focuses on audit committees. The following quotes give a flavour of some of the views in the literature:

*'One of the many lessons from the still unfolding Enron scandal is the critical role of audits and the trouble that can befall an organisation when its audit committee is not doing its job'. (Reed, 2002:40)*

*'Recent events in the U.S. economy have organisations scrambling to ensure they have all the right pieces in place to avert financial disaster. Many are discovering that one of the most important is a strong audit committee'. (Verschoor, 2002:26)*

*'Audit committee ineptitude, in particular, is generally acknowledged to be among the principal reasons why shareholders suffered billions of dollars in losses over the last year or so'. (Sweeney, 2002:16)*

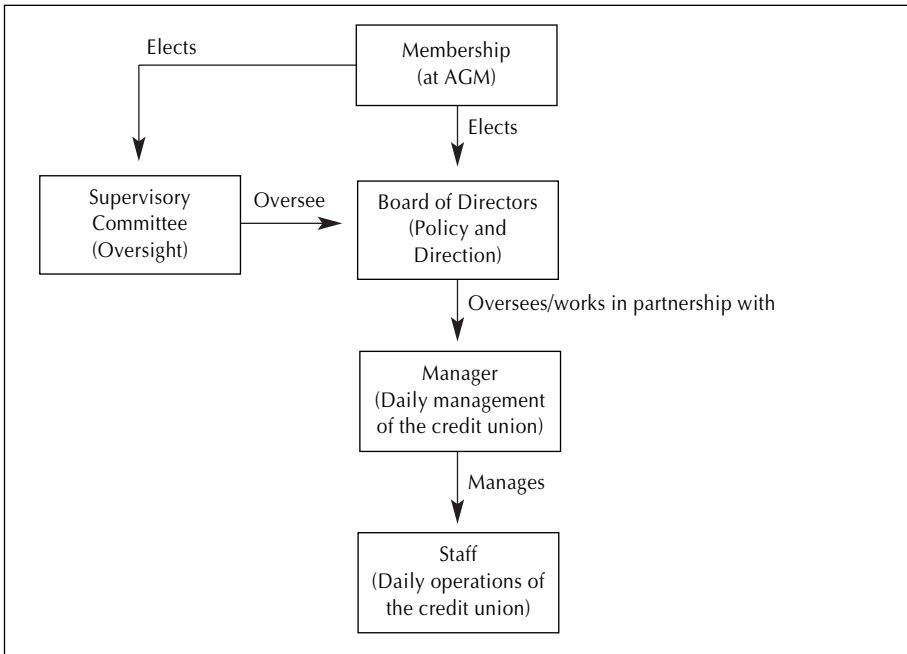
While active audit committees are now seen as an essential element for good corporate governance in corporate companies, there is very limited focus on the role of the supervisory committee in good credit union governance.

### **3. CREDIT UNION GOVERNANCE STRUCTURE**

#### **3.1. Individual credit union**

The governance structure in a credit union is comprised of four main elements: the membership at the AGM, the board of directors, the supervisory committee and the salaried management. This governance structure is presented diagrammatically in Figure 1.1 as follows:

**FIGURE 1.1.**  
**CORPORATE GOVERNANCE STRUCTURE IN CREDIT UNIONS**



As the diagram depicts, the supervisory committee performs the pure oversight role in the credit union.

The key issue in governance is that in most organisations, including credit unions, there is a degree of separation between those who own the organisation and those who manage the organisation.<sup>3</sup> Thus, there must be an oversight function of some sort in organisations to ensure that management always acts in the interests of the owners. In corporate companies, this role is performed by the non-executive directors and the audit committee. In credit unions, the board of directors perform an executive and to a lesser extent an oversight function. The supervisory committee in the credit union performs a pure oversight role.

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3 . In the case of the credit unions, the members own the organisation but they elect a board to run the organisation on their behalf.

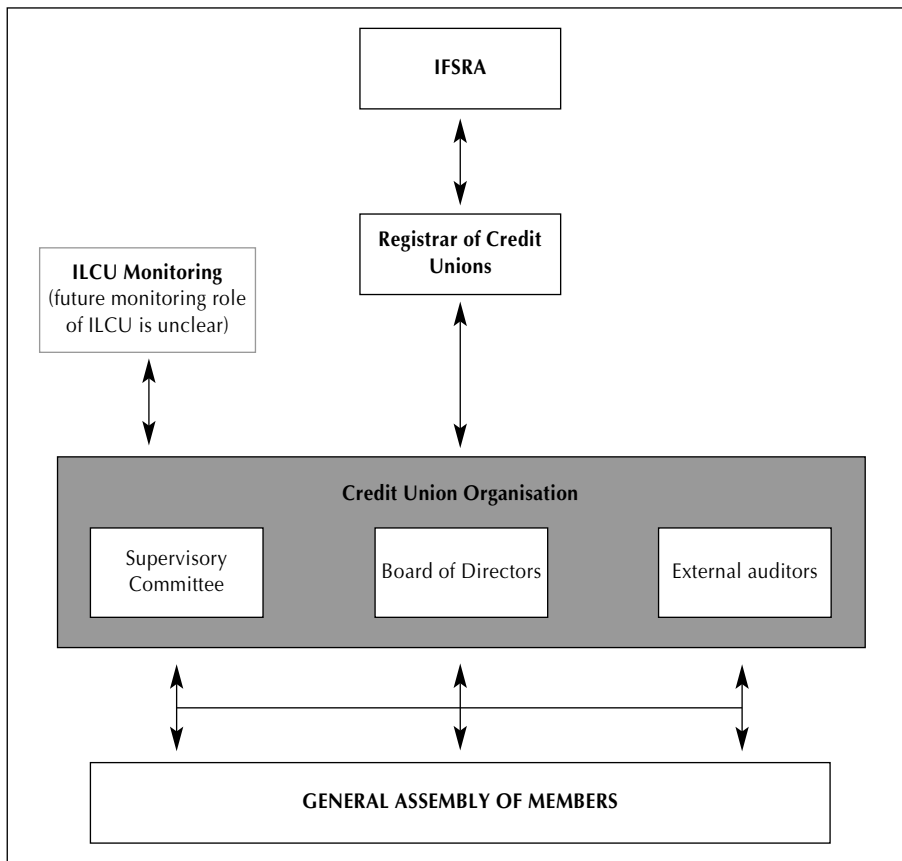


### 3.2. Credit union movement

There are a number of layers of supervision in the credit union movement. The ultimate supervisory authority is IFSRA, which, as a result of intense lobbying by the ILCU, has a dedicated Registrar of Credit Unions to regulate credit unions. The ILCU also acts as a monitoring body. It employs a number of field officers who visit credit unions and monitor their books and operations. However, the precise monitoring role the ILCU will play into the future is unclear at the present time, as it may be taken over by IFSRA.

The regulatory structure is presented diagrammatically in Figure 1.2

**FIGURE 1.2.**  
**CREDIT UNION SUPERVISION**



The role of the supervisory committee within the overall regulation of credit unions is as an internal regulator.

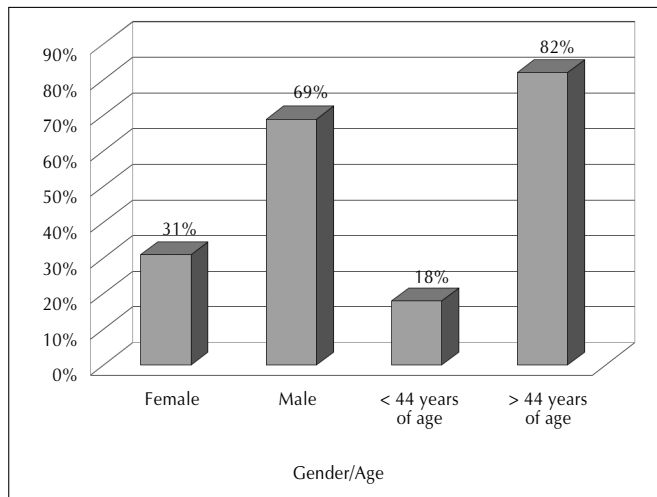
## 4. THE RESEARCH

This study consisted of both a quantitative and qualitative research methodology. The quantitative elements comprised of a survey with 125 supervisory committee members from 39 Irish credit unions. These surveys were administered face to face. The qualitative element of the study involved interviews with a number of key witnesses who are involved in credit union supervision, development and regulation. The main difficulty experienced while carrying out this research was that the regulation of credit unions has been under a period of flux and while uncertainties still exist it is difficult to offer definite conclusions.

## 5. FINDINGS – SURVEY

### 5.1. General profile of the individual supervisor

The research presents an overall profile of the individual who volunteers their time to the credit union as a supervisor. The most striking characteristic is that supervisors tend to be male and over 44 years of age. The numerical dominance of males on Supervisory Committees was also found by McKillop et al (2002).



Thus, it could be suggested that for regeneration and for representational purposes, supervisory committees should attempt to have greater balance in their membership.

## 5.2. Committee composition

The data was aggregated to determine the compositional profile of supervisory committees. The results are present in Table 1.

**TABLE 1.**  
**COMPOSITIONAL PROFILE OF SUPERVISORY COMMITTEES**

Supervisory Committee Composition	
<b>Gender</b>	
- All/majority male	78%
- All/majority female	22%
<b>Length of Service</b>	
- All members in their 1 <sup>st</sup> term (3 years and less)	18%
- At least one or more members in their second term or more	82%
<b>Previous CU experience</b>	
- No previous credit union experience on the committee	20%
- At least one or more members with previous credit union experience	80%
<b>Participation in relevant supervisory committee training</b>	
- No supervisory committee training received by the committee	10%
- At least one or more members who have participated in supervisory committee training	90%
<b>Formal accounting experience and/or qualifications</b>	
- No formal accounting experience and/or qualifications	36%
- At least one or more members on the committee with accounting experience and/or qualifications	64%
<b>Remuneration</b>	
- All supervisory committee members work on a voluntary basis	100%
<b>Independence of the committee</b>	
- All members of the supervisory committee are elected by the membership (shareholders) of the credit union.	100%
- There are no credit union directors, employees or other credit union committee members on the supervisory committee	100%

As can be seen from Table 1, credit union supervisory committees are numerically dominated by male members. As the authors are not aware of any gender research on corporate audit committees, it was not possible to make a comparison between the supervisory committee and the audit committee.

In terms of length of service on the committee, 18% of committees are in their first term. It could be suggested that these committees are inexperienced overall and have the disadvantage that they lack the guidance of more experienced members. PricewaterhouseCoopers (2000) point out that committees must consider both continuity and the desirability of fresh perspectives. They state that 'rapid turnover can be detrimental to the committee's effectiveness' since members need time to gain experience and the benefit of a historical perspective.

20% of the surveyed supervisory committees consist of members with no previous credit union experience, even though a good understanding of the business is essential to the effective operation of a supervisory committee. It is also interesting to note that 10% of committees consist of members who have never participated in supervisory committee training, while 90% of committees have at least one member with such training. It is interesting to compare this with training provided to audit committees. The American Society of Corporate Secretaries (ASCS) in its 1998 survey on audit committee effectiveness found that only 6% of 550 public companies provide formal training to their audit committee members.

36% of the supervisory committees surveyed have no formal accounting experience and/or qualifications on their committees. Smith (2003) recommends that there should be at least one member who is financially literate on the corporate audit committee. The audit committee survey carried out by the American Society of Corporate Secretaries in 1998 found that 74% of respondents had at least one audit committee member who had a finance or accounting background (PriceWaterhouseCoopers, 2000). The credit union supervisory committee, at 64%, compares well.

The research found that all the supervisory committee members work on a voluntary basis. This differs significantly from the corporate audit committee which is remunerated for its time.

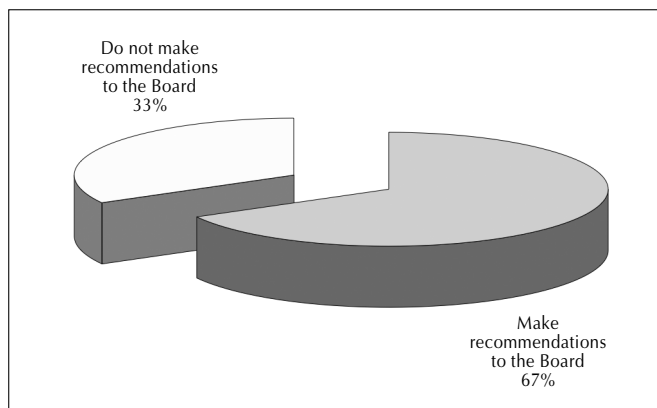
Supervisory committee members must be members of the credit union and must not hold a directorship or be an employee of the credit union. This helps to ensure independence and objective judgement. This differs from the audit committee where directors (independent and not) can be members of the audit committee. All the supervisory committees studied were elected by the membership of the credit union and are an independent entity of the board of directors. This differs from the audit committee selection methods. The Public Company Governance Survey (1999-2000) carried out by the National Association of Corporate Directors found that in 41% of companies the audit committee members are chosen by the full board and in 35% are chosen by the CEO and/or the board chair (PriceWaterhouseCoopers, 2000).

### 5.3. Activity level of the committee

Supervisory committees meet approximately 40 times or more in the year to carry out on-going spot checks on the general operations of the credit union. In addition to these meetings, supervisory committees are required to meet four times a year with the board, in the absence of salaried management, to report on the performance of the board. In contrast, the corporate audit committees normally meet 4 times a year in total.

In reporting to the board, the supervisory committee can make recommendations to the board for improving performance. While these are not binding, they are a useful measure of committee activity. Figure 3 shows the level of activity of supervisory committees in terms of recommendation-making.

**FIGURE 3.**  
**SUPERVISORY COMMITTEE RECOMMENDATION-MAKING TO THE BOARD**



The majority (67%) of the studied supervisory committees make recommendations to the board. However, a significant 33% claim not to make recommendations. Why do some committees make recommendations and others do not? To attempt to answer this, we cross-tabulated supervisory committee composition with the tendency to make recommendations to the board. The results of these cross-tabulations are presented in Table 2.

**TABLE 2.**  
**CROSS-TABULATIONS OF SUPERVISORY COMMITTEE COMPOSITION AND**  
**RECOMMENDATION-MAKING TO THE BOARD**

Supervisory Committee Composition	Committees which make recommendations to the board of directors	Chi Square Result $P \leq 0.05$
<b>Gender</b> - All/majority male - All/majority female	21 (72%) 4 (44%)	.122
<b>Length of service on committee</b> - All members in their first term (3 yrs or less) - At least one or more members in their second term or more	3 (43%) 23 (72%)	.140
<b>Participation in supervisory committee training</b> - None of the members have participated in supervisory committee training - At least one or more members have participated in supervisory committee training	2 (50%) 24 (69%)	.455
<b>Previous credit union experience</b> - No previous credit union experience on the committee - At least one or more members	4 (50%) 22 (71%)	.262
<b>Formal accounting experience and/or qualifications</b> - No accounting experience and/or qualifications - At least one or more members have accounting experience and/or qualifications	9 (64%) 17 (68%)	.813

While none of the above results are significant at the  $p \leq 0.05$  level, there would appear to be a slightly greater tendency for those committees which are male dominated, those with longer serving members and those with previous credit union experience to make recommendations to the board. It is important to remember that the sample size was small, being only 39 credit unions. An extension of the sample size in future research may alter the statistical significance of the findings.

## 6. FINDINGS – KEY WITNESS INTERVIEWS

Ten key witnesses were interviewed from the following organisations: ILCU, Credit Union Development Association (CUDA), IFSRA, Former Registrar of Friendly Societies, Credit Union Supervisors' Forum as well as other individuals who are deeply involved in the work of supervisory committees.

The interviews covered a number of areas, including the role and perceived skills of supervisory committees and the independence of the supervisory committee.

## 6.1. Role of the supervisory committee

Many of the key witnesses felt that there was often confusion in the minds of both the supervisory committee and the board of directors about their respective roles. The general agreement was that the supervisory committee must confine its role to oversight only. A quote from one of the key witness summarises this point:

*“Supervisory committees do not have any role in the running of the credit union, they cannot influence board decision making, cannot voice an opinion, but can make a point of order/or a point of information...supervisory committees must know how far they can go and must not go beyond this point.”*

One other key witness indicated that “on occasions, supervisors become involved in policy making and that this causes tension and problems in the credit union”. Another key witness indicated that the supervisory committee and the board often only become aware of supervisors’ roles when there is a difficulty in the credit union –*“from this comes more understanding and possibly respect from the board about the role of the supervisory committee”*. If this is the case, it is unfortunate that the credit union has to experience some turbulence before the role of the supervisory committee is fully recognised.

## 6.2. Skills required and shortcomings of the supervisory committee

The key witnesses were in general agreement about the important skills required on a supervisory committee. These are listed as follows in the general order of importance:

- Common Sense
- Human resources or people skills
- Financial skills
- Independence, sound judgement and the ability to ask constructive questions
- A clear understanding of roles
- The ability to view the overall picture and not simply focus on the routine aspect of their work

Almost all key witnesses felt that supervisors need common sense primarily, and then specialised knowledge. A quote from one key witness summarises that view;

*“A supervisory committee can have all the financial skills and qualifications but if it does not have common sense and people skills then this committee will not be effective.”*

However, in saying that, many of the key witnesses highlighted that a major shortcoming in many supervisory committees is a lack of financial knowledge. Many also felt a number of supervisory committees tend to overstep their role and to interfere with the role of the board. It was also suggested by some of the key witnesses that supervisory committees may have a tendency to over-focus on certain elements of their work while ignoring other areas. Spollen (1997) also alludes to this, when he says that sometimes the internal control function in a company tends to over focus on the areas known best and on simpler routine tasks while ignoring the more complex areas of the organisation. One key witness summarises this point as follows:

*"Some supervisors will put all their effort into balancing the bank reconciliation down to the last cent. When the organisation has assets of several million, supervisors must be able keep their work in context and see the overall picture."*

### **6.3. Supervisory committee as an independent entity**

A number of key witnesses feel that the supervisory committee, as an independent entity, creates tension in credit unions. These key witnesses feel that the committee should become a sub-committee of the board similar to the audit committee in corporate companies. This is already the case in many Canadian credit unions.

In Ireland, the statutory independence of the supervisory committee has, in fact, increased. In the Credit Union Act 1966, one director could sit on the committee. The 1997 Credit Union Act changed this to ensure that no director could be a member of the committee. It was felt by the drafters of the 1997 Act that a supervisory committee which contains directors 'defies logic' in that it does not make sense for a board director to be responsible for reviewing board performance.

While the Irish legislation is strengthening the role of the supervisory committee, other credit union legislation from around the world would appear to have weakened the role of the supervisory committee. Of 104 summary credit union legislations from around the world, only 10 mention the supervisory committee. While this may be so, the World Council of Credit Unions (WOCCU) has kept the concept of the independent supervisory committee in its model law for credit unions.

Should the supervisory committee remain an independent entity or should it be a sub-committee of the board? The view from the majority of the key witnesses was that the supervisory committee should remain independent of the board. Many felt that this independence was the key to its effectiveness.

In the corporate governance codes and literature, there appears to be a pre-occupation with independence. Spira (1999) indicates that substantial emphasis is placed on independence in Cadbury (1992), which she says implies that "independence is a prerequisite for ethical behaviour in the context of corporate governance". In fact, Higgs (2003), Smith (2003) and also Cadbury (1992) recommend that at least half of the board should be made up of independent directors. The majority of the audit committee is made up of independent non-executive directors



who also sit on the board and are involved in decision making. This has led a number of commentators (Spira, 1999:263, Collier, 1997:80) to highlight the conflict for the non-executive director in trying to carry out a decision-making role and a monitoring role at the same time. Spira (1999:263) has indicated that the corporate governance codes have not sufficiently dealt with this dilemma. O'Higgins (2003:32) highlights that this may result in a 'latent threat' to the unitary nature of the board.

Under the Stock Exchange's Combined Code, non-executive directors on an audit committee should be 'independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement'. However, because the audit committee is a sub-committee of the board and its members therefore also sit on the board, independence can be difficult. Vicknair, Hickman and Carnes (cited in Collier, 1997) have raised doubts about the impartiality of 'grey' area directors, who are 'not wholly independent of management' and who may undermine the position of audit committees as 'truly independent corporate governance entities'.

Thus, if independence and impacts on the unitary board are issues in corporate companies, perhaps it is better to have a group separate to the board who, if carrying out their role in an effective way, are truly independent and do not affect the unitary function of the board.

## 7. DISCUSSION

As already indicated, this research was greatly restricted by the lack of literature on credit union supervisory committees and credit union regulation. It is also limited in that it does not delve into the many complex issues which impact on supervisory committees, one being the psychological dynamics between the committee and the board/management. However, it is also disappointing to see that the audit committee research does not appear to cover this area to any great extent either. It is the hope of the authors that this research, along with the forthcoming UCC research on supervisory committees<sup>4</sup>, will be the foundation of more in-depth research in the future. Such research is important as it helps those outside the credit union and co-operative world to better understand these unique and important organisations.

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4. Forthcoming MComm. research in the Department of Food Business and Development, UCC

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**PART 2**  
**WINE AND OLIVE OIL**  
**COOPERATIVES**



# FAIR TRADE AND ETHICAL PROJECTS: NEW CHALLENGES FOR WINE CO-OPERATIVES?

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## 1. INTRODUCTION

Fair trade and ethical sourcing are of increasing social relevance. Even if it remains a marginal niche within international trade, such concepts are applied to a growing number of sectors and diffuse from North-South to North-North trade, pushed by the development of “responsible consumption.” In the case of agrifood supply chains, co-operatives are involved in these new trade relations, at production, trade or consumption levels. They appear indeed as specific organisations assuming such values as equity or democracy requested by “responsible consumers”. However, questions occur, especially in the wine sector, about the effective conditions and ways of control of their involvement in ethical initiatives. In France, wine co-operative directors have asked social scientists to assess their capacity to deal with such a movement. Viewing it as a means of integrating people with few resources in economic projects, policy-makers are also taking part in the debate about fair trade and ethical sourcing. However, due to growing critiques, there is a need to develop sociological and economic analyses that address both the soundness of such concepts and the relevance of co-operatives as ethical trade leaders when applied to Northern situations. Taking Languedoc (France) wine industry as an example, our paper offers an overview of this debate.

Firstly, we present the main issues of fair trade, ethical sourcing and responsible consumption in Southern and Northern countries. In the second part of the paper, we analyse from an historical perspective the evolution of Languedoc wine co-operatives projects and the expression of co-operative ethics at each step of their development. In the third part, we discuss the nature of an ethical project, its current conditions of development in wine co-operatives and suggest operational proposals.

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## 2. FROM ETHICAL INITIATIVES TO RESEARCH-ACTION PERSPECTIVES WITH WINE-COOPERATIVES

### 2.1. Forms and challenges of fair trade terms and organisations

Fair trade occurred as an alternative to conventional trade said to be “unfair” towards Southern nations. It was developed in the mid 1960s by Oxfam, a non-governmental organisation, pursuing the challenge of “Trade not aid,” referring to trade with developing countries. The objective was to guarantee a better income first to artisans and then to small-scale farmers in the South by short-circuiting trade middlemen, asking consumers to voluntarily pay higher prices and developing new outlets sustained by “fair shops,” as alternatives to supermarkets. In such a system, producers propose products respecting material, environmental and social quality standards, but also adapted to Northern sanitary norms and tastes. Consumers pay a “fair price”, higher than the international rate or production costs. This price includes generally the payment to the producer and an additional aid for local development and collective actions. Moreover commands are often pre-paid, for facilitation and guarantee. As fair trade thus deals with equity, solidarity and empowerment, a privilege is granted to producers’ “democratic groups,” often co-operatives in practice, with which contractual exchanges have been developed, initially by Northern fair trade shops, and now by more and more numerous supermarkets (Daviron *et al.*, 2002). Certified fair trade represented 400 billion euros in 2003, 0,01% of market shares within international commodities exchanges (OCDE).

By highlighting Southern small-scale producers poor living conditions, fair trade proponents support wider or complementary movements to promote “ethical sourcing.” Whereas fair trade focuses on trading terms and small producers, ethical sourcing is concerned with the work place, highlighting the welfare of producers and promoting “socially responsible” firms sourcing from developing countries (Barrientos, Blowfield, 2001). Developed from the 1990s and issued from social lobbies towards “Third World exploiter” firms like Nike, ethical trade is primarily undertaken by multinational brands or retailers, especially in food, textile and beauty sector (e.g. Nike, Body Shop, Ben & Jerry, etc.). It also involves the use of codes of conducts (based on ILO, International Labour Organisation) to ensure that suppliers meet minimum standards of employment, worker welfare and aspects of human rights standards. In the UK, the approach is well known through the “ethical trading initiative.”

As an important element of this general trend, a social movement towards “ethical” or “responsible” consumption is growing and the use of this concept is progressively extended to Northern products and firms. People are increasingly concerned by the social and/or environmental quality of the products they purchase. In France, for instance, 38% of people surveyed claimed to base their consumer choices on the “citizen engagements” of the productive firms : no child labour, national sourcing, labour standards respect, no polluting processes. Half of those surveyed claimed to be willing to pay 5% more for products respecting these conditions (Credoc, 2002).

Recent boycott campaigns towards Northern firms that had polluted or laid-off employees (for example, the French firm Moulinex) confirm the call from consumers for ethical sourcing in the North as well as in the South.

However, fair trade is argued to improve the power of Northern consumers rather than of Southern producers, to create price distortion and exclusions within local production territories, whereas ethical trade appears to be mainly a communication theme, without strict controls (Du Toit, Ewert, 2003). Indeed, simple reference to “democratic groups” or ILO standards is not enough to ground serious leverages for the transformation of international trade rules, especially within North-North trading exchanges. Many initiatives throughout the World “surf” on the ethical wave to build a renewed image and thus “attach” more consumers. There are, however, a huge diversity of practices and projects, among those claiming ethical production of goods and services. In order to be consistent with the objectives of sustainable development defined in the Rio Agenda (1991), economic regulations increasingly include the concept of the “social responsibility of firms,” which requires their engagement to take in account the economic, social and environmental impact of their activities with all concerned stake-holders. However, indicators are very general, with minimal requirements. Moreover, they have been produced for large firms, whose subsidiaries and contractors are not always evaluated through such indicators. Whereas private brands or NGOs are inclined to propose numerous panels of specialised labels to indicate ethical standards, policy-makers tend to set up an overall array of public norms meant to integrate and control the different dimensions of ethics. In addition, different actors carry out the project to strengthen the concept of ethical sourcing and trade by crossing commodity chains and territories.

Before assessing the legitimacy of wine co-operatives in such an ethics movement, one has to better understand the diffusion, in contemporary societies, of “fair” initiatives working towards better social integration.

## **2.2. Hyper-modernity and ethical movements**

In Northern countries, embedded in the wave towards “sustainable development,” new requirements related to “quality” appear as a trust crisis between consumers, producers and science (Joly, Paradeise, 2003). The consequences of over-production, the recrudescence of sanitary crises in the last ten years and the development of biotechnologies have led to the emergence of a new type of actor, the “citizen-consumer,” concerned, even anxious, about the environmental and social quality of the products she purchases.

More fundamentally, one has to refer to macro-sociological analyses about societies’ evolution to assess such new behaviours. The modern society following the last century’s industrial revolution (Weber, 1922) has evolved towards a post-modern society from the 1950s. The 1950s was assessed as the era of individualism, consumption and fashion, where social classes decline and institutions are called into question (Dubet, 2002). Some philosophers and sociologists thus interpret the

current ethical wave as a reaction to the negative consequences of post-modernity : loneliness, anomy, loss of sense, anxiety, etc. According to these scholars, a new period has developed since the 1980s, also called “hyper-modernity,” wherein individualism includes a humanist dimension in order to find sense again (Lipovetsky, Charles, 2004). In such an era where auto-control processes substitute for traditional framing social institutions, responsible behaviours are strengthening around fundamental human rights and altruism. Feelings and traditional values reappear, such as disposition to sociability, voluntary work, moral indignation towards violence, valorisation of love and solidarity. Such values are materialised through the exponential increase of local associations or through demonstrations about societal and political issues, such as war, lately. It arises with the emergence of new kinds of institutions, more labile and circumscribed, purportedly aiding cohesion and guaranteeing justice (Forsé, Parodi, 2004).

The hyper-modernity is thus grounded in the concept of “ethics,” as developed by Ricoeur (1994). According to Ricoeur, ethics consist of “individual behaviours aiming at a good life, with others, and in fair institutions.” As well as in the post-modernity era, hyper-modernity means identities built around consumption models. However, within them emerge new figures concerned with “responsible consumption”. In that sense, ethical consumption may not be only a fashion but may reflect a deep change in societies (Bajoît, 2003). However, one has to be aware of all possible negative consequences due to irresponsible behaviours, which constitute the other face of hypermodernity, due to the decline of social control meta-institutions. Nevertheless, insofar as identities of people are built into trading forms, and as policy-makers and economic actors call for a reflexive analysis around ethics forms and challenges, a frame of analysis is required.

### **2.3. From social demand to research perspectives about ethical organisations**

Although set within a broad societal movement towards ethics, pragmatic questions could be raised, such as those that arose within the wine co-operative sector. Both motivated and perplex when confronted with the huge diversity of ethical initiatives throughout international markets, the board of directors of the Crouzeilles wine co-operative (area of Madiran AOC wine) contacted us about their “legitimacy,” their role and the extent of flexibility within such a movement.

Southern co-operatives emerge as key figures in the organisation of fair trade, as ethical organisations promoting solidarity and small-scale producers’ empowerment. But Northern co-operatives, as they benefit from Northern living and production conditions, do not immediately appear as a natural partner of Northern consumers. Despite their formal democratic status, they call for a discussion about the domains of responsibilities and types of practices needed from co-operatives to be recognised, and possibly labelled, as socially responsible firms respecting fair trade and ethical



sourcing principles. This social demand raises the question of an appropriate frame of analysis, for which we suggest the sociology of organisations, conventions economics and economic sociology :

a) The production and marketing of wine in a co-operative are made of a specific array of actions and constitute an “organised action system” (Friedberg, 1993). This central concept is core to the *sociology of organisations* and allows the study of a wide range of situations where collective action is at work, from formal organisations to loose groups, bridging different levels of the studied phenomena. Entangled in enduring rules or changeable norms, interdependent actors need to co-ordinate their action with others, following strategic rationalities that may encompass different values such as solidarity, equity and justice. Finally, their own objectives partially overlap with the goal of the collective action to which they commit themselves.

b) The French research program of *conventions economics* is revisiting the economic models of firm and markets, demonstrating the necessity of collective forms of assessment, taking account of the notion of convention. This notion is defined as “a social representation on what could be argued, if required,” allowing “a satisfying level of co-ordination, inside the relevant collective identity” (Favereau, Lazega, 2003). Following a comprehensive approach, conventions could be analysed as solutions to economic co-ordination problems within various “organised action systems,” for example in a co-operative or along the commodity chain. Conventions enable “rationally limited” actors to qualify the transaction goods and establish the required behaviour rules through successive “trials of assessment.” They are illustrative of various principles of justice, mainly referring to domestic, industrial, merchant or civic “world” (Boltanski, Thévenot, 1991). Analysing the possible involvement of wine co-operatives in ethical projects and trade highlights the set of evolving conventions founding the organisation and its marketing chain.

c) By assessing markets and organisations as social networks shaped by values (White, 1992), *economic sociology* allows a complementary analysis. It prompts us to consider how “positions,” as specific relational profiles, rather than actors themselves, are built and evolve throughout economic dynamics. The challenge is then to distinguish and characterise the relations linked to the development of ethical trade initiatives, especially the “partnerships” claimed by consumers or firms managers with producers or previously neglected “stake-holders.” In that sense, “previously disadvantaged people” are no longer only characterised by poor level of economic resources, but also by their degree of insertion within power, information and trade relations. Then, one has to assess in what way ethical initiatives actually improve their positions in relevant networks allowing both the fixation of “just prices” in a context of incertitude about quality and the “attachment” of consumers. However, economic sociologists emphasize the mobilisation of specific skills (Favereau, Lazega, 2003) in the building and the management of such networks. The challenge may be then also to highlight the cognitive dimension of ethical organised action systems, through skills and conventions associated with them.

### 3. ETHICS IN THE CO-OPERATIVE PROJECT: HISTORICAL PERSPECTIVE IN THE LANGUEDOC WINE SECTOR

#### 3.1. The first wine co-operatives (1900-1930) : economic projects, social assertion, local and class solidarity

The first Languedoc wine co-operatives were created in 1901 by small winegrowers, in the context of a very strong wine market crisis. The “free winegrowers of Maraussan” case illustrates how ethical perspectives have been strongly linked to the economic and social issues of these organisational innovations. Documents and information about collective decisions collected during this period (Tarbouriech *et al.*, 1996) show how the founding members were presenting and building their project.

a) They mentioned that wine regrouping will improve their incomes, citing two reasons:

- The existence of better and more regular prices through more negotiation power with traders and by progressively “cutting out parasitic retailers and selling directly to consumers”;
- Better control over the wine quality and reduced technical risks and costs, first by “storing and transporting wine by their own means” and then by “processing grapes in a common cellar.”

These economic arguments clearly rely on the perception of both market and technological scale economies (Temple *et al.*, 1996). They were initially set as principles, but the recording of discussions between founder members suggest that these arguments were unfounded at the beginning. Nevertheless, first investments decisions were associated with an increasing turnover and showed that the project could be economically viable i) the co-operative bought horses, rail tankers and wine warehouses near Paris, ii) a new collective cellar was built in 1905 in front of Maraussan rail station, iii) wine prices awarded to members remained attractive and marketed wine volume increased until 1914.

b) These economic targets and activities were completed by a more implicit, but perhaps more powerful objective. The small growers wanted to assert themselves against the largest employing landowners and the traders who allegedly cheated them. Signs of this social assertion objective are numerous : the name of “free winegrowers” given to the co-operative, leaflets reproducing traders’ advertising, and the will to build the highest wine cellar of the village This collective assertion is based on mimetic mechanisms, with the landowner or the trader at the same time the rival and the model (Girard, 1983). It can also be interpreted as a means of building a new social status within local networks, but also within wine market networks.

Indeed, first co-operative texts identified more generally the collective project with the “emancipation of small growers within the wine industry”<sup>2</sup>.

Grouping wine for marketing and processing grapes in a common cellar have proved to be a successful innovation, aiming at economic and social assertion objectives. But formal rules, conventions and routines, that allowed and stabilised the action system, were also linked to ethics, extending their concerns at both local and “class” levels.

\* First, solidarity, democracy and support to education were explicitly promoted and implemented within the organisation. Ethical identity of Maraussan co-operative was affirmed by the motto written on the frontage of the cellar : “all for each one, each one for all.” In that case, the term “all” could be interpreted as restricted to the selective circle of the co-op members. Formal internal rules also expressed the democratic and “non capitalist” options of the organisation : i) decisions have to be taken following the principle “one man, one vote,” ii) co-operative benefits are distributed according to the wine volume delivered by each member, iii) the amount of grape that can be processed per member is fixed in order to support the small growers. Moreover, ethical principles were perceptible in many other rules or actions and have been extended within the local community:

- Pragmatic decisions led to introducing more equity in internal rules, recognising members specific contributions to the collective project, e.g., i) a “commission” was given to members who found new markets, ii) four wine qualities were distinguished by a tasting committee and paid by different prices.
- Some co-operative rules or decisions were specifically issued to promote mutual assistance between members : i) 35 % of the benefits were dedicated to a local “development fund,” ii) mutual help for sick or absent members was organised, especially during the First World War.
- Moreover, an explicit involvement in local solidarity and development actions was implemented through other organised action systems, presented as “auxiliary organisations” of the wine co-operative : i) the “Farmers Union” supplied growers with agricultural inputs, ii) the “Maraussan Union” was a very active consumers co-operative, iii) the “Rural Credit Local Branch” was providing credit, ensured by the regional co-operative bank, iv) the “Proletarian Beehive” invested in “small but clean houses” rented to wine growers families.

Thus, ethical concerns were core to the Maraussan co-operative project, integrated in a political perspective. Responsibility seems to have been extended to the whole

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2. Maraussan co-op has got a specific “status” in French political movement when Jean Jaures, leader of socialist party, visited the village and published in 1905 a well known article titled “The wine of the social revolution”.

local community, perhaps in order to integrate more members<sup>3</sup> in the co-operative networks or to become (collectively and individually) “great,” according to prevalent civic and domestic local conventions.

\* Secondly, Maraussan co-operative project and actions also referred to a more extensive area of solidarity, “popular classes,” which include French workers and (small) farmers. This category has been defined and idealised in socialist ideology and fitted the general perception of identity in many popular movements. Actually, the co-operative was producing basic wine, drunk by popular social classes. Thus, new markets were developing along with the development of an ethical behaviour. Indeed, this solidarity extended to all popular classes, in the case of Maraussan, it took a very concrete dimension, converging with its economic and marketing actions:

- The co-operative aimed at “providing consumers with natural wines” and at “connecting small wine growers and workers through the co-operative movement.” Maraussan succeeded in selling an important part of its wine to consumers’ co-operatives. This involvement led to the inclusion of internal rules that stated that 25 % of the co-operative benefit must be given back to consumers whose delegates were also invited every year in order to learn about real conditions of production.
- Moreover, Maraussan directors decided to support the development of the socialist co-operative movement, and some members actively participated in regional meetings, promoting the creation of wine co-operatives in other villages. The solidarity with “popular classes” has been extended to a “national solidarity” during the First World War, when the co-operative made a donation of 200 000 hectolitres to the French soldiers (mainly coming from popular classes). This action has been also interpreted as a clever “marketing strategy” (Tarbouriech *et al.*, 1996).

In the case of Maraussan co-operative, ethical principles (solidarity, democracy, social progress) were integrated in rules, conventions and routines through a pragmatic confrontation between local inherited conventions coming from local networks (worker groups, previous associations, mutual help relationships between neighbours or within families) and the socialist ideology brought by leaders such as Elie Cathala (Gavignaud-Fontaine, 2001)<sup>4</sup>. In the emergence of the first wine co-operatives, ethical principles can be considered as a source of co-ordination and networking within the economic organisation and among its marketing chain, reducing uncertainty but also promoting such a social experience at the national level. The nature, the role and

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3. In 1905 the co-operative numbered 230 members among 280 winegrowers in Maraussan.

4. In other regions, religious moral played the same role in the agricultural co-operatives emergence (Desroche, 1976).

the extension of these principles have been clearly determined by the historical context (wine market crisis, juridical acknowledgement of associations, evolution of political ideas and social movements), but also present many similarities with present day fair trade principles : local solidarity and democracy, direct relations and solidarity between producers and consumers, transparency and fair price within the commodity chain.

### **3.2. The development of the table wine co-operatives (1930-1980): mass production and regional corporate solidarity**

The expansion of the co-operatives cellars in Languedoc started after the First World War. Their number dramatically increased in the 1930s, reaching 550 in the 1970s. The number of members per organisation was also growing, in such a way that co-operatives took a dominant position in the Languedoc wine industry, producing at least 75 % of its wine. What conditions can explain this development and how could ethical principles have influenced it ?

a) Firstly, the co-operative's expansion was influenced by a more favourable context. Facing a possible repeat of the 1900-1907 national market crisis, the French government and regional wine leaders gradually negotiated the construction of a specific wine policy, aiming at the control of the wine supply by establishing "planting quotas" and rules which could frame the sales. In this new perspective, co-operatives were considered as possible tools for implementing this economic policy, instead of rebel organisations, as the "Free Winegrowers of Maraussan" were considered before 1920. Subsidies and fiscal advantages were accorded for co-operatives' development and were increased in 1936 by the "Front Populaire" government, politically aligned with regional voters.

b) In this context, the economic utility of joining a co-operative was strengthened and economic projects were converging towards the same organisational model : the "village table wine co-operative". Directors and workers were appointed to manage the wine processes ; the members of the co-operative delegated the wine production to them and specialised in grapes production. It resulted in a progressive objective and cognitive separation between the growers and the co-operative staff within this mass production organisation. Technological and commercial scale economies were established and reinforced by the first co-ops references and government subsidies. These economic arguments were strengthened after the Second World War when changes in farming systems implied new investments both in the vineyard and wine processes undertaken in the co-operatives. As a result of this opportunity, medium winegrowers became members of these organisations.

c) As we noted in the Maraussan co-operative, economic utilities were also complimented by social assertion objectives. The mimetic mechanism existing between small growers and the biggest wine producers also existed between neighbouring villages (Bort, 2003). Indeed, at this level, it often produced a rivalry that seems to have been more powerful than the need for inter-co-operative strategies.

Each village wanted to get the biggest and highest wine co-operative cellar. The co-operative became an institution, a symbol of the local identity for each village of the Languedoc plain.

d) With regard to ethical concerns, the same formal co-operative rules were followed, according to the evolution of the national juridical status of these organisations (Fontaine, 2003). The basic principles of democracy, responsibility, territory linkage and solidarity between members (e.g. in terms of capital) have formally shaped social interactions within the wine co-operatives. In many cases, we also note specific actions that reveal solidarity between members and extended further to the local community, as we found in Maraussan. We also noted many changes:

- The specialisation towards table wine production has changed the nature of conventions and ethical values. It strengthened egalitarian principles and limited references to equity : only one kind of wine was paid according to a very basic criteria, its alcohol degree and at a “political price.” Hence, members specific skills or assets were not acknowledged. Indeed, in the “mass production world,” industrial conventions are prevalent and fit with egalitarian principles (Salais, Storper, 1993). Finally, grapes and vine-growers tend to be valued as interchangeable production inputs and this presents an important weakening of ethics wherein *alter* is considered *per se*.
- The frontiers of the “ethical space” also changed : solidarity towards the “popular class” and consumers was relevant to fewer co-operatives. Through specialisation of tasks, relationships with consumers were carried out by retailers and traders who mixed Languedoc and Algerian wines. Temporary market crises could also be alleviated by corporate negotiations and lobbying rather than by new market niche investigations. Then, direct selling, connection and solidarity with consumers seemed to be less necessary. Moreover, the dynamics of the socialist ideology itself was changing in the society. The social representations linked to “popular classes” were not as wide spread as they had been previously. In fact, they could appear more repellent than attractive to potential members. Thus, the weakening of this ideological conditions opened the opportunity of integration for more vine-growers.
- However, this reduction in ethics along the vertical dimension of the value chain has been “substituted” by its regional enlargement, as a horizontal trade-off. The defence of “Languedoc wine” was the main objective in the 1970s and led to the institutionalisation of the corporate movement, initiated during the regional crisis in 1907 (Touzard, 2000). Departmental co-operative associations, connected with the regional wine growers union, regularly negotiated with the State and, if necessary, organised mass demonstrations.
- Another reduction in ethics occurred within the wine co-operatives. In many cases we note, specially during the 1970s and 1980s, an increasing gap between members and the staff, between vine-growers’ groups inside the co-operative

and, more generally, between founding ethical principles of the organisation and social practices of its members. The management of wine co-operatives became nepotistic in many cases (Chiffoleau, 2001), referring more to domestic and industrial conventions than to the former civic conventions of the co-operative movement.

In sum, during the 1970s, the co-operative projects were institutionalised through a mass production model, linked to the local space, formally oriented by the co-operatives' founding values, but hiding important "lock-in effects," such as dependency to mass technology, restriction of varieties in the production system, specialised routines and references to industrial and domestic conventions fitting with egalitarian principles.

### **3.3. Wine co-operatives facing globalisation and quality requirements : toward new economic and ethical projects ?**

Recently, tremendous transformations in the economic and political context skewed table wine co-operatives' trajectories and destabilised their regional corporate governance, opening opportunities for a wide diversity of strategies and projects.

a) Changes have simultaneously addressed different dimensions of the wine co-operative context:

- Societal changes in ways of life, such as driving habits, health concerns, etc., a decrease in the number of manual workers, rising incomes, demographic effects, etc., led to a strong reduction of table wine consumption in France.<sup>5</sup> It also led to a shift from table wine to "quality wines" consumption, i.e. more aromatic and with a well defined origin (specially AOC wines like Bordeaux). Moreover, the definition of wine quality progressively integrates new attributes such as environmental-friendly concerns and landscape management, health issues and traceability, packaging innovation, cultural image, as well as ethical concerns.
- French integration in the European Agricultural Policy, the enlargement of the European community and the wine market internationalisation modified the conditions of competition and political negotiations for Languedoc wine co-operatives.
- The development of the regional economy, based on new activities, pressured vineyard areas and reduced the economic and political regional weight of the wine industry to less than 5 % of the regional PIB in 1995.

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5. From 120 litres per adult per year in the 1960s, to less than 70 litres currently.

- The evolution of the co-operative juridical framework offered new opportunities, for instance for creating subsidiaries.

As a consequence of these changes, table wine prices and vine-growers' income decreased and a new economic policy was drawn up, including subsidies for the uprooting of vines, obligatory distillations, and incentives for replanting with aromatic vine varieties and for technological investments in co-operatives.

b) In this more open and changing context, Languedoc wine co-operatives chose to follow divergent directions : some of them tried to keep producing table wine without changing the inherited organisational model. It generally resulted in the reduction of costs and investments. This defensive practice led in many cases to "exit trajectories" both at the co-operative level (implicit bankruptcy and absorption by a neighbouring co-operative) and individual level (members leaving the co-operative in order to develop their own estate). But the majority of table wine co-operatives progressively engaged in "innovation trajectories" which included a large diversity of combinations between new activities (along the processing and marketing chain but also in tourism and local development), new wines (AOC or variety wines), new internal rules (e.g. for grape payment) and new economic or marketing alliances (Touzard, 2002).

An analysis of these innovation strategies showed that economic objectives and arguments have radically changed (Chiffolleau *et al.*, 2002) :

- The economic project deals with many fields of innovations which must be combined and tested in the new context. It introduces a new perception of risk in economic decisions that leads to the implementation of new kinds of control as bilateral contracts or labels. It also underlines the fundamental role of new factors of production such as knowledge in each field of innovation, but also in project management, social capital, information, culture and values. The following are the new strategic resources for post-industrial firms (Cohendet, Llerena, 1990).
- Former references to scale economies have changed for co-operative cellars : "critical size" of the co-operative clearly became relative to the kind of wine, the activity or the choices of the alliance.
- The efficiency of a project combining complementary fields of innovation is also determined by actions and networks to signalise this specificity.

c) In such a diversity of economic strategies and objectives, social assertion objectives seem to take ambivalent forms. The positive identity of table wine production disappeared both for growers' groups in each co-operative and for the regional corporate movement. It can be analysed as an internalisation by consumers and the media and politicians' repeated negative assessment of table wine. In many cases it means that the wine co-operative no longer fits a social assertion project. Members are ashamed of their co-operative and thus their involvement has diminished or is



limited to economic opportunities. But in fewer cases, a new identity has been built through new collective projects toward quality wine production. In these cases, the relation with prescribers' positions (wine writers, famous buyers, etc.), due to the implementation of new technical practices and personal involvement in networking, often allows the social construction of a new collective and individual status, objectified through awards, that can strengthen the economic project. Beyond those developments, some co-operatives, already committed to quality wines, aware of their ethical tradition, consider the current ethical trend in economics and society as an opportunity to renew and strengthen their social assertion.

## **4. BUILDING ETHICAL PROJECTS IN CO-OPERATIVE CELLARS**

### **4.1. Co-operative cellars as a social movement**

Through the different phases of their history, wine co-operatives develop their activities within an overt or tacit ethical framework. Indeed, co-operative actions ultimately are meant to contribute to *a good human life, with and for others, in just institutions* (Ricoeur, 1994). During a first phase of development, co-operatives enacted their ethical commitment to being part of the social movement of the early industrial society, oriented towards the central conflict of this era, capitalists vs. workers, calling into question the social control over historicity. The creation of just institutions was challenged and co-operatives were themselves a fundamental component of this process and message. During the productivist era, co-operatives, like the whole society recovering from the war, were primarily concerned with material production and distribution. They operated at the strategic instrumental level of action, backed by a strong political lobby and under the shield of favourable economic regulations. Currently, the whole society, in the midst of globalisation, faces new challenges and new debates that claim the creation of new meanings and a reinterpretation of norms and values to face the requirements of problematic social integration. The field of debate has been extended from the political arena to civil society and culture (Touraine, 1984). Wine co-operatives are standing at a turning point in their history. On one hand; rooted in their rich experience as a significant actor of a once powerful social movement, they may use this inheritance to contribute to the struggle for the control and the definition of a renewed historicity, enacting its ethics in the framework of new social movements. On the other hand, they may wish to unload the burden of the past and shift toward more usual firm management practices.

### **4.2. From conviction to consequential ethics**

Conviction ethics is based on a set of moral laws or formalized norms, abstract and independent from real situations. It considers action according to these forms

of laws and norms with little concern for the consequences of action. Co-operative ethics, from a convictional standpoint, means to respect and enact rules and norms as fixed in the status and contracts and by which cellars shall provide good human life to their members within just institutions. Facing the new requirements of the markets, the new attributes of quality (increasingly including social and environmental sustainability), the consequent multiplication of new tasks well beyond the production of grapes, rules and norms have to change and co-operative cellars now must acknowledge the different potential contributions of their members. Equity between members within this new economic context, as a consequence of the co-operative formal set of rules, requires then an adapted remuneration system that also accounts for the cleaning of dykes, the organisation of co-operative events or the short-circuited marketing of products. Distribution of satisfactorily incomes to the members is another important part of co-operative convictional ethics. In that sense, engaging themselves in an explicit ethical project may be a strategic decision of the board, aware of the changes in their economic environment that currently call into question the responsibility of the firm and put a strong emphasis on transparency. Thus, an ethical project may easily appear as a utilitarian move, aiming at the overall enhancement of the cellar economic efficiency.

At the current stage of knowledge and development, worldwide, another aspect of ethics, following a consequentialist approach of ethics asks to extend its concern to what is known as sustainability, covering three domains of accountability : economic, environmental and social. Fair trade, as described above, is a way of enacting modern ethics, wherein consumers and distribution agents include in their solicitude (Ricoeur, 1994) a wide range of stakeholders, in distant territories all over the world. When it comes to co-operative cellars, due to their history, their agricultural activities and their status, they have always been deeply and durably embedded in their local, physical and social environment. Hence, consequential ethics are most relevant to the territory in which they operate. Within this area, solicitude may be extended to members and employees as well as to people affected by the co-operative activities. Moreover, it may reach the different users and inhabitants of the common space and their following generations. Then the cellar has to reach an agreement about the limits of the area of its responsibility. It requires the acknowledgement of unfair and exclusive behaviours, their identification inside and outside the formal organisation and the identification of the most exposed stakeholders within this area, in order to promote justice in institutions and quality of life around them. Co-operative cellars are not havens of peace. Power issues often bias their democratic functioning. For instance, the ones who bring in a small amount of grapes or the part-time workers are not always considered as real producers. Youngsters unable to take over the farm from their elders, unemployed residents without economic means or social relations and often moonlighters in the vineyards, elderly people whose knowledge is usually discarded may prove useful and complementary to others. However, these people have no input in the collective decision process although they contribute to the final efficiency.

### 4.3. The building of an ethical project

First an ethical project is a project. In that sense, it is a figure of collective action that have been widely studied by sociologists or management scientists. It develops through crossed learning processes that occur in various part of the project structure. It may be directed both inward and outward. The actors benefit from the increasing knowledge produced through relevant networks bridging complementary positions (White, 1992) relative to the project. It activates social capital to invest in human capital and increase the collective efficiency.

Thus, an ethical project is oriented to the enaction of ethical principles, that is to say, the extension of the group solicitude toward other positions. Their identification is the touchstone of such a project. Nevertheless, solicitude does not mean charity (trade but not aid). A diagnosis has to identify existing skills and lacks of skills (to be developed through training policies) in the perspective of a renewed or extended productive project (goods and services). Hence an ethical project, in the contemporary situation, has to place the emphasis on job creation and on the mobilisation of a large array of skills. An ethical project is concerned with ethics in the methods as well as in the goals. Co-operative cellars may import and adapt standards and codes (SA 8000, ISO 14000...) that are judged relevant to their own environment or they may build this set of rules through different processes. In either case, the respect for others that lies at the base of every kind of ethics and the actual contradiction that may appear between different conceptions of ethics lays claim to the discursive design of the project (Habermas, 1998). Thus, at each step, stakeholders of the process should be able to present their own representation of the situation to be transformed and about the intermediary states of the ethical project. Evaluation, anticipation, diagnosis and choices must be made. Whereas firms usually appoint a specific committee backed by external experts to build their ethical project, the co-operative *modus operandi* is based on equality in participative decision. Thus, the co-operative institution, in itself, provides the ethical methodology. Nevertheless, members and other stakeholders are entangled in a set of strategic interdependencies that may impede the decision process. Moreover, the cellar cannot commit itself to such an endeavour without building alliances with other local agencies like municipalities, other co-operative organisations, solidarity associations and any kind of local group dedicated to the reduction of poverty and exclusion. Hence, co-operatives are also bound to hire social scientists in order to create conditions for reflexivity within the project building process and to facilitate the enlisting of new partners. Indeed, sociology of organisations and convention economics provide relevant tools to assess the different positions regarding the project, to open spaces and to organise discussion in order to arrive at a common definition of the project ethics and its area of responsibility.

Construed by social scientists as a system of organised action, the project evolves insofar as new actors are interested and "enlisted." A specific stress has to be put on downstream stakeholders and specifically on consumer organisations in order to highlight their different expectations, values and knowledge about ethical production

and consumption, to identify dedicated places, fairs and other commercial events in which alliances can be made.. Distributors and retailers are very diverse, engaged in the building of different images, aiming at different categories of consumers and striving to shape their behaviour. Among them, several organisations are already structured according to co-operative principles and share the same basic values as wine co-operatives ; they are already partners of numerous producers' co-operatives in the South and may appear as relevant partners in the development of ethical projects in the North. Supermarkets in general are often banished by fair trade leaders, even if some of them may be "just" partners. That prompts us to look beyond the formal market status to assess the relevant positions of potential collaborators.

Formalisation of the outputs of the process at different stages is key to its durability and enables the minimising of different biases already mentioned. These documents, often referred to as codes, may be shaped as a list of objectives, a set of rules and procedures, standards and norms. Throughout the different steps of elaboration of the ethical projects many drafts are to be produced and will serve as many intermediary objects (Vinck, 1999). Such objects enable the different stakeholders engaged to focus the discussion on explicit items. They will help further adaptation through inner discussion. They will also enable discussion with outsiders through communication policy. Outsiders may be seen as actors not yet enlisted in the ethical project development. As seen above, outsiders may be directly related to the economic aspect of the project (e.g. consumers, middlemen, traders) or to other components of the social movements in which co-operative ethics are rooted.

Such a process, enlisting new positions at each step, adapting its design with newcomers, backed by appointed experts, makes any precise anticipation about its stabilised form difficult. In a given territory and within a social movement, there is a high degree of heterogeneity among actors. Their different potential connection may bear a wide range of outputs. Thus, one must accept that the final outcome is unknown and that the process is more important than the goal. Ultimately, developing an ethical project provides an opportunity to shape new social capital and, consequently, human capital.

## 5. CONCLUSION

When located in the South, co-operative organisations are widely considered a priori as "legitimate" actors in North-South fair trade. When located in the North, they must prove that they do provide the just institutions that ethics oriented Northern consumers wish to support when buying goods. Languedoc wine co-operatives present some sound arguments, built throughout one century of their history. However, the current difficult context may drive some of them to ignore some founding ethical principles and practices, following the dynamics of second generation co-operatives that select their members based on efficiency (Nilsson, 1997). Hence, the "justice" within the cellar will never be given and final, which calls for a permanent effort to stimulate reflexive activities, the basic constituents of the action-research methodology.

Indeed, in the matter of research, the specificity of co-operative organisations engaged in complex innovation processes, among which is the renovation of their ethical framework, address different trends in social sciences. Wine in and of itself raises specific questions. The health risk associated with this product makes some wine producers doubtful about such an opportunity. In a scientific perspective, it joins a research question raised by economic sociologists notably, that stress how market relations may be influenced by the nature of the commodity exchanged (Di Maggio, Louch, 1998). Wine is nevertheless one of the products of concern to the UK ethical trading initiative, for instance wine co-operatives operating in South Africa (Ewert, 2003). Therefore, comparative analysis is needed to highlight the different lessons that could be drawn from this experience. We thus are developing the analyses of the South African cases (Dreyfus, 2002) to assist our French partners to obtain data in order to make decisions around whether or not to engage in ethical trade.

Finally, it appears that the problematic situation put forth by some stakeholders (practitioners) and the research agenda of social sciences may be articulated in a process of action research. Indeed, action research is often related to a mutually acceptable ethical framework for researchers and stakeholders, which perfectly fits the ethical goals and methods of the project building. Moreover, the process of action-research itself, consisting of cycles of four major phases of planning, acting, observing and reflecting (Masters, 1995) overlaps substantially with the building process of an ethical project. Consequently, practitioners and researchers are prompted to commit themselves to an ethical, action-research backed project, bound to bridge different levels and to enlist a variety of positions not yet identified, locally or more distant. This array of actions and social interactions may be seen itself as an organised action system, aiming at the production of both scientific knowledge and practical solutions through deliberative and reflexive activities.

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# MANAGING TO SURVIVE: INNOVATION AT SOUTH AFRICAN CO-OPERATIVE WINE CELLARS IN THE AGE OF GLOBAL COMPETITION

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## 1. INTRODUCTION

Over the last decade or so the South African wine has been undergoing a radical process of transformation, prompted by three major forces: deregulation, democratization and internationalization. Of all growers and cellars, cooperative wineries faced the greatest challenge as they were the ones who had been sheltered by a regulation regime in force between 1918 and the early 1990s. The main components of the regime were a minimum price for wine, planting quotas and 'surplus removal'. The biggest cooperative of them all, the KWV<sup>1</sup>, was both producer and regulator by law. It also possessed the monopoly on exports of South African wine.

However, regulation, protection and special treatment by the old government came to an end for all practical purposes by 1992. Left without any coordinating body or overarching strategy, every grower and cellar – including the cooperative wineries – had to find its own recipe for survival and the road ahead. Because they never had to deal with the market in the past, most were to find this a very trying process.

Starting from very small volumes in 1993, the share of South African wine in an important market like that of the UK has grown to over 9%. Although a handful of coops have seized to exist and others are fighting for survival, a number of others have made the transition with a fair measure of success. To illuminate the steps taken, the measures adopted and the mistakes made along the way, is the main purpose of the paper. It does so by using a number of case studies from different regions of the industry.

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1. Cooperative Wine Growers of South Africa. It converted itself into a company in 1998.

However, before the detailed description of the cases, the paper looks at the erstwhile regulation regime in order to contrast the new era and its particular challenges. This is followed by an analysis of current production and market trends and a scan of the new institutional environment of the South African wine industry. The paper ends with a number of conclusions to be drawn from the case studies.

## 2. THE BURDEN OF THE PAST: THE REGULATION REGIME AND ITS LEGACY

One of the most noticeable features of the South African wine industry between 1917 and the mid-1990s was its elaborate regulatory system, presided over by the KWV. Planting quotas, minimum prices and mechanisms of 'surplus removal' decisively shaped the dominant features of the South African wine industry for the greater part of the 20<sup>th</sup> century.<sup>2</sup>

At the level of primary production the central part was played by the co-operative cellars, which came to dominate wine production. Most of these implemented a 'pool system' in terms of which grapes of a particular cultivar were sold in bulk, with farmers being paid according to the number of tons delivered and the selling price realised for the pool as a whole. An important objective of every co-operative was to realise the highest possible financial return ('payouts') for its members.

Co-ops were also linked closely to the networks of white power in the Cape region of South Africa. Rural civil society in the farming areas of the Western Cape was dominated by the white landed settler elite. Formal institutions such as the National Party obviously played a key role; but as important were the informal networks of filiation and affiliation between key settler families – and the way these networks allowed political control of agro-institutions.<sup>3</sup> As a result, farmers and coops alike received all kinds of special treatment from the powers that be. Not only was the regulation regime kept intact and elaborated upon – often against the demands of the producing wholesaler lobby in the industry – but farmers and their cellars were also aided by favourable tax regimes and subsidised bank loans<sup>4</sup>. Producers returned the favour by keeping the National Party in power for almost half a century.

From early on this system was marked by a high degree of downstream concentration and integration. Farmers and their co-operatives sold most of their wine in bulk to the KWV and other producing wholesalers. Although they were

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2. J. Ewert 'Co-operatives to Companies: the South African Wine Industry in the Face of Globalisation', R. Almas and G. Lawrence (eds), *Globalisation, Localisation and Sustainable Livelihoods*, (PLACE: Ashgate, 2003); G. Williams and N. Vink, 'Co-operation, Regulation and Monopoly in the South African wine industry, 1905-2000', *Proceedings of I Simposión Internacional de Historia y Civilización de la Vid y el Vino*, El Puerto de Santa Maria, vol. 2.

3. For an example from the fruit farming regions, see A. du Toit, 'Hunger in the Valley of Fruitfulness: globalization, 'social exclusion' and chronic poverty in Ceres, South Africa', Paper presented at the conference 'Staying Poor: Chronic Poverty and Development Policy' at the University of Manchester, 7 to 9 April 2003, [www.chronicpoverty.org](http://www.chronicpoverty.org).

4. However, they never received direct subsidies like growers in the EU for instance.

guaranteed a minimum price, periodic surplus production and a limited domestic market continued to favour the wholesalers well into the 1990s. In addition, the distilling industry – buoyed by South Africa’s distinctive brandy market - played an unusually important role. Not only did it help with the removal of surplus wine, but the producing wholesalers on whom co-operatives so heavily depended came to see distilling as the place where the real money was to be made: one author described the South African wine industry as ‘...a vast distillery draining a partly subsidised annual wine lake.’<sup>5</sup>

Though these features institutionalised the power and interests of the farming constituency, it also had very important consequences for the development of the core of the industry. It encouraged the development of a mass production regime that rewarded those who could deliver high volumes of low quality grapes with high sugar levels. Grape growers, protected by their co-ops’ duty to buy whatever members produced, concentrated on getting their tons per hectare high. ‘Quality’ had not yet become the hegemonic concept it was to become in the 1990s, and concepts like ‘terroir’, ‘super blocks’ (of vineyards), ‘canopy control’ etc. were not part of the co-op discourse before the 1990s. Wine makers and co-operative staff were not required to develop special skills regarding marketing. Furthermore, with capital expenditure having to be funded out of lower payouts for members (co-ops were prohibited by law from sourcing equity on the capital market), essential improvements of cellar equipment for the purpose of differentiated quality production were left to languish. In any event, with little domestic demand for quality wines and with the KWV’s statutory monopoly barring local producers from international markets, few saw any need for change.

### 3. NEW TIMES: THE DEMANDS OF THE MARKET

Given its history, the industry came face to face with novel and important challenges on the moment regulation ended. These challenges need to be very clearly understood. It is a truism in the South African wine industry<sup>6</sup> that ‘the future’ lies in re-orienting production away from bulk wine and developing the ability to produce for the quality market.<sup>7</sup> Like most truisms, it is in equal parts fundamentally correct and seriously oversimplified. Wine is never just wine, grapes are never just grapes, and the implications of ‘the demand for quality’ differ from context to context. The global alcoholic beverage market is fragmented and complex and the markets for South African wines and wine grapes are no exception.

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5 . J. Robinson, *The Oxford Companion to Wine* (Oxford: Oxford University Press, 1999), p. 648.

6. Today the industry consists of approximately 4300 growers, 66 cooperative wineries, 330 private cellars, 93 estates and 16 producing wholesalers. Personal communication, Debbie Wait, SAWIS, 28 April 2004. Although in a minority, the cooperative wine cellars produce close to 70% of the total volume of wine.

7. P. H. Spies, *Strategic Outline for the South African Wine Industry* (Stellenbosch: Winetech, 2001).

Three linked trends in the international alcoholic beverage market and its commodity systems have played a particularly important role. Firstly the global beverage industry has increasingly come under pressure, partly because of the global economic downturn and partly because of increasing health concerns among consumers. Secondly, the wine market has been increasingly affected by the growth of supermarket wine retailers, which have fundamentally changed the way in which wine is consumed and marketed. This is closely linked to the third trend, which is the increasing prominence in the premium and super premium<sup>8</sup> wine market of branded wines promising to deliver not only quality but also consistency.

Together, these trends have meant that wine markets have been characterised by increasingly divergent price trends. Low-priced blended table wines have poor prospects in a world where consumption has fallen by a quarter since 1982. In France and Italy – the bastions of working class wine drinking – consumption has halved in the past thirty years. At the same time there is a global trend towards buying better-quality wines.<sup>9</sup> While wine sales at lower price points have remained stagnant, higher price points have shown buoyant growth. At the turn of the new century the most lucrative price bracket was at over 4 pounds sterling in Britain and \$7 in the USA. In the latter market, wines selling at more than \$7 account for only 22% of sales by volume, but almost 50% of revenues. As *The Economist* put it in a recent survey of the international wine industry: ‘... [T]he message is clear: the best place is at the upper end of the market, where growth is fastest and margins are fattest’.<sup>10</sup>

The most important international wine market is Western Europe, where 70% of the world’s wines are still made and consumed. Within this region, Britain is particularly important for premium wine exporters. Unlike the parochial market of France, where imports command less than 5% of premium wine consumption, Britain is the fourth largest wine market and world’s biggest importer of wine – and supermarket retailers are particularly prominent here. Supermarkets distribute over 60% of all wine consumed in the UK<sup>11</sup>. The main beneficiary of this trend has been

8. The South African beverage industry distinguishes ‘good wine’ into ‘Standard Price’ (SP), ‘Medium Price’(MP) and ‘High Price’(HP) categories. SP wine is essentially good wine of the lowest quality – that sold at or below production costs in the infamous *papsakke* (foil bags) and soft plastic bottles. MP wine is of slightly better quality and is often sold in two-litre box format, while HP wine is often broadly categorised as anything in a 750ml glass bottle and/or with a cork (*Beverage Business Yearbook 2002*:121-123). Increasingly, however, wine industry analysts follow Rabobank’s distinction of the wine market into ‘Basic’, ‘Premium’, ‘Super Premium’, ‘Ultra Premium’ and ‘Icon’ categories. These do not refer simply to price points but also to the markets in which these wines compete. ‘Basic’ wine, comprising some 50% of the international wine market, is anonymous, with little or no linkage to vineyards or even countries. Premium wines comprise some 30% of the wine market: they are usually of better quality, often retail through the supermarkets in the “value for money” market, and usually linked to distinct brand (rather than vineyard or cellar) identities. Super premium wines comprise about 10% of the wine market and sell on the basis of quality style and perceptions about their unique identity in the market. Ultra premium wines are of highly distinctive and individual quality, and are not marketed on a mass basis. Finally, Icon wines are those whose value is mainly linked to the act of purchasing them. (See SS Loubser, ‘The Wine Business: a strategic marketing framework’ (Stellenbosch: Winetech 2001)).

9. G. Rachman, ‘The Globe in a Glass: a Survey of Wine’, *The Economist*, December 8th, 1999, pp. 97-115.

10. G. Rachman, ‘The Globe in a Glass’, p. 111.

11. The situation is similar in the Netherlands, South Africa’s second most important market in Europe. In the USA 45% of all wine is sold in supermarkets. (Rachman, 1999: 107)

Australia, which has pioneered the industrialisation of premium branded wine production; while France has traditionally had the biggest share of the British market, Australia's share of the UK wine market has risen from 8% to 15% between 1993 and 1999, while 7 of the top selling wine brands in the UK in 2001 were Australian.

South African wines have also made important inroads into this market. After the lifting of sanctions, exports increased by 1000% between 1994 and 1997, although this was from a very low base.<sup>12</sup> After this spectacular increase, export growth slowed down to 5% in the late 1990s, only to increase again by 26% in 2002.<sup>13</sup> In that year South Africa was the fastest growing wine country in the UK. In 2003 total South African wine exports grew by 10%. Last year its market share in the UK stood at 9,3% - despite ferocious price cutting from Australia and California.<sup>14</sup> And for the first time the country had a brand listed in the top five wines retailed in the UK with 'Kumala' at number four<sup>15</sup>. The share in the British market represents approximately 45% of volume of total South African wine exports and just over 50% of all bottled exports<sup>16</sup>.

This growth has contradictory implications for wine makers. The most important buyers of South African in Britain are Britain's eight big supermarket chains. To land a sales contract with one of them is a much sought after prize in the Western Cape wine lands (especially for co-operative cellars). But while these new markets mean new opportunities, they also mean tougher bargaining. Supermarkets have stringent purchasing practices. They impose strict phytosanitary and technical requirements on suppliers and – through projects like the Ethical Training Initiative - are increasingly looking to impose ethical requirements as well.<sup>17</sup> Those who cannot conform to these threshold requirements risk being left out of this market altogether.

So, although South African growers and cellars are starting to learn the rules of the market, competition is unrelenting and severe. With the threat of a surplus both at home and abroad, competition between wine-producing countries and between individual producers is bound to intensify. Much will depend on the ability to establish 'branded' wines that stand out from the rest. This requires not only the ability to make good wine, but also the ability to deliver consistency and volume at the same time. To build a brand in the UK, for instance, requires the ability to bring 3 to 6 million litres

12. J. Ewert, J. Hamman, N. Tregurtha, N. Vink, C. Visser and G. Williams, *State and Market, Labour and Land – the South African Wine Industry in Transition. Research Report* (Stellenbosch: Department of Sociology and Department of Agricultural Economics, 1998).

13. Between 1999 and 2002, total exports of natural wine climbed from 127.6 million litres to 215.7 million. Export's share of the total drinking wine production climbed from 20.2% to 38.4% (SAWIS, *Wine Industry Statistics*, 27 (2003), p. 24).

14. *Wineland*, March 2004, p.29.

15. 'KUMALA' is marketed by the British firm Western Wines and blended from wines sourced from a variety of Cape cellars.

16. Personal communication, Gerard Martin, SAWIS, 3 October 2003.

17. A. du Toit, 'Globalizing Ethics: Social Technologies of Private regulation and the South African Wine Industry', *Journal of Agrarian Change*, 2, 3 (2002), pp. 356 - 380.

to the market per year, and to support it through strong advertising and an efficient logistical supply operation.<sup>18</sup>

These trends are particularly significant given that the most important growth opportunities for South African wine remain in these overseas markets. In the context of the South African beverage industry as a whole, wine has done relatively well and the market for table wines and lower end premium wines blended in bulk has remained healthy.<sup>19</sup> These markets, however, show scant opportunity for growth. And, more to the point, there is very little money in them for grape growers. Bulk wines, after all, can now be sourced internationally, and even South African stalwarts such as 'Tassenberg' include wine made from Argentinean grapes.

Survival is not made any easier by the fact that globalisation is a two-way street. In 2002 South Africa imported approximately 31 million litres of 'natural wine', compared to approximately 216 million litres of exports<sup>20</sup>. While most imported premium wine remains unaffordable for all but the wealthiest section of South African society, it is the import of bulk blending and distilling wine that is impacting the most on South African co-operative wineries, many of whom came to rely on the product for the greater part of their existence. Most growers and cellars were poorly prepared for the new environment to which they awoke at the beginning of the 1990s. At that stage, less than 20% of South Africa's good wine production qualified for the "HP" price category<sup>21</sup>. Also, the industry was almost exclusively oriented towards the domestic market. Having neither the know-how, nor the confidence to compete in international markets on a big scale, the industry found it difficult to venture into foreign domains. This is especially true for the co-operative sector.

#### 4. ADVICE AT A PRICE: THE INSTITUTIONAL ENVIRONMENT AFTER DEREGULATION

When the cooperative wine farmers and their cellars emerged from the era of regulation/protection and international isolation, they were in need of mainly four things: market knowledge, technical know-how, a business plan and capital.

Initially market knowledge was not freely available. It was only in the late 1990s that a marketing body called WOSA<sup>22</sup> was established for the benefit of the industry as a whole. Until then cellars had to learn the marketing 'game' on their own and

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18. S.S. Loubser, 'The Wine Business: A Strategic Marketing Framework' (Stellenbosch: Winetech, 2001) p. 36.

19. For instance, wines such as Distell's mass-market leaders 'Graca', 'Paarl Perlé' and 'Autumn Harvest Crackling', *Alcoholic Beverage Review* 2002

20. SAWIS, *Wine Industry Statistics*, 27 (2003), p. 26.

21. 80% of all South African wine sold in the UK, costs 4 Pounds or less. Personal communication, Pieter de Waal, secretary, Paarl Vintners, 23 March 2004.

22. 'Wines of South Africa'.

from scratch. There was an existing organization called SAWIS, but it mainly gathered and diffused production statistics and data with regard to market trends. Like just about everybody else in the industry, they had no experience of how to pitch wine at a specific price point or how to deal with potential clients, not to say the cultural particularities of specific markets.

Given this lack, it was very difficult for most to draw up a 'strategy' and a business plan for putting it into practice. Although it didn't take cellars too long to realize that in international markets there was a greater demand for red, rather than white wine, it was an altogether different proposition to find the capital for replanting the vineyards and retooling the cellars<sup>23</sup>. By law cooperatives were (and still are) prohibited from taking in shareholders who do not grow grapes. As a result, the transformation has to be financed from the cellar's (i.e. the members') revenue and/or bank loans. An alternative option is converting to a company. In fact, a number of South African cooperatives have gone down that route since the late 1990s, but mostly for political, rather than commercial reasons<sup>24</sup>.

The situation is considerably better when it comes to technical know-how (i.e. viticultural and oenological knowledge). There are several bodies that offer know-how on anything from 'terroir' to yeasts. For instance, there is the South African Viticultural and Oenological Association which holds meetings twice a year, the attendance of which is free. In several of the wine regions cellars (and their members/owners) are organized into 'wine route' associations. Although mainly set up for marketing purposes, they regularly invite experts to give a talk on technical topics, like "What is 'quality'?" for instance. At the cellar level (and providing continuity with the past) farmers often form 'study groups' where anything from vineyard practices to wages are discussed.

While the knowledge diffused through these bodies is practically free, it is not hands-on and tailor-made for the specific farm. The latter can be had, but at a price. One of the main agents is 'Vinpro', an organisation with technical consultants in every region of the wine industry<sup>25</sup>, available at a moment's notice. In addition, there are individual consultants. However, like the VinPro people, they cost money and do not come for cheap.

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23. It is estimated that it costs R 70 000 (almost 9000 Euro) to establish/replant one hectare of vineyard (excluding the price of land). A small, non-automatic 60 000 liter stainless steel tank costs approximately 5 500 Euro.

24. In the late 1990s, the then Minister for Agriculture and Land Affairs took the KWV to court when it announced its intention to convert to a company. The Minister argued that the KWV's assets had been build up with the assistance of the state over seven decades and that the members (i.e. 4200 farmers) could not simply 'bag' these assets for themselves. In the Minister's view they had to be shared with the workers on whose backs the industry had been build in the first place. This action on the part of the ANC minister send ripples of fear through the farming community, expecting the minister to bring similar action against cooperatives. Converting to a company was considered a way of preventing the state laying its hands on the assets.

25. There are a total of 12 regions, stretching from the Cape of Good Hope in the south to the Orange River on the border with Namibia.

Financing the transition is not easy. However, equally difficult is organizational change. At the heart is the coop's payment system. What is required in the new era is a system that nudges members towards producing 'quality' grapes, is market related, but does not alienate the 'stragglers' that find the transition more difficult to make. For this challenge there were no blueprints available – neither locally nor from sources in other countries where the wine industry had faced similar problems, but at an earlier stage. In any event, the contexts were quite different.

It was only towards the end of the 1990s, after the initial enthusiastic response to deregulation and new market opportunities, that some groups in the industry started to promote the idea of a comprehensive 'strategy' for the industry. Thus was born 'Vision2020', a strategic analysis of future 'options' for the industry. The message coming out of this was clear: South Africa needs to produce better quality wine if the industry is to survive in a fiercely competitive international market. 'Better quality' was defined mainly in terms of the 'premium' and 'super premium' price categories. In order to achieve this, the study argued, growers and cellars had to embark on 'ring fencing', adopt a 'market orientation', become 'terroir' minded, develop 'brands' and the build reliable, efficient 'international supply chains'. It also recommended that a industry body be established that could drive the necessary changes.

Such a body was established two years later<sup>26</sup>. Called the 'South African Wine and Brandy Co.' (SAWBC), it is a non-profit organization, ostensibly representing the main stakeholders in the industry, i.e. growers, cellars, labour and the 'trade'. Precisely a year after its establishment, the SAWBC came up with its plan for transformation, the 'WIP' (Wine Industry Plan). Defined as the core of the plan are the strategic objectives of 'competitiveness', 'equity'('empowerment') and 'sustainability'. Progress towards these objectives will be measured by way of a 'scorecard'.

Sound as at least some of the analysis in both 'Vision2020' and 'WIP' may be, it is of little practical value to cellars. It may provide a 'helicopter view' and the SAWBC may speak on behalf of the industry (vis a vis government, for instance), but for those cellars that are in trouble, it is of no operational use. For the other coops it comes after the fact. Eight to ten years ago they had to make their own plans lest they wanted to survive. It is to these stories of survival and success that we now turn.

## 5. SURFING THE TIDAL WAVE: TALES OF SURVIVAL AND SUCCESS

So far no exhaustive study of the South African cooperative sector has been done, mapping the pathways of *all* 69 (former<sup>27</sup>) cooperative cellars from the territory of mass production. The largest study until now is the one by Martin (2001). Undertaken

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26. To be precise, in October 2002.

27. The official SAWIS statistics record list 66 cooperatives in 2004, but we know that more than 3 have changed their status since the mid/late 1990s. Researchers put the figure closer to 20.



in 2000, it tries to capture the different types of responses to 'deregulation and globalisation'. Based on three criteria, the study distinguishes five types of responses or 'firms': (1) old style cooperatives that sell most or all of their wine in bulk to wholesalers; (2) 'paper companies' that operate like type number (1), have converted to company status, but are companies in name only. Amongst the 'firms engaged in their own ways of doing business' Martin distinguishes between (3) cooperatives 'evolving to a renewing of the project', (4) co-operatives and (5) 'self-marketing companies' (Martin, 2001: 19).

The study is useful in that it maps the outcomes of recent processes of restructuring. However, it does not tell the story itself, i.e. sheds little light on the kinds of steps that were taken by individual cellars and why. The case studies below want to make a start towards filling that gap.

## 6. CASE STUDY 1: PLANNING IS EVERYTHING

This co-operative has 28 farming units, owned by 63 members. Eight of these produce approximately 80% of all wine. Fifty per cent plus of total production is sold in bulk, both domestically and internationally. Sixty two percent of total production is sold in the international market.

This cellar decided to restructure when the regulation era came to an end (i.e. 1992), in other words quite early on in the new era of the South African wine industry. Significantly this was before the political transition in 1994. The decision to restructure coincided with the appointment of the present manager who has been the driving force since then. It was he who convinced the board of directors and the members to improve each class of wine in small incremental steps, i.e. gradually replant and improve the quality of the vineyards. This became part of the collective definition of a 'production wish list'. He also told the members that everybody had to accept 'joint responsibility for success and failure'. Two important aspects which he stressed were critical volumes (i.e. the ability to supply sufficient quantities) and adding value.

According to the manager, the most difficult part of the transition was 'to find out what our products are worth in the market. We had no real frame of reference and, in the past, information was not freely available, and because of that we made many mistakes. It is important to build networks of information within the industry. In this way, a level of knowledge regarding prices can develop informally. One needs to have people in such a network which you can trust regarding prices and new developments in the industry. This co-operation must happen voluntarily in order to operate effectively'<sup>28</sup>. However, mistakes were made and members of management involved in marketing 'had to learn to be able to walk away from business'. In other words, not to sell the wine at a price that left the cellar with ridiculous margins.

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28. Personal communication, manager, cooperative 'R', 22 April 2004.

In the early nineties the strategy of the cellar shifted up another gear. It was decided to systematically 'build up' various products on a yearly basis. These products had to climb a step higher on the quality ladder every year. 'We had to decide what we were going to do in order to achieve higher prices for our cheaper products. We decided upon certain future goals and desired outcomes were encouraged. All our members were informed of this strategy and we recommended that they make certain changes, for example to plant and press 5% red wine grapes for a start. Once returns became evident, other members also followed'.

As a result, production of red wine has increased from 31 tons 12 years ago, to 5000 tons today. Although the 'wish list' of the early 1990s has changed since then, that kind of planning allows the cellar to predict exactly the amounts and cultivars they will be pressing in the two years from now. The cellar claims that 'at any given time we will know exactly which variety, from which producer and which amount will be arriving on a certain date'. At the end of July beginning of August, the cooperative already starts planning for next year's sales and vintage. This is done according to the motto 'You can't make money with surprises'.

A crucial link in the new approach is the appointment of viticulturalists - one full-time and one on a part-time basis. They grade the grapes in the vineyard. The grading system ranges from 1-6 of which 6 is the highest class. In order to qualify for a class 6 grading producers have to apply the correct vineyard practices and stick to a certain winter- and summer programme. Producers are compensated according to the quality of their blocks. The chemical and physical test that is applied when the grapes arrive at the cellar merely serves as a final quality check. The price of the grapes is already determined two months in advance. There is no cross subsidisation between varieties or classes within the same variety.

Nothing is left to chance. Cellar staff know exactly which grapes are about to be delivered on any given day and into which classes they have been categorised. The differentiation of grapes into different classes is verified by a tasting test involving the manager, winemaker and viticulturalists.

This kind of precision planning doesn't end there. Each block of vineyard is assigned to a specific label. As a result, a client can meet the producers whose grapes go into the label(s) sold by him.

Members' grapes, although differentiated into different classes and separated into different tanks, all belong to the coop's 'A' pool. In addition the cellar created a 'B' pool for the grapes of non-members which are bought when the need arises and on the basis of short term contracts. Surplus grapes from A-pool members can also be sold to the B-pool. This pooling system ensures that production remains constant and that the necessary volumes can be delivered, even though some members have left the cooperative<sup>29</sup>. Whereas 'A' pool members receive their payment within 6 months after the harvest, 'B' pool members often have to wait somewhat longer for their money.

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29. Members unhappy with some of the changes brought litigation against the cellar, but in the end the case was settled out of court.

Naturally this kind of 'differentiated quality production' goes hand in hand with a proliferation of fermentation and maturation tanks. Over the last three years alone, the number of tanks has increased from 150 to 350. This expansion was financed solely from cellar profits.

In accordance with the policy of the board of directors, training is done on an ongoing basis. Cellar workers have been sent to courses offered by an agricultural college near Stellenbosch. In addition, farm workers employed on member farms have attended pruning courses arranged by the local 'wine route' committee and financed by the South African Wine Industry Trust<sup>30</sup>. Of course the cellar has an interest in correct vineyard practices. Generally speaking the cellar has a hands-off policy, but when practices are not performed correctly, the viticulturist will make recommendations to members and in extreme cases the co-op will intervene. A detailed record is kept of every visit the viticulturist pays to a member's farm.

To facilitate the marketing of their wine, the cellar took several steps. Rather than converting to a company, the cooperative established a separate marketing company. This put the cellar in a position to involve one of the most successful wholesalers as a partner and in this way source capital. The company is responsible for sales and does marketing on behalf of the co-op.

Secondly, the company has contracted an individual who acts as an independent agent regarding marketing. He deals directly with agents and potential buyers and is the cellar's most important market link.

Thirdly, the cellar places great importance on cultivating personal relations with overseas buyers and agents. Members of management try to see the latter at least once a year. In the view of the cellar, personal attention is of utmost importance and can distinguish one from another supplier. Whenever managers travel internationally, they try to combine 'old' with 'new' business (i.e. seek new clients). 'Adjustment' (to different clients, cultures and markets) is deemed very important, as well as excellent service. The latter 'can distinguish your product from one that is of the same quality'. As part of its service strategy the cellar makes use of an electronic system to track wine samples on their way to our international clients. The credo is one of permanent innovation: 'One can't afford to run out of ideas!'

The ideas and strategies of the management executive have the full backing of the board of directors. According to the manager the board is 'rationally minded, flexible and cooperative'. They are all producers themselves and have degrees in commerce, marketing, etc. Each member is responsible for a certain portfolio. For example, if director X has the marketing portfolio, he would have to meet with overseas agents/ guests and then report back to the board meeting. Like the board, the cellar as a whole attributes a large measure of its success to 'teamwork'.

The figures speak for themselves: except for winning one of the major red wine trophies in a region where it was thought impossible to produce good reds, turnover is ten times higher than what it was when the cellar embarked on its new path a decade ago.

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30. This body is charged with the 'empowerment' of the 'historically disadvantaged' in the industry.

## 7. CASE STUDY 2: RADICAL SURGERY

This cooperative is owned by 80 members. Of these 20 deliver 92% of the entire product.

Total production is 4.5 million liter. Of this 2.5 million is bulk wine (55%). The rest is bottled. One and a half million liter bulk wine is exported. All the bottling is done by the coop itself.

Unlike the previous cellar, serious restructuring at this cooperative only started two years ago. That was the time when the present (general) manager was appointed. Previously he had worked at South Africa's biggest liquor firm (i.e. Distell) and a cooperative that went bankrupt. At a strategic planning meeting the cooperative decided to establish itself as a *cellar*. On that occasion it was also decided to: withdraw from the standard price market; improve the quality of the products; identify niche markets; improve cellar technology and tighten up the financial management of the cellar.

Flowing from this, a financial manager, a marketing manager and a viticulturalist were appointed in the course of the next two years. The functions of winemaker and cellar manager had already been separated years before.

A crucial strategic decision was to withdraw from the 'foilbag' market (i.e. 'standard' or cheap wine). A considerable number of members were unhappy about this and put up resistance. They were not convinced by the argument of management that it was not a profitable market segment. Because they would not tow the new strategic line, 51 members were 'suspended' recently. In the words of the general manager: 'We need serious producers to produce good quality products'<sup>31</sup>.

One problem that continues to face the cooperative is the diversity of producers in the region. It is not always easy to get everyone to agree to a long term strategy. The needs to create incentives to encourage producers to continue with grape production instead of switching to more lucrative produce markets such as (indigenous) herbal tea or citrus.

As part of the focus on niche markets new plantings include rare varieties such as Temprinello, Sangiovese, Touriga Nacional, Chianti<sup>32</sup>, Grenache and Voignier. Most of our old traditional variety vines have been replaced with the newer varieties. Both noble white and red cultivars have been planted, especially the latter.

In order to improve quality the cellar appointed a full-time viticulturist in 2003 who works alongside the cooperative's VinPro consultant. Together they evaluate the practices on members' farms, check vine cultivation and see to it that correct viticultural practices are adhered to.

Grading in the vineyard determines the price of grapes. Blocks are classified during the pruning season. Producers can voluntarily submit certain blocks for the premium classes. If their applications are successful they are able to deliver grapes

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31. Personal communication, general manager of cooperative 'C', 26 April 2004.

32. The cooperative negotiated with the EU to retain their license to sell Chianti. They agreed provided the cellar only sells it on the domestic market.

for the cellar's three premium classes (i.e 'high', 'medium' and 'low'). Each of the premium class blocks are earmarked for a specific label. The viticultural practices differ between the premium class ranges. For example, less attention is given to the 'low premium' range than to the others. All grapes that do not make the premium class, are classified as 'bulk'. The latter compile 55% of the cellar's entire production.

All grading is done by the viticulturalist. If the producer is delivering grapes for any of the three premium classes, he receives an evaluation report from the viticulturist after each visit/inspection. If the viticulturist is not satisfied with what he sees and if the producer does not adhere to his recommendations, he has the authority to downgrade the grapes to a lesser class. As an example, a 'low premium' block which earns R3500 per ton can be downgraded to bulk which only receives R1200. Thus, the difference is evident when it comes down to final payments. Part of the cellar's long term strategy is to add value to the bulk wine class and to increase the percentage of premium class wines.

In accordance with the new planting programme and the class differentiation of grapes, cellar expansions to the value of R2,9 million have been completed during the past two years. The expansions include new smaller tanks, upgrading of equipment such as bulk filters, vats and floor repairs. Part of the capital was financed through a bank loan with a three year down-payment plan. The cellar mostly has 2700 liter tanks. Wines from separate regions are kept in separate tanks.

The last two years has also seen a strong initiative with regard to training. This has received an extra boost by the fact that the cellar has signed up to Fair Trade. Fair Trade aims to give everyone in the value chain a 'fair' deal. They donate funds to a local community development project, the main goal of which is training- and life skill programmes. The cooperative has also send cellar workers to an agricultural college for the upgrading of cellar skills. To date some 51 workers have attended a total of 64 courses. Pruning skills are taught by the viticulturalist.

Like the cooperative in our first case study, this one has no desire to convert to a company. According to the general manager, 'the only advantage of a company is from the producer's point of view as they receive their payment immediately, as well as the prospect of possible dividends at the end of the financial year'. He believes that 'a co-operative is in the best position regarding a surplus market'. He does not envisage a change within the next 5 years.

Like the other cooperative, this one also established a separate marketing company, responsible for wholesale and retail distribution, as well as contract bottling. Products such as beer, brandy and whisky are also purchased and then sold by the company. Interestingly enough, the cellar does better in rural areas and smaller towns than in the cities of South Africa.

The general manager himself is responsible for the international marketing. The cooperatives most important export markets are the UK, Western Europe and Scandinavia. Recently the cellar succeeded in gaining a foothold in Mauritius, Madagascar and the Caribbean Islands. The cellar does not make use of agents that act as a link between itself and its overseas clients. In other words, the contact is direct.

## 8. CONCLUSION

The two case studies discussed above raise a number of interesting questions, both for the 'conventional wisdom' regarding the transformation of South African wine cooperatives, as well as theory of organizational change:

- Timing of transformation/restructuring: hitherto it was thought that the watershed for most cooperative cellars in South Africa was the year 1995/6. After the historical election of 1994 proved to be peaceful and the transition was holding, the majority of cooperatives supposedly started to restructure in earnest. The two case studies above, plus a handful of others which have not been discussed here, indicate that the restructuring has been happening in a much more random and staggered fashion. Some, like our first case, already embarked on a new path two years before the political transition, while others only started to get onto a different trajectory as recently as two years ago.
- The crucial catalyst in changing direction seems to be a new (general) manager. Innovation appears to be driven from the top down, and not from the bottom up when conventional vineyard practices hit the proverbial wall and prompt farmers to exert pressure on the coop management to take a different course. Although farmers at our second cellar already landed in a cul-de-sac some years ago, the cellar only started to change once the new manager had arrived.
- A key part of strategic change is a long term vision. Central to this, in turn, is a cultivar or varietal plan which is like a beacon by which growers can orientate themselves.
- The new manager is also a crucial force in changing the management structure and the division of labour in accordance with the rules of the 'quality revolution'. Key is the appointment of a viticulturalist who can drive the change towards differentiated quality production in the vineyard and a new grading and payment system that rewards quality practices. He/she also plays a key role in upgrading the vineyard skills of farm workers.
- Also very important are the appointment of a marketing and financial manager who can handle these functions in a professional manner. Where no special marketing manager is recruited, other members of management have to learn the marketing 'game' by doing. Forging informal networks for trustworthy market information and close personal ties with clients, especially in different cultural settings, seem to be crucial for success.
- Another way of professionalising the marketing function, is to separate it from the coop as an organizational and legal entity. This not only focuses the mind, but makes it also possible (at least in the South African legal system) for the cooperative to have the best of both worlds: keep intact the coop organization and identity and source equity capital on the open market through joint ventures with wholesalers or retailers.

- Our case studies put into question one of the central 'mantras' of recent strategic studies of the South African wine industry, viz. that survival can only be had by bottling wine, develop 'brands' and move into the 'premium' international market. While it remains true that competition is stiff both at home and internationally, our case studies show that money can be made even with bulk wine and at price points lower than high premium. In fact, 80% of South African wine is sold below four pounds in the UK market and market share is on the rise. Two of the most successful South African labels in the same market are blended wines and not 'brands' in the conventional sense of the word. It does not seem to be a question of either/or (i.e. bottled or not bottled), but to have the 'right' product at the 'right' price point. In other words, value for money. Even in a more health conscious world, not everybody is drinking premium reds.
- While it is important to maintain solidarity almost by definition, strategic change sometimes makes it necessary to get rid of members who are holding back the cooperative. When market signals, a new payment system, advice and persuasion still have no effect, it may be necessary to change the statute of the cooperative in order to remove the obstructionist vote and create the room for manoeuvre.

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# **ANALYSIS OF AGRICULTURAL CO – OPERATIVE MEMBERS’ COMPROMISE LEVEL WITH SPECIAL REFERENCE TO THE CASE OF WINE CO – OPERATIVES IN “DENOMINACIÓN DE ORIGEN ALICANTE”**

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## **1. INTRODUCTION AND OBJECTIVES**

This paper pretends, after a review of the literature related to participation and member commitment and the effect of this compromise in their satisfaction as parts of an organisation, to answer some questions that arise from this review in the case of the wine co – operatives in Denominación de Origen “Alicante”.

The next section discusses some of the authors that have looked at democratic participation, compromise and member satisfaction in co – operative organizations.

García – Gutiérrez (2002) speaks about the definition and features of participative companies (as he quotes). According to him, participative companies are those in which membership is acquired (formally or informally) taking part in the process that defines a company: production and distribution process. These companies represent the democratic restitution (one person, one vote) in the market, as it seems to happen in the political environment. This is backed by the process that supposes the higher the real participation in what persons do the higher the requirement for taking part in what persons want to do (establishment of objectives).

A way to approximate the problem of satisfaction through co – operative member participation is analysing the factors that affect the compromise level of members towards their organisations. It can be said that the higher the satisfaction the higher the compromise. However, the inverse should also be asked: can a higher compromise lead to a higher satisfaction?

Fulton and Adamowicz (1993) point to the members’ level of compromise as a key element for co – operative survival, analysing the factors that influence the compromise of members with their organisation.

A interesting theoretical work about participation is presented by Náchér (2002). This author says that human groups can be analysed as network organisations in which information and knowledge flows among their members in order to ensure the group's survival in relation with its environment. If members can be considered as rational beings, the group survival is a way to ensure individual survival (i.e. the real objective). The work provides alternative explanations for inhibiting citizen's participation and it concludes by saying that democratic participation is an alternative if it produces pleasure or beauty.

Mozas (2002) did an empirical approximation of member participation in agricultural co – operatives. The author points out the reasons that, according to several authors, explain the common break of democracy in these organisations (e.g. lack of co – operative culture, members unawareness of the duties of decision taking persons, group size and heterogeneity, lack of training, external agents involvement in the social mass). Some questions are asked about member participation in co – operatives. The work has two objectives: to give a participation perspective taking into account the elements that are needed to guarantee efficiency in co – operative companies and to describe through empirical research the member's behaviour in relation to participation. The author concludes by saying that members are in charge of practising real democracy in co – operatives. To develop it depends on their willingness to do so. If members detect an unfair decision taking process, this leads to the withdrawal of democratic participation. It could be interesting to ask if the unfair decision taking process is due to the withdrawal of democratic participation.

Van Dijk and Werts (1996) argue that member's compromise is the co – operative most important asset. Their work is not empirical, but it is interesting because they make a detailed exposition of the present criticisms of the co – operative model. However, they reject the critique. According to them, arguments against co – operatives are based on the Agency Theory model. According to this approach the main problems are:

- a) *Common property*: new members get immediate access to co – operative assets, while existing members get no part of co – operative value. This implies, according to them, a non – optimal decision taking process in co – operatives.
- b) *Portfolio election*: each member has a different risk behaviour. This hampers the possibility of satisfying all members' preferences and interests through investments.
- c) *Planning scenario*: younger members have a different planning profile than older ones. Co – operatives cannot develop the best investments for all members.
- d) *Decision making process*: managers cannot be aware of opinions from a broad and complex social mass.
- e) *Control*: members are not able to control managers because the latter have more and better information and are more motivated.

Responding to these criticisms, the authors argue that these problems are not characteristic of all co-operatives, but only exist when members compromise towards the co – operative is very low.

Agency Theory, according to Van Dijk and Werts (1996), is based upon the idea that every investment has capital profits as an objective, but it does not consider that an investment or the property of assets can have the sustainability of commercial relations as an objective as well. Van Dijk and Werts (1966) argue that co – operative rationality is better explained through Transaction Cost Theory.

Álvarez *et al* (2000) also apply Agency Theory to first tier co – operatives. They list some specific problems related to the presence of managers and members in co – operatives (e.g. financial problems, lack of motivation for new investments). They propose some solutions from the perspective of increasing finance and promoting a more professional management.

The Transaction Cost Theory perspective in co – operative has been introduced by authors like Staatz (1987). This theory starts from the idea that a group or organisation can invest in some assets (although these assets could have less value for other purposes) just for working as a company. As a result, the group needs to protect its investments of the hypothetical “dishonest” behaviour of the members. Theories and market procedures do not work as expected.

Van Dijk and Werts (1996) add that agricultural production needs big investments in physical assets that have almost no alternative use and this production has a high degree of uncertainty.

Farmers carry the risk of being “exploited” in oligopolistic markets. According to this, co – operatives have the mission of reducing transaction costs of their members. These organisations have a role to play in situations where market mechanisms do not work correctly for a number of players. If these market mechanisms would work as expected, there would be no reason to maintain co – operative structure unless its disappearance generated the same problems in the market that existed previous to its existence.

Van Dijk and Werts (1996) argue that members’ compromise is the most important asset of a co - operative. According to them, if members consider the co- operative as important for them, they want to finance it, trade with it, they get involved in organisational control, and they accept its rules and accept its corporate objectives. However, they emphasise that members’ compromise is not acquired through advertising and promotion, but because it is the best option for members. The authors also argue that the number of members in a co – operative does not correlate with their compromise towards the organisation.

Fulton and Adamowicz (1993) did empirical research on factors that affect members’ compromise towards a co – operative. They analysed the case of *Alberta Wheat Pool*, one of the most important cereal marketing co – operatives in Alberta (Canada). According to the authors, it is responsible for 60% of the cereal production in this area.

According to this case study, the factors that are important for ensuring member compromise are:

- a) Capability of allocating benefits from a part of the results.
- b) Capability of buying pest control and fertilising products from the co – operative.
- c) The percentage of members' total income acquired from the co – operative.

These authors used a discrete election model that admits that an individual will choose an option depending on the utility of the election. Elections will depend on organisation and individual features.

Members' level of compromise is a classical example of the future player problem. There is no danger if a member decides to leave the organisation. However, if a group of members start to be disloyal towards the co – operative, the danger for co – operative survival will be evident.

These authors propose Non Co –operative Games Theory for structuring the problem.. They use the prisoner's dilemma for several periods. This was already employed by Staatz (1983) for modelling member's loyalty towards their co – operative. However, he wanted to look at existing differences between applying the model for one period or more in an agricultural co – operative. The equilibrium result (or dominant strategy) when the game is used for one period is to leave. So, everyone leaving leads to co – operative failure. When the game is proposed for several periods, the results are more interesting because it is possible to obtain an optimal result if players choose co – operative option. The conclusions for Staatz (1983) are:

- a) Farmers that bear in mind leaving this activity in the near future will be less loyal to their co – operative than those who plan keep on farming in the future. The exception will be farmers that are able to keep a (economic or psychological) benefit after leaving the organisation.
- b) Farmers will be more loyal to their co – operative if the punishment (economic or psychological) for being disloyal is higher.
- c) Farmers with a low discount rate will tend to be more loyal towards their co–operative. An optimal solution where players co – operate in the game for several periods depends on the players' preference for their money in terms of time. Players with low discount rates will give more value to future situations and actions. The result will be a situation with higher probability for co – operation in the present. A consequence of this is the fact that younger players, with higher debt levels, have higher discount rates and, as a result, are less loyal towards the co – operative.

Ambiguity of this theoretical analysis about the effect of age in the player behaviour (a) and b) is a result of considering time as a substitutive variable. In a) is a substitutive variable of the time that last for leaving farming and, in b) of the debt level. So, a

direct measurement of these variables is desirable when empirical research is undertaken. The problem is how to do this and why age is used as a substitutive variable.

Other aspects of co – operative management were also modelled with Co – operative Game Theory by Staatz (1983) and Sexton (1986). Results show that there is more efficiency in common actions than individual ones.

However, this depends on two conditions: players can communicate amongst them, and moreover, they can get a real compromise among them. So, opportunities that offer to players a premium for staying in the co – operative have to be defined. The challenge is to identify and promote ways of distributing these opportunities in such a way that a member feels worse if he / she is not a member of the co – operative.

If heterogeneity of membership is assumed, conditions that can be interesting for some members can be useless for others. The conclusion for Staatz (1983) and Sexton (1986) are interesting: perhaps the optimal situation would be a different treatment for each member. However, this is not in line with one of the co – operative's basic principles. These authors identify these arrangements as a need when co – operatives grow and diversify.

Some questions arise from this problem. They could be answered through empirical research:

- a) Does the level of compromise change according to the member's age?
- b) Does the level of compromise change according to the member's debt level?  
This could be related to full time or part time farmers.
- c) Does the level of compromise change according to the member's perception of his/her ability to participate in the co – operative's benefits through the allocation of the results of this compromise?
- d) Do farmers feel the need for a differentiated treatment and are there members that leave the co – operative because this is lacking?
- e) Is there a specific feature about co – operative organisations that override short – term advantages? (e.g. better prices)

There are studies that try to answer some of these questions about the different perceptions that farmers have of co – operative versus non-co – operative companies. These include Schrader *et al.* (1985), Burt and Wirth (1990), Jensen (1990), Wadsworth (1991) and Mozas (2000).

Schrader *et al.* (1985) measured farmers' perceptions about co – operative and non-co – operative companies. Results showed that farmers considered non-cooperative companies better in the sense of being more efficient and more profitable. However, if other aspects of management were taken into account (e.g. price stability for farmers, services and products supply for farmers, information for farmers, reaching cost reductions, satisfying special needs, promoting vertical co – ordination in the marketing system, supplying consumers, controlling power use by market agents and

contributing to the general interest) co – operative companies were considered to be better.

Burt and Wirth (1990) did a survey among farmers and managers of agricultural input supply co – operatives in Oregon (USA). Their conclusions showed that farmers did not perceive important differences among co – operative and non-co – operative companies. Moreover, some of them thought that members were not sufficiently aware of the performance of their co – operative. Farmers would not be as loyal to the co – operative if they had to pay higher prices. It seemed that they were against the idea of equality principles in relation to prices and credit terms.

Jensen (1990) did a survey among milk producers in Tennessee (USA) in order to determine the factors that affected their election of milk buyers. Farmers that preferred operating with co – operatives chose as key factors a safe market and better services. Farmers that preferred brokers, chose better prices and lower deductions as key factors for their election.

Wadsworth (1991) studied the features associated with the use of a co – operative among farmers in the USA. The study looked at how features such as the type of farm, size, situation and age were related to the use of a co - operative. The author concluded that the highest probability of using a co – operative was in the milk and cereal sector, for big farms and in some areas of the USA.

Mozas (2000) analysed the economic participation principle of members in agricultural co – operatives, looking specifically at exclusivity. The objective was to determine if both the co – operatives' performance and members' behaviour in front of exclusivity, constituted a useful tool for defending and assuring the fulfilment of equity principles. The author tried to link member's self – fulfilment of exclusivity with an efficient co – operative management. In order to do so, the author undertook an empirical research among co – operatives in Jaén (Spain). Conclusions were that member's non-loyalty was an indicator of business inefficiency.

## **2. DATA GATHERING AND METHODOLOGY**

The ideas discussed in the previous pages were studied in first tier wine co - operatives in Denominación de Origen "Alicante" (Spain). A survey among their members was done.

There were 3.134 members of these wine co – operative at the time of the survey. The chosen sample size was 300 (5% of sample error and 95,5% level of confidence) (Hair *et al*, 2000). Two pre-test were done. The first one was made taking into account opinions from survey design experts and the second one was made selecting a sub – sample (30 members). Information was obtained through personal interviews. Respondents were casually found in the villages where these co – operatives are settled.

### 3. THE WINE CO – OPERATIVES OF THE DENOMINACIÓN DE ORIGEN ALICANTE.

The Regulatory Council of the Denominación de Origen (D.O.) Alicante was officially established in 1932. However, its initial Rules were settled in 1955. Present Rules were established on the 19th of October of 2000 (B.O.E. 3rd of November of 2000).

According to data from the Regulatory Council, the registered area was 14.254 ha. in the 2002-2003 campaign (this represented 2,23% of the total surface under vine in Spain). There were 3.155 registered farmers (1,9% of the total in Spain), 21 of these farmers were not members of any wine co - operative.

There were 48 registered companies. Of these 16 of were non-bottling companies. There were 17 registered co – operatives. 118.405 hl. were marketed in 2000 – 2001 campaign (1,20% of the total in Spain). Two thirds went to the national market (1,21% of the total in Spain); the rest is exported (1,18% of the total in Spain).

### 4. RESULTS.

The results of the survey amongst the farmers are discussed below.

#### 4.1. Does the level of compromise change according to the member's age?

Figure 1 shows the age structure of the respondents. 68% of respondents are more than 60 years old. The importance of objectives according to age can be seen in Table 1. There are similarities and differences regarding the importance of the objectives that farmers declare to have in relation to the co - operative. All the groups mark as the most important objective *to ensure the harvest sale* and as the least important *Inertia (Lack of objectives)*. However, the youngest group gives the highest mark to this objective. *To get cheaper products and assessment* was the second objective for the groups of more than 60 years old and 30 – 40 years old. *To increase profits* was the second objective for the groups of 50 – 60 years old and 20 – 30 years old. *To participate in a co – operative organisation* was the second objective for the group of 40 – 50 years old. From this, it can be concluded that the level of compromise changes in relation to the declared objectives of the members.

**TABLE1.**  
**IMPORTANCE OF DECLARED OBJECTIVES FOR MEMBERS BY AGES**

Age	To ensure the harvest sale	To get cheaper product and assessment	To increase profits	To participate in a co - operative	Inertia (lack of objectives)	To get subventions
<b>&gt; de 60</b>						
Average	9,27	8,17	8,15	7,71	2,69	6,67
Mode	10	10	10	10	0	10
Variance	1,14	3,88	4,44	6,49	10,69	10,87
St. Deviation	1,06	1,97	2,10	2,54	3,27	3,29
Minimum	5	0	0	0	0	0
Maximum	10	10	10	10	10	10
<b>50 – 60</b>						
Average	8,81	7,58	7,94	7,65	2,52	6,69
Mode	10	8	10	10	0	10
Variance	3,15	6,50	4,90	5,60	9,25	9,92
St. Deviation	1,77	2,55	2,21	2,36	3,04	3,14
Minimum	1	0	2	0	0	0
Maximum	10	10	10	10	10	10
<b>40 – 50</b>						
Average	8,94	7,86	7,52	7,89	2,65	6,50
Mode	10	10	10	10	0	10
Variance	1,78	5,41	5,55	6,09	9,63	12,20
St. Deviation	1,33	2,32	2,35	2,46	3,10	3,49
Minimum	5	0	0	0	0	0
Maximum	10	10	10	10	9	10
<b>30 – 40</b>						
Average	8,55	8	7,83	7,44	3,77	5,77
Mode	10	8	10	8	2	8
Variance	2,84	2,58	3,79	2,37	9,71	10,06
St. Deviation	1,68	1,60	1,94	1,54	3,11	3,17
Minimum	5	5	5	5	0	0
Maximum	10	10	10	10	10	10
<b>20 – 30</b>						
Average	9,66	7,33	8,33	7,55	5,33	7,77
Mode	10	10	10	7	5	10
Variance	0,5	5,5	3	4,77	8	7,19
St. Deviation	0,70	2,34	1,73	2,18	2,82	2,68
Minimum	8	4	5	4	0	4
Maximum	10	10	10	10	10	10

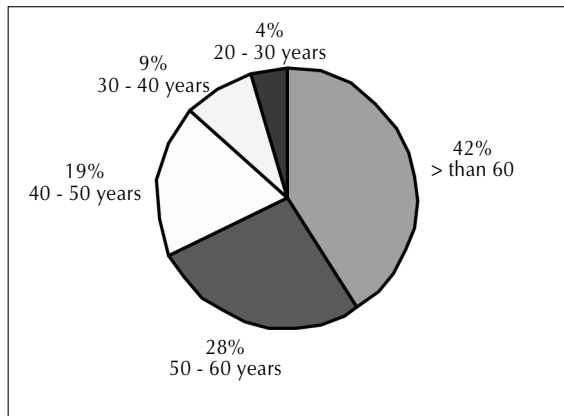


#### 4.2. Does the level of compromise change according to a member's debt level?

This question needs, firstly, to limit the scope of debt to the activity that relates the member to the co – operative. That is to say, the more he / she risks, the higher should be his / her compromise. So, it seems clear that the member who receives the major parts of his / her income from agriculture and is a member of the co – operative, has a higher compromise with the organisation. This is the reason to link part – time farming with a lower debt level. 78% of respondents admitted that their incomes mostly came from activities not related to agriculture. This includes the major part of pensioners. This hampers the discussion because the major part of respondents admitted they do not obtain an important part of their incomes from their relation with the co – operative.

Table 2 shows the percentage of affirmative answers to some questions depending on part time or full time farming. A better knowledge and a higher degree of relation with the co – operative can be appreciated in those farmers who declare themselves as full time farmers. There are bigger similarities with regard to the last two questions, perhaps due to a common disenchantment or tiredness in members.

**FIGURE 1.**  
**AGE STRUCTURE OF RESPONDENTS (%)**



**TABLE 2.**  
**PERCENTAGE OF AFFIRMATIVE ANSWERS DEPENDING ON**  
**PART TIME OR FULL TIME FARMING**

Question	% of affirmative answers	
	Part time farming	Full time farming
Could you tell us which are the market objectives of your co – operative?	23	66
Do you imagine this co – operative as a different sort of company?	14	56
Have you talked with other members the reasons for being in the co – operative and what they expect from it?	40	63
Do you know which other plans members have related to their relation with the co – operative?	23	54
Do you evaluate and update abilities and knowledge of your managers?	26	24
Do you think members understand how the co – operative works?	53	47

#### **4.3. Does the level of compromise change according to a member's perception of his/her ability to participate in the co – operative's benefits through the allocation of the results of this compromise?**

It is necessary to clarify which are the benefits that produce this allocation of results. In this case, results mainly come from the wine sale. This wine is produced from the grapes that members sell to the co – operative. The degree of members' compromise does not just depend on the grapes sold to the co – operative, but also on the fulfilment of quality standards settled by the co – operative. If the co – operative does not settle quality standards, it is not possible for members to show effectively a higher level of compromise, because all the grapes will be treated as similar.

Members were asked if their co – operative had clearly defined quality standards in terms of products and services. 60% of respondents answered in the affirmative. The latter were asked if they thought members would be able to explain these standards. 32% responded affirmatively. Finally, they were asked about who was responsible for evaluating these standards. 73% of respondents pointed to the oenologist. From this it has to be concluded that the major part of members do not think that a higher compromise leads to higher profits.

#### **4.4. Do farmers feel the need for a differentiated treatment and are there members that leave the co – operative because of the lack thereof?**

All the responded ticked *to ensure the harvest sale* as their main objective related to the co – operative. Moreover, 93% of respondents admitted to be satisfied in with the co – operative. It does not seem that there is any need for a differentiated treatment from the side of members. However, a deeper research could identify it.

#### **4.5. Is there any feature about co – operatives that overrides short – term advantages? (e.g. better prices)**

Farmers were asked about the co – operative's advantages. 40% of respondents declared that the best advantage was *bringing the grape and forgetting everything else*. 15% of respondents pointed to small farmers' union. 10% of respondents spoke about product quality. 7% of respondents declared that there was not any advantage but a need. The rest of respondents made references to the co – operative's closeness, the presence of the co – operative in a specific area, services, on time payments, and retail sales. These answers show that the co – operative's best advantage is perceived to be the guaranteed buying of the grapes. This is not good news in a competitive environment, because the best product will have other markets and the co – operative will remain as the buyer of the worst production.

Farmers were also asked why they were satisfied with their co - operative. 31% of respondents answered *it is the only way for selling the product or middlemen do not take advantage*. 30% of respondents spoke about *it works well or I like Council of Directors' management*. 12% of respondents ticked *they make my life easier or I bring the product and I forget everything else*. 7% of respondents pointed to *they cover my needs or immediate assessment*. These answers support what has been said in the previous paragraph.

## **5. CONCLUSIONS**

This paper has looked at the possible variations of the compromise level of D.O: Alicante wine co – operatives members according to five factors: age, higher or lower relation with the co – operative activity, perception of members capability to take part in the co – operative profits through allocation of this compromise results, the need of a differentiated treatment, the existence of a unique and different feature in co – operatives that makes compromise with this sort of organisations better than short term profits.

It has been observed that compromise level changes with age and with the higher or lower relation with the co – operative activity.

The rest of questions got no clear answer mainly due to the features of respondents (age and part time farming) and features of these co – operatives, e.g. lack of quality standards clearly settled and known by members.

From the results it would appear that the members of these co – operatives do not think about this option as the best one, but as the only one. This invalidates some of the hypotheses generated by the review of the literature, like the idea that there cannot be any compromise without a declared desire of election or the higher the conscious participation in what you do, the higher the willingness to participate in the formulation of objectives.

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# THE FUNDAMENTALS OF THE CONTROL OF MANAGEMENT IN OLIVE-OIL COOPERATIVES

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## 1. INTRODUCTION

In an attempt to continue with the same line of investigation that we have been following in the university for several years, this paper aims to gather a series of empirical data derived from cooperative companies within the olive-oil extraction sector.

With the knowledge derived from our experience of the olive-oil sector, and having reviewed part of the literature that refers to control in organisations, we consider the possibility of carrying out an in-depth analysis of the management in this type of company. Our aim is to identify those circumstances or factors that determine the control that the partners within the olive-oil cooperative exercise over the managers (presidents and/or directors).

This general objective can be broken down into three specific objectives: to become aware of how the process of control is carried out in these organisations and the bearing that this function has on achieving company objectives; to become aware of how control is enforced in olive-oil cooperatives, who is charged with this task and the means that they use for this purpose; and, finally, to deepen our knowledge of those circumstances that lead the partners to exercise control over the managers, which we refer to as control fundamentals.

In order to achieve these objectives, and having reviewed the bibliography that deals with control in organisations and the manner in which the olive-oil cooperatives function (decision-making, participation and management), we devote the first section of this paper to the control process. Subsequently, we focus on the olive-oil cooperatives, studying the manner in which this process is developed and identifying its most characteristic features. The empirical evidence allows us to highlight the key factors that we identify as the control fundamentals in this type of company.

The theoretical grounding that provides us with the tools that we have used to reach the conclusions of this paper is the agency theory, and therefore we feel that the relationship that exists between the partners and the management can be described as an agency relationship.

## 2. THE ROLE OF CONTROL WITHIN THE MANAGEMENT OF ORGANISATIONS

Organisations can be defined as groups composed of individuals that seek to achieve a specific aim, which, in addition, present three characteristic features: a) each organisation has a distinct purpose that is generally expressed in terms of goals and objectives, b) each organisation is made up of people and c) each organisation develops a structure that defines and limits the behaviour of its members. Despite their formal aims, organisations are composed of individuals who have their own interests and it is necessary to influence or control their behaviour in order to achieve the objectives of the organisation (Flamholtz, 1996).

### 2.1. Control: conceptual definition

Organisational control has been interpreted in various ways over the years. Despite this fact, many researchers feel that we have failed to discover the essence of the concept, which has led to continuous attempts to present appropriate study frameworks and conceptualisation (Flamholtz et al., 1985).

The majority of the literature dealing with organisational control defines the term as a cybernetic process<sup>1</sup> and a feedback process. From this point of view, control is considered to be the process via which an attempt is made to ensure that the behaviour of the members of the organisation is in keeping with the plans and objectives that have been previously established. Therefore, this process requires: a) the setting of an objective, which will provide a reference point to measure performance, b) the implementation of programs and policies, c) the measurement and comparison of results and d) feedback or corrective actions when deviations from the predetermined objectives arise (Hofstede, 1978, Tosi, 1983, Veliyath et al., 1997).

Others attempt to offer a vision that is not exclusively cybernetic, feeling that it is appropriate to talk about control as a synonym of power, authority and influence. In this line we refer to the contribution made by Flamholtz et al. (1985), who define control as “a series of mechanisms that are designed to increase the probability that individuals behave in such a way that they are able to achieve the aims of the organisation”. They believe that control is designed to meet these objectives and its purpose is none other than to influence people so that the act and make decisions that are in keeping with the objectives of the organisation.

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1. The cybernetic approach falls within the general systems theory. The difference between each perspective is a result of the environment under consideration. Otley et al. (1995) state that the former refers to closed systems whilst the latter takes in systems that are more open. In any event, the objective of the cybernetic perspective is to eliminate the differences between the results and the predetermined standards, thereby guaranteeing organisational control (Lawler, 1976).



Ouchi (1979) reviews the main interpretations of the term and points out that certain theorists link control to the problem of making and supervising rules via a system of hierarchical authority that allows the organisation to operate with maximum efficiency. Merchant and Simons (1986) point out that definitions of control generally include two basic aspects of control: the first centres on the behaviour of the members of the organisation, and the second refers to the effect of this behaviour on the results of the organisation.

## **2.2. Why is control important within organisations?**

When a company is made up of a number of individuals, one of the problems that arises involves the attempt to ensure that this group of different people will make a commitment to carry out the activities that contribute towards meeting the objectives of the organisation. If everyone behaved with the best interests of the organisation in mind, control would be unnecessary. However, sometimes individuals are unable or unwilling to act in the best interests of the organisation (Merchant, 1985). Coordination and control are necessary and the fundamental problem of how to efficiently achieve objectives arises in every organisation.

The importance of control has been justified by the contribution of Pfeffer (2000:135), amongst others: "... control is simultaneously a basic problem for management and organisations and the implicit focus of a large number of studies concerning the organisation". Braverman (1974) states that "control is...the central concept within all systems of administration" and a fundamental problem within organisations. Moreover, Geringer and Hebert (1989) assert that control plays an important role in a company's capacity to meet its objectives.

Child and Faulkner (1998) justify the importance of control in collaborative relationships and state that control is a determining factor in the success of all collaborative relationships. Each member attempts to protect the integrity and the use of the resources with which they collaborate, attempting to find a certain degree of control over this collaboration. Control is also justified by the need to find a compromise between individual and organisational objectives and the culture of the organisation. This balance is extremely complicated, but it is possible with a suitable level of control. Moreover, control represents a source of confidence for the partners of the cooperative, who feel more secure and more confident when they exercise an appropriate level of control over the members of the organisation and the organisation itself (Das and Teng, 1998).

In general terms, the need for control is determined by the supposition that any planned activity must be the object of control in order to ensure that the planned activity is correctly implemented and that progress towards achieving the objectives is made. It is possible to plan well, it is possible to create the appropriate organisational structure to facilitate the effective and efficient attainment of objectives, and employees can be controlled and motivated. Nevertheless, there is no guarantee that activities

will be put into practice as planned and that the goals of the administrators will actually be met. Thus, the effective administrator needs to monitor the process in order to ensure that the actions that will be carried out by other people and the objectives that have been set will in fact be carried out and accomplished. Therefore, we can assert that control is important because it is the last link in the functional chain of management. However, it is not merely an indispensable function for the owner of the organisation who seeks to meet the goals that have been set, but rather also contributes to the attainment of the individual objectives of each of its members.

On the basis of the matters outlined above, the importance of control within organisational analysis is clear. Whilst the life of an organisation revolves around survival and the search for efficiency, control becomes a crucial aspect as it is linked to other elements that form a part of the running of the organisation, such as authority and the distribution of power. Moreover, as the size of an organisation increases, the problem of control acquires greater relevance. The survival of organisations in turbulent environments to a large extent depends on the coordination and integration mechanisms that are used to control different activities. Indeed, the focus of control has shifted away from the problems of controlling people/tasks towards an approach that focuses on the control of the organisation. These changes are due to the dynamic nature of the environment wherein these organisations operate.

Having considered the main aspects of organisational control, we now turn our attention to specifying the specific features that characterise this function in our particular case: cooperative companies within the olive-oil extraction sector. In other words, we will determine who exercises control, who or what is subject to control and the resources and mechanisms that are used for this purpose.

### **3. THE CHARACTERISTICS OF CONTROL WITHIN OLIVE-OIL COOPERATIVES**

The behaviour of the businessman within the olive-oil sector does not differ from the behaviour displayed by man since the beginning of time, wherein organised groups are formed for the purposes of making tasks easier to perform with improved implementation. Thus, the olive-oil cooperatives are established using a business model that differs from the capitalist model, wherein collective action and democratic participation become the basic features of the structure.

Thus the olive-oil cooperative companies are set up with certain specific aims: satisfying the common needs and expectations of the partners. To this end, they act in accordance with certain values and norms (principles, laws and articles of association) that condition their behaviour and define their organisational structure. Moreover, they need proper control in order to accomplish these objectives.

### 3.1. Ownership and control

Ownership and control are characteristic features of olive-oil cooperatives. Both functions involve the partners.

Ownership of the company is held by the title-holders of the capital of the same, which has been viewed as the main source of legitimate power. In our case, the partners of the olive-oil cooperative participate in the financial flow via their contribution to the company capital and therefore are the legitimate owners.

On the other hand, the double role of partner/supplier<sup>2</sup>, entails certain risks: the amount of residual income is uncertain and therefore there is a risk that is compensated by the income. Moreover, as businessmen in the agricultural sector, the benefits of their assets, or their income, will depend on the efficiency of the management of the cooperative company to which they belong, and the assets will appreciate on the basis of the future benefits that they produce. Thus the farmer, who forms part of the olive-oil cooperative takes a considerable risk.

The accumulation of risks may pose a problem for the partners, given that some of them possess assets that are concentrated in a few areas. Therefore, when deciding on the investments of the cooperative company, not only the risk of the project will be borne in mind, but also the diversified risk of the same. This will not affect all of them to the same degree, leading to preferences and different interests that give rise to the need for a mechanism that unifies diverse volitions for the purposes of decision-making.

In short, we can assert that the partner, as an owner, possesses two formal rights: the control of the company and the securing of benefits or residual earnings. Moreover, given that all of the company partners take risks, they must exercise control<sup>3</sup>.

Normally, when any market transaction takes place, the person who makes the decisions is the title-holder and, as such, they assume the negative and positive consequences of their decisions. On the other hand, in organisations, the person making decisions relating to the use of resources in many instances is not the title-holder and the consequences of their decisions do not affect their assets, but rather the assets of the owner of the aforementioned resources (Arruñada, 1990).

In olive-oil cooperatives, the owners delegate their rights to the governing board or, on occasions, to the management, who act on their behalf, providing that the latter feel that their wishes are being carried out and their interests are being met. In other words, while the owners receive earnings that are in keeping with the expected return of their investments, boards and managers will continue to act on their behalf, otherwise, the owners will attempt to regain control and incapacitate the management.

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2. The partners of the olive-oil cooperatives are, at the same time, businessmen, suppliers of raw materials and consumers of the end product.

3. The papers by Alchian and Demsetz (1972) and Jensen and Meckling (1976) allude to the control of management and assign this task, for the most part, to those supplying the risk capital.

Companies wherein the owners and the management are separate entities are frequently affected by conflicts of interest between the management and the owners and therefore control becomes much more important.

### **3.2. Mechanisms of control: participation in the company**

Democratic management is another characteristic feature of the olive-oil cooperatives that is evident in the partners' participation in decision-making. This participation derives from the rights that the legislation confers to the partners as businessmen/owners<sup>4</sup>, and is brought to bear via the management organs of the company.

Basing our conclusions on the results of the study carried out by García and Ruiz (2001), we feel that, along with other resources such as information and communication, participation is one of the mechanisms used by partners to control the running of the organisation<sup>5</sup>. In keeping with this notion, this participation presents certain implications that need to be considered.

In olive-oil cooperatives we find two highly significant facts in relation to partner participation: the partners do not normally attend assemblies and, when they do, their participation is minimal. At first glance, this behaviour could lead us to believe that the partners are prone to a generalised lack of interest in the management of the cooperative. However, absent partners frequently employ information channels to obtain details of the agreements that have been adopted. We believe that this behaviour can be explained by the underlying view that these businessmen take of the company: rather than viewing it as their own company, they see it as a company belonging to a third party, which they can use to sell oil. Nevertheless, despite the minimal participation that has been noted, uncertainty within the sector is causing partners to take a greater interest in and be more concerned with matters relating to the cooperative, which inevitably leads to greater participation and increased control over the running of the cooperative.

We have also noted that assembly attendance varies in accordance with certain circumstances that we outline below:

Participation depends on the size of the farm: we have found that those partners who own a medium-sized farm, which is their only business and sole source of

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4. Article 38 of Law 2/99, concerning Andalusian Cooperative Companies, states that the partner has a right to participate: a) in the stated objective of the company, b) in the adoption of general assembly agreements and the agreements of other company organs of which they form part, with the rights to be heard and to vote, c) in a share of the surplus in proportion with the activity carried out in the cooperative, and d) in training and inter-cooperational activities within the company.

5. However, we do not wish this to be interpreted as meaning that the lack of participation, which is common in this sector, implies a lack of control given that, in these circumstances, other resources are used to exercise control.

income, show a greater degree of involvement with the cooperative. They actively participate in decision-making and exercise tight control over the activities that are undertaken. It should also be pointed out that some of the partners with small farms continue to play an active role in the company, which can be explained in part by their place of residence (which is normally in the same place as the cooperative's company headquarters) and due to the fact that they have a long tradition of working with olive-oil. However, a clearly defined behavioural pattern on the basis of the size of the farm does not exist, given that owner of the smallest farms, who has fewer interests in the cooperative, participates less, whilst the owner of the largest farm shows a greater degree of participation (Hernández and García, 2001). Thus, we find both small-scale farmers who actively participate and owners of large farms who participate less.

Differences also arise when we consider the partner's usual place of residence. In small localities, the cooperative is usually the daily meeting point for many partners. These informal meetings facilitate the exchange of information relating to the management of the company, which allows for greater participation in decision-making and more frequent and tighter control. In larger localities visits to the cooperative are less frequent and the partners are made aware of matters concerning the running of the cooperative solely through the correspondence that they receive and in the assemblies, which means that, whilst these partners are involved in decision-making, they have less contact with the organisation. In addition, partners who live in rural areas and who do not have their own means of transport and partners who live in other regions find it more difficult to attend assemblies and therefore participate less.

Nevertheless, confidence in the members of the governing board is an essential factor when analysing partner participation. This confidence is not given blindly, but rather is inspired by a past record of good results. Confidence in the abilities of the board, on the basis of previous results, allows the partner to take a more relaxed approach to management and forgo attending meetings, as they feel that their interests are properly represented (Hernández and García, 2001).

#### **4. CONTROL OF THE OLIVE-OIL COOPERATIVES FROM THE PERSPECTIVE OF THE AGENCY THEORY**

We can state that the object of the agency perspective is basically to control the agent in order to ensure that the interests of the principal are adequately protected, and therefore it is the theoretic framework that is most frequently used to explain control in organisations<sup>6</sup>.

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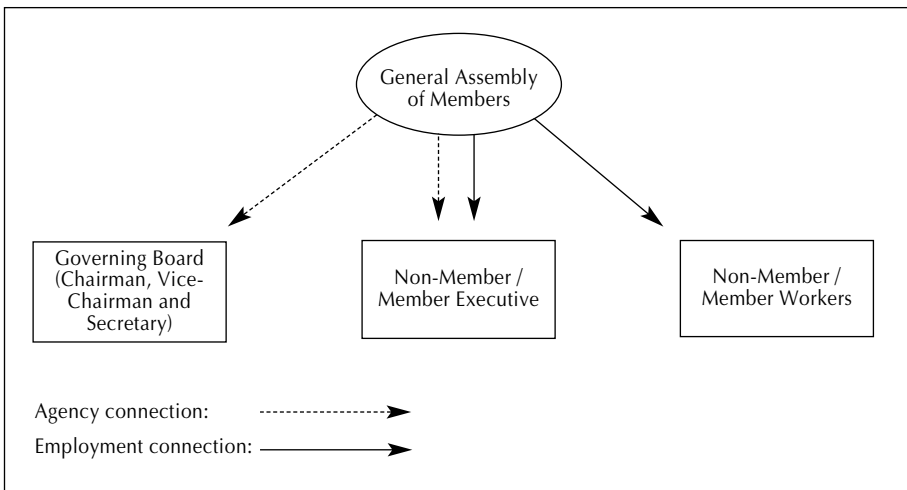
6. As Eisenhardt (1988:489) points out, the application of the agency theory to the literature on organisational control is evident in the works of Thompson (1967), Ouchi (1980) and Pennings & Woiceshyn (1986).

The reasons for controlling the agent stem from the existence of an agency problem, which arises when one, of the following circumstances occur<sup>7</sup>: asymmetric information, different attitudes to risk and conflict of interests.

The cooperative company is a participative company wherein all the partners participate in the “cooperatised” activity and possess a common property. The fact that the partners own the property and exercise control of the company implies a lesser degree of specialisation in production factors: the partners are, at the same time, suppliers and capitalists. Their role involves the relatively direct assumption of the three functions of the provider of capital: the actual financing, risk assumption and the exercise of control. These models of collective property and partners who assume control confer special characteristics on the contractual or agency relationship that arises in the cooperatives (Álvarez et al., 2000).

Amongst the members of any olive-oil cooperative we can identify the following: owner-suppliers (partners or associates), members of the governing board (partners), managers (who may be partners or professionals who are not owners) and workers (who may be partners or individuals who do not form a part of the cooperative). In figure one, below, we illustrate the different types of relationship that we have identified.

**FIGURE 1.**  
**CONNECTIONS BETWEEN MEMBERS OF AN OLIVE OIL COOPERATIVE**



Source: devised by the authors..

7. Certain authors refer to two agency problems : the conflict of interests and risk aversion (Eisenhardt, 1985, 1988, 1989; Macho and Pérez, 1994; Azorín and Varela, 1996). The reason for combining asymmetric information and conflict of interests is that if the interests of the principal and the agent coincide, the transfer of all relevant information would occur automatically and the asymmetry would be innocuous (Macho and Pérez, 1994:18).

### *Owner-partners and the members of the governing board*

This can be classified as an agency relationship insofar as the partner (as the principal) entrusts the board (as agents) with tasks, giving them wide-reaching powers of decision-making.

### *Owner-partners and partner/non-partner managers*

This can be classified as an agency relationship where the owner-partner, or governing board, delegates authority to a third party, the manager, whose activities must be in keeping with the partner's interests. In those cases where the manager is not a partner, we can also identify an employment relationship<sup>8</sup> that exists between the two parties (partners and managers).

### *Partners and wage earning workers*

Regardless of whether or not the workers are partners, this is an employment relationship.

Using the agency theory as our approach, we believe that the relationship that arises in the olive-oil cooperatives between partners and managers is an agency relationship, wherein the partners (as principals) delegate the authority to make decisions to the governing board and/or management (as agents)<sup>9</sup>. Therefore, the latter are charged with the task of protecting the interests of the principal.

When the partners select the members of the governing board as the organ charged with the management of the company, an a priori compromise is made that will affect the future behaviour of this organ. In this case, the conferral of authority to manage the company permits the advantages of specialisation of functions as management capability and ownership do not necessarily implicate the same person. In this manner duties are assigned more efficiently and the partners achieve better results as each member performs the function with which they are most familiar and which is best suited to their abilities.

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8. In keeping with Salas (1993), we feel that an employment relationship exists where the employee provides services in exchange for a salary. The employer decides how to allocate these services on the basis of his or her needs.

9. The following possibilities have been considered in this case: a governing board made up of partner-owners; a governing board that appoints a third party as manager, wherein the third party is a partner; and a governing board that delegates authority to a manager who is not a partner. Bearing in mind that the post of manager does not exist in all the olive-oil cooperatives and that the functions attributed to the manager are not the same in each case, we must point out that the governing board frequently takes on the tasks of management whilst the manager takes charge of administrative duties. Moreover, the people who occupy these posts normally are not professionals. This lack of professionalism has become one of the most marked problems in these companies.

As a direct consequence of this compromise between each party the partners of the cooperative loose autonomy. Thus the question is whether or not this delegation of authority could give rise to negligent behaviour on the part of the agent wherein he or she uses the delegated powers for his or her own interests, to the detriment of the interests of the partners. All circumstances that lead the agent (member of the governing board, president or manager) to behave in a manner that adversely affects the interests of the partner, give rise to the need for the partner to control those in charge of management.

## 5. THE FUNDAMENTALS OF CONTROL IN OLIVE-OIL COOPERATIVES

At this point our objective is to identify those circumstances that may arise within the management of olive-oil cooperatives that generate an agency problem. These circumstances will cause the partners to attempt to tighten control of the management of the company. We believe that these factors represent the fundamentals of the control of the management in these types of organisations. Thus, the issue becomes whether or not asymmetric information, different attitudes to risk or a conflict of interests occur in this relationship<sup>10</sup>.

One of the most frequent problems that arises in the relationship between members of the governing board and the remaining partners involves transparency during information transfer. Whilst in the majority of the cooperatives the partners and members of the governing board are usually mutually aware of the decisions that are taken, there are occasions when the governing board makes decisions without consulting the partners. This may be due to the fact that the partners do not have the technical knowledge to understand the decision and make a pertinent contribution, because they are simply not interested or due to lack of time when faced with a decision that requires immediate action. These circumstances give rise to asymmetric information.

Another element that may cause asymmetric information is the clash between the individual values of each partner and the cooperative values that they need to possess within this type of company. The defence of individual interests leads to certain information being hidden from the remaining partners and at the same time highlights one of the other problems that we have pointed out: the conflict of interests.

A conflict of interests may occur for several reasons. Taking the concept of the company as a contractual phenomenon, as defined by Coase (1937), as a starting point, we can assert that contractual relationships are the essence of the company and involve not only the contracts linked to production, but also the series of contracts

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10. To justify the inclusion of these factors in the companies that form the object of this paper we have based our approach on the findings of the paper published by García in 2002. This author used a sample of 31 olive-oil cooperatives and carried out 140 interviews with people who held different posts within the cooperative in order to determine the presence of each of the problems outlined in the agency theory.



that arise between the company and its environment. This concept of the company leads us to conclude that the company lacks its own objectives, rather, it is the contracting parties (in this case the partners) who possess individual attributes such as objectives and responsibility. The conflict of interests in olive-oil cooperatives can occur in two ways: conflict between the non-partner manager and the partners and conflict that occurs between the governing board or the manager-partner and the partners. This distinction is significant where, in the first case, the manager does not have an interest in the company.

A conflict of interest occurs when the partners seek to form part of a cooperative company for a number of different reasons and where their farms are of a different size and their level of involvement in the agricultural sector is dissimilar. These situations may lead to inefficiency when establishing the objectives of the company.

Something similar occurs with the appointment to different posts. The criteria used by the partners to select their representatives does not only involve a conflict of interests: in general, the people who occupy these posts (most notably in the case of the president) are usually of an advanced age and their educational background and training is not always suited to the post.

Whilst attempts are made to ensure that the partners of the governing board are partners with farms of varying sizes, thereby representing the interests of all partners (the majority of the partners possess small-scale or medium-sized farms), owners of medium-sized and large farms predominate (most notably in the post of president). The partners' motives for making appointments resides in the belief that a greater interest in the company will mean a greater defence of the interests of the remaining partners. Thus, on occasions social status is given preference over appropriate educational background and training and presidents are chosen from within the farmers' collective who do not possess the necessary know-how to carry out their duties and who are in no way capable of defending the wide range of interests of the partners. On other occasions the governing board is made up of partners who are involved in the activity on a part-time basis, rather than professionals who are exclusively dedicated to the activity.

A conflict of interests can also occur as a result of the high degree of prolonged incumbency in the posts of president and manager. This situation has two consequences: on the one hand it is a problem given that, where there is no rotation of the posts, this does not facilitate the participation of all the partners or the representation of the range of interests in the management organs; on the other hand, permanence in a post is a sign of good management and the partners' faith in their managers. Where the partners have faith in the performance of the president and managers over the years they take a more *laissez faire* approach to the management of the company.

The advanced age of the managers and their, at times, limited or ill-suited educational background and training aggravates the problem of the limited rationality of the agents and has a detrimental effect on their attitude to risks as they may not always make the best decisions and control of the company may be lost if the set objectives are not achieved.

Attention should also be drawn to the limited initiative for investment amongst the partners. Whilst the partners always receive payments, these payments vary in accordance with the value of the product that they contribute. This factor, along with the high risk<sup>11</sup> within the olive-oil sector means that the business perspective of the partner is more limited in the short term. Thus, they are usually reluctant to adopt decisions that involve a certain degree of risk such as capital increases or allocating funds to self-financing, etc. Moreover, the lack of freely transferable shares means that the partners are not motivated to invest, at least where they hope to remain in the company for the length of time required to recover their investment. This problem adversely affects the investment choices made by the governing board. Partners prefer to invest less and take on projects that offer a short-term recovery period. The partners' reluctance to invest is also reduced when new partners enter and have an equal share in the benefits of prior investments. The direct consequence is that disagreements over where and when to invest arise whilst profitable projects are rejected.

At times the advanced age of the managers affects their attitude to risks. This aspect makes them more conservative with a preference for tried and tested areas rather than venturing into new areas.

Asymmetric information and the conflict of interests give rise to the problems of moral hazard, adverse selection and signalling, which are outlined in the agency theory.

When the governing board fails to provide the partners with clear and complete information in relation to their management of the company, and the partners, due to a lack of time or experience, fail to supervise this management, a problem of moral hazard may occur. Moreover, partners frequently appoint other partners to the post of board members on the basis of their standing within the locality, more active participation in assemblies or ownership of larger olive farms, as they feel that in such cases their own interests will be better defended. However, it is extremely likely that the interests of these partners are different to those of the remaining partners. In the case of partners with more assets linked to the activity, we undoubtedly find a greater degree of aversion to risks, and when faced with certain decisions they will act to protect their assets even where another course of action is advisable.

However, a moral hazard problem may also occur in an inverted sense, which makes control amongst the partners even more important. The governing board may establish general guidelines for the running of the company, placing their faith in the good intentions of the partner. Nevertheless, they do not know how the partner will react, and opportunistic behaviour may occur. The partners are responsible for their own farms, but only they are aware of the quality of the product that they contribute to the cooperative, whilst this affects the benefits of all of the partners. Some partners have privileged information that leads them to forgo participation in the assemblies and acquire information on the agreements informally, via third parties.

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11. It should be borne in mind that the agricultural sector entails high risk insofar as, amongst other factors, it is dependent on the weather conditions and the majority of the partner's assets are linked to this activity.

Adverse selection is another problem that arises in the olive-oil cooperatives. When the general assembly appoints the members of the governing board, the majority of the partners employ the same criteria: the standing of the person within the locality, the value of his or her assets, cultural level, etc. However, a priori, they do not actually know whether or not the person charged with managing the company has the necessary aptitudes to carry out the appointed task. Along the same line, the person chosen to manage the company may have no knowledge of the tasks that they will have to perform, in which case, even where their personal qualities are known, there is no way of knowing whether or not they will be able to perform this role. Moreover, the partners' difficulties with the evaluation of the candidates means that they are less likely to know whether the companies results are due to the actions of the governing board or the adversities of the environment (restrictive regulations, unfair competition, policies that go against farmers' interests).

The problem of adverse selection may occur when someone expresses their desire to form part of a cooperative. The governing board may use certain criteria to reach a decision regarding this request, but they do not check the quality of the farm or attempt to discover whether or not the new partner is a good farmer.

When the partners choose the members of the governing board, they have no criteria that allow them to identify the most suitable candidates, and are guided solely by the actions that partners use to stand out from the remaining partners (public speaking in language that is accessible to the partners, contributing ideas in assemblies, visiting the installations of the cooperative on a frequent basis, etc). If these signals emitted by the partners who wish to occupy a management post do not entail the possession of the necessary qualities and abilities to carry out this role, we are faced with a problem of signalling. However, the governing board receives few signals from those farmers who wish to form part of the cooperative, and their approval is based on a simple request that outlines the size and characteristics of the farm in question and the volume of production that can be contributed, etc. Nevertheless, the real motives behind the request to form a part of the cooperative are not expressed. Thus, the only means of discovering whether or not the behaviour of the new partner is suitable is through day-to-day management.

## 6. CONCLUSIONS

Control plays an important role in an organisation insofar as it involves the attempt to ensure that all members collaborate to meet shared objectives. In this sense, control becomes a critical aspect that must be borne in mind when analysing any company. For this reason we have considered control in our study of the cooperative companies within the olive-oil extraction sector.

In the case of olive-oil cooperatives, the partners, as owners, participate in the setting of objectives and their behaviour must be geared towards the common interest. However, the reality of these companies shows us that the partners delegate decision-

making functions to the partners in charge of management (the governing board, president and or manager). Thus, in the course of the general assembly, the partners establish the general objectives and delegate powers to the governing board as the executive organ. Subsequently, the governing board and management take steps to ensure that the objectives that have been set are accomplished, whilst the partners take on the task of controlling their activities, allowing the managers to get on with the task of managing with faith in their professionalism.

Using the agency theory as a basis, we feel that the relationship that arises between the partners and those in charge of management is an agency relationship. The essence of this relationship involves controlling the actions of the agent in order to ensure that the interests of the principal are protected. However, what circumstances give rise to control being exercised over the agent, and what are the fundamentals of this control?

Empirical evidence shows us that within the olive-oil cooperatives (more specifically, in terms of the performance of the managers and their relationship with the partners) we can identify a series of problems that lead to a control-related problem. Thus, we have identified factors such as the educational background and training of the partner, the size of the property and the level of involvement in the company, which leads to information asymmetry and a conflict of interests. The age, educational background and training of the partners also restricts their business perspective, which at times leads them to take a different attitude towards risks which may cause the loss of a profitable project.

Therefore, as the agency theory establishes, all control-related problems that occur between the principal and the agent arise as a consequence of information asymmetry, a conflict of interests and different attitudes towards risk. Our study leads us to conclude that we find these problems within the management of olive-oil cooperatives, which we identify as the fundamentals of control in these organisations.

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**PART 3**  
**COOPERATIVE  
GOVERNANCE AND WORKER  
COOPERATIVES**





# CONTROL STRUCTURE AND STAKEHOLDER INVOLVEMENT IN CO-OPERATIVE GOVERNANCE: A COMPARATIVE ANALYSIS

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## 1. INTRODUCTION

Corporate governance is often analyzed using the Principal-Agency theory or Trustee- Stakeholder theory, which each reflects both narrow and wide interpretations. The former seeks to discipline managers as agents so that shareholders as principals can get the maximum return for their investment. The emphasis is thus placed on how to control and monitor managers. The internal control mechanism is created to make managers accountable for their conduct, while the external control is exercised in the form of corporate ratings and takeovers. The latter expects managers to coordinate the competing interests of different stakeholder groups so that they can get maximum satisfaction. The emphasis, therefore, is on how to involve stakeholders including customers, employees, suppliers, banks, and communities at large.

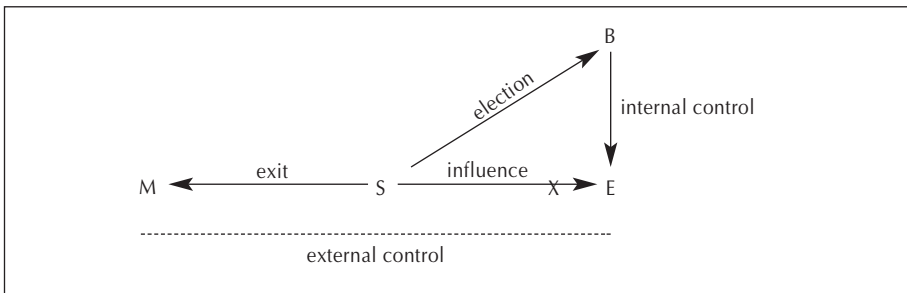
Co-operatives have many features in common with investor-driven firms of the corporate governance structure, but they have different characteristics as user-driven enterprises. They have similar internal control mechanisms with regard to board-manager relations and the auditor's role. But the external control is quite different since co-operatives are not threatened by the market of corporate control, which may result in the lack of accountability of incompetent managers. Therefore, supplemental controls and a monitoring mechanism by or for co-ops are needed. In addition, in co-operatives the members are the principal stakeholders, commingling investor and user roles. Member participation is thus given priority, to enable members to exercise real influence on a co-op's decision-making and provide effective feedback to a co-op's operation. At the same time, the other stakeholders, especially employees and suppliers, also need to be involved in the governance process.

This paper will trace the basic structure of a firm's corporate governance and its transformation. Then, it will discuss the special features of co-op's governance both in terms of the control mechanism and stakeholder relationship. It will also discuss the implication and problems of multi-stakeholder co-ops.

## 2. GOVERNANCE STRUCTURE AND CONTROL OF JOINT STOCK COMPANIES

The Principal-Agency theory developed by Jensen and Meckling provides the basis for analyzing the governance structure of joint stock companies. The shareholders (S) elect the board of directors (B), which exercises internal control over the executive officers (E). They exit from the firm by selling shares in the stock markets (M), which exercises external control over executives through corporate ratings, takeovers and SRI. This scheme is described as follows.<sup>1</sup>

**CHART 1.**  
**GOVERNANCE STRUCTURE OF JOINT STOCK COMPANIES**



In joint stock companies it is supposed that shareholders have only limited liabilities and are not directly involved in the management of the firm. The ownership and the management are institutionally separated and so X E control is negated. Here arises the agency problem; how shareholders can control management. They elect the board (S→B), which controls executives through appointment/removal and performance monitoring (B→E). This constitutes the mechanism of internal control in governance structure, including subcommittees of the board and compensation programs.

On the other hand, shareholders can exit from the firm by selling their shares in the stock markets (S→M). When the share price falls, it becomes easier to buy out shares, take over the firm or influence management's behavior, thereby exercising an external control mechanism (M→E). The external control includes accounting rules and regulatory reporting requirements, external auditors, investment banks, securities analyst, and potential product markets. This is the case of publicly traded companies (PLCs), while non-listed companies or ventures are not subject to some of these controls.

However, in the beginning of 20<sup>th</sup> century, the bulk of the American joint stock companies became 'managerial firms' where managers dominated as described by

Berle and Means. The share ownership was dispersed among a large number of small shareholders, none of whom could effectively control the firm's management, viz. lack of

S→B control. As a result, the general meeting of shareholders became merely a name, being controlled by the management. Insiders in the firm largely dominated the board until the 1970's. Even external directors were often composed of persons with whom the CEO had a friendly relationship, thus B→E control was severed. On the other hand, highly dispersed share ownership meant fluidity in the stock market and resulted in M→E control under the threat of takeovers. Accordingly, managerial firms severed the internal control, but were placed under the external control with restraint to share price.

In Japan, banks and corporations were separated by the decree of the dismantling of the *zaibatsu* after WW, but they soon rejoined in corporate groups and created a form of managerial firms with different governance structure. The banks and corporations contained the dispersed ownership through cross-shareholding. The resultant large and friendly shareholders rarely opposed the proposals of firm's board/management, rendering general meetings meaningless. Almost all board members are composed of internal directors who are also executives, thus the functions of board and management are united. Under the mechanism where the president/CEO de facto nominates other board members as subordinates who work as the firm's executives, board control over executives is severed. In addition, the external control through takeovers and its threat is also made void by cross-shareholding and interlocking directorships. In this sense, the Japanese firms have a high degree of managerial control free from internal control by shareholders and the external control by the market. Hence they are characterized as having strong insider control, often fortified by *Keiretsu*. However, the management is subject to daily monitoring by Main Banks, which intervene in the firm's management when it faces financial crisis by providing financial support for reconstruction, removing current board/CEOs, appointing new board/CEOs and undertaking insolvency procedures. In this sense, Main Banks exercise the contingent external controls in place of the corporate control market.<sup>2</sup>

Managerial firms such as these became the dominant model of large firms in most industrialized countries. However, corporate raiders started attacking firms backed by discontented shareholders in the 1980s in the United States facing downgraded competitiveness and floundering stock price. Namely, a large number of hostile TOB took place, new instruments for financing through junk bonds and leveraged buyouts were developed, thus 'a market of corporate control' emerged. However, the stock market crash on Black Monday in October 1987 put an end to boom financing and hostile takeovers, which were made very difficult by the enactment of anti-raiders legislations.

In the 1990s, the reform of corporate governance became a focus of discussion and a number of institutional arrangements were introduced in the US. The institutional investors, inter alia pension fund and insurance companies came to control a substantial number of shares and became to voice proactively requesting that the

majority of board should be composed of external directors since their exit might induce a downturn in stock prices (shareholder activism). As a result, S→B control was revitalized and the CEOs of many major firms including GM, IBM, Apple Computer, were dismissed by the initiatives of external directors. They were expected to monitor the management performance and constituted a major part of nominations, compensation and audit committees within the board. This meant the revival of B→E control, but they were not necessarily capable of monitoring management due to asymmetric information. So the stock option was widely introduced to give managers incentives to raise stock prices. The monitoring of stock prices by rating companies and securities analysts was expected to exercise M→E control. As such, the American corporate governance system largely depended on stock option incentives and external monitoring under ever-rising stock prices. This model has given great impact to governance reform in many countries, but lost its credibility after the corporate scandals involving Enron, WorldCom and others on the threshold of the new century. The reform of corporate governance was prompted by regulatory changes including the Sarbanes-Oxley Act of 2002 and new governance guidelines from the NYSE and NASDAQ, but its effects are still to be observed.

### 3. GOVERNANCE STRUCTURE AND CONTROL OF CO-OPERATIVES

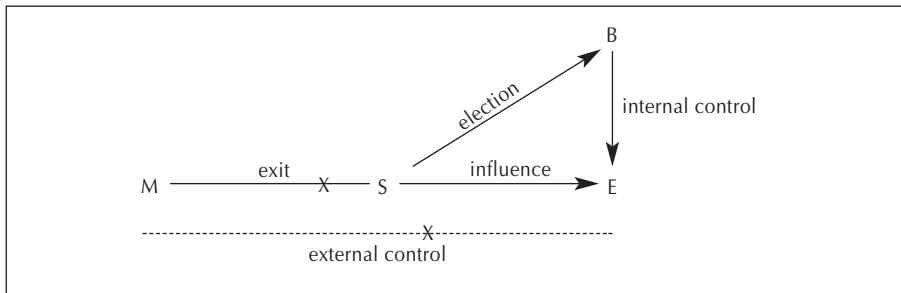
Co-operatives have evolved in parallel with joint stock companies since the mid 19<sup>th</sup> century, with some differences in the incorporation system. Both are economic associations, but the former has the objective of meeting member's economic, social and cultural needs and aspirations, while the latter seeks to bring shareholders the highest return for their investment. The German Co-operative Law defines co-operatives as having the promotion objective (Förderungszweck), i.e. "to promote member's business and household economy through joint business activities".<sup>3</sup> In addition, in co-operatives, members have three functions as owners, users and decision-makers, (the identity principle) while in joint stock companies shareholders are separated from users and decision-makers. In both cases governance problems arise between ownership and decision-making, but combining ownership with user status is the dividing Merkmal. In this sense, the USDA's definition of co-operatives involves elements as user-ownership; user-control and user-benefits<sup>4</sup> Cand Münkner distinguishes co-operatives as user-led firms compared with joint stock companies as investor-led firms<sup>5</sup>.

Such a difference is reflected in the governance structure of co-operatives. The 2<sup>nd</sup> Co-operative Principle, 'Member's Democratic Control' reads, "Co-operatives are democratic organizations controlled by their members, who actively participate in setting their policies and making decisions." The 4<sup>th</sup> Principle, Independence and Autonomy reads, "Co-operatives are autonomous, self-help organizations controlled by their members. If they enter into agreements with other organizations, including

governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their co-operative autonomy."

As such, member's democratic control has fundamental meaning in co-operative governance. Co-operatives have similar internal control mechanism as compared to joint stock companies in that members as Shareholders elect the Board of Directors which controls Executive officers, ( $S \rightarrow B \rightarrow E$ ) but the higher positioning is given to the general meetings as the supreme decision-making organ, which covers a wide range of matters including the approval of accounts and the decision about business plans/budgets, which are generally delegated to boards in the latter case. This means the decision making of basic matters is generally retained in the organs closest to the overall membership. The shareholders derivative actions may reinforce members' rights as owners. In addition, members as users can influence decisions and operations to be made by the management through various media and channels of communication ( $S \rightarrow E$ ). This is to supplement ownership-based control and may bring a potential competitive edge if feedback is made through active members' participation.

**CHART 2.**  
**GOVERNANCE STRUCTURE OF CO-OPERATIVES**



Co-op members are prevented from forming coalitions because of equal voting rights (one person one vote) and influential voting rights as exercised by institutional shareholders are excluded by principle. Furthermore, in many cases within consumer co-ops members have only minimal, (1 in the UK) or no share (in Denmark) and therefore little stake in co-operatives. These factors may cause serious agency problems, making the internal control very difficult. As a result, the management might intentionally control the general meetings and boards, thus creating typical managerial control, as described by Berle and Means, with full autonomy free from internal control mechanism.

In addition, members collectively own co-operatives. A part of their capital is also collectively owned as indivisible reserves. But it does not necessarily lead to effective democratic control by members, as widely dispersed small ownership easily

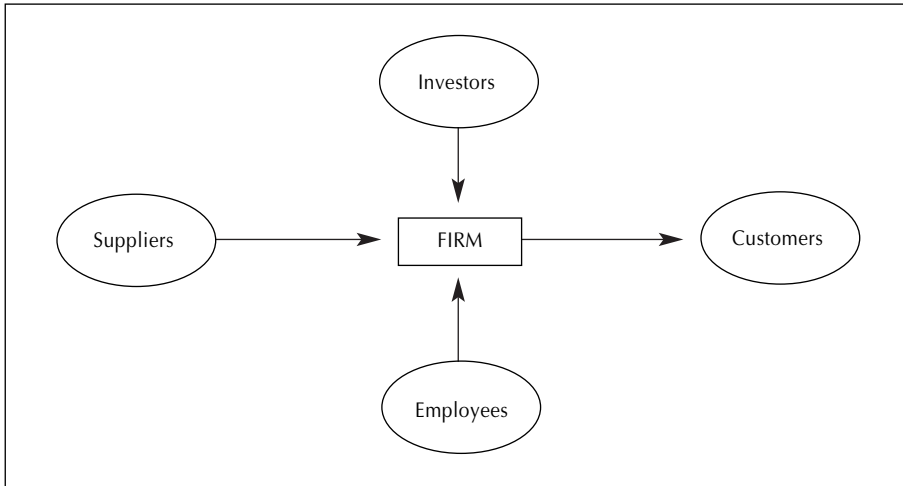
causes agency problems. This situation is comparable to the fact that state or all people's ownership being advocated as the supreme ownership form in the socialist countries became no one's ownership and resulted in the top down control by state/party technocrats. Co-operatives in those countries were 'semi-nationalized' by governments through enforcement of business plans, appointment of top management and soft restraint for budgeting (deficit to be covered by states). When they underwent the transition to a market economy, they had to reconstruct the individual property rights of members, but often allowed top management of nomenclature class to usurp a significant part of their capital.

On the other hand, shareholder can sell their shares on the stock markets, while members can only leave co-operatives since their shares are usually non-transferable. There exist no external control over top management through corporate rating, takeovers, or SRI. This means it is difficult for co-operatives to discipline poorly performing managers by the pressure of the market. They need to establish an alternative mechanism for external controls, i.e. monitoring and auditing by federations or external auditors. In Germany all the co-operatives are obliged to affiliate with and be audited by the sectorial auditing federations, while in the UK, co-ops are monitored by Co-operatives UK and audited by external auditors. In Japan agricultural co-ops are subject to monitoring and auditing by central unions, but consumer co-ops are yet to build such control mechanisms.

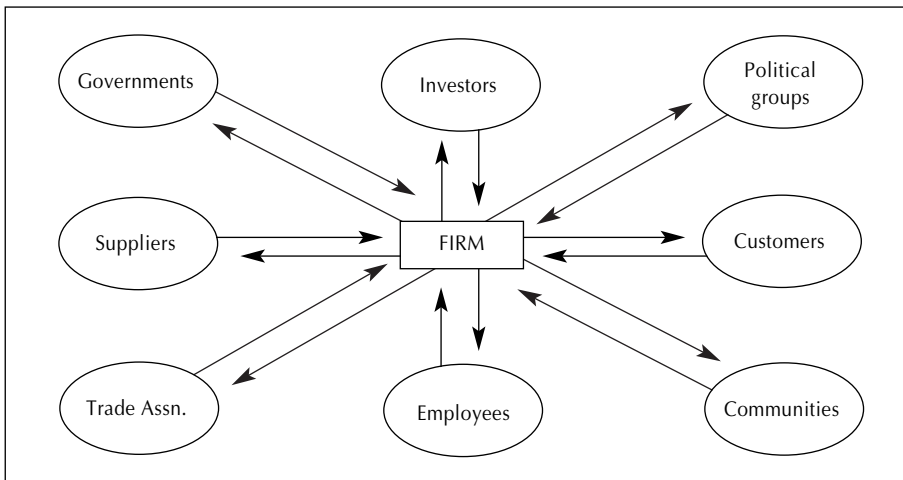
#### **4. IS STAKEHOLDER MODEL APPLICABLE TO JOINT STOCK COMPANIES?**

Freeman initiated a stakeholder theory of the firm, insisting that the concept of managerial capitalism could be revitalized by replacing the notion that managers have a duty to stockholders with the concept that managers bear a fiduciary relationship to stakeholders who have a stake in, or claim on, the firm, including suppliers, customers, employees, stockholders and the local community, as well as management in its role as agent for these groups.<sup>6</sup> Donaldson and Preston explained the stakeholder model in contrast to the conventional input-output model.<sup>7</sup> In Chart 3, investors, employees and suppliers are depicted as contributing inputs, which the firm transforms into outputs for the benefit of customers. As a result of the competition, input contributors receive only "normal" benefits in the long-run equilibrium while the bulk of benefits will go to the customers. In contrast, the stakeholder analysts argue that all persons or groups with legitimate interests participate in an enterprise and there is no *prima facie* priority of one set of interests/benefits over another. Hence, the arrows between the firm and its stakeholder groups run in both directions and all stakeholders are equidistant from the firm as described in Chart 4. They also suggested that the stakeholder theory has strong links with Corporate Social Responsibility (CSR). In fact, all studies on CSR make explicit and implicit reference to stakeholder perspectives.

**CHART 3.**  
**INPUT-OUTPUT MODEL**



**CHART 4.**  
**STAKEHOLDER MODEL**



However, a controversy exists on whether the stakeholder model of governance is applicable to the joint stock companies, which prime objective is to give the highest return on share investment. The stakeholders other than shareholders have different stakes, higher pay and better labor conditions for employees, lower prices and higher quality for customers, better trading terms and continuation of transactions for suppliers and banks. It is difficult to define the common interests mediating these competing stakes. It is also difficult to motivate managers to realize agreed objectives, even if they are defined.

Jensen criticized the stakeholder theory as being anachronistic and a source of managerial confusion that ends up contributing to corporate failure, stating, "Without the clarity of mission provided by a single-valued objective function, companies embracing stakeholder theory will experience managerial confusion, conflicts, inefficiency, and perhaps even competitive failure".<sup>8</sup> But admitting that corporate managers must satisfy and enlist the support of all stakeholders in order to maximize value as the only corporate objective function, he suggests 'enlightened value maximization' or 'enlightened stakeholder theory' which "uses much of the structure of stakeholder theory, but accepts maximization of the long-run value of the firm as the criterion for making the requisite tradeoffs among its stakeholders". Miyamoto also suggests the only possible objective agreed upon by all stakeholders would be to 'maximize the long-term corporate value,' insisting that the Japanese firms have practiced the stakeholder model governance with such an objective. He quoted Tirole's 'designed stakeholders,' which included long-term shareholders, long-term employees and long-term suppliers. However, the advent of the American-style shareholder-centered governance mechanism may sever the relationship with such core stakeholder groups and place the stakeholder model in a dilemma.<sup>9</sup>

How are the stakeholders placed in the widely known Corporate Governance Principles or Code of Best Practices? The OECD published its Principles in 1999, which recognized the roles of stakeholders including creditors, employees and governments, and stated, "The corporate governance framework should recognize the rights of stakeholders as established by law and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises."<sup>10</sup> In addition, the OECD published a draft revision of the Principles in January 2004 proposing stakeholders, including individual employees, should be able to freely communicate their concerns about illegal or unethical practices to the company board without compromising their rights and the corporate governance framework should be complemented by an effective insolvency framework and adequate enforcement of creditor rights.<sup>11</sup> The International Corporate Governance Network proposed to amplify the OECD Principles, arguing performance-enhancing mechanisms including broad-based ESOP and other profit-sharing programs will promote employee participation and align shareholder and stakeholder interests.<sup>12</sup>

At the national level, many of the economic ministries, stock markets, pension funds, mutual funds, accounting firms and individual enterprises publish their own guidelines, most of which deals with the internal control mechanism and disclosure.



Some of them touch upon the relationship with stakeholders as a part of CSR (e.g. TIAA-CREF). The Japan Association of Corporate Executives published a report emphasizing that management should pay attention not only to the creation of short-term profits but also to different stakeholders including customers, employees and communities etc in order to enhance long-term shareholder's interests.<sup>13</sup>

## 5. HOW STAKEHOLDER MODEL WORKS IN CO-OPERATIVES

Roger Spear pointed out that the stakeholder model was more relevant to co-operatives, however he admitted the potential effect of increased transaction costs. In addition, the competing interests of stakeholders are not automatically mediated. On one hand, dividend on share or interest on share representing owner's interests is limited by the Co-operative Principles and often fixed at the interest rate of bank deposits. On the other hand dividend on purchase or patronage refund representing user's interests has been generally recommended as a desirable method of distributing surplus. When members share holdings and patronage are homogeneous, the interests of shareholders and users do not clash, but there might be conflicts between those who have a large number of shares, but don't use co-op services and vice versa. The former expect to have higher returns on shares while the latter expects improved services and dividend on purchase. In particular, in multi-purpose co-ops where the types of businesses and composition of membership are diversified to a large extent, the interests of the minority full-time farmers and the majority part-time farmers differ substantially. Many co-ops seek to solve this dilemma by aligning members' share holding to their patronage. To improve services and extend operating hours aiming to enhance user's satisfaction may affect employee's working conditions and often induce a strong resistance from labor unions. When co-operatives face a financial crisis or go bankrupt, the collision of interests can be serious among members, employees, suppliers, creditors and communities.

Chris Cornforth compared a variety of competing theories on Corporate Governance and corresponding models of boards.<sup>14</sup> He analyzed the stakeholder model, expecting that organizations would be more likely to respond to broader social interests than the narrow interests of one group, i.e. owners, by incorporating various stakeholders on board. This lead boards to take on a political role in negotiating and solving the potentially conflicting interests of different stakeholder groups in order to determine the objectives of the organization and set policy. For co-operatives this raises the question of how should the interests of other stakeholders beside members be represented?

**TABLE 1.**  
**THEORIES ON CORPORATE GOVERNANCE AND CORRESPONDING MODELS**  
**OF BOARDS**

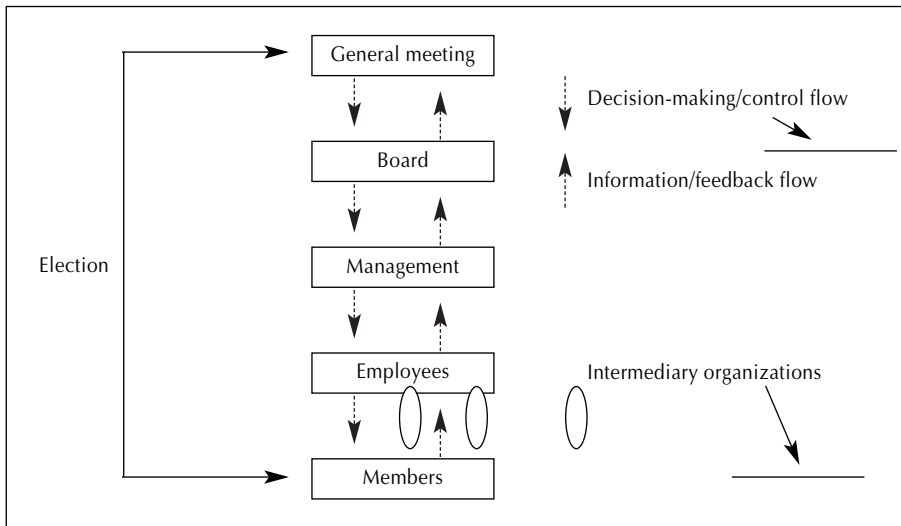
Theories	Model of boards	Roles of boards
Democratic perspective	Democratic model	To represent members' interests and resolve interests of different groups and set the overall policy
Agency theory	Compliance model	To monitor and control the behavior of management to ensure it acts in the shareholders best interests
Stewardship theory	Partnership model	To work with management to improve organizational performance, thus add values to top decisions
Resource dependency theory	Co-option model	To maintain good relations with key external stakeholders in order to ensure the flow of resources into/from organization
Stakeholder theory	Stakeholder model	To coordinate various stakeholders interests in order to determine the organization's objectives and policy
Managerial hegemony theory	Rubber stamp model	To legitimize management's actions without critical assessment

When applying stakeholder theory to co-operatives, we need to examine who should be counted as stakeholders among various groups having stakes in co-operatives. Freeman defined both the narrow sense and wider sense as the former being the crucial group for the survival and development of the firm including shareholders, employees, suppliers, customers, communities and managers, while the latter is persons/groups who affect the firm and can be affected by it. Here I would like to examine how the key stakeholders such as users (customers), employees and suppliers affect the governance of co-operatives.

A key characteristic of co-operatives is that members are both owners and users (i.e. identity principle). Members have stronger interests in satisfying their economic, social and cultural needs as users through patronizing co-operative goods/services rather than in earning higher dividend as owners. They have the potential to give effective user feedback which is used in the decision making of co-op and contributes to enhancing its competitiveness. Their voice through general meetings and boards is a basic route for members to express user's interests, thus directly influencing co-operative decision-making. If the board of directors represents user-members and is run in accordance with user's interests, the co-operative can conduct attractive business to meet members' needs and aspirations. At the same time, if members' interests are diversified, it is more difficult to coordinate them while directors representing users might lack the indispensable knowledge and competence in understanding the business. This is the dilemma facing most consumer co-ops with strong user representation.

In addition, it is neither possible to solve all the day-to-day business matters in the annual general meetings in larger co-operatives nor realistic to deal with all the local interests on the boards. So, these statutory bodies are often supplemented by intermediary members' organizations concerned with co-operative businesses. To this end, producer's groups for marketing produce or purchasing farming supplies are organized within agricultural co-ops in line with specific products; consumer's district/store committees and study groups for various topics concerning products are set up within consumer co-ops; user's committees and patient's groups are formed in hospitals/clinics within health co-ops; tenant's councils are set up in each block of flats within housing co-ops and so on. Customer's suggestion boxes exist along with hot lines and opinion polls where user's voices are directly transmitted to management. Some consumer co-ops in Japan promote employee's listening and quick response to members voice so that they can improve operations and enhance member's loyalty. Here Masuda suggests the pluralistic governance model where the top down information flow from management to members is supplemented by bottom up information flow through member's intermediary organs and suggestion schemes.<sup>15</sup> However, the bulk of co-operatives in industrialized nations has not fully exhausted the potential of user's participation and has treated members as mere customers. In contrast, the private sector firms promote customer relation's management, customer-centered marketing and customer loyalty programs aimed at enhancing customer satisfaction.

**CHART 5.**  
**PLURALISTIC GOVERNANCE MODEL OF CO-OPERATIVES**



In a sense, employees have the strongest stake in that their wage, working conditions and employment itself depends on the co-operative business. They are expected to act as service providers to members but also as agents in case of consignment sales of member's produce or coordinators in case of member relations. Employees are also expected to facilitate communication between members and board/management through daily operations, thus filling information gaps between them. Such roles and functions can influence the co-operative governance through various types of management participation schemes. The forms of employee participation to co-operative management are classified as follows:

- A. Bottom-up decision-making through Quality Circles or suggestion schemes
- B. Internal promotion of employees to executives
- C. Works councils for consultation between management and labor unions
- D. Board member representing employees
- E. Voting rights given to general employees

A and B have been often associated with the Japanese style management. The bottom up method may raise employees' morale by aligning their own initiatives with organizational goals, although it may result in intensified managerial control by enforcing such 'voluntary' commitments. It is said that internal promotion is conducive to obtaining employees' loyalty and forging implicit knowledge within the organization. It has functioned as such and contributed to overall enhancement of productivity, but now faces the challenge of globalization, which requires the development of a more professionally skilled work force rather than a contextual one. It also depends on the existence of managerial labor markets. C is widely used as an effective participation form in many countries. It may facilitate employees to reflect upon their views of overall policies and supervise top management. It is especially important to build upon their monitoring functions within the governance mechanism since they are likely to have much more internal information in comparison with other stakeholders. The labor unions are the typical worker's organizations involving a bulk of employees and have the legitimate right to negotiate on the working conditions and are expected to play a vital role in corporate governance through Works Councils. D is the German system where employees' representatives constitute a half of the Supervisory Board Aufsichtsrat on the basis of the Co-determination Act, while E is used by worker co-operatives where worker-members elect boards and managers amongst themselves. But these forms of employees' direct involvement in management functions are often criticized as infringing upon owner's property rights or seen with reservations as causing a dilemma about director's roles as employee representative.<sup>16</sup>

Suppliers have only contractual rights and obligations with co-operatives in usual transactions, but they may affect the co-operative governance if they are in a contractual relationship involving special commitments on the supply of specific products/services. In Europe, consumer co-ops had been boycotted by suppliers

under shopkeeper's pressure and had to establish their own federations in order to undertake production/wholesale functions. In fact, they had to give up production units due to requisite massive investment facing stiffer competition and switch to outsourcing from suppliers. In most countries, except Switzerland and a few others, co-ops are selling private brand products manufactured by suppliers in accordance with contracts based on co-op's specifications. In this case, co-ops need to carry out regular inspection of suppliers' factories to assure quality of products and make an even stronger commitment to implement supply chain management through sharing sales information with suppliers and optimizing logistics.

In Japan, consumer co-ops have promoted direct transaction with farmer's groups including agricultural co-ops to sell safer and more reliable produce, bypassing conventional wholesale markets. This type of transaction (*Sanchoku*) has expanded to give benefits to both consumers and producers; the former could assure the supply of safer products by identifying producers and guaranteeing the production process (organic, low chemical or no antibiotics etc.), while the latter could internalize the risk of price fluctuation. In addition, they have made efforts to reduce asymmetric information and uncertainty by exchanging information on what consumers request or how produce is grown, thus cultivating mutual understanding. Such practices have been crystallized into *Sanchoku* Principles (identified producers, identified production process and consumer-producer exchange) and promoted as long-term continuous transactions based on the trust forged by a strong commitment from both parties. However, the lack of a system securing such trust relationships and the uneven distribution of risk on quantity adjustment induced opportunistic behavior such as false labeling of production area and/or process by producers. Consumer co-ops are obliged to now rebuild *Sanchoku* through the introduction of a traceability system, mutual or third party verification and fairer distribution of risk

## 6. IMPLICATION OF MULTI-STAKEHOLDER CO-OPERATIVES

Pestoff distinguishes three primary functions of capital owners/financiers, producers/workers and consumers/clients in the production and consumption of goods/services. He recognizes that co-operatives differ from private firms in that they normally attempt to fuse at least two of these functions and suggests the potential of multi-stakeholder co-operatives as involving all three functions in the organizations.<sup>17</sup> The traditional co-operatives are single stakeholder co-ops as in the cases of consumer co-ops, farmer co-ops and worker co-ops. They have the potential conflict of interests with other stakeholders, but he argues in multi-stakeholder co-ops the potential collision of interests of plural stakeholder groups might be institutionalized into the governing bodies of co-operative, which then become a forum for discussing the quality of goods/services provided.

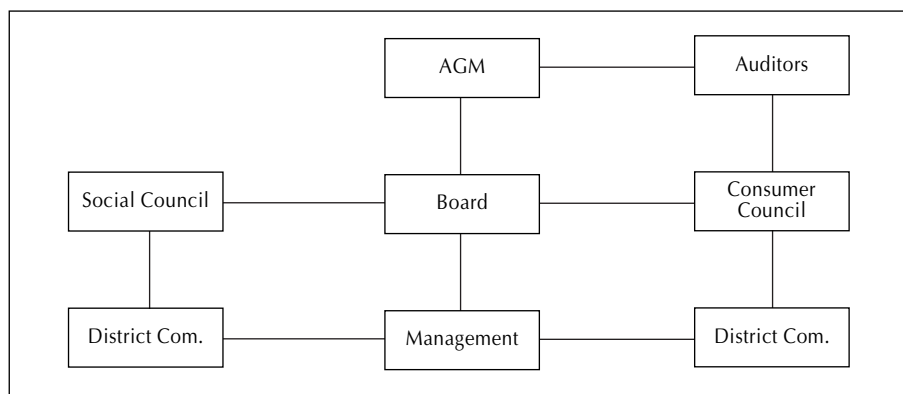
Structures need to be developed for an alignment of the divergent interests of various stakeholder groups. Multi-stakeholder organizations provide one method of resolving some of these differences of interests. Certain significant stakeholder groups could be given representation on the board of such organizations. It is often argued that firms owned by heterogeneous groups will have significantly higher transaction costs for decision-making. These potentially higher costs are offset by greater staff engagement; lower contracting costs, higher quality services, consumers as producers, etc. Multi-stakeholder organizations promote a dialogue between producers and consumers of goods and services and help to eliminate information asymmetries normal to single stakeholder organizations.

He argues multi-stakeholder co-operatives offer various advantages compared with traditional nonprofit organizations or for-profit firms, especially when market or contract costs are notably greater than ownership costs or the cost of collective decision-making.<sup>18</sup> They may provide consumers with more reliable guarantees of services provided in the presence of information asymmetries help to generate greater trust between providers and consumers of personal social services, thus help to transform the welfare state into a welfare society. At the same time he raises several questions to be answered. Are there some limits in terms of size and complexity of an organization? Will federative models of single stakeholder co-ops work better when the interests of various stakeholders substantially differ? Which stakeholders should be included as members and given voting rights? Is it possible to develop rules that help to reduce the collective decision-making cost? Can some stakeholders be indirectly represented, like children by their parents, handicapped by their relatives or the elderly by neighbors?

He introduced the Canadian 'Co-operators' insurance group, Italian and Swedish social service co-ops, and Spanish integral health co-op system in Barcelona as examples of multi-stakeholder organizations. Here I would like to supplement with the Spanish bi-stakeholder co-op Eroski and Japanese health co-ops. Eroski Co-op as a part of the Mondragon Group is known as a hybrid co-op involving dual membership of consumers and workers, and is registered as a mixed type co-op under Basque Co-operative Law. It amassed 517,000 consumer members in 2002, which owned a symbolic share capital of only 1.2 euros per capita while it had 13,000 worker members, which invested a substantial sum of 7,800 euros on average and therefore had a strong stake in the governance. The Consumer Council is an advisory body to the board representing consumer interests and takes part in drafting consumer education program and consulting on rules. The Social Council is also an advisory body to the board representing worker interests and has a labor union like function. It supports 16,000 non-member employees, who have less incentive to become members by investing the large sum required for membership, since their rights as workers are identical to that of members. In addition the Mondragon's capital system, in which 10% of the annual net profits is donated to charity, 40% is retained in the collective internal account and members cannot withdraw share capital until their

retirement, gives disincentive to the share investment. As a result, in general, only 10% of the newly employed became members. Both consumer and worker members send 250 delegates respectively to the AGM where a chairperson is elected among consumer members. Any conflict of interests is to be reconciled by the board, which is composed of 6 consumer representatives and 6 workers.

**CHART 6.**  
**GOVERNANCE STRUCTURE OF EROSKI CO-OP**



The Japanese health co-ops are classified as user-owned by the extensive survey conducted by the UN.<sup>19</sup> This classification is correct, since they are owned and controlled by members, overwhelmingly consumers, and registered under the Consumer Co-operative Law of 1948. The majority of the members are consumers, mostly healthy people who wish to be prepared for the risks of illness or accidents. In this regard, health co-ops are different from organizations exclusively composed of patients with illnesses. At the same time, medical professionals including doctors, nurses, technicians and chemists are also involved in health co-ops as members. According to the statistics for 1999, there are 112 health co-ops with 2.1 million members, out of which 17,787 (0.8%) are employees, including 1,485 doctors, 8,764 nurses, and 2,917 administration officers. This membership composition leads to a user-dominated board of directors; 2,133 lay board members representing users versus 740 paid board members representing providers. In case of Saitama Medical Co-op, 27 board members represent users, while there are 10 full-time board members consisting of 3 doctors, 1 nurse and 6 executive directors. In many cases, the chairpersons of boards are doctors. As such, medical professionals exercise much greater power than proportional, which may raise some problems in governing co-ops in a democratic and effective manner. So special efforts have been paid to train

professional board members in order to enhance their understanding of co-operative values and make them responsive to user's concerns. A recent opinion poll showed their strong commitment to the social dimension of health co-ops. When asked for the reason they joined the co-op, "can work in my hometown," earned the highest points with 21.7%. This was followed by "interested in health co-op" with 11.8%, and "can make social contribution" with 10.0%.<sup>20</sup> The managing director (CEO) is expected to function as a trustee by bringing different interests together in health co-ops, while there is less inclination for managerial control, which is questioned in many retail co-ops.

## 7. CONCLUSION

Corporate governance in the real world continues to evolve rapidly. In the 1990s, the Anglo-American model seemed to offer the best answer to solving most of the agency problems through independent outside directors, active institutional investors, external auditors and pressure from the market. It was an enormous influence on global standards of the governance reforms in many countries including continental Europe and Japan. But a number of corporate scandals at the turn of the century revealed serious flaws with this model. A flurry of reform measures was introduced, but the confidence in corporate governance is yet to be rebuilt. In addition, there is mixed evidences as to the correlation between governance the governance's mechanism of a firm and its economic performance. Co-operatives have taken some elements from governance reforms within the for-profit sector, but still lags behind it in many aspects including weak internal and external controls. They cannot demonstrate their potential advantage, combining ownership and user-ship, except for in a few examples. The multi-stakeholder model seems to offer the most effective solution to involve multiple interests of various stakeholders, but a number of questions associated with tradeoffs and prioritizing among competing interests still needs to be solved.

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# HUMAN RESOURCE MANAGEMENT AND THE ORGANISATION OF INCENTIVES IN WORKER COOPERATIVES

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## 1. INTRODUCTION

Human Resource Management<sup>1</sup> (HRM) has two key functions: to place people in the most suitable jobs according to their potential and to provide people with the necessary encouragement to obtain from them the best identification with the collective objectives<sup>2</sup>.

In an associated labour cooperative (spanish name of worker cooperatives), the aforementioned functions of the HR Manager will take place within an organisational context of “relations among equals” (the member-workers have exactly the same rights over the company). Therefore, the various human resources policies that these functions are going to perform will have to be applied taking into account this factor that differentiates associated labour cooperatives from traditional capitalist companies<sup>3</sup>.

On the other hand, the HR Manager must bear in mind that associated labour cooperatives, just like traditional capitalist companies, follow the *team production model* in Alchian and Demsetz's (1972) sense, and the human resources policies

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1. In this study we will take Human Resource Management to mean “... the set of organisational policies and measures, adopted in order to: achieve the human structure suitable for the organisation's tasks and purposes, as well as to give the people of which it consists the necessary capabilities at all times, and the incentives that are of the greatest possible interest to the organisation, its objectives and tasks” (Herrera Gómez, 2001, 49).

2. The strategic Management of human resources—which is a widespread approach—, deals with this question by establishing a design for all human resources policies and by making it possible to introduce the policies designed. This introduction of policies must be dealt with in a way that guarantees that the practices are consistent with each other and that they help to achieve the company's objectives (García-Tenorio and Sabater, 2004)

3. It is known that in Associated Labour Cooperatives the *control over decision-making* stage, that is the stages of choosing alternatives and control over the execution of the chosen alternative, falls on the members who are both member-workers of the company and are represented in the managing body of the associated labour cooperative. This is the aspect that makes the organisational context of associated labour cooperatives so singular (see the study by Orellana, Chaves and Rueda (2003)).

that are adopted will therefore have to be brought into line with the organisational context of the associated labour cooperative and with the problems that any team production involves.

It is known that team production must resolve two fundamental organisational problems: 1) *The organisation and coordination of activities for the efficient running of the company*; and 2) *The measuring and determining of the members' individual production or contributions to collective production*<sup>4</sup>.

The first question—the organisation and coordination of activities—is related to the necessary exchange of information between the members of the company in order to coordinate the various activities. The second question—the need to measure and know individual contributions—, originates from comportmental aspects of human behaviour, due to the fact that (according to the behaviourist hypotheses of the team production model) one cannot ignore the fact that in companies people seek their own personal profit or benefits not only by increasing their monetary income but also by dedicating less effort to collective tasks (Alchian and Demsetz, 1972).

This study analyses the various questions that the HR Manager faces when tackling problems caused by team production, bearing in mind the organisational context of an associated labour cooperative and people's behaviour. Accordingly, we draw an action framework based on several works about organisational theories and organisations' economy.

## 2. MANAGEMENT OF WORK WITHIN COMPANIES<sup>5</sup>

In matters of the organisation of work, transaction cost theory holds that two fundamental dimensions must be taken into account when establishing human resources policies: the degree of human asset specificity for the company, and the degree of interdependence of the tasks that they perform.

The first dimension will be determined by the degree to which the knowledge acquired by a worker is not transferable to another company—that is, when the work becomes idiosyncratic—. In this case, it will be difficult for the worker to apply the specific knowledge acquired in that job to another company, and it will be difficult for the company to substitute the idiosyncratic worker. Therefore, both employee and employer will have strong incentives for sustaining their contractual relationship. On the other hand, if there is little or no work specificity there will be no incentives to maintain a continued contractual relationship, as the worker could apply his/her

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4. According to Alchian and Demsetz (1972), team production is characterised by the fact that it uses different kinds of resources, the product is not a sum of the separate productions of each resource, and what is more, there is a need for coordination in order to obtain the product.

5. Williamson (1985) uses the term “governance of work” to refer to the management of work in the company. In this study we will extend this concept to human resources policies in companies.

knowledge in other companies (and could therefore change company with relative ease), and the employer could find substitutes without a great deal of difficulty by resorting to the labour market.

The second dimension is related to the degree to which a worker can be *substituted* without this having any disturbing effects on the coordination of work or, therefore, on the productivity of the unit to which he/she belongs. This dimension is also related to the degree of interdependence of the work that the person performs and therefore, with the degree of difficulty in measuring their individual work.

In accordance with the dimensions above, Williamson (1985) distinguishes the following alternatives for work management (see figure 1):

- a) Internal spot market ( $K_0 S_0$ ): Non-specific human assets and work which is easy to measure. With this situation there are no incentives of efficiency for either of the parties to sustain the working relationship.
- b) Primitive team ( $K_0 S_1$ ): Non-specific human assets and individual production which is difficult to determine due to the interdependence of its members' work. Although the makeup of the team could change, it is difficult to determine individual productivity, making it necessary to include supervision as one of the coordination mechanisms.

**FIGURE 1.**  
**EFFICIENT MANAGEMENT OF WORK IN THE TRADITIONAL**  
**CAPITALIST COMPANY (WILLIAMSON, 1985: 251)**

	$K_0$ Non-specific work	$K_1$ Idiosyncratic work
$S_0$ Separable work	Internal spot market	Obligational market
$S_1$ Non-separable work	Primitive team	Relational team

- c) Obligational market ( $K_1 S_0$ ): Specific human assets and individual productivity which is easy to measure. Due to idiosyncratic technological experience and idiosyncratic experience of the organisation, it is in the interests of both the employee and the company to keep up a long-term relationship. Therefore, safeguards are put in place in order to discourage arbitrary dismissal, and the workers are rewarded in order to discourage untimely resignations.
- d) Relational team ( $K_1 S_1$ ): Human assets specific to the company and work which is difficult to measure. Here the work carried out by the idiosyncratic worker is inter-related with the work of the rest of the members. Therefore, the human

resources policies will be designed to “socialise” the members, they will encourage job stability, loyalty to the company and a sense of belonging to a group. That is to say, the human resources policies will be designed to achieve situations and relationships for the company that occur in clan-type organisations, in “... which the differences between the goals of individuals and those of the organisation are reduced and a powerful sense of community is created” (Ouchi, 1980: 136).

### 3. BEHAVIOUR IN TRADITIONAL COMPANIES AND IN ASSOCIATED LABOUR COMPANIES

It is known that an organisation can only exist insofar as there are people who are capable of joining together with others, who wish to collaborate in an activity, and share a common goal or end. Likewise, in order for cooperation to take place, individuals must be induced to cooperate by means of incentives (Barnard, 1938; Simon, 1947).

Accordingly, behaviour in companies will be determined to a great extent by the incentives people have to participate in the collective activity, and the rewards and inducements they have to remain with the company. Therefore, one may expect people's cooperation if the company's objectives have a direct personal value for them or if the company manages to capture the individual's interest by offering paid rewards in return for working for the company.

That is to say, the incentives the company must provide in order to obtain and maintain the commitment of its members, may be directly related to meeting the company's objectives or to its growth (as are the incentives of the owners or top managers of a company), or they may not be directly related to the objectives, or to its growth (as is the case of incentives given in the form of a salary). Simon (1947) calls the former *conservation values* as they are directly related to the company's continuity. These values provide the basis for an organisational loyalty which gives rise to support for the company's necessary adaptations to changes, even if these changes involve changes in the organisation's objectives.

Incentives for employees, on the other hand, are fundamentally related to the material and immaterial rewards offered by the company, even though the rewards may not be related to the scale or growth of the company.

We should mention that there is no overall independence between the different types of inducements or incentives. Thus, conservation values are also of importance for the employees —especially for those with hopes of occupying management positions—, as a prospering organisation offers greater possibilities in terms of prestige and progress than those which are at a standstill or in decline.

What is more, and according to March and Simon (1958), human behaviour in companies is not only determined by motivational factors, as is the case with incentives, but it is also determined by organisational factors that affect individuals' use of reason. And this is because the organisational context of the company acts upon the individual's rationality, whether it be by limiting their alternative courses

of action or by giving them greater knowledge and more information. For example, it seems obvious that the position a person occupies on the hierarchical scale, or the degree of specialisation of the tasks that he/she performs, will alter the extent to which he/she uses his/her individual rationality.

Likewise, we should emphasise the fact that not only individual rationality takes place in companies, but there is also a collective rationality that will affect people's individual behaviour. This collective rationality, which Williamson (1985) calls *organic rationality*, arises from the organisation itself and ends up becoming a kind of collective knowledge. What characterises this kind of rationality, is the fact that it comes about as a consequence of the accumulation of experience in the company, of the history of the company, the habits, rules and regulations that the company usually follows, the style of management, the relationships of trust, and the ways in which different tasks and procedures are performed. All this leads to what Nelson and Winter (1982) call *routines*, and it is on the base of *know-how* that arises and emerges from the organisation, from organisational practice, by nurturing, training and bringing out people's rationality. Organic rationality results in a series of codes of communication and knowledge that allow the members of the company to correctly interpret messages and respond to them.

One should bear in mind that organic rationality can lead *to the extension of an individual's area of rationality beyond that set by the organisation for the performance of his/her tasks*, meaning that companies may set organisational conditions that encourage the development of organic rationality or that make it more difficult. And the emergence and development of this kind of rationality may be more suited to an organisational context such as that of an associated labour cooperative.

In short, human behaviour in companies, both in traditional capitalist companies and in associated labour cooperatives, is fundamentally determined by: a) material and immaterial inducements or incentives; b) the extent set by the company for each person to use rationality; and c) organic rationality. And as organic rationality arises from the company itself—even if it is generated by its members and their interaction—, one may consider organic rationality to be the base upon which the extent of rationality and the incentives that the company assigns to each person determine people's behaviour.

The use of bounded rationality, measured in relation to the *extent of rationality that the company sets for each person*, and the two kinds of inducements or incentives people have to remain with the organisation (the *conservation values* and the *material or immaterial rewards*), allow us to establish four behavioural situations in organisations (see figure 2):

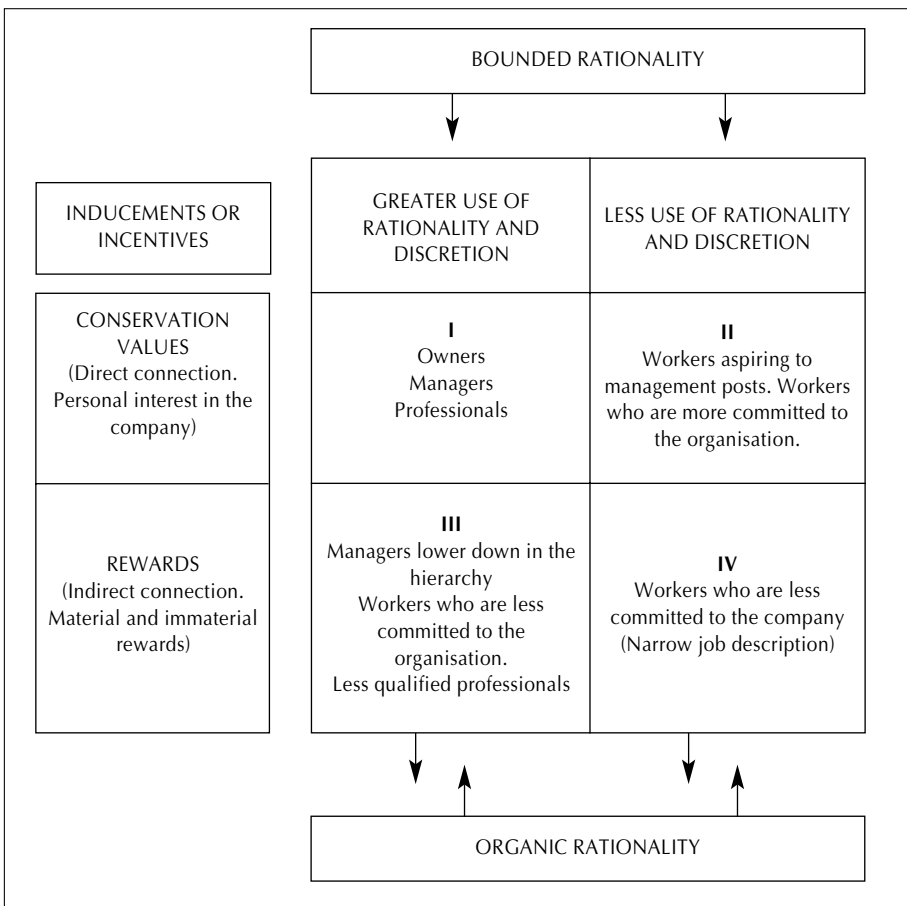
1. *Behaviour determined by inducements or incentives of the "conservation values" type in an organisational setting where there is greater use of rationality.*

People's hierarchical position helps determine their behaviour, since greater or less use of rationality and discretion is involved when one has access to more information and a wider perspective of the organisation. Conservation values are the main motivation for people who occupy high positions in the hierarchy. This is the behaviour expected of owners and top managers, and it may also correspond to professionals that carry out highly-skilled jobs, although in this case greater use of rationality may not be linked to hierarchical position.

II. *Behaviour determined by incentives of the “conservation values” type in an organisational setting where there is less use of rationality.*

In this situation, people use of rationality and discretion to a lesser extent because their behaviour is more regularised than that of managers and owners, and therefore their perspective of the organisation is more limited. This behaviour is common in workers with specialised jobs—mainly in the vertical dimension—, who are committed to the organisation or have hopes of reaching positions of greater responsibility.

**FIGURE 2.**  
**BEHAVIOUR IN COMPANIES. MOTIVATIONAL AND RATIONAL PERSPECTIVES**



Based on Barnard (1938); Simon (1947); March and Simon (1958); and Williamson (1985).



III. *Behaviour determined by incentives of the “material or immaterial rewards” type in an organisational setting where there is greater rationality.*

This corresponds to people with a broad job description, which allows them a greater use of rationality and discretion—even though this may be less than that of owners and top managers—. As the motivating incentives take the form of material or immaterial rewards, they are less committed to the company. This behaviour occurs with workers who are less committed to the company, less qualified professionals, and managers who are lower down in the hierarchy.

IV. *Behaviour determined by incentives of the “material or immaterial rewards” type in an organisational setting where there is less rationality.*

This behaviour corresponds to the more specialised jobs both in the vertical and horizontal dimensions, thus allowing people less use of rationality and discretion. The behaviour in this case is more mechanical and passive and is motivated by material rewards, thereby decreasing their degree of commitment to the company. This situation occurs in a typical working relationship in a capitalist company, in which the worker, in return for a specific remuneration, agrees to obey the instructions of an employer *within certain limits*.

People’s overall pattern of behaviour in organisations, presented in figure 2, helps us to understand the behaviour of members of cooperative companies.

In associated labour cooperatives situations in which the incentives correspond to *conservation values*, which are the base for loyalty to the organisation, take on particular significance; that is, situations in which the incentives are related to far-reaching objectives, such as the scale, survival and growth of the company.

One should bear in mind that loyalty to the organisation gives rise to support for necessary adaptations to internal and external changes; even for adaptations that involve changing the organisation’s objectives.

Therefore, depending on the extent to which incentives for the members of the cooperative company are of the *conservation values* type, they will be more willing to approve the changes that are put forward by the company’s governing body.

## 4. HUMAN RESOURCES MANAGEMENT IN AN ORGANISATIONAL CONTEXT OF ASSOCIATED LABOUR

In view of the above, in the case of associated labour cooperatives the work relations established between the company and the member-workers are of an idiosyncratic nature, meaning that they will be much more stable than in traditional capitalist companies, and there will thus be a high prevalence of the  $K_1S_0$  and  $K_1S_1$ <sup>6</sup> forms.

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6. Although in companies in which a proportion of their workers are not members there will also be work governance formulas of the  $K_0S_0$  type

The reasons for seeing it this way are due to the fact that the experience and information that the members share, the relationships of trust and the fact that individual interests coincide with the objectives of the cooperative company, all give the member-worker idiosyncratic characteristics which are difficult to find in the labour market. These characteristics are also present in member-workers due to their connection with the cooperative company (more permanent than that of workers in traditional capitalist companies), their status as members and their knowledge of the company. All these factors make it more difficult for the values and the sense of clan developed in the group relations in the cooperative company to be transferred to another organisation.

As regards the degree of interdependence of tasks and therefore the extent to which members' work is measured, the working relationship may correspond to types  $S_0$  and  $S_1$  alike, as the variable "degree to which the work is separable" depends on the particular task that each person performs.

In the  $K_1S_1$  (*relational team*) situation, human assets are of greater importance to the company as the work that people carry out is difficult to separate and is therefore difficult to measure. It coincides with the main activities of the company, those which are most difficult for the competition to imitate. The workers have capabilities and skills that are essential to the company. For this reason the activities carried out must be coordinated basically by means of non-structural mechanisms such as the organisation's culture and the information systems. In the  $K_1S_1$  situation, the institutional conditions of associated labour cooperatives, which give the work its idiosyncratic nature, ensure greater success when introducing and developing less structured coordination mechanisms.

In the  $K_1S_0$  (*obligational market*) situation, the contractual relationship that the members establish with the cooperative is enough to govern these relations, and as the work is easy to separate and measure, it can be coordinated by means of coordination mechanisms which are in line with the task, the technical system and the preparation needed in order to perform the activity. In the  $K_1S_0$  situation, the work carried out by the members corresponds to a stage in the process that is separable, therefore lending itself better to individual incentives in accordance with the work performed, unlike in the  $K_1S_1$  situation in which group incentives have greater significance.

In any case, in the management of work, and in the management of human resources, people's behaviour plays an important role, which is why the backdrop remains the model of behaviour described above and summarised in figure 2.

With regard to the above, the processes of communication and leadership within an organisational context of associated labour (as is that of an associated labour cooperative) promote organic rationality and also a greater use of rationality and discretion by the members (greater than that which could occur within the organisational context of a traditional capitalist company). This greater use of rationality and discretion will also be encouraged in the members' participation in the running of the company through its governing bodies. As a result, we may assume that the

member-workers show behaviour corresponding to situations where there is a greater use of rationality and discretion, such as situations I and III in figure 2.

Thus, when people's behaviour patterns respond, to a greater extent, to incentives of the *conservation values* type, one should use means of governing work of the Relational Team ( $K_1S_1$ ) type, and when people's behaviour patterns respond to incentives of the *rewards* type, the way in which work is governed should keep to the Obligational Market ( $K_1S_0$ ) type.

In both cases the associated labour company and the idiosyncratic member-worker have strong interests in sustaining the contractual relationship. The difference in the way in which work is governed lies in the design of the incentives system, which is orientated more towards collective work in the first case and more towards individual work in the second.

In the case of workers who are not members, or member-workers in more horizontally and vertically specialised positions, one should assume that they have less scope for using rationality and discretion (situations II and IV in figure 2).

For workers that have not yet become members, their later joining the company as full members would likewise involve greater commitment to the company, and therefore their behaviour would fall within area II (figure 2). In this area the efficient governance of work must obey forms of governance corresponding to idiosyncratic work ( $K_1$  type) with a prevalence of the  $K_1S_0$  forms of governance (it cannot be  $S_1$  because this type of work requires greater use of discretion and rationality, and would therefore not fall within I area II, but in areas I and III of figure 2).

In the case of workers who are not members and who have no prospects of becoming full members in the short or medium term, their model of behaviour should fall within area IV (the area corresponding to workers who are less committed to the company), and efficient governance of the work carried out by these people in the company should be governed using forms of the  $K_0S_0$  type (non-idiosyncratic work which is easy to measure). All this is seen from a largely economic point of view, since the cooperative principles that should prevail over such economic criteria state that workers of the  $K_0S_0$  type should not exist in associated labour companies for an indefinite period, and their existence is therefore only justified in temporary situations.

## 5. CONCLUSIONS

The contractual context of associated labour cooperatives and the behavioural assumptions resulting from this context, create —just as in traditional capitalist companies— problems for measuring and supervising individual production and also the need for efficient forms of governance of work.

As a solution to these problems and needs, determining the degree of human asset specificity, and the degree of interdependence of the tasks performed by these human

assets, provides a solid base for establishing human resources policies in associated labour cooperatives.

As regards behaviour in associated labour cooperatives, and unlike traditional capitalist companies, one may expect a prevalence of greater use of rationality and discretion of the member-workers and a greater development of organic rationality. This situation, promoted by the member status, leads to a prevalence of idiosyncratic workers ( $K_1$ ) for whom efficient work governance structures the *obligational market* ( $K_1S_0$ ) and *relational team* ( $K_1S_1$ ) types must be established. The *obligational market* form of governance of work lends itself more to individual incentives and the *relational team* form of governance of work, more to collective incentives.

In the case of workers who are not members but have short-term prospects of becoming full members, the efficient form of governance of the work that they perform should correspond to forms of the primitive team ( $K_0S_1$ ) type, in which the *direct supervision* coordination mechanism must play a fundamental role, since the work is not separable and it is therefore not easy to measure productivity.

In the case of workers who are not members and do not have medium-term prospects of becoming members, the efficient form of governing the relationship should be that of the spot market ( $K_0S_0$ ) type, which recommends outsourcing this kind of transactions (or in their case developing individual incentives). It is assumed that the model of behaviour for the worker of the  $K_0$  type falls within quadrant IV (figure 2).

In the case of workers of associated labour cooperatives who carry out work of the  $K_0S_0$  type and for who it is not possible in the short term to join as a full member, the company must establish staff policies orientated towards achieving greater commitment from the workers so that their behaviour follows the area II pattern (figure 2). Likewise, the company must establish policies to allow these workers to join the company as full members.

As a final conclusion, we should emphasise the crucial role played in associated labour cooperatives by institutional aspects<sup>7</sup> and the different behaviour patterns of the members. For this reason, these aspects must be taken into account when designing the different policies that make up the process of human resource management in an associated labour company.

Due to the influence of institutional and behavioural aspects, the managers of associated labour cooperatives must handle and apply the most widespread models and policies of human resource management with care, since said models have been designed to be applied fundamentally in organisational contexts of traditional capitalist companies and not in participative contexts of associated labour companies.

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7. In FAMA, E., and JENSEN, M. (1983a and 1983b) these matters are analysed in greater depth.

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# HOW SHOULD THE COOPERATIVE NETWORK AND ITS GOVERNANCE STRUCTURES BE DESIGNED TO REMAIN COMPETITIVE IN A GROWING EUROPE. THE MONDRAGON CORPORATION CO-OPERATIVE (MCC) CASE

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## 1. INTRODUCTION

One of the main challenges of co-operatives today is how to build and/or retain their competitive advantages and establish their relevance in a growing Europe on a globalised economy. To be effective and successful, a cooperative federation must continuously achieve two interrelated goals: a) strengthen the autonomy of its affiliates but maintaining social networks, enhance viability and improve ability to service its members, and b) remain an economically viable, innovative and competitive enterprise.

To reach those objectives **Social Capital** has gained considerable attention in recent years. Social Capital – the “features of social organisation, such as networks, norms, and trust, that facilitate co-ordination and co-operation for mutual benefit” (Putnam, 1993) – fosters collective action and civic participation and helps to build dynamic communities.

Most theories of innovation remain heavily focused on the individual firm because, in capitalist economies, the firm is the main repository of productive knowledge. What we have tried to do, however, is to suggest that this focus is narrow and restrictive. In other words, to develop a better understanding of innovation, we need to focus both in the individual firm and in the ensemble of relations in which firms work and systems interact.

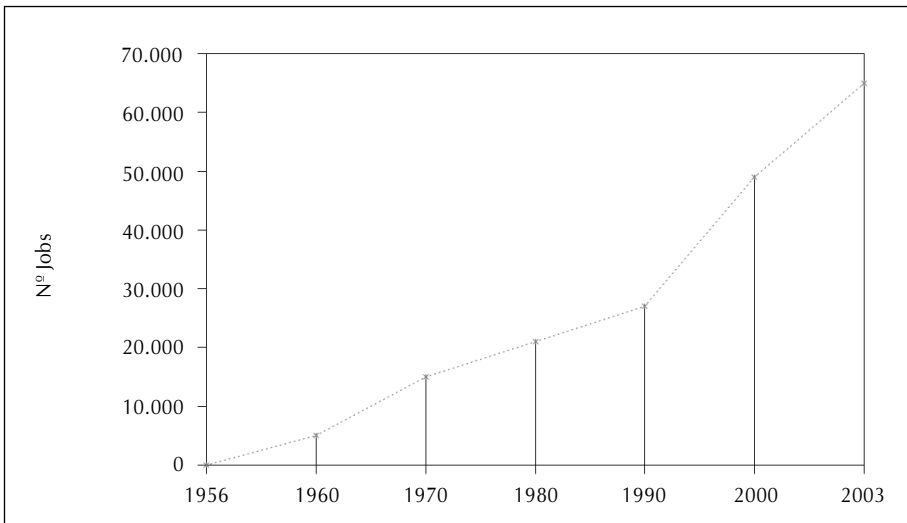
While Schumpeter’s “heroic entrepreneur” still resonates in certain circles, the fact remains that innovation is a collective social endeavour. For this reason the capacity to collaborate is becoming an ever more important attribute when knowledge is the most important resource, and learning the most important process.

We maintain that within and between firms, Social Capital reduces organisational dissolution rates, facilitates innovation, entrepreneurship and the formation of start-up companies, and strengthens supplier relations, regional production network relation and interfirm learning. In fact, high trust, learning capacity, and networking competence are now widely perceived to be associated with relative economic and social success.

One of the cooperative groups where the potential of associative action is more apparent may be the MCC.

MCC is the result of a first industrial co-operative created by five young entrepreneurs in 1956 in Mondragon, a small industrial valley located in north-eastern Spain. Today MCC is composed of near 70,000 employees working in more than 120 different cooperatives, with 39 subsidiaries spread all over the world with 6.200 employees in march 2004. The evolution in the number of employees is shown in this chart:

**GRAPHIC 1.**  
**EMPLOYEES EVOLUTION OF MCC**



The nature of networks at MCC has had a flexible evolution during the last decades, motivated mainly by changes in the global economic and competitive rules. For a better understanding of how MCC works, we may classify those networks in different levels:



- I. Operative internal networks: A) Sharing economic results to avoid bankruptcies in cooperatives having difficulties, B) Interchanging employees to avoid members' unemployment, C) Equalizing salary conditions, working calendars, regulations, etc.
- II. Supporting external networks, called Corporate Activities: some institutions that work also as free market agents for any other firm, have been created by the cooperatives to support their activity: the University, four Research Centres, etc.
- III. Personal networks and Institutionalised social interaction, through the values of sharing personal lives in small valleys, with a shared value system that facilitates information, trust, and common norms, and the social interaction by participating in the boards of the Corporate Activities.
- IV. Generic external networks, national and international: MCC belong to regional, and international cooperative networks, in order to structure the social economy sector, to work close to the legislator, etc.

In a growing Europe, with new countries that host some of the subsidiaries of MCC, the key questions are focused on the future suitable organisational structures and networks that will successfully be able to survive to the new competitive scenario of the globalisation, the innovation, and the information technologies.

## 2. LITERATURE OF THE SOCIAL CAPITAL

One of the main challenges of co-operatives today is how to build and/or retain their competitive advantages and establish their relevance in a growing Europe on a globalised economy. To be effective and successful, a co-operative federation must continuously achieve two interrelated goals:

- a) Strengthen the autonomy of its affiliates but maintaining social networks, enhance viability and improve ability to service its members.
- b) Remain an economically viable, innovative and competitive enterprise.

The term "social capital" initially appeared in community studies, high-lighting of the networks of strong, crosscutting personal relationships developed over time that provide the basis for trust, co-operation, and collective action in such communities (Jacobs, 1965).

Later, social capital was present mostly in political and social science literature. Subsequently, it was incorporated into economic writing as so-called intangibles became considered crucial factor for economic development. Hence, social capital is considered an asset, just as other traditional forms of capital. It is attained through the processes of interaction and learning that take place in society. However, unlike

other commodities, it cannot be traded or exchanged (Maskell 2000). To some extent, it has become a concept for defining “the missing ingredient” in successful practice that economics cannot explain (Cooke and Clifton 2002).

Literature brings numerous definitions of social capital (box 1), which all emphasise the following two components:

- a) Shared value system, norms and institutions (most notably trust and reciprocity)
- b) More or less institutionalised forms of social interaction such as networks or other forms of social organisation.

Some of these definitions focus primarily on social capital as a resource that inheres in the social network tying a focal actor to other actors. On this view, social capital can help explain the differential success of individuals and firms in their competitive rivalry: the action of individuals and groups can be greatly facilitated by their direct and indirect links to other actors in social networks.

In contrast to this view of social capital as a resource located in the external linkages of a focal actor, other strands see the social capital of the collectivity’s external ties (organisation, community, nation, etc.) not so much in that collectivity’s external ties to other, external actors, as in its internal structures – in the linkages between individuals or groups within the collectivity, and specifically, in those features that give the collectivity cohesiveness and facilitate the pursuit of collective goals.

## BOX 1. SELECTED DEFINITIONS OF SOCIAL CAPITAL

- \* "The aggregate of the actual or potential resources which are linked to the possession of a durable network of more or less institutionalised relationship of mutual acquaintance or recognition". (Bourdieu, 1985)
- \* "Social capital is defined by its function. It is not a single entity but a variety of entities with two elements in common: they all consist of some aspect of social structures, and they facilitate certain actions of actors – whether persons or corporate actors – within the structure". (Coleman, 1990)
- \* "the number of people who can be expected to provide support and the resources those people have at their disposal". (Boxman, 1991)
- \* "...features of social organisation such as trust, norms, and networks that can improve the efficiency of society by facilitating co-ordinated actions". (Putnam 1993)
- \* "... the ability of actors to secure benefits by virtue of memberships in social networks and other social structures". (Portes, 1998)
- \* "Social capital represents the degree of social cohesion which exists in communities. It refers to the processes between people which establish networks, norms and social trust, and facilitate co-ordination and co-operation for mutual benefit". (World Health Organisation, 1998)
- \* "... the information, trust, and norms of reciprocity inhering in one's social networks". (Woolcock, 1998)
- \* "Social capital is an instantiated informal norm that promotes co-operation between two or more individuals". (Fukuyama, 1999)
- \* "The process by which social actors create and mobilise their network connections within and between organisations to gain access to other social actors' resources". (Knoke, 1999)
- \* "Social capital is networks together with shared norms, values and understandings that facilitate co-operation within or among groups". (OECD, 2001)

The literature identifies a range of potential sources of social capital, and factors that can influence the rate and extent of its formation (or destruction), although gaining a precise picture of the sources and determinants and how they operate is difficult. Among other reasons, there may be complex feedback effects between social capital, its sources and its effects.

The literature suggests that social capital may generate benefits for society in four main ways:

- by reducing transaction costs;
- by facilitating the dissemination of knowledge and innovation;
- by promoting co-operative and/or socially-minded behaviour; and
- through individual benefits and associated social spin-offs

### **3. EVOLUTION OF THE STRUCTURE OF MCC**

#### **3.1. Identity attributes of co-operatives in MCC**

We can classify the identity attributes of MCC in two groups:

- A. Social: Workers' involvement in the entrepreneurial activity, which is the result of putting into practice several co-operative principles alongside all the existence of MCC: Democracy (one member one vote), Participation and Solidarity.
- B. Management: Continuous competition of the co-operatives, as the origin of the high qualified job creation, which is the result of putting into practice a business policy based on: Innovation, Reinvesting Profit, Permanent Training and Internationalisation.

#### **3.2. Evolution of the organizational structure**

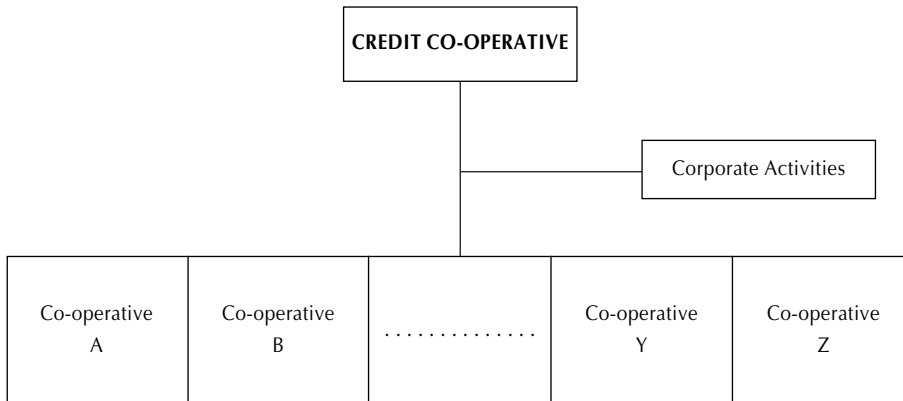
It is interesting to remark, before any other statement, that any individual co-operative has all the power and autonomy on its hands, through the General Assembly. This is a volunteer association of people, therefore not under a certain hierarchy based on a criteria of capital owning. Actually every year there are co-operatives that decide either to enter or quit the structure: for instance in 2004 both have happened. Freedom of association is absolute, and therefore MCC is not a conventional holding or a capital-based corporation.

Alongside all the co-operative experience in Mondragon we can consider five different stages that have been developed with no any organizational instability.

##### *3.2.1. From 1956 to 1964*

Economic growth was important, there was a lack of products on the market, taxes on borders strongly limited imports, and all the production was sold, getting good profit margins. Almost all the industrial firms succeed, and the success of the first co-operatives encouraged other entrepreneurs to start-up their own co-operatives, getting individually linked to the credit co-operative, Caja Laboral.

**FIGURE 1.**  
**CORPORATE FIRST STRUCTURE**



Source: Authors.

In this first stage, each of the two parts of the social capital that are analyzed below had a very different development:

- Personal networks: Industrial co-operative plants were located in towns, not in big cities, so that personal networks were strong, because most of the members of co-operatives lived within the valley, living together and sharing social particularities, influenced by the fervent religious faith and the severe social norms of Franco's dictatorship. There was no cars, parties and holidays were celebrated by people on each town, and to most of the citizens travelling was not a common activity.

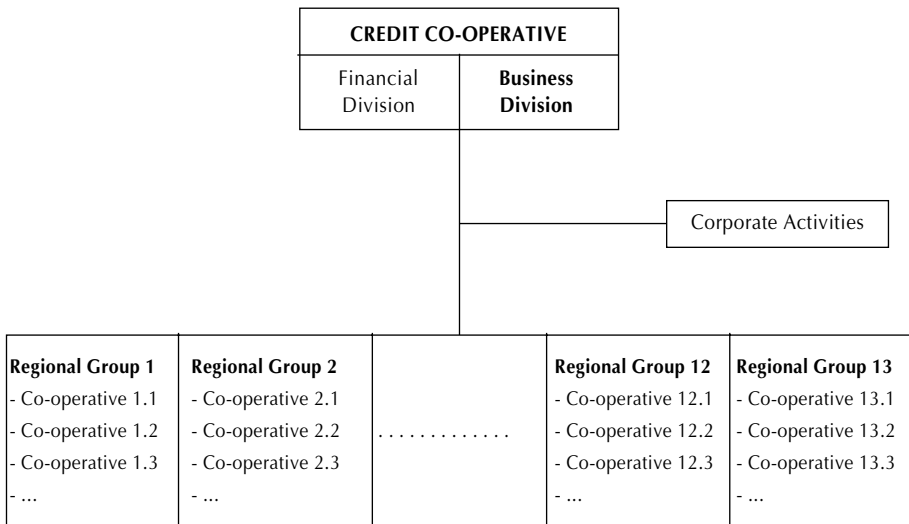
Personal trust in the co-operative leader, Father Don Jose Maria Arizmendiarieta, and in the young entrepreneurs that started the first co-operatives, was high and searching new members or capital for investments was not a difficult task, because workers went to them asking for being members of the new co-operatives.

- Institutionalised social interaction: The only elements of the superstructure that were created were the training ones. In fact, they were the origin of the whole co-operative movement, since they were created before the industrial ones. Besides, during Franco's dictatorship associations were banned by law, and it was with the support of the Church that the interaction between different people involved in the project was possible.

### 3.2.2. From 1964 to 1987

With the objective of getting synergies and under the leadership of the first cooperative, Ulgor, in 1964 the first co-operative group was created within the Mondragon Valley, initially called Ularco Group and since 1986 Fagor Group, integrated by five co-operatives. Also the campus of the School of Engineering and the School of Business were built, in 1966 Lagun Aro the Welfare co-operative was created, as well as Ikerlan the research center in 1974, specialized in metal mechanics, and the Entrepreneurial Division within Caja Laboral. Therefore this evolution of the structure leads us to:

**FIGURE 2.  
CORPORATE SECOND STRUCTURE**



Source: Authors.

There was not any horizontally interlinking element yet, such as Congresses or Co-operative Assemblies and the most meaningful official events were the General Assemblies of Lagun Aro and Caja Laboral, where individual co-operatives, both in industry and services, were members.

This second stage has been the most creative one. Don Jose Maria Arizmendiarieta was a man with a great vision, and had the ideas to provide most of the necessary elements to individual co-operatives, which were what today is called Corporate

Activities: such as training, research, social security and financing. All this made that the initial differences between the two parts of the social capital disappeared:

-Personal networks: Even though their strength was maintained the massive use of the car changed the traditional social live. Many technicians and professionals living in another regions and valleys did not live in the towns where they worked, but they drove everyday from their hometowns to the Mondragon valley. Driving from Vitoria (35 kms), Bilbao (50 kms) or San Sebastian (75 kms) to a production plant located in a town within the Mondragon valley and going back home at night became something common, so this fact divided social and professional live. Personal live was not shared any more in the street or in the leisure facilities. Human closeness, as Father Arizmendiarieta said, strongly decreased.

On the other hand, educational qualification of members in co-operatives went up, being most of the new managers graduated in universities. Many tasks were readapted into technical processes and both educational and retributive gaps between workers and managers became bigger, increasing from 1 to 3, to 1 to 4,5. Some good professionals quitted in co-operatives to move to enterprises in the same sectors.

Also, in times of economic recession, some new job policies were started with the aim of eliminating unemployment: a) members with no enough work within their co-operative were located in other co-operatives, b) temporary workers were hired, and c) time to become members was increased for young people to three years. All this facts brought the existence of workers with different status: members of the co-operative, members of other co-operatives, hired workers, young workers in the process to become members, that changed the style of relations related above.

Finally, it is interesting to remark that new start-ups in other provinces of Spain made that co-operative members outside the Basque Country went up to over one thousand.

- Institutionalized social interaction: Corporate Activities increased the interaction between professionals within co-operatives. We have take into account that all the Corporate Activities are mixed co-operatives, of first or second degree, and that they are composed of members that can be workers or other enterprises, so that they are in General Boards, being Presidents traditionally enterprises-members rather than being individual worker-members.

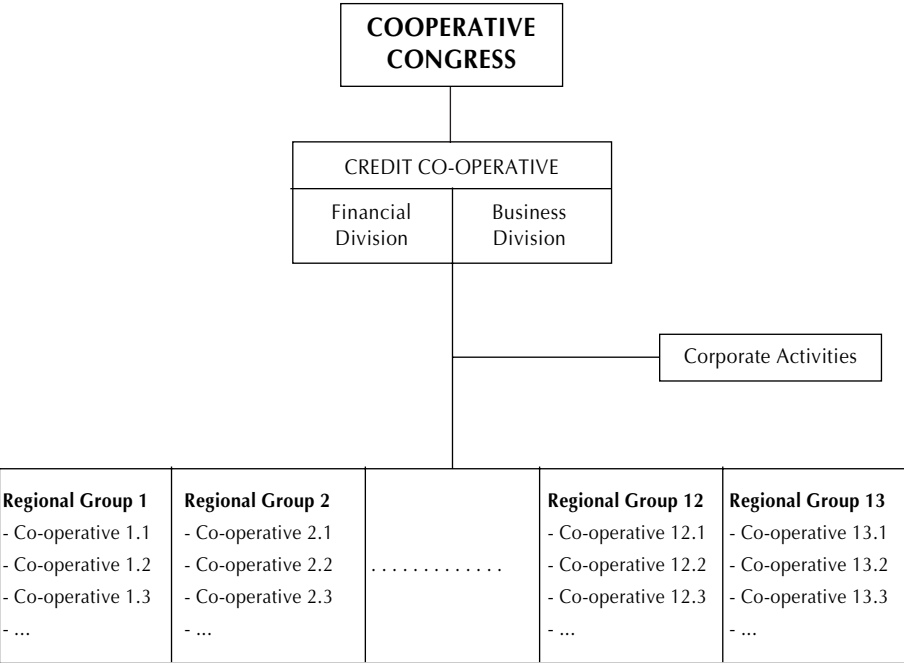
### *3.2.3. From 1987 to 1992*

As Spain entered the European Union in 1986 and the international competition was increasingly bigger a new need appeared: designing a new structure, going from the valley groups to sectorial groups.

In 1987 the first co-operative congress took place and this was the first step towards the constitution of MCC, that was officially launched in 1992 having as a result the transformation of the Entrepreneurial Division of Caja Laboral into Central Services of MCC. Most of the professionals of the Fagor valley group moved to those Central Services too.

In this long process of establishment of MCC, there were six industrial individual co-operatives, that decided not to integrate within the new corporate structure, because individual co-operatives were going to lose great sovereignty and freedom of management. Other reasons given were that under the new structure they were going to lose personal networks among the valley groups, and that it was not logic to share economic outcomes with co-operatives to whom they had not ever been linked. However, all of them continued linked to the credit co-operative Caja Laboral and to the welfare co-operative Lagun Aro.

**FIGURE 3.**  
**CORPORATE THIRD STRUCTURE**



Source: Authors.

- Personal networks: On the one hand, interaction between different members of the groups increased and it was then when firstly a sense of belonging to a common co-operative project existed. On the other hand, some people were afraid of losing the sense of belonging to the valley organizations with similar cultures, with closer links that to the geographically far new sectorial co-



operatives with no solidarity links ever. In this stage the retributive gap became bigger and joint-ventures with non co-operative firms were started.

As long as the borders in Europe were quitted for import-export and the first joint-ventures were created in foreign countries, mentality of members in co-operatives changed, considering the internationalization as a new relational factor.

- Institutionalised social interaction: participation in the sectorial clusters of the Basque Country became stronger and the second research center was created, Ideko, specialized in Machine Tools. Also it is remarkable the fact that MCC took part in a International Economic Interest Group, launched by the European Union, in the housing sector together with French and British partners.

#### *3.2.4. From 1992 to 2004*

The new structure has been strengthen and slowly the function of the different agents like the Congress, Central Services, Divisions, Groups and others have been establishing. The Presidency of MCC was created, the Vice Presidency as well and the Directors of Groups, also the Central Services created five Directors supporting the divisions, with a total staff of 70 professionals.

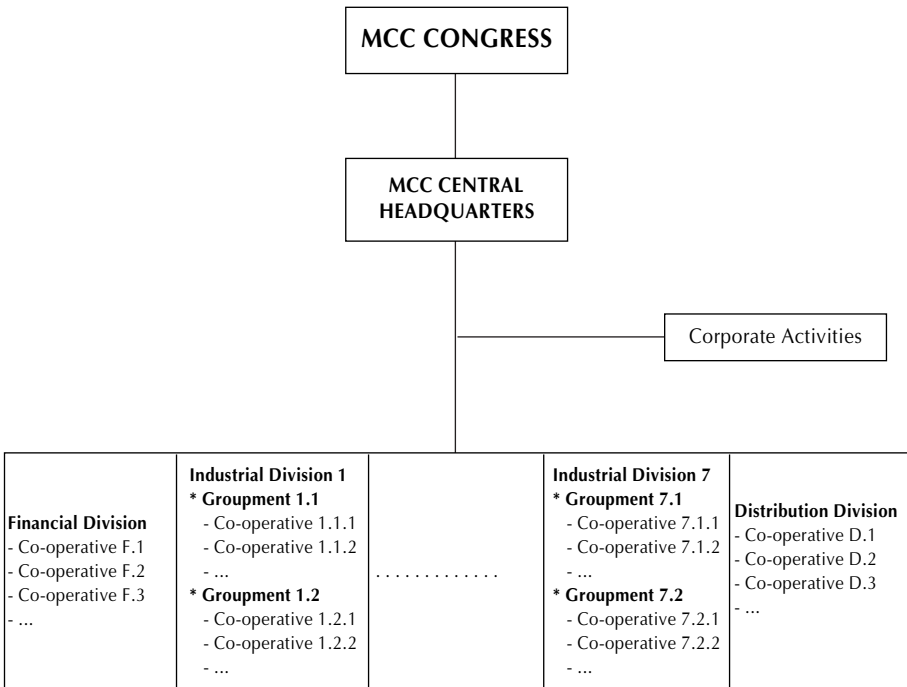
The Ulma group that did not enter in the previous stage, entered in 2000, other individual co-operatives as well entered within the corporation. As related above, going out or in the corporation is a decision that the members of each co-operative make through the general assembly. However, groups like Fagor today still maintain a certain cohesion, through some normative and operational links of the previous stage. Individual co-operatives belonging to different sectorial divisions live in relation with sectorial co-operatives and valley groups in a complex mix of interest and equilibrium.

This is the stage where the globalisation of the economy became a reality, which made enterprises to locate some of their production processes all over the five continents. So in 31<sup>st</sup> March 2004 there were 39 production plants outside Spain, having 6.202 employees. 12 were in the European Union with 728 employees: France (4), Germany (2), Italy (2) and Great Britain (3), 5 were in the ten countries that became part of the European Union in 1<sup>st</sup> May 2004 having 1.897 employees: Poland (1), Czech Republic (4), and 107 employees in Rumania (1) and Turkey (1). The other 21 plants having 3.468 employees are located in Brazil (5), Mexico (5), China (6), India (2), Thailand (1) and Morocco (2).

Those joint-ventures were created always by the individual co-operatives, having MCC only some functions of financial or relational support. Therefore, decision making process in those processes is different from the transnational enterprises, where central headquarters decide the location. This process of relocation has basically three motives: a) the lack of competitiveness in costs due to the different salaries between different countries, b) the compulsoriness of being close to other transnational

enterprises for co-operatives producing components and c) finally commercial reasons to gain market share being in countries with a increasingly bigger GNP.

**FIGURE 3.  
CORPORATE FOURTH STRUCTURE**



Source: Authors.

-Personal networks: There is a process of adaptation and a change from relating with people of the same regional culture to relating with other co-operative members of further regions. The establishment of MCC in 1992 made that the level of integration of the Regional Valley Groups, in some cases like the 8 co-operatives of the Fagor Group with a 100% rate of sharing profits and losses and same legal rights between members, changed into the 7 industrial Divisions and their Groups, with different rate of sharing profits and losses between 25 to 100 % and different normative. The levels of integration have been increasing but still in 2004 there are differences, which generates different perceptions of the co-operative thing.

Regarding members, the gap in salaries has been of 1 to 12, with a higher diversity of relations depending on the sectorial divisions and the regional groups where they come from.

On the other hand, participating in joint-ventures with non co-operative enterprises has become something common and as a consequence the existence of some different status of workers, being in late 2003 non members more than the 40% of the employees in MCC, under the logic of paying attention to job creation and after checking if it is co-operative or not. All this makes towards a diversity in personal relations, both at a national or a international level, where the levels of Democracy, Participation and Solidarity of non members employees is different in each case, but generally being closer to a non co-operative firm rather than to a co-operative.

- Institutionalised social interaction: In 1997 the University of Mondragon was established, also three other new research centers and the Innovation Technologic Center Garaia in 2001. In all these cases the model of mix co-operative enterprises has been maintained, with the participation of co-operative enterprises in its assemblies and general boards. It is interesting to remark as well that the University and the Research Centres are mix co-operatives, private and not for profit organizations, open to the whole society with no any distinction.

In Spain participation of MCC in clusters and sectorial associations has increased, and internationally this participation has just started.

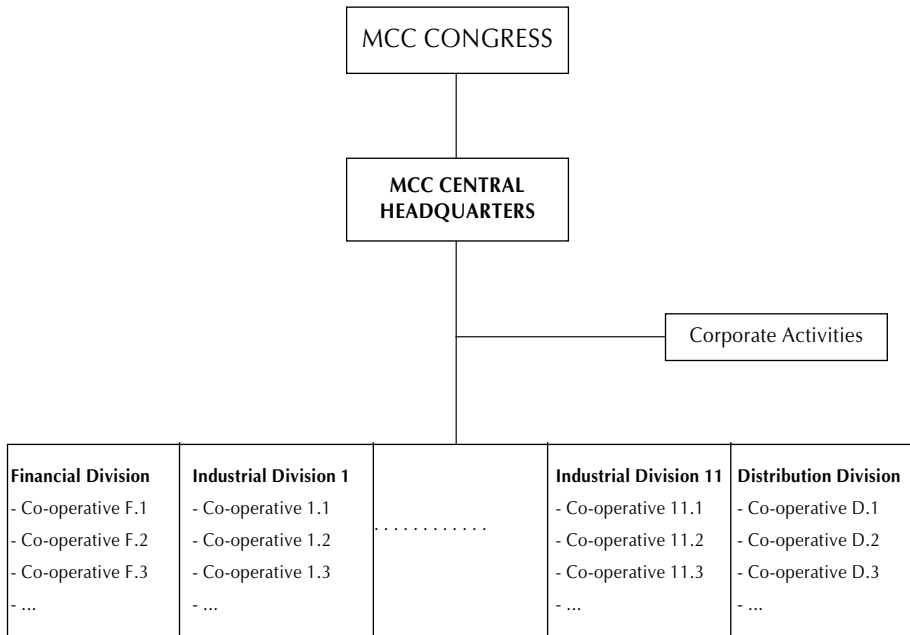
### *3.2.5. Future project*

Taking into account the current management model created in 1992, with its positive and negative elements, and the existing corporate common culture, in 2003 a little group of managers and professionals joined in a new commission to analyze the viability of the existing management model and to propose improvements. After first drafts, in early 2004 a new organizational proposal have been launched to individual co-operatives to be discussed and analyzed, and it is programmed to be voted in the Co-operative Congress in 2006.

The proposed model looks for increase the amount of Industrial Divisions, focusing more on the sectorial synergies and eliminating Groups, and probably the trend will be to join the representation of all the Industrial Divisions in a reduced amount of Vice Presidents, to maintain the equilibrium of representation with regard to the Financial and Distribution Divisions.

Regarding the relocation process, it is considered as necessary to maintaining job even in the co-operatives of MCC in the Basque Country, moving outside the production of labor intense production, and estimating to be 60 subsidiary plants in the next 60 years.

**FIGURE 4.**  
**CORPORATE FUTURE POSSIBLE STRUCTURE**



Source: Authors.

- Personal networks: it is predictable that a few changes are going to happen in the personal relations of members both in a regional or state level, but in MCC exists a serious determination that at least 30% of the employees of the productive subsidiary enterprises in foreign countries will have some participation in the profit sharing process and in the decision making process, close to the levels of the members. Such participation will be subordinated to the different legislation in each country and as a consequence the formulas used will be different.

On the other hand a higher participation of both members and non members in the joint-ventures is forecasted, as a formula towards the success within the Information Technology Communications (ITC) and the knowledge society. And the objective is to locate members and other workers as main actors of the permanent innovation within the enterprises, being the human capital the base for the development of the competitiveness of the enterprise.

- Institutionalized social interaction: Participating in international co-operative organisms is to be incremented, as well as sectorial clusters of the countries where there are production subsidiaries.

### 3.3. Promoting external support entities

The strength and permanent innovative attitude of the co-operative in MCC has made their initiatives to be internal but as well involved in the region or state.

Consequently, since 1983 MCC has participated in starting and strengthening the sectorial clusters in the Basque Country, being at present 11 clusters that join more than 300 enterprises. Also in late eighties co-operatives in MCC were pioneers in starting AENOR (The Spanish Association for Normalisation), in charge of ISO Quality Certifications in Spain, being its first president a manager from the Fagor Group. Also in the Basque Country, MCC promoted Euskalit, an organisation with the same aim but in a regional level.

Finally, it is remarkable the important role played by the co-operatives of MCC at all the levels of research, development and innovation in a regional level, with the participation in the Association of Centers of the Basque Country – EITE, with the participation and later involvement in the three Regional Technologic Parks and the creation of the Innovation Center Garaia.

## 4. SOCIAL CAPITAL IN FUTURE NETWORKS AND STRATEGIES

Much of the recent work in economic geography and regional studies has focused on the importance of strong economic and social networking to the success of regional and local economies. Concepts such as industrial districts, innovative milieus, clusters and learning regions have assumed great importance in much of this research.

From the regional development point of view, social capital can be seen as collective capacity of key socio-economic players in the region (e.g. individuals, companies, authorities, research centres, business support agencies, etc.) to form and effectively use networks or other form of co-operation on the basis of shared value system, norms and institutions (e.g. trust and reciprocity) in order to enable and accelerate the process of regional learning. In the field of innovation policy, it means creating an efficient regional innovation system that facilitates the generation, diffusion and economic exploitation of knowledge in the form of new or improved economic activities (products, processes and services) in a region.

Social capital being an important component of regional innovation system, the objective of MCC, should be to promote the creation or strengthening of regional innovation system in order to increase regional competitiveness.

Considering the importance of the social capital dimension for regional competitiveness, and the difficulties it may cause when it is too weak, finding ways

to foster social capital at regional level has become a priority for MCC. In recent regional policy approaches, regional co-operation (inter-firm and private public) is seen a fundamental key to the international competitiveness of the regional economy, largely due to the systemic way in which the regional innovation process takes place: co-operate locally to be able to innovate in order to compete globally. How to improve this capital, which allows knowledge and innovation to flow and thus contribute to an efficiently working regional innovation system and promote economic development in ?

Practically all definitions of social capital mention networks as a means of building social capital. MCC has to try to provide a framework for direct involvement, collaboration, and common action among private and public regional actors, in order to exploit synergies and liberate latent energies and creativity, which are at the roots of economic renewal and the identification of new business opportunities.

To contribute to these issues we suggested to improve regional public private partnerships for innovation policy. The participation of private sector representatives in the decision making process of innovation policies should be stimulated. This can be done through the creation of regional innovations forums and working groups with representatives from both private and public sectors. The link between co-operatives and the regional "knowledge base" should be a key priority for regional innovations policies. This can be made by developing networks between university, technology centres and co-operatives.

In this way the Innovation Centre Garaia is an excellent framework to lead the co-operation between Mondragon University and the short and long run research requirements of the enterprises, finding out means to facilitate the movement of knowledge and to build up a more intense and continuous relation between the University, the Research Centres and the R&D departments of the enterprises. All this fact will produce a higher regional development that will let co-operative firms to exist within an innovative and learning region, and as well will strengthen their position in international markets.

Therefore, it is essential to create a solid and competitive network based mainly on knowledge in order to produce innovation.

## 5. CONCLUSIONS

1. The proposed changes in the new organisational structure in 2004 tend to eliminate the level of Groups within the Industrial Divisions, in order to get a *less hierarchic structure*, with a minimum amount of levels between the individual co-operative the Central Headquarters of MCC. The same process is going on as well in each of the individual co-operatives, where work by processes and matrix structure are leader concepts.
2. *Independence between assemblies* remains within the individual co-operatives, to decide both to stay or leave MCC or to decide the viability of investing in another country through a productive subsidiary.

3. The *sectorial corporative structure* gives to individual co-operatives most of the synergies of a typical corporation, as an essential issue in order to compete in a global market.
4. The *progressive relocation of the productive plants* causes that a) co-operatives base their jobs on the permanent innovation and in the competitive put in practice of the ITC's, and b) international synergies are to be found participating in clusters and international organisms to promote new institutionalized social interactions.
5. The *co-operatives will have to grow in size* in order to reach the dimensions dictated not by the managers, but by the nature of the markets in which they operates. Co-operatives need to learn how to make better use of their combined strength, which, among other advantages, gives companies, a much more visible business image and provides them with an enviable degree of negotiating power.
6. Collaboration agreements are a way of joining forces to achieve common objectives. The co-operative values does not prevent from *working with other non-co-operative companies*, but rather serves as a stimulus in the development of common areas of interest.
7. Furthermore, companies that are more specifically involved in the field of knowledge attainment and development, in particular the technological centres, consultants, engineering agencies and the University will not be working alone. They will join forces to form the Knowledge Group, with the aim of acting as a permanent source of innovation within the Corporation.
8. The years to come will be characterised by the size and scope of the world markets, a consequence of the growing phenomenon known as *internationalisation*. MCC has to play even more active role on this new scene, since the future of all business fields is at stake.
9. The concentration of another twenty business-related technological centres in the same area as the Mondragon University, Ikerlan and a number of engineering and consultancy services will create an *intellectual cluster* that will not only contribute to the development of the individual co-operatives, but also to the improvement of the local social environment.

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# PARTICIPATION AND DEMOCRACY IN INTERNATIONALISED COOPERATIVES\*

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## 1. INTRODUCTION

Throughout their history, cooperatives, have had to adapt to the capitalist economic system but, at the same time, the vision that cooperation offers, as opposed to capitalism, is quite different, and presents itself as an alternative to the transformation of the current model of business enterprise and society.

These past few years, it has been observed how many cooperatives have become involved in a deep process of internationalisation, which has brought with them the transformation of cooperative experiences in multinational businesses with a nucleus that maintains their cooperative nature and a periphery made up of multiple production centres, subsidiaries, within a framework of capitalist relationships (Clamp 2000; Errasti *et al*, 2003)<sup>1</sup>.

In order to survive, cooperatives cannot become just another multinational and be carried along with the rest of the multinationals in this runaway world. The cooperative commitment is based on the *adaptation-transformation* dialectic that, on the one hand, demands adapting to new circumstances of the environment but, on the other, transforming the manner of operating in cooperative terms.

In this context, we believe that one of the principal challenges for these cooperatives lies in the search for new business models which marry the traditional cooperative principles and values with the reality of production and distribution systems at an international level. This challenge materialises in the creation of *another multinational business model*; one that is more democratic, i.e. a business model which channels relationships with subsidiaries, not through administrative or bureaucratic authority, but through interchange relationships based on inter-cooperation and democracy.

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1. In fact, this paper is a continuation of the article Errasti *et al* (2003). In the referred article we analysed the international expansion of Mondragon Corporacion Cooperativa, but the aim of this paper is to build another model of global cooperative or multinational democratic enterprise.

Traditional research, in the field of multinational company control, have centred on the international regulation of multinational enterprises (Kline, 1993), and on the topics referring to codes of conduct and social responsibility (Murray, 2000; Kolk, 1999; Kerkew *et al*, 2003). Nevertheless, over the past years, research has started to appear dedicated to analysing specific aspects referring to the democratic governance of multinational companies (Thompson, 1997).

In the field of cooperative studies, there are increasing numbers of academic works related with the internationalisation of cooperatives (Normark, 1996; Clamp 2000; Spear, 2001; Errasti *et al*, 2003; Bakaikoa *et al*, 2004). One conclusion arising from these studies is that cooperatives have the necessary experience and know-how when contributing novel solutions to the difficult task of developing democratic and efficient structures in the field of international activities. The development of democratic models of management and organisation for multinational businesses has thus become one of the most important challenges for cooperative thinking and practice in the XXI century.

In this presentation, we analyse the possible ways of developing another model of multinational business from three points of view: firstly, we analyse the role that can be played by the codes of conduct as complementary instruments for designing an the social policy of the internationalised cooperatives; in second place, we briefly look at the intercooperative multinational as an alternative to the capitalist multinational business model; finally, from a broader perspective, we make reference to how to develop a model for a more democratic multinational enterprise, as well as to some conditioning factors that affect the functioning and the decision-making process of multinational companies. In concrete, we deal with the mechanisms of co-ordination between the different units that make up the multinational structure and the features of their subsidiaries, as regards their strength or quality.

## 2. CODES OF CONDUCT

Over recent years, within the ambit of normalisation and harmonisation, there has appeared a series of initiatives related to ethics and social responsibility within business, especially in the sphere of international activities. These have to be seen as an integral part of an important current of social initiatives which, emanating from the private sector, have proliferated in the last decade within an environment characterised by economic globalisation (Heras and Errasti, 2001). Amongst other initiatives, one can cite, for example, the unprecedented rise in codes of conduct and social labelling for multinational companies (the International Labour Organisation found that more than two hundred codes of conduct and twelve social labelling programmes existed) (ILO, 2001), as well as initiatives being undertaken by investors, NGOs and international-level bodies (OECD, UNO, the European Union).

As an exercise in synthesis, the great variety of codes of conduct — greatly differing in content, promoters, methodologies and areas of application (ILO, 2001) — can be classified into three types of initiatives:

- Firstly, *codes of conduct dealing with basic working conditions*, such as the SA 8000 and AA 1000 codes, which look to the compliance with certain basic standards of these conditions as established by international bodies (Murray, 2000; Mújica, 1999)<sup>2</sup>.
- In second place, *international codes that offer general guidelines for action for multinational companies*, outstanding amongst which is the code proposed in 1990 by the *United Nations Centre for Transnational Corporations (UNCTC)*<sup>3</sup>;
- Thirdly, *codes of conduct proposed by Non-Government Organisations*, which attempt to respond to the interests of enterprise, the workers, the community at large and public administration (which is why they are also referred to as *multi stakeholder initiatives*)<sup>4</sup>.

It has to be pointed out that these codes are not free of problems, weaknesses or criticism. In effect, from many different angles there are those who question the efficiency and credibility of codes of conduct (Murray, 2000). This scepticism results, as Kerkow *et al* states (2003, 24), “from experience with the day-to-day practice of many companies. All too often, a considerably gap has become apparent between the rhetorical commitments to environmental and social action made by companies and the real impact of their activities on people and the environment”. From another point of view, it is clear that the codes of conduct, audits and social certifications should not become an alternative to legal systems of regulation. Neither are the tools to substitute trades or other labour unions representing workers. Their objective should not be to become mere public relations tools aimed at easing the consciences of consumers. On the contrary, codes of conduct can be valid initiatives for developing

2. The certificate is a measure to assure minimum practices, both for consumers and other purchasing agents and for companies (it is a certificate that establishes a model of certification very similar to the successful ISO9000 and ISO14000).

3. This code sets out advances in the commitment of companies to workers, to the business environment and to society, where the economic activity is being carried out abroad, and applicable in different ambits such as, for example, ownership and control, employment and training, publicising information, transfer prices, taxes, technology transfer, the environment and relations with governments and with society as a whole. As Professor Dunning has pointed out (1993), it is an ambitious code, unlike others (the OECD directives for multinationals, for example), and was drawn up taking into account the interests of developing countries. Although, in the end, it was not approved, because of the pressure exercised by multinationals and because of “the different interests of countries in the North and the South” (Kolk, 1999), we believe the study and its application has elements of great interest for cooperatives, and more so in a situation where it would appear that once again, and from many different ambits, the actions and behaviour of multinational groups are being called to account.

4. In general, heterogeneity dominates, given that some concern themselves with consumption, others with trade and others with production. The Initiative for Ethical Trade, Forest Stewardship Council, Global Reporting Initiative, Clean Clothes, etc, are examples of this. The special thing about these codes is, not so much their content as in the methodologies developed for their design, implementation and monitoring, which make them more interesting from a cooperative perspective. The main characteristics of this type of code are as follows: they stress the need to for those affected by the codes (workers in the subsidiaries) to participate in the whole process of design, implementation and monitoring, b) they attempt to adapt codes to local needs, based on international regulations; c) they promote the participation of external controllers/monitors in the monitoring of codes, both professionals and NGO members, North and South.

certain business policies by means of interaction between enterprise, workers, society at large and public administration (Jefcott and Yanz, 1999) <sup>5</sup>.

From our point of view, the key lies, rather than in the nature of the codes, in the objectives of the company for adopting these initiatives, and in the level of commitment acquired for their introduction and application. They will, therefore, be useful instruments in so far as suitable methodologies are applied to their design, (focus and participation), application and monitoring. In that sense multistakeholder initiatives can play a trendsetter role by going beyond the existing legal regulations in committing companies involved on social, environmental and human rights standards (Kerkow *et al*, 2003) <sup>6</sup>.

In this context, we think that the codes of conduct could be instruments for helping cooperative enterprises design and develop their own social policy closer to the values of cooperation. These initiatives and the recently-developed methodologies for their application, beyond the mere instrumental objective that capitalist companies may have, offer a suitable framework to determine a more responsible and cooperative framework, not only in the world of labour, but also in the relations between the cooperative and its subsidiaries, as well as in the commitment to the general environment. But, given that the codes try to lay down some basic rules about the activities and behaviour of multinational companies (Sethi, 2003), they can only set out minimum standards for the international socio-economic policy of those multinational companies wishing to make progress on the road to democracy, i.e. they can be considered to be the first preliminary steps for the application and development of the principles of cooperation, participation and democracy <sup>7</sup>.

In this way, we put forward two levels of social responsibility within the cooperative movement: a business company level, a minimum one, as corresponds to any business enterprise, and another, cooperative level, without any limits other than those arising out of cooperative principles.

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5. We develop these questions in other works presented by the authors: Heras and Errasti (2001).

6. As Ans Kolk points out (1999), the interaction of the different agents in the promotion and development of these codes of conduct is the most interesting novelty in the coming years. But it is not enough: It is necessary changes in the policy frameworks to establish binding corporate rules at global level.

7. Of course the international socio-economic policies of cooperatives will be well above the minimum standards established by international bodies; but it would not be out of place to analyse the social situation and working conditions of the subsidiaries from this perspective, and deal with the attainment of this type of certification. The social standards established by international bodies and/or the market should be the basis of any international social policy as they can contribute in effecting monitoring supervision and vigilance of the organisations themselves, as well as the members, suppliers or clients. Also they can contribute to allay doubts and improve image before consumers and society in general, and specially before the cooperative members themselves. Nevertheless, we believe that from the viewpoint of cooperative societies, the codes we mention forthwith are of more interest.

### 3. THE COOPERATIVE WAY: THE INTERCOOPERATIVE MULTINATIONAL

For adapting to international competition the commitment to the cooperative ideal demands that all the existing possibilities in the cooperative framework should be explored to the full. This adaptation can not be limited to the specialisation of the cooperatives in their own markets but have to be extended via cooperative initiatives which could facilitate their internationalisation, including their multinationalisation.

Arizmendiarieta, the founder of the Mondragon cooperative movement, in an interview conceded to the *TU Lankide magazine* in 1976, pointed out that, in a way, an integrated cooperativism could be thought of, with the necessary provisos, as equivalent to the multinational (Larrañaga, 1998)<sup>8</sup>. According to Bööck (1992), a multinational cooperative organisation can only come about as a result of democratic agreement of all the cooperative organisations in the various countries involved<sup>9</sup>.

However, problems thrown up by the creation of a multinational cooperative as opposed to the creation of private capital multinationals are much more complex. Private capital companies carry out their international activities through the markets and capital, wherein the economically strongest elements dictate the conditions. The private capital companies can act with great ease: absorptions, fusions, agreements to interchange capacities as well as influences on the markets are carried out efficiently. The capital subsidiaries can be carried out with fluidity because there is no need to transport ideas or persons or concepts of democracy; only the flow of capital is necessary (Ormaetxea, 1996).

Cooperative multinationalisation is theoretically carried out by means of democratic negotiations between cooperatives in different countries and from which arise stable co-operation. However, this alternative presents problems that are difficult to resolve: i) the cooperative sector is limited; ii) there exist divergent concepts of cooperativism in different countries; iii) intrinsic cooperative problems.

With all this, and as pointed out by Lanki, the Institute of Cooperative Studies at the University of Mondragon, "To analyse and take to its limits all existing possibilities in this field is the inescapable obligation of cooperativists today. What is needed here is an assessment of whether we feel committed to the expansion of the cooperative movement on an international level or whether we are part of the generalised belief that the only future belongs exclusively to the capitalist economy" (Proyecto testimonio, 1999). Thus, we highlight here various lines of possible action<sup>10</sup>:

8. According to J. Larrañaga's book (1998), *El Cooperativismo de Mondragón. Interioridades de una utopía*, in the above-cited interview, Arizmendiarieta stated: «the multinationals are taking over in the world. But why? Everybody talks about tentacles and so on and they have a bad image. But, why don't we question things more deeply? Is it really true that they are not necessary? (...) One way or another we have to see that the equivalent to the multinational is, with the necessary provisos, integrated co-operativism ».

9. The constitution of a co-operative organisation formed by members carrying out their activities in different countries would be another possibility but the current legislation of the various governments on co-operatives does not allow it.

10. Another field which opens great possibilities for commitment to cooperativism is that of cooperation in development. But we will not analyse it here as we have limited ourselves to the ordinary activities of companies.

- a) The transformation of foreign affiliated companies into cooperative societies (wherever the most ideal conditions allow).
- b) Simultaneously, efforts have to be made in the development of methods of cooperation between interdependent cooperatives in different countries. In this sense, an important step could be the *legislative initiatives*, as a future legal corpus for the European Cooperative Society, that could emanate from the European Union to achieve a common legal framework for companies involved in advancing Social Economy (for example, in order for the cooperatives to be able to install as a cooperative regime in the different member states, or for cooperatives in different member-states to be able to carry through processes of integration).
- c) The possibility of finding help and collaboration from other cooperatives when considering installing in another country, in such a way that international expansion and external production could be carried out in the fields of inter-cooperation, both through technology transference and through the creation of *joint ventures* or businesses, preferably cooperative ones, which have shared ownership.

A clear policy in favour of these plans of action, with the necessary financial and human resources is a priority from the point of view of cooperative commitment and responsibility. Possibly and initially of an experimental nature, they would allow the exploration of new ways of confronting the challenge of internationalisation, and would form a priceless source of information on genuinely cooperative possibilities in a globalised economy.

#### 4. A DEMOCRATIC MULTINATIONAL COMPANY

The traditional multinational company is characterised by having power of coordination and controlling operations in more than one country, even without having ownership (Dicken, 1998). That is, the relationships of the multinationals are conditioned by the capacity the parent company has for exercising its control over its respective subsidiaries (Andreff, 1996). The main centre of decision-making is outside the territory where business activity takes place, giving rise to a decoupling of economic activity and its direction, on the one hand, and, on the other, of the people involved in the activity and the surrounding society. A conventional multinational plans its activity in function of the advantages accrued in each country in such a way that, amongst other possibilities, it can open or close plants, cut or increase workforces, locate or eliminate research centres, always having an ample margin of action and, wherever the location might be.

The enormous economic, social and political repercussions of the actions of multinationals and the concentration of power of these companies in the hands of a few – shareholders or directors – makes it necessary to take on board the possibility



of democratising the bases for exercising this power (Thompson, 1997). It is an unavoidable necessity to put forward alternatives to the business and economic model represented by current multinationals, given over to large-scale production and distribution with no regard whatsoever to the indiscriminate exploitation of natural resources or of local labour. Multinationals -like the majority of large businesses, as Turnbull points out (2002, 2)-, are based on “command and control” hierarchical organisations, characterised by a centralised and centralising power which tends to become corrupt, to have difficulties in managing complexity and to have lack of checks and balancing mechanisms.

Nevertheless, if the difficulties implied in the development of representative and, above all, participatory democratic forms in any company are considerable, in the case of multinationals these difficulties augment due to the existence of legally differentiated units in different countries, each with its own legal, socio-economic and cultural environments. Participation in ownership, participation on Boards of Directors, participation in management, and in profits, give rise to greater problems than those that an independent local company will have<sup>11</sup>.

It may even be said that multinational and democracy are antagonistic terms: multinational refers to the capacity for control by a centralised unit distant from the various units spread over a number of countries (hetero-management), while the concept of democracy refers to the direct control by those involved in the process (self-management). However, exploring and innovating different ways that exist to democratise companies, even multinationals, is a challenge which cannot be ignored by society nor by companies if they wish to continue producing goods and services in a way that is distinct from the traditional capitalist enterprises. Seeking productive multinational business models, ones as democratic as possible, is a challenge, above all for those democratic companies that have had to become multinationals.

Now we will present some key points related to this quest. Firstly, we refer to the structure of governance of the democratic company in general terms. In second place, we will analyse the question of the participation of workers in the ownership and management and in the distribution of results, following the classification suggested by Hermel (1990). Thirdly, we will look at other aspects that affect the decision-making process of the subsidiary, such as the structure and quality of the subsidiary.

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11. The possibilities for the introduction of participatory democracies of workers are reduced in those companies that require narrow forms of coordination and strict administrative controls (Mintzberg, 1992). The need for sophisticated systems of coordination, in bureaucratic machines and compartmentalised forms, as is the case with many multinational companies, significantly conditions the possibilities of effective participation of workers in decision-making processes. Some multinational enterprises have been in the vanguard in applying a wide range of participatory experiences in management; for example: employees' suggestions, redesign of jobs, autonomous and semiautonomous work groups, quality circles, etc., mainly aimed at the elimination of the most negative aspects of work and at the motivation and involvement of employees with the aim of enhancing productivity and product quality. However, this type of participatory experiences has clearly-defined limits. Participation concentrates exclusively on questions related to job posts, without it involving participation in the economic running of the enterprise, e.g. decisions on investment and the distribution of profits, etc. Also, this form of participation can be unilaterally revoked at any time by the company, and even jobs can be done away with, the link with the company relinquished or the company itself relocated.

Finally, as a conclusion to this section, we present a model for the progressive introduction of participatory social policies in the subsidiaries.

#### **4.1. The structures of governance: democracy & inter-cooperation**

The democratic character of the multinational depends on the degree in which it encourages participation and foments democracy amongst the people involved in its activities. That is to say, what distinguishes a democratic company from a non-democratic one is the degree of participation of people in those centres where control is exercised and decisions are made. The principle of exclusive decision-making by traditional multinationals is in keeping with their control of capital and as exercised by the subsidiaries' directors who are designated by the parent company. The corollary is that workers, both in the subsidiaries and the parent company, are excluded. In contrast, the principle that should be guiding the make-up of these power and decision-making centres of a democratic multinational company has to be based on the principle of inter-cooperation and on that of democratic participation.

- *Democratic participation* means that those centres where control is exercised and decisions are made cannot be exclusively in the hands of shareholders, nor in those of elite groups of directors, nor in those of the workers solely of the parent company, but it has to be redistributed and relocated in and throughout each centre of activity and include each person involved in the multinational network.
- *Inter-cooperation* has the aim of enabling balance to be achieved, based on interdependence, i.e. achieving an equilibrium between the necessary co-ordination within the multinational group and the autonomous management of the subsidiaries. The relation between the degree of autonomy/dependence with respect to the parent company will influence the internal exercise of decision-making power, as well as the form of measuring and controlling economic-business decisions. On the one hand, the composition of the governance bodies of both the parent company and the subsidiaries have to be taken into account, as well as the degree of participation of those making up the multinational group, as we shall see shortly. On the other hand, the organisational structure of the multinational has to be taken into account<sup>12</sup>.

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12. Probably the most difficult element to carry out and achieve. It is well known that autonomy with respect to external demands and self-governance of the company are the prime elements of democratic enterprise systems, such as is the cooperative (based on the "one person, one vote" formula). However, the contrary is the case of the multinationals, given that they are characterised by unity in directorship from the parent company and by absolute dependency of the subsidiaries. These principles well reflect the incompatibility between democratic business systems and conventional multinational companies.

The definition and the composition of the functions of the governance bodies, both of the multinational group and of each participating company therein, will be made based on these two principles of inter-cooperation and democratic participation. The networked governance structures, equivalent to the current structures of some cooperative groups, can serve as a reference for the development of democracy in multinationals (Turnbull, 2001). To this end, in the transition towards the democratic multinational company, the following aspects, at least, will have to be reflected on:

a) *The representativeness of the Boards of Directors:* Designing balanced and pluralistic Boards of Directors, which include representatives of the subsidiaries' workers, and also of other interest groups.

- The composition of the Boards of Directors of the subsidiaries, in addition to the manager and those members of the of the of the Board of Directors of the parent company, has to take into account the participation of workers' representatives of these subsidiaries and of other, external agents drawn from the country of location of the subsidiary<sup>13</sup>.
- The composition of the of the Board of Director of the parent company, in addition to the workers' representatives of the subsidiaries, may include workers' representatives of subsidiaries, without prejudice to the participation by external agents representing other interest groups.

Nevertheless, taking into account the relative impotence of the Boards of Directors, anything less than a substantial change is purely formalistic. As Mintzberg points out, "...a seat on the Board of Directors does not mean being able to control the decisions that the company takes directly. Nevertheless, forms are important and representative democracy grants greater legitimacy to enterprises (Mintzberg, 1992).

b) *Other forms of workers' representation:* From our point of view, the less representative democracy and workers' participation there is, the more is there a need for certain forces, such as trades' unions, to counteract the power of the parent company (particularly in the case of workers in developing countries, which lack the necessary conditions to bargain collectively on equal terms with multinationals. The role of these labour unions in the parent companies by means of, for example, the Works' Committee or similar body representing the overall workforce of the multinational, enhances the right for workers in this type of company to information and to be consulted<sup>14</sup>. Now, with basic levels

13. The proposal for the democratisation of the business company, from the viewpoint of the employees or internal agents, can be enhanced by also considering the possibilities for the participation of other groups of agents who are also affected by the activities of the enterprise; these may be made up of consumer groups, ethnic minorities, local community or other public interest representatives, non-governmental organisations, etc.

14. In accord with the European Council Directive 94/45/CE, of 22 September 1994, modified by the Directive 97/74/CE, of 15 December 1997, concerning the constitution of a European-level Work's Committee or of a procedure for workers' rights in companies at Community-level to receive information and be consulted.

of information and consultation as a starting point, the way forward towards more developed models of participation has to be considered, as we will see in the next section, always taking into consideration the role of the trades' unions in this process.

#### **4.2. Workers' participation: ownership, management and results**

In the previous section, we referred to the participation of workers in the organs of governance of the multinational firm. In this section, we will refer to participation of workers in the ownership, management and results of the company, fundamental aspects of economic democracy in enterprises (Hermel, 1990). The waged employee system whereby there is a free hand with jobs and a monopolisation of profits by capital are the most characteristic features of the capitalist system. This is why the objective of a democratic multinational will be, apart from improving the working and social conditions of the employees (contracts, wages and salaries, the working day, promotion systems, training and education, etc.), to implement procedures enabling the *development of models of participation*, both in ownership, in the process or functioning of the enterprise itself, as well as in the results of the subsidiaries and in those of parent companies or networks, as we shall see below:

- The participation of workers in ownership, in a progressive way and without limits. This will enable progressive access to the company shareholders which, in turn, will translate into achieving increasing control over the important decisions and directives of the company, as we have seen in the previous section.
- The progressive participation in management, in a scale from participation as an implicit result of the labour being carried out itself, to participating in the conception or design of this work and which represents the fullest manner of workers' participation, given that this enables them to jointly define, with the rest of the workforce and persons in posts of responsibility, the objectives of their work, and to organise both the most suitable strategy and means for achieving those aims. (Hermel, 1990, 125)<sup>15</sup>.

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15. The participation in management or in decision-making is a complex and diverse process (Ford and Flotter, 1995). According to the power employees have in management decisions, we can talk about various levels of participation in management. Following the model developed by Pardo and Lloyd (2003) for gauging participation, decision-making processes may be divided into different levels in which employees may influence, for example, the identification of the problem, the design of alternatives, the taking of the decision and, finally, its implementation and revision. What is more, business decisions can vary significantly and may be classified hierarchically into strategic, tactical and operational decisions. The hierarchical levels participating in the decisions also have to be considered: directors, intermediate managers, operatives, as well as other aspects such as the formal or informal character of the participation, their direct or indirect forms and the degree of influence that collaborating agents are permitted.

- Participation in the results is also to be encouraged, within a framework which involves the equitable distribution of the wealth generated by the company. The *policies of distribution of results* can be considered as an indication of the level of commitment of the company to its workers and to the environment in which the enterprise finds itself; policies which can follow the usual cooperative postulates, involving profit-sharing amongst workers, obligatory reserve funds and education and promotion funds and could be set up for subsidiaries.

There are various models of participation in ownership and financial participation of the workers in the company: the handing over of shares by the company, the granting of share options rights, the contributions of the employees to an investment fund managed by a specific company<sup>16</sup>, etc. Along these lines, independently of the model, the European Commission has adopted a series of general principles which structure the financial participation of workers in companies: voluntary participation, extending the plan to include all workers, clarity and transparency, defined systems of participation, systemisation, risk avoidance for employees, distinguishing salary from dividend, plans compatible with the mobility of workers (European Commission, 2003).

From our point of view, and looking to the democratic model of the multinational, it is essential that this system have, moreover, other requisites such as being closely linked to systems of workers' participation in decision-making, becoming involved in an even deeper concept of what is democratisation in a company. Specifically<sup>17</sup>:

- We understand that participation of workers in the ownership and profits of the company has to be linked to participation in control and management, in such a way that the organisation and ownership tend to models of co-management and self-management.
- The percentage of company capital that the workers have should be sufficient so that, in accord with company law and the company statutes, they have the right to direct representation in the administrative bodies of the company.
- With the aim that participation has a real presence amongst the collective of workers, the percentage referred to in the previous paragraph would have to be held by at least 25% of fixed-term employees in the company.

These participatory formulae are an instrument to advance in the construction of the democratic multinational and increase, amongst other factors, the productivity of

16. In the style of the Plan for Participation in the Ownership by Employees and Plans for Participation by Employees in Purchasing or Employee Stock Ownership Plan (ESOP) and Employee Stock Purchase Plan (ESPP).

17. These criteria, according to the definition of the participating companies in the II congress of ASLE, held in December 2002, the organisation that represents and defends the interests of the cooperative societies, the organisation and ownership of which are based on the principles of co- and self-management, and of enterprises in the Basque Country where workers participate in ownership control (San José, 2003).

companies, given that they improve the involvement of workers in the company, tending to bring together the perspectives of capital and labour. They also constitute an element of primary distribution or sharing of income.

### **4.3. Other factors: quality subsidiaries in the multinational network**

We can now briefly consider two facts related to the internal functioning of the multinational company and which will condition the possibilities of developing models of participation and democracy. On the one hand, unlike the traditional model of the multinational company in which the various units relate to each other in a hierarchical and centralised way, we present other models for multinational organisation, amongst the most noteworthy of which are those based on networked structures. In this sense, within the framework of the new paradigm for knowledge management, it can be seen, together with the human factor, that networked structures and relational characteristics have become ever-more important for the efficiency of businesses (Gupta and Govindarajan, 1991). On the other hand, we see that the business strength of each unit or the quality of the subsidiaries of the multinational company is a variable that can significantly condition the level of democracy of the whole.

#### *The multinational network*

One of the aspects to be considered when democratising the multinational company is the relation that exists between parent and subsidiaries. The organisational structures of multinational companies influence the internal functioning of the various units and the decision-making process. Achieving a level of efficiency makes it necessary to seek adaptation between the environment, strategy and the organisational form of the multinational company. From our point of view, it has also become necessary to adapt forms of democracy to the multinational organisational model<sup>18</sup>.

There is ample literature in the field of multinational company organisation such as how units are differentiated, integrated, controlled and co-ordinated (Durán, 2001;

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18. The study of the factors that influence the structure of the multinational companies has managed to bring them to the attention of many authors. Some put emphasise on the features of the immediate environment (amongst these, Porter's 1988 contribution is particularly noteworthy), the organisational structures of the multinational companies depending on these environments that they face (Ghosal and Noria, 1993); while others refer to the company's own strategy and resources (Ghosal, 1987; Roth and Ricks, 1994). So, there are multiple external and internal factors which influence the structure and decision-making processes of companies: environment, technology, size, tasks, culture, organisation, resources, etc. Likewise, taking into account that the subsidiary companies face different conditions depending on the environment they find themselves in and that the historical circumstances are different in each case, it is quite possible that the co-ordination structure for a multinational may not be homogenous. So each subsidiary context is different and the relations between the parent company and its subsidiaries present different control problems (Prahalad and Doz, 1987).

Dunning, 1993). The objective in establishing a link between the various units of the multinational company lies in the need to balance the requirements of autonomy, co-ordination and control with the aim of achieving global competitiveness, flexibility and the learning of organisational know-how (Barlett, 1999). In this section we wish to point out that there are several possibilities in this respect and to ponder on the possible alternatives to the traditional multinational, centre-periphery model.

From the research of Pelmutter (1969), several types of multinational companies are differentiated, in function of the perspective of the management with respect to the geographical and strategic orientation of the multinational company. As regards these, Barlett and Ghosal (1989) differentiate between three models of multinational companies: multinational, international and classical global. But they herald the appearance of a new model of a *transnational company* which breaks with that of the multinational with a central, dominant headquarters and substitutes it with another type with a heteroarchival relation based on criteria of flexibility and cooperation. Other authors have named them “multi-centre companies”, “the heteroarchival multinational” (Hedlund and Rolander, 1986), “the flexible transnational” or “networked multinational”<sup>19</sup> (Dicken *et al*, 1994). The most interesting aspect of this approach is observing how the different forms of organisation of the multinational company can condition the levels of democracy and participation in each unit. So, each organisational form responds to a set of characteristics of the sector, the complexity of the environment, the level of local resources, and so on. A priori, it seems that the transnational model is the one that can best meld the characteristics of a structure of democratic governance with the efficiency needs of a business company. Amongst the *transnational* model the fact that multiple centres exist is notable to the extent that the competitive advantages are not exclusively inherent to a country or a unit, but can develop in any of the company’s global operations. Thus, the flow of skills and of product offers should not be one-way from the parent company to the subsidiary, but also the reverse and from one subsidiary to another. This is what Bartlett and Ghosal calls “*global learning*” (1992). Nevertheless, the question requires further and deeper research.

### *The quality of subsidiaries*

One thing that has to be taken into account is the functional capacity, the occupational profile and the business level of the multinational subsidiaries, which can vary considerably and, therefore, condition the levels of participation and democracy in the multinational companies. In the literature, those subsidiaries characterised by functional improvements and organisational developments have been classed as “quality subsidiaries” “networked subsidiaries”, “technical subsidiaries”

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19. Related names are “performance companies” and “creative subsidiaries”.

or “developing subsidiaries” (Amin *et al*, 1994, Crone 2000). A multinational company will find it difficult to be democratic if it does not base itself on a structure which encourages the strengthening of the various units of which it is made up.

The differences in the quality of subsidiaries can be illustrating using a comparison between developed subsidiaries, which we will call “idealised quality subsidiaries” and which correspond to subsidiaries of networked multinationals, and “traditional auxiliary subsidiaries”, typical of the multinational based on the “centre-periphery” model.

Compared to the auxiliary subsidiaries, the higher quality subsidiaries have a greater range of functions and powers, such as greater autonomy in management decision-making to the extent that its strategic value within the multinational company is enhanced. As a consequence they have a better quality of job posts and, thus being less vulnerable to closure, have a more stable source of labour power in the medium term. It is also suggested that plants of a higher quality will be able to exercise a more positive influence on the local economy through supply links, technological spill-overs<sup>20</sup> and even the creation of new spin-off firms (Crone, 2000; Amin *et al*, 1994).

Perhaps the most noteworthy point lies in the fact that the quality of the subsidiaries is not a fixed variable, but one that can be developed. The strategic positioning of subsidiaries depends on certain exogenous factors in which features that are characteristic of the country are important, on the sector and the networks in which they are immersed; but it also depends on endogenous factors, amongst which are the consequences of decisions taken by the parent company. Another factor which should not be forgotten is the human capital of the subsidiaries, as the principal depository of knowledge of the organisation and principal source of its competitive advantages.

A parent company policy which positively decides in favour of the strengthening capacities of subsidiaries enhances the general competitive position of the group. The subsidiaries, like any other company, acquire competitive advantages and consolidate themselves in business terms in function of technical and human skills. The competitive advantages will be sustainable in as far as there is a commitment to ongoing learning and innovation activities.

#### **4.4. Model for the progressive introduction of company participatory policies in subsidiaries**

In conclusion, we will now present a model for the progressive implantation of company policies which lead to establishing a model for a democratic multinational company. This model attempts to bring together both ethical principles which underlie the cooperative movement and the exigencies of the internationalisation of companies, in order to achieve the end aim of the harmonious development of cooperatives and their subsidiaries.

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20. Voluntary or involuntary exchanges of useful technological information without tangible remuneration (De Bondt, 1996, 15).



The basic elements of the model are principally related to the participation of the workers in the subsidiaries, and questions about the relation between the various units of the multinational network are left to one side, as are those concerning the quality of the subsidiaries.<sup>21</sup> Thus, the model is divided into five levels and poses the following variables related to participation:

- Participation in management
- Participation in the organs of governance:
  - \* Workers' representation body
  - \* Representation of workers on the Board of Directors of the subsidiary
  - \* Representation of workers of the subsidiary on the Governing Council of the cooperative or on the supreme body of the multinational group
- Participation in profits
- Participation in the ownership of the subsidiary

Some variables are easily quantifiable as, for example, the percentages of participation in the profits, participation in ownership or the number of representatives of workers on the Boards of Directors. Other variables are more complex to measure. Thus, the participation in core management is more difficult to evaluate, as it depends on a great number of situations, relations and behaviour thrown up in the course of the development of activities undertaken by the company. Likewise, it is the type of participation that has generated most polemic in the literature and the parameters thereof are still not completely defined such as, for example, the details referred to or the manner in which these should be dealt with. Because of this, we have opted to include this variable following the scale presented by Hermel (1990): "Information", "consultation", "co-decision" or "self-management", according to the power that employees possess: to be solely informed by management, to be consulted but not necessarily obeyed, to be obligatorily taken into account with their criteria when making a decision or, simply, to take decisions for themselves just like members of the company<sup>22</sup>.

We believe that the model we present here, with all its limitations, is an interesting one to move forward along the road of participation of workers in subsidiaries, principally for two reasons:

- The model serves for evaluating the levels of participation in any organisation based on a pre-determined scale. Each level represents a determined level of

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21. Neither have we included other variables such as the participation of interest groups on the Boards of Directors or in the decision-making process of the company. But we would undoubtedly consider their inclusion as advances in the democratisation of companies and, as we have mentioned previously, they become more necessary the greater the power of the multinational company and the repercussions of its activities.

22. Just as with that proposed by Hermel, other levels can be put forward. For example, Moro (1977) distinguishes between co-deliberation, co-decision or determination and co-management.

participation and democracy, which facilitates the comparison of levels of participation amongst different organisations.

- The model has a dynamic character, which enables the levels of participation of the employees in the subsidiary to proceed in an ascending progression. In principle, it is the task of the organs and bodies of governance of the company to establish the desired level of company participation<sup>23</sup>.

**FIGURE 1.**  
**LEVELS FOR THE PROGRESSIVE INTRODUCTION OF PARTICIPATORY**  
**POLICIES IN SUBSIDIARIES**

**LEVEL 1. Participation in Management: minimum level**

- Introduce participatory management model. Information
- Complying with SA 8000 recommendations (with or without homologation)

**LEVEL 2. Low-level company participation**

- Participatory management model. Information and Consultation
- Organ of social representation
- Participation in profits (up to 20%)

**LEVEL 3. Medium-level company participation**

- Participatory management model. Consultation and codecision.
- Organ of social representation
- Representation of workers on Board of Directors of affiliated company
- Participation in profits (up to 40%)
- Participation in ownership (from 5% to 15% of capital; >25 % of employees)

**LEVEL 4. High-level company participation. Participatory management model.**

- Co-decision
- Organ of workers' representation
- Representation of workers on Board of Directors of affiliated company
- Representation of workers of affiliated company on Cooperative Governing Council or on the supreme organ of the multinational group
- Participation in profits (over 40%)
- Participation in ownership of the affiliated company (from 15% to 45% of capital; >40 of employees)

**LEVEL 5. Conversion into Cooperative / Democratic Multinational Enterprise**

- Participatory management model. Self-management
- As a European Cooperative Society.
- As a Mixed Cooperative with participation of the parent company

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23. Following the guidelines of the VIII Cooperative Congress, each cooperative can decide for themselves regarding the policies of company participation in the subsidiaries.

The focus of this proposal is contingent. The aim - to achieve a model of the most democratic multinational company possible – will be conditioned by the objective to maintain a certain level of efficiency. The size of the multinational company and the subsidiaries, the level of the existing concentration and competition, the location of the subsidiaries and their characteristics, the characteristics of the environment it finds itself in are factors that have an influence when putting forward objectives of a more suitable participation in each particular case.

## 5. CONCLUSIONS

Although cooperatives opt for growth and internationalisation in order to adapt themselves to the imperatives of the market, other aspects which are part of their nature cannot be overlooked, such as democracy and the transformation of business and society models. For the cooperatives it is not enough just to adapt and create a conventional multinational. The current business model, in which a minority of cooperativists has become capitalist owners of a group of companies which involve a majority of contracted workers and largely located in developing countries, is antagonistic to the cooperative project. The next step after international business expansion has to be that of transformation in cooperative terms. The internationalised cooperatives are facing the challenge of developing an international socioeconomic policy more in accord with its principles and values than the creation of a new model of a multinational cooperative or democratic enterprise.

The democratic management of the organisations and the persons involved in internationalised cooperatives have to meet three conditions: In the first place, multinational cooperatives have to take into account all employed workers - and not just the cooperative members – in a way that is fair and equitable (apart from the rest of the stakeholders). This, above all, in the case of workers in developing countries which lack the necessary conditions to negotiate with the multinational on equal terms. In the second place, multinational cooperatives should act as positive and proactive agents through the mechanisms at their disposition for guaranteeing basic working rights and facilitating the implementation of the cooperative values of democracy and participation, which is the *raison d'être* of cooperatives. And, thirdly, the cooperatives ought not to see these lines of action as discretionary or necessary inconveniences, such as the costs of carrying out business abroad. On the contrary, such actions should be considered as part of their commitment to the expansion of the cooperative movement at an international level.

In this sense, analysis of the social responsibility of multinationals and current codes of conduct, as we have seen, may offer valuable information to business groups wishing to encourage progressive socio-economic policies regarding their subsidiaries; although they be limited. We believe that the objective of the internationalised cooperatives is rooted in the search for a Democratic Multinational Company goes beyond mere codes of conduct: it is about creating a new model of international

business company which substitute the traditional multinational hierarchy. Undoubtedly, it is a more complex process than just democratising an individual enterprise and there are no reference models for this task to be carried out. The cultural, legal and economic difficulties are legion. Nevertheless, the search for new forms of multinational organisation is an unavoidable necessity for those companies committed to the cooperative ideal.

From our point of view, this has to involve progressive changes in multinational organisation based on the participation and the democracy of persons and on the inter-cooperation amongst the different units making up the organisation. It involves creating a new model that transforms the traditional institutional architecture, as it were, of the multinational companies, by means of a new model that tends to become a network, not composed of all-powerful parent companies and their dependant subsidiaries, but made up of quality units, co-managed, and in which persons increasingly become the centre of the organisation. The key resides in boosting the levels of participation of the people involved in the activities of the enterprise, its ownership, its results, its management and in its decision-making bodies, both in the subsidiaries and in the parent company.

The internationalised cooperatives offer a unique opportunity to define new parameters of action in international relations based on the cooperative principles of inter-cooperation and democracy. Taking this challenge on board is one of the most valuable contributions that these cooperatives can make to the development of economic democracy in the XXI century. Growth means certain risks for the cooperatives; but also opportunities: given that large enterprises, the multinationals above all, are not going to disappear but, on the contrary, their presence and power are set to increase, this contribution that internationalised cooperatives can make to the democratisation of large companies, within the framework of international socio-economic relations, is of paramount importance.

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**PART 4**  
**PATHS IN INNOVATION,  
EDUCATION AND  
COOPERATIVE  
DEVELOPMENT SYSTEMS**



# THE PRESENCE OF SPANISH CO-OPERATIVES ON THE INTERNET AND “.COOP” DOMAIN

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## 1. INTRODUCTION

The Internet and the new information and communication technologies are producing important modifications in the traditional business models. The relationship between a company and its corresponding value chain has been changing over the last years due to the new possibilities of the Internet-related technologies. In this context, cooperatives are not an exception.

Regarding the above, companies are evolving through four different levels created by the Internet as follows (Laso and Iglesias, 2002):

- “Company with a website”, positioned in the Internet for advertising purposes or with information for the different stakeholders related to the company (partners, investors, clients, suppliers...). Regarding this situation it should be noted that financial information is one of the contents that has experienced the highest evolution in the Internet, not only in terms of the information provided by companies through their sites, but also through the services offered by specialized portals.
- “Internet-enabled company”, which adds the company new online capabilities without significant changes to its position in the value chain of its sector. In this sense, companies at such level start to implement e-business to their different areas, such as electronic services capabilities for the supply chain (eSCM). Currently, most companies have not reached this level and are in the previous stage.
- Finally, we find the “Internet ready Company”, and later on the “Company reinvented for the Internet”, which entails the consequent reconfiguring and rethinking of the company’s business model in order to make the best use of its competitive advantage based on the intensive use of the new information and communication technologies.

Therefore, we consider that the corporate online presence is an extremely interesting aspect for cooperative societies, which - as we will point out below - have a specific domain name in order to maintain and increase their competitiveness, and coordinate it with their own principles.

## **2. BACKGROUND AND CURRENT SITUATION OF THE “.COOP” DOMAIN NAME**

At the end of 2000, the ICANN committee (Internet Corporation for Assigned Names and Numbers), which regulates the assignment of names for Internet generic domains at the international level, had a meeting with the objective of approving new generic domains to make more fluent those already in use (“.com”, “.net” and “.org”). The objective was to respond to the need for new domain names in order to meet the large demand of generic domain names.

Any official accredited by the ICANN could propose new domain names. Among the names proposed, the committee selected seven new domain names: “.biz”, “.info”, “.name”, “.pro”, “.museum”, “.aero” and “.coop”.

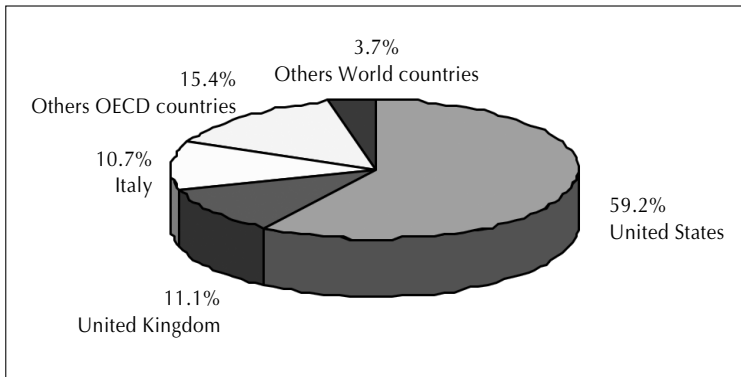
One of the factors that influenced this choice was the assignment of domain names according to sectors or activities, thus the top level domain names resulted as follows: “.biz” (abbreviation of business) for companies, “.info” for informative pages, “.pro” for professionals, “.name” for personal pages, “.museum” for museums, “.aero” for companies of the aeronautical industry, and “.coop” for cooperatives. It should be pointed out that the “.coop”, “.museum”, and “.aero” domain names were conceived as restrictive, that is, they can only be registered by the sector-specific companies they represent.

The new “.coop” domain name is sponsored by the US National Cooperative Business Association (NCBA), with the support of the International Cooperative Alliance (ACI) and other cooperative organizations.

In general, the most popular Internet domain names (.com, .net, .org) are very concentrated by countries. As indicated by other variables of the Internet geography (distribution of telecommunication lines, users’ number by countries,...), the development and use of the Internet, these run parallel to the geography of the wealth, technology and political power (Castells, 2001). At the end of 2000, the United States had most of the Internet domains (50% of the total), followed by Germany and the United Kingdom with 8 and 9 percent.

As for the “.coop” domain name, the current situation (February 2004) is similar, since most of the active domains (96,3%) are located in OECD countries, that is, with the highest incomes per capita. In the first position is the United States with 59.2%, followed by the United Kingdom (11.1%) and Italy (10.7%). Spain represents 2.3% with 79 active ‘.coop’ domain names.

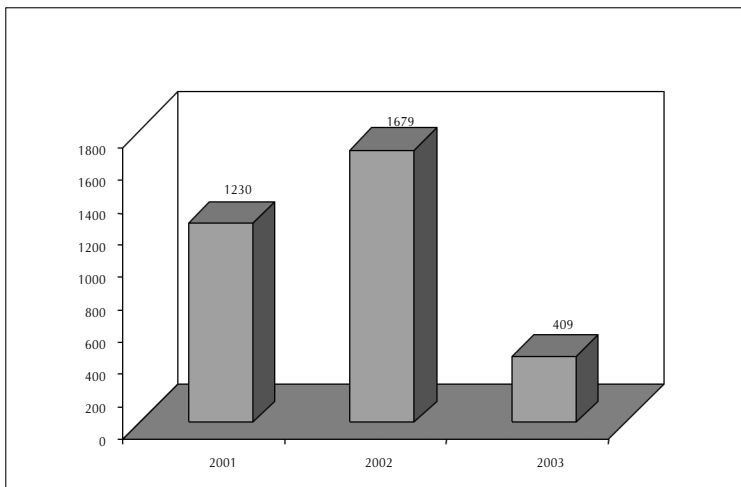
**FIGURE 1.**



Source: DotCoop Alliance, 2004.

Regarding their establishment, it should be noted that from the 3,368 active “.coop” domains at the moment<sup>1</sup>, approximately one third were established in 2001, while in 2002 these active domains increased in more than half of the total. Nevertheless, figures in 2003 show a decline in that tendency.

**FIGURE 2.**



Source: DotCoop Alliance, 2004.

<sup>1</sup>. Data from February 2004.

The “.coop” domain name originated with the objective of promoting and protecting the cooperative values in the Internet, thus facilitating economic development and other mutually beneficial relationships between cooperative organizations, with the purpose of achieving a higher economic and social progress for their members. Moreover, the original aim was to counteract the so-called “digital gap” as far as possible and help cooperatives with limited resources to access and use the new information and communication technologies.

### 3. SITUATION OF THE .COOP DOMAIN IN SPAIN

#### 3.1. Methodology

The list of active ‘.coop’ domains in Spain<sup>2</sup>, obtained from the website for promotion and use of the ‘.coop’ domain (www.coop), was used as the source for the analysis of the operative websites based on different criteria (García-Martínez and Polo, 2003).

Besides the typology of cooperative organizations and their geographical distribution, different basic aspects on web hosting and design have been considered:

- Availability of the “.es” and/or “.com” domain names besides ‘.coop’, and verification of whether the former have already been registered by other organizations or companies.
- Website technical support, considering it as basic if it only has text and static images; medium if it includes a navigation bar, pictures and dynamic images; and advanced if it has animations and elements such as Intranet for members, or restricted access for clients and suppliers, or even the possibility of application of e-commerce.
- Popularity of these websites, that is, the number of pages containing a link to this webpage, which is confirmed by means of a specific tool of the search engine *Google*.

Regarding contents, during the first stage it was followed the self-evaluation scales for SMEs from the Code of Good Practices for the Online Dissemination of Financial Information, developed by the New Technologies and Accounting Committee of the Spanish Association of Business Accounting and Administration (AECA, 2002). In terms of the company’s online information, this scale recommends to comply with at least two of the following six aspects:

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2. Data from April 2004.

- Information on the main business activities.
- In-house business news service.
- Precise and quantitative information on the R&D&I investment policy.
- Information on the application of quality standards to different processes or products.
- Accurate and quantitative information on the company's environmental protection policy.
- Accurate and quantitative information on the human resources strategy.

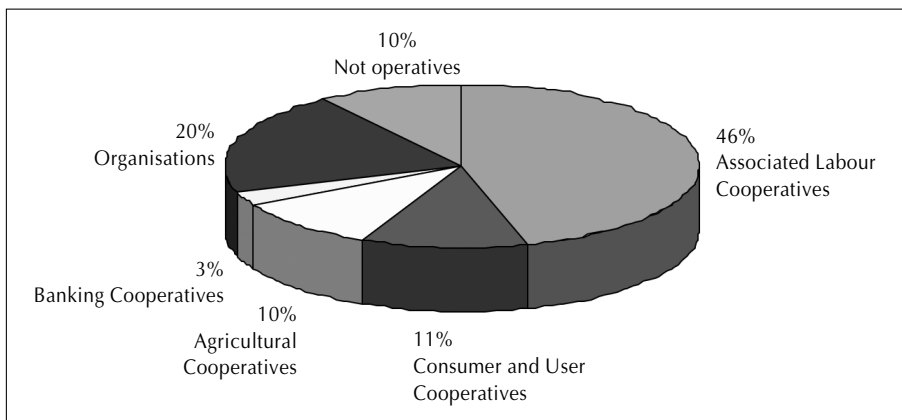
Regarding the financial information, with a more in depth detail in the contents, at least three from the following six aspects are advisable:

- Access to the last year's complete annual accounts.
- Access to the last three years' complete annual accounts.
- Unequivocal identification of the accounting principles applied for the elaboration of the accounting information published online.
- Individual access to the audit report (if required) related to the annual accounts available online.
- Specification of whether the accounts available online (if applicable) have been audited or not, regardless of the annual accounts.
- Access to the annual report.

### **3.2. General aspects**

Upon applying the methodology described above, we only find 71 operative websites out of the 79 considered as active. Regarding the distribution according to the typology of cooperatives, the larger group corresponds to associate worker cooperatives (46%), as shown in the following chart:

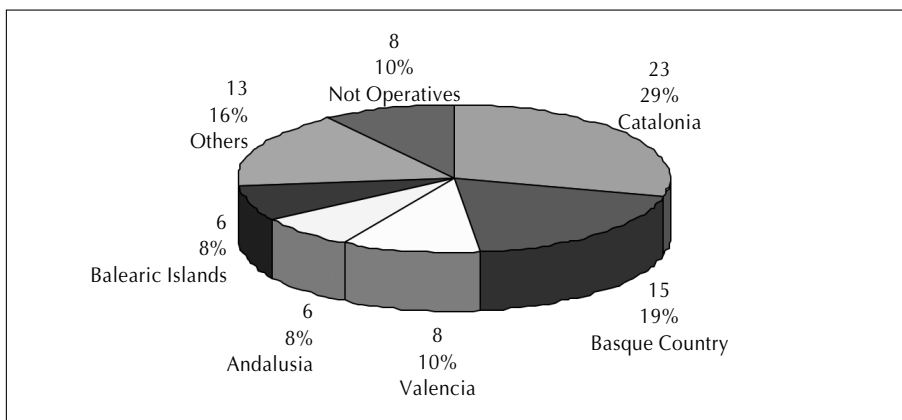
**FIGURE 3.**



Source: DotCoop Alliance, 2004.

As for the geographical distribution of cooperatives with a .coop domain name, the chart shows that most of them (74%) are located in Catalonia, the Basque country, Valencia, Andalusia and the Balearic Islands.

**FIGURE 4.**



Source: DotCoop Alliance, 2004.



### 3.3. Web hosting and design

From the basic domain aspects analyzed in the methodology applied, two differentiated groups can be highlighted: On one hand, those entities that have registered their domains correctly and have an “.es” or “.com” address next to ‘.coop’ (20 cases), although sometimes they are pointed from the “.coop” site, therefore they do not promote such domain name. On the other, those entities that in most of the cases went online probably late and only have the domain ‘.coop’, since the ‘.es’ or ‘.com’ had already been registered by other companies (37 cases).

Based on the previous description, in terms of the interface, from the 71 websites, 23 have a simple design (including 9 sites under construction), other 29 show an average design, and 19 have an advanced design. Among these latter we find some cases of e-commerce features, which despite its difficulties, will become a field to be more widely explored and developed in the future.

According to the survey carried out by the Spanish Association of Electronic Commerce, 6.5% of a representative sample of companies in our country trade their products or services through the Internet (AECE, 2003).

In addition, the analysis of popularity has allowed to contrast whether the development of the existing websites corresponds to an active or testimonial policy of Internet presence for this type of organizations. In this sense, from the websites analyzed only 22 contain links to others, and 14 of them with a low proportion (less than 10 links). In this sense, it should be pointed out that the development of a website is not completed when it is hosted in a server; it has to be promoted, since 70% of the users make use of search engines to locate them. Therefore, it seems advisable to promote links to the sector’s websites, starting from specialized portals and cooperative organizations (Puccini and Briz, 2003).

### 3.4. Contents

Only 17 of the sites analyzed (without including the organizations) exceed the scale proposed regarding online corporate information, mainly because they include information on the activity developed and they include a news service on the development of such activity. The main deficiencies detected correspond to contents on Research and development, Human resources and Environment. As for financial information, only 5 sites include some of the aspects assessed in the scale proposed, and comply with the recommended levels, therefore this is one of the deficiencies in terms of web content that should be improved in a near future.

In any case, we consider that the scale used does not correspond completely to the specific features of a cooperative society as it does not include some aspects of its social dimension. In this sense, and as a draft proposal for parameters of the new guidelines for Internet dissemination of cooperative information, which we are considering as a future research line, we suggest two new aspects to be included in the scale (García-Martínez and Polo, 2003):

- Clear reference to its cooperative status or to some cooperative principles.
- Information on the application of surpluses and/or reference to the contribution to the Fund for Education and Promotion (FEP) and its use.

Regarding the former aspect, only 30 cooperative societies show a clear reference to their condition as cooperative, and from them, only 8 include some comments or information on the application of their surpluses or some reference to the contribution and use of their cooperative funds.

It seems reasonable to think that the cooperatives that use the .coop domain should be those more involved in this sense, and although we do not have elements for comparison, it is undoubtedly an aspect to take into consideration and improve.

### **3.5. Assessment of the cooperative presence in the Internet**

Before concluding, we have considered interesting to contrast the previous criteria with a representation of the cooperatives at the national level, extracted from the ranking of business of the 2002 Social Economy Yearbook (CEPES, 2003). It does not contain a list of such companies arranged by a specific criterion; although it includes symbolically the most outstanding entities according to the organizations in their structure. In any case, after a first approach, we consider that they are representative for our study.

In the first place, we observe that from the 85 organizations included in this ranking, 54 are cooperatives, among which 41 are not included in cooperative groups. For simplification's sake, we analyze these 41 cooperatives, from which 24 have a website (59%), and only 4 have a .coop domain name. Despite the low availability of corporate websites in Spain, around 29% (SEDISI, 2003), far below the average in other European Union countries, we believe that due to their representativeness, this level should be higher. But the scarce use of the '.coop' domain name in these cooperatives, lower than 10% is even more drastic.

In terms of the interface, from the 24 websites studied, 7 have a simple design (including 4 sites under construction), 7 more show an average design, and 10 have an advanced design. Proportionally, the advanced level is higher, but the basic level is lower. Therefore, it seems that this technology is more intensively used than in the cooperatives with a '.coop' domain name, which seems coherent as they are the most relevant entities, and in many cases, with a higher economic capacity to develop them.

On the other hand, from the Web pages analyzed, only 13 contain links to others, and 11 of them with a low proportion (less than 10 links), therefore we consider that they have the same problem mentioned above, which seems applicable to the whole sector.

Finally, only 6 co-operative societies do not make a clear reference to their condition of cooperative; in general the information on this aspect is noticeably improvable.

## 4. CONCLUSIONS

In sum, we believe that the cooperatives that use the '.coop' domain as well as those that do not use it do not make the best use of the Internet technology opportunities, which represents a challenge that should be taken up as soon as possible.

Recently, the European Commission has adopted a communication on the promotion of cooperative societies in Europe<sup>3</sup>, which reveals that the potential of these organizations has not been exploited enough. The aim is to promote their image at the national and European level, and improve their popularization and understanding. Therefore, different actions, classified into three main lines, are being developed. Although these actions do not include any explicit reference to the use of Internet and the development of websites in co-operatives, we understand that given the potentiality of information transfer of this tool, the final actions should include this resource. This support can be an inflection point in the use of these technologies within the Social Economy context, which as we have seen, is desirably and substantially improvable. Therefore, it will enable to structure a joint image of co-operatives, and the role of the ".coop" domain name will be reconsidered as an identity mark in the Internet, which should be encouraged in Europe.

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# ICT SUPPORT SPECIFYING CO-OPERATION BETWEEN MEMBERS WORLDWIDE

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## 1. INTRODUCTION: SITUATION IN CZECH CO-OPERATIVES

Housing co-operatives must be privatized into shape of associations of owners recently. Law is no longer allowing them to keep the form of co-operative. All co-operative farms were transformed into co-operatives of owners ten years ago. Many of them changed its legal status (Table 1).

**TABLE 1.**  
**RESULTS OF SELF-PROTECTION BY CZECH FARMING CO-OPERATIVES**

	<b>Co-operative Farm</b>	<b>Joint Stock Farm</b>	<b>Limited Partnership Farm</b>	<b>Listed Enterprises No. Total</b>
Before 1993				1076
Number of Year 1993	1221	37	163	1421
Number of Year 2002	698	662	1448	2808
% change in numbers of legal bodies 2002/ 1993	57%	1789%	888%	197%
% of Land 2002	27,2 %	22,7 %	21,7 %	71,6 %

Sources: Lux/Min of Agriculture (1993), CM SZD in Stryjan (1994); Agriculture Chambers (2002): Basic Principles of the Agricultural Association's Structure.

Number of joint stock companies increased the most. Number of co-operatives is still decreasing. It is difficult for members to keep the form of co-operative. Members,

who are willing to prevent transition of co-operative into other legal form of company, are preparing arguments to influence an annual meeting. Lawyers usually do not allow discussion and written proposals are handled by not transparent way. Old members, who form the majority, are confused and afraid to disagree with lawyers who lead the meeting. Therefore, the result is as it is shown in table 1.

People, who lost their co-operative, must to seek new ways of co-operation. Just because their resources are not allowing them to start any independent business and unemployment cuts them off the most of jobs. Protection of members from external impulses causing loss of immunity proved to be worse option than co-operative training of members in personal data processing in e-business environment. Therefore, it is proposed in this article to train them in new e-business tools completing their offer and demand.

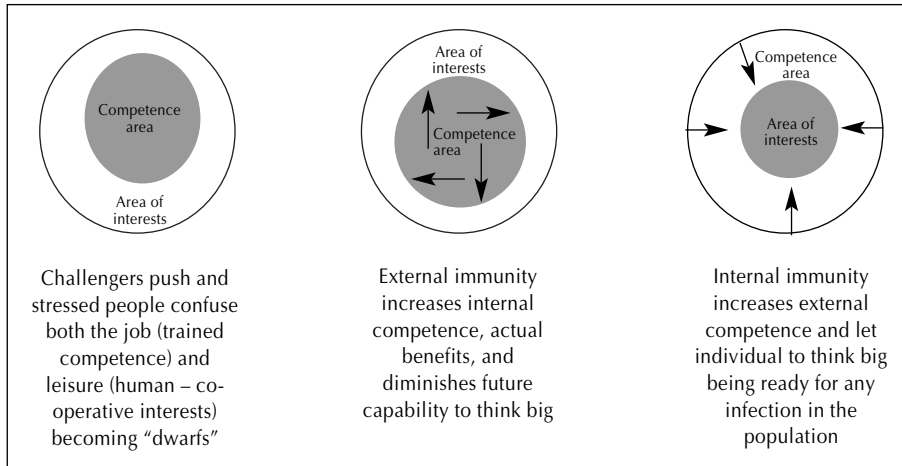
## **2. LITERATURE OVERVIEW**

A variety of competing theories have been proposed to try to understand the role of boards in the private sector, for example agency theory, stewardship theory, stakeholder theory, and managerial hegemony (Tudory, Cornforth, 2001). Taken individually these different theories are rather one dimensional, and have been criticised for only illuminating a particular aspect of the board's work. Morgan (1986: 339) in his groundbreaking study of organisations argues that many of our theories and ways of thinking about organisations do not match the complexity and sophistication of the organisational realities we face. In order to address this problem he argues that it is necessary to take a multi-paradigm or perspective approach in order to 'understand and grasp the multiple meanings of situations and to confront and manage contradiction and paradox, rather than pretend they do not exist'. This has lead to calls for a new conceptual paradox perspective framework that can help integrate the insights of these different perspectives (Hung, 1998: 108-9; Tricker, 2000:295). We are substituting multi paradigm of paradox perspective approach by immunity and infection based approach.

## **3. INDIVIDUALS AND CO-OPERATIVE ACTION: VULNERABILITY TO INFECTION**

Immunity system can individual either let think big or small. Individual trained to handle usual infection, transmitted through the population can think big. Individual exposed to the same infection without training will collapse into something reminding dwarf (Figure 1).

**FIGURE 1.  
INCREASED PERFORMANCE OF INDIVIDUAL RISE FROM  
THREE POSSIBLE STRATEGIES**



Czechs were so used to cooperatives that they forgot to strengthen internal immunity of co-operative members. Therefore, co-operatives were transformed easily into co-operatives of owners in 1992 and membership rights were lost mostly in joint stock companies few years later.

The question is if former members or idle people reject the proposal of e-business training and implementation and become dwarfs or build internal immunity and external competence either with or without support of training and implementation of e-business.

Healthy individual without support of e-business can co-operate to become successful by three ways:

- react on impulses, which s/he can influence (ii),
- co-operatively react on any impulse s/he can or cannot influence alone (i),
- plan and co-operatively develop skills, which are actually out of reach (iii)

These three ways to competence cannot be used if impulses are filtered or others have better access to information and impulses. And others do have this advantage. Therefore, the option of development of individual inside of co-operative can be either problem or the advantage. Depend on training. And training in e-business techniques and implementation can be done both in co-operatives and outside of

them. Czech co-operatives are almost erased, and therefore, the new co-operation, even without legal framework of co-operative, is the most important option.

Twelve years after transformation of co-operatives into co-operatives of owners, which should enable ownership relations to work, we call for new systems to force owners of land and apartments to implement their interests “because the real maintenance of own property has high transaction costs, the owners choose less costly way to manage their property giving up part of their ownership rights to some representatives” (Havlíček, 2004). Therefore, following theories are used to explain how individuals handle own trials in external environment or populations.

#### 4. REPRESENTATIVES OF POPULATIONS

Impulses from external environment are filtered (by media, by self) or too complex. Therefore, immunity system and brain of individuals processes incomplete or unreal conditions. Individuals then make decisions damaging themselves and their friends. Having this bad experience, individuals select some of them giving them own rights to represent them to the third party - representatives. What happens is shown in the table below:

**TABLE 2.**  
**SELF-PROTECTION BY FOLLOWERS**

THEORY	INTERESTS	BOARD MEMBERS	BOARD ROLE	MODEL
<i>Agency theory</i>	‘Owners’ and managers have different interests	‘Owner/ mandators’ representatives	Conformance: - safeguard ‘owners’ interests - oversee management - check compliance	Compliance model

Conflicting interests give no possibility to increase performance of the group. Group can only copy approaches of others with usually worse results then these of whom they copied it. Later, representatives turn the story up side down and announce that former voters are here to act as slaves, or at least as employees. Few such paradox examples, these followers keep hidden and “members” do not understand, follow:

- The tension between board members acting as *representatives* for particular stakeholder groups and ‘*experts*’ charged with driving the performance of the organization forward.



- The tension between the board roles of driving organizational *performance* and ensuring *conformance* i.e. that the organisation behaves in an accountable and prudent manner.
- The tension between the contrasting board roles of *controlling* and *supporting* management.
- The ambiguities that stem from accountabilities to multiple stakeholders.

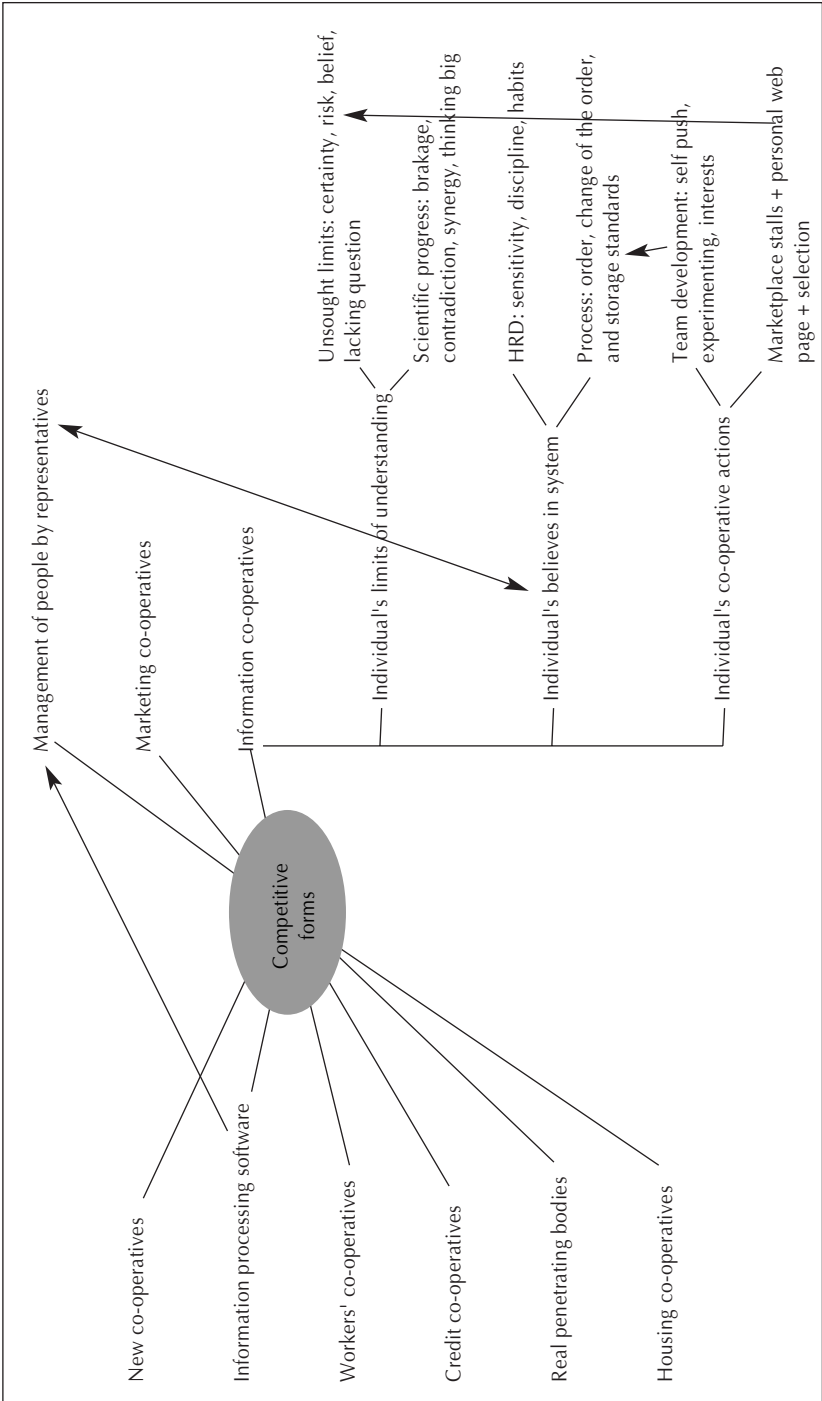
Each of the paradoxes is discussed and illustrated by drawing on examples from recent empirical studies by the author and other researchers (Cornforth and Edwards, 1998; Cornforth, 2001). We further skip the worst alternatives, in which representatives govern voters by political manners just to misuse their posts or calm down protests or share resources created by people on the bottom. And we concentrate on alternatives increasing performance and rapid growth – see table below.

**TABLE 3.**  
**DRIVING FORCES FOR IMPROVEMENT AND DEVELOPMENT**  
**OF NEW SOLUTIONS**

THEORY	INTERESTS	BOARD MEMBERS	BOARD ROLE	MODEL
<i>Stewardship theory</i>	Owners' and managers share interests	'Experts'	Improve performance: - add value to top decisions/strategy - partner/support management	Partnership model
<i>Resource dependency theory</i>	Stakeholders and organisation have different interests	Chosen for influence with key stakeholders	Boundary spanning: - secure resources - stakeholder relations - external perspective	Co-optation model

Partnership model is the most resistant to the influence of media and can improve performance of lonely small and medium entrepreneurs or expelled members during transition from co-operative to joint stock or from limited liability company. E-Business fulfils the principle of co-optation based on offered resources (Table 3). Therefore, is proposed to establish a kind of co-operative – the information one, which is marked green (Figure 2). Different sorts of co-operatives are marked by red colour contrary to private sector, which is marked black (figure 2).

FIGURE 2.  
MIND MAP OF THE BALANCE OF PRIVATE, INDIVIDUAL AND CO-OPERATIVE PERFORMANCE



Blue arrows show main directions by which information co-operatives compete with private sector and information systems applied to technologies. Information systems are ordered and designed to strengthen decision making power of top managers but not their perceptiveness. Other people are excluded from decision making even if their incentives can be vital for survival and growth. Contradictions between management by representatives and information technologies weaken private sector competitiveness. The information co-operative challenge is elaborated further.

## 5. OBJECTIVE

It is proposed to replace data processing function of computers and function of representatives by co-operation of individuals in e-business based system. Management hierarchies become more flat and management responsibilities for development must be shifted to preparatory period and to people performing tasks. Such members' take-over depends on methods how these e-business based factors and methods will be derived (Figure 2, Table 3) and tailored up.

## 6. METHODS

Following raw data about needs of organizations and limits and potential of individuals are selected from co-operative principals of organisation (A) and co-operation principals of individual (B):

- A. Boundary spanning of organizations during developmental efforts (Table 3):
  - secure resources
  - stakeholder relations
  - external perspective
- B. Feedback factors of individuals during take-over of responsibilities for development (Figure 2):
  - Individual's limits of understanding:
    - \* Unsought limits: certainty, risk, belief, lacking question
    - \* Scientific progress: brakage, contradiction, synergy, thinking big
  - Individual's believes in system
    - \* HRD: senzitivity, discipline, habits
    - \* Process: order, change of the order, and storage standards
  - Individual's co-operative actions
    - \* Team development: self push, experimenting, interests
    - \* Marketplace stalls + personal web page + selection

Further, data are transformed into dialogs of e-business offers and demands. Different ways of organization of market-place-stalls and individual web pages or advanced e-shops are tested to find if replacing of traditional information system and representatives is possible. Traditional e-business techniques, which are used to reach the whole World population, are tested if they can transmit also co-operative principals.

Trial and error method will use above mentioned techniques during implementation of e-business for each SME or community. Individuals learn together in these experiments how they can learn competitiveness with the private sector. Principles of individual capabilities and common immunity (Figure 2) will be trained to improve synergy of co-operation. Resulting  $\pm$  growth of turnover will be observed and obstacles recorded and corrected.

## **7. RESULTS**

Factors facilitating co-operation through e-business are tested between small and medium enterprises, communities, and associations. Co-operatives are usually not interested. Mostly because of strong managers who keep members on distance from decision making.

## **8. CO-OPERATION BY E-BUSINESS**

Dynamic web database was designed with three functions: order, change of the order, and storage consequences (<http://www.eb-eu.cz>). Individual marketing activities of SMEs are attached to this database (<http://web.quick.cz/linhart.zdenek/lov/jelen2.htm>). Detailed order or offer from database appears once the client click on the order ([http://www.eb-eu.cz/kurz.php?kurz\\_key=28](http://www.eb-eu.cz/kurz.php?kurz_key=28)) and dialog follows (<http://www.eb-eu.cz/prihlaseni.php>). This mechanics is well known. The main difference is in price. Web page is for free and display of one order or offer costs EUR 1. Once the turnover increases, the entrepreneur can buy whole database for EUR 100 for ever. That makes the difference from e-shops which begins with monthly fee EUR 20 till 100.

Small entrepreneurs do not believe that e-market is relevant for them. Therefore, they are not against it but also do not support it. Associations of such entrepreneurs emerge in the form of market-place stall (<http://www.eb-eu.cz/seznam.php>). Real associations are formed to solve common problems. Participants of associations grow through several roles.

## 9. IMPROVEMENTS IN PARTICIPANT ROLES

Improvements are derived from discussions between instructors, clients, and users. Improvements deliver targeted “co-operative data processing” technology. Firstly, few examples:

- Competition of offers and assembly of orders enable and simplify the service and gains volume discount
- The list of orders and offers on the web marketplace enable complete total order from partial offers and save time for seeking lacking orders and negotiations against powerful business partners
- The language has to find commonly understandable expressions, for example: instead of product code (expression used in storage) is used variable symbol (expression used during payment). Therefore, all participants in e-business chain use the same language, which was lost in former large co-operatives and other organisations because of internal borders
- First time visitor is transformed into market place observer to get later ownership rights for own e-market place, eventually purchase of professional turn key e-shop (this spin off effect is not used in other information systems where readers are transformed into writers, but never skip over designer who controls them for ever as slaves)
- Owner of e-business is obliged to transform and liberate his/her users into partners and them into competitors (this was always problem of elderly cooperatives but normal practice of trainees of former craftsmen)

The list of personalised roles shown above proved that co-operative data processing can attract and enrich by advantages listed above widely scattered small and medium entrepreneurs, consumers, and community members.

## 10. EXAMPLES OF ASSOCIATIVE AND COMMUNITY E-CO-OPERATION

EU grant for training and implementing e-business for small and medium entrepreneurs is decomposed into processes with common and diversified parts. Bee keepers, handicapped people and employers, salespersons, independent manufacturers, eventually organizers of different actions applied for this e-business proposal because it simplifies co-operation between them and others. International dimension of this co-operation seems to be very easy and important as partners from different EU countries agreed upon.

About ten people (two mayors, consultants, chamber representative, and young computer people) were on the kick off meeting in Mlada Vozice micro-region. Direct order was received and three contact persons appointed. They made also schedule

for next meetings. Entrepreneurs immediately proposed that this system should help to old people to formulate orders for maintenance of their houses and negotiate better price with craftsmen. Second application developed in this discussion was co-operative shopping as shop in villages disappeared. The third application was proposed based on following results of community management practices in Great Britain.

Some practical examples of the use of new technology are outlined below (Olaussen, 1999):

- One project, known as 'Council Access Point' involves a shire county and some constituent districts in providing better information on council services in rural areas (principally through libraries)
- One pilot authority has taken 'Property for People' as its year 2 BV theme, using technology to develop a 'front office/back office' structure for seamless one-stop shop provision of services. Technology includes websites, video conferencing, ATTACH info kiosks and voting handsets for public meetings.
- A London borough and a new unitary council are piloting a cashless school meals service using swipe cards.
- One largely urban and one quite rural district have projects aimed at streamlining systems to deal with council tax and housing benefits admin. In the case of the urban authority, the project is PFI approved.
- A new unitary authority has reviewed its planning and development control systems and resolved to upgrade systems and to integrate them with a new corporate GIS system.
- Two shire counties are investing heavily in technology to move away from dependence on buildings for library services.
- A metropolitan district chose ORACLE for their integrated finance and other IT systems after review and presentations by various suppliers to a cross-section of staff.
- A shire county is investing heavily in IT for Highways Maintenance, including a Clarence Call Centre for defects and new "superservers" to replace existing server management.
- One shire district is developing a pilot scheme to provide greater access to health information in isolated rural areas, with funding from the local Health Action Zone.

All these examples can be transformed into orders or offers and community members can use e-business techniques to vote and select the option which fits them the most. Representatives are replaced by better communication, which solve individual needs and warm up interpersonal relationships between community members. The least important issue is that awareness of multiple solutions for community problems is created and can be discussed later.

## 11. TOPICS OF GLOBAL E-CO-OPERATION

Following trends in e-business should be revised from point of view of their capability to facilitate global e-cooperation:

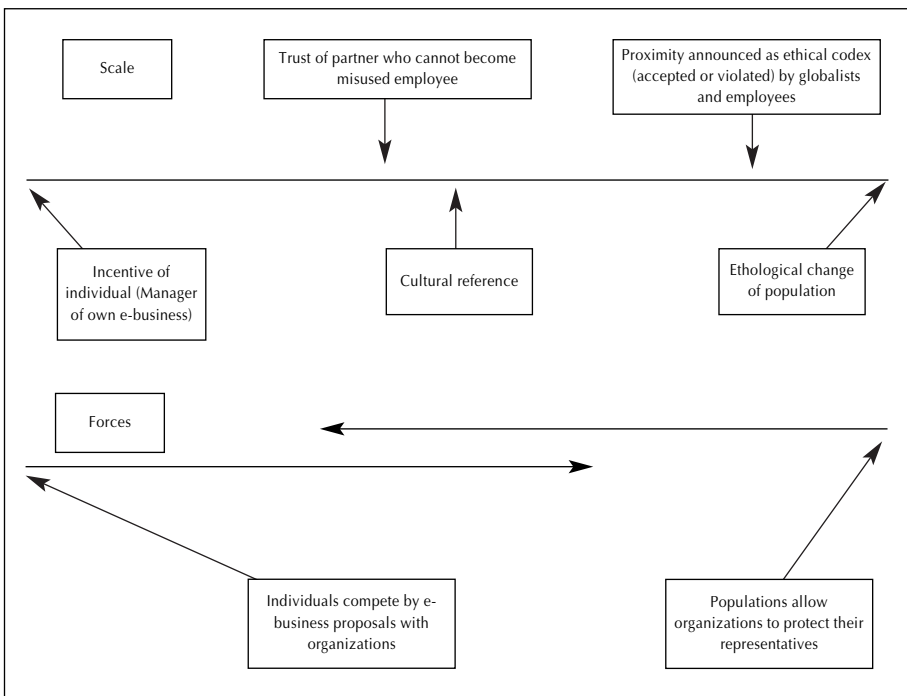
- Application of Custom Relation management systems
- E-Business models
- Effective consumer response
- Supply chain management
- Loyalty programs and permission marketing
- Innovation of the sales strategy / methodology
- Virtual chains
- Tracking and tracing
- Services to customers
- Accurate fulfilment
- Affiliate marketing ( marketing with support of a specialised E-partner)
- Trusted Third Parties ( use of intermediaries as Interpay)
- Internet and purchase policy
- Internet and marketing policy
- Internet and pricing policy
- Internet and production policy
- Internet and distribution policy
- Multi channelling
- WEB-marketing
- E-mail marketing
- WEB- branding
- WEB-promotion
- WEB-vertising
- WEB-purchase
- WEB-sales
- E-Business, CRM and enterprise resource planning (ERP)
- How can SME's train and educate staff in an effective way?

Community e-co-operation principals are pointing on common problems of community management. Therefore, it is expected that code of good practice can be transmitted through e-co-operation also. Techniques shown on the above list just need to be tailored up to trade with community management practices. All these above mentioned techniques are just applicable forms of communication and they are not very relevant for the content of the message, which was discussed above.

## 12. MISSION SELECTION

Simplification of offer and demand is the process selecting and presenting the information by the most understandable way. Understandable information is developed in competition of many proposals. Therefore, persons must compete with their proposals for actions of others. Winners gain managerial functions in fact. This process of offer, and order development is elaborated further.

**FIGURE 3.**  
**ORDERING AND COMMUNICATION E-BUSINESS MODEL**



Two figures are integrated in figure 3. Scale above shows measurable phenomena. Forces below are showing contradictory powers. It is paradoxical that proximity based co-operation must be rejected and e-business partnership proposed. Proximity is promoted recently by multinational companies. Proximity is close to “glasnost”. Discussions without action and results kill interests and cut individual out of results. Such looser will accept proximity announced by globalists and become vulnerable to infections of populations. Infection is the term explaining the effect of quickly spread diseases shown for example by scandals of Enron or Parmalat. Therefore, the



mission selected is "Individual gains better benefit from competing local actors than from care of representatives".

### **13. E-BUSINESS OFFER AND ORDER DEVELOPMENT TRAINING AND IMPLEMENTATION**

Active individuals are supported by e-business training and implementation for small businesses, associations and micro-regions.

Entrepreneur has own web page. Training explains and implementation delivers button on his/her static web page. Visitor of that page clicks on button "order" or "offer", which displays on the screen an alternative of the shopping basket with the other button "I accept". Then, goods are subtracted from the storage, or capacity of offered action, and confirms to ordering person that ordered transaction was completed as ordered.

This looks as very simple e-shop. It is true, and besides, this simple option has following effects:

1. Mayors of communities or chairmen of associations have displayed complete market place for offers and orders of their members where the final value can be assembled from many partial orders or offers. More advanced entrepreneurs can use this market place also. The most advanced entrepreneurs are recommended to buy professional e-shop software.
2. Training lasts just two hours and participants are leaving with own web page which is related to the database. Accompanying information can trained users publish on web through sharing the web publisher.
3. Database enables following functions if order or offer is put there:
  - subtracting from the storage or capacity
  - confirming acceptance of the message (ordering or offering) by server
  - confirming that claimed procedures were accepted by supplier and delivery begun
  - displaying and removing messages as was ordered before without any action of operator

It is up to association or community how they arrange to display new offers or orders into the database. Trainers can do it in beginning period for them also. Communication is done by e-mail or phone.

Firstly, order and its confirmations are shown and trained. Secondly, turnkey solutions are introduced for advanced users. Thirdly, actions increasing turnover are proposed based on specifics of the sector and goods.

## 14. CONCLUSION

Targeted e-Business based advantage of co-operation was derived from the development in population of Czech agricultural companies during last 12 year period, where co-operatives were legally restricted (Table 1). Disadvantages of co-operatives and the potential of co-operation was analysed from point of view of an individual and his/her representatives.

Former members, small and medium entrepreneurs, communities or associations, are lacking resources to compete independently and increasing unemployment makes difficult to get a job. Therefore, they are trained to understand and formulate simple order / offer. Associative approach is connects growth of individual on the market-place stall. Further, several examples explains content and form of tools, message and global effects of e-business techniques for co-operation and synergy. It is already clear that global penetration bodies are implementing same e-business principals into communication with suppliers i.e. TIMS (Tesco Internet Management System).

Training for small groups lasts two hours. Administration of one transaction lasts about 10 minutes. Market place of community or association emerges automatically when database is ordered and reshaped after its needs what costs about ten hours. Registration on other servers is done by trainee. Communities and associations can print and display list of orders and offers for these people who have not internet access.

SME partners and associations can use the competition of ideas, services and goods offered and ordered inside to compete with offers of organisations outside. It is expected that many goods and services will be exchanged without money and taxation. Further implementations and training of e-business will show whether local competitiveness of SMEs will offset drive of global organisations creating global population. Broadcasting of ideas of co-operation of individuals in contrast with employment and legal restrictions is the next stage to be researched.

Opponents may say that this proposal is the invention of some local bureaucrat, run by some consultant. It is true now. But both of them disappear in the latter stage. Actual trainees take the lead as it happened already on the first meeting.

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# THE IMPACT OF AGE AND EDUCATION ON TENDENCIES TOWARD DIFFERENT TYPE OF CO-OPS IN IRAN

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## 1. INTRODUCTION

The basic question of the research, considered being: has the age and education, significant impact on people tendencies toward different types of co-ops in Iran? In order to study such relationships, a theoretical framework was the guide for the research design, and formulation of the hypothesis.

This research was carried out in the Lorestan region in west of Iran. Lorestan is an agricultural area and most of the people in the region are engaged in some kind of agricultural activities.

Contrary to such possibility in this region the rate of unemployment is high and most of the young people including, farmers, particularly young ones, emigrate to large cities, particularly to Tehran (capital of Iran), where the average rate of unemployment is around 15%

It should be noticed that 70% of 70 million population of Iran are less than 30 years of age. Therefore, developing opportunities for employment is an urgent government issue, and creating jobs in agricultural activities, particularly in farm and food products is quite possible in Lorestan region.

Ministry of Cooperative of Iran has established in each 26 states, an Office and support development of Co-ops activities. However, agricultural cooperative activities are under Ministry of Jihad and Agriculture.

Such dual management system is of course a pitfall and impeding factor to the agricultural cooperative success.

Based on Government Cooperative Office Reports, in Lorestan state, from 1979 to 2002, 1800 Co-ops were registered formally. Most of these Co-ops are of course inactive.<sup>1</sup> These Co-ops are considered to be research population and the research hypotheses are tested by the data gathered from these population.

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1. Reports released by Ministry of cooperative office in Lorestan state; 2002.

Based on some deductive reasoning it was claimed that young and more educated people in Iran have more tendencies toward service and construction Co-ops and fewer tendencies toward agricultural and mining.

## **2. METHODOLOGY**

### **2.1. The Research Question**

The main research question which is mentioned in the introduction of the paper is: has age and education impact on people's tendency toward different types of Co-ops in Iran?

### **2.2. Theoretical Framework**

A theoretical Framework related to the question that: What motivates people (Members) to participate? Was selected as research guide.

To develop a conceptual Framework, The following theories been considered:

- A. Theoretical model of motivation
- B. Strategic management concept

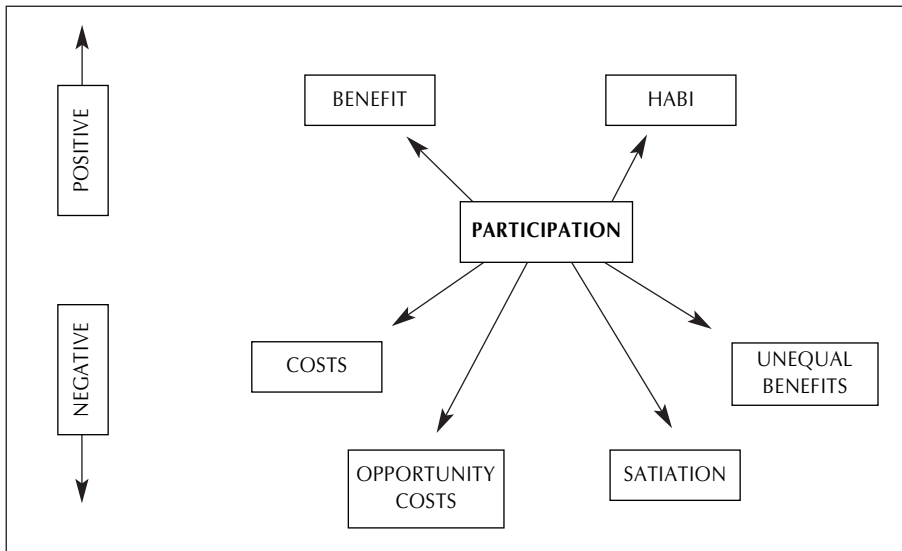
From theoretical model of motivation point of view which claims to include political science, sociology, social psychology and economic concepts as well, the following stages are considered.

1. Characteristics of each sector
2. Background conditions for participation
3. Measuring motivations of participants
4. The dynamics of members participation
5. The dynamics of organizational participation

From strategic management concept point of view the outlooks of two schools of thought on strategic management are considered, namely, inside out and outside in outlooks. That is: (a) the willing, believes, tendencies and behavior. (Inside out) (b) The social political, economical and cultural, phenomenological environment (outside in) which in some strategic management models is called SWOT analysis.

From the theoretical model of motivations point of view the third stage were considered which is based on the concept that people are motivated by a complex mixture of both individual and collective incentives. Individual self interest is the focus of this research but not considering only economic interest but social and cultural interest as well.

**FIGURE 1.**  
**PROCESS OF INDIVIDUAL MOTIVATION**



At collective level, it is claimed, even if the participant do not receive individual benefits, there collective incentives outweigh the individual ones.<sup>2</sup> It is claimed based on a national research done in Iran that such values are not visualized in Iranian present culture, although it is said that cooperation level is higher in that region, particularly among farmers.<sup>3</sup>

At individual level, people calculate costs and benefits of taking part, in our case, taking part in cooperative activities, (see figure 1). This is considered to be negative in case of young educated people in Iran.

### 2.3. The Research Hypothesis

Based on situational audit, particularly Socio-cultural political and economic environment in which: individualistic interest is dominant, there is not opportunity for young people and low earning to demonstrate tendency toward Co-op participation. Therefore the two following hypotheses been formulated.

2. Johnston Birchall and Richard Simmons; what Motivate Members to Participate? A Reworking of a Theoretical Model and some findings; Local Society and Global Economy: The Role of Co-operatives ICA International Research Naovssa 2002 pp.133-139.

3. Nasser Mirsepassi; Recommended Strategies for Effective Participation of Co-operatives Members in Iran co-ops Activities ICA Research Conference 2001.

2.3.1- The age and education have significant impact on tendencies toward different type of Co-ops.

2.3.2- The young educated people have fewer tendencies toward participating in agricultural and mining Co- ops.

## 2.4. The Data Collection and Analysis

The data for testing the research hypothesis was gathered from the Ministry of Cooperative Lorestan province Office which includes 792 registered Co-ops.

The data collected and classified first separately as follows:

2.4.1. *Agricultural Co-ops*: 136 cooperative firms was the population. A random sample of 39 Co-ops, based on statistical formula with 5% accepted error, were selected, (23% of population) and the data first were classified by age as it is indicated in table 1.

**TABLE 1.**  
**AGE DISTRIBUTION OF MEMBERS**

Age	20 - 25	25 - 30	30 - 35	35 – 40	40 – 45	Total
Members	41	43	41	39	43	207
Percentage	20%	20%	20%	20%	20%	100%

The data shows that the percentage of the members in all age class are the same, However, the interview with the members reveal that agricultural Co-ops mostly are registered by families and mostly by parents which were above 40 years of age. And youngsters are almost compulsory members and while they are members formally they are not actually active members.

Then the data were classified by education as indicated in table 2.



**TABLE 2.**  
**EDUCATION DISTRIBUTION OF AGRICULTURAL CO-OPS MEMBERS**

<b>Education</b>	<b>Below H.S</b>	<b>H.S.and above</b>	<b>Buchler and above</b>	<b>Total</b>
No. of members	106	69	32	2.7
Percentage	51%	33%	16%	100%

H.S. = High school

As table 2 indicates almost half of the agricultural Co-ops members' education is below high school. This data indicates the education level of agricultural cooperative members is low. Those 16% who have higher education are members of those Co-ops which require education, are fishery cooperatives.

#### *2.4.2. Housing and Construction Co-ops: 5 cooperatives firms are considered.*

From these five Co-op firms data were available for four of them, as table 3 shows.

**TABLE 3.**  
**AGE CLASSIFICATION OF HOU. AND CONS. MEMBERS**

<b>Age</b>	<b>20 - 25</b>	<b>25 - 30</b>	<b>30 - 35</b>	<b>35 - 40</b>	<b>40andabove</b>	<b>Total</b>
Members	7	5	7	3	6	28
Percentage	25%	17.8%	25%	10.7%	21.5%	100%

As the data indicates, 67.8 of the Construction and Housing Co-ops members are under 35 years of age. That is to say mostly are young.

The classification of the data for member's education also indirectly supports the claiming hypothesis. (Table 4)

**TABLE 4.**  
**EDUCATION DISTRIBUTION OF HOUSING AND CONSTRUCTION**  
**CO-OPS MEMBERS**

<b>Education</b>	<b>Under H.S</b>	<b>Above H.S</b>	<b>B.S and above</b>	<b>Total</b>
Members	6	12	10	28
Percentage	21.5%	42.8%	35.7%	100%

### 3. MINING CO –OPS

**TABLE 5.**  
**AGE DISTRIBUTION OF MINING CO-OPS MEMBERS**

<b>Age</b>	<b>20 - 25</b>	<b>25 - 30</b>	<b>30 - 35</b>	<b>35 - 40</b>	<b>40andabove</b>	<b>Total</b>
Members	9	12	14	17	17	69
Percentage	13.12%	17.4	20.28%	24.6%	24.6%	100%

**TABLE 6.**  
**EDUCATION DISTRIBUTION OF MINING CO-OPS MEMBERS**

<b>Education</b>	<b>Under H.S</b>	<b>H.S and above</b>	<b>B.S and above</b>	<b>Total</b>
Members	32	33	4	69
Percentage	46.2%	47.8%	6%	100%

### 4. SERVICES CO-OPS

**TABLE 7**  
**AGE DISTRIBUTION OF SERVICES CO-OPS MEMBERS**

<b>Age</b>	<b>20 - 25</b>	<b>25 - 30</b>	<b>30 - 35</b>	<b>35 - 40</b>	<b>40andabove</b>	<b>Total</b>
Members	29	27	29	21	9	115
Percentage	25.2%	23.5%	25.3%	18.2%	7.8%	100%

**TABLE 8.**  
**EDUCATION DISTRIBUTION OF SERVICES CO-OPS MEMBERS**

<b>Education</b>	<b>Under H.S</b>	<b>H.S and above</b>	<b>B.S and above</b>	<b>Total</b>
Members	41	51	23	115
Percentage	35.6%	44.4%	20%	100%

## 5. MULTIPURPOSE CO-OPS

**TABLE 9.**  
**AGE DISTRIBUTION OF M.P CO-OPS MEMBERS**

<b>Age</b>	<b>20 - 25</b>	<b>25 - 30</b>	<b>30 - 35</b>	<b>35 - 40</b>	<b>40andabove</b>	<b>Total</b>
Members	4	4	10	2	16	32
Percentage	—	12.5%	30.25%	6.25%	50%	100%

**TABLE 10.**  
**EDUCATION DISTRIBUTION OF M.P CO-OPS MEMBERS**

<b>Education</b>	<b>Under H.S</b>	<b>H.S and above</b>	<b>B.S and above</b>	<b>Total</b>
Members	11	12	9	32
Percentage	34.3%	37.5%	28.2%	100%

## 6. INDUSTRIAL CO-OPS

**TABLE 11.**  
**AGE DISTRIBUTION OF IN. CO-OPS MEMBERS**

<b>Age</b>	<b>20 - 25</b>	<b>25 - 30</b>	<b>30 - 35</b>	<b>35 - 40</b>	<b>40andabove</b>	<b>Total</b>
Members	66	57	31	52	60	266
Percentage	25%	21.4%	11.6%	19.5%	22.5%	100%

**TABLE 12.**  
**EDUCATION DISTRIBUTION OF IN CO-OPS MEMBERS**

Education	Under H.S.	H.S. and above	B.S. and above	Total
Members	123	114	29	266
Percentage	46.2%	42.8%	11%	100%

## 7. TRANSPORTATION CO-OPS

**TABLE 13.**  
**AGE DISTRIBUTION OF TRANS. CO-OPS MEMBERS**

Age	20 – 25	25 - 30	30 - 35	35 - 40	40andabove	Total
Members	5	3	1	5	4	18
Percentage	27.7%	16.7%	5.5%	27.7%	22.4%	100%

**TABLE 14.**  
**EDUCATION DISTRIBUTION OF TRANS. CO-OPS MEMBERS**

Education	Under H.S.	H.S. and above	B.S. and above	Total
Members	13	5	–	18
Percentage	72.3%	27.7%	–	100%

## 8. SUPPLIER CO-OPS

**TABLE 15.**  
**AGE DISTRIBUTION OF SUP. CO-OPS MEMBERS**

Age	20 - 25	25 - 30	30 - 35	35 - 40	40andabove	Total
Members	–	3	1	5	3	12
Percentage	–	25%	8%	42%	25%	100%

**TABLE 16.**  
**EDUCATION DISTRIBUTION OF SUP. CO-OPS MEMBERS**

<b>Education</b>	<b>Under H.S.</b>	<b>H.S. and above</b>	<b>B.S. and above</b>	<b>Total</b>
Members	8	4	–	12
Percentage	67%	33%	–	100%

## 9. HANDMADE CARPET CO-OPS

**TABLE 17.**  
**AGE DISTRIBUTION OF H.C. CO-OPS MEMBERS**

<b>Age</b>	<b>20 - 25</b>	<b>25 - 30</b>	<b>30 - 35</b>	<b>35 - 40</b>	<b>40andabove</b>	<b>Total</b>
Members	11	8	7	1	4	31
Percentage	35.5%	25.8%	22.5%	3.2%	13%	100%

**TABLE 18.**  
**EDUCATION DISTRIBUTION OF H.C. CO-OPS MEMBERS**

<b>Education</b>	<b>Under H.S.</b>	<b>H.S. and above</b>	<b>B.S, and above</b>	<b>Total</b>
Members	19	10	2	31
Percentage	61.3%	32.3%	6.4%	100%

## 10. CONCLUSION

Based on the data gathered for eight different types of cooperatives from Lorestan province which is an agricultural zone of Iran, and rank ordering the age and education of members of different Co-ops, (table one to table 18) and summery of those tables in table 19, the following aspects are concluded.

**TABLE 19.**  
**AGE AND LEVEL OF EDUCATION OF COOP MEMBERS IN IRAN**

Rank	Types of co-op	Members age20-30years	Members University	
			Under high school level Education	Graduate and above
1	Hand made carpet	61.3 percent	61.3	6.4
2	Services	48.7 percent	35.6	20.0
3	Industrie	46.4 percent	46.2	11.0
4	Transportation	44.4 percent	72.3	0
5	Construction	42.8 percent	21.5	35.7
6	Agriculture	40 percent	51	16.0
7	Mining	30.52 percent	42.2	6.0
8	Multi purpose	12.5 percent	34.3	28.2

The hypothesis that, the age and the level of education have impact on tendencies toward different type of cooperatives is to some extent supported. That is to say: The younger people have more tendencies to be active participants in services and industry cooperatives and less tendency toward agriculture and mining. The more educated people have tendency toward construction, multi- purpose and service cooperatives.

As it is demonstrated in table 19 the hand- made carpet Co-ops members are the youngest but with low level of education, and transportation Co-ops members in middle ages but with lowest level of education. This, of course may be the effect of the situation and nature of the work and labor.

Based on researchers observation including myself, in hand mad carpet Co-ops membership is mostly, superficial in hand made carpet industry in which even children are working, under unaccepted working conditions, and high unemployment rate made such situation compulsory.

In transportation Co-ops, members are mostly drivers who usually have low level of education in almost all regions of Iran, and probably most countries. The final result, therefore, which was our main hypothesis, which is a serious economic and social problem of Iran at present time, is a high rate of unemployment, particularly in western area of Iran, the region which its climate and its situation is more appropriate for employment through agricultural cooperatives development, unfortunately there is a strong negative tendency, among youngsters, toward such activities.

Based on this conclusion two strategies may be recommended.

1. To invest more intensively on industry, construction and Housing Cooperatives in this region.

2. To persuade Government to employ a cultural and training program to help changing values and attitudes of young people and children in schools and training centers to help changing these inappropriate tendencies of youngsters, at least in this agricultural region.

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# THE SWEDISH COOPERATIVE DEVELOPMENT SYSTEM: AN EMERGENT COMMUNITY OF COOPERATIVE PRACTICE

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## 1. INTRODUCING THE PHENOMENON

The Association for Cooperative Development, FKU (acronym for the Swedish *Förening för kooperativ utveckling*) is a national organization of local cooperative development agencies (in Swedish LKUs, a term that corresponds to CDA in English). The organization was formally established by its members in 1994, and has at present twenty-five members, all fully independent secondary cooperatives that employ roughly 90 persons, that together constitute a cooperative development system with a nationwide coverage. the cooperative development system unites and balances a number of different (and not fully compatible) identities, within an organization that provides national impact, high performance and is maintained by an ingenuous financing system.

On the face of it, the FKU system can be viewed as an ingenuously constructed quasi-public agency, that implements government policy in the field of social integration and job creation. As such, it has been evaluated and documented (with highly favourable results) by the National Board of Auditors and a number of other public enquiries<sup>1</sup>. The system's financing arrangements (that parallel and in some fields also predate EU financing mechanisms) deserve of particular interest. Simultaneously, the organization is very much of an interest organization shaped to further and lobby for its own agenda, that needs not be identical with the government's. The attention deservedly devoted to those highly visible political and administrative features, tends to obscure what is perhaps this system's core identity: rather than a public agency or an interest organization, the system should be viewed as a *community of practice* (Wenger, 1998; Wenger *et al* 2003), that stewards and nurtures its own body of knowledge and competence.

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1. RRV(Swedish Audit Bureau) (RRV,1993) found that he LKUs had, at the time, a joint turnover of 20 MSEK. 300 new co-operatives were started, with a combined turnover of about 500 MSEK, and 1300 jobs were created with the LKUs' assistance or through their initiatives, at an average cost of 11,000 SEK per job. By comparison, The National Labour Market Board's (AMS) cost per job created 1992 was 72,450 SEK; see also Jonnergård and Svensson, 1990.

A feature that distinguishes this case from communities of practice studied, is the community's relationship to its organizational host. Originally, the community of practice concept was coined to describe a system of collective learning and practice that links employees *within* a given company. Subsequent research has followed a knowledge-management approach, and explored ways of initiating, supporting or maintaining such communities within corporations and across industries. In all cases, organization precedes community, and its existence is largely taken for given. The case dealt with here is nearly the obverse of the above: community clearly precedes organization, and it is possible to see the FKU as a nascent community of practice that has shaped an organization to accommodate itself.

## 2. THE FIRST COMPONENTS EMERGE

The development history of the LKU system and of its apex organization provides an outstanding example of an essentially spontaneous process of local self-organizing that evolves within a highly structured institutional environment and the phasing in of internal dynamics of formation, with the stimuli and constraints generated by this environment (cf Stryjan, 1997). To begin with, the institutional climate was initially far from positive. The traditional Swedish Model assigns a central integrative role to the labour market. The maintenance of full employment, through an active labour-market policy that is managed by public authorities stands at the normative core of the model (Stryjan, 2003, see also Hedborg and Meidner, 1984). With time, however, the assumptions of a growing economy and full employment that formed the foundations of the model were eroded (Cf Meidner, 1992). The first field in which the shortcomings of the model became evident was local development. In the early 80s, disillusionment with attempts to 'remedy' the countryside's problems by subsidising the migration of jobless from the countryside to metropolitan areas where the jobs were<sup>2</sup>, and of companies to the countryside, where the jobless were, resulted in growing interest in local initiatives. A number of highly publicized local projects helped to set the trend. (e. g. 'The Norberg Model', see Bäckman et al, 1982; Arbetsmarknadsdepartementet, 1984). The first co-operative development centres, in Jämtland and in Värmland arose in 1982 from such local initiatives. A cooperative project in Trolhättan and a centre in Örebro soon followed (see below). Social contacts and friendships between founders and supporters of these and similar initiatives provided an important and lasting infrastructure for later developments.

In parallel with those initiatives emerging locally, a process of institutional realignment started at the national level, that was given momentum by a surge in youth unemployment in the early 80s. A program against youth unemployment was jointly launched in 1984 by the government, established co-operation, and the trade

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2. A policy that came to be nicknamed 'flyttlasspolitiken' (the removal-van policy).

unions. The program constituted a major departure from Swedish labour tradition on a number of counts: By involving social economy actors (in practice, established cooperation<sup>3</sup>), the initiative departed from the tradition of leaving labour market issues to business and labour market organs. This was probably the first time in the Swedish administrative tradition that partnership and matching financing arrangements were introduced. There is no evidence that the model was influenced by the EU practice that was rather undeveloped at that time. The partnership model also endorsed two traditional anathemas: (a) the involvement of state organs (in this case SIND, the State Industry Board) in *direct* job creation (other than in welfare services); and (b) the formation of worker co-operatives, an organization form that both Swedish labour movement and consumer co-operation traditionally treat with the utmost suspicion (see SOU 1996; Stryjan, 1996). The program included youth worker co-operative training programs (see, e. g. Axelsson, 1985) and, at the national level, a Co-operative Council (*Kooperativa rådet*), was formed, consisting (at that stage) of representatives of the government, established co-operation, and trade unions<sup>4</sup>. The two developments- of grass root formation and mobilization at the political level came to converge in 1986 in a program (indirectly inspired by UK experience) under the auspices of the Council, that institutionalized public support for LKUs. To start with, the structure of the program did closely follow the traditional blueprints of Swedish associative tradition: two strong central programs were established (the one dominated by farmers' and the other by consumers' cooperation). Along with these, resources were earmarked for the development of local CDAs, and a set of rules for the disbursement of these (that strongly stressed matching financing practices) was shaped. The pattern of a strong centre that channels resources to a struggling periphery of weak organizations is quite common in Swedish organizational tradition, and generally is self-perpetuating. This time however, development proceeded in an entirely different direction.

### 3. THE FKU TAKES SHAPE

By the time the Cooperative Program became operative, the youth unemployment of the early 80s that gave rise to it vanished (temporarily, as it turned out) in the overheated labour market of the late 80s. Consumer and Farmer co-operation's involvement waned gradually as well (Jonnergård and Svensson, 1990), which resulted in a decline, and finally disbandment of the central programs. Thus the new LKUs were left without an apex organization, and essentially forced to reinvent themselves, shaping a new practice and looking for new tasks, and, not the least, for new members and sponsors. In doing that, they may have laid the cornerstone for a new model. A

3. The *Economie Sociale* concept was not introduced on the Swedish scene at that time

4. Appointed personally, not ex officio; significantly, other associations and popular movements were not invited to join.

detailed analysis of this process, in which coincidence and personality definitely played a role, lies beyond the scope of this paper.

The rules laid for the formation of- and support for LKUs provided the local organizations with a robust base, that was quite independent of the performance of the central service-organizations: An association has to be established first, by locally-based organizations belonging to established consumer and farmer co-operation, local government agencies<sup>5</sup> and, increasingly, by new co-operatives. (the specific local constellations vary from case to case), that mobilizes pledges for local financing. Once such pledges by member organizations and local government organs are secured by the founders, these provide the LKU *in spe* with an entitlement for matching financing. In the period discussed, this was provided by the co-operative council. Together, local and central funding form the LKU's baseline operating budget, and provides for employment of a skeleton staff, and finances the LKU's mandatory activities, namely the dissemination of information to the public, and providing initial counselling services free of charge to the general public and would-be co-operators. This arrangement was primarily dependent, for its success on local contacts, commitment and competence, which were successfully mobilized in most counties. By the end of 1987, there were 8 LKUs in operation and the figure rose to 18 in 1992. By that time, the emergent group gathered sufficient weight to become a part in the discussion of its financing with the public authorities. The number of employees that was eleven (merely adding up to 4.5 full time equivalents) in 1989, reached to 35 in 1993. This expansion was largely accomplished by creating positions for persons that already were active in the field, voluntarily or as freelancers, a move that consolidated the community, rather than diluting it..

#### 4. THE FKU NETWORK

The LKUs have maintained a loose contact network from their very inception, mostly by periodical meetings and, eventually, a newsletter. Though informal co-operation forms developed quite early in the process, the network members jealously stressed their independence and local embeddedness, according a first priority to local, rather than national networking (an approach well motivated by local financing imperatives. The motivation to create, or to join a national organization was, to begin with, quite low. The pressure to create a firmer organization increased gradually, and from a number of different sources: increasing population density, and the approaching of a full national coverage strengthened the need to maintain an interface towards national authorities, and to fill the void created by the slow unravelling of the Cooperative Council. No less importantly, the growing need to pool and share

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5. The circle of member organizations, was initially restricted by statute to established co-operative enterprises, It was widened in 1990, under pressure from then existing LKUs, to also include other associations, and (where the organization finds it relevant) organs of local government, whose tinvolvement in local labour market development issues increased considerably (Stryjan, 2004)) A breakdown of organizational members in .

professional experience increased, as the scope of activity grew larger than the web of personal acquaintances and old friendships could alone sustain, and the employee group doubled, from 35 in 1993 to over 70 in 1996 (Stryjan, 1997).

Such national organization, the FKU was constituted, after much discussion, in 1994. An important additional stimulus for this step was provided by Sweden's accession to the EU, that heightened the LKUs need for representation outwards, at both national and international levels. The FKU association had no permanent staff in the first decennium of its existence (a first contract employee was employed, as the association's full-time coordinator in 2003) and it generally does not run its own projects. It is incorporated as a voluntary association (*ideell förening*), which further limits its economic leeway. The posts of chairman and vice-chairman rotate (chairmanship was held, in chronological order) by Gothenburg, Kronoberg, Östersund and presently Dalarna). Organizational matters (such as organizing and hosting LKU meetings, formulation of internal policy guidelines, etc) are often handled by ad-hoc delegation to one, or a group of, LKUs. Every LKU is an independent organization, constituted by juridical persons. All CDAs are incorporated as associations<sup>6</sup>, three of which are *ideell* (voluntary), the remainder economic. On the whole, the FKU has no ultimate say in the internal affairs of any member LKU. However, through its position as a member of the Co-operative Council (at that time in charge of state funding), and its accumulated prestige, it became early in the course of the 90s somewhat of an informal accrediting institution for would-be LKUs. This position that emerged informally, became de-facto institutionalised, not the least through the association's direct influence on the disbursement of state financing (which is presently handled by the Swedish Business Development Agency, NUTEK).

Formally, and governance wise, the association is a federative body of CDAs. The board is elected by constituent organizations on a representative basis. Nominations are balanced by region, and voting rights allocated by CDA. Various CDAs may send as delegates counsellors or board members (that normally are employees of supporting organizations), and the two general meetings (Autumn and Spring) feature a mixture of both groups.

Yet, even more that associating organizations and aligning boards, the FKU first and foremost (both historically and demographically) an organization associating its cooperative consultants, and stewarding the creation of knowledge in the entire group, a task that involves the management and boundary maintenance of community, domain and practice.

- *Community*: the strong bonds, friendships, and shared identity that link the group of consultants (and large sections of the CDAs boards) formed the enterprise's start capital. Bonds often date back to the formative period of the group. Many of the participants participated in the starting of their own CDA,

6. The Värmland LKU, established in 1983, before the form was institutionalised started initially as a foundation. Though the foundation still exist, operations were eventually transferred to an economic association.

while some have moved since to another locality, and took employment in a different CDA. Naturally, long acquaintance, or even friendship does not imply a pastoral harmony, and the community harbours, as communities do, also conflicts and differences. Trust, in this context is primarily a matter of familiarity with others' strengths and weaknesses. At the same time, the groups' growth, and continued new recruitment pose a challenge of accommodating new entrants into existing social networks, and of perpetuating the perception of community and mutuality (cf Wenger, 1998:237) in an geographically dispersed organization whose membership is changing. An important role is played by *facilities for face-to-face encounters*<sup>7</sup>. Such are provided by the biannual meetings, by regional meetings, and by a mesh of common projects, run by different constellations within the organization. The difference between the layout of the general meetings of the FKU and the highly formalized mainstream Swedish association tradition is highly instructive: to start with, general meetings<sup>8</sup> are held twice a year. They are considerably less streamlined, and intentionally provide a deal of room for social interaction.

- *Domain*: Domain, in this case, is a matter of a clear perception of the field of activity, both as a profession, and as an organizational mission. To some extent, the boundaries of the domain are also institutionally safeguarded, by the formal standing of the CDAs. As recipients of public resources. Challenges to the definition of domain come, predominantly from two corners: locally, as largely self-financing organizations, CDAs have to position themselves as regards the pursuance, or turning down of consulting contracts and publicly paid assignments, and the choice of fields of operation, as regards both professional identity and public image. Externally, in joining projects and initiating activities on the European scene, CDAs open them selves to, and have to handle, broadly different organizational traditions. Such international cooperation is normally handled by those of the LKUs that have developed own international contacts, rather than by the rather small central organization. An important arena for the ongoing negotiation of domain, is the Web-base course and discussion *Clea* forum that links the LKUs and is open for consultants and board members..
- *Practice*, for the LKU consultant, practice comprises of a set of interlinking fields. The core professional task of providing advice and information, and consulting to would-be cooperators also presupposes a deal of working knowledge of the intricacies of public contracting, the social insurance and employment support regimes in the integration of marginalized groups, and, increasingly, the procedures and networking that are essential for joining EU projects. Keeping this complex and constantly changing body of knowledge up to date, and maintaining vital external contacts is a task that lies beyond

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7. See also Stryjan, (2002)

8. In Swedish organizational terminology, a general meeting is called *årsmöte*, literally, a yearly meeting.

any single person's reach. The same applies to the maintenance, updating and development of the extensive networks that are necessary to get tasks done. While some of these networks- those at locality and county level are primarily of importance to the local LKU, others, that reach outside the county or lie at national or international level. Conversely, national initiatives that aim to introduce new fields of operation (currently: the introduction of social accounting practices, dissemination of social-cooperative models, and development of cooperative forms for elderly care) presuppose, for their local implementation, the aligning of actors that run the project at national or international level, with local networks." A history of mutual engagement around a joint enterprise is an ideal context for this kind of leading-edge learning, which requires a strong bond of communal competence along with a deep respect for the particularity of experience. When these conditions are in place, communities of practice are a privileged locus for the *production* of knowledge (Wenger, 1998:214)".

## 5. CLOSING REMARKS

The FKU may be viewed as a system that primarily aligns and develops human capital, whose main asset is the capacity to regenerate itself, and reformulate its medium-range goals. When charting the development of a system, there is an ingrained, and quite natural tendency to focus on the creation of formal institutions, and to record explicit organization forms. Though important in themselves, these observable measures of performance are a by-product of the organizing process, rather than its end. The actual creation, sustainment and development of the system is borne forth by the community of practice that the organizational system harbours. Cultivating this community, by way of maintaining channels of communication and interaction on one hand, and the joint pursuit of new initiatives, and the recruitment potential they create, on the other.

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**PART 5**  
**COOPERATIVES AND SOCIAL  
ENTERPRISES**



# SOLIDARITY-BASED ENTERPRISES: NEW COMPRISING CONCEPT FOR THE ENTERPRISE OF THE FUTURE<sup>1</sup>

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## 1. INTRODUCTION

The present economic environment, with the market as the essential element determining the whole activity, presents a series of dysfunctions with consequences far beyond of the economic ones. Nowadays being excluded from the labour market supposes not only the loss of economic rights but also an exclusion of the social life and even the loss of the civil rights.

The effects of disintegration and social marginality that these phenomena bring with them are acquiring structural character, questioning the fundamental rights that as persons have those affected by this process of exclusion.

In this situation there are many voices demanding another logic in the functioning of our society, another way of understanding the function and social legitimization of the enterprises; in this way, the Social Forum is acquiring a greater social recognition with a clear demand of 'another way of making economy'. New times demand a new generation of responsible companies, deeply rooted in their environment and guided with new criteria beyond the exclusive logic of the economic benefit.

Along the last years we are witnessing a blossom of socio-economic alternative initiatives that identified themselves as 'Solidarity-based enterprises'.

Solidarity-based Economy is an emergent concept that in the last decade has a great development. Only in the Autonomous Community of Basque Country (CAPV) it generates more than 174 million euros on sales and more of 12.500 employments, that represents 1,4% of the total employment of CAPV; growing more than 10% per year (AA.VV. 2004: pp.89-90).

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1. This paper is a summary of a research developed by University of Deusto and REAS titled *The Solidarity based Economy and its Insertion in the University Training*. Concretly, it is the first chapter of the final report during 2002 and 2003 under the direction of the Institute of Human Rights Pedro Arrupe of University of Deusto, in which other researchers took part Dr. Xabier Etxeberria, Dr. Angel Toña, Dra. Laura Gómez and D. Marcos Medina, among other collaborators.

2. REAS = Red de Economía Alternativa Solidaria = Network of Alternative Solidarity Economy.

Nevertheless, concept of Solidarity-based Economy has important problems of understanding. In occasions it is used recounted to Social Economy, in others to Third Sector, in many cases to areas related to social well-being or employment policies, or even it's identified with new emergent realities as Insertion companies.

The goal of the present article is to describe denoting meaning of the concept of Solidarity-based Economy, trying to identify limits that separate it both from Social Economy and from Third Sector; as well as points of intersection between them. Later, the paper tries to penetrate into the differences inside Solidarity-based companies, identifying -basically depending on the addressees of their performances- four families inside the Solidarity-based Economy: Promoters and the Solidarity-based entities, Entities to Social Initiative, Entities of cooperation to development and Special Centers of Employment.

Research departs from a terminological approximation that tries to identify with aim of exhaustivity, diverse denominations used in different parts of the world to identify the concept of Solidarity-based Economy. Later the historical evolution of the concept is approached in Spain, from the initially adopted name of Social Marginal Company, to a descriptive analysis of the term, on the basis of principles accepted in *Letter to Undertake a Solidarity-based World*. Then the paper passes to one of the principal problems: limits of Solidarity-based Economy in relation with Social Economy and Third Sector, where it's proposed a graphical model of terminological integration.

The work finishes with an identification and proposal of definition in relation with internal differences between organizations of Solidarity-based Economy and diverse kind of entities to which these differences give place. It is, undoubtedly, one of the few works that exist in this direction, and though the conclusions are subject to later contributions and critical reviews, represents an important document of reference in demarcation of this diffuse area that drawn entities with social purpose.

## 2. TERMINOLOGICAL APPROXIMATION

Since we propose ourselves to define what we understand as Solidarity-based Economy, it becomes necessary before hand to show the existence and use of other expressions that, sometimes are use as synonymous or are very similar and that generate certain confusion when trying to make a definition of the concept we are interested in. Doubtless, all these concepts maintain certain similarities, for example their origins, or in relation with some of their inspiring values and functioning principles.

But it is not less certain that they present differences not only among them, but also respect Solidarity-based Economy. These differences may become essential, as the for profit purpose or not, the experiences that are based on, underlying ideology, the scope and the materialization of the functioning principles, or the primordial emphasises

In the first place, as far as the origin of the movement of the Solidarity-based Economy and the different families that are included inside it, we understand that share with others, for example, cooperativism, a desire of change of an economic and social system that is considered unfair and with which they share neither its organization nor the consequences that it originates, all this led by popular classes. It might be understood from this point of view as a reactivate movement. In the case of the modern cooperativism in Great Britain (Rochdale, 1844) is a consequence of the 19th century, in the hit of expansion of the industrialization, as well as the denial of the social and economic rights of participation to an extensive part of the population. The Solidarity-based Economy can be understood also as the manifestation of an objection, though attending the situation of the end of the 20th century.

Both, though other movements and ideologies might be mentioned, can be considered a response to the socio-economic concrete situation of the historical moment in which they take place. In words of P. Warbasse, to search "another way of making economy". Though the author was referring to the classic concept of Social Economy, it can be today perfectly extrapolable to the Solidarity-based Economy and to other similar movements.

But the Solidarity-based Economy, as it happened with cooperativism, not only must be seen as a reaction, as a counter-system movement, but also both have had the capacity - and that was the reason of their survival - of becoming positive, of elaborating proposals, of organizing themselves, of trying to be defined in positive, establishing its values and functioning principles, of clarifying the type of society and economic relations they persecute, but depending on themselves and not on their opposites.

Hereby, both managed to find their place within the socio-economic panorama and to differ from others. In case of cooperativism and nowadays of the Solidarity-based Economy, the success has been becoming a certain alternative, and to become active and transforming agents.

This disagreement -or the desire of improvement in the social and economic fields- with the economic system has presented diverse manifestations, from different approximations and ideologies. Without intention of being exhaustive, but in order to demonstrate that the materializations of the expression "another way of making economy" are very diverse, we will refer to some, in some cases as a for curiosity, but specially for its relation with the Solidarity-based Economy. It will offer a key to delimit and clarify the concept.

For all this, and with the purpose of presenting the elements that allow us to bring over the concept of Solidarity-based Economy of the following epigraph, we will do a reference to other terms that sometimes are compared to this one, warning that they are not equivalent. First, we shall gather a series of terms frequently used in Latin America, region of which they are mostly originated and are linked to its peculiar social and political reality, or probably better, in its different socio-political realities, and they relate to concrete experiences that in the above mentioned region are being developed.

The meanings, on the other hand, have been evolving along the history: A very clear example is that of Social Economy, which one has been adapting to the changes that from the 19th century have been taking place for the emergence of new theoretical frames, legislative modifications or changing experiences. Likewise, they present different scopes according to the countries or regions in which every term is studied, that would demand a more detailed study than we offer in this analysis.

Later, in the subparts 2 and 3, we will focus on the definition and scope of two of them, Social Economy and The Third Sector, to which we will dedicate major attention and a certain thoroughness. It is due to the fact that they are terms used extendedly in the European area, our primary area, though not exclusive, of reference. On the other hand, they are two concepts that are consolidated at a doctrinal level, and that comprises some experiences that might be understood within Solidarity-based Economy concept. It, in a superficial vision, might lead us to think about the lack of need of a new name for nonexistence of conceptual new elements for being only a new family inside another major element already existing. As we will demonstrate in the following epigraph, we can no agree with that idea, and that's why we set in this moment the bases for the later comparative analysis.

- **Alternative Economy**, with an extended use. It refers to the common character of these movements in which its main engine is to develop socioeconomic performances in a different way from the existing system. It might be understood equivalent to Warbasse's expression of "another way of making economy", gathering in its name a positive element as it considered itself as an alternative, a possibility of change the socioeconomic existing system. It is a generic expression that includes a good number of other organizations and experiences of very heterogeneous character.
- **Economy of donations**, of recent use, this is used as a special type of transfers and flows of economic assets of unidirectional character, which go from a donor to a beneficiary or recipient. There are included only the cases that fit to those that are effected with social aims, usually framed in organized processes and not in family or friends.
- **Selfmanaged Economy**, where those forms of organization of economic activities based on selfmanaged work would be included, that is to say, where workers participate in the structures of power, management and control of the organization.
- **Economy of the Solidarity**, term coined by professor Luis Razetto Migliaro, whose objective is to introduce the solidarity in the economy, so that solidarity joins in the theory and in the practice of the economy. It is a generic expression that includes a set of such realities as cooperativism, selfmanagement, the economy of communities, the economy of ethnic traditional groups, family economy and the rural economy, etc.



- **Popular Economy.** It refers to the creation and establishment of numerous small productive and commercial activities whose protagonists are the social impoverished groups of the marginal neighborhoods populations. Normally they constitute an alternative to unemployment, being work the most intensive factor. Associated with this one, there have been used expressions as black economy, small popular urban production, invisible economy, economy of subsistence, popular economy. The aforesaid expressions are not identical and in a more detailed analysis of each of them significant shades are observed.
- With this term of Popular Economy solidarity is sometimes associated, talking about **Popular Solidarity-based Economy.** It gathers the idea of a grupal or collective dimension, since it is not a question only of individual activities but joined in a desire of improvement as a group, neighborhood or certain collectivities as those of women or young people.
- **Economy of the work,** preferring the value of the work -sometimes as the only available factor on the part of the most disadvantaged social groups- over the capital. It focuses on the value of the person who through work achieves his/her sustenance and that of his/her family and acquires a social role.
- This expression of Economy of the work sometimes is associated with solidarity: **Economy of Solidarity and Work,** where the relation between the culture of the work and of the solidarity is revealed, which is generated among groups of workers, as a way of attaining collective, and not only individual improvements.

## 2.1. Social Economy

Among all of them, the concept that undoubtedly is more consolidated and has a general recognition at a doctrinal and legal level is **Social Economy.** For that reason, in the context of this research, the delimiting and differentiation turns out to be necessary between this concept and that of Solidarity-based Economy. Which is -or which are- the differentiating aspects of Solidarity-based Economy in relation with Social Economy? The latter also is based on values, among them solidarity, and includes not for profit entities that develop activities of job insertion...

For that reason, the approach of what a **Solidarity-based enterprise** is, leads us to delimiting before the Social Economy concept to see which are the relations or intersections between both. We consider which are the peculiarities of Social Economy considering if Solidarity-based enterprises are inserted necessarily or if the Solidarity-based enterprises are always a part of the Social Economy. We approach to a very wide and ambiguous expression where important discrepancies exist worldwide. It is not the object of our study to deepen into this debate, widely developed, but to point out a few minimums commonly accepted on what the phenomenon of the Social Economy is.

And in spite of the differences and the lack of coordination among the different countries, it exists -in Europe- a common root and a few shared bases on what "Social

Economy” means that can be found in the workers’ organizations of the XIXth century declared by authors as Owen or Busier. This concept has gone through a deep evolution from its birth to nowadays; when in 1830 the Frenchman Dunaié writes an book on Social Economy and uses this expression which appears as an alternative to the industrial revolution, capitalism and social deficits that they were bringing. Little by little, this expression would extend along the XIXth century and under it different currents of thoughts are included; this way the socialist school, the liberal one or the social and christian tried to identify Social Economy with its proposals. Little later this expression will be identified by those economic questions that are not limited to the market or to the benefit and that extend to “the social matter”.

Today, delimiting Social Economy demands to reject several ideas that have been associated and that have drawn it as an alternative to capitalism or as a way to save sectors in crisis. Social Economy has to be understood nowadays within the economic globalization and within the advanced political and economic process of integration in which we are immersed. In this new context a redimension of the productive sectors has been taken place, a restructuring that concerns changes in the strategy of the management on the labour market with all the social implications that it has. Added to it, there were some political situations that favour the phenomenon of the Social Economy in a moment in which the Welfare state appears incapable to cover and satisfy social demands raised by citizens. A new situation happens in which neither the performance of the public sector nor the private manage to satisfy the needs that appear and where Social Economy seems a possible response for social demands in areas as health, education, elderly people care, environment, and other areas related to a better quality of life.

It seems, therefore, that Social Economy entities have peculiarities that make them more suitable for some activities than other organizations and those peculiarities would be essential: profit is not the main priority, no discrimination (‘open doors’), democratic management and independence with regard to public organizations.

In the same sense, we can use the definition by the Belgian Social Economy Council, according to which Social Economy is formed by economic activities carried out by entities that are principally cooperatives, mutual and not for profit organizations that follows the principles of prioritization service to the members or the collectivity above economic and financial profit and independent management (in reference to the autonomy with regard to public organizations). We cannot forget that this does not exclude the search of managerial efficiency and economic and financial profit, that can be said that belong to an intermediate place between the public and private sector.

Due to difficulties to settle down the limits among these realities, many authors insist on the flexibility of the Social Economy concept understanding that it has components that are transforming according to the circumstances. It would be an absolutely flexible concept that has to be studied in relation with other economic areas: first of all with the public sector, to which it relates in the services given by the States together with Social Economy entities; on the other hand, if we refer to the private sector we find a clear example of its proximity to Social Economy in all those

enterprises which give participation to workers in managerial matters and making decisions. In the center of this map we would find the “hard core” of Social Economy, whose definition is going to be determined by the ambiguity of the concept that delimits the sector, existing a great variety of ideas about the concept depending on the country or legislation to which we refer to.

One of the factors that limit this wide set is, undoubtedly, the already mentioned aspect of ‘profit’ understood in two different ways: the first one priorization of the mutual benefit and, secondly, in relation to the distribution of the economic profit, which is an answer to the participation of persons and not of capital. We return, therefore, to the idea of the agents of the Social Economy as those that are capable of developing an economic function in a efficient way (rejecting the idea of mere charitable organizations) but fulfilling simultaneously a social function and distributing its income in a fair way.

In agreement with it, inside the Social Economy organizations the main group would be cooperative, mutual, associations and foundations, (though the presence of this group is not exempt from discussion). In them we find easily the characteristics pointed out in the definition of Social Economy, like democratic management, or voluntary participation of the members, accompanied by other peculiarities as different ways of understanding the property or the achievement of a collective common purpose that occurs in some of them.

The widest vision of this reality would include commercial societies in which some forms of participation is articulated.

## **2.2. Third Sector**

In a first approach to the concept, we find literature and abundant doctrine in relation to the Third Sector, and even one might affirm that is a widely accepted terminology: tercer sector, third sector, tiers secteur... Although as soon as we begin to analyze it, the unanimous acceptance of its content and definition is not so wide.

Firstly, and as for the name itself, The Third Sector, refers to a first great delimitation, slightly exact, understood as a sector half way between private and public sector, leaving always aside families or household economy. This classification comes from the system of national accounting proposed by United Nations where the government or public sector -based on general interest- is considered to be the primary sector, the private sector -based on profit- the secondary one, being the fourth sector the families. There would remain the third sector, whose definition is rather negative, what is not included in the previous ones.

Since we try to describe and to specify the content and limits of this Third Sector, established by a negative definition, doctrinal discussions begin. On one hand, we find the existence of two big general conceptual blocks or considerations, and on the other hand, specificities by countries. To make things even more difficult, new expressions are being used, added to the already traditional ones, that we also will have to take into account in our analysis. Briefly and not in depth, we shall make a

small tour along the Third Sector, its meaning and differences with other similar concepts.

As a summary, we can say that we find two models: the continental European of French origin, exported to Canada and Latin America (with its own specificities), where both expressions -Social Economy and Third Sector- are used as synonymous and include cooperative societies, mutualities and associations. And on the other hand, the model *NPO (Non-profit sector or non-profit organizations)*, of Anglo-Saxon origin, with strong implantation in The United States, in which are only included organizations that fulfill certain requirements (according to the model established by the University Johns Hopkins and its prestigious study on the matter):

- Private, that is to say, separated therefore from the public sector, so they should not belong to a public structure, nor receive from the public sector any interference in its management.
- Formally organized, with a certain degree of institutionalization, not being admitted the so-called *informal sector*.
- With capacity of self-government, that is to say, without interferences of any type of external entities.
- Of altruistic character, in the mobilization of financial and work resources.
- Not-for-profit, so benefits cannot be distributed among the persons who control the organizations, it must be used to the fulfillment of its aims or to aid people that do not exert any type of control within the organization.

But not only we must establish the conceptual delimitation of the Third Sector respect of Social Economy, but also of other expressions that in occasions have been used like synonymous or similar. For example, **voluntary sector, not for profit, independent sector, informal sector, charitable sector, free of taxes sector or civil society, non governmental organizations sector, intermediate sector, non lucrative entities sector, philanthropic activities sector**. Most of these terms refer to one of the characteristics that are attributed to the Third Sector, but not enough to define it.

Also we find particularities if the study is done by countries or big regions. For example, in Latin America is frequent to use indistinctly Third Sector and Social, Solidarity-based or Popular Economy; in the United Kingdom we find the *voluntary organizations* or the *non-statutory organizations*; in Germany, the term *Gemeinwirtschaft* (economy of general interest or of the community), or the organizations *Ideell* in Sweden... At the European Union level, when a consultative committee was created including all these organizations it was avoided to choose a concrete terminology and finally used a descriptive denomination: Consultative Committee of Cooperative Societies, Mutualities, Associations and Foundations (CMAF).

Considering synonymous Social Economy and Third Sector causes a great misunderstanding as includes diverse organizations and realities, in spite of counting

on common characters (not primacy of the benefit, but of the persons, work and service to the collectivity, democratic management, autonomous management...). That is why it has begun to consider the Third Sector as one of the main elements of the Social Economy, attributing it some differentiating characteristic:

- The services offered are aimed to members or to a more wide collectivity and usually has non commercial character.
- Its members can be either natural and legal persons.
- It develops a democratic management style, based on the principle 'one person, one vote'.
- It is financed with fees or non refundable donations, as well as of public subsidies.
- It is not for profit since the benefit is never distributed among its members directly but re-invested in the attainment of its own aim.

Within the European Union an evolution in the matter took place, so although firstly a section of Social Economy inside the XXIII Directorate was created, in the year 2000 it was divided attending to the evident differences and needs of the different types of organizations.

From CIRIEC-Spain two concepts are used: **market social economy** and **not market**, this one with a certain equivalence with the most modern concept of Third Sector, which is avoided to use. This differentiation is based on the methodology of the European System of National Accounting (SEC). This system distinguish between the subsector of market: companies with democratic organization and with distribution of benefits not linked to the contributed capital and subsector of not market formed by not for profit private institutions at the service of the homes (ISFLSH).

The last ones would be entities provided with juridical personality that develop a productive activity, but that do not distribute benefits, obtaining its main resources of voluntary contributions, of the payment of the public administrations and always not linked to the volume or value of the production and revenues of the property. Likewise, there would be necessary to clarify that not all the not-for-profit-institutions -according to the national accounting system- are included in this section, which makes it even more difficult its definition and measurement.

Other authors consider synonymous the Third Sector and **Civil Society**, formed by those entities of joint interests that not necessarily imply an economic activity of production of goods or services, but that pursue other diverse interests (as leisure, socialization, management of a collective interest...) assimilable to the development of the citizenship, as professor Tomás considers. A part of the doctrine eliminates this factor of the concept of social economy and of the third sector, as the North American doctrine does, that demands the development of an economic activity.

From recent times, a few positive important values are being recognised to this Third Sector. Not as a sector with a subsidiary character where the traditional market does

not obtain benefit or fails, but a system that develops activities that cannot be expressed in monetary terms -as the desire or the need to learn- or as complement to the intervention of the public sector. The search of benefits beyond the financial ones, or the protagonism of society, the promotion of a participative and democratic culture, or the fact of being specially sensitive entities towards the captation of new social needs and pioneers in the innovation of satisfying them are emphasised. In the same way a positive evolution is observed as for its growth and importance.

In **conclusion**, we can affirm that, in the last years, the concept of Solidarity-based Economy is starting to occupy an important place in the mass media, as a reference to different reality of dealing and developing economic relations. Nevertheless, it turns out to be a elusive concept. On one hand, the existence of strong interactions and even of common zones with the Social Economy and with the so called Third Sector, much more established realities, makes it difficult to understand the concept suitably; on the other hand, the eclectic entities that are included under this denomination increase the difficulty in obtaining the characteristic shared by all of them.

### 3. DEFINITION OF SOLIDARITY-BASED ECONOMY ENTITIES

In Europe, it is emerging and developing gradually a conglomerate that gets together -in a diffuse way- volunteers' organizations, associations, cooperative societies, foundations, and all kinds of more or less formally organizations, whose main characteristic is its not-for-profit spirit and independence from the Public Power and of the market organizations. The above mentioned conglomerate is generating some new guidelines of economic management, that might be considered as alternatives, since they try to answer not only to the lacks in the European Social well-being system, but also -and even principally- to the processes of inequality and exclusion generated by the predominant logic in the free market capitalist economy.<sup>3</sup>.

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3. The common characteristics to these organizations would be the following ones:

- a) Institutionalized, in terms of the own organizacional structure, independently of the legal form;
- b) Private, in the sense of constituting a structure separated from the government. Which does not mean that, under certain circumstances, these organizations could not receive governmental support, or that employees and government employees could not be members;
- c) Non lucrative, meaning that benefits are not distributed among its members or executives. Nevertheless, they can accumulate benefits as result of its operations, with the obligation of reinvest them to the fulfillment of its mission, and never to the distribution among members;
- d) Selfmanaged, that is to say, that they have their own bodies of government and support the autonomy and the control of their actions;
- e) Voluntary, or that involve in many cases -of significant form- the participation of not paid collaborators;
- f) Not religious, meaning that their basic purpose is not linked to religion or beliefs, though they are not excluded by no means the organizations promoted or linked to churches;
- g) Independent of political parties, meaning the aim can not be neither to impose any political idea, nor to reach the power in the State, though entities promoted by the political parties can not be excluded.

Nevertheless, neither the lack of profit aim -common to all this type of organizations- nor the constitution under social economy formulae place them immediately within the diffuse area of what is understood in Europe for Solidarity-based Economy, and what's more, not all the organizations included in this conglomerate can be considered to be Solidarity-based enterprises.

Solidarity-based Economy entities cannot be identified by its legal form, since within itself we can find cooperative societies, associations, foundations, labour societies, commercial societies and even self employed workers. They cannot also be identified by its sector of activity since, though some of them could be statistically more frequent, any activity can be developed by this kind of enterprises. And even though all of them share certain worry for employment and its quality, we can find entities whose aim is specifically employment creation for the most excluded people, and beside it we find others that, in the opposite side, do not even generate employment or employment created does not have anything to do with the exclusion -that is the case of some consumers' cooperative societies or of specialised services entities-.

Considering this miscellaneous panorama it is necessary to wonder if, beyond the philosophical identification with a concept of solidarity -understood on very diverse forms-, there are some defining characteristics that justify the establishment of a differential category that could cluster a specific type of entities.

In order to have a better understanding the concept of Solidarity-based Economy we are going to analyze its evolution that in Spain.

### 3.1. Historical evolution of the concept:

The historical precedents of the denomination go back to the end of the decade of the eighties, more concretely to 1989, when *Traperos de Emaús* organised a conference in Pamplona (Navarre, Spain), in which they used for the first time the expression of **Social and Marginal Company** and **Social Handicap**, looking for a parallelism with physical and mental handicap already legally admitted.

Later, in 1994 in Beire (Navarre, Spain) a Second Conference took place organized by Aurkilan and Gaztelan, where the denomination of Social and Marginal Company, selfmarginating in its own denomination, is replaced with the term of **Social Solidarity-based enterprise**, defining it as shown in the figure 1.1. This concept soon starts enjoying certain success among the entities of the sector, and in the same way do not know any that would have defined itself as a social and marginal enterprise; on the contrary, a increasingly number of entities have started being called themselves as social Solidarity-based entities. At the same time this terminology started being used in the doctrinal literature.

**FIGURE 1.1.**  
**CHARACTERISTICS OF THE SOCIAL SOLIDARITY-BASED ENTERPRISE**

**INSERTION:** their aim is, both finalist and transition, that mainly look for the workers quality of life employing and re-inserting through a pedagogic support, to persons with difficulties in insertion; the minimal percentage of persons of insertion is the 25% of the workers.

**NOT FOR PROFIT ENTERPRISE:** This kind of entities are non lucrative, though they must be profitable economically. The benefits will be destined to the self-financing of its growth and to the funding of other Solidarity-based actions.

The share capital contributed in case of leaving the company or the Solidarity-based lendings obtained will be rewarded as maximum to the CONSUMER PRICES INDEX, and the wages will be able to exceed neither the triple one of the minimal interprofessional salary, nor a scale from 1 to 2 between the ends of the same company.

**PARTICIPATION:** One of the challenges of the ESS is to create methods and training processes in order to enable all the members of the company to understand all the philosophical, managerial, accounting decisions... making possible the fact that all the persons involved in the company have the right of decision. An economic transparency and a type of information that comes to every workers is chosen; and in relation to external communication, an informative transparency is demanded.

**ECOLOGY:** the enterprises must assume clearly form an ecological option, which assumes the following aspects as point of reference: 1. Clean processes of work; 2. Minimization of the consumption of energy across the accomplishment of energetic ecobalances; 3. Economic activities that minimize the pollution will be carried out; 4. A type of philosophy of recycling will be spread (3 Rs) 5. Commercial relations must be equitable; 6. Consistent consumption will be favored.

Source: Own elaboration from a summary published in the informative Bulletin of Aukilan and Solidarity-based Company meeting, celebrated in Beire in 1994.

At the same time, the European Network of Alternative and Solidarity-based Economy is created in Belgium in February, 1992, with 50 nets and associations from of diverse parts of the planet; which has as repercussion the creation of the Network of Alternative Solidarity-based Economy (REAS, in spanish) in the I Meetings on Solidarity-based Economy celebrated in April, 1995 in Cordoba. The above mentioned meetings, which they have a bianual character, they have been, together with *Carta Emprender por un Mundo Solidario*, one of the areas that have caused the evolution **from the Social Solidarity-based enterprises to the Solidarity-based Economy.**

Finally, the **Social Forum of Porto Alegre**, with participation of entities from almost all the countries of the world, is leading the generalization of the expression 'Solidarity-based Economy' in the spanish speaking countries, extending considerably its original meaning when considering that "the Solidarity-based Economy integrates solutions that go from the local level up to the global one and includes the multiple human dimensions and potentials. It is intrinsic to the Solidarity-based Economy the



aptitude to articulate constantly the political and social dimension as well as the economic dimension, with an environmental concern”.

In the 2002 Social World Forum, as Reintjes reports us, the following aspects are identified as relevant to the solidarity-based economy and its organizations:

- respect for the autonomy of the entrepreneurial activities without the guardianship of centralized of public powers and far from, the bureaucratic cooperative practices;
- organizational model characterized by selfmanagement, from independence, autonomy and responsibility, and the cultural and individual respect;
- social, cultural, and environmental usefulness of these initiatives;
- denial of exploitation of human work by means of appropriation of the means of production and
- generated benefits propitiating the social property.

Likewise, local and territorial dimension of these initiatives was emphasized to recover the control on the economic processes and to guarantee the social and individual well-being. It was also mentioned democracy -equivalent to one person one vote- in the processes of decision making, independent from the modalities that are adopted; and the participation as organizational model and process of channeling and decisions making that implies all the workers and partners.

With regard to the profit, in the Forum there has been specified that the solidarity-based economy claims and needs economic viability by means of selfsustenance for its own yields and the generation of surpluses to re-invest them in the consolidation and in the extension in entrepreneurial initiatives or in the production of common good for the community.

Finally, it was specified that solidarity-based economy organizations compromise themselves to an economic activity not based on the competitiveness among themselves, but in the search of mechanisms of cooperation and solidarity.

### **3.2. Defining Characteristics**

We find necessary to try to approach this concept by means of one or several operative definitions, though in an intuitive way we could catch some experiences that can be considered within the category of Solidarity-based Economy, and even inductively indicate some of the characteristics of this model. This is the way done by the sisters Vilanova in one of the first researchs published in relation to the topic, where from the analysis of concrete experiences the autonomy, solidarity and equality stand out as values of this type of economy system, as well as the different interpretation of economy, and especially of role of money.

The first definition that comes to the mind is the proposal from REAS<sup>4</sup>, in which **Solidarity-based Economy (SBE)** is understood as “the socioeconomic, cultural and environmental system developed in an individual or collective form through solidarity, participative, humanist and not for profit for the integral development of human being as the aim of economy”.

This definition, nevertheless, turns out to give too wide boundaries, since at least most of the third sector might enter in the definition, and even the public sector; this has led some researchers to look for more restrictive definitions, as that of Ignacio Palacios, that considers solidarity-based economy as a set of “not for profit organizations, of a private nature, whose corporate purpose is the achievement of a altruistic social benefit, consisting in making possible, in a wide sense, the social insertion of excluded persons or in risk of exclusion, by means of promotion of activities of production or rendering services developed from the suitable organization of material and human resource”. In our opinion, the above definition includes some of the most specific aspects of Solidarity-based Economy, as the not lucrative character, the implication with the processes of insertion, the search of social benefit, the work with persons, and the managerial or organizational components.

In the same line, but with a major degree of concretion, we can point out the conceptualization used by Travaglini in his study of the characteristics of social cooperative societies in Italy, which includes already some identifying elements.

Nevertheless, the suitable comprehension is difficult to reach exclusively using a definition, and must be combined with a descriptive approximation, capable of enumerating the characteristics of the entities included in the mentioned category. In this respect, we believe that the most accepted document by most people is *Carta Em prender por un Mundo Solidario (Letter to Undertake a Solidarity-based World)*<sup>5</sup>, whose principles are gathered in the figure 1.2.

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4. It is aproved in the Assembly of Malaga (2000) in the context of redifinition of REAS as Net of Networks at the suggestion of the delegation of REAS Euskalerrria, that had been elaborated and approved before by the board that year.

5. The Letter *Em prender por un Mundo Solidario* is born in the context of the European initiative Horizon, more concretly inside a transnational programe composed of: three Spanish centers (Ataretaco, Trinijove and Foundation Deixalles), three Belgian centers (Hefboom, SAW and Tremplin 2000) and French centers (GIEPP and Agora).

These centers, taking into account their work and coincidences “decide to elaborate the letter as an instrument of work to deepen criteria of action of the solidarity based economy and especially for having a few principles of reference that would help to the continuous reflection on our economic practices as much internally as externally. This opened a process of discussion among the different centers, to which the REAS BOARD joined. After multiple and varied discussions a definitive agreement was reached about the criteria of the letter”. Text sent by Toni PONS, President of Deixalles and of REAS, and principal maker of the “Letter” in Spain.

**FIGURE 1.2.**  
**PRINCIPLES OF THE CARTA EMPRENDER POR UN MUNDO SOLIDARIO**

**Equality:** To satisfy in a balanced way the respective interests of all the protagonists interested in the activities of the company or of the organization.

**Employment:** The aim is to create stable employment and to favor the access to disadvantaged or slightly qualified persons. To assure work conditions to every member of the personnel and a fitting wage, stimulating his/her personal development and his/her responsibilities taking.

**Environment:** To favor actions, products and methods of production not harmful to the environment in a short and long-term.

**Cooperation:** To favor cooperation instead of competition inside and out of the organization.

**Not for profit:** The solidarity-based initiatives will not have as the main aim the obtaining of benefits, but the human and social promotion, which does not prevent mean that is not indispensable to balance incomes and expenses, and even, if it is possible, to make profit. Now then, the possible profits will not be distributed for particular benefit, but will be reverted to society by means of the support of social projects, to new solidarity-based initiatives or to cooperation to the development programs, among others.

**Commitment with the environment:** The solidarity-based initiatives will be fully included in the social environment in which they develop, which demands the cooperation with other organizations that face diverse problems of the territory and the implication in networks, as the only way in order that solidarity-based concrete experiences could generate a socio-economic alternative model.

Source: [www.reasnet.com](http://www.reasnet.com)

Together with this fundamental principles, other criteria of solidarity are given, that even are not present in all the entities, that was why there were not included as fundamental principles, are characteristics fulfilled by a good group of entities, and undoubtedly, are criteria of good practices of the organizations that incorporate them into its management. The above mentioned criteria are gathered in figure 1.3.

**FIGURE 1.3.**  
**COMPLEMENTARY CRITERIA**

The products, services, actions proposed or achieved by solidarity-based company/organization contribute to improve the quality of life.

It must be integrated to its local area from the economic, social and ecological point of view. It must try to minimize the indirect expenses that are paid by community. It dialogues regularly with groups or persons by means of its actions, products, services or production processes.

The company/organization is managed in a way as autonomous as possible with regard to the public power or any other organization though they finance it.

It adopts a critical position with regard to the excesses induced by the productivist career, the competitiveness and the technological investments.

It develops fair commercial relations.

The traffic of the information is assured inside and out of the company/organization. It is related to the financial and human aspects of management, the development strategies, the hierarchic structure of the organization, its impact in society...

Workers will be associated with decisions that concern their work or the future of the company. The processes will favor internal democracy, among others training.

The differences of maximum wages will be defined and controlled collectively.

Formulae of distribution of tasks accompanied by the creation of employments will be created.

A particular attention will be paid to the quality of work and to an improvement in the qualification of the whole personnel, thanks to, especially, evaluations, training and the adapted work instruments.

If existing volunteers in the organization, a collective reflection will be carried out on the role of the voluntary work and its work conditions. They will have guaranteed a correct integration and training. Nevertheless, the priority will be centred on the access to paid work.

The company/organization supports solidarity-based initiatives tackled inside disadvantaged groups or regions.

Source: [www.reasnet.com/fcarta.htm](http://www.reasnet.com/fcarta.htm)

On the basis of these complementary criteria, we can make a better picture of what entities can be included within Solidarity-based Economy, since -for its more specific character- tend to make concrete the general principles; in this respect, it would be suspicious an entity that affirms to accept the six basic principles but does not fulfill any of the complementary criteria. In any case, the belonging to the Social Economy does not appear so much in terms of incorporation or exclusion for the fulfillment or breach of criteria, but as a constant process towards the mentioned principles.

### 3.3. Typology: Families of the Solidarity-based Economy

Once located the concept of Solidarity-based Economy, we will approach the problem of trying to groups or subgroups with the diverse existing realities. No one can deny that, though we are capable of finding a basic substratum -tied to the social transformation by means of economic instruments- in entities such fair trade shop, a insertion company, an association for socio-economic promotion and a cooperative society for ecological consumption, are very diverse realities with differential particularities.

This problem, of theoretical nature, raised in the practice when, valuing the possibility of developing an Ethical Banking in Spain<sup>6</sup> wondering who the targets, were for the marked research: It seemed that “solidarity-based economy entities” had a too wide meaning that did not define a specific group of potential customers.

In order to make our research, we accepted the division proposed in the above mentioned study, in which, based on the purposes and characteristics of every entity, four groups or families were defined inside the Solidarity-based Economy: the first group would be **Promoters and Solidarity-based entities (I)**, that characterized for being orientated to the creation of alternative companies, that in the first moment they were named social solidarity-based. Fundamentally they were organised around REAS. With regard to their legal form, it is necessary to differentiate promoters entities, normally with form of Association or Foundation, of the promoted entities, generally with form of commercial societies, with capitalist or social aim. This group can be considered as Solidarity-based Economy in the most restrictive sense understood as the set of entities with the immediate purpose of creation an economic alternative or, at least, the generation of experiences that demonstrate that other way of behaviour for companies and the economy is possible. Mainly they are grouped in the Network of Alternative Solidarity-based Economy (REAS, in spanish), entities such as Rezikleta, Emaús, Aurkilan, SARTU, or Gaztelan, among others, that include themselves actively in the area of the Solidarity-based Economy and work for a new model of economic relations.

Secondly another group was identified that partly belongs to the first one, and partly to the second: that of the **Organizations of Cooperation to Development (OCD) (II)**. Though it is true that fair trade might be catalogued in the category of solidarity-based companies, and what is the performance of social promotion in the destination countries in the group of social character entities, it is also true that the double dimension and the specific of their aim, as well as their important development and their self identification as a group, leads us to consider them a third family of the Solidarity-based Economy. For a reference it can be mentioned any of the entities belonging to the OCD's Coordinator or to that of Just Trade.

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6. The author refers to the group composed by REACE Euskalerrria, the Cáritas of Biscay, Gipuzkoa and Alava and the Christian Communities, which in those moment it was autonamed B3A and which later it would evolve to the creation of FIARE (Foundation Investment and Responsible Saving).

The third group was composed by the **Entities of Social Initiative (III)** typified like “externals”<sup>7</sup>, that is to say, that focus their approach on the addresses of the activity, and more specifically in the social and labour promotion. Though they do not take as an immediate purpose the creation of an alternative economic reality, they do take part through their values and the social and labour insertion processes in the construction of a more human and solidarity-based World; and in a form, explicit or implicit way, they were fulfilling undoubtedly the six principles laid by the Letter *Emprender por un Mundo Solidario* which we have already make references to. In the Basque Country, some examples can be Cáritas, Agintzari or Proyecto Hombre.

In fourth place, we would find the entities that work for the insertion of handicapped groups, even though they might link with those that work with persons at risk of exclusion, their wider development and the existence of a legal regulation: **Special Centers of Employment (IV)**, in our opinion, it provides them with some differential characteristics with regard to other groups of the Solidarity-based Economy<sup>8</sup>, and that in the Basque Country these entities are more widely represented in Elhabe.

In the group of promoters entities and solidarity-based companies, it is necessary to distinguish clearly the first ones from the second ones. The **Promoters Entities (I.1)**, as its own name indicates, beside being solidarity-based entities, would have as corporate purpose the promotion of **Solidarity-based Companies (I.2)**, whereas these would be or promoted by the mentioned entities or created by other promoters, whose aim, apart from the generation of employment, would be fundamentally mercantile.

On another hand, solidarity-based companies can be also divided into several types: **Insertion Companies (EE.II.) (I.2a)**, some of which are fitted in the in legal regulation and others not; with **Solidarity-based Companies that are not of insertion (I.2b)** since they do not generate employments capable of being assumed by persons in risk of exclusion; and very possibly with **Companies** that in their origins were of insertion but due to its **finalist character (I.2c)**, at present workers have already “settled down” and it can hardly be considered an insertion company.

The incorporation of Insertion enterprises in the group I of the Solidarity-based Economy does not mean, now this companies are having an important legislative development, that all insertion companies can be framed within the Solidarity-based Economy, as it is possible that companies of this type consider the economy of market and the capitalist company as the ideal, and only aspire that persons who work with are successful in the current capitalist system, without the assumption of the six basic principles, nor the economy as an instrument to the service of the persons.

7. This tipificación is commented by Pló, P.L. in the paper “Economía Social y ONL. Realidades paralelas, ¿por qué no convergentes?” in the Meeting *El Cooperativismo y la Economía Social en la Sociedad del Conocimiento*. Zaragoza, 2003. P. 529.

8. Created by Royal Degree 2273/85, 4th december (Official Gazzete, 9 december 1985).

In fact, and although it seems paradoxical, the transitory insertion companies that are capable of developing the principles and criteria of the Solidarity-based Economy, will find difficulties in the solution to the contradiction regarding to the labour possibilities that can offer to people in insertion processes. The reason is that the transfer to a capitalist economy company, far from a progress in their human development, is going to imply worsening the job conditions. If on the contrary, they choose to maintain the workers indefinitely they would have stopped being an insertion company. In this respect, probably the only solution to the paradox goes through the development of an important net of social and solidarity-based companies that could employ people who finish their process in an insertion company. Due to the reality of the solidarity-based companies, it does not seem that they are going to be able to meet this challenge, probably a major link would be necessary with the Social Economy area that, at least in certain countries, does have aptitude to fulfill this challenge.

Concerning the group II, we can distinguish two main subgroups, **Entities of Cooperation (II.1)**<sup>9</sup>, and **Fair Trade organizations (II.2)**; the first ones focus on cooperation for the development of the countries with major problems, and adopt functioning principles and an ideology, that -though formulated from the specificity of their activity- are very similar to that of the Solidarity-based Economy, producing an evident juxtaposition of values<sup>10</sup>. On their side fair trade shops are a commercial structure raised explicitly from the solidarity economic, and although their sectorial specificity and their group around the Coordinator of Fair Trade, they maintain differential characteristics in relation with companies (I.2) in strict sense, if this internal cohesion did not exist they might be considered a part of it.

On another hand, in the group III, **Entities of External Social Initiative**, we find a less developed situation, since normally the entities include themselves in the Third Sector, without explicit references to the Solidarity-based Economy; that has led to an absence of reflection on the diverse typologies of this type of entities. What we can point out is that promoters entities (I.1) would fulfill also the requirements to be included in this group, nevertheless they are excluded and considered in group I, for their specificity and their explicit acceptance of a commitment for the creation of solidarity-based companies. Undoubtedly, this is a group that demands a deeper analysis to allow a better and more suitable segmentation.

Finally, in the area of disabled people's social and job integration; it would be necessary to distinguish two different subgroups, one are the **Special Centers of Employment (IV.1)** created under the protection of the legal regulation previously mentioned, and whose working conditions have been regulated by law, and **Protected**

9. We repeat that in the study we have centred only what affects the Basque Country, that is to say in the economic activity realized by the above mentioned entities in the territory of the CAPV, excluding its activity in the countries in those who realize its activity.

10. It is estimated in the "Manifiesto de Cooperación Solidaria" ([www.ongdseuskadi.org/Manifiesto\\_c.asp](http://www.ongdseuskadi.org/Manifiesto_c.asp)) and in the "Código de Conducta" ([www.ongdseuskadi.org/Codigo\\_Conducta\\_c.asp](http://www.ongdseuskadi.org/Codigo_Conducta_c.asp)) of ONGD's Coordinator of the Basque Country, entity that groups the most representative organizations of the sector.

**Workshops (IV.2)**, where the process of social and job insertion does not appear properly as an area of employment and, therefore, under the labour legislation, but principally as a training area, rewarded by means of scholarships or another type of economic compensations, but with a stabler character than the merely formative one.

This is the classification that we have adopted for the research *La Economía Solidaria y su Inserción en la Formación Universitaria*. We understand that it is an open proposal for discussion to define clearer the borders of this new concept of integration, as the first step for the creation of networks of joint work for the strengthening of this type of organizations.

#### 4. CONCLUSIONS

Fundamental conclusion does not derive of the recognition of the concept of Solidarity-based Economy -since it is a premise with which the work begins- but of the boundary mark of the term, in function on one hand of its descriptive characteristics, and for other one of its differentiation with concepts of Social Economy and Third Sector.

Independent of theoretical success that could have this terminological remark, it's true that, in the reality, Solidarity-based Economy represents a movement with entities, nets and areas of reflection different from those of Social Economy and Third Sector. As synthesis, we might identify the fundamental difference with Social Economy in the absence of aim of profit, whereas the fundamental difference in relation with Third Sector would come given by their managerial character.

It's true that in Social Economy we meet realities -as some co-operatives of education- with total lack of aim of profit, and in Third Sector we find associations that have an evident managerial dimension. Nevertheless, and beyond the casuistical complexity, the certain thing is that these three realities, beyond their intersections and general approaches in common, represent "different orders"<sup>11</sup> of social participation.

Beyond their differential characteristics, the source of identity for Solidarity-based Economy are principles shared by entities that form this movement, withdrawals in *Letter to Undertake a Solidarity-based World*. In synthesis, we can say that take part of Solidarity-based Economy all that entity that of conscious form try to develop in the entity, in the surrounding reality and in the world in general, the following principles: 1) *Equality*, as a balanced satisfaction of different interests of the totality of stakeholders; 2) *Generation of full time and quality employment*, capable of being occupied by people with difficulties to entry in labour market; 3) Development of

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11. EME, B. (1997) "Órdenes legítimos de participación social y lógicas de cambio social", in Defourny, J.; Favreau, L. & Lavielle, J.L. (dirs.) *Inserción y Nueva Economía Social*, cap. 11, pp. 295-318; Ed. CIRIEC-España, Valencia.



proactive performances for the *environmental improvement*; 4) To favor *cooperation in opposite to competition*, in the organization and in relation with other companies; 5) *Commitment with environment*, in local level -as nearby area of performance- and in global level -as fight for a more just and solidarity-based world-; and 6) *Without aim of profit*, because the economic activity is understood as instrument for personal and collective development, and not as an end.

Logical intermanagerial differences in the area of Solidarity-based Economy give place to differentiated types, that -as happens in Social Economy- we might name families. It's proposed a initial division in function basically of the addressees of the performances in four groups: 1) Promoters and Solidarity-based entities, basically directed to people with problems of insertion on labour market; 2) Entities of Social Initiative, centred on performances in the area of social well-being and for people with problems of exclusion or discrimination that exceed the labour one; 3) Organizations of cooperation to development, focused on development of people who live in Southern countries; 4) Entities that work for socio-laboral insertion of people with officially recognized disabilities, and that depending on the labour legislation constitute a clearly differentiated group.

Undoubtedly, this characterization and organization for families doesn't try to be final point in the analysis of a tremendously dynamical and changing reality, but a objective reflection that could continue in researchs and later reflections that deepen into the topic, being able to unify or subdivide current groups in relation to qualitative and quantitative evolution in Solidarity-based Economy.

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# SHARPENING THE NOTION OF ‘NONPROFIT’: THE SOCIAL ENTERPRISE

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## 1. NONPROFITS: GENERAL CONSIDERATIONS

Nonprofits are broadly defined as organizations pursuing activities that neither the state nor the free market are capable or willing to perform. This should enable to avoid the limitations of anonymity and bureaucracy typical of the state and the self-interested and profit orientation of the market. To carry out their objectives, nonprofits are accorded a special legal status with tax reliefs and are usually prohibited from distributing any surpluses accruing from their activities. Unlike in a for-profit firm where the return to capital through distributed profit provides the main incentive for investment, distribution in a nonprofit is commonly proscribed. The nondistribution constraint has been named “the cornerstone of economic theories on nonprofit organizations” (Clarke and Estes, 1992; Hansmann, 1987: 28). A major objective assigned to the nondistribution constraint is to obviate the well-known “information asymmetry” prevailing between consumers and providers of goods and services under conditions of for-profit transactions. In this way, “(...) the nonprofit corporate form with its nondistribution constraint, mitigates the incentives of the agent [organization] to act contrary to the interests of the principal [client]” (Hansmann, 1987: 7). This market imperfection is called in the economic literature the “contract failure”. Another such imperfection is the “government failure”. Here, nonprofits are expected to be able to fill the gap produced by the tendency, by government agencies, to satisfy the average voter (Weisbrod, 1988; Clarke and Estes, 1992; Ben-Ner and Van Hoomissen, 1991).

## 2. NONPROFIT: DISCERNING TRENDS AND DIFFERENCES

According to the above general considerations, the thesis could be advanced that in a perfect market with symmetrical information and without contract failures, the nonprofit form would have no reason to exist (Zamagni, 2003: 268). Such a proposition clearly runs counter to those who maintain that the notion of nonprofit

goes beyond the need to avoid the market imperfections, so as to favour and sustain the creation and growth of a special kind of organizations combining the social and the economic component. In contrast to the first proposition that obviously strengthens the prevailing neo-liberal economic system, the second calls for an alternative to it.

At this point we can suggest a first differentiation among nonprofits: on the one hand, those organizations that can be labeled as 'transitional', or 'conservative'. and, on the other hand, those with a more radical character, definable as 'transformative'. Under 'transitional' (Hansmann, 1987) can be included all those organizations that, by common neo-liberal standards, are expected, in time, to disappear, or to turn into company businesses. By 'conservative' are meant organizations whose ongoing existence and performance is assured by their being 'innocuous' to the dominant economic system, as their role is mainly one of charity, or philanthropy, according to the US model. Both types accommodate in one way or another, the capitalist system. By contrast, the 'transformative' type of nonprofit offers an alternative to the capitalist way of economic entrepreneurship. As will be seen below, the 'social economy' and the 'social enterprise' suggest the possibility to legitimize an economic system that can distribute surpluses and still remain 'nonprofit, (as is the case of most cooperatives); can avoid to distribute surpluses and still be an economic enterprise (as is the case with most 'social cooperatives' and the associations performing as 'social enterprises); and can be part of the market without necessarily surrendering to the hegemony of capital.

Let us now consider the features that define the various kinds of nonprofits. By moving down, from the general to the more specific level, we shall note how adding features helps to sharpen the notion of the 'social enterprise and to make it more specific.

### **3. THE NONPROFITS AND THE 'THIRD SECTOR'**

According to the well known study undertaken by the John Hopkins University (Salamon and Anheier, 1999) the Third Sector is commonly identified with a diversity of nonprofit organizations, ranging from public institutions like universities, hospitals and foundations, to private organizations of a voluntary-helping nature. Third Sector's organizations are commonly characterized by such features as 1) having a formal constitution; 2) being juridical private bodies; 3) being self-managed and with voluntary adherence; and – most importantly – 4) banning any form of profit distribution (Salamon, 2002). The latter criterion explains the exclusion, from the study, of cooperatives, on the ground that they 'distribute surpluses', albeit according to participation and not to the kind and amount of members' equity.

It is argued that this exclusion bears heavily on the configuration of the third sector and its potential role in social policies.

#### 4. THE SOCIAL ECONOMY

The re-emergence of the social economy<sup>1</sup> as a typical European phenomenon can be seen as antithetical to the Anglo-Saxon interpretation of the Third Sector. Cooperatives make the chief component of the Social Economy, together with the mutuals and the associations. In this way, the cooperatives excluded from the John Hopkins University research, fulfill here a leading role in the attempt to set up an economic system marked by a clear priority of the social over the economic. The social economy has been characterized by the following features: 1) the priority of man over capital; 2) free association; 3) internal and external solidarity (mutuality); 4) democratic management; 5) the indivisibility of reserves; 6) disinterested devolution of the assets upon dissolution. The development of the social economy over the past years<sup>2</sup> has aroused the interest of the countries candidates for the European Union (see CECOP, 2002).

#### 5. THE 'SOCIAL COOPERATIVE' AND THE 'SOCIAL ENTERPRISE'

The 'social cooperative' aims at particular kinds of beneficiaries: the 'disadvantaged' and the larger community. The social cooperatives were formally established by the Law 381 of 1991 enacted by the Italian Parliament. The Law provides for two types of cooperatives: 1) type A, consisting of activators cooperatively organized for the supply of social and educational services to 'disadvantaged' people; 2) type B, dealing with productive activities aiming to introduce to gainful work 'disadvantaged' people. These have to be not less than 30% of the total labour force of the cooperative and can be members of it. The number of voluntary members should not exceed 50% of the membership. By emphasizing a specific solidarity – rather than mutualistic – aim, the social cooperatives pursue 'the general interest of the community, the general wellbeing and the social integration of the citizens' (article 1). This Law generated other similar legal enactments in Belgium, Spain, Portugal and France. By servicing categories of people beyond the classical realm of members; by providing for a strong

1. The notion of 'Social Economy' was born in France in the second half of the 19th century as a reaction to the free-market system and a means to redress the damages caused by it (Vienney, 1994)

2. According to recent data, the social economy in the European Union comprises 9 million people making up 10% of the salaried employed and 10% of the GIP. A 2002 definition says: "The organisations of the social economy are economic and social actors active in all sectors. They are characterised principally by their aims and their distinctive form of entrepreneurship. The social economy includes organisations such as cooperatives, mutual societies, associations and foundations. These enterprises are particularly active in certain fields such as social protection, social services, health, banking, insurance, agricultural production, consumer affairs, associative work, craft trades, housing, supply, neighborhood services, education and training, and the area of culture, sport and leisure activities (CEP-CMAF - European Standing Conference of Cooperatives, Mutual Societies, Associations and Foundations, 2002).

presence of voluntary work and by admitting for a variety of stakeholders (disadvantaged or not; members or not; remunerated or not) the social cooperatives, in a way, 'violate' some of the ICA principles (Borzaga, 1995).

The 'social enterprise', as the operational unit of the social economy, embodies the elements of self-help, self-management and nonprofit yet sharpens their specificity in the context of the social enterprise: self-help can typify a therapeutic group without necessarily implying an economic enterprise; self-management can typify a single or group enterprise without necessarily implying a not-for-profit orientation; nonprofit can typify a philanthropic, public or charitable institution not necessarily controlled by the user-members or non members, as the case may be (Levi, 2003). The specificity of the social enterprise has been further accentuated by a number of characteristics: that distinguish it from other nonprofit organizations:

*Compared with non-profit organizations, which perform mainly lobbying or advocacy functions, social enterprises give priority to their economic activity; compared with social projects and charitable organizations, which are mainly financed by private and/or public donations, social enterprises earn their own incomes; compared with public services, which are often subject to bureaucratic rules and controls, social enterprises enjoy an independence or a structural freedom that enables them not only to be innovative but also to supply services more closely aligned with needs; lastly, compared with private profit-oriented firms, the public utility-oriented of social enterprises enables them to operate in unprofitable or loss-making areas like the non-resourced or under-supplied markets of areas afflicted by poverty or crisis*

(Birkhölzer and Lorenz, 1998)

A recent definition of the social enterprise comprises five economic and six social criteria (The Okapi Project, 2000). The first are: 1) the production of services and goods in continuous relationship with the market; 2) managerial autonomy, to mean that the social enterprise should not be a branch of another organization; 3) minimal economic risk; 4) the presence of paid manpower; 5) an innovative service or process of supply. The second are: 1) the social enterprise has to be an initiative taken up by a group of citizens; 2) it contributes to local development through the link to the territory; 3) decision-making not based on the ownership of capital; 4) democratic management based on the principle 'one man, one vote'; 5) limited profit distribution<sup>3</sup>; 6) an explicit social purpose.

This definition is almost identical to the first one, formulated by the European network EMES in 1996 (Defourny, 1997).

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3. The original text specifies that 'contrary to the American school where profit distribution is the only standard adopted, it is necessary to find, together with a no distribution constraint, other standards that shall protect the social purpose'.

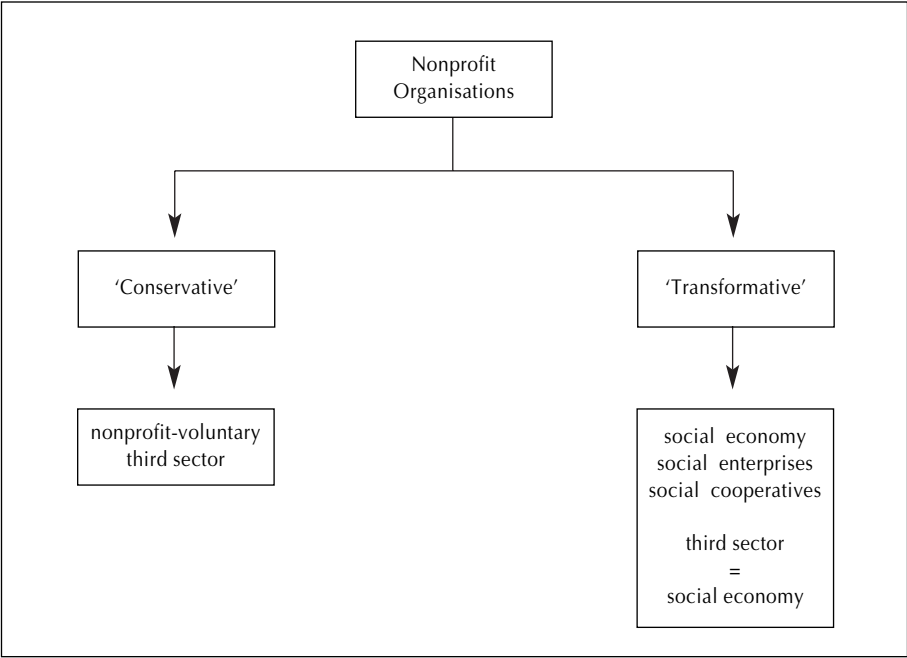


## 6. THE US AND THE EUROPEAN MODEL OF NONPROFIT

The difference between the US and the European approach to the third sector is epitomized, firstly, by its respective connotations: 'nonprofit', or 'voluntary' in the first and 'social economy' (mostly in the Latin part of Europe) in the second. Behind these semantic differences lie dissimilar operational and conceptual approaches. While the American approach, based on utilitarian and pragmatic methods, emphasizes the economic aspects of the issue and deals mainly with descriptive-quantitative aspects of the sector, the European approach is focused on such social aspects as organizational pluralism, how to give a voice to the more marginal groups, how to encourage the economic participation of citizens and the overall role of the social economy in a macro context (Colozzi e Bassi, 2003: 35-36). Underlying such differences are historical considerations. In the US, the nonprofit organizations stemmed mainly from typically for-profit firms and philanthropic groups. The connotation is one of 'no-market', contrary to the European 'no-state' one. Since the term of reference in the American culture is the profit interest in a market system, an organization willing to distinguish itself from mainstream economics, would have no alternative but to connote itself as 'nonprofit' (Zamagni, 2003: 265-267).

By distinguishing itself from other nonprofit organizations the social enterprise allows for the differentiation between two categories of nonprofits: 'conservative', acquiescing to the dominant economic order and 'transformative', striving for an alternative to it. The first operates within the existing economic system and doesn't attempt to change it. The second questions it and attempts to challenge it by offering an alternative model of economic entrepreneurship. This differentiation is illustrated by the US and the European profiles, respectively. The following tables summarize our presentation by distinguishing 'conservative' from 'transformative' nonprofits and by comparing the respective main attributes.

**TABLE 1.**  
**AN ATTEMPT AT CLASSIFICATION OF NONPROFITS**



**TABLE 2.**  
**AN ADDITIVE VIEW OF ORGANISATIONAL ATTRIBUTES**

	<b>Nonprofit third sector</b>	<b>Social economy</b>	<b>Social cooperative</b>	<b>Social enterprise</b>
<b>1</b>	Formal constitution	Priority of man	Pursuing the interest of the community	Production of services & goods
<b>2</b>	Juridical private bodies	Free association	Providing social welfare and educational services	Managerial autonomy
<b>3</b>	Self-management	Internal & external solidarity	Providing employment for disadvantaged people	Minimal economic risk
<b>4</b>	Voluntary adherence	Democratic management	Volunteers up to 50% of membership	Presence of paid manpower
<b>5</b>	Distribution constraint	Indivisibility of reserves	Multi-stakeholders (members and not)	Innovative supply
<b>6</b>	–	Disinterested devolution	Limited distribution of profits	Citizens' initiative
<b>7</b>	–	–	–	Link to the territory
<b>8</b>	–	–	–	Decision-making delinked from capital
<b>9</b>	–	–	–	One man – one vote
<b>10</b>	–	–	–	Limited profit distribution
<b>11</b>	–	–	–	Social purpose
	{Salamon, 2002}	(CECOP ,2002)	(Borzaga, 1995)	(Defourny, 1997 and OKAPI, 2000)

Table 2 shows how the notion of 'nonprofit' used to characterise the third sector as a macro organisational setting, sharpens when it comes to define the social economy and its component elements, such as the social cooperative and the social enterprise.

## 7. LIMITATIONS AND CAVEATS

Our brief discussion would fail to do justice with the complexity of the problem without mentioning –albeit in a summary way – a number of limitations and caveats. First, some limitations. Current literature on the topic still points to the absence of a clear theory of nonprofit and of a common juridical set of definitions and rules befitting the actual member countries of the European Union. Not less importantly, the lack

of a theory regarding the forms of participation and of rewarding different kinds of stakeholders while maintaining the democratic control.

Among the caveats, the danger of *isomorphism* to the surrounding capitalist system has been recently emphasized, on the ground that '(...) the social enterprise is not exempted from a subjective reading of the needs of its beneficiaries, just because its end is not maximization of profit (...)'. This means that despite the nondistribution constraint, the enterprise might perform as a common for-profit organization, thus justifying the 'failure of the nonprofit' (Zamagni, 2003: 287).

Then, the danger of *commodification*. The moment the catchword 'nonprofit' becomes a cover for voluntary - hence cheap - labour; a means to save costs by banning distribution of surpluses, and to promote education to nonprofit values as a source of income, the result is an abuse of a well-intentioned concept to benefit opportunistic interests. If 'nonprofit' serves to deprive the intended beneficiaries of the expected benefits just to serve selected 'haves', why shouldn't we replace 'nonprofit' with the term *noprofit*, to mean that what could be gained has already been taken by others? (Tubaro, 1999:68).

At the root of the issue we find the rationale underlying the 'transformative-alternative' model of nonprofit. Under the assumption that the third sector is the inevitable shelter for those excluded from the first and second sectors, the test of its viability as an alternative to their respective bureaucratic and for-profit approach will be the extent to which unemployment and socio-economic gaps are tackled through organisational systems that approximate the 'social enterprise' rather than the generic 'nonprofit' model.

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# **WORKER'S SOCIAL ENTREPRENEURSHIP. A CASE STUDY OF TEXTILE FACTORY IN LODZ, POLAND**

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## **1. THE SOCIAL AND ECONOMIC SITUATION IN POLAND AND IN THE ŁÓDZ REGION**

The 14 years' period of transformation changed the structure of the Polish industry and had a profound impact on the Polish economy and society. The traditional mainstays of Polish industry, such as heavy industry (mining, metallurgy), shipbuilding and textile industry lost their competitiveness on the European and on the global market due to rising costs of labour and -maintenance but as well as due to dysfunctions in management on the micro and macro levels, and hundreds of thousands of employees from these branches of industry were laid off.

The restructuring and privatization processes in the economy did lead to a functionally necessary modernization and to improved efficiency (that unavoidably entailed reduction of employment). However, flaws in the process, caused at times by new owners' incompetence, and in other cases by intentional policies of running the new acquisitions to the ground, also caused an uncontrolled and unwarranted rise of unemployment. The lack of sufficient national and local economic strategies (that were only partly and belatedly developed under EU pressure), combined with need of employing about 600-800 thousands of young people born during the demographic boom of the 80s furthermore, caused the ratio of labour market participation in Poland to drop to the dangerous level of 50 –55%. Nationally, unemployment in Poland reached the highest ratio since transformation – 21,4% in 2003 (and 40 percent for youth up to the age 24). Large pockets of unemployment where unemployment rate reaches 40-50% exist as well. The most severe social situation occurs in the areas formerly dominated by now disbanded state farms, primarily in the warminko-mazurskie and west-pomorskie voivodships.. This is where “basins of unemployment” are formed in which unemployment spans over generations and encompasses entire families (grandparents, parents and children) and acquires a permanent character (ever since 1992, the year the state farms were liquidated) and this is where the poverty, undernourishment, the sense of detriment, helpless, loss and shortage of prospects dominate.

The situation in some of the urban communities in Poland is hardly brighter. Lodz, that until 1989 was the center of textile industry was particularly affected by the loss of COMECON markets and the opening to cheap Asian imports. Textile enterprises in the Lodz region employed thousands of workers in the professions of weavers, spinners, knitters and finishers. The restructuring and privatization processes of the enterprises changed entirely the employment structure on the regional labour market. A large portion of the light industry enterprises in the region went bankrupt in the course of recent years; some of these were made consciously insolvent by sharp operators, as will be illustrated by the case discussed in this paper. There had not been any investors in their places. The core of the large group of unemployed in Lodz is formed by workers discharged from enterprises which went bankrupt. The ranks of unemployed are continuously reinforced by youth entering the labour force.

The unemployment rate in Lodz reaches at present 22 percent; 36 thousand of people, of which 19 thousands women are long-term unemployed (lack employment for one year and longer). The situation is even worse in the city's periphery: the number of long-term unemployed in the Lodz region reaches 129 thousand of people, of which nearly 80

The relatively few new workplaces that are being created provide employment first and foremost to highly qualified manpower, and hardly contribute to employment of people with lower professional qualification. Lodz, former industrial city became the city of trade and service. Dozens of markets and 21 hypermarkets, were built, and hundreds of pubs and restaurants were started. However, the high rates of unemployment and poverty cannot generate sufficient demand for the services offered.

Breaking this deadlock would require creation of new places of employment and the preservation of existing ones. In the present situation of investor shortage (both domestic and foreign) entrepreneurship and self-employment can become important venues for job-creation. To mobilize the entrepreneurial spirit which sometimes slumbers in people. we need to have a lot of self-restraint, determination and initiative. Such the needs became a determinant in the extremely difficult situation, when all the prospects of external support let down and when it stands clear that breaking the deadlock is run on one's own accord. Successful attempts of starting own small business by unemployed people (mostly by women) in many regions of our country attest . Small enterprises, often started without sufficient external support, respond to the basic needs of local society, reduce the unemployment rate and provide a sense of safety for hundreds of thousands of families, which until recently could not see any improvement prospects for their living conditions.

My private experience as author, promoter and chairman of a women NGO which create chances for employment in your own company confirms foregoing opinions. Of the 3000 people who graduated from the training program "How to run your own company" over the past twelve years about 40 % used the new qualifications gained to attain a job and, furthermore, employ other unemployed people.



## 2. ENTREPRENEURSHIP AS A MANNER OF WORK AND SOCIAL ACHIEVEMENT. THE CASE OF ŁÓDŹ

The basic features of entrepreneurship are: initiative, persuasiveness, the ability to take risk and to work hard, flexibility, creativity, independence, imagination and persistence (Piasecki, 1997). According to the researchers of this subject the enterprising features increase with experience. Psychologists that study entrepreneurship notice in such people the desire to create, building the visions, social interactions and willingness to take risks. Undoubtedly the entrepreneurship may have individual (initiator, entrepreneur) or group character. In the condition of group entrepreneurship for example working group reacting on the disadvantageous relations of work, the concepts of solution a difficult situation are generated within the team. A group integrated around common objective (for example conflict with a boss on the grounds of wages) can create a scenario for solving a problem be it through negotiation, protest action, or the generating of an entirely new solution.

The takeover of the Łódź Textile Mill is an example of group entrepreneurship, in which 400 textile workers in a privatized enterprise on the verge of bankruptcy, deprived of their pay and social insurance package, decided to protest against their situation, to take the erstwhile owners to court, and to restart production amidst liquidation proceedings. The privatized enterprise was a pride of pre-war (then as Scheiblers and Grohman's) and of postwar Łódź, employing six thousands of workers in the 80s. Management of such a huge enterprise in the transformation period was made extremely difficult by the collapse of eastern markets. Although the company's product had a strong brand and a reliable workforce, no suitable restructuring plan was developed, and the company's liabilities grew steadily. The company was privatized on very generous terms in 2001. Although it was in debt, substantial assets were bound in the vast factory grounds and the machine park. The new owners previously acquired at bargain price a textile company in Białystok. At the time of the Łódź purchase the Białystok company was technically insoluble and liabilities reached 8 millions zloty. Obviously, this questionable track record did not disqualify the group's privatization bid for the Łódź plant. Unfortunately, the privatization contract was not made in good faith, and the new owner's covert objective seems in retrospect to have been to siphon away as much as possible of the acquired company's assets.

Though the Łódź company was constantly kept in production (including a night shift) for delivery, primarily to other firms under the owners' control, losses kept growing and the liabilities were constantly accumulating, through a web of internal transactions and questionable transfer pricing. Thus, yarn spun in the Łódź plant was sold to the Białystok companies below the costs of production, a difference amounting to more than 5 millions PLN (approx 1 mill EUR) over the years 2001-2003. Deliveries to customers were moved from one intermediary to another, each of them adding his own margin, collecting profits and deferring payment to the producer. Intermediary firms were consciously created by owners to handle input purchases as well, such as cotton, pigments and even coal. In the same manner, personnel administration was

"outsourced" for a million PZN fee to another company linked with the same owners at of distant about 300 km distance from Lodz, despite the fact that the factory had well-functioning personnel administration.

Discontent among the staff started to grow. As finances deteriorated wages payments to workers dwindled (to 10 percent of regular pay) and finally all but stopped, while company executives and 'external' consultants to the enterprise received their salaries on time. The crew does not want to agree with such a situation noticing methods of deliberate generation of losses for the company while collecting profits on the same transactions elsewhere. These profits lined the pockets of owners and their advisers.

The enterprise's financial resources were also used to take over the assets of other fictitious companies which profited from the sales, such as the purchase of a rest-center on the Baltic sea coast, while the Lodz enterprise landed at loss (also counted in millions). These and similar transactions investigated later on by the National Supervising Institution provided, eventually, the ground for a court indictment.

The most likely objective of these operations, watched by an increasingly frustrated and no longer paid workforce, was to drain the company of all assets, making it a receptacle of debts and losses accumulated by other units in the concern, and, probably, driving the empty shell into bankruptcy once sufficiently burdened with debt.

The difficult social situation led to a wave of protests which culminated in an occupation strike. The grievance which directly precipitated the factory occupation was the owners' decision to remove all machines and other mechanical equipment from the factory (a legally questionable step, since the enterprise was technically bankrupt at the time). The workers managed to stop those activities and decided to strike. A strike committee that represented both (otherwise competing) trade unions and all departments was formed. The strikers' demands were:

1. Payment of all wage arrears. The workers were paid only 1/10 of their wages in the period of nearly 6 months directly preceding the strike.
2. Payment of overdue social insurance rates (these are detracted by the employer along with taxes directly from the gross paybill; withholding these payments directly jeopardized workers' social insurance rights).
3. Maintaining employment in the factory (the owners decided to move part of the machine park and crew to another company)
4. Control over the distribution of produced goods (the owners had been selling the goods under production costs so as to generate losses).
5. Information about the factory's future.

Then the mediation between crew and the management of the company began. The author of this paper took part in the negotiation as a mediator, and alerted the public prosecutor. The irregularities were reported by the team, in due course, to the

public prosecutor. The latter (and rising media interest) drew the attention of the National Audit Institution to this pathological situation.

The sit-in strike lasted more than 3 weeks and generated significant support from local politicians and local and national media. The demands of the striking crew and the mediations were only partly successful. However, the strikers managed to keep most of the machinery in place in the factory and- by occupying a store textiles whose value would have been sufficient to match their claims- effectively forced the owners of the company to start paying off on their wage arrears.

It should be underlined that strikers were perfectly organized. The Strike Committee consisted of representatives of two workers unions (Solidarity and Trade Union) and the representatives of each factory departments (production, administration, warehouse). All production staff (300 workers) took part in the strike. The occupation of the factory continued also during holidays, to safeguard that no material or equipment could be removed.

The author's participation in described clash confirmed the crew about rightness of their activities. The staff understood that bankruptcy and the appointment of a public receiver (Syndyk in Polish; an official appointed by the Treasury to supervise production by the work-team and liquidation or reconstruction proceedings) was the best way to preserve the enterprise as a going concern, and the workforce as a functioning team. Forcing the factory owners to apply for bankruptcy was indeed the most important long-range achievement of the strike.

The application for opening of bankruptcy proceedings was handed in March 2004, and the company was declared bankrupt in September 2004. The Receiver largely followed the line of action suggested by the workers' committee.. It is worth to emphasise that the material situation of workers and their families was (and still is) very difficult. Nonetheless, the workers decided to pursue a takeover strategy. A worker-owned company was formed with funds obtained from the National Guarantee Fund as its start capital, and preparations for a bid for the plant were started. Other activities led to:

1. Applying for funds from the state budget (for creating places of employment)
2. Sounding potential customers and market contacts for the factory's output (market research)
3. Inspection of unutilized machines
4. Screening of staff for employment work in the reconstructed company

The company was set up by the strike leaders (3 persons) and by two engineers who became company's management. The initial stock amounted to 140 shares out of which 80 were held by workers. Later on the capital was increased through a new stock emission, and the managers obtained 420 shares while workers got further 200. payments for worker's shares were detracted from the personal allowances paid by the Guarantee Fund.

In December 2003 the Treasury granted the group funds for setting places of employment. With this financing, the workers took part in the tender for the factory's machine park bid to lease the production halls. In January 2004 they became the owners of the machines. Since that time worker's initiative gathered momentum. Endless debates, enforced by gained specialists of managing and technology created the possibility of coming true the worker's dreams. They started to come into contact in all haste with customers. The strike leaders have become members of the company's supervisory board and are responsible for purchases and contacts with clients.

The struggle for the enterprise's future met many allies. The workers were supported, in various ways by:

1. Parliament members (in my person)
2. representatives of local government
3. City's government
4. Voivodship Assembly (sejmik) and state government ( Voivode and Ministry)
5. Employment Office
6. The National Health Insurance
7. The Treasury
8. Public utilities (power Station, water)
9. Media (newspapers, radio, television)

Operations (re)started with 90 employees in March 2004. The remaining workers that invested in the company stock were put on a waiting list, pending further developments and future expansion of the workforce. Production started with the cheapest and the most simple articles. Considerable effort was devoted to regaining customers (that were previously linked through the former owners' intermediaries) and win new ones. The objective of the company was from the outset to increase employment to 150 by April 2005. By December 2004 the company employed 120 people, and the target employment figure of 150 was met in April, as planned. There is hope that the company, whose market position improved significantly, will show good economic results. The total stock at present is 760 shares. Share majority is now held by the company's management (the president and vice-president hold 200 shares each and a former CEO holds 60). The remainder of the stock is spread between the employees, (today 145, most of which are shareholders) that hold between one and ten shares each. The company's shares may not be freely traded.

Working in a company managed by themselves changed employee attitudes. A significant improvement in self-discipline and social control was achieved. The most active members of the strike-committee reemerged as foremen and company board-members in the new enterprise.

Initial success notwithstanding, this is merely the starting phase of a long-range project. Substantial problems remain: first and foremost, and due to the founders'

pressed economy, capitalization is fairly low, which in turn means that operations are cash strapped and liable to liquidity problems. It also generates a drift towards a more centralized ownership structure. Secondly, EU accession and the Union's recent opening for cheap Asian textile imports may threaten the enterprise's economic viability. Lastly, social control, in this extremely demanding situation generates in the long run considerable social strains, especially when combined with increasingly skewed ownership distribution.

To recapitulate: the positive outcome of this clash was decided by the workforce's stubbornness, determination and desire to return to work. These entrepreneurial features are fully reflected in the workers' conduct in the course of the strike and the subsequent company restart. The leaders of the strike committee (currently in the company's management) have shown courage, leadership skills, perseverance, stubbornness, an ability to take risk and first and foremost creativity. The long run prospects for success will hinge on the availability of suitable institutional frameworks that can reconcile social objectives with business operation. The case described above unfolded in parallel with legislation in Polish Parliament, passed to adapt Polish law to the European law. The present legal situation opens new possibilities to create novel incorporation forms that are better suited for the task of job-creation. Undoubtedly, the creation of social co-operatives could aid in solving urgent social problems which affect the growing group of long-term unemployed and permanently marginalized.

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**PART 6**  
**MERGERS AND  
DEMUTUALIZATION**





# THE DEMUTUALIZATION PROCESS OF EUROPEAN COOPERATIVE SOCIETIES

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## 1. INTRODUCTION

Although recognition of the importance of cooperative societies varies greatly among different European countries despite cooperatives' long history and experience, the substantial contribution cooperative societies make to job creation and mobilization of resources, above all at the local level, has been acknowledged in international forums like the European Commission, the United Nations and the International Labour Organization.

Nevertheless, in recent years it has become clear that as the European cooperative movement evolves there is a tendency toward processes of demutualization as many traditional cooperative societies respond to increased competition and the globalisation of markets. This de-cooperativization or demutualization shows up, in one way, in the process of corporate mergers; and, in another way, in the increase and consolidation of funds acquired by cooperative societies through resources furnished by investment partners who are not recipients of the cooperatives' services.

Both are formulas that attempt to encourage cooperatives' growth and their access to capital markets, but difficulties arise related to maintaining the differences that give cooperatives their distinct identity. In fact, the myriad processes found in the financial linkages, from fusions to the creation of cooperative groups, have revealed in many cases problems to synthesize cooperative societies that have reached large proportions with their correct functioning in agreement with cooperative principles. This calls into question the whole cooperative system when the cooperative societies resulting from concentration processes group together thousands of members who see their rights and responsibilities reduced to a minimum and who come to be considered mere customers or suppliers rather than partners in some cases. In other cases, to finance these cooperative growth processes capitalist investors are invited to participate in the social capital with social and economic rights often comparable to those of the cooperative members themselves.

The European Union has tried to solve this problem by stimulating the concentration of capital from different member countries through the regulation of

European Cooperative Society Statute. A detailed analysis points up how the statute creates a possible solution to the first factor causing demutualization analysed in this article. But the statute aggravates the second factor, since it gives flexibility to the economic-financial status of the non-cooperative investor members by trying to make the investment attractive in two ways: first, through the awarding of the right to vote, thus augmenting investor confidence as this can be considered a means of controlling the investment; and second, by not limiting the return that can be earned by participation.

## 2. THE DEMUTUALISATION PROCESS OF CO-OPERATIVES SOCIETIES

Co-operatives have felt the need to expand in the market through business mergers which help them to adapt their structures to the demands of the global market. In cases where there is a need to adapt to circumstances, a large scale business merger can be a genuine survival technique even though these large corporations have inherent difficulties in integrating standard co-operative forms of management (Parra, 1974: p.5). For this reason co-operative mergers must simultaneously take into account aspects of business as well as those norms which differentiate and characterise co-operative societies: co-operative principles (García-Gutiérrez, 1994: p. 421).

One of these principles actually sets out to encourage this kind of process. It is called the Principle of Intercooperation (ICA, 1996). In order to achieve the objective outlined in the Principle of Intercooperation, any societies can collaborate being them co-operatives or conventional capitalist businesses. The first instance could be considered strict intercooperation while the second could be considered broad co-operation.

This broader intercooperation is what has been highlighted by “demutualisation” or the tendency by large co-operatives either to slide towards capitalist forms of societies, to create instrumental commercial corporations as a flexible form of growth, to involve themselves in large scale fusion projects with companies outside the third sector and has been the response of many considerably successful co-operatives in the fields of banking, retail and agriculture<sup>1</sup>. This has been called “cooptalismo” (Belley, 1988) or “isomorfismo” (Bager, 1994; Chaves, 1997).

In concordance with an empirical analysis undertaken by Bager (1994: 53-54), over the last decades co-operatives have frequently undergone a complete or partial transformation into other types of businesses or hybrid organisations. This transformation appears to be all the greater when faced with a combination of strong outside pressure and internal weaknesses.

According to a study by Ciriec (Barea *et al.*, 1999) in Spain the main co-operative groups Mondragón Corporación Cooperativa (MCC), Grupo Empresarial Cooperativo

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1. See practical examples in: BAREA, J.; JULIÁ, J.L. and MONZÓN, J.L. (Dirs.) (1999) *Grupos empresariales de la Economía social en España*. Valencia: CIRIEC-España.

de Valencia (GECV) and Grupo Agroindustrial ANECOOP, have all eventually used conventional commercial corporations as a form of expansion. Nonetheless, the second grade co-operative group or society strategy (whereby structures of a higher grade integrate other co-operative societies via explicit legislation, either state or autonomous), has permitted these groups to develop respecting ACI philosophies and principles.

In order to prevent decooperativisation in mergers it is important to avoid the risks involved in a switch from a direct to a delegated democracy. The merger must assure homogeneity among members according to their contributions to real flows as well as to finances whilst ensuring that responsibility for decisions taken depends on activities not on capital.

Paradoxically however, this tendency towards demutualisation has, in many countries, been encouraged by co-operative legislation itself. Such legislation has permitted the access of new elements which, while moving away from co-operative identity and practice, were introduced with the aim of facilitating access to the financial markets and guaranteeing enough flexibility to adapt to changes in circumstance.

With this in mind, those countries where regulation for co-operative societies has been recently adopted (France, Italy, Spain, Belgium, Portugal, Denmark, Finland and Sweden), have in fact authorised investment by non-user third parties (European Commission, 2001: p. 21) thus dangerously raising the percentage of social capital in the hands of these parties.

The European Union in its awareness of the new challenges faced by co-operative societies and of the problems of demutualisation provoked when these reach a size comparable to a large-scale business, has encouraged the raising of capital from various member states in order to develop cross-border activities through the regulation of the Statute for European Co-operatives (SCE)<sup>2</sup>.

However, even though the statute aims to encourage transnational co-operation between physical persons or legal entities from different member states of the E.U. (SCE Statute, article 2), it has followed the tack of most national legislation in allowing for the existence of external investors who contribute financially without participating in co-operative activity (SCE Statute, article 14.1) but limiting their voting rights to a maximum of 25 per cent of the total votes (SCE Statute, article 59.3).

The most serious aspect of this statute is that it does not limit the percentage of social capital held by either user or non-user members. A maximum limit should have been set whereby the majority of a co-operative society's social capital is held by co-operative members i.e. those who, either as clients or suppliers, contribute financially and participate in the co-operative activity. If a limit is not set, the statute in fact goes against the eventual aims of the SCE set out in its own explanatory statement.

2. Council Regulation (EC) No 1435/2003 of 22nd July 2003 on the Statute for a European Cooperative Society (SCE). *Official Journal of the European Union*, L 207/1 of 18.8.2003.

Moreover, the SCE allows for a cooperative society to distribute the surplus remaining after allocations to the legal reserve and the payment of dividends as a return on “paid-up capital and quasi-equity<sup>3</sup>”. In this way, by not setting limits to the remuneration of social capital and being part of the profits, the return is brought into line with dividends distributed by conventional limited companies.

The introduction of non-user members or investors without the establishment of certain limitations however, does imply an explicit recognition of the power of capital in co-operatives societies, a factor traditionally considered subordinate or instrumental (Pastor, 2002, p. 113).

In any case the possibilities offered by the new statute are still little known and we will have to wait a while before being able to evaluate its results and whether or not it has come up to expectations.

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3. However, the explanatory statement would appear to be contradictory to “the return on loan capital and share capital must be restricted”. The shares to which the legislator refers are understood to be in social capital, given that article 1.2 rules that: “the subscribed capital of an SCE will be divided in shares”.

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# **ESTABLISHMENT OF EUROPEAN CO-OPERATIVE SOCIETIES BY MERGERS OF COOPERATIVES FROM DIFFERENT MEMBER STATES**

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## **1. INTRODUCTION**

Cooperative societies are active in almost all business sectors of the European Union (EU), operating with considerable success in sectors like banking, agriculture, health care, education, housing, etc., which confers them an outstanding role in the European economy.

As an example of their relevance in some sectors, it can be emphasized banking cooperatives, with market shares in 1995 of 37% in France, 35% in Finland, 31% in Austria or of 19.5% in Germany (ACI, 1998). In the agricultural sector, where cooperatives are highly established, these forms of association exceed market shares of 70% in several products and countries, such as the case of fruits and vegetables in Belgium and Holland, or 80%, as it happens with dairy products in Austria, Denmark, Finland, Holland, Ireland, Luxemburg, Portugal or Sweden (COGECA, 2000). Other representative sectors are health care or housing. Thus, in the first case we can highlight the Spanish or the Belgian cooperatives, with market shares of 21% and 18%, respectively, and 45% in housing cooperatives in the Czech Republic (ACI, 1998).

Nevertheless, the parameters for many of these sectors, with a high competitive pressure, lead companies to approach strategic solutions that allow them to maintain and increase their share of power in the market. In this sense, the establishment of alliances between companies, and the integration processes have played an important role.

The different legislations that regulate cooperative societies have, in many cases, reflected this need, and have taken into consideration different integration formulas in their articles, among which merger plays an important role, given the synergies in different business areas, or the reduction of costs, appearing thus as a very valid formula to solve the problem of business atomization in some sectors.

In fact, competition, concentration and business growth are among the tendencies and structural changes in the evolution of cooperatives included in the consultative document "Co-operatives in Enterprise Europe", presented by the European Commission in 2001, which states that there are already multiple mergers that have materialized among cooperatives from different Member States, as well as between these and those from candidate countries or third countries, which found difficulties in many cases, given the current diversity of legislations and the consequent legal conflicts that have appeared on many occasions, therefore, hindering the processes.

It should be noted that the legal framework applicable to the EU economic activity is still based, to a large extent, on national laws, which leads to many difficulties when approaching merger operations between societies located in different Member States.

Undoubtedly, it was necessary to adopt rules concerning the demands of those companies whose activity exceeded only one Member State, allowing them to reorganize and restructure their activities on a Community scale, by means of the creation of societies with participation of companies from different Member States, as in fact European companies have had since 2001 Council Regulation (EC) No 2157/2001 of 8 October 2001, adopting the Statute of the European Company (SE), from now on ESAE.

Council Regulation (EC) No 1.435/2003, of 22 July 2003, concerning the European Co-operative Statute (ESCE), responds to such demands, making available to cooperatives the necessary legal instruments for the development of crossborder activities, which, on the other hand, are more and more frequent and necessary.

This Regulation will be applied from 18 August, 2006, and constitutes the legal basis for the constitution of co-operative societies from natural persons and/or societies located in different Member States, and therefore subject to different cooperative laws, at the same time that regulates the possibility of formation of these societies by merger of cooperatives from different Member States, or from the transformation of cooperatives, as stated in whereas 13.

In consequence, from the date of its application, there will be a double regulation for the processes of cooperative mergers: one for the mergers between cooperatives located in only one Member State, or internal, determined by the regulations of the different national laws concerning cooperatives, and another one established by the ESCE, applicable to crossborder cooperative mergers or between societies from different Member States.

Therefore, Spanish cooperatives will be regulated, depending on whether they participate in a crossborder or internal formation by merger, by the ESCE or by the cooperative law in force in Spain (national or regional), what will promote the appearance of differences in the steps to follow by cooperatives and in the merger itself. The aim of this paper is to show the specific features of formation of cross border cooperative by merger, covered by the ESCE, with special attention to those aspects that distance them from the internal formation by merger, within the Spanish legal framework.



Nevertheless, given the legislative diversity in Spain - there are 13 autonomous and one national cooperative laws - and as the regulation of mergers is very similar in all them, we will take as a referent for our study Cooperative Law 27/1999, of 16 July, (from now on Law 27/1999), although we will make reference to the autonomous Laws where applicable, due to its reference in the ESCE itself.

## **2. MERGER AS A FORMULA TO ESTABLISH EUROPEAN COOPERATIVE SOCIETIES**

The ESCE considers several possibilities when creating a European Co-operative society (SCE) (art. 2 ESCE). An SCE may be formed as follows:

- By natural persons resident in at least two Member States (with a minimum of 5),
- By natural persons (minimum 5) and societies or legal persons resident or regulated by the legislation of at least 2 Member States,
- By companies and other legal bodies, governed by the law of at least 2 different Member States,
- By a merger between cooperatives formed under the law of a Member State with registered offices and head offices within the Community, provided that at least two of them are governed by the law of at least 2 different Member States,
- By conversion of a cooperative with its registered office in a Member State if for at least two years has had an establishment or branch governed by the law of another Member State.

Regarding the formation by merger, the ESCE provides two procedures (art. 19 ESCE), the so-called merger by acquisition, in which one of the cooperatives implied in the merger (acquiring coop) acquires the assets and liabilities and hosts the members of the rest of cooperatives, and simultaneously taking the form of an SCE, and merger by formation, in which the cooperative to which the assets and liabilities and members transferred is newly formed, and is formed as an SCE, as shown in table 1.

**TABLE 1.**  
**EFFECTS OF THE MERGER**

	By acquisition	By formation
Universal transfer of all the assets and liabilities of:	each cooperative acquired to the acquiring cooperative	the merging cooperatives to the society formed.
Members of the cooperatives acquired will become:	members of the acquiring cooperative	members of the SCE formed
Cooperative that disappear:	acquired cooperatives	all the merging cooperatives
Society resulting from the merger	the acquired cooperative will become an SCE.	SCE formed after the merger

Source: Own elaboration from the ESCE (art. 19 and 33)

The cooperative resulting from merger shall be subject to the provisions in the ESCE, although in those aspects not covered by it (completely or partially) they shall be governed by the dispositions in force regarding cooperative mergers of the Member State to which they are subject, and, failing that, to the national dispositions for the internal mergers of public limited liability companies (art. 20 ESCE).

Therefore, the Spanish cooperatives involved in these processes shall comply with the requirements of the ESCE regarding the merger procedure, which differs in several aspects to the procedure in the national legislation (Law 27/1999 and Regional Laws), arising the question of which legislation is to be applied in substitution of the Statute, in the aspects not covered in this (totally or partially). In fact, the reference expressed in the 1993 text has disappeared, which considered the possible existence of regional laws, thus enforcing the autonomous legislation applicable (Fajardo, 2001).

According to Vicent (2004), regarding the references of the statute to the cooperative legislation of the Member State in which the cooperatives are registered, and especially the case of Spain, according to the Constitution and the Statutes of Autonomy, the autonomous Law corresponding to the registered office shall apply and not the 27/1999 Cooperative Law.

On the other hand, an element to highlight within the framework of mergers regulated by the ESCE is the power conferred to the Member States to avoid the participation of a cooperative subject to their legal order in a merger that will have an SCE as a result (art. 21 ESCE). In this sense, although it specifies that this decision shall be based on public interest reasons, and the possible opposition appealed with legal actions, the indefiniton or ambiguity pointed out makes it difficult to imagine the powerful reasons that could lead a country to avoid a process with these characteristics. Some examples in this sense could be to ensure the supply of energy products or other supplies of vital interest for the population, which do not seem usual in the case of cooperatives, just as Vicent (2004) points out.

### 3. FORMATION BY MERGER FROM THE EUROPEAN CO-OPERATIVE STATUTE

#### 3.1. The draft terms of Merger

The draft terms of merger is a document that the management or administrative organ of the cooperatives (Decision-making councils) involved in any merger have to prepare, which later on shall be adopted by the general meetings of all them (arts 22 and 27 ESCE).

The preparation of this document also constitutes one of the guidelines in the procedures of formation by merger of EU public limited liability companies, as stated in the Third Council Directive 78/855/CEE, of 9 October 1978, on the mergers of public limited liability companies, (from now on Third Directive), to which the commercial dispositions of the different Member States had to adapt, as specified in article 1.

All the cooperative laws in the Spanish territory include also the obligation of preparing this document, although its contents differ in different aspects to what is established in the ESCE.

In fact, the draft terms of merger defined by the ESCE are much more similar to what is pointed out in the Third Directive and to that already covered by the mentioned Statute of the European Company (ESAE) to that considered by the Spanish cooperative legislation.

Among the differences found in the detailed contents of the ESCE and the Cooperative Law 27/1999 (Table 2), it should be pointed out the following:

First, the ESCE establishes the need to quantify the relationship of exchange of the shares and the amount of the compensation to be paid in cash. This clause is part of the terms of merger carried out by companies, as it comes from the Third Directive, not being included in the cooperative mergers governed by Law 27/1999, which only requires to identify the system by which the share capital will be transferred from the resulting cooperative to the members of each cooperative involved.

This seems logic, since Law 27/1999 does not mention that the share capital can be divided in shares, and only indicates that it shall be formed by the members' contributions, (art. 45 Law 27/1999).

In fact, although there are cooperatives with a registered office in Spain whose share capital is divided into shares, in which an exchange "relationship" could be established to assign the share capital between the members of the cooperative resulting from the merger, we cannot overlook that many of them do not consider social shares with assigned nominal value, therefore the system used to assign the capital to each member in the resulting cooperative will require a different procedure.

Nevertheless, we find that this requirement can be sometimes adequate, since in many cooperatives the willingness to attract new members has resulted, in the long run, in unfair imbalances regarding the investment in the cooperative by some of its members. In these cases, mergers can offer an excellent opportunity to clarify this

situation, promoting the establishment of shares whose determination is usually recommended to be carried out depending on the unit of activity of the cooperative (surface unit in agricultural cooperatives, livestock in farming cooperatives, etc.), the link between the members and the cooperative.

It should be noted that in both cases we refer to the assignment between the members of the reimbursable assets in case of disappearance of the resulting cooperative. We should keep in mind that cooperatives have another type of corporate assets, in many cases considerably higher, which cannot be distributed, composed of the non distributable reserve invested by the companies in compliance with the legislation in force. Therefore, and although not covered in the legislation, we understand that these corporate assets shall also be valued and the appropriate means should be established to balance possible imbalances between the cooperatives involved in the merger (Juliá, Server, Meliá, 2004).

The form of transfer of the SCE's shares, as well as the date from which these will grant the right to participate in the benefits, at the same time that any special condition that affects this right, are the minimum contents of the draft terms of merger of the ESCE, not included in the 27/1999 Law either, for similar reasons to those presented in the previous case, as this Law does not recognize the stake in the capital.

Moreover, the draft terms of merger of Law 27/1999 do not provide for the protection method of the creditors' rights of the cooperatives that merge. Regarding the creditors' rights of merging cooperatives, the ESCE refers to the legal order in public limited liability companies' mergers of the Member State in which each participating cooperative is registered, taking into account the crossborder nature of the merger (art. 28 ESCE).

Therefore, there may be differences regarding their procedures of application and obtaining of credit collection guarantees, depending on the Member State in which the cooperative has a registered office. On the other hand, it does not coincide either, in the case of Spanish cooperatives, the procedure for creditors of cooperatives involved in a national merger (therefore regulated by the national or autonomous region law), with the procedure of cooperatives in a crossborder merger (regulated by the legislation on public limited liability companies mergers, as stated in the ESCE).

Therefore, based on the Legislative Royal Decree 1564/1989, of 22 December, adopting the Consolidated Text of the Company Law (hereinafter TRLSA) effective in Spain, creditors will have 1 month, from the date of the last announcement of the agreement of the general meeting (general assembly in our case) to oppose to the merger in the terms foreseen in article 166 (art 243 of the TRLSA), which differs from that governed by Law 27/1999, established in 2 months from the publication of the announcement of the agreement (art. 66 Law 27/1999).

Another clause included in the draft terms of merger not covered in the Spanish cooperative legislation encourages to specify the particular advantages attributed to the experts that study the draft terms of merger, as well as to the members of the administration organs, management, supervision or control of the merging

cooperatives. This clause is also part of the contents of the draft terms of merger established by the ESAE, as well as that covered by the TRLSA for the internal mergers of public limited liability companies, and it seems to respond to the possibility to confer advantages, usually financial, to the experts appointed or to the administrators, to be paid by the society resulting from the merger. If these advantages are established, their inclusion in the draft terms of merger seems logic, since they should be known by the members when approving the merger.

Finally, it should be noted that unlike Law 27/1999, the ESCE establishes the inclusion of information on the procedures in the draft terms of the merger through which the conditions of the employees' involvement are determined in accordance with Directive 2003/72/CE, as well as with the statutes of the SCE. In this respect, it should be highlighted that when the latter are not part of the draft terms of the merger covered by Law 27/1999, as we will see later, they include the information that this law states to make available for the members before the meeting called to approve the merger.

Apart from the clauses defined as contents of the draft terms of merger, the ESCE includes the possibility that merging cooperatives add other elements to the draft text (art. 22.2. ESCE).

There is no indication in the ESCE about the approval of the draft terms of merger by the administrative organs of the cooperatives, or about the time limit of validity of this document to be ratified by the general meeting of the merging cooperatives. Nevertheless, the ESCE refers "regarding terms of merger", to the law applicable to public limited liability companies (art. 22.3 of the ESCE), which will apply by analogy to the cross border cooperative merger.

**TABLE 2.**  
**CONTENTS OF THE DRAFT TERMS OF THE MERGER ACCORDING TO**  
**COUNCIL REGULATION (EC) NO 1435/2003 ON THE EUROPEAN**  
**CO-OPERATIVE SOCIETY STATUTE, AND COOPERATIVE LAW 27/1999**

ESCE	27/1999 law
a) the name and registered office of each of the merging cooperatives together with those proposed by the SCE;	a) Name, class and type of the merging cooperatives, including the data that identify their registration in the corresponding Cooperative Register, and those of the new cooperative if applicable.
b) the share exchange ratio of the subscribed capital and the amount of any cash payment. If there are no shares, a precise division of the assets and its equivalent value in shares.	b) System followed to establish the amount each member of the cooperatives paid as contribution to the share capital of the resulting cooperative, and compute, when available, the distributable reserves.
	c) Rights and obligations recognized to members of disappeared cooperatives in the new or acquiring cooperative.
c) Transfer methods of the shares of the SCE.	
d) Dates from which the shares will give right to participate in the benefits, as well as any special condition that affects this right.	
e) Date from which the operations carried out by the cooperatives that disappear can be considered for accounting purposes carried out by the new or acquiring cooperative.	
f) the special conditions or advantages attached to debentures or securities other than shares which do not confer the status of member.	
g) the rights conferred by the SCE on the holders of shares to which special rights are attached and on the holders of securities other than shares, or the measures proposed concerning them;	e) Rights that correspond to the holders of special shares, shares or securities similar to those of the disappearing cooperatives.
h) The forms of protection for the rights of creditors of merging cooperatives.	
i) any special advantage granted to the experts who examine the draft terms of merger or to members of the administrative, management, supervisory or controlling organs of the merging cooperatives;	
j) Statutes of the SCE.	
k) information on the procedures by which arrangements for employee involvement are determined pursuant to Directive 2003/ 72/ EC.	

Source: Own elaboration from the ESCE and Law 27/1999.

Upon consulting the ESAE, we find that it does not include any indication in this respect either, and refers in general to the Regulation mentioned in the aspects not regulated by it to the national laws that regulate mergers of public limited liability companies, in accordance with Third Directive (art. 18 ESAE). However, although the LSA takes a position in this respect, it does not seem the same case of the Third Directive, which only makes reference to the obligation of administrators to establish the draft terms of the merger in writing, not specifying any term of validity, neither conditions of the signing (art 5 Third Directive).

Consequently, it does not seem logic to apply the indications of the TRLSA in this respect, when they do not come from the Third Directive, when the Spanish cooperative law, to which the ESCE refers in what this does not regulate, it does contain requirements in this respect. Also, the reference of the ESCE to the legislation applicable to the public limited liability companies “regarding terms of merger” seems to refer more to aspects related with its contents than to formalities to carry out from it.

Therefore, given the reference in what is not included in the ESCE regarding the applicable legal order to merger of cooperatives of the Member State to which each cooperative is subject, the provisions in Law 27/1999, or in the pertinent Autonomous Community law shall apply. Therefore, according to Law 27/1999, the managers of cooperatives will approve the draft terms of the merger, and after this, they should refrain from carrying out any act or any contract that could create obstacles to its approval by the general meetings or modify the proportion of the disappearing cooperative members’ share in the resulting cooperative (art 63.5. Law 27/1999). On the other hand, the draft terms of merger will have no effect if the merger is not approved by all the cooperatives involved within 6 months from the date of approval by administrators (art. 63.6 Law 27/1999).

Identical indication and time limit is included in the 13 autonomous cooperative Laws (in some cases for reference to Law 27/1999), except for the Cooperative Law /1999, of 30 March, of the Community of Madrid that establishes 4 months.

It should also be pointed out that in spite of the questions presented when deciding which articles to apply, the specifications and the suitable term of validity for Law 27/1999 coincide with those provided by the TRLSA (art 234 TRLSA).

### **3.2. Independent Experts’ Report**

Clause i) of the draft terms of the merger defined by the ESCE points out another substantial difference regarding the process established by Law 27/1999. The obligation imposed to each cooperative of commissioning one or several independent experts a written report about the content of the draft terms of merger provided by article 26 of the ESCE and not included in Law 27/1999.

This is another example of the approach of the crossborder cooperative merger to the merger of public limited liability companies, since this report is part of the documents that the administrators should commission in the mergers of public limited

liability companies regulated by the ESAE (art 22 ESAE), which is also referred to in the procedures of formation by merger regulated by the Third Directive (art 10 Third Directive), and in consequence in those processes governed by the TRLSA, (art. 236 TRLSA).

The ESCE confers all cooperatives the possibility to commission one report, although only when their national laws so permit. In Spain, the TRLSA, to which we refer since the cooperative law does provide for this demand, includes that possibility (art. 236.2. TRLSA).

Regarding the contents of the report, the ESCE only states that it should include an opinion about the share exchange ratio or the value of the shares to be distributed in exchange for the assets of the merging cooperatives, which shall be aimed at being part of the documentation on the merger available for the members.

Regarding experts' rights or obligations, the ESCE also specifies that (art. 26), the public limited liability companies law shall apply by analogy. Therefore, the ESAE specifies that these experts shall be authorized to request to each one of the merging companies any information they consider necessary (art. 22 ESAE). Regarding their obligations, the ESCE does not include anything, thus if we refer to the TRLSA (236.4.), in accordance with the Third Directive (art. 10.2.), we find that they shall draft a report which includes the methods followed for the determination of the exchange relationship, as well as their adequacy, by mentioning the values each one of them leads to, as well as the possible special difficulties.

As for the appointment of the experts or independent experts, it shall be carried out (art 4.6. ESCE) upon applying by analogy the national Company law of the SCE's registered office. In Spain, the TRLSA (art. 236) states that the commercial registrar of the registered office of each cooperative designates the expert or independent experts at the request of their administrators. If only one report is to be requested for all the societies, it specifies that the business registrar of the new society's registered office (acquiring of new formation) shall be the person responsible to appoint them.

### **3.3. Administrators' Report**

Another obligation of the administrative body of each cooperative in crossborder mergers is to draft a comprehensive report which explains and justifies from the legal and economic point of view the draft terms of the merger, especially the exchange ratio, and also includes any special difficulty during the evaluation process (art. 23 ESCE). Again, this brings us closer to mergers of companies or firms, and appears away from the Spanish cooperative law in force, since an identical requirement is included in article 9 of the Third Directive, as well as in article 237 of the TRLSA, which on the other hand, should depend on the merging societies resulting in a SAE, as this aspect is not included in the ESAE, and the abovementioned statute refers to the Company law, as we have already said.

It should be pointed out that article 63.7.b) of Law 27/1999 includes the administrators' obligation of drafting a report, but it only indicates that it shall express



the adequacy and effects of the merger proposed. Therefore, it does not define it as a document aimed at justifying the draft terms of merger in their legal and economic aspects, but rather it is aimed at expressing the management or administrative organ's opinion about the merger, as well as the effects and consequences it is expected to generate.

With regard to the drafting of the report according to the ESCE, applicable therefore to merger of crossborder cooperatives, there are several bibliographical references about their content, as it has identical characteristics to the report of similar transactions in companies or firms. In this sense, LARGO, R. (2000, p. 449) recommends that administrators select those headings of the draft terms of the merger with a special interest for the members and emphasize them, especially those related with the valuation and the establishment of the exchange ratio, according to the TRLSA.

### **3.4. Public disclosure of the draft terms of Merger**

Regarding the publication of the draft terms of merger, the ESCE refers us to the Company law again, which will apply by analogy to each merging cooperative, although it indicates that the additional national requirements of each Member State should also be respected. In addition, it specifies that the publication of the draft terms of merger in the Official Journal should include the following information (art. 24 ESCE):

- a) the type, name and registered office of each merging cooperative;
- b) the address of the place or of the register in which the statutes and all other documents and particulars are filed in respect of each merging cooperative, and the number of the entry in that register;
- c) an indication of the arrangements made in accordance with Article 28 for the exercise of the rights of the creditors of the cooperative in question and the address where the complete information on those arrangements may be obtained free of charge;
- d) an indication of the arrangements made in accordance with Article 28 for the exercise of the rights of the members of the cooperative in question and the address where the complete information on those arrangements may be obtained free of charge;
- e) the name and registered office proposed for the SCE
- f) the conditions determining the date on which the merger will take effect pursuant to Article 31.

The ESCE does not provide further explanations on the Official Journal to publish the mentioned information, what leads us, given its reference to the Company law concerning the disclosure of the draft terms of merger, to consult the ESAE. In this

context, the ESAE includes identical requirement for the publication of the information mentioned about the merging societies, and states that it will be published in the Official Journal of the Member State where each cooperative has its registered office.

The questions that raises concerns also the form in which the SCE should disclose the draft terms of merger. There is no specific reference in the ESAE, what leads us to consult the provisions for companies or firms in each Member State, in accordance with the Third Directive. Its article 6 states that the draft terms of merger will be subject to public disclosure according to the forms foreseen by the legislation of each Member State, in accordance with article 3 of Directive 68/151/CEE, for each one of the merging companies, at least one month before the date of the meeting of the general Assembly called to decide on the draft terms of merger.

The Spanish norm, adapted to this directive, establishes that the administrators of the public limited liability companies involved in a formation by merger are obliged to deposit a copy of the draft terms of merger in the corresponding Business Register to each one of the merging cooperatives, then the qualified inspector shall inform the Head Office Business Register for its immediate publication in the “Official Bulletin of the Business Register”, on the deposit and the date; the General Meeting to decide on the merger shall not be called before that deposit (art. 226 of the Business Register’s regulations, hereinafter RRM<sup>1</sup>).

Therefore, we understand that the administrators of the Spanish cooperatives involved in a merger under the ESCE shall deposit the draft terms of merger in the Business Register, and then the registrar shall appoint the expert or independent experts, as mentioned above, who shall draft the report for the members and follow the disclosure requirements.

### **3.5. Information to Members**

The members of the merging cooperatives are entitled to consult the documentation listed in Table 3 in the registered office of the cooperative, at least 1 month before the date of the general assembly of the merger, and they can request a copy or summary at no charge (art. 25 ESCE) 25 ESCE).

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1. Royal Decree 1784/1996, of 19 July, adopting the Business Register’s regulations. BOE no 184, 31 of July 1996.

**TABLE 3.**  
**INFORMATION TO PROVIDE TO MEMBERS IN THE REGISTERED OFFICE**  
**ACCORDING TO COUNCIL REGULATION (EC) NO 1.435/2003 ON THE**  
**EUROPEAN CO-OPERATIVE STATUTE, AND THE COOPERATIVE LAW 27/1999**

ESCE	Law 27/1999
Draft terms of the merger	
The annual accounts and management reports of the merging cooperatives for the three preceding financial years.	The annual accounts and management reports of the merging cooperatives for the three preceding financial years, and if applicable, the auditors' reports
An accounting statement drafted in accordance with the provisions applicable to the internal mergers of public limited liability companies, to the extent that such a statement is required by these provisions;	The merger balance of each one of the cooperatives when different from the last annual balance approved. Merger balance shall be the last annual balance approved, to the extent that it had been closed within the six months previous to the meeting that has to decide on the merger.
The experts' report on the value of shares to be distributed in exchange for the assets for the merging cooperatives or the share exchange ratio as provided for in Article 26	
The report from the cooperative's administrative or management organs as provided for in Article 23.	The reports, prepared by the Decision-making Councils of each one of the cooperatives on the convenience and effects of the merger projected.
Included in the SCE's draft terms of merger	The draft Statute of the new cooperative or the entire text of the amendments that have to be introduced in the Statutes of the acquiring cooperative.
	The Statutes in force of all the merger cooperatives.
	The list of names, last names, age, if natural persons, or the names or registered office if legal persons and in both cases, the nationality and the address of the consultants of the merging companies and the date from which they hold their positions, and if applicable, the same indications of those who will be proposed as consultants as a consequence of the merger

Source: Own elaboration from the ESCE and Law 27/1999.

As pointed out in Table 3, the information provided to the members is very similar to the information detailed in Law 27/1999; some aspects should be highlighted:

Regarding the accounting statement regulated by the ESCE, drafted in accordance with the provisions applicable to internal mergers of public limited liability companies (When the provisions require the drafting of the accounting statement), we refer to the TRLSA, which provides that each company shall use as merger balance the last annual balance approved, provided that it had closed within the six months previous to general meeting that approved the merger. Otherwise, a merger balance shall be

drafted *ex profeso* and different to the last financial year balance approved, which will be carried out following the same methods and approaches of presentation of the last annual balance, in addition to being closed after the first day of the third month previous to the date of approval of the draft terms of merger. At the same time, the merger balance shall be verified by the society's auditors, provided that there is obligation to audit, and subject to the board that decides on the merger (art. 239 TRLSA).

The circumstances established by Law 27/1999 and those provided by the ESCE, for which a cooperative involved in a merger should draft a new merger balance are identical, although these latter take into consideration two requirements with regard to this accounting statement that was not covered in Law 27/1999: to be closed after the first day of the third month previous to the date of approval of the draft terms of merger, and to be audited, when the society is required to audit its accounts.

Law 27/1999 does not include either in the information to provide to members the expert's report about the value of the shares to be divided in exchange for the assets of the cooperatives, which as we have mentioned previously, does not consider the exchange ratio either. Nevertheless, we consider that such requirement benefits members in any case, as the independent expert's report on the economic agreements of the merger is an additional guarantee.

On the other hand, unlike Law 27/1999, the ESCE does not include among the documentation to consult by members the statutes that will govern the new society, since they are part of the draft terms of merger, or the statutes of the rest of societies involved in the merger.

Lastly, the information regulated in the ESCE does not include either the relationship of the consultants of the merging societies and the date from which they will hold their positions, and if applicable, the same indications of those who will be proposed as consultants as a consequence of the merger.

This deficiency is somehow beyond understanding, since it does not exist in the case of mergers to form a SAE. In fact, this information is provided to the members in the case of Spanish public limited liability companies involved in the formation of a SAE, since although the SAE regulation does not include in any article on the information to provide to members, it is complementarily applied to the TRLSA, which indeed includes it (art 238 TRLSA).

### **3.6. Approval of the Merger and disclosure of the agreement.**

The ESCE specifies that the merger shall be approved by the general meeting of each merging cooperative. However, it does not state the type of majority required, therefore, according to article 20, which states that for those aspects not provided in the ESCE, the national legislation of the Member State regarding formation of cooperatives by merging shall apply, the Spanish cooperatives shall require the majority provided for by the Cooperative Law by which they are regulated (autonomous

or Law 27/1999). Thus, in the case of Law 27/1999 it is two thirds of the votes present and represented (art. 64, law 27/1999); the majorities stated in the rest of the autonomous Laws are shown in table 4.

Once the merger is approved, the ESCE establishes that each cooperative makes it public, through the procedures foreseen in the legislation of each Member State, in accordance with the legislation that regulates the mergers of public limited liability companies (art 32 ESCE). Therefore, in the case of the Spanish cooperatives involved in a merger, and following a similar procedure as in public limited liability companies, it shall be published three times in the “Official Journal of the Business Register” and in two newspapers of large circulation of the provinces in which each society has its registered office, including in each announcement the right of each of the members and creditors to obtain the entire text of the agreement adopted and the balance of the merger (art. 242 TRLSA).

### **3.7. Protection of the interests of creditors, bondholders and members.**

Regarding the rights of those creditors of the merging cooperatives, as well as of the bondholders, the ESCE refers again to the company law on mergers of the Member State in which each participant cooperative is registered (art 28 ESCE).

Therefore, new differences will arise between their rights, given a national and a crossborder cooperative merger.

Consequently, although Law 27/1999 has a deadline of 2 months from the publication of the merger announcement, during which creditors (it does not specifies whether bondholders or not) can oppose to the merger, the LSA, concerning crossborder cooperative mergers has 1 month, starting from the date of the last announcement of the general meeting’s agreement, giving the same term to bondholders, provided that the merger had not been approved by the bondholders assembly (art. 243 LSA).

Regarding the safeguarding of the members in disagreement with the merger, not considered by the ESCE, we should refer to the cooperative law of the Member States of the merging cooperatives, which in Spain corresponds to the provisions of the different autonomous cooperative laws and Law 27/1999. Thus, this latter establishes for these members the right to cancel their membership from the cooperative, provided that it is requested in writing to the President of the management or administrative organ within forty days from the publication of the announcement of the agreement. The merging cooperative should also assume the obligation of liquidating them their contributions within the period established under Law 27/1999 for the case of justified cancellation of membership and according to the statutes of the cooperative of the member (art. 65 Law 27/1999). The autonomous cooperative laws establish the same procedure, although they differ in the deadline to send the writing to the management or administrative organ, as shown in Table 4.

### **3.8. Control of the procedure and the legality of the Merger and registering of the SCE**

Each merging cooperative shall control the legality of the merger, in compliance with the legislation applicable to the cooperative merger of the Member State to which it is subject, and failing that, in accordance with the dispositions applicable to the internal mergers of public limited liability companies. The ESCE also states that a court, a notary or another competent authority shall issue a certificate to confirm the completion of the acts and formalities before the merger (art. 29 ESCE).

This certificate will be submitted later on by each cooperative to the competent authority regarding control of the legality of the cooperative merger concerning the merging and constitution of the SCE (failing that, of the merger of public limited liability companies) of the Member State of the future registered office of the SCE, within six months from its issuing, and a copy of the draft terms of merger approved by the cooperative (art. 30. ESCE).

The mentioned authority shall verify in particular that the cooperatives have approved the draft terms of the merger in a similar way, that the dispositions regarding the involvement of employees as provided by Directive 2003/72/CE, and that in the cases of merger by acquisition, the constitution of the SCE is adjusted to the conditions laid down in the legislation of the Member State of the registered office.

These formalities are a necessary condition for the registration of the SCE, which will take place in accordance with article 11 of the ESCE in the Member State of its registered office, in the register stated by its legislation in accordance with the legislation of public limited liability companies, which seems to lead us – if the registered office of the new SCE chosen is in Spain - to register it in the Business Register.

**TABLE 4.**  
**MAJORITY REQUIRED TO APPROVE A MERGER IN THE SPANISH**  
**COOPERATIVE LAW AND DEADLINE FOR CANCELLATION FOR MEMBERS**  
**IN DISAGREEMENT**

Cooperative law	Majority for the merger agreement	Separation time limit for members from the publication of the latest announcement of the merger agreement
País Vasco	2/3 of votes present and represented	40 days
Navarra		30 calendar days from the publication of the announcement of agreement in the Official Journal of Navarra
Extremadura.		40 days
C. de Madrid.		1 month
C. Andaluza.	1 call: 3/5 votes present and represented 2 call: 2/3 votes present and represented	
Law 27/1999).	2/3 of votes present and represented	40 days
Galicia.		2 months
Aragón.		1 month
La Rioja.		40 days
Castilla y León.		1 month
Cataluña.		
Castilla-La Mancha.	2/3 of votes present and represented	40 days
C. Valenciana.	2/3 of votes present and represented, which in turn represent the majority of votes of the cooperative	40 days from the adoption of the agreement or the reception of the agreement if absent from the meeting.
Baleares.	2/3 of votes present and represented	1 month

Source: Own elaboration from cooperative legislation.

In fact, articles 11 and 12 of the ESCE direct the SCE to the application of the rules of disclosure established by the First Directive for public limited liability companies, which according to Vicent (2004), “will determine the registration of the SCE in the Business Register, since there is a Community interest in a unified disclosure in all the legal forms of company, and without a doubt of the SCE, what does not condition the legislative competence of the Autonomous Communities.”

In Spain, the different Cooperative Registers have the competent authority in what concerns the legality of formation of cooperatives by merger. In fact, as stated in

article 4 of Royal Decree 136/2002, which approves the Regulation of Cooperative Registers (RRC), the qualification and inscription of co-operative societies is one of its objectives, as well as the acts and legal businesses provided for by Law 27/1999 and in the Regulation itself.

Regarding public limited liability companies, and “article 231 of the RRM, it is deduced that the control of the legality requested by the mergers by the Third Directive is attributed to the commercial registrar corresponding to the registered office of the acquiring company or of the new society, after the inspectors corresponding to the registered office of the disappearing societies have declared the nonexistence of register obstacles for the merger, in connection with each one of those societies” (Sánchez, 1998).

However, in the field of cooperatives, we do not find completely logic that the ESCE refers to the Business Register regarding the deposit and disclosure of the draft terms of the merger, and entrusts it that once the draft terms are received appoints the experts in charge of its analysis; and at the same time, once approved the merger make the agreement public, and register the new SCE if the registered office of the resulting entity is in the Spanish territory, and on the other hand, the Cooperative Registers are in charge of the legality of the merger. In fact, unlike the Business register, which covers the explicit procedure for mergers, the Cooperative register does not mention this aspect.

On the other hand, when registering the SCE it is essential to have reached an agreement of the employees’ involvement in the SCE, pursuant to article 4 of Directive 2003/72/EC, which shall detail, among others, the composition of the employees’ representative body, which shall decide, among other aspects, on the division between the employees’ representatives of the different Member states, of the positions in the administration or supervisory body of the SCE.

In addition, regarding the labor conditions of the workers of the different cooperatives involved in the merger, they shall be transferred to the SCE. In fact, article 33.4. of the ESCE specifies the transfer to the SCE of the rights and obligations of the participant cooperatives regarding employment conditions, individual or collective, derived from the legislation and national practices, of the individual contracts or of the industrial relations on the date of registration.

Finally, upon registering the merger, the ESCE specifies that the SCE shall report immediately to the members of the acquired cooperative on its registration in the register of members and on the number of shares they have.

#### **4. CONCLUSION**

Undoubtedly, the ESCE is a highly valuable tool for European cooperatives regarding the reorganization and restructuring of its activities on a Community scale, enabling the constitution of cooperatives integrated by members (natural and/or legal persons) from different Member States, and allowing them to overcome the obstacles



for the merger operations, given the different laws in force in the UE countries.

Thanks to this statute, the formation of a SCE by merger appears as a concentration transnational formula that European cooperatives may choose, which will allow them to intensify their presence in the whole European area.

The articles of the ESCE that regulate mergers are characterized, among other aspects, by a constant reference to the current legislation regarding formation by merger of public limited liability companies, being distanced in many cases from the dispositions in this respect covered in the Spanish cooperative law.

On the other hand, we find in the ESCE some lacks with regard to the Spanish cooperative legislation. In fact, it does not consider the possibility of participation of non-cooperative societies in a merger aimed at an SCE, and refers in its definition of the process to "Cooperative merger" (art. 2.). It does not include formulas like the so-called special merger, covered by Law 27/1999 which regulates the merger between cooperatives and other legal forms of enterprise.

In addition, the dispositions included in the ESCE concerning the applicable legislation to the SCE, sets new aspects to consider in the procedures of formation by merger, nonexistent in those of internal or national character. In fact, the ESCE establishes that the SCE shall be governed by the Regulation itself, by its statutes in those aspects specifically authorized, and in those areas not regulated or only partly regulated, by the cooperative law of the Member State of its registered office.

Therefore, the Member State in which the registered office is located will be a decisive factor for the freedom of the future performance of the SCE, since in the aspects not regulated by the ESCE, and provided that this is not explicitly referred to in the statutes of the cooperative, the rules of the Member State where it is registered shall apply. Therefore, this aspect will be considered by the merging cooperatives when deciding the type of merger to choose (formation or acquisition), the assigning of the role of the acquiring or acquired society in the cases of merger by acquisition, and in the case of merger by formation, the choice of the Member State in which to register the resulting cooperative. In addition, in the Spanish territory, the possibilities multiply, given the existing legislative plurality on cooperatives.

Special consideration should be given, for its influence on the resulting SCE from the merger, to the possibility covered in the ESCE that in the event of liquidation, the net assets (assets remaining after the payment of all the amounts due to creditors and the reimbursement of the money contributions of the members), can be allocated according to the principle of disinterested adjudication or, when the legislation of the Member State of the registered office of the SCE allows, by means of an alternative system specified in the statutes of the SCE (art. 75).

From the above, it could be considered that the cooperative's assets that cannot be divided, became distributable after the merger, provided that it had a registered office in the appropriate Member State and the option were included in the statutes. Nevertheless, we understand that the participation of a cooperative subject to the Spanish legislation in a cooperative merger that includes in its statutes such a possibility, for the purpose of asset valuation before the merger, should be related

to the formula of special merger mentioned above, in which the non-divisible social funds are dedicated according to the provisions in case of liquidation.

Finally, we should emphasize that when approaching these processes it is necessary to overcome a number of obstacles, regardless of legal considerations, derived from possible oppositions to the merger by some member of the governing bodies, managers of the cooperatives or members, differences in the operative, logistical, productive or administrative area, among others, that may appear in the cooperatives, of the difficulty that it represents to configure a new directive structuring, etc., which will be necessary to overcome during the negotiation process. In fact, sometimes they appear in national formations by merger, which will require more efforts in the case of crossborder mergers, since it will also be necessary to overcome language differences, as well as those derived from different customs and cultures in the different Member States, which undoubtedly will be reflected in their cooperatives.

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# A STUDY OF MERGERS IN THE UK CONSUMER CO-OP SECTOR

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## 1. INTRODUCTION

This paper examines mergers of UK consumer co-ops during the 20<sup>th</sup> century. There were about 1,400 of these at their peak in 1904. This didn't change too much for the first half of the century, but by the 1960s the pace of mergers had begun to gather. This reached a peak in the 70s, and has now tailed off with only about 45 societies remaining. There is currently one large national society and several large regional societies – these comprise most of the consumer co-op sector.

This study was initially prompted by the view that mergers of co-operatives does not take place easily – there are governance issues as well as institutional and ideological barriers which mean that mergers of last resort often take place; and that during periods of concentration which take place in industrial sectors periodically, co-ops are disadvantaged by this incapacity to merge, and suffer market decline or failure.

## 2. TYPES OF MERGERS

There are several types of mergers:

- Horizontal: these are within the same industry;
- Vertical: typically this involves vertical integration, when suppliers are taken over or merged. And
- Conglomerate mergers which are a mix of these two.

This paper is only concerned with horizontal mergers, since this is central to the concentration process.

### 3. CONTEXTUAL FACTORS LEADING TO BUSINESS MERGERS

The following factors are regarded as important influences on the tendency for firms to merge. The first two related to increasing globalisation, which typically involves competition from large firms. The third refers to government policies to combat globalised competition and sustain national enterprise.

- Increased international trade
- Foreign investment
- Government intervention policy
- Concentration and competition

Within a specific sector there will be initiatives to increase enterprise size to combat competition (global or local);

- This is to exert influence in markets, and because
- Large enterprises influence institutions, and government policy;

This can be seen in sector trends where in many cases increased concentration may be seen over a period of time (as measured by market share of the top 5 firms).

Concentration and competition are regarded as particularly important. Mergers, in this view, arise because of level of competition in the sector and the extent to which there is a high degree of competition within the industry. Thus if there is a higher level of competition, there will be strong pressure for improving efficiency and this may lead to mergers. They are a defensive reaction against high competitiveness [NB a related factor is the extent to which a sector is closed/protected from outside entrants]. In this perspective mergers would impact on competitiveness in a sector. This would influence the level of concentration in the sector.

Concentration (in an industry) may be measured by the level of business held by the largest firms in an industry - for example, the five firm concentration ratio is the proportion of industry assets accounted for by the largest five firms. (cf. Top 5 firm concentration ratio (Gough, 2000, pp. 109)). It is also possible to consider other dimensions of size, such as total assets, employment, turnover, etc).

**Institutional Factors** also play a part in influencing mergers – in particular deregulation reduces protection in a sector, and increases competition.

### 4. HYPOTHESES ABOUT MERGERS

The **initial hypotheses** which prompted this study were to do with observations that in economic downturn, and in response to waves of concentration in sector co-operatives didn't appear to merge at the same rate as conventional business; and a recognition that there appeared to be barriers to mergers in social economy organisations.

In terms of conventional business the rationale for mergers is regarded as being due to the following drivers: greater profitability, speculative motives, stakeholder/manager motives. Real changes to demand or costs are said to be due to increases in the market power or reduction of costs of the firm.

#### 4.1. Greater profitability through economies of scale

It is argued that mergers can lead to a reduced cost base (economies of scale or greater efficiency (cf. Gough, 2000, pp. 95-96). There is a strongly held view that many industries have an economy of scale which leads to increasing size of business organisation. The reasons for economies scale may be to do with facilitating specialisation of labour, the use of more efficient machinery and equipment, and the advantages of bulk buying. Size may also improve a firm's ability to raise capital and so reduce costs in this way.

However, dis-economies of scale may be incurred because of transaction costs and information costs associated with larger size. Thus dis-economies may be due to bureaucracy of larger organisations and inflexibilities to do with larger scale business systems. And there are economic theories that indicate that there may be a minimum cost for a specific size of a particular organisation in a particular sector/industry. Organizations tend to cluster around the minimum point of this cost output curve.

The evidence seems mixed: in studies of economies scale in building societies (mutual savings and loans societies) there is a study by Ghosh (1974) who found that there was no clear evidence of *economies of scale* in building societies, because there was no clear association between management expenses and size. There have been other studies such as Greer who argues that data justified mergers into larger units; whilst Gough found that larger building societies were not more efficient.

Whilst Gilchrist and Rothwell (1998) argue that there are clear advantages of economy of scale for the larger group of organisations in their sample. We may conclude on the evidence of the building societies that there is not clear evidence of economies of scale, and that there may be other factors that work explaining difference in cost base such as the importance of the number of branches for example.

#### 4.2. Greater profitability through greater economic power (due to size)

Another way of examining efficiency is to do with profitability - here the argument is that large profits may be as a result of *market power*, and this may or may not reflect efficient scale of operations. Market power may be increased by improving the demand characteristics for firm's products or raising various entries in the market.

However Gough (ibid) found in his study there was no clear relation between profit and the size of building societies. However there does appear to be evidence that there are economies of scale for very small societies. But the evidence for larger societies is weak and inclusive. But this view may be confirmed by evidence of

patterns of mergers in the building societies sector that have shown that the majority of these have been amongst smaller societies (Gough, 2002)

In the building society sector there has been a general increase over the years from 1950 onwards, in the five firm concentration ratio (the higher the concentration, the lower the competition - this is the argument although one can make competing claims.). Those might be argued in the case of the largest retailers in the UK (Tesco's, versus Sainsbury's, versus Wallmart/Asda).

#### **4.3. Speculative motives (share prices)**

Speculative motives - this theory is due to shifts in the expectations of share holders and non shareholder either optimistically or pessimistically leading to incentives by non owners to buy the shares and so opening up possibility of mergers or takeovers. (This situation does not apply in most social economy organisations).

#### **4.4. Stakeholder motives – especially managers**

This refers to growth or its associated rewards:

a) Growth as a business objective

b) Serving interests (and rewards) of different stakeholders

Directors	to achieve more challenges
Managers/staff	to gain more pay + better conditions
Members	to gain a bonus or additional payments on merger;
Customers	to achieve better service/lower cost.

In addition there are interesting views on the profits of promoters of mergers versus the insider (manager) who gains due to their better information. There has been some evidence (e.g. Gough) indicating that mergers are generally unprofitable from the perspective of the stockholders of the acquiring companies.

There are several alternative theories about the goals of large business organisations that fit with this managerialist perspective; many emphasise that managers are actively pursuing their own ends in relation to salary, status, prestige, etc. And several theories emphasise the trading of profits against growth. This is because size is more often closely related to the managerial goals just mentioned than profit; thus a larger organisation tends to provide larger salaries to create greater status and prestige for its executives, and provide better promotion opportunities. There are several theoretical perspectives associated with this view:

Baumol sees the "managerial" theory of the firm as a maximization of sales revenue; Marris sees the theory of the firm as a maximization of growth; and Williamson sees the managerial theory of the firm as maximizing managerial utility.



In contrast, and again associated with this perspective, reasons for failure of proposed mergers or poor subsequent performance may be due to:

- No jobs for managers, relocation problems
- Branch and business incompatibilities  
(thus proximity may be a factor in mergers – location of head office).

Thus barriers to mergers may be due to senior managers not having a position in the new structure, decisions about the location of head offices, especially if they are some distance apart; and changes in the balance of power amongst senior managers.

On the other hand smaller organisations have the advantage of a smaller “distance” between people dealing with investors and borrowers and managers dealing with the policy matters. This thus reduces problems of agency and information problems. Smaller organisations also have the advantage of being closer to their community having possibly more limited, but more local activities with a lot of informal links between the customer base and members of the organisation. Thus there are countervailing influences on mergers.

## **5. CO-OP MERGER HYPOTHESES**

There are, in addition to conventional business pressures (and hypotheses) towards mergers, a number of hypotheses specific to co-operatives that may explain the tendency to merge or to avoid merger.

### **5.1. Defensive – mergers of last resort**

Dewey (1961) has put forward the view that mergers are in inexpensive way for failing firms to liquidate their assets - a merger of last resort. There may also be tax advantages in mergers.

In co-operative sectors, mergers of last resort are frequently said to occur in the co-operative sector, and there is plenty of evidence to support this view. Such mergers occur when there is no alternative other than economic failure, due to liquidity problems, fraud, and protecting the interests or investments of members, etc.

### **5.2. Co-operative - relations between co-ops**

In principle if a co-operative wants to merge, it is likely to find greater understanding of its distinctive character from other co-operatives, so mergers with other co-ops is likely to be preferred. In addition since co-operation between co-

operatives is a co-operative principle, such mergers may arise from a partnership built up over a number of years.

### **5.3. Institutional factors outside – deregulation**

In some areas of the world, co-operatives have some protection given to them by the state, often in exchange for fulfilling a state objective – such assisting a poor community, developing poor farmers ... However with increasing globalisation such bargains are being re-assessed and markets are becoming more deregulated. This deregulation is likely to increase competition and the pressure to merge.

### **5.4. Institutional factors (within sector)**

There may also be institutional factors that support mergers. Thus government policy may favour the creation of larger co-operatives (or federal bodies); co-operative unions or federations may have policies favouring mergers, etc. In the UK for example there have been several national federation reports favouring merger e.g. Wilson Committee for building societies (Gough, pp. 158), and in the co-op sector several committee reports recommending mergers (see later details).

On the other hand various institutional factors may inhibit mergers, thus an ideology (co-operative principle) favouring co-operation between co-operatives is likely to inhibit competition between co-operatives, or at least find ways of managing the boundaries of such competition (at the geographical boundaries for example, or by product/service differentiation).

### **5.5. Lack of co-operative mergers – hypotheses**

This leads into a consideration of hypotheses for a lack of co-operative mergers. And it is possible to suggest 4 possible ones, the first three of which are interlinked.

#### *5.5.1. Weak Governance Structures*

As argued in another paper (Spear, 2004) co-operatives and mutuals have weak governance structures due to a lack of institutional investors and difficulties mobilising large numbers of members through the democratic process to exert governance pressure on boards. Thus boards are often reactive to managers rather than exerting effective control and direction on the enterprise.

### *5.5.2. Weak market for corporate control*

In addition, due to the difficulties of accumulating shares (one person, one vote), and a lack of institutional investors, the market for corporate control is weak and under-developed. This means the threat of hostile takeovers is virtually non-existent, thereby reducing a pressure to merge with a friendly partner.

### *5.5.3. Autonomy of managers*

And given the above context, there is less pressure on managers, and thus have more autonomy than in conventional business. By the law of averages some managers will be less effective than others, but one would expect them to lose their jobs with conventional business structures. In weaker governance contexts that apply in co-operatives, this can lead to situations of ineffective or “sleepy managers” holding sway with little prospect of dislodging them.

### *5.5.4. Local/community roots*

Many co-ops and mutuals have strong local community relations; their values and democratic structure enhance this dimension of their character, and it is regarded as a strength. Thus there may be ideological reasons for preserving this; and in addition for board members and senior staff there may be the prospect of loss of jobs and prestige, etc. associated with a merger and the moving of office headquarters, etc.

In addition there are also important issues of democracy – how to develop appropriate structures in a new larger configuration. And in cases of merger, there are issues about how dissemination of information amongst members should be conducted. For example, in the case of building societies it has not always been the case that members have been properly consulted prior to mergers; indeed a ballot is not required for transfer of engagements or in the case of a union.

## **6. MERGERS: EVIDENCE FROM UK CONSUMER CO-OPS SECTOR**

The UK context for retail consumer co-ops has seen increasing competition over the 20<sup>th</sup> century. Retail price maintenance (RPM) was abolished in 1963/4, since when price competition has gathered pace. And with this has come increasing concentration – with the largest 5 retailers (all private companies) taking a greater and greater share of the retail market. Evidence of economies of scale may be seen in a number of areas: national branding which this allows, and the capacity to invest in large out of town shopping hypermarkets. Evidence of market power can be seen

in their increasing dominance of supply chains, with periodic complaints by suppliers about the intensity of pricing pressure.

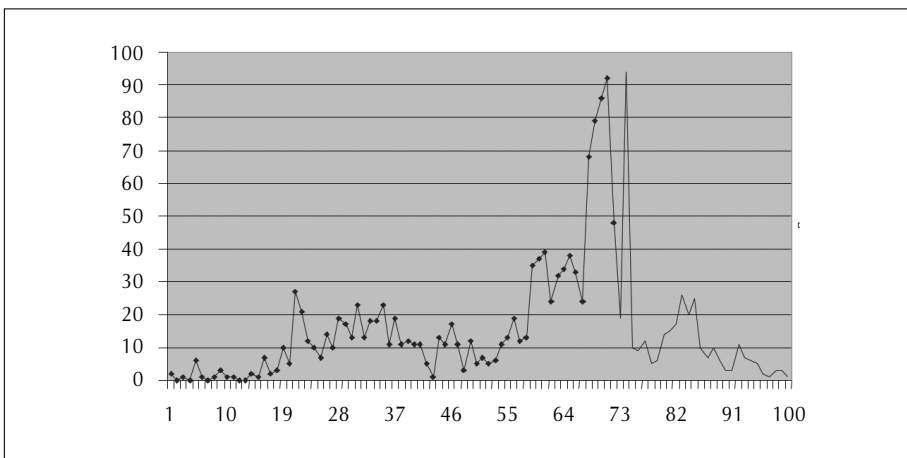
It is interesting to note that this may not represent a decline in real terms, rather a failure to grow to meet new demand – for example the turnover at 1992 prices was about £5bn in 1945, growing to £7bn in 1950, but has returned to £5bn during the period 1970-1990.

Similarly in the co-op sector the largest 5 consumer societies have increased the % of turnover amongst co-operatives from 40% in 1965 to about 90% in 1990. Recognition of the need to strengthen market power of procurement can be seen in the formation of Co-operative Retail Trading Group (CRTG), which was formed to facilitate access to co-operative buying power.

The consumer co-operative sector has seen a massive decline in its market share over the 20<sup>th</sup> century. It now has stabilised around 4% of the food market, but in 1955 this was about 20%, and around 8% in 1990.

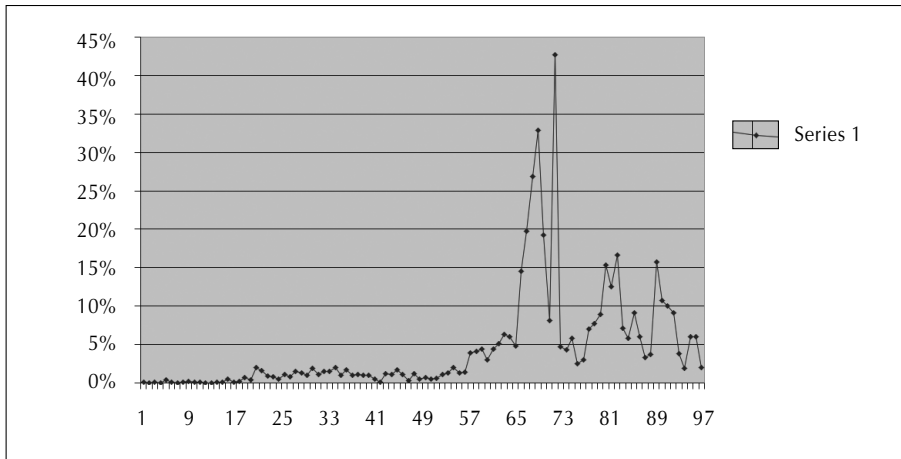
The general pattern of mergers in the consumer co-op sector has been an increase over the 20<sup>th</sup> century with some large peaks during the 60s, 70s, and 80s (see graphs below). There has been a general decline in the numbers of societies from around 1,400 in 1905, to 45 currently. At the same time membership maintained an upward path until the major waves of mergers in the 60s and 70s, since when it has been in decline (however some of this data may not be totally reliable as databases on membership have always not been well maintained).

### UK MERGERS DATA . NO. MERGERS YEAR FROM 1900



NB Peak years for mergers were in 1970 and 1973.

### UK MERGERS DATA . % MERGERS / TOTAL SOCIETIES FROM 1900-2000



The deregulation of retailing through the abolition of retail price maintenance in 1963/4 seems to have had a clear effect in a steady growth of mergers during the 1960s, and this was followed by a decade of intense price competition in the 1970s.

Preliminary analysis of the data shows that mergers of last resort were quite a small proportion of the total: 11.3%. However this is assessed by quantifying takeovers by CRS (the “ambulance service” of the movement), and there undoubtedly will be additional numbers to be added to this when the data is fully validated and analysed.

And failures were surprisingly low at 6.2%. However mergers of last resort represent a category of “almost failures”.

Overall the picture is one of apparent reluctance to merge, and the two peaks can only be explained by institutional factors internal to the movement – see next section.

## 7. INSTITUTIONAL FACTORS ASSOCIATED WITH MERGER IN THE CO-OP SECTOR<sup>1</sup>

A major factor that may push firms towards mergers is the attitude of influential bodies such as the registrar of friendly societies (in the social economy sector). And

1. Note that in building societies, the influence of registrars is clear (see the Wilson committee report on the functioning of financial institutions (HMSO, 1980). The recommendations in relation to building society included recommendations to give the registrar greater powers in promoting mergers in the case of particular societies facing difficulties. (Chapter 24).

there have been suggestions that the registrar is in favour or has been in favour of mergers in the past. In addition bodies such as the Co-operative Union have from time to time had committees that report on the size and structure of the sector and have advocated an increased level of merger particularly between smaller societies.

In the last century the role of co-operative institutions is very interesting, particularly the increasing pace of activity after 1958, and the move from campaign type of activity through report, to plans. In particular it seems that the peaks of merger activity in the charts above can be clearly related to institutional interventions –see below.

## 8. SUMMARY OF INTERVENTIONS BY CO-OP INSTITUTIONS

1914	Amalgamation ‘campaign’ begun by Co-operative Union as overlapping and competition between societies increases.
1919-20	‘General Survey Report’ points out the benefits of large societies from the economic standpoint as well as a remedy for overlapping.
1938	CU ‘Economic Survey Report’ (J A Hough) determines areas where amalgamation ‘deemed necessary’.
1958	Independent Commission Report. Sets a target of the ideal number of societies as 200 to 300 at a time when total was approaching 1,000. New initiative is called for from Co-operative Union. Minority report calls for a National Society.
1960	CU National Amalgamation Survey. Recommendations would reduce the number of societies from 875 to 307. ‘The large number of societies places the Movement under a severe handicap in competing with the multiples’.
1965	Joint Reorganisation Committee. Concern about Movement’s fragmentation - proposes central buying agencies.
1967	CU ‘Regional Plan for Co-operative Societies’ - aims to reduce number from 467 to 50 in England, Wales and Ireland. Scottish position left to Sectional Board and SCWS. Plan inspires reduction of one third by April 1970.
1970	North Eastern Society formed with considerable sponsorship from CWS. Seen as a special case because of problems (eg decline of staple industries) in area. Over 30 societies come together.
1971	Regional plan for Scotland - 100 societies to be reduced to 5.
1983-85	CU Merger Unit formed to give impetus to amalgamation programme.
1995/96	CU Strategic Review - sees no support for single society and advocates strong regional societies.

## 9. CONCLUSION

These preliminary findings on mergers in the UK consumer co-operative sector clearly show increasing pressures to merge. They indicate clear evidence of economies scale/power and an increasingly powerful private sector. However there seems to have been a distinct reluctance to merge spontaneously – thus there was a delayed response to the deregulation embodied in the abolition of retail price maintenance. Preliminary findings indicate that there were relatively few failures, but a more general failure to compete is evident (declining market share). And one of the key findings is the key institutional role of federal bodies in promoting mergers. Thus federal structures have important competitive features for a co-operative sector.

Increasing size has also resulted in declining membership levels (relatively), thus there are issues of democratic deficit to be addressed (but Spear, 2004, shows that these are not irreversible trends).

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**PART 7**  
**COOPERATIVE PRINCIPLES**



# MATURE CO-OPERATIVE GROUPS SEEKING NEW IDENTITIES: THE CASE OF BELGIUM

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## 1. INTRODUCTION

The co-operative sector in Belgium has been characterised by a number of very distinctive features. The majority of the co-operatives in the country belonged to the major social movements that the country has known since the late nineteenth century and that have since become part and parcel of the neo-corporatist social system of the country. These social movements, the Christian workers' movement, the Christian farmers' movement and the socialist movement were the backbones of the so-called "pillars" of the Belgian socio-political formation. The co-operatives played a peripheral and instrumental role in these social movements and mainly supported the dynamics of their trade union and mutual wings (see Kwanten, 1987 Gerard & Martens, 1981). Since the nineteen nineties the remaining co-operatives that were mainly operating in the banking and insurance sector, for a number of reasons, have sought new avenues. They were challenged by the centralisation, merger, amalgamation and Europeanisation movements within the banking and insurance sector in Europe.

In this article we are interested to know what the fate has been of these co-operative groups. How have they been restructured, and mainly, how have they managed to maintain *casu quo* adapt their co-operative identity and strategy? And, what role have the new paradigms of sustainable development and stakeholder management played in this?

The focus in this article is on the two most important (in terms of members, clients and assets) co-operative groups in the country. The first co-operative group, now called Group ARCO, has its origin and still belongs to the Christian workers' movement of Belgium. The second group, now called Cera, has its roots in the Christian farmers' movement and is the Belgian wing of the Raiffeisen rural co-operative movement.

In the text we will first focus on the distinctive features of the Belgian co-operative scene because, as we will see, the changes and transformations in the co-operatives are to a great extent path dependent in the sense that structural and institutional characteristics profoundly influence and determine the changes.

We will then make a sketch of the changes and transformations that both ARCO and Cera have undergone since the early nineteen eighties and identify their new structural and cultural dimensions. We will see that they follow a similar path but have opted for a slightly different positioning in the Belgian social and economic landscape.

In a third section we will delve into the sociological consequences of their repositioning and the trilemma it produces. Indeed, in their quest for a new position in the Belgian social and economic landscape the co-operatives have to find non-contradictory answers to the new demands of the Market, the Civil Society and the State.

The analysis is based on extensive documentary research and interviews with key-people of both ARCO and Cera.

## **2. ARCO: THE CO-OPERATIVE BRANCH OF THE CHRISTIAN WORKERS' MOVEMENT**

ARCO has opted to remain an integral part of the Christian workers' movement, which is the biggest social movement or social conglomerate in the country and particularly the Flemish region. ARCO is one of the four branches of the movement, along with the Christian trade union, the Christian Mutual Health Insurance Funds and a set of socio-cultural organisations such as a working women's movement, an adult education movement and a youth movement. These movements have always had a lot of influence on the developments of their co-operatives. For a long time, movement militants collected savings and insurance premiums and movement representatives were the directors of the co-operatives (Kwanten, 1987; Gerard & Martens, 1991). It was a system of "indirect co-operation par excellence".

The present-day ARCO has come into being after the merger of 29 regional co-operative structures. These were involved in a broad array of co-operative activities, including collective buying, travel, housing, printing, banking and insurance. The banking and insurance co-operatives played a pivotal role in these regional co-operative activities. They were also major financiers for the movement as a whole.

They were the ones that first merged and integrated in a centralised co-operative bank (BACOB) and an insurance company (DVV/LAP).

The consequence of this institutional starting point was that the Group ARCO has remained a strategic vehicle and partner of the Christian Workers' Movement and has developed its new agenda in close interaction with the movement leadership. As such its co-operative agenda, as we will see, reflects the broader multipurpose agenda of the movement.

### 3. CERA: THE NEW “RAIFFEISEN” CO-OPERATIVE

The recent history and development of the Cera is somehow different than the ARCO-history and development. The end result can partly be explained by the position Cera held vis-à-vis the farmers’ movement and the strategic choices made in recent years.

Cera, although closely linked with the farmers’ movement “Boerenbond”, always had its own inspiration, the Raiffeisen tradition, and had also more autonomy than the Christian Workers’ Co-operatives. Still, within and close to the farmers’ movement some other important co-operatives also existed. Those were and are involved in insurance, farm supply and commercialisation of products. Although belonging to the same social movement, these co-operatives had less institutional linkages and were less intertwined than was the case in the workers’ movement. Only between the financial and the insurance co-operatives did there exist close ties. Unlike the ARCO-group, Cera cut through the linkages and institutional ties with the other farmers’ organisations altogether. It has become a co-operative holding in its own right.

This stand-alone position explains why Cera needed a different stakeholder and shareholder approach than ARCO.

Before the merger and amalgamation process started, the Raiffeisen group existed out of more than 200 local and regional co-operatives that were linked to the “Central Raiffeisen” or “Cera”. These have been merged into one single co-operative holding: the Cera.

Contrary to the ARCO Cera does not have a background in a multipurpose co-operative movement. Cera’s tradition goes back to the mutual savings and credit system of the Raiffeisen-type. It is therefore no surprise that the present-day holding is a mono-holding solely involved in banking and insurance operations.

### 4. NEW STRUCTURES

With respectively 900,000 and 420,000 shareholders, both ARCO and Cera are important co-operative groups in the country. As we have seen, both had first their own primary financial societies that federated into a larger unit and later created their own bank (BACOB and Cera Bank). In order to prepare their new relationship with the financial institutions in the country the co-operative structures had to be reorganised.

#### **4.1. New structures for the co-operative activities of the Christian Workers' Movement**

BACOB, the bank of the Christian Workers' Movement, and its sister-insurance institution DVV/LAP, had an atomised shareholders structure. The consequence was that strategic and economic decisions were hard to take. The transition to a new structure and strategy was facilitated by the creation of intermediary co-operative financial holdings in which individual and institutional shareholders could invest. This was in turn instrumental in the expansion of the BACOB-co-operative bank that bought a number of smaller Belgian banks.

At the same time the fusion of the regional co-operative societies into Arcofin allowed for greater concentration of capital and a strengthening of strategic management.

In 2001, Arcofin traded its bank and insurance activities for 15,3% of the shares of Dexia Bank and –as such– became a reference shareholder of one of Belgium's most important banks.

Presently the ARCO-group brings together 900,000 individual shareholders and the social organisations it is still very much intertwined with. The Group has a total capital of some 1.5 billion Euro (ARCO, 2004).

The activities of the ARCO-group are two-tiered. One 'branch' is composed of financial co-operative societies and the other of investment companies. The individual shareholders, but also the organisations of the Christian Workers' Movement take shares in the financial co-operatives Arcopar and Arcoplus. As such they provide the financial means of the Group. These financial institutions are the most important shareholders of the investment companies Arcofin and Auxipar.

As said, Arcofin is the reference shareholder (15%) in the Dexia Bank but also a principal shareholder in the savings bank VDK that is a regional bank that also originated within the same movement.

The investment company Auxipar manages the participation of the Group ARCO in the services and utilities sectors. Through Auxipar the Group ARCO pursues a policy of diversification. Besides participation in a number of pharmaceutical co-operatives of the movement, the Group has taken important positions in companies active in wastewater treatment, energy and the environment.

The Group ARCO continues to realise its social mission through the different organisations of the Christian Workers' Movements but has also created its own services and structures to support the social movement and the wider civil society in Belgium. Important vehicles for this are Procura and Syneco that give support to the non-profit sector and the new social economy in the country.

## 4.2 New structures for the co-operative activities of the Raiffeisen-group

The Cera Bank, the bank associated with the farmers' movement also faced severe challenges in the 1990s. It had to formulate an appropriate answer to the many mergers and the Europeanisation of the banking sector. Consequently, the number of remaining local co-operative societies was reduced significantly through mergers.

The present-day Cera came into existence in 1998 on the basis of the merger between the Cera Bank, the ABB co-operative insurance company (linked to the 'Boerenbond' and the Cera Bank) and one of Flanders' major financial groups, namely the Almanij Group (the main shareholder of the Kredietbank). As a financial co-operative holding, Cera Holding regrouped the shares of the former shareholders.

Cera, first had –directly and indirectly– a 37% participation in Almanij, which on its turn is the major shareholder of the new KBC-Bank and Insurance. Early 2005 Almanij ceased to exist. With 27% of share capital directly and indirectly the Cera became the reference shareholder of the KBC-Group.

The Cera co-operative holding has presently some 425,000 individual shareholders and total capital of over 460 million Euro.

The co-operative leaders that were involved in the regional structures of the old co-operative have found a new place in the 45 regional advisory councils. They were joined by new members and presently represent some 900 shareholders. These councils have 180 representatives in the national advisory council of the holding. This council functions like the "parliament" of the holding.

Unlike ARCO, Cera discontinued the privileged relation with the broader social and farmers' movement. While, for example, ARCO gives important financial support to the international development organisation (Worldsolidarity) of the Christian Workers' Movement, Cera has created its own international branch, the Belgian Raiffeisen Foundation (Develtere & Pollet, 2004).

## 5. NEW CO-OPERATIVE MISSIONS?

Both co-operative groups were profoundly challenged by the transformations they underwent during the 1990s. Many observers foresaw a process of rapid demutualisation of these two most important co-operative groups in the country. As a matter of fact the flagships of the co-operative movements, namely the financial co-operatives and later the co-operative banks BACOB and Cera, had lost their co-operative profile and presented themselves as ordinary –but consumer and people-oriented– retail bankers.

For the leadership of both groups, the manifold interactions they had in that period with other banks and financial institutions produced moments of reflections about their co-operative distinctiveness. This feeling was reinforced by the vivid reactions to the mutations within very restricted but militant movement circles that were still very attached to 'their' co-operatives. The opportunistic reactions of some shareholders,

stirred up by shareholder-defence actors (Deminor and Modrikamen, in particular) forced the leadership to find genuinely co-operative solutions to the many tricky legal transformations they managed.

How then does the co-operative solution look like? The ‘modernised’ co-operative content of the two groups can be gauged by the way they reformulated their mission, by their partnerships, their investment policy and their member-management approach.

### **5.1. Groep ARCO: “your share in a better society”**

The Groep Arco has opted for limited change in its co-operative identity (Spiessens, 2003). Just as before the transformation, the prime mission of the co-operative holding is to manage and defend the financial and economic interests of the social organisations and the individual shareholders. Arco also insists on its social and ethical approach as a co-operative holding: non-speculative investments (by individual shareholders and by the Group as a whole) in sectors of high social importance, long-term participation and stakeholdership.

The choice for Dexia-Bank was –amongst others– motivated by the fact that Dexia itself has its origins in the “*credit communal*” which was largely owned by the Belgian cities and communes. The latter are –next to ARCO– a major shareholder of Dexia. So, in fact, we see the coming together of a co-operative bank with expertise and interests in the social profit sector and a bank with expertise and interests in the public sector.

As a second investment strategy, the group invests in the utilities and service sector. Through its investment co-operative Auxipar the Group participates in a wide variety of sectors such as water purification, the energy and environment sector, pharmaceutical co-operatives, the media, and some others.

The Group follows a number of principles in its participation policy. Investments go solely to businesses and enterprises that produce a social plus-value and pay attention to sustainable development aspects. Participation is a long-term and not a “hit and run” option. The businesses and enterprises must take into account the interests of the shareholders as well as those of personnel, clients and society at large.

The Group’s policy is to actively participate in the businesses in which it invests. As a matter of principle the Group insists on sustainability and stakeholdership within each of its partner-enterprises. This is the case for Dexia, as well as for the public utilities companies in which it invests. ARCO, for example, insists that Dexia would remain the market-leader in ethical investment funds.

Apart from this participation and investment policy the Group ARCO also develops services for its shareholders, both individual shareholders and social organisations. ARCO has a legal service that can be consulted by shareholders on a wide variety of issues such as consumer rights, family and property rights. The Group also established two non-profit organisations that support initiatives in the social profit and the social economy sector (Procura and Syneco). The interest for the new social



economy within the Group is increasing as is witnessed by the recent capital investment it has made in two financial co-operatives that provide credit to social economy enterprises (Hefboom and Crédal).

Finally, the Group ARCO also “socialises” some of its profits by supporting amongst others different segments of the Christian workers’ movement, the non-governmental development organisation of the movement (Worldsolidarity) and the Belgian Olympic Committee. This is called the “social dividend”.

In terms of member-management and participation, the Group does still follow the indirect approach. The president of the Christian Workers’ Movement acts as president of the two largest financial co-operatives (Arcopar and Arcofin). The boards of the co-operatives are composed of elected representatives of the different organisations of the movement (the umbrella organisation, the trade union, the mutual health funds,...).

## **5.2. Cera: “Investing together in welfare and wellbeing”**

Cera still explicitly refers to its Raiffeisen background. The holding advances five values that give direction to its operations: embeddedness, concertation, rural and agrarian perspective, ethic entrepreneurship and commitment of directors and management (Tanghe, 2002). The co-operative approach of Cera is reflected in the four “products” that Cera offers to its shareholders: the financial dividend, other member-benefits, social projects and participation in decision-making.

The co-operative dividend is determined every year. As is the case for co-operatives that are recognised by the National Co-operative Council, the co-operative dividend of Cera (as well as the dividend of ARCO) benefit from a tax exemption. As a matter of (co-operative) policy the dividend gives a fair but not necessarily maximum return (currently 4% + 2% bonus).

Co-operative members can also get substantial rebates on certain goods and services such as tickets for music festivals, sport events or tourism activities. The criteria used for these goods and services are multiple: they have to be collective and reach as many people as possible, they have to be non-elitist, local, substantial and if possible have a link with one of the social projects Cera supports. Cera has a double objective with this member-benefit system. It has to help for members to identify themselves with the organisation and it has to create opportunities for multiple interactions between the members and the co-operative holding.

Commitment to society is one of the major missions of the new Cera. Cera has become one of the biggest Maecenas of the country. Cera supports social projects that reflect the fundamental values of the co-operative (co-operation, solidarity and respect for the individual). Cera sees the investment in social projects as a “retribution” for past and future co-operative generations (Tanghe, 2002). Cera distinguishes between national projects that receive support from the Cera Headquarters from regional and international projects. Regional projects are selected and monitored by

the regional advisory councils of Cera. International projects are taking place in southern countries and are supported by the non-profit organisation Belgian Raiffeisen Foundation.

The 45 regional advisory councils play a key-role in the new organisation structure and dynamics. They are the regional antennas of the holding. Each board has about 20 members. Apart from their involvement in selection and monitoring of regional projects, these boards also play a role in the decision-making process of the co-operative holding. Each board has four seats in the national advisory board. With 14 of the 20 seats, these co-operative representatives subsequently have a majority position in the board of Cera.

Recently the Cera has broadened its participation approach by organising regional shareholders meetings. These meetings are used to inform the shareholders about the holding's investment policy and the social projects. In this way about 3% of the shareholders are reached in a face-to-face manner. Some 13,000 shareholders with special interests into the operations of the holding receive an e-magazine.

While the active shareholders are considered the core stakeholders of Cera, the holding also identified the KBC-group, its own personnel, the personnel of the bank, the other shareholders and the beneficiaries of the social projects as the stakeholders of its new co-operative model.

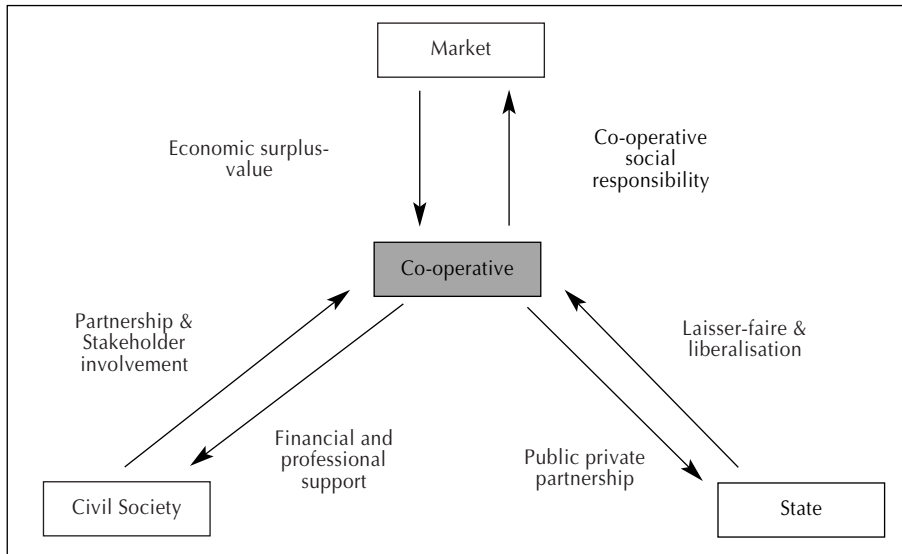
## **6. THE TRILEMMA CHALLENGING THE CO-OPERATIVE SECTOR**

The trilemma that every co-operative has to deal with nowadays is how to reconcile the imperatives imposed on every business undertaking by a complex and highly competitive market with the democratic and material claims of members and the advances of the new welfare state. Can these three objectives be reached simultaneously or do they have to be traded-off? Two is company; three is none? To put it differently: does emphasis on one or two of these imperatives crowd out the other one(s)?

The present paper does not permit us to give a full answer to these questions. But a quick look at the features of the interaction patterns of the two co-operative holdings under review with the market, civil society and the state can reveal to what extent these co-operative groups have begun to find or formulate answers to this trilemma.

The following scheme does give an oversight of the triple challenges and the responses of the co-operatives.

## THE CO-OPERATIVE TRILEMMA



### 6.1. Co-operatives and the market

One thing which all individuals and institutions involved in a co-operative undertaking require in order to benefit from the business is that it is commercially successful. Therefore they have to accept and follow the rigours and disciplines imposed by the marketplace. Much of the recent structural changes that the co-operative sector and particularly the two co-operative groups under review underwent were inspired by the desire to remain economically and financially viable. Before the drastic restructuring of the co-operative sector, the belief persisted that co-operatives could and had to correct dominant patterns in the market. In 1994, Rik Branson, CEO of the ARCO group, stated that “in former times the co-operatives wanted to regulate the market, but we abandoned this philosophy. Generally, the market is sufficiently flexible to react to aberrations on its own”.

The co-operatives under review relate in a new way to the market and its institutions. They have sought to create economic surplus-value while at the same time adding co-operative and social value. They have done so in following (and to some extent leading) the movement for corporate social responsibility in the country. But they have tried to go beyond the minimum agenda of social responsibility and work towards co-operative social responsibility. They do this by explicitly using their business operations as vehicles to reach their co-operative goals: “your share in a better society” (ARCO) and “investing together in wellbeing and welfare” (Cera). The option for CSR is thus pro-active and voluntary. And, importantly, stakeholder

management means in the first place member-management and involvement (in the case of Cera) and active linkage with civil society (in both cases). In both cases, co-operative social responsibility is also linked to concrete business options. In the case of ARCO the option is for profitable but sustainable investments in Dexia-bank (as the banker of the public sector and the social profit sector as well as the leader in ethical investments) and investments in public utilities sector. For Cera, as a mono-holding, the choice for the KBC bank was a choice for a bank firmly embedded in the Belgian society.

## **6.2. Co-operatives and civil society**

The co-operative movement in Belgium –as in any other country– has a long-standing relation with civil society. But the Belgian civil society-co-operative relation is very particular. As we have seen co-operatives were instruments of major social movements in the country and had no separate social movement mission. They had to advance the material and economic interests of particular segments in society (workers, farmers) as well as those of their movement and related institutions (trade unions, adult education organisations, etcetera). There was thus a considerable overlap between the membership of these other movement institutions and that of the co-operatives. And, importantly, there was homogeneity of interest and communality of purpose between the co-operative and the other movements. This facilitated collective decision-making.

The co-operative – civil society partnership model has changed over the last decade or so. In both cases the co-operatives have attracted a wide and sociologically very diverse group of shareholders. In this way, the co-operatives have made inroads into other segments of civil society. In the new model the two co-operatives under review have sought to harness this transition in a slightly different way. In the case of ARCO, the Christian workers' movement remains the cardinal stakeholder, the preferential shareholder and the ultimate authority within the co-operative group. In the case of Cera, a new decision-making system has been worked out in order to give shareholders a voice in both social and financial investments.

At the same time, both co-operative groups have broadened their civil society relationship. ARCO gives managerial and legal support to a very broad group of non-profit organisations. This is consistent with the general policy of the Christian Workers' Movement to develop coalitions with other parts of the country's civil society. In addition, ARCO has become the major financier of two of the most important financial institutions of the new social economy. Cera has become one of the biggest mecenass of the country and finances hundreds of local and national projects every year. This financial support comes along with professional backstopping of many fledgling new social and self-help initiatives.

The end result is that the social base of the two co-operatives is presently probably much broader than ever before, but that it is more volatile and less coherent in its demands and claims towards the co-operatives.

### 6.3. Co-operatives and the state

Co-operatives and the state in Belgium have never had intense relations. In fact the Belgian State –and the co-operative movement– opted for a very liberal co-operative legal framework and a *laissez-faire* policy. The consequence is that not all co-operatives in the country are motivated by the co-operative ideals. In 1955, a National Council for Co-operation was established to allow “real” co-operatives (those that shared the co-operative ideals) to differentiate themselves from the other co-operatives and to affirm their identity (Defourny, Simon & Adam, 2002). Co-operatives that are accredited by the National Council receive special fiscal and economic treatment, whose scope is nevertheless limited. Of the approximately 30,000 co-operatives in the country, only less than 5% is registered with the Council. This reflects the lasting poor recognition of the specific role and contribution of co-operatives in Belgian society and economy.

It is thus the co-operative sector itself that had and has to take the initiative to re-style and recalibrate the sector to make it attune with modern style economics and social relations. Thus, since the early 21<sup>st</sup> century the two co-operatives under review –together with the federation of socialist co-operatives (FEBECOOP) – have engaged in a number of activities to promote co-operation. They finance research and teaching on co-operatives, organise conferences, set-up “the week of the social economy” in universities and launched a C-day (1<sup>st</sup> of December, 2004).

These promotional efforts are not only ways intended to inform the public of the new practices in the co-operative field. It is also geared to come public with what they already did without telling anybody. As Vivet remarks the co-operative giants (notably the ARCO and Cera co-operative groups) combined an erosion and banalization of their co-operative practices in the last two decades of the 20<sup>th</sup> century with substantial financial support for the emerging new social economy (Vivet, 2000). In recent years, the two co-operative groups have increased their financial support to and intensified their involvement in the new social economy. They have become real stakeholders of this social economy that for long was very subservient to and an instrument of the (regional) state(s). They give advice to, provide management expertise and create forums for many social enterprises, work-integration enterprises and other not-for-profit organisations and businesses. Both in terms of finances and professional backstopping the co-operative groups and the State(s) have come on an equal footing. This public private partnership for the new social economy has not come on the demand of the State. It does have considerable consequences for the interests and relations in the sector since the co-operatives bring along with their money new thinking and preferences (mainly professionalism, market-orientation and stakeholder management).

The initiative for public private partnership has also come from the co-operative side for what the investments in other fields is concerned. As we have seen the ARCO group invests in the utilities sector because of concern for universal service and affordable pricing. But because these (private) companies are active in a market that remains highly regulated or controlled by the State it is no surprise that ARCO meets government(s) among the shareholders of many of these companies (Spiessens, 2003).

## 7. CONCLUSIONS

Over the last two decades co-operatives have not got a lot of public attention in Belgium. They did not call for much attention either. Much had to do with the general feeling among shareholders, social movements, opinion-makers and academics that a degeneration process had made a halt to the co-operative project in the country. In Belgium and other countries many believed that the advent of co-operative holdings would inevitably lead to a final de-co-operativisation (Côté, 2001).

The foregoing analysis of the two most important co-operative groups in Belgium to a certain extent contradicts this degeneration thesis. Both the ARCO-group and the Cera-group have recently engaged in a process of co-operative regeneration. The picture that is emerging is not a simple remodelling of the old co-operative sector. It is a new model that carries traces from the past but repositions the co-operatives in their relationship with the market, with civil society and with the State.

The traces are clear in both cases. The ARCO-group remains the co-operative wing and project of the Christian Workers' Movement. The movements' organisations are still the cardinal stakeholders and ultimate decision-makers of the group. And, ARCOs social outreach projects are developed in collaboration with the organisations of the Christian Workers' Movement. Cera continuously refers to and propagates its Raiffeisen background and values. Many of the participants in the regional and national advisory boards come from the previous co-operative structures while new participants are attracted by the co-operative values. And, the project portfolio remains profoundly impregnated by the rural and social background of the Cera.

Both groups though have explicitly reformulated their mission and have changed their *modus operandi*. They want to realise their mission not by being co-operative bankers or insurance agencies anymore, but through principal stakeholder participation in two of the major Belgian commercial banks. In the case of ARCO this also goes along with stakeholder participation in the utilities sector.

This new approach has brought about a new interaction pattern with the market, the civil society and the State. The co-operatives under review try to respond to the triple challenges stemming from these forces by combining co-operative social responsibility in a market environment with partnerships with certain civil society actors and a *de facto* public private partnership.

This seems to be the new scenario. The two co-operative groups, desirous to reformulate and reactivate their co-operative identity, have written their respective scripts. It is, however, not clear as yet how the different partners and stakeholders will react and interact. Will shareholders support the new agenda? Will the business partners accept the co-operative approach to corporate social responsibility? How will the other non-co-operative shareholders interpret the effect of it on their return on investment? Will the civil society organisations be content with the financial and professional support they receive in return for a relatively vague "partnership role" and a stakeholder position they have to share with many others? Finally, will the proposal for public private partnership induce changes in the attitude of State agencies towards the role and responsibility of co-operatives or will co-operatives continue to benefit (or suffer) from benign neglect?

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# OWNERSHIP IDENTITY OF COOPERATIVES IN THE NEW EUROPE

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Poland

At the turn of the twentieth century, Europe has focused for the fourth time on the problem of its internal integration. Although Europeans' standard of living is higher than that of any other continents' inhabitants (among the ten biggest trade countries in the world – there are seven European countries), they cannot ignore world-wide changes and threats: demographic explosion, the greenhouse effect, a revolution in biotechnology and social communication, the interrelation between *private* and *common* ownership or the contamination of natural environment. So Europeans must define not only the form of the future Europe (taking into account the expansion of the European Union), but to predict the results of global changes as well. The changes of the cooperative social-economic forms are one of them.

Today, many Europeans wonder, whether Europe can cope with the problems of integration (which has an ownership basis) while the world faces global problems. But the intellectual elite shape their future in categories of an economically, politically and culturally united identity. In a new, global reality Europeans are doomed to *communitarism* (as opposed to an egoistic individual attitude). What is essential on the way to this, is to not forget the strong relation of a communarity with its roots (with cooperativism). Europeans create a canon of their continent's principles, believing that integration is the best way of fighting global problems; some people, like Paul Kennedy, say ironically, that as Europe devotes time and effort to its own integration, it has little time to prepare itself to face global challenges (Kennedy, 1993). The force of the changes, not only in Eastern Europe is so big, that some cooperative members and cooperative theoreticians ask themselves: will cooperatives survive the transformation?

A new version -after 1989- of European integration is based on economic and political ties, but the main motive of a new, united formula is European community. European social and economic development draws our attention to the special historical role of cooperative ties in order to neutralize those conflicts that came due to privatization, poverty, unemployment – to exist in some parts of Europe. The creation of a new common economy of EU is not possible without taking into account the specific role of cooperatives to neutralize contradictions between rich and poor states and inhabitants in the western, central and eastern parts of Europe.

## **1. COOPERATIVE OWNERSHIP – AN OLD QUESTION IN THE NEW EUROPE**

The economic development of Poland shows the significant role of rapid and fundamental ownership changes. The place of cooperatives in the economy of the Polish People's Republic (PPR), in terms of ownership can be characterized by three concepts described by K. Boczar (Boczar, 1986: 185-186). The first was present for a short time just after WWII and appealed to the autonomy of cooperatives in relation to central planning and conceived of them as one of three independent sectors (alongside the state and private sectors). The second concept, which appeared by the 1950's and assumed the superiority of state over cooperative ownership, was related to a trend of eliminating many branches of cooperatives. The third concept accompanied a revival in the idea of cooperatives in the 1960's and 1970's. This took place under the influence of changes in the structure of managing the economy that underlined the special role of cooperative ownership in Poland and Hungary.

It can be noted, that the decreed understanding of cooperatives after 1989 is closer to the second of the concepts described. It is founded on the superiority of private ownership over cooperative ownership and remains subject to the aim of privatization of cooperative property.

Brodziński gives the following figures for the changes of Polish cooperatives in privatization processes: there were 19,775 cooperatives in Poland in the REGON register in 1997; the employment in cooperatives decreased over 75% in the years 1989-1996; by the end of 1996, 613,800 people were employed, 72,5% less than in 1989 - the decrease of employment was 5,3% in national economy; the total number of workers in cooperatives in 1996 was 4% of the employers in the national economy - 10% in 1995 (Brodziński, 1999: 48).

After 1989, together with the process of marginalizing cooperatives, both as a form of economic management and as a social idea, important actions were taken against this process. They defended the economic and social role of cooperative ownership under conditions of commercialization, reductions in employment, privatization and corporatization (Przeczyszewski, 1994).

If it is recognized, that the understanding of cooperative ownership simply as a kind of "state" ownership before 1989 was extreme and dogmatic, then after 1989 a new kind of extremism and dogmatism appeared, – the recognition of cooperative ownership as private ownership.

## **2. THE PROBLEM OF COOPERATIVE OWNERSHIP**

In the history of the idea of cooperatives, they have been understood as associations of people (as a rule, of the weakest economic groups) and as enterprises. This tradition, continued by the thesis of G. Draheim formulated in 1952 (Kowalik, 1986: 174,

Sowa, 1976), which speaks of the bimodal nature of cooperatives (as unions of people outside the economy and as enterprises), has since 1990 in Poland been subjected to a test of liberal economic practices, whose representatives have referred to the experiences of EU member states. These experiences lead however to different conclusions about cooperatives than those intended, because cooperative ownership occupies an important place in the economy of the EU.

In 1994, there were 135,000 cooperatives in the then member states of the EU and more than 100 smaller cooperatives operated outside the organizational structures of the cooperatives themselves. There were 60,000,000 members or 19 percent of the population. Cooperatives employed 2,500,000 workers. One third of the total income came from German and French cooperatives. Italian cooperatives were in third place (Bajtaj, 1998) in this regard. There were 40,000 cooperatives with 8,000,000 members and 700,000 employees in the agricultural sector of EU member states.

### 3. OWNERSHIP IDENTITY OF COOPERATIVES

*Pluralism in the form of cooperatives*, that is ownership with different degrees of socialization, make up a general category of cooperative ownership. At the same time, in a market economy there are many kinds of shared management, which (like producer groups) only seemingly fulfill the criteria of cooperative ownership. This makes the economic problem of ownership all the more important and leads to the question, what is cooperative ownership? What makes it different from non-cooperative forms of ownership? Defining this, as M. G. Brodziński has indicated (Brodziński, 1999: 98), brings a series of other dilemmas along with it. These include the “problem of intangibility of cooperative ownership”, and also the contradiction between its present definition as private ownership and capitalistic practice, since before 1939, when it was not conceived of in this way. The thesis grounded in law, about the specific private nature of cooperative ownership is a source of enough fundamental doubts, that they lead to an acceptance of a more cautious and pragmatic point of view when it comes to cooperative ownership. The practical interpretation that comes from such a perspective, as can be found in the work of one of the representatives of this standpoint, calls for taking the concrete social and economic conditions into account as a basis for recognizing cooperative ownership as private or social. This achieves the desired “pluralism of ownership that calls for many forms of cooperative ownership in a social economy” (Nowacki, 1993:13) and is a perspective that is close to a general economic and sociological theory of ownership, that also greatly emphasizes the analysis of real social and economic relations and which is the foundation for the observations made here.

Ownership identity is a question of the theoretical and practical understanding of the idea of the cooperative itself. In the document of ICA *Statement on the Co-*

*operative Identity*, 1995 the following definition appears: "A co-operative is an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise" (ICA, 1995).<sup>1</sup>

These principles shape cooperative identity and describe their ultimate goal of collective self-help, which has inspired cooperative leaders and members throughout the world. The principles of cooperatives are, however, different from those used by other private businesses such as corporations (see Table 1) and create distinct problems for cooperatives in raising capital.

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1. Source : ICA News, No. 5/6, 1995. The others conditions are values and principles. **Values:** Co-operatives are based on the values of self-help, self-responsibility, democracy, equality, equity and solidarity. In the tradition of their founders, co-operative members believe in the ethical values of honesty, openness, social responsibility and caring for others. **Principles:** The co-operative principles are guidelines by which co-operatives put their values into practice. *\_1st Principle: Voluntary and Open Membership* Co-operatives are voluntary organizations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination. *\_2nd Principle: Democratic Member Control* Co-operatives are democratic organizations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary co-operatives members have equal voting rights (one member, one vote) and co-operatives at other levels are also organized in a democratic manner. *\_3rd Principle: Member Economic Participation* Members contribute equitably to, and democratically control, the capital of their co-operative. At least part of that capital is usually the common property of the co-operative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their co-operative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the co-operative; and supporting other activities approved by the membership. *\_4th Principle: Autonomy and Independence* Co-operatives are autonomous, self-help organizations controlled by their members. If they enter to agreements with other organizations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their co-operative autonomy. *\_5th Principle: Education, Training and Information* Co-operatives provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their co-operatives. They inform the general public - particularly young people and opinion leaders - about the nature and benefits of co-operation. *\_6th Principle: Co-operation among Co-operatives* Co-operatives serve their members most effectively and strengthen the co-operative movement by working together through local, national, regional and international structures. *\_7th Principle: Concern for Community* Co-operatives work for the sustainable development of their communities through policies approved by their members.

**TABLE 1.**  
**COMPARISON OF COOPERATIVES AND PRIVATE BUSINESSES**

Features	Cooperative	Limited Company
Corporate Objectives	service to members, promotion of collective action, participation of members through democratic processes, empowerment	profit, competitive power and survival
Ownership	by members who join primarily to use services of the coop	by investors who may or may not be involved in the operation of the enterprise
Control	one member one vote, regardless of shares held; prominence of elected officers and board; considerable oversight and intervention by government authorities in many countries	one share one vote; prominence of elected officers, board and management
Nature of Subscribed Capital	shares are purchased and redeemed at par; redemption may be time-consuming; capital revolves as new members join and old members leave; shares may be issued in lieu of cash payments to members or from deductions from cash payments to members, from deductions from cash payments by members for services used; regarded as the least expensive form of capital or source of finance	shares are negotiable (i.e. they can be bought and sold freely, unless otherwise agreed by shareholders) but not redeemable; price determined by negotiations between buyers and sellers or through bid/offer transactions; regarded as the most expensive form of capital or source of finance
Financial Structure	often dominated by members' shares where credit is difficult to obtain; dominated by debt when foreign or government assistance is readily available; varies by type of industry or activity	varies by industry and by firm
Value of investment by Owners	redeemable value of shares plus savings from favourable prices offered by the cooperative on services used by the member	market value of shares
Distribution of Net Income	in proportion to patronage, i.e., the extent of use of services provided by the coop measured in financial terms	in proportion to shareholding
Return on Owners' investment	limited return on shares, limited by law, tax considerations or by custom; benefits from use of services provided	dividends as decided by the board of directors, plus appreciation or depreciation in share values, depending on performance and financial market conditions

Source: The changing cooperative environment: <http://www.fao.org/docrep/003/w5069e/w5069e04.htm>.

#### 4. GENERAL ECONOMIC AND SOCIAL OWNERSHIP THEORY AS A BASIS FOR THE ANALYSIS OF COOPERATIVE OWNERSHIP IDENTITY

The meaning of the interpretation of cooperative ownership in a market economy then has practical consequences. S. Nowacki systematically ties it to the influence on the way of understanding and achieving the goals of economic cooperatives. These include property questions, the contributions of members and the benefits they derive, the social role of cooperative actions that require capital expenditures etc (Nowacki, 1993:13). Neither is it indifferent to the concept of social order that this theoretical and practical dimension of cooperative ownership is placed in. This makes it possible to at least visualize a general comparison of liberal, solidarity-based Christian and socialist standpoints (see Table 1). Inconsistencies in interpretation in this area can lead to clear contradictions. For example an understanding of cooperative ownership as private property cannot be reconciled with the idea that a cooperative is one way to counter harmful economic effects that arise from private ownership.

**TABLE 2.**  
**THE PLACE OF COOPERATIVE OWNERSHIP (CO) IN DIFFERENT BASIC CONCEPTS OF SOCIAL ORDER**

Concept name	Understanding of CO	Main argument
Liberalism (social and economic)	A form of private ownership ("Social capital" is a result of the unification of the capital of individuals.)	In reality, only individuals exist and not social groups or society (which are only theoretical constructs)
Christian "Solidarity"	A part of the "common good", guarded by the cooperative (as well as the state and other organizations) as an association of persons working together based on private ownership	Goods created on the basis of private ownership have a social destiny.
Socialism	Collective ownership (a "new social and economic category"), economically and socially separate from individual and private ownership	Counteracts the harmful effects of economic activities based on private ownership

Source: Author, based on: S. Nowacki, *Miejsce spółdzielczości w nowym łańdźie ekonomicznym* (The place of cooperatives in the new economic order), Materiały SIB, Warszawa 1993, pp. 10-12.

The market and/or market economy is also a criteria for the separation of market cooperatives (Münkner, 1996), or for cooperatives that arise in market conditions and develop in non-market conditions, as well as the reverse – as noted by Brodziński (Brodziński, 1999: 74), who rightly contrasts the idea of pluralism of forms of ownership in a market economy with a vulgar ownership reductionism that leads to the existence of the market for private ownership of a single type, and that also avoids mention of the great amount of forms of private ownership, capitalistic and small, and state ownership, communal and cooperative.

## 5. THE CONCEPT OF COOPERATIVE OWNERSHIP

The contemporary, as opposed to traditional, view of the *private* and not *social* nature of cooperative ownership is reflected in one of the three concepts of this ownership, which can, in the view of the author, be distinguished during the period of the PPR, as the sum of private ownership relationships, as “intermediate ownership” as well as group ownership.

The concept of cooperative ownership as the sum of private ownership relationships is based on a view of non-participation in a socialist society (as a real or desired state) in commercial relations as these bring about capitalistic relations.

This dependency is contained in the work of J. Stalin's *Economic problems of socialism in the USSR*. It is there stated that selling the basic means of production “as property to the kolkhoz” would lead to “an increase in the circulation of goods”, which would contradict the thesis that “the circulation of goods cannot be reconciled with a view on the transformation to communism” because it leads to “the rebirth of capitalism” (Stalin, 1952: 94-96).

Another example of such an approach is the view of F. Castro from 1967, that the cooperative is “the sum of a certain number of individual economies and it would be sufficient for one or two families to be against us for their influence to affect the entire group. The cooperative is not a socialist form of ownership. The threat even exists that it will lead to the appearance of another kind of land ownership, which would be an obstacle for true socialization. I do not have the impression, that this problem has been resolved in other socialist countries” (Chołaj, 1968: 5).

On the basis of such an approach, the nature of cooperative ownership would result from the commercial relations, with which it is tied.

A general economic and sociological theory of ownership, however, does not authorize such a statement. Because understood this way, the sources (genesis) of ownership are not commercial relations, since these are only intermediaries of ownership -as a specific relation of benefit from material and spiritual objects- (Kozyr-Kowalski, 1977: 74). The views set forth so far might also be an example of ideological thinking in the theory of cooperative ownership as that in which valuation precedes knowing (Kozyr-Kowalski, 1982: 39). W.I. Lenin earlier made a declaration about such practices. “We still often understand things in the way, ‘capitalism is bad,

socialism – good.’ This kind of understanding however is incorrect, because it does not take the entire set of existing social and economic arrangements into account, it merely excerpts two of them” (Lenin, 1978: 417). There is no way to not notice the currency of this observation in relation to contemporary discussions about cooperatives and cooperative ownership as well.

The law concerning cooperatives, updated in 1994, states that cooperative property is the private property of the members of the cooperative. The resulting interpretation of cooperative ownership makes it possible to treat it as private ownership by a group. The legal regulations in this regard as noted by Chrzanowski, blur the lines between cooperative ownership and companies and corporations in business law (Dowda, 2001).

## **6. COOPERATIVE OWNERSHIP AND COOPERATIVE MANNERS OF PRODUCTION, EXCHANGE AND RENDERED SERVICES**

In accordance with the assumption accepted in the introduction, the economic and sociological theory of ownership is (may be) a cognitively effective tool for the analysis of the question of cooperative ownership in conditions of social transformation.

The economic-sociological theory of ownership supposes that: “Ownership is a relation (of individual or community) to the objective work conditions (tools of production, exchanges, services), which enables to make use of the benefits and useful effects of not own work (force)” – (Kozyr-Kowalski, 1977: 75, Tittenbrun, 1986).

The basic idea of this theory preserves its legal validity also in relation to cooperative ownership. This mainly concerns the following statements about ownership. It exists independently of the law; it is a kind of (specific) utilization of the means of production, the means of commercial exchange, the means of rendering services as well as the labor force (ability to work), and so it is not “having the right to something”, “disposition”, “rule”, “decision”, “choice”, “direction”, “management” etc; this utilization (cooperative ownership) is carried out *through* economic relations; this connection with work makes it possible to distinguish cooperative methods: production, commercial exchange as well as rendering services.

The fundamental characteristics of methods of production (as methods of connecting cooperative ownership with labor) can be presented in the following manner:

- 1) the subject of the cooperative’s relations of ownership, connected with a given cooperative’s method of production is defined as a set of producers;
- 2) there are other methods of cooperative production, which differ among themselves in the range of socialization of the principal means of production (agricultural *artel*, a company for the common cultivation of land and others);



- 3) the differences between cooperatives are related to the method of utilization of common ownership and different proportions in the division of income according to contribution and work;
- 4) Alongside the traditional mixed cooperative methods of production, there are new types of these methods (for example a cooperative that is a national agro-industrial enterprise)

## 7. "LUMPEN-COOPERATIVE OWNERSHIP"

On the basis of this, economic-sociological, theory, it is also possible to understand the phenomenon of cooperative ownership in the sphere of those marginalized by society, or the socially pathological – as a kind of lumpen-cooperative ownership. Lumpen-ownership is basis for lumpen-work: it is about phenomena such as theft, or beggary, and production of drugs etc. (Galor, Stępień, 2002: 59-62).

In light of these observations, it is possible to state that generally cooperative ownership is a kind of ownership held in common, by groups at different levels of socialization and is expressed through the division of income according to contribution and according to labor. Between "group held private ownership" (which is not cooperative ownership) and "group held social ownership" (which indicates full socialization) there is a continuum of varieties of cooperative ownership according to degree of socialization.

The identity function of cooperative ownership and the illegal aspect of the "lumpen-cooperative ownership" can not be reduced to non ethical economic forms. A cooperative -in opinion of Flanagan- is all legal entity in which the employees are the owners and share in its profits. Any number of persons may form a cooperative, there is no requirement for capital, however all cooperatives that operate within the organized civil and treaty economies will need to be registered. In registering, one should state the name of the cooperative, its operating procedure, its officers, how its meetings are to be held, its codes, where its real estate is held and what type of enterprises the cooperative will be involved in. In a cooperative there is no requirement to name or register all of its employees, persons may freely enter and leave the cooperative or to do business with it in any legal way one chooses without being bothered by any further regulations. Only the cooperative officers will need to be registered. Persons in a cooperative who commit criminal offenses, of course will be prosecuted, first of all the officers will be held culpable, also all individuals who directly vote for or knowingly support criminal activity may also be prosecuted for those crimes. Since the cooperative is a legal entity it will be held liable in litigation suits, with damages being paid out of its joint assets which are the owners investments in the cooperative. Persons who are members of the cooperative who have knowledge that the cooperative is engaged in illegal activity and choose to support the cooperative or its officers in carrying out illegal actions shall be held culpable as an accessory (Flanagan, 1999).

## 8. COOPERATIVE OWNERSHIP AND CONTRADICTIONS BETWEEN “WESTERN” AND “EASTERN” PARTS OF THE NEW EUROPE

The Mondragon group is a frequently mentioned example in support of the idea that breaking the developmental barriers connected with the management of traditional cooperatives is a necessity and can be effective (Roelants, 1999: 130-131). The consortium, whose beginnings go back to 1943, assembles cooperatives, research institutions and the Mondragon bank. The group has many areas of activity, for example research institutions involved in planning and production are located in the areas of computerization, energy, machine technology and plastics. This together with the scale of its organization would appear to make it the incarnation of a new generation of cooperatives. It can be said here regarding cooperatives, that large is beautiful, and this may be a pre-condition for cooperatives to compete with non-cooperative actors in a market economy dominated by large corporations. The developmental tendency for cooperatives in Poland appears to be going in the opposite direction, for example legal regulations are most supportive of small and self-help cooperatives. The traditional form of cooperative ownership, which comes from the early stage of cooperatives is touted as “modern”.

The simplest criteria for distinguishing traditional and contemporary cooperative ownership is based on understanding the prevailing sentiments before and after 1989. This leads to the labeling as “traditional”, not only the forms of this kind of ownership from the time of the PPR, but also those from earlier times. At the same time, it leads to an apparent paradox. Because if the currently propagated model of a return to the source, to the “true” or older form that dates from its beginnings is taken under consideration, then contemporary cooperative ownership would be traditional ownership. Other forms of distinguishing them also come into play. These include their genesis, those that arose through the (traditional) “cooperative movement” and through the “state”; market or non-market oriented appearance and development age – “old” and “new”; the kind of political system they come from – only Western cooperatives are recognized as traditional, while those that arose in socialist conditions are referred to as “cooperative-like economic structures of Eastern origin” – opinion of Valko (Kowalik, 1971: 16).

The definition of traditional cooperative ownership with the help of this model has a special meaning. The two-part structure of cooperative ownership has not lost its modeling relevance. This model, in which the owners are a group of members, was described by Marszałek in 1957 but first appeared in capitalistic conditions. The two parts are 1. represented by dues paid by members and 2. represented by the collected reserve funds, for social aims, not divided among the members (“everyone’s and no one’s property”) – which is an expression of the socialization of the means of production though in capitalistic conditions (Marszałek, 1957:20-26). This traditional model makes use of the *rule of identity*, which as Münkner points out (Münkner, 1999:89) recognizes the cooperative as a company owned and controlled by its users (“owners, directors and users are the same people”). The weakening or non-fulfillment

of the rule of identity seems to be one of the main characteristics of the development of contemporary forms of cooperatives. By this, the roles within the cooperative should not be understood as only the owner, director and user, but also the employee of the cooperative. The relation between cooperative membership and ownership as not identical is analyzed in the works of Stryjan (e.g.: Stryjan, 1990).

**TABLE 3.**  
**COOPERATIVE OWNERSHIP (CO): TRADITIONAL AND CONTEMPORARY UNDERSTANDINGS**

	<b>Traditional understanding</b>	<b>Contemporary understanding</b>
Way of thinking	legal, economic, formal	economic and sociological, empirical
Notional relationships	CO – cooperative enterprise	CO – cooperative manner of production
Character of CO	social	private
Main goal of CO	social needs	member needs
Management	closely connected with CO	loose or questioned connection with CO
administrators	cooperative members	managers
Organizational forms	based on a close observation of cooperative rules	based on a loose approach to cooperative rules
Rule of identity	maintained	not observed

Source: author.

Contradictions of UE economic development are reflected not only in the economic state of cooperatives, but in understandings as well: two -traditional and contemporary- understandings of cooperative ownership can be distinguished (table 3).

Contemporary cooperatives are both traditional and “modern”. In the rapidly changing former socialist countries, autonomous cooperatives, controlled by their members, take on a special meaning. In industrialized countries however, there are also traditional cooperatives made up of small compact groups; integrated as well as market oriented (Münkner, 1999: 88).

“Modern” forms of cooperative ownership depart from traditional models. According to Stryjan, new cooperatives are organizations, which “generally conform to cooperative rules, were created by their future users, but at the same time are not completely connected to the existing cooperative system” (Stryjan, 1992: 109). Examples of these new forms include: aid cooperatives, related to housing -which arise from housing cooperatives or the work place- within larger enterprises; alternative

cooperatives, to which belong children's daycare (in Sweden, the US), joint shopping clubs (in Japan), neighborhood or workplace self-help organizations (in Germany), work cooperatives often founded by the unemployed – and also as professional cooperatives, because cooperatives founded by highly qualified specialists can offer specialized services.

The importance of the analysis of cooperative ownership identity for contemporary processes of European integration is indicated by two problems as well: ideology vs mythology as structure policy formation and the degeneration of cooperative ownership.

### **8.1. Ideology vs mythology**

Agricultural Producer Groups (Rolnicze Grupy Producentckie) in Poland are meant to be synonymous with the current changes in Polish cooperatives and with them there is the hope, that they will become typical "modern" cooperatives (Brodziński, Piechowski, 1999: 14). Whether these groups can be recognized as cooperatives based on the traditional model of cooperative ownership is an open question, which demands in depth analysis. Pragmatic arguments that express practical advice, like "You just need to convince farmers, that a producer group can be a cooperative, or a cooperative may be a producer group," (Łaniewski, 2000: 26) are inadequate. They seem to be a good example of the ideological mode of thinking in cooperative theory. The main feature of this mode is, that evaluation precedes cognition. Without ownership analysis -"before"- one can say that producer group is a cooperative and it will be right on the ideological basis of thinking.

The difference between ideology and theory is an especially important question in a period of transition in Europe. It is analysed as a question of "genuine cooperative" -among other- by Swain, for who "the key problem is the chasm between mythologies of political rhetoric and mundane socio-economic realities" (Swain, 2002). Swain's classification of ideological forms as mythological, made as a result of an analysis of agricultural cooperatives, is important, in my opinion, for the research on cooperative ownership identity in the new Europe. Six mythologies (as characteristic for cooperatives in transition) were described. One of them is the myth of the "genuine cooperative" itself. The statement concerning the universality of consumer (not producer) cooperatives -as "genuine"- belongs to this myth.

### **8.2. Cooperative ownership identity and degeneration**

Kalmi relates degeneration to the decline of employee ownership in transition: "this term refers to the attrition of the ownership base in employee-owned firms, because the incumbent owners have insufficient incentives to increase the number of owners" (Kalmi 2002:2).

From point of view of cooperative ownership identity -in my opinion- the issue of degeneration can be understood as the failure to include new cooperative members as co-owners of the cooperative, related to two trends, namely privatization (in Western Europe) and nationalization (in Eastern Europe). The results are the same in both cases under the legal-organizational form of cooperative enterprise, there is a non-cooperative form of ownership; similar to (or the same as) private enterprise and similar (or identical to) state enterprises.

Cooperative ownership identity plays a leading role between the fundamental characteristics of a cooperative in European transition, which are decisive in determining its future, and include the recognition of members as the most important element, limitations of the process by which cooperatives become similar to ordinary joint-stock company as well as the incorporation of new areas and the creation of jobs.

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# THE BLENDED SCORECARD: A TOOL TOWARDS BALANCING CO-OPERATIVES` PERFORMANCE

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## **1. INTRODUCTION**

An organization is first of all a group of people. It is the people who make an organization into a social structure that is capable of pursuing different objectives depending on its mission.

A firm is a particular form of organization. A firm is specifically involved in doing business and pursuing evident economic goals. Therefore, each firm has, as a result of its nature, a socio-economic structure.

However, it is particularly within the co-operative organizational form, [which we may define as an organization formed by a group of people who have developed an economic activity to meet their own needs (ILO, 1956, p.21)], that this *dual socio-economic reality* becomes most intense and manifest. Co-operatives must deal with a duality of purpose that, at times, generates conflict and division. Because co-operatives are more likely to encounter this reality, we would do well to see what others have said about the nature of this duality.

Cujes presents this duality as the social and economic improvement that co-operatives search for; he says that out of all co-operatives, it is worker co-operatives that set the highest goals because they strive to organize an industrial order. He concludes that "... co-operatives have an additional characteristic which separates them from other types of businesses: They are as essentially associations of persons as they are business organizations" (Cujes, 1986, pp.11-12).

This definition draws on the fact that co-operatives face the same economic difficulties as other firms, and that is exactly the point from which this paper springs.

As Cujes states, the particular nature of co-operatives makes their socio-economic duality even more intense because, "... a cooperative is simultaneously a group of

persons and a business enterprise. Both aspects must be kept in balance. The relationship may be expressed: priority of business, but primacy of social aspects" (Cujes, 1986, p.18).

Keeping a balance between business and social aspects is essential. It is not a matter of making one more important than the other, rather, it is a matter of striking and maintaining a balance. Nonetheless within this balance there is a priority. Attaining economic goals makes it *possible* to attain social goals. Thus one strives for economic efficiency in order to be socially successful.

Father Jose Maria Arizmendiarieta, founder of the Mondragon co-operatives, makes a similar point when he says, "... you must be excellent in your economic performance before you can be excellent in your social performance" (found in Morrison, 1997). Father Arizmendiarieta concluded that "a company cannot, and must not, lose any of its efficiency just because human values are considered more important than purely economic or material resources within that company, on the contrary such a consideration should help increase efficiency and quality" (The Mondragon Experiment, p.25) (found as well in Morrison, 1997, p.111).

Further support for this view can be found in Laidlaw, who sees as one of the pillars of co-operative philosophy, the linkage between a group of economic goals and a group of social ideas, so as to form an essential defining element. This view is shared with Alfred Marshall. Marshall has said that while some organizations may have high social-interests, and others may have a great economic-base, co-operatives are the only ones that have *both* (collected in Laidlaw, 1980, p.122, collected in Mugarra, 1996).

Laidlaw goes on to say that even though co-operatives have both economic and social objectives, co-operatives are fundamentally economic and they must be successful in business in order to remain. If a co-operative fails in doing business it can't be a good influence in a social sense, especially if it disappears. Therefore, while economic goals and social ideas are like two faces of the same coin, viability as a healthy business must take priority (Ibid., p.123).

Aranzadi also argues that social objectives will never be accomplished without economic success, and that efficiency and return on capital, which are a cooperative's business strengths, are essential conditions not just for its success but for its existence. Finally, it is precisely this economic efficiency that leads authors like Aranzadi to stress the importance of 'entrepreneurship' as a key characteristic of the successful co-operative manager, since social goals are not possible without economic success (Aranzadi, D., 1992, p.18, p.290, collected in Mugarra, 1996).

Kurimoto concludes that success in business operations "is the precondition to support the fulfillment" of the ICA principles (Kurimoto, 1999).

Marcus also supports this position saying that no co-operative can survive without business efficiency, because meeting members' economic needs is an essential task for a co-operative; if not, it doesn't play any role at all (Marcus, L. 1988, p.32, collected in Mugarra, 1996).

So there is widespread support for the position that if co-operatives are to fulfill their social goals, they must first be successful economically. However, even if we

agree with this basic philosophy the issue of *how* to achieve economic success remains a great challenge. In a modern environment, where increasing complexity is a daily reality, economic success is not easily earned.

In the first part of this paper we wish to discuss recent developments within the field of management. In particular, we wish to draw attention to the success enjoyed by firms that have adopted the 'Balanced Scorecard' approach to management. In part two, we want to propose a relationship between the 'balanced scorecard approach' and the pursuit of co-operative ideals.

## **2. THE BALANCED SCORECARD (BSC)**

### **2.1. History of the BSC**

The BSC was first created in 1992 by Robert S. Kaplan, a professor at Harvard, and David P. Norton, a consultant from Boston (Kaplan and Norton, 1992, pp.71-79) (Niven, 2002, p.11). Even though the BSC was created in early 90s, Kanji mentions that Epstein and Manzoni identify an antecedent in France in the beginning of the twentieth century under the name of Tableau de Bord (Epstein and Manzoni, 1998, pp.190-203, collected in Kanji, 2002, p.155).

Kaplan and Norton (foreword by Kaplan, in Niven, 2002, pp. VII) state that within the last ten years, the BSC has been adopted in every nation in the world and by every kind of firm, "manufacturing and service, for-profit and not-for-profit, private and public" and that the BSC has evolved "from its initial purpose of an improved performance measurement system to become the basis of a new management system, one that aligns and focuses the entire organization on implementing and improving its strategy" (Kaplan and Norton, 1996; Kaplan and Norton, 2001).

About the dimension of the BSC, Niven concludes that the BSC is now a critical business tool for thousands of firms all over the world (Niven, 2002, pp.4).

### **2.2. Features of the BSC**

The BSC was originally a tool designed for measurement (Niven, 2002, foreword by Kaplan) that was, and is, based on the following four perspectives:

- Financial: The strategy for growth, profitability, and risk viewed from the perspective of the shareholder. Five measures (22 percent).
- Customer: The strategy for creating value and differentiation from the perspective of the customer. Five measures (22 percent).
- Internal business processes: The strategic priorities for various business processes, which create customer and shareholder satisfaction. Eight to ten measures (34 percent).

- Learning and growth: The priorities to create a climate that supports organizational change, innovation, and growth. Five measures (22 percent). (Kaplan & Norton, 2001, pp. 22, pp. 23, pp. 375).

Kaplan and Norton (2002, pp.48) state that these four perspectives have proven to be a pattern, they are not inevitably necessary or sufficient, because depending on each sector and strategy other perspectives may be as valid.

Niven affirms that benchmarking studies between organizations implementing a BSC, have shown that it usually contains 20 to 25 measures, however, as few as 15 (or as many as 30) may be adequate (necessary) to coincide with the meaning and distribution of those measures between the four different perspectives given originally by Kaplan and Norton (Niven, 2002, pp.151-152).

A particular strength of the BSC approach, according to Kanji, is that it, "Puts together, in a single report, many of the seemingly disparate elements of a company's competitive agenda, ability to translate an organization's vision and strategy into tangible objectives and measures, holistic approach to performance measures and focus on a limited number of critical measures (avoiding information overload)". (Kanji, 2002, pp.160-161). Clearly, any approach that is able to accomplish those objectives would be a valuable and effective tool for managers.

Quite naturally similarities between the BSC and other approaches to management will be cited. For example, Lee, Lo, Leung and Ko (2000, pp.407-23) relate the BSC to "McGregor's 'Theory Y', which assumes that the employee, if directly involved in the goal-setting process, can be relied upon for self-control", Martissons, Davison and Tse (1999, pp.71-88) relate the BSC to "assumptions and theories that underlie business process re-engineering, as advocated by quality management". In the same direction Lengyel (2000, pp.40-48) states that "the novelties introduced in the year 2000 revision of the ISO standards, (in particular the idea that the documented process management system has to cover all business processes of the value-chain including the analysis of customer requirements, the monitoring of customer satisfaction and the cycle of revision and learning), represent a clear evolution tendency in the direction of the adoption of a BSC by companies that follow the ISO 2000 standards".

So the BSC approach should not be seen as entirely novel and unconnected to other approaches – inevitably there is overlap. But the BSC is much more than old wine in new bottles. The BSC approach provides a fresh and unique way of packaging a family of management, performance, and strategic issues that enables companies to become more effective and more efficient.

### **2.3. The EFQM**

Even though BSC is a worldwide tool, its effect is greater in the USA than in Europe. Firms in Europe had already embarked on development of new management tools. In 1988, fourteen leading companies established the European Foundation for

Quality Management (EFQM). EFQM is an alternative management tool that bears some similarities to the BSC. The purpose of EFQM was to promote excellence in quality management in Europe through the Total Quality Management (TQM) model (Kanji, 2002, p.61).

Kanji (2002, p.75) defines the EFQM Excellence Model as “a non-prescriptive framework based on nine criteria. Five of these are ‘Enablers’ and four are ‘Results’. The Enablers are (a) leadership, (b) people, (c) policy and strategy, (d) partnership and resources and (e) processes. The ‘Enablers’ criteria cover what an organization does. The Results are: (a) people results, (b) customer results, (c) society results and (d) key performance areas. The ‘Results’ criteria cover what an organization achieves. ‘Results’ are caused by ‘Enablers’”.

Lengyel (2000, pp.40-48) adds a precise comparison between Business Excellence Models (BEM) in general (and EFQM in particular) and the Balanced Score Card. He says that “the BSC covers most criteria of the EFQM Excellence Model” and concludes by saying that “BSC has one main advantage over the EFQM model: it connects strategic and operative planning not only by determining the objectives, but also by defining the way to achieve them. On the other hand, the EFQM model is a more uniform, standard system, making comparisons across organizations easier. The author suggests that integration between the two approaches can be beneficial and that some companies (such as the British Post Office and the Hungarian Telecommunications Company) apply both of them with positive results” (all collected in Kanji, 2002, pp.165-166).

Kanji (2002, pp.36-39) contrasts the BSC’s strengths “low complexity, high flexibility, low cost, strong result orientation and excellent trend analysis” with its weaknesses “low validity, low reliability (little guidance to measuring), low systems approach (cause and effect interactions), low coverage of TQM principles, low process orientation and low benchmarking”. Similarly, the EFQM possesses strengths like “high coverage of TQM principles, excellence benchmarking and trend analysis” and EFQM’s weaknesses include “low flexibility, high cost, low reliability (little guidance to measuring) and low systems approach (cause and effect interactions)”.

It is not our intention to pit one approach against the other. Nonetheless it is important to indicate that while there is *some* overlap between these approaches, the BSC is gaining wide acceptance and appears to account for improved performances over a wide spectrum of business contexts. For example, Niven says that today the BSC is a widely accepted management tool that has been adopted “by thousands of organizations” (Niven, 2002, p.36). He further quantifies this acceptance by stating that almost half of the Fortune 1000 firms have adopted it (Niven, 2002, p.12, p.325) (Kaplan and Norton, 2001b, pp.73-77, collected in Niven, 2002, p.4). He indicates that within the first four years of implementation, some organizations “achieved immediate results” (2002, p.11) and over longer periods (ten years) the BSC approach “has had a profound effect on the practice of management around the world” (Niven, 2002, p.324). Furthermore, “the potential for future growth and development of the Balanced Scorecard is dramatic” (Niven, 2002, pp.324).

#### **2.4. Effect of the BSC, benefits for those firms adopting scorecard approaches like BSC / EFQM**

Measurement is not an end but a means to improve performance. Measurement assists firms in making better decisions to achieve real value for their organizations.

According to Kanji (2002, p.69), "Peter Drucker (1964) believed two concepts that underlie organizational performance are *efficiency* (doing things right) and *effectiveness* (doing the right things)".

It is interesting to remark the relation between the two concepts mentioned by Drucker and the BSC. The BSC measures the improvement alongside different periods of time, which is exactly doing things right, what Drucker calls efficiency. On the other hand, the BSC also links different features of the four perspectives that must lead the firm to financial success, which is exactly doing the right things, what Drucker calls effectiveness. Both are connected to measurement, a key concept in today's management.

As Niven says, measurement has never been as important as it is today. He also cites Drucker who observed that "few factors are as important to the performance of an organization as measurement, and measurement is among the weakest areas in management today" (Niven 2002, p.5).

On the other hand, to be useful measurement must always be connected to strategy. Kaplan and Norton (2002, pp.51-52) state that their idea of strategy is very close to Michael Porter's (Porter, 1980) (Porter, 1985), and besides they say that they have checked that this approach works properly in dozens of organizations. Therefore, it is exactly this wholeness that makes the BSC so effective.

In supporting this point of view, Niven adds that besides a "proven and effective tool" the BSC also allows firms to "successfully implement differentiating strategies" (Niven, 2002, pp. XI-XII) with a 97 percent "of measurement-managed organizations achieving success in their last major change effort" (Niven, 2002, pp. 34).

BSC has a dramatic "potential for future growth" (Niven, 2002, pp. 324) and going beyond this point, he concludes saying that in ten years the BSC "has had a profound effect on the practice of management around the world" (Niven, 2002, pp. 324), because "in a recent study by the Cost Management Group, the vast number of respondents believed it was worth implementing the Balanced Scorecard in their organization" (Niven, 2002, pp. 36) and "in a recent survey conducted by the Institute of Management Accountants, 90 percent of respondents said the Balanced Scorecard was worth implementing in their organization (Frigo, 2001, pp.1-4, collected in Niven, 2002, pp. 34).

Frigo (2002) mentions a survey that said the BSC also helps to identify new performance measures, cause and effect linkages and to improve the effectiveness of performance measurement systems in communicating strategy to employees.

## 2.5. Research on the impact of the BSC / EFQM

A study on organisations of different sizes and of different types within the UK manufacturing sector showed that “there is little variation between organisations in performance measures used, most responding organisations felt no need to specify performance measures outside the list provided, and that those that did, provided variants, rather than truly novel, measures and that key aspects of financial performance are financial return and working capital” (CIMA, 1993, pp. 19).

Before such an unsophisticated scene, the value of the BSC as a key factor to link between measurement and the competitive environment becomes really important and a possible source of competitive advantage. In this sense, Rohm (2002) mentions the value of the former to link excellence in strategy and operations in order to survive in the latter.

Niven (2002, pp. 34) states that besides its acceptance in thousands of organizations, the BSC has proven the effectiveness of an innovative and transforming way of doing things in firms, which means using measurement to drive “agreement on strategy and the communication of that strategy, leading to successful change efforts and ultimately improved financial performance”. Niven concludes that one of the main benefits of the Scorecard system is “the creation of a new language that galvanizes an entire organization toward the achievement of overall goals” (2002, pp. 34).

## 2.6. Conclusion

Empirical evidence from different sources leads us to think that using the BSC *will improve competitive performance* and will provide other positive effects for firms. There is clear and mounting evidence that the BSC is a management tool, which promotes business excellence by developing effective firm-based strategies for a new and complex business environment. For firms in competitive environments, committed to economic survival and success, adopting the BSC will help to ensure that they reach their goals. The difficulty of course is that the BSC only addresses one aspect of the socio-economic duality that co-operatives face. Adopting the BSC approach may increase the likelihood that a co-operative firm will reach a level of economic stability. However, having achieved this stability the co-operative firm must continue on to pursue its social objectives.

But even this is an inadequate depiction. To portray the relationship among objectives as simply a sequence of independent outcomes, with one objective merely preceding the other, is to ignore the true complexity that co-operatives face. It has already been argued in this paper that *a co-operative's socio-economic duality requires a balance* between its social and economic objectives. Therefore, co-operatives are a special case and they will need *an expanded* scorecard if they are to achieve this balance through such a management tool. In other words, *the duality* that is essential to the co-operative form has to be reflected in the management tool

itself! Here we are proposing such a tool. We refer to this new, more complex tool as a "*Blended Scorecard*". The Blended Scorecard is an idea for a management tool that will address directly the socio-economic duality, which co-operatives operating in contemporary competitive environments must face.

We return now to the other aspect of the socio-economic duality we talked about earlier and focus on the social objectives that co-operatives pursue.

### 3. SOCIAL BALANCED SCORECARD

#### 3.1. Social audit: The standard for social measurement

In recent years there have been several efforts to develop instruments and tools that will measure outcomes of the firm. Some of these have had a social focus. In this section we will discuss some of these developments and attempt to assess their relevance to our broader objective of constructing a *blended scorecard*. Among the developments just mentioned is the social audit.

Social auditing has been developed as an approach to measure social performance in conventional firms. Social auditing may be useful for co-operatives as well, because it is more a matter of performance outcomes than of agents of performance. Quarter et al. define social accounting as "a systematic analysis of the effects of an organization on its communities of interest or stakeholders, with stakeholder input as part of the data that are analyzed for the accounting statement"; this definition fits well with the ICA principles (Quarter, Mook and Richmond, 2003, pp.40-42). Besides, it is the opinion of the authors that if co-operatives want to be seen as strong alternatives to conventional firms, they must be able to fairly compare their social performance to that of conventional firms. Using only co-operative indicators and writing down particular reports distant from the trends in modern management will only marginalize the co-operative.

The Co-operative Union of Canada supports this point of view when it says "... for co-operative organizations, social auditing has particular relevance, because it reinforces the commitment to social improvement which lies at the heart of the co-operative philosophy" (Co-operative Union of Canada, 1985, pp. 2).

Abt distinguishes between uses which a firm can make of a social audit. He identifies two levels, in the *first* level the firm "... assumes only the core group of social responsibilities" and "the simple qualitative statement of its aims in social performance are: (1) make a profit and (2) stay legal" (Abt, 1977, pp. 38). He calls the *second* level Integrated Social/Financial Audits where a social benefit/cost approach is integrated with financial accounts and financial statements. "Here we can make direct trade-offs between social and financial investment and social and financial returns and maximize both" (Abt, 1977, pp. 41). The *integration* of social and financial elements is also emphasized by the Co-operative Union of Canada when it says "... it is essential, however, that from the start, the social audit process be integrated with



other planning mechanisms. It is not a separate, isolated activity. It is effective only if it is used in conjunction with other management information systems" (Co-operative Union of Canada, 1985, pp. 2). This is precisely the aim of this empirical study.

Choquette & Khoury state that "even though there has been a great deal of progress in the area of employee and customer performance measures" (Choquette & Khoury 2000, pp. 11), and "in the development of non-financial performance measures, some areas are more advanced than others. For instance, many organizations have developed employee – or customer-related performance indicators. Due to environmental reporting, environmental performance measures are also more advanced. However, many other areas that fall under the broad umbrella of CSR –community investment, human rights and supplier relationships– are at an embryonic stage" (Choquette & Khoury, 2000, pp. 30). To solve this imbalance, they propose a performance indicator hierarchy approach to underdeveloped areas of CSR. This approach consists of four elements: Category (the activity or area being measured), goal (the objective of that activity or area), indicator (the way it can be measured) and target (the quantifiable goal of performance).

Also commenting on the contribution of social accounting, Feagin, Orum and Sjoberg say "... this satisfies the need to create an inter-subjective and comparative basis for observations and thereby helps insure that observations will be roughly identical from one observer to the next" (Feagin, Orum and Sjoberg 1991, p.18). At this time we lack social standards that would make comparisons of performance possible (Blake, Frederick and Myers, 1976, p.42, collected in Bowie, 1982, p.112). The short tradition of social accounting, if we compare it to the conventional accounting, is the reason for this limitation. It is obvious that more research is necessary to provide *standards* against which the social performance of firms can be compared. Setting targets requires a long process of data collection and benchmarking. As Quarter et al. argue, "... without some form of benchmarking or external comparisons, the social statement will only supply subjective information from a variety of viewpoints" (Quarter, Mook and Richmond, 2003, pp. 56).

So we can say that social accounting is a 'work in progress', but to its credit, the approach recognizes and faces 'head on' the need to integrate social and financial measures.

### 3.2. Social measurement in co-operatives

As Cujes states "social reporting/auditing is especially vital for cooperatives on account of their dual nature. They are at the same time a group of people and a business enterprise. Manager's reports and auditor's reports reflect the activities of the cooperative in the business year as business. Social reports and social audits reflect activities of the cooperative as group of people working together towards realization of social goals of the cooperative" (Cujes, 1986, p.5). However, he concludes that "experience indicates that cooperatives do many things in this area [social goals of

the cooperative], but somehow they are not used to report on them, at least not with sufficient emphasis".

Finally, other researchers have suggested that the real value of a social auditing process in co-operatives is that, "... integrating Total Quality Management methods with the seven principles will add real value for customers and hence for the organization" (Davis and Donaldson, 1998, p.105).

### 3.3. Measuring Co-operative principles

Throughout the history of co-operatives there have been different attempts to improve co-operatives' social performance by developing social indicators for measurement. Some of the most recent examples can be found in Japan (Kobe), Canada (Quebec) and Spain (Mondragon).

One of the most important advances in this field has been accomplished in Japan by Co-op Kobe, the biggest consumer co-operative in the world with more than one million members. In 1998, they developed the '*Comprehensive Evaluation*' conducting a survey where 1,776 persons out of 2,791 responded to the questionnaires (63.6%) (Kurimoto, 1999).

This study represented by the statistical illustration of four social perspectives, based on the ICA's values, as "Sincerity and Caring for Others", "Participation and Democracy", "Social Responsibility and Fairness" and "Autonomy, Solidarity and Improvement", and two business perspectives in numerical values, "Business Efficiency" and "Expansion Potential".

Kurimoto defines this method as "an elaborated method of evaluating co-operative performance from viewpoints of both co-operative values and business operations" that are to be exposed to "comparisons and benchmarking" (Kurimoto, 1999).

As Tsuda, one of the advisors in the project, states "... comprehensive evaluation aims at evaluating co-operatives comprehensively from the two dimensions of basic values and management foundations and provides a frame for evaluating whole businesses and activities of Co-op Kobe by the six evaluation indexes" (Tsuda, 2003, pp.1-2).

Kurimoto (1999) mentions some other antecedents in measuring principles like "Social Reports by Migros (Switzerland) or ICIMF, Social Audit Report by the Co-operative Retail Service (U.K.), Social Balance Sheets by Italian co-ops, Environmental Report by KF (Sweden) and so on".

In Quebec, Canada, under the direction of Perron (2003), the *Coopérative de développement régional, Québec-Appalaches* (CDRQA) has completed the "*Certification de la conformité aux pratiques coopératives*" [certification of compliance with co-operative practices]. The project is exclusively based on the seven principles of the ICA, so that it has a wholly social dimension.

As Perron (2003) says "the document is divided into seven parts, representing the seven principles of the International Co-operative Alliance. Each principle is then divided into dimensions".

The objective of the project, assisted by some consultants and academics, is “to develop a tool that will enable a co-operative to objectively evaluate its compliance, in terms of its co-operative practices, with the seven principles of the International Co-operative Alliance; and thus to optimize the potential of the specific nature of co-operatives; and to maximize its overall performance” by “encouraging co-operatives to continually improve their distinctiveness by developing a system for certifying their compliance with co-operative practices; this certification will reward managers, administrators and employees for their efforts and enhance the increased value associated with the co-operative difference, resulting in provincial, Canadian and international visibility” (Perron, 2003).

In Spain, Mondragon Co-operative Corporation (MCC) has designed its own tool for measuring the social performance of co-operatives in the corporation. Based on the EFQM model, MCC first designed its management model ‘*Modelo de Gestion*’ (Management Model) in 1996, and evaluated it in 2000. It is remarkable that MCC defines its strategy based on four pillars, one of those being the group of ten co-operative principles of the Corporation, which are very close in meaning to the ICA’s principles. Later there are seven groups of agents that are to accomplish the strategy. The outcome of the overall performance of each firm is measured by five conventional business groups of indicators and a sixth one that is the social implication.

MCC divides social implication into different indicators classified as: Global satisfaction of the people; Quality of employment; Welfare, Labour Conditions and Safety; Motivation and Implication; Training and Personal Development, Remuneration and Job Promotion, Perception of the Society about MCC, Contribution to the Local Economy and to the Society as a whole, Implication in the Local Economy and in the Society as a whole; and Preservation and Concern in Environment (MCC, 1996).

On the other hand, the *Departamento de Gestion Social* in MCC is at present working on defining a group of indicators directly based on the ten principles of the corporation (MCC, 2003).

These independent developments strongly suggest that some form of integrative measurement/management tool is needed.

### 3.4. Comparison methods

Kurimoto says that “there are 3 ways of plotting the evaluation results; relative evaluation against the data of the basic year, absolute evaluation against the fixed criteria and fulfillment evaluation against the target figures (i.e. 5 year plan)” and that “since it was difficult to set the fixed criteria and the target figures for all items, the relative evaluation was adopted” in the Kobe project” (Kurimoto, 1999).

Completing Kurimoto’s point of view it is interesting to report the experience carried out in Quebec, Canada, using a different approach to evaluating results. Directed by Perron (Perron, 2003), a group of researchers, used an ‘ISO approach’ composed of three different degrees. The first degree determines if the information is

available for the co-operative managers, the second degree determines if the managerial team analyzes that information and makes decisions and the third degree determines if there is any feedback and improvement from those decisions made before.

As Perron (2003) says "for each dimension, there are three degrees of requirements to be met. The degrees correspond to difficulty levels. The difficulty levels for each degree are essentially the same for all dimensions and principles. Generally, the first degree is related to the gathering of information. The second degree is related to the decision-making and the third to putting the decisions in practice" (Perron, 2003).

## 4. THE BLENDED SCORECARD

### 4.1. Duality is compatible

As several authors in the co-operative movement have stated, it is economic excellence that makes attainment of any social goal possible. A firm needs money to accomplish any activity. It is evident that two firms producing the *same* product or service will face the *same* difficulties and will feel exactly the same needs to produce an item of good quality and price, in order to convince the customer to purchase. The fact that a firm is a co-operative may mean something in certain business-to-customer relations, but it means nothing in most cases; customers do not base their product-selections on differences in the legal status of a firm.

Making profit is essential just because losses are not sustainable by non-public firms. Therefore, the use of excellent management methods is as important to co-operatives as it is to conventional firms. This is one reason why we are proposing the 'Blended Scorecard' as a useful tool for co-operatives.

The proposed *combination* of features of the conventional Balanced Scorecard *with* social indicators should yield considerable benefit for co-operatives. Supporting this point of view, Parra Luna claims, that the General Theory of Systems defines an enterprise as a unit composed of interconnected elements whose output (economic profit), will be maximized only by integrating social variables (Parra Luna, 1988, p.15, collected in Mugarra, 1996). Similarly, Cote (2003) argues clearly that the most successful co-operatives will be those that integrate co-operative values into their management practices.

Thus co-operators should be persuaded to adopt co-operative principles because they provide a natural source of competitive advantage and not simply because they are compulsory in firms having the legal status of co-operatives. This advantage will become more evident if research shows visible parallels and overlaps between co-operative practices and modern management practices designed and proved by conventional firms.

The blended scorecard we are proposing is focused on both attaining economic goals *and* attaining social goals. We call it "blended" because we base our work on

an tool that was intended originally as an 'economic-financial' tool - Kaplan and Norton's Balanced Scorecard and we propose to integrate social indicators from the ICA's seven principles into this proven framework.

The proposed card does not seek to just 'merge' social and economic features into one management tool but also to stand as a first step towards in the development of the very challenging idea of exploiting the benefits of co-operative organization.

As currently proposed, the card has causal linkages only on the economic scorecard. Further research into the social dimension may lead to causal linkages there as well. Over the longer run the aim is to integrate social indicators in the economic scorecard as supporting elements in accomplishing managerial tasks.

The following cards are shown as examples of the "Blended Scorecard". They are to be used in studying the performance of eight different worker co-operatives in Quebec (Canada), Emilia-Romagna (Italy) and Mondragon (Spain) in the winter, spring and summer 2004. Those worker co-operatives have been chosen because they meet the following criteria:

1. The co-operatives are manufacturing firms (and therefore they are under pressure to exploit modern technology such as CAD/CAM, automation, innovation and design,
2. Each is competing within a global market,
3. Each has at least one significant competitor based elsewhere in the world and this competitor is not a co-operative,
4. Each co-operative is economically successful,
5. Each has the formal structure of a co-operative,
6. Each firm is located in Quebec, or Mondragon or Emilia-Romagna. Hence each firm operates within an environment (region) where co-operation is "embraced".
7. The firm appears to be adhering to the ICA co-operative principles.

Therefore, the indicators are designed according to the particular features of such firms. Variations are expected. The social and the economic elements of the "Blended Scorecard" would be adapted to the specific features of any firm. The number of indicators is not fixed rather it is a matter of choice for each managerial staff willing to build its own "Blended Scorecard".

The proposed scorecards use 'criteria' that have been identified through a literature review. These are measures commonly used by companies that have adopted the balanced scorecard approach. Of course individual scorecards may use different criteria that better reflect a particular set of circumstances. Thus we are using a 'representative balanced scorecard', which employs 25 measurable criteria. What we are testing, with the firms we are interviewing, is their 'compliance' with these representative economic criteria. That is, do these firms use these criteria in assessing

performance? We are also testing their compliance with other criteria that are used to gauge their attention to co-operative principles. The combination of these is what we refer to as a *blended scorecard*.

Arrows in the Economic Balanced Scorecard represent different steps linked by a causality relation between each of the four strategy goals (on the vertical axe) and the twenty-five indicators all over the four perspectives (on the horizontal axe). Indicators are divided in these four perspectives, they leave from Learning and Growth, pass through cause-effect relations to Internal Business Processes and Customer, and finally reach the final goal of every firm: having a good Financial outcome.

There is no any causality logic in the Social Scorecard, they are independent indicators.

We think integrating social indicators in this causality logic is an ambitious challenge. Consequently linking their performance to economic indicators will make to recognise their value in economic terms. This challenge will lead co-operatives to a sustainable competitive advantage inherent to their co-operative nature. Success in facing this challenge will strengthen the position of co-operatives in those times of globalisation and increasing competition.

Anyway, we state that further research is essential in this field, where interaction between academics and managers of co-operatives will have to be based on comprehension towards the everyday economic exigencies that co-operatives in global competition, as we have related above, face everyday.

THE ECONOMIC BSC

(K & N, 48) STRATEGY	(K & N, 42,142) LEARNING AND GROWTH	(K & N, 106) INTERNAL BUSINESS PROCESSES	(K & N, 80) CUSTOMER	(K & N, 59) FINANCIAL			EVA (P)
				Sales to Net Working Capital (E)	Current Ratio (S)		
HIGHER SALES (S)	Employee Satisfaction (ES)	On-time delivery (T)	Customer retention (%) (R)		New customer acquisition (%) (I)	ROA (P) ROE (P)	Total Liabilities to Net Worth (S)
		Time from the call to the solution of the problem of the customer (T)	Sales growth per segment (%) (I)	Market Share in targeted segments (%) (MS)			
HIGHER TURNOVER OF ASSETS (A)	Employee Productivity (EP)	Manufacturing Cycle Effectiveness (MCE) (P)	Yield (P)	Customer profitability (return on sales)	Customer Satisfaction (complaints) (S)		
	Investment over Sales (S)						
HIGHER OPERATING MARGINS (M)	BET (P)	Cost of repairs (C)	Return rate (Q)	Customer Satisfaction (complaints) (S)			
	Employee Turnover (ER)	Defect rate (Q)	Customer Satisfaction (complaints) (S)				
LOWER OPERATING EXPENSES (E)							

### THE SOCIAL BSC

	%	INDL.	A	B	C	D	E
1. VOLUNTARY AND OPEN MEMBERSHIP	15%	4	Relative facility of membership	Percentage of work that is co-operative	Membership growth	Ease of redemption of share-capital	X
2. DEMOCRATIC MEMBER CONTROL	20%	5	Member participation in discussion	Turnover of board membership	Percentage of members who volunteer for committees	Percentage of hours for committee work	Percentage of board for blue-collar workers
3. MEMBER ECONOMIC PARTICIPATION	15%	4	Salary ratio highest to lowest	Rate of absenteeism and rate of overtime	Wage comparison with other firms (by sector or region)	Percentage of social equity	X
4. AUTONOMY AND INDEPENDENCE	10%	2	Percentage of sales to top three customers	Degree of independence from lending institutions, % of borrowings	X	X	X
5. EDUCATION, TRAINING AND INFORMATION	10%	2	Percentage of profit for education	Ratio, investment in education in blue-collar jobs / investment in education in total jobs	X	X	X
6. CO-OPERATION AMONG CO-OPERATIVES	10%	3	Profit-sharing between firms	Interco-operative shared funds	Interco-operative job transfers	X	X
7. CONCERN FOR COMMUNITY	20%	5	Annual job growth	Profit to company equity (not to shareholders)	Percentage of profit to community-projects	Investment in environment	Percentage of capital belonging to employees



## 5. CONCLUSION

This work leads to the following conclusions:

- Co-operatives, as any other firm acting in the free market economy have to be competitive and profitable in order to be able to survive in the long run.
- Co-operatives, as any other firm working in the free market economy and facing same difficulties, should pay attention to the new management tools, to achieve business excellence.
- Among the new management key factors, today measurement is one of special importance. Improvement is not possible without measurement.
- The BSC is a proven model that can lead co-operatives towards business excellence, and therefore the accomplishment of social goals.
- Further research is necessary in social measurement, benchmarking seems to be the best way to gather enough data in order to make true comparisons among co-operatives. Co-operation among co-operatives as an ICA principle should be a basis to start a global sectorial co-operative data-base.
- Finally, we should remember that the intense socio-economic duality in co-operatives is not an impediment to success in business, but a remarkable and useful strength that may lead co-operatives to sustainable competitive advantages. This is the real challenge of the co-operative movement all around the world to be able to successfully face the globalisation of the economy we are living in.

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# ACCOUNTING PRINCIPLES *VERSUS* CO-OPERATIVE PRINCIPLES: INFLUENCE IN THE CO-OPERATIVE IDENTITY

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## 1. CO-OPERATIVE PRINCIPLES: PUTTING CO-OPERATIVE VALUES INTO PRACTICE

The co-operatives as we know them today appeared towards the middle of the 19th century, although there are authors who indicate certain realities as being remote co-operativism records, such as guilds, irrigation communities, etc. Nevertheless, and as Sanz (1974) pointed out: *“Throughout this phase of records [...] there are only principles or a certain element of cooperation, nothing more, merely simple bases for the future development of the system.”*

At the end of the 19th century, certain basic regulations are recognized as having existed. One case among others is that of the present-day Spanish Commercial Code, dating back to the 19<sup>th</sup> century (1885<sup>1</sup>).

The co-operatives emerged in Europe in the 19th century in view of the need of guaranteeing the subsistence of the weak, which was endangered by the industrial revolution and by the changes in the market. This was achieved by concentrating efforts by means of a volunteer association. It could be said that the co-operatives began their activity as a result of misery.

After various failing efforts, the first co-operative to have a lasting success was constituted in the Manchester area. The year was 1844 and it was called the *Rochdale Society of Equitable Pioneers*. It was a co-operative retail society whose purposes were also related with building houses for the members, manufacturing production, farming fields and interco-operation. After a 10 year existence the co-operative had 1,400 members. After twenty years, it set up three branches.

However, beyond these figures the importance of the Rochdale co-operative lay in the fact that *“they put the regulations of an internal organization into practice,*

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1. Article 124.

*some of which were of great importance since the Co-operative Principles in practice nowadays are derived from them"* (Ballestero, 1990: 161).

The International Co-operative Alliance (ICA) was founded in London in 1895. ICA is a non governmental organization that unites, represents and serves co-operatives worldwide. Some of its members are either national or international co-operative organizations from all activity sectors. ICA was the first non governmental organization to which the United Nations passed a consultative statute to in 1946. Nowadays it is one of the 41 organizations that are featured in Category I of the list of organizations that hold a consultative statute before the Economic and Social Council of the United Nations (ECOSOC)<sup>2</sup>.

In 1937 the ICA passed the first formulation of Co-operative Principles which were based on the 1844 Rochdale co-operative statutes. These principles underwent a new formulation in 1966 by the ICA which *"endeavoured to achieve a greater acknowledgement of the fact that strong complementary traditions existed within the co-operative banks, agricultural, workers and service sectors, without detriment to the Rochdale traditions"* (Thordarson, 1993).

In 1988 the ICA undertook the final worldwide review process of the Co-operative Principles. The result of this process was the Böök<sup>3</sup> report, which greatly influenced the ICA Declaration on Co-operative Identity that took place in 1995 during the 31st ICA Congress, in which the reformulation of the Co-operative Principles was passed. These reviews *"demonstrate how the co-operative thinking may be applied to a world of changes"* (ICA, 1995).

During the aforementioned Congress held in 1995, the ICA established that the principles are *"criteria through which the co-operatives put their values into practice"* (ICA, 1995) these being: self-help, self-responsibility, democracy, equality, equity, solidarity. They are therefore *"like behavioral guidelines"* (García-Gutiérrez, 1999).

Thus Co-operative Principles are key components when it comes to putting Co-operative Identity into practice. That is, carrying out a co-operative initiative, an arduous task in a world filled with changes and with increasingly more complex and competitive markets.

It is appropriate to point out the differential aspects of a co-operative with regard to capitalist companies. Firstly, and also in keeping with their origins, co-operatives are companies with a different purpose, this being the fulfillment of needs that are not only of an economic type, but also the cultural and social needs of their members. This is the *"raison d'être"* of the co-operatives. Their relationship with their members is not limited to a mere financial investment with profitability prospects, as it is in the capitalist companies. Secondly, and by taking their type of operation into account, they place certain stress on people rather than on the capital, which is, the capital is at the service of the people rather than the reverse concept.

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2. Source: ICA (<http://www.ica.coop/ica/>)

3. See Böök (1992)

In the 1995 Congress, the ICA formulated seven Co-operative Principles (one more than in 1966). These are detailed as follows:

- 1) Voluntary and open membership<sup>4</sup>.
- 2) Democratic member control.
- 3) Member economic participation.
- 4) Autonomy and independence.
- 5) Education, training and information.
- 6) Co-operation among co-operatives.
- 7) Concern for the community.

By using a quote from the ICA (1995), we ought to highlight that *“Those principles that constitute the centre of the co-operatives are not independent of each other.”* Therefore they influence each other, and even though *“the co-operatives should not be assessed upon the basis of a given principle; instead they should be assessed upon the basis of how they support the principles as a whole”* (ICA, 1995). The relation between the aforementioned principles means that if one principle is weakened due to repercussions from an International Accounting Standard, this must make us consider what effect such an influence has on the full set of principles, and therefore on the co-operative identity.

As we have already mentioned, a certain basic legislation already acknowledged the existence of co-operatives at the end of the 19th century. However, the situation is very different nowadays and things have not remained in merely a simple acknowledgment of their existence. Most countries have developed their own legislation for co-operatives. This is reflected for Europe in the following chart.

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4. Also known as an “open doors” principle.

**CHART 1.**  
**LEGAL FRAMEWORK OF CO-OPERATIVE SOCIETIES IN EUROPE**

Belgium	Regulation on co-operative societies included in articles of the Commercial Code (Book I, Title IX, Section VII, Art. 141-164)
Denmark	No specific legislation exists on co-operatives. They are governed by statutes.
Germany	The Co-operative Law of 1989, changed by law in 1990.
Greece	The cooperative Law 602/14 The Law 1667/86 on urban cooperatives The Co-operative Law 1541/85 The Law 2076/92 on credit institutions that determined the status of cooperative banks.
Spain	The Co-operative Law and Autonomous Laws 27/99.
France	Law 1947 relative to co-operative statutes. Law from the year 1867 relative to open-ended societies. Law from the year 1972 relative to agricultural co-operatives (Rural Code of the year 1981) Law from the year 1992 on modernizing co-operative enterprises. Other sectorial laws.
Ireland	No specific legislation exists on co-operatives. They are governed by the Law of Societies and Friendly Societies of the year 1983, reformed in 1978.
Italy	Legal framework in Art. 45 of the Constitution. Specific Regulation on co-operatives in the Civil Law Articles (Art. 2511-2545 of Title VI in Book V). The Co-operatives law 59/92.
Luxemburg	Grand Ducal Decree dated 17/09/45, amended by Law dated 25/08/86 (Agricultural co-operatives). Law dated 10/08/50 (Commercial Law Co-operatives)

Source: Julia y Meliá (2003), Karafolas (1997)

The above chart shows the legal framework of European co-operative societies, in which we find the regulation models described by Sanz (1974) currently in force:

- a. States without a regulation in co-operative matter.
- b. States that contemplate the co-operative society under its overall, civil or commercial legislation.
- c. States with regulations regarding co-operatives within the overall regulations on associations (not currently present in any state).
- d. States with specific co-operative laws.

Even within the last of the four cases, (d), subdivisions can be established should any special laws be presented, or a general co-operative law, that mainly consider the activity sector. Spain is doubtlessly the country that has a larger collection of



regulations on co-operatives; a state law, a special sectorial law (credit unions), the regulation of the insurance co-operatives contained in the special insurance activity legislation, and 14 autonomous laws to date<sup>5</sup>.

We have studied the European setting using Montolío (2000) as a starting point by synthesizing the Co-operative Principles reflection within co-operative legislation with the following casuistry:

- No specific reference is made to the Co-operative Principles; they have to be deduced from several precepts (Germany, Austria, Belgium (the principles become weakened after the legislative reform in 1991), France, Holland (they only reflect the “open door” and democratic proceedings principles) and Great Britain (the same as Holland)).
- They are neither declared nor demanded by any regulation. Nonetheless, through the historical development of co-operativism, commitment to the principles is established in the majority of the statutes (Denmark).
- No reference to the principles is made, they are only referred to in the mutualist purpose of the co-operative (Italy).
- References are made to Co-operative Principles and they are depicted in detail in articles (Portugal, Spain<sup>6</sup>)

We understand that the Co-operative Principles are more than a deontological statement, since they are present in some way or other in co-operative legislation, as already observed. However, due to the fact that the principles appear to be conditioned on the laws themselves, Vicent (1999, 528) points out that: “...*the character of compulsory regulations seems to be weakened*”. This assertion, referring to the Spanish regulation context, can be extended to the rest of the countries.

All in all, a generalized acknowledgement of the Co-operative Principles exists in co-operative legislation, and consequently in co-operative statutes, which therefore show, as is logical, differences in their materialization in each country’s laws on co-operatives.

## 2. THE CO-OPERATIVE PRINCIPLES AS MOTIVATORS OF CO-OPERATIVE ACCOUNTING PECULIARITIES

The Co-operative Principles as the behavioral patterns they are, will characterize co-operatives of other non co-operative societies. The co-operative as a conceptually different economic unit is to have both accounting and economic repercussions.

5. February, 2004.

6. We have commented on the plurality of existing regulations in Spain. They all refer to the principles, either through remission, or by being included in the legal text itself).

The co-operative as a differentiated economic unit, along with the Co-operative Principles, have been objects of study as far as economic analysis (Ballesteros, 1990), and company administration (García-Gutiérrez, 1999) are concerned. On the other hand however, little study has been conducted on their accounting influence.

We find one of the few reflections regarding just this in Almiñana's work (Almiñana, 1998), although deep down his analysis is somewhat limited to the specific materialization framework of these principles, a materialization which came about by the old General Co-operative Law (Law 3/1987) of the Spanish State.

The quoted author (Almiñana, 1998) points out that: "*what makes co-operative accountancy different to the accountancy of other legal forms is the binding of the so-called Co-operative Principles*".

We estimate that an analysis made on their accounting repercussions is worthy of a great opportunity due to the present-day normative accountancy setting, which is characterized by its international orientation, exactly as the next paragraph shows.

These differentiated characteristics of societies have motivated a specific accountancy regulation for the co-operatives to come into being. However, this has occurred infrequently. One such case is the *Statement of Position 85-3 Accounting by Agricultural Producers and Agricultural Co-operatives*, del American Institute of Certified Publics Accountants (AICPA) from 30<sup>th</sup> April, 1985; the *Audits of Agricultural Producers and Agricultural Co-operatives, Audit and Accounting Guide* del AICPA, the *Audits of Credit Unions, Audit and Accounting Guide* and also from AICPA, the *Emerging Issues Task Force 89-3* (EITF 89-3) of the FASB (USA), as well as two *Emerging Issues Committee* (EIC), specifically both the EIC 68 *Patronage Allocations* and the EIC 72 *Presentation of members' shares in a co-operative organization as liabilities or equity* of the CICA (Canada).

We also find certain references made on the accountancy of co-operatives in general accounting regulations. Such references are made in the French Chart of Accounts<sup>7</sup>, which entitles co-operatives to certain specific accounts, and also in the Civil Code of Holland, and in the *Guidelines for Annual Reporting in the Netherlands* from the *Koninklijk Nederlands Instituut van Registeraccountants* (NIVRA).

Spain has recently promulgated the Regulations on Accounting Aspects of the Co-operative Societies (Decree ECO/3614/2003, published in the Official Spanish-Government Publication dated 27th December, 2003). This may be considered to be a truly great pioneering measure taken in Europe since previous European references are very superficial.

We must stress the fact that we are faced with one of the few explicit references made to accounting repercussions of Co-operative Principles in an accounting regulation, more specifically so in section II of the introduction after the transcriptions. Here it is pointed out that this reference came about so that these particularities (the Co-operative Principles) are met.

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7. Decree dated 27th April, 1982 of the Ministry of Economy and Finances, which passed the Reviewed Chart of Accounts, amended by Decree on 9th December, 1986 of the Ministry of State, Economy, Finances and Privatisation.

### 3. ACCOUNTANCY IN AN INTERNATIONAL CONTEXT

We have attempted to approach the Co-operative Principles in the previous epigraphs, and these present accounting repercussions that have motivated the development of accounting regulations.

We cannot ignore the current international context of accounting standardization in the present-day.

The accounting standardization originally came from the Anglo-Saxon world: The United States and Great Britain. The professional accountancy associations soon state the need to homogenize the information supplied by the different companies, giving rise to an incipient issue of accounting regulations that favour a standard presentation of Accounts.

The 1929 crisis made the requirements of financial information all the more pressing. It was then that this need for homogenization came to be shared by the society as a whole. Among investors there is a feeling of distrust towards the information supplied by the companies, and therefore regulations need to be established in order to return the confidence that was lost in business information.

The term Generally Accepted Accounting Principles comes from this period of time. Specifically in 1934 the *Securities and Exchange Commission* (SEC) adopted the Audit Certificate form established by the *American Institute of Accountants* (AIA), which contained the reference made to *Generally Accepted Accounting Principles* for the first time.

The importance of the accounting standardization lies in securing a common language and reference points (Cañibano, 1985) among all the strata involved in the accounting information, which makes the following possible:

- Orientate the issuer of the accounting information in producing this information, so that this production of accounting information is performed with criteria that are commonplace to all involved, to therefore obtain homogeneous information.
- Issue the auditor with a preceptive opinion on the financial statements, where this opinion is the reference element.
- Ensure that the user of accounting information interprets this information correctly.

Therefore the accounting standardization allows standard financial statements to be generated as far as their structure, terminology and devising criteria are concerned. This means that homogeneous accounting information is achieved, which in turn is comparable and may be added to. It is therefore possible to conduct temporal, inter-company analyses, so fundamental for both economic management and for decisions to be made by the different users.

Even though these accounting standardization purposes were taken into account “when the issuing of accounting regulations started, it was considered on a national

*level. However this was seen as insufficient a long time ago*" as Lorca (2001) points out only too well.

Two factors which propel the internationalization of accounting standardization clearly stand out:

- a) The growth and development of multinational companies.
- b) Economic globalization, especially that of the capital markets.

Thus, we can state that *"as different accounting regulations coexist with a growing interdependence on the world financial markets, this gives rise to two considerable problems"* (García, 2003).

The **first problem** affects the users of accounting information, mainly investors. The lack of comparability of accounting information creates uncertainty in the investing decision-making process. Furthermore, this lack of comparability of accounting information causes the financial information that one same company presents to vary significantly to what is in accordance with the national regulations applied. This fact creates confusion among investors as it affects the confidence they have in company accounting information.

The **second problem** concerns those who issue the accounting information: the companies. As for the multinational companies therefore, as we have already mentioned, the holding company must consolidate the financial statements of the affiliated companies which were drawn up from the accounting standards of their respective countries. Other than the multinational company problems, any company that resorts to national and international financial sources must formulate their financial statements according to the corresponding national accounting standards. They must also be formulated according to the accounting standards of the countries that it wants to be quoted in.

If we can argue about the need for international accounting harmonization, then it is possible to deal with the matter of the subject who must carry it out.

Both public and private harmonizing initiatives have been produced. From a public sphere, we can quote those that were conducted in the heart of the UN and the OECD. A little later on however, we shall see how the most successful attempt emerged from a private organ.

The International Accounting Standards Board IASB<sup>8</sup> was created in 1973. It was formed by professional organizations from nine countries (Australia, Canada, France, Japan, Mexico, Holland, the U.K. the U.S.A. and the Federal Republic of Germany). The first International Accounting Regulation (known as IAS/IFRS from now onwards) was issued in 1975. More members have gradually joined, and in 1982, as a result of an agreement made between IASB and IFAC, the members of the latter also joined

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8. Presently known as the International Accounting Standards Board (IASB). We use the present-day name of (IASB) throughout this work, although it actually corresponds to IASC as it was known in the past.

the IASB (Tua, 1983). Nowadays it is made up of associations from 112 countries (Lorca, 2001).

The IASB is the present-day referent on international accounting harmonization as a result of agreements made with the *International Organization of Securities Commissions* (IOSCO) and with the European Union.

The European Union committed itself to the IAS/IFRS final Communication (COM [95] 508) "Accounting harmonization: a new strategy in the face of international harmonization". Subsequently in June 2002, the (EC) Regulation 1606/2002<sup>9</sup> was passed. This regulation was relative to applying international accountancy regulations in which the IAS/IFRS, that were previously adopted by the UE in the production of the Annual Consolidation Accounts of those societies accepted for the regulated market of any member state, were made compulsory. Likewise, the member states could permit or demand the IAS (International Accounting Standards) to be applied to the Individual Accounts of the aforementioned societies, as well as to the Consolidated Accounts, to the Individual Accounts, or to both account types, belonging to the non quoting enterprises. Finally in September, 2003, all the existing IAS/IFRS to date, except the IAS 32 and 39 (then undergoing a review process) were adopted by the (EC) Regulation 1725/2003 of the European Commission.

It is anticipated that the IAS/IFRS will have an influence on the national accounting legislation of the state members outside the compulsory suppositions established by the quoted Regulation 1606/2002. Therefore, any study on them attains great importance not only in the case of the quoting enterprises' Annual Accounts.

This epigraph could not be complete without at least briefly mentioning the FASB, the other authority which influences the international sphere. Even though the FASB (the Financial Accounting Standard Board) is a United States-based sphere, it may also be considered as the other international standardizing reference as it is the issuer of the United States accounting principles (US GAAP), compulsory for all companies, independently of their nationality, that wish to quote on the American Stock Exchanges. Nonetheless, as a result of the so-called "Norwalk Agreement" (FASB-IASB, 2002), a rapprochement period commences between the IASB and the FASB, which could lead to a body of accounting regulations throughout the world.

#### 4. THE PURPOSE OF THE FRAMEWORK IN THE ACCOUNTING STANDARDIZATION

As we have already pointed out, the accounting standardization became important at the beginning of the 20th century; firstly, there was an attempt to extract the accounting regulations from the accounting practice during the so-called **generalized acceptance stage**.

9. Published in the European Community official Journal (ECJ) on 11/09/2002.

Subsequently, the accounting standardization attempted to find a rational means of support with regards to its approaches by issuing statements of an “omni-understanding” character (**the logical stage**). Awareness came about of the difficulty with the accounting standardization and also of the lack of neutrality in the regulation. This occurred at the **teological stage**. The *raison d’être* of the regulation was considered.

Nowadays the accounting standardization constructs the theoretical body that provides support to the accounting regulations by means of the **frameworks**. In light of this, the definition by Gabás (1991:19) is particularly significant to us, where a framework is seen to be as *“an interpretation of the general Accountancy theory, through which the theoretical foundations, upon which the financial information is supported, are established through a logical, deductive program”*.

Therefore the framework constitutes a deductive logical program, in which each of its stages, and consequently the accounting regulations, which are its final product, have to be coherent in all the previous steps.

Therefore by following a deductive-logical program, the IASB framework contemplates:

- Users and their information needs.
- The financial statements objectives.
- Underlying assumptions
- Qualitative characteristics financial statements.
- The financial statements elements.
- Recognition of the financial statements.
- Measurement the financial statements elements.
- Concepts of capital and capital maintenance.

Indeed, all these points follow a thread, thus the definition of the objectives must be coherent with its users’ information needs. The underlying assumptions are basic regulations for the smooth running of the whole system. The qualitative characteristics are the requirements needed for the financial information to fulfill its objectives. The elements that make up the financial statements are defined and their recognition is established, as are the criteria that determine both the capital maintenance as well as its impact on the result concept.

As a financial statements objective, the IASB framework establishes the supply of information concerning the financial situation, economic management and changes within the financial position. All this in order to make this information useful to a wide range of users who make economic decisions.

The main users and their information requirements have already been mentioned. We are mainly interested in the relations with investors. Thus it is established that it is the investors who need information to help them determine whether they purchase, keep or sell shares. Likewise, shareholders are also interested in information that allows them to assess the company capacity to pay dividends.

If we base ourselves on all this, it is simple to deduce that this framework has been drawn up without considering the co-operative societies characteristics, which offer different purposes, as we have already considered in a previous section. This fact is not at all together purely incidental, since *“...it is admitted that different rules may exist for each specific purpose, which commences with the financial information objectives...”* as Tua (1997:236) points out.

Indeed the financial information objectives are to determine the accounting model to be followed. In this respect, the IASB accounting model is included within the utilitarian paradigm of the accounting information. However, the investors needs happen to occupy a preeminent place in the IASB framework. We can therefore conclude that the IASB model mainly fulfills the large capital companies' needs.

The framework, as itself indicates, has been developed for a wide range of accounting models, which can be seen for itself in the IAS 1 (4th paragraph). It indicates that this range is applicable to both public enterprises and to companies with no lucrative aim, by changing the description of the financial statements entries, and also by opting to include additional components to these.

Even though there are enterprises with no lucrative aim within the co-operative enterprises, their non-lucrative-aim definition is in no way a distinctive characteristic. On the other hand, the joint company pattern is distinctive when its purpose is to fulfill its members' needs. This represents a substantially different reality that assumes that the result has another meaning, where the investment return capacity expression is of secondary importance. Doubtlessly, the different purpose of the co-operative enterprises offers restrictions, both qualitative and quantitative, to the accounting information comparability with capitalist companies.

## **5. CO-OPERATIVE PRINCIPLES AND INTERNATIONAL ACCOUNTING STANDARDIZATION: TOWARDS AN ACCOUNTING INTERPRETATION OF THE CO-OPERATIVE PRINCIPLES AS A PREMISE FOR THE INTERNATIONAL ACCOUNTING HARMONIZATION OF THE CO-OPERATIVES AND A RELIABLE REPRESENTATION OF ITS REALITY**

We have verified the fact that Co-operative Principles are motivators of accounting peculiarities, resulting in specific accounting regulations in the countries quoted.

Either due to a different specific national accounting regulation being applied, or due to a different national general accounting regulation being interpreted, what actually occurs is that the co-operatives accountancy suffers from a lack of international accounting harmonization. An example of which is highlighted by the document *“IAS-32 Classification of shares made by members as either liabilities or as equity”* of the World Council of Savings and Credit Unions (WOCCU, 2003).

This document points out that the Savings and Credit Unions of the United States, Ireland, Australia, New Zealand and almost all the provinces of Canada classify members' shares or contributions as current liabilities rather than as equity. This

cannot be said of most Western European countries where they are considered to be equity.

Even in Spain, in spite of the recently promulgated regulation we have already mentioned, a complete harmonization within the co-operative accountancy is not achieved. This is due to the fact that more than one accounting regulations issuing authority exists in Spain. Thus, the accounting regulation issued by the Bank of Spain for financial entities is applied to the credit unions, which unlike the previous regulation, considers Education, Training and Promotion Fund as a reserve.

Within the international sphere, the authorized regulation issuing authority is doubtlessly the IASB. Yet, its framework and its regulations are drawn up to consider the large capital companies, as we have already pointed out in the previous epigraph. We have also indicated that some regulations or others would come about, according to the objectives that the financial information pursues. The result is in fact that the IAS/IFRS have nothing to do with the co-operative phenomenon. Therefore we ought not to be surprised by the present-day set of problems of the current IAS 23 and 39 regarding the co-operative share capital being treated as a debt rather than being equity.

We understand that the root of the problem lies in the IASB Framework not knowing the co-operative concept. We must recognize that if it is admitted that some regulations or others will arise according to the financial information objectives pursued, the making of a generally applied framework proves to be extremely difficult, and even an incongruity, to a certain extent. We are aware that this particular argument underlies the present-day critics of the IAS/IFRS, as far as the lack of sectorial accounting standardization is concerned<sup>10</sup>.

The differences seen are due to the different purposes of an accounting entity. This situation means the equity is considered as being different **within the framework itself**, depending on whether it is an enterprise with either lucrative aims or non lucrative aims, as in the case of New Zealand (NZSA, 1993).

It is our opinion that even though the co-operatives' singularities do not need their own framework for financial information purposes, rather the overall purpose framework concept can be applied to them, they do however need to clarify certain points.

We estimate that the study concerning the Co-operative Principles accounting repercussions in the heart of the frameworks is a **necessary** starting point for the accounting regulations to be drawn up both fairly and reliably. The same is to be said of the subsequent interpretation of this study with regards to the co-operatives.

We deal with the matter in the next epigraph, but only with regard to the co-operatives share capital, a topical aspect and one of important consequences. It should be borne in mind that this situation is a momentary consequence of what has already been indicated. Therefore situations like this particular one could arise once

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10. For example, the IASB is studying the possibility of drawing up accounting regulations for small- and medium-sized enterprises.



more, provided that the correct presentation of the co-operative reality in the financial statements is not dealt with.

## 6. THE PROBLEMS WITH PROCESSING THE CO-OPERATIVE SHARE CAPITAL ACCOUNTANCY

The co-operative share capital is repayable to the member should the member leave, in view of the first Co-operative Principle: A voluntary and open membership. Generally speaking in the EU member states, the accounting processing of the co-operative share capital is considered equity<sup>11</sup>. We understand that this is mainly due to legal influences, by considering that the member's contribution to the share capital represents a fraction of the society's capital, where the national co-operative laws apply. This also applies to the European Co-operative Society, as it refers to the accounting regulation of the member country where it is based.

As for the IAS, paragraph 68 of the framework, in reference to enterprises other than Public Companies and the like, stipulates that they limit the responsibility (individual enterprises, partnership associations, associations...): *"Nevertheless, the definition of equity and the other aspects of this Framework that deal with equity are appropriate for such enterprises"*. Therefore we will analyze the relevant IAS since they will be applicable to co-operatives, just as the previous paragraph points out.

The old IAS 32 and 39, and SIC 5 did not explicitly mention co-operatives. For Lang *et al.* (2001:18), the IAS do not clarify the processing of the share capital and of other co-operative funds.

The IASB issued the draft proposal of IAS 32 in June, 2002. Co-operatives are explicitly mentioned in paragraph 22B: (*Exposure Draft of proposed amendments to IAS 32 Financial Instruments: Disclosure and Presentation IAS 39 Financial Instruments: Recognition and Measurement*): *"For example, open-ended mutual funds, unit trusts, partnerships, and some co-operative entities [...] meets the **definition of a financial liability and is presented as such.**"* However, this reference point is quite ambiguous, since it neither clarifies which co-operatives it refers to, nor the specific conditions the co-operative share capital is referred to. We will come back to this matter later on.

On 17th December, 2003 the IASB finally passed the new IAS 32 and 39. The IASB has not been receptive to the requirements the co-operative movement had highlighted during the stage for comments, prior to the definitive enactment of these regulations.

It is specifically worth mentioning what the ICA itself quoted during the requirements in their press release dated 20<sup>th</sup> November, 2003: *"Accounting Standards*

11. Within the World Council of Credit Unions document it is indicated that Western European Cooperative bank movements consider these contributions as being equity, although it quotes Ireland as a European country where they are considered as debts.

*threaten Co-operative Identity*" (ICA, 2003). In fact, as this document indeed points out, the matter not only concerns accountants, it is a clear indicator of what the accounting sciences call "the economic effects of accounting standards". This is undoubtedly worthy of study.

Indeed issuing accounting standards is not a purely technical matter, nor is it neutral. As we have mentioned, economic effects emerge from accounting regulations, thus, the issuing authorities are subject to pressures from the different groups of interest. In the United States, unlike what had happened with the IASB, the co-operative movement demands (NCBA, 2003) had achieved an indefinite postponement of a regulation being imposed<sup>12</sup> in this country, which established a processing similar to the previous one for co-operative share capital.

As the quoted press release points out (ICA, 2003), the accounting processing established in the IAS 32 and 39 has a serious potential effect on the viability of many co-operatives worldwide. We believe that two effects can actually be distinguished:

- i. **Firstly**, the co-operatives considering the financial statements analysis conducted under these regulations, will struggle to gain access to the financing mechanisms in the market. At the same time they will feel discouraged in financing themselves through contributions from their members, since they are considered to be a debt. All this in spite of the fact that such contributions are one of the most important financing sources for the co-operatives, as they actually offer a high stability rate.
- ii. **Secondly**, as a consequence of the previous point, the measures that are expected to be taken from the co-operative legislation in order to mitigate the previously mentioned situation, may affect the smooth running and the identity of the co-operatives by amending the regime regarding the departure of a member, as this would alter the Co-operative Principle of a voluntary open membership (open doors), as we now go onto look at.

Specifically in Spain, and in view of the Bank of Spain's intention of applying the IAS/IFRS to all financing entities as from January 2005, a reform in the Law on Credit Unions is being prepared (Law 13/1989, dated 26th May), that allows the possibility of contributions being made to the share capital, without the requirement of them being repaid until a settlement is reached. For a member to be able to recover his/her contribution should he/she wish to leave, without having the capital reimbursed, a transferability of these contributions is foreseen by means of a regulation made by the General Assembly.

At any rate, it has to be stated that the ICA does not claim either a special treatment, only a fair treatment. We believe that the new IASB regulations are especially motivated

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12. Statement no. 150 Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. From the Financial Accounting Standards Board, May, 2003.

by the proliferation of new financial instruments with characteristics that are mixed between equity and debt, such as certain preference shares etc. However, as we have already claimed, it is not simply a further financing source for the co-operative societies; rather it is one of their main financing sources. What is more, it is not only a financing source; rather it determines a double tie of members to the society: a financial contribution and the use of the co-operative services. As we see it, the co-operatives at least need a provision adaptation period given the importance that the IAS definitively issued by the IASB have.

IAS 32 defines financial liabilities as a commitment that assumes a contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity. Likewise, certain derived instruments are also defined as financial liabilities. It goes on to define a capital instrument (equity) as any contract that shows interests in the company assets, once all its liabilities are deducted. It also points out that it is the substance of the financial instrument, rather than its legal form, that determines how it is classified on the balance sheet.

The co-operative share capital has both characteristic types. According to the IASB criteria however, what is particularly relevant to its classification is the member's right to repayment, as we will stress upon later.

After the enactment of the IAS 32 and 39, two possibilities remain given their devastating effects:

- a) An interpretation by the International Financial Reporting Interpretations Committee (IFRIC), a consultative body of the IASB.
- b) The European Union excludes the co-operative share capital when it adopts IAS 32.

Firstly, the means through which work is being completed is that of an interpretation made by the IFRIC. Specifically, the study on the IAS 32 regulation was included in the February committee agenda for the share capital of co-operative banks in order to pervade to the co-operatives' share capital in general. As highlighted in the IFRIC meeting last March, where references were made to the co-operative share capital in the set points to be discussed, they were done so independently of the economic sector. All in all, the European co-operative bank organizations have been the most dynamical in this sense.

Representatives from the European Association of Co-operative Banks (EACB), the German Association of Co-operatives (DGRV) and from the Confederation Nationale du Crédit Mutuel, as well as members of the European Commission (the latter as observers), specifically attended the February meeting.

It was verified in this particular meeting that both the IFRIC and the IASB had begun to understand the working order of the co-operatives as well as their

characteristics<sup>13</sup>. An indication of this is the fact that specific mention was made to examples of the IAS 32 as being particularly **non** explanatory for bank co-operatives. In light of this, we should point out Example 8 (*Entities with some equity*) which represents the co-operative share capital as a specific entry (*share capital repayable on demand*) **within short-term current liabilities**. We understand that they are equally reprehensible for the remaining co-operatives.

We next focus on accounting arguments where discussion is focussed on the right to repayment. The following points were considered in the meeting held in February:

- a) With the exception of the right to repayment, Could the members' share capital be classified as being equity?
- b) Is it a cause to classify the co-operative share capital as current liabilities under such circumstances where the member has the right to repayment?
- c) By assuming that the circumstances mean the classification is considered as either being current liabilities or a co-operative share capital debt, do these circumstances differ enough to those contemplated in IAS 32, which suggest that the IFRIC should recommend that the regulation ought to be amended?

EACB representatives took part in preparing a summary. It was estimated in this summary that it would prove useful if the IFRIC were to consider five possibilities with regard to co-operative share capital repayments. These possibilities start from the discretionary decision made by the Co-operative Council, without any conditions to an automatic repayment subject to the payment possibility, and without this either negatively affecting the co-operative liquidity or breaking the laws or regulations.

The IFRIC provisionally agreed that there is no obligation to make repayments, only at the issuer's discretion (the co-operative). It would therefore be classified as being equity under such conditions.

IFRIC rejected the alternative proposal made by the EACB during the March meeting. This proposal consisted in:

- A co-operative share capital being repayable to the member under his/her order – it should be classified as being equity until the member in question requires its repayment. It should then be reclassified as a debt.
- Alternatively, the co-operative share capital classification should include the probability that members require repayments in the future.

The IFRIC agreed that the interpretation did not concern an industrial sector, rather the co-operative share capital characteristics; in this respect, it gave the IASB

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13. As the letter from the General Management of the Home Market of the European Commission clearly stated to the Spanish Business Confederation of Social Economy (CEPES), dated 23rd March, 2004.

“Staff “ the task of drawing up a draft interpretation that provides an additional guide to clarify the processing of the co-operative share capital. It is expected that once this year is completed, this interpretation will be presented and that it will clarify when the co-operative share capital will be considered as being equity, by having taken into consideration that the repayment is subject to the co-operative Council decision, and that this repayment neither assumes an automatic or an unconditional repayment to be fulfilled by the co-operative.

Through this particular Interpretation we understand that the share capital is considered as being equity, by avoiding economic repercussions with regard to their access to the capital market, the economic repercussions featured in the prior point i). However, we fear that this is at the expense of sacrificing the co-operative principle regarding the open and voluntary joining of members, as far as a member’s departure is concerned. Consequently, this would mean amending the status of the co-operative members’ contributions established in the Member States’ Laws and also in the European Co-operative Society itself. Such modifications are of great significance to both the co-operative identity and co-operative legislation, and they should be carried out with appropriate reflection.

We have studied all the aforementioned accounting arguments expressed by both the IFRIC as well as by the co-operative organizations. In the next section we go on to provide our opinion, which will doubtlessly enrich the debate in question, since it is supported by foundations that have not been previously diffused.

## 7. TOWARDS THE APPROPRIATE PRESENTATION OF CO-OPERATIVE SHARE CAPITAL IN THE FINANCIAL STATEMENTS

Our consideration commences from the **double tie** the co-operative member has. Specifically the so-called “user members”<sup>14</sup>, as the term indeed indicates, participate in the co-operative purpose it deals with (consumption, production, etc.). Generally speaking however, one has to be a member to enjoy these co-operative “services”, and to become a member, the third co-operative principle has to be considered, that is, the member has to contribute to the co-operative share capital, this means he/she must contribute with funds, at least when he/she joins. Furthermore, and as a consequence of the first co-operative principle, this capital will be variable (“open-ended”), due to the repayment being made to the member when he or she leaves. The repayment to the member, with all the legal cautions, when he/she leaves is a prior deduction from the co-operative losses, and the member’s responsibility generally persists up to five years after their departure.

We must state that a co-operative cannot exist without its members (users) apart from their financial contribution, since without them there would be no reason for the

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14. Designated as such in Spanish legislation.

co-operative to exist as it would not undergo any co-operativized (economic) activity.

Having reached this point, we now go on to interpret a Balance Sheet as shown in the aforementioned Example 8 of IAS 32. The co-operative share capital is presented in a specific entry (*share capital repayable on demand*) within the short-term current liabilities. What this example conveys is that: as the co-operative share capital can be required to be repaid at any given time, we must reflect it as a current liability, and a short-term one besides. However, seeing as the user members have a double tie, **we are implicitly questioning the underlying assumption of “going concern” within the IASB Framework.**

Simply for arguments sake, let us accept for an instant that the underlying assumption of “going concern” does not take place in any co-operative, we could not thereby apply the rest of the system (Framework) nor the regulations (IAS) that have been issued under this underlying assumption. In this case, the information that is to be reflected must be produced on the basis of the co-operative settlement. Upon such a basis, and therefore in a real co-operative settlement, it is clear that the co-operative share capital represents an interest in the company equity, once the liabilities have been deduced, something similar to that of a capital society. In such a situation, it could be objected that the co-operative member, unlike a member of a capital society, has no right to all the equity when the third co-operative principle is considered. One part of the capital is common property of the co-operative, and in general terms, even after the co-operative settlement, it is not distributable among the members, rather it is destined to the co-operative movement. However, what has been stated before does not interfere with the argument in hand, since it is irrelevant from an economical point of view that part of this interest (residual) in the enterprise assets is not destined to the member.

After more than one hundred years, experience shows us that the co-operatives are entities in which underlying assumption of “going concern” is indeed feasible.

We are therefore left with the following as options, either the co-operative share capital is a permanent (long-term) liability, or it is an equity instrument. This gives rise to a paradox that is, although the share capital is a capital that is lent by the member to the co-operative, even though the case may rise when the member may demand its repayment at any given time. On the other hand however, this capital has a different sense for the co-operative **as a whole**, as it generally becomes a financing source with a high rate of continuance.

Therefore what exactly is its nature? How should it thus be shown in the financial statements so that it is reliably and truly represented?

Even in the assumed situation in which the co-operative share capital is automatically repayable by the co-operative through the requirement of a member, this share capital is not in any case a pure debt. Nevertheless, neither does it offer all the share capital characteristics of the capital companies.

We can summarize the characteristics that the co-operative share capital represents:

1. Property resources of the members (owners) and contributed by these members with a permanent character.

2. A variable character as it is repayable to the members when they leave and due to the compensation of losses, although certain co-operative laws and/or statutes stipulate a minimum share capital.
3. Guarantee or solvency of the society to third parties (subject to risk)
4. Lack of an organizational function, as it does not define social rights (especially the right to vote).
5. The economical rights are not defined (distribution of returns).
6. A limited compensation may be established to the capital given (a set limited interest rate, not determined with regard to the paid-in surplus)
7. It may be subject to an updating process.

Upon the previous basis, the co-operative share capital is seen to be a hybrid fund between the financial liabilities and the equity instruments; and it should be shown as such in the balance sheet, exactly as the Co-operative Accounting Standards Committee (CASC, 2002) claimed. Reflecting it in one extreme or in the other means a loss of information.

We understand that if it is acknowledged as a hybrid fund in a third financial instrument category is not only the fair solution but also the correct one. We therefore think that the people who are bound to the co-operative world consider it appropriate that the co-operatives count on financing sources other than the co-operative share capital to make improvements to stability in times of crisis. One such case is that of indivisible reserves. Under certain circumstances, the repayable condition of the co-operative share capital can mean that in the face of certain members leaving, a deluge of other members leaving may take place, that could shatter the stability of the co-operative.

This presentation of the financial statements, without detriment of part of this capital (since it is considered as a minimum share capital by law or by statutes, and if the share capital were to be placed under this, it would be a cause of a dissolution), must be considered as being equity since it is a guarantee amount that remains stable in the face of third parties, just as the social capital is for the capital societies.

Likewise, the co-operative share capital, according to its specific conditions, does not assume a contractual obligation with regard to its repayment, since this repayment is under the discretionary decision of the co-operative, and classified as being equity in any case. All co-operative share capital whose repayment does not mean a decrease in the co-operative share capital amount, through whatever means, should also be reflected as being equity<sup>15</sup>.

There are indeed hybrid financial instruments, however, unlike these; the co-operative share capital is inherent to the co-operative itself, as it is not merely another financing technicality. If we are to consider this singular situation, we estimate that

15. For example, postpone the repayment to transfer shares to a member about to join.

it should be reflected as such in the balance sheet, within a specific grouping of balance sheet liabilities after the equity. Notes should expand on this information. This could be achieved by indicating the number of members that joined and left, the consequent variation of the share capital, the resulting variability on the share capital total, and also the estimated probability of it being repaid in the future.

The solution which offers the best representation of the reality will mean not only the basis for a correct understanding of the co-operative financial statements, allowing the co-operative to develop, but it will also mean that non co-operative third parties would make the appropriate decisions.

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# CO-OPERATIVE PRINCIPLES AS “CATALYTIC MECHANISMS”

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## 1. INTRODUCTION

This study explores Jim Collins' (2001, 1999, 1997) managerial technique and proposes an application of his method in the co-operative context. Collins' analysis of “great companies” and their success is a convincing tale about powerful managerial tools, which seem to already form an integral part of every co-operative. Therefore, the claim made in this paper is that Collins' managerial devices -termed *catalytic mechanisms*- have a natural environment in a co-operative setting. If applied carefully and persistently they will help build a successful business, while preserving the co-operative identity and co-operative values. In fact, there are examples of successful co-operatives that do apply such mechanisms, as is the case for successful investor-owned businesses in Collins' study. The difference is that investor-owned business has to search for goals and mechanisms that will generate consensus among insiders and create an identity for the company. Co-operatives on the other hand, have an idea about their co-operative identity from the start, and need to cultivate it through maturity by turning it into a business strategy.

The purpose of this paper is to offer a practical framework for development of effective co-operative management techniques, by offering a discussion of potential catalytic mechanisms for co-operative businesses, and to investigate some elements that constitute a path to effective management solution for co-operatives. Collins' approach is summarized in section 2, section 3 describes some problems co-operatives typically face in their mature phase, and in section 4 we examine the co-operative principles that may be turned into catalytic mechanisms. Some conclusions follow in section 5.

## 2. A SUMMARY OF JIM COLLINS' APPROACH

Collins centred his work on companies whose performance turned “from good to great”. He examined over 1400 companies and found that for the most successful firms in his study the ingredients of success are: 1. a big long term goal the company wants to reach, which spans over decades, and 2. mechanisms in their daily business that will automatically lead to that goal (the *catalytic mechanisms*).

In defining the goal, the company *core values* and *purpose* have to come through. Building the mechanisms, on the other hand, is an evolving process that must include ideas from all members of the firm and may take time to develop. “Mechanisms force things to happen that reinforce company’s core purpose, converting that purpose into action.” (Collins, 1997)

Among the examples of those great companies with specific goals and catalytic mechanisms are *Granite Rock*, and *3M*. *Granite Rock* is a company whose goal was to ensure complete customer satisfaction. To reach that goal, they introduced the *short pay* policy, where customers can choose not to pay for a delivered product if they are not satisfied with it for any reason at all, and without obligation to return the product. *Short pay* was a catalytic mechanism by Collins’ definition because it automatically lead to improvements in areas where improvement was needed and brought the company closer to achieving their goal of providing full customer satisfaction. Another example is *3M*. Their mechanism was the *15% rule*: they gave to their researchers 15% of free time to work on inventions of their choice, rather than spend all of their work hours developing ongoing projects. This lead to an increase in the number of innovations and produced a continuum of great new products, which is this company’s long term goal.

Some characteristics of a catalytic mechanism are that it distributes power from the center down (which is a potential problem for some managers), and that it “has teeth”, i.e. it is a device that has the enforcing power. This mechanism “...puts a process in place that all but guarantees that the vision will be fulfilled” (Collins 1999, p.76). Another characteristic of this mechanism is that it automatically ejects the wrong kind of people, and attracts the right kind. The right kind of people is defined as those individuals who share the firm’s *core values*. In Collins’ words: “The old adage “People are your most important asset” is wrong, the *right* people are your most important asset. The right people are those who would exhibit the desired behaviours anyway, as a natural extension of their character and attitude, regardless of any control and incentive system.”(1997, p.77). Last, a good catalytic mechanism, according to Collins, produces an ongoing effect under the condition that it evolves, it may last for decades.

Catalytic mechanisms are “specific, concrete and powerful devices that lend discipline to a vision”. The power of catalytic mechanisms is that they become the way to control one’s decisions, decision making becomes clear and transparent to all involved, including the employees who in fact participate in the creation of catalytic mechanisms.

## 2.1. Co-operative governance problems

The key for co-ops not to fail as co-ops -where failure as a co-op need not imply failure as a business (Griffiths 2003)- is in maintaining their identity and preserving their values in the long run. They have to keep their members enthusiastic and excited about their co-op. In fact, this is no different from keeping employees of any firm enthusiastic about their work place, but here members are owners and, theoretically, it should be that much easier to keep them involved. However, often times after years of changes, growth, membership turnover, and market pressures, the co-operative identity may be lost on new members. Some members may become cynical at the mention of co-operative values if those values lose substance over time.

Another side of the problem are management practices that create conflicts between business operation and co-operative principles. Co-operatives often hire managers who need not share in the purpose and values of the organization. Partly, they are not asked to, and partly, their business skills are valued more than their co-operative skills, since it is the former that the co-op typically demands. Co-operative businesses are businesses after all, they hire managers who can deliver on a business plan, who are knowledgeable about competing in the market place, and with skills to manage a particular type of business, not necessarily a co-op. Therefore, a sound business decision, particularly in a global corporate environment, may require a decision which will not be in line with co-operative values. This is often quoted as one of the reasons behind conversion of co-operatives into investor-owned business.

Generally speaking, entrepreneurial role for a co-operative management is limited because of its defensive nature, limited access to capital, the horizon problem and costly consensus building (Cook, 1994). With some exceptions, co-operatives are typically on the defensive, rather than engaging innovative managerial techniques and strategies.

Mintzberg (1971) (Cook (1994) for cooperatives) groups managerial roles into three categories: interpersonal relationships, transfer of information, and decision making. Collins' approach presented above may facilitate those managerial roles: since catalytic mechanisms are developed by all members of the organization, this process builds and strengthens interpersonal relationships, as well as aids in the transfer of information in a clear way. Decision making becomes transparent since all involved are aware of the process, and aware of their organization's priorities, and of the mechanisms to help them reach their common goal.

## 2.2. The co-operative solution

International Co-operative Alliance (ICA 1995) provides the essence of co-operative identity in the form of Co-operative values and principles. The co-operative values (self-help, self-responsibility, democracy, equality, equity and solidarity) must be in the core of the company long term goals if it is to survive as a co-operative. Those long term goals will include the purpose of setting up a co-operative, the common goals

of the members, be it their economic, social, and/or cultural needs. Co-operative principles are “guidelines by which co-operatives put their values into practice”. Those guidelines should be followed closely by each co-operative business, by definition

As co-operatives mature and establish themselves in the market place, the market forces tend to dominate the co-operative values since often there is a trade-off between the degree of co-operation and the extent of market pressure. However, if we turn co-operative principles into catalytic mechanisms successfully, we will have created the natural device, acceptable and transparent to all members, that can function as a bond among the members, and at the same time induce the manager to endorse the co-operative culture of the members and help put it into practice.

Some examples of successful co-operatives who put their co-operative identity into practice are *Inkwork Press* (Marszalek, 2003) whose goal is “green business”, and the *Co-op Group* in Britain, behind the “Fair trade” initiative. Their long term goals may be defined as a wish to preserve the environment, while they educate consumers and influence other businesses and community in the process (*Inkwork*); or righting the wrongs of corporate free trade by affecting the distributional impact of globalization (*The Co-op Group*). *Inkwork* has, among other mechanisms, implemented one that ensures at least 80% recycled content in their paper supply. They then had to go to great lengths to find a supplier who can guarantee their requirement. This is a catalytic mechanism by Collins’ definition, since it automatically guarantees that they will come closer to fulfilling their long term goal. “Fair trade” is another example of co-operative principles turned into catalytic mechanisms to achieve the long term goal of *The Co-op Group*, no matter how ambitious.

The process of building the catalytic mechanisms is ongoing, they must be updated and changed over time. This process gives members a chance to voice their views about the goals of their co-operatives and preserve what they hold dear. If they are employees with heterogeneous sets of values, through this process they have to find a common goal. To “go green” is not restricted to a co-operative, as any investor-owned business may opt for this strategy, but it follows naturally in a co-operative, as it folds into its principles and its values, available *a priori*. The whole organization shares the goal, it should not have to depend on a manager’s vision, but it needs a manager to be on board to lead in the business strategy, and a manager who will be passionate about this goal for the organization.

On the practical note, the role for the Board of Directors, besides its control function (Bruun and Oleson, 2002), is to hire the right kind of manager, by keeping the job description transparent, and expectations of the manager’s qualities in line with the process of building the vision for the co-op, applying mechanisms to achieve it. Co-operatives must use their own principles, ensure that their manager follows the process, and that is good at motivating the members, employees and all involved in turning their business into a success story. Collins (2001) describes those types of managers as “ambitious for their companies and not for themselves”.

The Board, with the manager, should ensure that the process of defining the organization's purpose and building and revising catalytic mechanisms is institutionalized, by giving powers to committees or members who will oversee and promote different aspects of the agreed-upon process, thereby taking the power away from the manager. In case of management change, a new person who understands both the business they are about to run and the process of building a successful organization pursuing a long term goal *via* catalytic mechanisms, would automatically have to be hired. The organization does not have to have managers who share all co-operative principles *ex ante*, but they must deliver on motivating the employees and members through this institutionalized method. As long as the manager follows the rules presented to her, strengthening co-operative identity will become a part of the job. The catalytic mechanism will have been built in an automatic trigger that ensures preservation of firm's identity, goals, culture and membership.

The manager is a very important part of the process, and, ideally, the process would be built in with a great manager who shares the vision. If that is not the case, an automatic system must be in place to integrate co-operative values into the core purpose of the business organization. Without it, a co-operative has a better chance at failing as a co-operative, even though it may survive as a business.

Lastly, the measure of success will differ in a cooperative and an investor-owned business. While the latter has a clear mandate to maximize profit, co-operative businesses have multi-dimensional objectives (Cook, 1994 for example). The process of determining the core values and purpose of the organization should, therefore, be used as the platform to define those objectives (they will not be the same for all co-ops). The manager and membership cannot expect to base their measure of success on simple return on assets or return on investment, and there will be an important element of the consensus-building process when they have to agree on the set of indicators they will use to measure success.

### 3. CONCLUSIONS

There is a sense in the co-operative community that co-operatives already have built in mechanisms that put them at an advantage over investor-owned firms, but it is difficult to formulate them. Collins' approach provides just that kind of formulation. His framework was described above as a natural management strategy for co-operatives. Collins describes a company's wildest dreams as BHAGs ("big hairy audacious goals"), where core values and purpose of the firm must be preserved as a long term strategy. Co-operatives, we argue, already have those values in place in the form of co-operative values, by definition of co-operative business. Collins goes further to define the catalytic mechanisms as BHAGs' foundations specific, concrete and powerful devices that bring those goals to completion. Co-operatives have those mechanisms already built in, in the form of Co-operative principles. The task then

is to turn those principles into catalytic mechanisms and achieve success in realizing the goals of the organization.

The core purpose of many co-operative businesses includes social goals and community. They are not pressured by the bottom line in the sense of investor-owned firms, and they may have an advantage in pursuing their wildest dreams because of that. They just have to put the co-operative advantages into practice.

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**PART 8**  
**COOPERATIVES, LAW AND  
PUBLIC POLICY**



# THE EUROPEAN COOPERATIVE SOCIETY AND ITS APPLICATION IN SPAIN

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## 1. INTRODUCTION

The consolidation of the internal market has become a priority objective in the European Union as it contributes to achieve the improvement of the economic and social situation. Therefore, it is necessary to remove the obstacles to exchanges, and carry out a restructuring at the level of the UE production organization. For that purpose, it is essential that companies of all types, the business of which is not limited to satisfying purely local needs should be able to plan and carry out the reorganisation of their business on a Community scale.

However, the legal framework within which business should be carried on in the Community is still based largely on national laws and therefore does not correspond to the economic framework within which it should develop if the objectives set out in Article 18 of the Rome's Treaty are to be achieved. This situation may hinder considerably the creation of groups of companies subject to the legislations of the different Member States.

A first advance to solve these legal problems was the approval of Council Regulation (EEC) no 2137/85 on the European Economic Interest Grouping (EEIG), which has allowed companies to jointly promote certain activities, while preserving their independence.

Likewise, and more recently, Council Regulation (EC) no 2157/2001 has been promulgated, which establishes the legal form of the European Company (SE<sup>1</sup>) in accordance with the general principles of the public limited liability company.

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1. The Council Regulation named the European Company SE, latin acronym.

However, these instruments do not adapt to the specific characteristics of cooperatives. The United Nations have urged all countries to ensure a favorable environment in which cooperatives can participate in equal terms with other forms of enterprise. Also, crossborder cooperation between cooperatives in the Community is currently hampered by legal and administrative difficulties, which should be eliminated in a market without frontiers (Dabormina, 1994).

Therefore, the European Community, with the objective of ensuring equal terms of competition and contributing to its economic development, has provided cooperatives, which are a form of organization generally recognized in all Member States, with a European Cooperative Society Statute (SCE<sup>2</sup>) by means of the approval of Regulation no 1435/2003 (EC), which is an adequate legal instrument capable of facilitating the development of their crossborder activities.

Given the importance of this new legal instrument, this paper analyzes the advantages or inconveniences for Spanish cooperatives to become an SCE; therefore we should take into consideration the profusion of commercial regulations in Spain regarding cooperatives. Thus, 13 Autonomous Communities have already regulated this sector through their own cooperative laws, which differ considerably with each other in some aspects.

To develop this work, we will concentrate on the aspects that affect the economic régime of cooperatives and we will analyze, in the first place, the European Cooperative Statute, and compare it with the commercial legislation in Spain, in order to identify the divergences or convergences between them.

## 2. THE EUROPEAN COOPERATIVE STATUTE

As stated in the first recitals of Regulation (EC) no 1435/2003, cooperatives are, primarily, groups of persons or legal entities with particular operating principles that are different from those of other economic agents. These include the principles of democratic structure and control and the distribution of the net profit for the financial year on an equitable basis.

These particular principles include especially the principle of the primacy of the individual, which is reflected in the specific rules on membership, resignation and expulsion; this principle results in the one man, one vote rule and the right to vote is vested in the individual, and involves that members cannot exercise any rights over the assets of the cooperative.

The main objective of the European co-operative society shall be the satisfaction of its members' needs and the development of their economic or social activities.

Thus, it shall have legal personality and respect the following principles, according to Whereas 10 of the Regulation that governs it:

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2. The Council Regulation named the European Cooperative Society SCE, latin acronym.

- Its activities should be conducted for the mutual benefit of the members so that all members benefit from the activities of the SCE in accordance with their participation,
- Members should also be customers, employees or suppliers or should be otherwise involved in the activities of the SCE,
- Control should be vested equally in members, although weighted voting may be allowed, in order to reflect each member's contribution to the SCE,
- There should be limited interest on loan and share capital,
- Profits should be distributed according to business done with the SCE or used to meet the needs of members,
- There should be no artificial restrictions on membership,
- Net assets and reserves should be distributed on winding up according to the principle of disinterested distribution, that is, to another cooperative body pursuing similar aims or general interest purposes.

To constitute an SCE, it is necessary a minimum of 5 natural or legal persons resident in at least two Member States, allowing also its formation by merger of two existing cooperatives or by conversion of a national cooperative into SCE without first being wound up, where this cooperative has its registered office and head office in a Member State and an establishment or subsidiary in another Member State.

The minimum amount of share capital subscribed is established in 30,000 Euro, being variable since it can increase by the admission of new members and decrease by means of total or partial reimbursement of the contributions.

Likewise, the Statutes shall be drawn up by the founder members, in accordance with the provisions for the formation of cooperative societies laid down by the law of the Member State in which the SCE has its registered office. Therefore, the Community regulation avoids contradictions with the legislation in force of each Member State. For this purpose, it establishes that this legislation on preventive control will apply by analogy to the control of the formation of the SCE.

According to the general principles that govern this legal form, next we will review the regulation applicable to European Cooperatives with special emphasis on those aspects that may cause more adaptation problems in Spain.

## **2.1. General rules**

Regulation (EC) no 1435/2003 defines as principal object of the SCE the satisfaction of its members' needs and the development of their economic and social activities, in particular through the conclusion of agreements with them to supply goods or services or to execute work of the kind that the SCE carries out or commissions. Therefore, it seems logic that the disposition that establishes that the SCE shall not admit

that third party who are nonmembers benefit of its activities or allow them to participate in its business, except where its statutes provide otherwise. Thus, allowing the Statutes freedom to regulate a truly controversial issue which in Spain is subject to an important limitation.

Thanks to this Regulation, the Statutes of the SCE become priority dispositions, therefore it can be stated that the Community law is very open and flexible with a great potential for adaptation, although sometimes seem to lack precise limits.

As we have already mentioned, a relatively high minimum amount of capital is established if we compare it with the amount requested in Spain, which seeks to ensure a minimum size of the company and, at the same time, respects the cooperative "open door" principle, as it emphasizes the variable nature of the capital.

According to the Regulation, the SCE shall be registered in the Member State of its registered office, particularly in the registration stated by the legislation of the Member State in accordance with the regulations applicable to public limited liability companies. That is, in Spain one would refer to the Business Register. This raises a number of inconveniences since Cooperatives in Spain do not register in the Business Register, but in the Cooperative Register established to that effect in each Autonomous Community under the cooperative legislation, or in the Cooperative Register of Madrid in the cases provided by Law 27 /1999.

It is evident that for a better control of the Cooperatives that are formed under this new legal form, it would be convenient that the registration were carried out in the corresponding Cooperative Register.

Regarding the conditions to fulfill to be listed in the Register, although it is formed by merger, it is necessary to highlight the need established in the Regulation to reach an agreement of the employees' involvement pursuant to Article 4 of **Directive 2003/72/EC**. With the approval of this Directive, the requirements to meet by the agreements have been established for an SCE to be formed. This is an important aspect to keep in mind, since the Statutes shall not include dispositions contrary to these agreements.

When the legislation of the Member State allows it, the SCE admits the possibility of investor members or non users, that is, people that do not expect to use or produce the SCE's goods and services. In this case, the acquisition of membership shall be subject to approval by the general meeting or any other organ delegated to give approval by the general meeting or the statutes.

A file with all the members shall be kept at the SCE, with their addresses and the number and, if appropriate, class of shares they hold. Any transaction which affects the ownership or distribution of capital, or its increase or reduction, shall be entered in the file of members within a maximum of one month. These transactions shall not take effect with respect to third parties having a direct legitimate interest until they are entered on the file of members.

## **2.2. Establishment**

The Regulation (EC) no 1435/2003 governs the establishment of the SCE by the Cooperative mergers and by transformation of an existing cooperative into an SCE provided that it has its registered office and its head office in a Member State and an establishment or subsidiary in another. The procedures of formation by merger include 18 articles that develop its main characteristics, but this exceeds the scope of this research and will not be dealt with.

## **2.3. The structure of the European Cooperative society**

The SCE will have of a General Assembly and depending on the management and control of the society, two systems can be distinguished:

- Onetier system, with only one administrative organ.
- Two-tier system that consists of two organs, control and management.

In the General Assembly, it should be pointed out the members' right to vote. Obviously, each member shall have one vote, regardless of the number of shares he/she holds. However, the Community legislator, aware of the variety of legislations applicable in this area, with its most outstanding example in the situation we have in Spain with 14 cooperative laws, admits, when the legislation of the Member State so permits, weighted voting. That is, it can be established in the Statutes that the number of a members' votes is determined by its share in the cooperative activity by different means from the capital contribution. This attribution shall not exceed five votes per member or 30% of the total voting rights.

In SCEs the majority of members of which are cooperatives, if the law of the Member State in which the SCE has its registered office so permits, the statutes may provide for the number of votes to be determined in accordance with the members' participation in the cooperative activity including participation in the capital of the SCE and/or by the number of members of each comprising entity.

As regards voting rights which the statutes may allocate to nonuser (investor) members, the SCE shall be governed by the law of the Member State in which the SCE has its registered office. Nevertheless, nonuser members may not together have voting rights amounting to more than 25% of total voting rights.

## **2.4. Application of results**

The Regulation does not define in detail the results of the financial year, leaving its regulation to the applicable legislation in the Member State.

However, it establishes that the Statutes will foresee, in the event that such surpluses exist, that before any other application of the results, one part of them goes to the constitution of a Legal Reserve.

Until such time as the legal reserve is equal to the minimum capital referred to in the legislation of the Member State, the amount allocated to it may not be less than 15% of the surplus for the financial year after deduction of any losses carried over.

This Legal reserve shall not be divided between the members, since the Regulation establishes that the retiring members shall not allege any right on the amounts dedicated to this Reserve. However, it does not define its final use.

These dispositions generate, as we will see in the following sections, contradictions with the autonomous cooperative legislation, due to the importance given to the contributions to the Obligatory Funds.

### **3.THE COOPERATIVE LAW IN SPAIN AND ITS DIFFERENCES WITH THE EUROPEAN COOPERATIVE SOCIETY**

The Spanish legislation on cooperatives, as we have already mentioned, is very extensive because thirteen Autonomous Communities making use of their competences in this matter have issued legislations (Table1); in addition to those laws we should add the Cooperative Law 27/1999 promulgated by the central Government to regulate the cooperatives located in Autonomous Communities that do not have specific regulation.



**TABLE 1.**  
**AUTONOMOUS COOPERATIVE LAWS**

<b>Autonomous Community</b>	<b>Law</b>
Estatal	Cooperative Law 27/1999, of 16 July, Law 20/1990, of 19 December, on tax regimes of cooperatives.
País Vasco	Law 4/1993, of 24 June, on Cooperatives in País Vasco, amended by law 1/2000, of 29 June.
Cataluña	Cooperative law 18/2002, of 5 July.
Andalucía	Cooperative law in Andalucía, adopted by the Andalucía parliament on 10 March 1999.
C. Valenciana	Law 8/2003, of 24 March, on cooperatives in the Valencian Community
Navarra	Law 12/1.996, of 2 July, on Cooperatives in Navarra.
Extremadura	Law 2/1.998, of 26 March, on Cooperatives in Extremadura
Galicia	Law 5/1998, of 18 December, on Cooperatives in Galicia.
Aragón	Law 9/1998, of 22 December, on Cooperatives in Aragon.
Madrid	Law 4/1999, of 30 March, on cooperatives in the Community of Madrid.
Rioja	Law 4/2001, of 2 July on cooperatives in La Rioja.
Castilla y León	Law 4/2002, of 11 April, on cooperatives in the Community of Castilla y León.
Castilla –La Mancha	Law 20/2002, of 14 November, of cooperatives in Castilla – La Mancha.
Baleares	Law 1/2003, of 20 March, on Cooperatives in Baleares

Source: Marí, S. (2003).

Next, we will carry out a comparative study of these legislations with European Cooperative Statute.

### **3.1. Characteristics of the cooperatives governed by the Spanish law and Regulation (EC) no 1435/2003**

Through the study of all the Cooperative Laws in force in Spain, we have extracted the possible differences between the Spanish cooperatives and the SCE as shown in tables 2, 3, 4 and 5.

**TABLE 2.**  
**CHARACTERISTICS OF THE COOPERATIVES UNDER LAW 27/1999,**  
**ANDALUSIAN COOPERATIVE LAW 2/1999, COOPERATIVE OF ARAGON LAW**  
**9/1998 AND COOPERATIVE OF BALEARES LAW 1/2003**

	<b>Law 27/1999).</b>	<b>Andalucía</b>	<b>Aragón</b>	<b>Baleares</b>
Operations with third parties	According to coop. type	According to coop. type	According to coop. type	According to coop. type
Minimum capital	Statutes	3.000 euros	Statutes	1.803 euros
Investor member	Collaborator member	Member	NO	Member
Weighted voting	When member is coop. or institution. In agricultural, transport, services and fishing coop	NO	When member is icoop. or institution.	In agricultural, transport, services and fishing coop
FRO non divisible	YES	NO 50% to member in case of deletion	YES	YES

Source: Own elaboration from different cooperative laws.

**TABLE 3:**  
**CHARACTERISTICS OF THE COOPERATIVES UNDER CASTILLA LA MANCHA**  
**LAW 20/2002, CASTILLA Y LEÓN COOPERATIVE LAW 4/2002, CATALUÑA**  
**COOPERATIVE LAW 18/2002 AND EXTREMADURA COOPERATIVE LAW 2/1998**

	<b>Castilla La Mancha</b>	<b>Castilla y León</b>	<b>Cataluña</b>	<b>Extremadura.</b>
Operations with third parties	According to coop. type	According to coop. type	According to coop. type	According to coop. type
Minimum capital	3.000 euros	2.000 euros	3.000 euros	3.000 euros
Investor member	Collaborator member	Collaborator member	NO	Member
Weighted voting	When member is. coop. or institution	When member is coop. or institution. In agricultural, transport, industrial, and community farming coop.	YES, except in associated workers and consumers coop.	In agricultural coop.
FRO non divisible	YES	YES	YES	YES

Source: Own elaboration from different cooperative laws.

**TABLE 4.**  
**CHARACTERISTICS OF THE COOPERATIVES UNDER GALICIA LAW 5/1998,**  
**MADRID COOPERATIVE LAW 4/1999, NAVARRA COOPERATIVE LAW 12/1996**  
**AND PAIS VASCO COOPERATIVE LAW 4/1993**

	<b>Galicia</b>	<b>Madrid</b>	<b>Navarra</b>	<b>País Vasco</b>
Operations with third parties	According to coop. type	According to coop. type	According to coop. type	According to coop. type
Minimum capital	3.000 euros	1.803,04 euros	NO	NO
Investor member	Collaborator member	Member	Member	Collaborator member
Weighted voting	In agricultural, services and fishing coop	NO	NO	When member is coop. or institution.
FRO non divisible	YES	YES	YES	YES, with exceptions

Source: Own elaboration from different cooperative laws.

**TABLE 5.**  
**CHARACTERISTICS OF THE COOPERATIVES UNDER LA RIOJA LAW 4/2001,**  
**AND VALENCIA COOPERATIVE LAW 8/2003**

	La Rioja	Valencia	SCE
Operations with Statutes	According to coop. type	According to coop. type	NO, except third parties
Minimum capital	1.803 euros	3.000 euros	30.000 euros
Investor member	Collaborator member	Member	Member State
Weighted voting	In agricultural, services and transport coop.	YES	YES, with limitations
FRO non divisible	YES	YES	YES

Source: Own elaboration from different cooperative laws.

The points analyzed correspond to those in which significant differences between regulations have been identified. Also, these questions coincide with those frequently discussed throughout the drafting of the Statute of European Co-operative Society (Minondo, 2002), since the European regulation in these matters is very different.

Thus, we find that the Statute of European Co-operative society does not authorize the realization of transactions with third parties nonmembers, unless they are admitted in the Statutes of the Society. In Spain, we find that they are mainly limited depending on the type of cooperative, but their existence is admitted in any case.

With regard to the amount of minimum capital, these vary considerably in Spain from one Autonomous Community to another, and they are very far from what is provided for by the SCE, therefore this circumstance shall be kept in mind by the cooperatives willing to become an SCE.

The role of the investor member was polemic in the discussions towards the agreement of this Statute in the European Union (Minondo, 2002) since this role does not exist in the German and Portuguese legislation. Therefore, the solution was to adopt it provided that it was considered by the legislation of the Member State. In Spain, we find the role of collaborating member in Castilla La Mancha, Castilla León, Galicia, La Rioja, País Vasco and the Autonomous Communities that have not regulated this aspect and, in general, in all those cooperatives that are governed by Law 27/1999. The role of the associate member in the legislation of Andalucía, Baleares, Extremadura, Madrid, Valencia and Navarra, may open the possibility for investor members depending on its regulation in the Cooperative Statutes. Therefore, this figure shall not be an employee only in 2 Autonomous Communities: Catalonia and Aragon.

Weighted voting has also been resulted a very controversial issue in the drafting of the European Statute, since it is not known or very restricted in the legislations of the United Kingdom, Ireland and Germany, however it is admitted to some extent in other Member States. A similar situation is found in Spain. Regarding first order cooperatives, it is not admitted in Andalusia, Madrid, Navarra, while in the rest of the Autonomous Communities it is considered with many limitations, depending on the type of cooperative or on the type of member present. However, all over Spain the weighted voting is admitted in the case of second order cooperatives.

Finally, another characteristic analyzed refers to the non-refundable nature of the Obligatory Reserves Fund, in the case of liquidation. In this sense, the Statute of European Co-operative Society does not define this Legal reserve, but simply establishes a series of precautions concerning its allocation and non-refundable nature. In Spain, the cooperative laws of Valencia, Andalucía and País Vasco admit the possibility that some of the profits allocated shall return to the members in some cases; thus, the cooperatives located in these Communities willing to establish an SCE shall regulate this situation in their Statutes by defining the Obligatory Reserve Fund as non-refundable to comply with Regulation (EC) no 1435/2003.

Likewise, another difference between the different regulations is the minimum obligatory allocation to the so-called Obligatory Funds that we examine in the following section.

### **3.2. The minimum obligatory allocation to the Obligatory Funds**

Article 65 of the Statute of European Co-operative society establishes the obligation of the society of allocating the Legal Reserve in cases of positive surplus, with 15% of the benefits, after deduction of any losses carried over, until the Legal Reserve reaches as minimum amount of share capital required to establish an SCE, 30,000 euros. However, it does not define in detail this reserve, except for the disposition already mentioned about its nonrefundable nature.

However, all the Spanish cooperative laws take into consideration two Obligatory Funds that may slightly vary its name from one Autonomous Community to another, they are: the Obligatory Reserve Fund mainly used to compensate losses and the Fund of Education and Cooperative Promotion used in shares aimed at developing cooperatives.

Thus, the Obligatory Reserve Fund is assimilated with the Legal Reserve mentioned in Regulation (EC) no 1435/2003, and therefore it is necessary to verify if it complies with the minimum allocation established in the European legislation.

In order to verify this, we have revised the minimum allocations established in the Cooperative Laws in Spain applicable for the Obligatory Reserve Fund (Table 6).

**TABLE 6.**  
**MINIMUM ALLOCATIONS TO THE OBLIGATORY FUNDS IN SPAIN AND ACCORDING TO REGULATION (EC)**  
**NO 1435/2003**

Minimum allocations to the Obligatory Funds		Fulfillm. SCE
Rgter. (CE) nº 1435/2003		
Law 27/1999		
Andalucía	Si FRO ≤ CS Si FRO > CS	FRO = 0,15 RDI FRO = 0
	FRO = 0,20 RCAL + 0,50 REAI	
	Si FRO ≤ CS FRO = 0,20 RCAL + 0,80 Rdos 3 <sup>o</sup> + Rextr	Si FRO > CS FRO = 0,15 RCAL + 0,80 Rdos 3 <sup>o</sup> + Rextr
Aragón	Si FRO ≤ 0,5 CS FRO = 0,30 RCDI+ 0,50 REDI	Si 0,5 CS < FRO FRO = 0,25 RCDI+ 0,50 REDI
		Si FRO > 2 CS FRO = 0,20 RCDI+ 0,50 REDI
Baleares	FRO = 0,20 RCAL + 1 EAI	
Castilla La Mancha	Si FRO ≤ 2 CS FRO = 0,20 RCAL + 0,50 REAI	Si FRO > 2 CS FRO = 0,15 RCAL + 0,50 REAI
Castilla León		
	FRO = 0,20 RCAL + 0,50 REAI	
Cataluña		
	FRO = 0,30 RCAL + Capital gains + 0,50 REAI	
Extremadura	Si FRO ≤ 0,5 CS FRO = 0,30 RCDI+ REDI	Si 0,5 CS < FRO ≤ 2 CS FRO = 0,25 RCDI+ REDI
		Si FRO > 2 CS FRO = 0,20 RCDI+ REDI
Galicia		
	FRO = 0,20 RCDI + 0,50 Rextr + Rdos 3 <sup>o</sup>	Si
Madrid	Si FRO ≤ 3 CS FRO = 0,20 RCDI+ REDI X ≤ 0,20	Si FRO > 3 CS FRO = x RCDI+ REDI
Navarra	Si FRO ≤ 0,5 CS FRO = 0,30 RCDI+ 0,50 REDI	Si 0,5 CS < FRO ≤ 2 CS FRO = 0,20 RCDI+ 0,50 REDI
		Si FRO > 2 CS FRO = 0,10 RCDI+ 0,25 REDI
País Vasco	Si FRO ≤ 0,5 CS FRO = 0,25 RDI	Si FRO > 0,5 CS FRO = 0,20 RDI
La Rioja	Si FRO ≤ 0,5 CS FRO = 0,20 RCAL+ 0,50 REAI	Si FRO > 0,5 CS FRO = 0,15 RCDI+ 0,50 REDI
Valencia	Si FRO < CS FRO = 0,20 RCAL+ 0,50 Rextr + Rdos 3 <sup>o</sup>	Si FRO ≥ CS FRO = 0,50 Rextr + Rdos 3 <sup>o</sup>

Source: Own elaboration from different cooperative laws.

Where:

FRO = Obligatory Reserve Funds

CS = Share Capital

RDI = Results after subtracting Corporate tax.

RCAI = Cooperative Results before subtracting Corporate tax.

RCDI = Cooperative Results after subtracting Corporate tax.

REAI = Extra cooperative results before subtracting Corporate tax.

REDI = Extra cooperative results after subtracting Corporate tax.

R Extr = Extraordinary Results of the financial year.

Rdos 3<sup>o</sup> = Derivative results of operations with third parties nonmembers.

In the cooperative norms applicable in Spain, with the exception of the Pais Vasco Cooperative Law, there is a distinction between cooperative and extra cooperative results; these latter are those derived from the cooperative activity with third parties nonmembers. According to some of the Laws studied, these results would also include the so-called in accounting, extraordinary results, which are those not related with the ordinary activity of the society. However in Andalucia and Valencia they are separated and assigned with different purposes.

According to the results obtained, the minimum allocation to the Legal reserve established in the community Regulation is fulfilled, therefore if the cooperative complies with the legislation in its Autonomous Community, it will also comply with the EU legislation.

## 4. CONCLUSIONS

The Statute of European Cooperative society is open and compliant with the regulations of the Member States. In fact, it introduces aspects that although regulated by some EU countries, others do not mention it, and set forth as a condition for their application to be admitted in the Member State (Fajardo, 2002). That is the case of the investor member, a polemic role, due to the possible contradiction with the spirit of cooperatives, but extremely useful from a financial point of view. However, it is evident that cooperatives governed by regulations that do not take into consideration this financing opportunity will not be able to benefit from it, as it happens in Spain with Catalonia and Aragon.

Nevertheless, the non-refundable nature of the Obligatory Reserve Funds stated in the Statute of European Cooperative society, conflicts with the cooperative law of Valencia, Andalucia and País Vasco, where it is admitted that part of the benefits allocated to the cooperative may return to the members with certain requirements. Therefore, in these Communities, the cooperatives willing to become an SCE shall clearly define this aspect in their Statutes, in this case giving up the possibility of division.

On the other hand, weighted voting, as well as the minimum allocation to the Obligatory Reserve Fund and the minimum amount of capital, shall be established in the Statutes of the Society, which appear as the supreme norm for the cooperative.

In sum, the Statutes cannot contradict the applicable autonomous regulations in each case, and they obviously shall respect the minima established by the EU Regulation of the European Co-operative Statute.

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# HUNGARIAN EXPERIENCES IN REFORMATION OF AGRICULTURAL CO-OPERATIVE SYSTEM

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## 1. SHORT HISTORICAL BACKGROUND

In Hungary the agricultural self-organisations have very old tradition. Before Second World War the farmers' interest representing organisations, supplying, marketing and credit co-operatives were wide-spread in the rural areas helping farmers in their production and partly in their consumption activity. This development after Second World War was interrupted. At the second part of the 1940s' the farmers' self-organisations were totally liquidated and collectivisation of the agriculture had started and which was completed by 1961.

During the economic reforms from the middle of 1960s a Hungarian agricultural producers' co-operative model was developed. The reforms changed the relations between the co-operatives and state administration. The economic reform increased the autonomy of co-operatives' decision-making in the establishment of co-operative unions, creating their structures from the bottom upwards. In addition, the co-operatives were not given plan orders. Parallel to this process, the co-operatives were forced by the state and party organisations and, in some cases, by the co-operative management to merge into larger units. Under the reform, the co-operative management (the "experts") gradually took over the control of the co-operatives. In spite of fact that the formal democratic fora still functioned,<sup>1</sup> this social group became the strongest one, while "simple" members were gradually pushed into hired-labour positions.

In spite of the economic reforms dating back to the middle of 1960s, the Hungarian co-operatives could not accommodate themselves to market-economy conditions. We can summarise the main causes of this situation with the following points:

- In spite of the reforms, the co-operative system in Hungary had also been characteristically "socialist", since producers' co-operatives dominated the sector.

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1. The formal democratic fora of co-operatives were under, more or less, informal control of party organisations. Practically no president of a co-operative could be elected and stay in his position without the consent of the regional party organisation.

- The producers' co-operatives were horizontally organised. The secondary co-operatives, as well as supply, marketing and real credit co-operatives, were totally missing.
- Their "integrating organisations" were state owned enterprises, which had been sold to domestic and foreign investors and not to the co-operatives or private producers.
- Following the "large is beautiful" slogan, ineffective, inflexible, bureaucratic co-operatives were created.
- The economic reform of the 1960s was based on management, and the members' control was weakened.
- The federations of the several co-operative branches were under co-operative management control, mainly that of the presidents.
- The privatisation of the co-operative assets was not controlled. This was in the favour of the management.
- The new political regime was hostile towards every kind of co-operatives.

The period between 1988-1990 was important for the Hungarian farm sector's transition towards market-economy conditions, which concerned the individual farm sector and the farmers' self-organisations as well.

In 1988 the modification of the Co-operative Law was a milestone of the Hungarian co-operative legislation. Due to this modification after a 40-year pause, the Co-operative Law again provided the opportunity for private (individual) producers to establish so-called "small producers' co-operatives", which were in fact supply and marketing co-operatives. Another modification of the Co-operative Law in 1989 authorised the co-operatives to privatise (that is, "to assign") 50 per cent of their indivisible assets in favour of the members.

Another important step was the acceptance of the so-called Law on Associations in 1989 (Law No. II of 1989). From this time forward, the right of association in Hungary was declared a fundamental human right. This law provided the possibility to create associations by citizens, and for individual farmers to recreate so-called "farmers' cycles" to enforce their interests. The character of the associations, including the farmers' cycles, was determined by the fact that they were not allowed to establish primarily economic and entrepreneurial purposes.

The change in the political system put the issue of co-operatives into a different perspective. The new regime (and, let's add, public opinion as well) considered co-operatives relics of "state socialism". In this light, the new government did its best to break the backbone of the co-operative system (e.g. the producers' co-operatives), but did not take steps towards making marketing, supply and credit co-operatives widespread in the market economy. (As we are used to saying: the new regime poured the baby out with the bath water.)

Under the former Co-operative Law, the producer-type co-operatives were obliged to employ their members. The main economic objective of these co-operatives was determined by this fact. The contribution of agricultural producer co-operatives to employment was essential, especially in the rural areas.

The agricultural producers' co-operatives, and to some extent the consumer co-operatives, had integrated the production of a huge number of individual agricultural small producers directly and (through the so-called "special groups") indirectly. During the transition period, the agricultural producer co-operatives gave up integrating small scale producers. The consumer co-operatives did the same.

In early 1992, the Parliament passed the Law I of 1992 on Co-operatives ("The Co-operative Law") as well as Law II "On the Entry into Force of Law II Co-operatives in Hungary before June 31, 1992" ("Law of Co-operative Transition").

Under these laws, the co-operatives were collective enterprises based on the private property of their members. The Co-operative Law provided a legal definition for co-operatives: "A co-operative is a collective established in accordance with the principles of the freedom of association and self-help that pursues entrepreneurial and other activities serving the interests of members, through the personal participation and financial contribution of members, and within the framework of democratic self-government. The co-operative is a legal entity." (Article 3)

A co-operative could be established by at least five people, and at least 15 people were required for the foundation of a co-operative to function in an educational institution (school co-operative), or for the setting up of a credit co-operative. The members of a co-operative were natural persons, and the bylaws also permitted the membership of legal entities.

A person joining the co-operative was required to buy at least one share, and could subscribe more if the bylaw allowed it. Each member's liability was restricted to his shares. Dividends were to be paid on each co-operative share, from the after-tax profit of the co-operative. The members could make contributions in other forms as well as subscription to shares, and they could apply for shares up to the value of their contributions.

Under the Law of Co-operative Transition, each existing co-operative:

- had a choice between re-registering under the new co-operative law or transforming itself into a company with limited liability or joint stock company;
- the members were allowed to secede from the co-operative;
- groups of co-operative members could also choose to secede from a larger co-operative.

The three decades of collective farming in Hungary made the agricultural population hired labourers. The entrepreneur-like mentality was almost totally lost over the years. After the political change, most of the co-operative members insisted on having a work place and did not want to secede from the co-operative to become

individual farmers. This was one of the main obstacles to the faster transition of Hungarian agriculture.

The Co-operative Law of 1992 was the result of a compromise, and it was mainly in favour of the agricultural producers' co-operative. It did not provide a legal basis for a "new type" of co-operative, i.e. supply and marketing co-operatives.

After a long preparatory period, the Hungarian Parliament on 19 December 2000 accepted Law No. CXLI on "The New Co-operatives". Under this law: "The co-operative is established with an amount of share-capital determined by the bylaw, operating on the principle of open membership and of variable capital, as well as serving to promote the individual economic activity of its members -including the consumption of its natural person members- and furthermore occasionally serving to satisfy the cultural, educational, and social needs of the members, employees, and their relations; it is an economic organisation with legal entity." [Article 3. (1)]

This law, like the previous one, puts emphasis on the obligations of the co-operative members towards the co-operative. It is not enough, to state it will be "serving to promote the individual economic activity of its members". This "obligation" is too general. The other problem with this law is that it defines only some aspects of the co-operative as a particular economic organisation. Many "open questions" remain and this makes it possible to create pseudo-co-operatives as well. For instance, the law did not state whether the co-operatives can maintain business activities with non-members as well, and if they can, to what extent.

## 2. CHANGING IN THE FARM STRUCTURE

The basic question in the transition period in Hungary was whether the country would be able to transfer farm structure and to create farmers' self-organisations. At the beginning of the 1990s there were hopes for "organic" transformation (inner decentralisation) of the farm structure from the large-scale co-operative farms into small and medium scale family ones, and the parallel recreation of "new type" interest enforcement organisations and co-operatives.

Three scenarios for the transformation of the farm structure were outlined at the beginning of the 1990s:

1. splitting up the existing agricultural producers' co-operatives. (This was the aim of the first freely elected government.)
2. holding together the agricultural producers' co-operatives by transforming them into companies. (This was the favourite scenario of the co-operative union.)
3. carrying out an inner decentralisation of the agricultural producers' co-operatives. This decentralisation would have been the "organic" transformation of the farm structure. (This scenario was proposed by some experts working for the Hungarian Co-operative Research Institute)

Because the government did not enforce its policy against the co-operative union, and neither the government nor the co-operative union were partners for the third scenario, the second scenario dominated the transformation.

The result of transformation of the farm sector is summarised in the next table.

#### FARM STRUCTURE BY LAND USE (AGRICULTURAL AREA), %

Size categories	1997	2003
Large scale	56	40
Medium scale	12	20
Small scale	32	40
Altogether	100	100

Large scale 300 hectares and more, medium scale 30-300 hectares, small scale: 30 hectares or less

(Data for 1997 are actual, while those for the other years are expected.)

Source: Az agrárgazdaság, a vidékfejlesztés és a területfejlesztés stratégiai kérdései (Strategic Questions of Agriculture, Rural Development and Regional Development), Ministry of Agriculture and Regional Development, Budapest, March 1999. Magyarország mezőgazdasága (Agriculture of Hungary) Hungarian Central Statistical Office, 2004

The data shows that the large scale (company and co-operative) farms continue to dominate the structure. In spite of that the large scale farms as a whole are unprofitable, they need every year substantial state support for covering their lost.

The proportion of the desirable and profitable medium-sized farms makes up 20 per cent in 2003. This category of farms could provide the backbone of the "new" type co-operation. The lack of a strong small- and medium-size farm sector causes another loss in income for the agriculture. The experience of Western European countries shows that the commercialised small- and medium-sized farms can create and receive an economic advantage from self-organisations.

### 3. CURRENT STATUS OF THE FARMERS' SELF-ORGANISATIONS

After the political change, several farmers' self-organisations have been established by the individual farmers in Hungary. In 2003 about 900 local farmers' associations (cycles, societies and village clubs) with the aim of representing farmer-interests were functioning with some 42 thousand small- and medium-sized farmer-members. About 800 selling-, servicing-, and supplying-co-operatives, machine rings, and organic-products organisations, among others, were functioning in last year.

The number of individual (family) commercialised farms belonging to supplying, servicing and marketing co-operatives is estimated at 35 thousand ones. Obviously the overlapping of the two types of farmers' self-organisations is almost complete.

Among the 800 selling-, servicing-, supplying-co-operatives, machine rings, organic-products organisations and others, there can be found: (1) well functioning democratic economic organisations, (2) badly or hardly functioning co-operatives in every respect, and (3) pseudo-co-operatives (established with the aim of obtaining state support). By my estimation<sup>2</sup>, only one-tenth (!) of the "new type" co-operatives, or about 80 entities, belongs to the first category.

In the Southern Great Plain Region the "density" of the commercialised individual farms is enough for the creation of farmers' self-organisations. This is the reason why in this region the most "new" type co-operatives can be found. In spite of that several obstacles blocked the further strengthening of the individual private farm sector in this region too.

Either the private farmers did not access their share-assets and "old" type co-operatives used these assets, or the "old" type co-operatives were liquidated while the former management received all the assets. Now most of the individual farms could not be commercialised because of lack of assets, capital, credit, etc. Every five to ten individual farms are able to produce for the market.

The commercialised small- and medium-sized individual farmers in the Southern Great Plain Region are mostly open towards the new farmers' organisations. The regional- or county-level organisations (like the regional development council, the county agricultural chambers, the county offices of the Ministry of Agricultural and Regional Development and its local representatives, the village agronomists) play a very important and positive role in restructuring the farm structure and establishing farmers' self-organisations.

Selecting the self-organisations for the case studies was a very hard task. In the Southern Great Plain Region about a hundred farmers' servicing, purchasing, marketing self-organisations are registered. As in the Southern Great Plain Region, a great number of pseudo, new-type co-operatives are in operation; when we were looking for organisations that answer to the selection criteria, only about a dozen could be found.

Selection criteria were as follows. They had to be:

- created and operated by individual farmers,
- operating in real terms,
- democratic organisations,
- consistent with the economic goals of its members,
- non-profit organisations.

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2. This estimation is based on a survey. During this survey ten per cent of the new type co-operatives were interviewed.



After all, during the project five self-organisations of the Southern Great Plain Region were selected. We acquainted only two of five. In every settlement twin self-organisations were established by the individual farmers, the first being an interest-representing association and the other a “new” type co-operative.

Among the selected farmers’ self-organisations there were so-called “agency” types, “enterprise” types, and mixed type co-operatives. The main characteristics of these organisations can be summarised in the following paragraphs.

The economic activity of the “agency” type co-operative is determined directly by the members’ needs, so this type of co-operatives represents the vertical expansion of the members’ “basic” activity (subsidiary character). This type of co-operative itself has no economic goal of its own; it is a co-ordinator of otherwise independent farmers’ units. “The co-operative does not pursue a separate economic career apart from its member farms. Instead, the member farms each pursue their own economic careers and own and operate their co-op activity jointly in order to pursue their separate economic careers more effectively.”<sup>3</sup>

As the organisation grows large, the “enterprise” character is strengthened. The members become less familiar with each other and the co-operative may lose its subsidiary character. The autonomy of such co-operative has increased achieving its own economic goal and independent business policy. The co-operative development usually leads to a two-fold direction control. The membership exercises the owner control, whereas the management ensures the control of technical character. In this latter case, this might mean that the management places or may place the co-operative enterprise’s interest above the single member’s interest. There is a real danger in the case of “enterprise” type co-operatives in which the management manages to “seize the power” and to transform the co-operative into a company.

#### 4. GRASSROOTS, AGENCY TYPE SELF-ORGANISATION IN GÁDOROS

Gádoros is a typical medium-sized agricultural settlement in the middle of the Southern Hungarian Great Plain Region. The population of the village has declined steadily because of the drop in living conditions. Ten years ago the population was about 6,000, now it is 4,200.

The soil is very good, one of the best in the region and in the country. The production pattern is a conventional grain and pig dominated structure. Mainly in the middle of the last decade, 1200 of the co-operative members over time lost their jobs and became compulsory small-producers.

Relatively recently (that is, only in 1998) and on the basis of the Law on Associations, a group of individual small- and medium-sized farmers created an interest in a defending organisation, the Association of the Gádoros’ Agricultural

3. Philips, R.: Economic Nature of the Co-op Association, *Journal of Farm Economics*, Febr.1953. p. 131.

Producers. The association was registered and joined the Hungarian Association of Farmers Circles and Co-operatives.

The association provided for meetings and discussions of their problems. It was also vitally important that the farmers as an organisation and through their leaders could express their problems at both the county and national levels and could obtain direct information.

Before the establishment of the co-operative, the individual dealers (in the local usage “jobbers”) bought up the pigs. The pig-breeders were totally defenceless against these dealers. The dealers designated the pigs’ qualifications and the farmers could not control the result of qualification.

Seeking some solution for the basic problems of the individual farmers, the leaders of the association took part in several meetings in the county seat where they heard of the “new” type of co-operatives and they initiated a movement to establish a supplying and marketing co-operative mainly for the pig-breeders. In April 1999, 74 small- and medium-sized individual farmers established the Gádoros’ Farmers’ Purchasing and Selling Co-operative. The chair of the association was elected president of the co-operative. The same people were elected into the board of directors. As regards the leaders, there is a perfect “personnel union” between the two farmers’ self-organisations of the village.

Roughly one third of the co-operative membership consists of retired small producers, one third of part-time, young, small-sized farmers, and one third of medium-sized full-time farmers. This last group of members is the most active and seemingly they play the leading role. This means only that they are mainly interested in the successful activity of the co-operative. Some of the producers sell through the co-operative 500-600 pigs, some of them only 1 or 2. What is more, some people joined the co-operative who had stopped pig breeding. They are potential pig-breeders.

These two self-organisations are really very democratic, grassroots organisations. The president and the board members have personal contact with all members and know their problems.<sup>4</sup> “Both sides” of the co-operative, i.e. the members and the board of directors, perfectly understand the “economic character” and the “economic nature” of such an organisation. That is, the co-operative must take the interest of individual farmers. The general assembly of the co-operative is held every quarter of a year. The board of directors meets every month. Every month, on the first Thursday of the month, information meetings are held for the members. Half of the members take part at these meetings regularly. In winter this percentage is higher, in summer lower.<sup>5</sup>

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4. Making this case study I spent two days in the village, mainly in the small office of the co-operative. During this two days about half of the members came in the office to clarify the same questions concerning the pig market.

5. During the two days I spent in the village I listened to the dialogues the president and the members coming in the office of the co-operative I felt a *déjà vu* feeling that I lived through like this once upon a time. And I realised that was not a *déjà vu* feeling I lived through this in Southern France twenty years ago. I experienced again the real mentality of the farmers who are anxious for the price and 1 HUF (USCENT0.5) surplus in the price per kilogram of pork has significant for them.

It is an interesting situation, the board of directors and the president not only understand the “economic character” of such an organisation, but depend on the members because the co-operative has no assets of its own. If the co-operative wants to buy something, to invest or to ask for credit, it can do so only through the membership as only they have assets granting mortgage. If the co-operative had its own assets, the situation would be different. In this case the character of the co-operative may change. This is the big dilemma for the future: should the assets of the co-operative be financed directly by the members or should the assets be allowed to accumulate by the co-operative itself? (Currently this situation is out of question as the co-operative is unable to accumulate.)

The co-operative is dealing with pig marketing and supplying with several fodder components and brood sows of the pig-breeders. Another interesting and new activity is providing members a so-called production loan from the farmers’ credit they received.

Now the co-operative members and the association members have an advantage over the non-members’ contractors. The co-operative deducts 2 per cent from the price, in the case of non-members, but for members of the association it deducts 3 per cent and from a non-co-operative and non association members 4 per cent. The co-operative enforces the same percentages in the case of the fodder and the production loan also.

The co-operative has a medium-term, five-year frame-contract with two slaughterhouses. The co-operative continuously bargain with them and regularly inform the members on the prices. The pig-breeders receive higher prices thanks to the co-operative bargain power and have received a safety net as regards the market and the qualification.<sup>6</sup> This is the case for fodder as well.

This co-operative is a non-profit organisation in real terms. Its income just covers the expenses of the salaries of two people, the honorarium of the president and the other expenses (maintenance of the office and travel costs).

## 5. AN ENTERPRISE TYPE CO-OPERATIVE IN A DISADVANTAGED REGION

Mórahalom is a so-called agricultural town and is a micro-regional centre in the Hungarian Great Plain. This kind of town is widespread where the settlements are surrounded with a great number of scattered farmhouses. Most of the population of such kind of towns consists of farmers who have a house or a flat in the town, but from spring to autumn they are living in scattered farmhouses.

In this micro-region sixty-eight (!) percent of the population lives off the agriculture. This is the highest rate among the micro-regions in Hungary. The quality of the soil is one of the worst in the country – it is a wind-blown sandy one. This micro-region is a geographical unit at the same time. Its name is “sandy ridge”. The production pattern is adjusted to this natural condition: grape, fruits and vegetable production dominate. The climate and the soil are extreme but favourable for premier fruit and vegetable production.

Consequent to the specific farming system at the beginning of the 1960s in Mórahalom, a “lower type” and “special” co-operative was organised. In this type of co-operative the farmers could keep 3-5 hectare land in spite of the producers’ co-operatives where the land was cultivated collectively and only half-hectare land was allocated to the members. The special co-operatives had some land in collective use, but the members might keep all animals in their so-called member-farms. The main function of this kind of co-operative was to provide services to the member-farms, buying up and partly processing the products of them.

After the political turn, the special co-operative lost its traditional partners as they were privatised or went bankrupt. This special co-operative was liquidated in 1992, and after that about 1,500 individual private farms were restored. As the former co-operative members depended on the special co-operative this was a new situation, a learning period for them.

In 1993 the self-government realised this problem and decided to manage the individual farmers. Firstly an agricultural commission was created inside the municipal corporation, and following this a department was established in the self-governmental office promoting the individual farmers’ activity. This department was a forerunner of the so-called village agronomist system introduced in 1994. This self-governmental department provided an extension service, and advises the newly independent farmers.

A part of the farmers very quickly adjusted to the new situation and as a result of this the production started to increase. The help that the self-governmental department could provide was not enough; the farmers needed other and further assistance.

Leaders of the department of the self-government initiated in 1994 the establishment of an association for the commercialised farms with name of Association of the Agricultural Entrepreneurs of Mórahalom. Thirty-five individual farmers joined the association. Now the membership consists of nearly 200 farmers.

The head of the department operating within the self-government was elected for chair and the deputy-head of the department for the secretary. The association has organised training, study tours, excursions and provided the members with industrial materials (fertilisers, pesticides etc.) at wholesale prices. The individual farmers could experience the usefulness of such an organisation and could realise that they had same problems to solve.

After the liquidation of the special co-operative, the private farmers sold their products individually. They had problems with the marketing of the products, and the establishment of a purchasing and selling co-operative was initiated. In April 1995, 52 local producers established the Mórakert Purchasing and Servicing Co-operative.

After five years of the political turn, the establishment of a “new” type of co-operative was a brave and necessary step. In that time the restructuring process of the farm-structure was stopped and the producers’ type co-operatives were reinforced or were preserved for posterity by transforming into companies. Foundation of this co-operative was among the first in the country.

The institutional development of farmers’ organisations in this agricultural town was very impressive. The result of two years of preparation work and in four steps a

“new” type of co-operative was established. There is no doubt that the foundation of the co-operative was in favour of the private farmers, but was initiated by the officials of the self-government and not by the farmers themselves.

This self-organisation was created “up down” rather than “down up”. This circumstance affected the operation of the co-operative. The democracy has not been as strong as in the case of a “bottom up” organised farmers’ organisations. The real decisions have been made by the board of directors and not by the general assembly. Operation of this last forum has been more formal than in small grassroots farmers’ self-organisations. The foreign experience shows that it is very important that the members feel that the co-operative is part of their own entrepreneurship. If it is not, the co-operative may drift away from the members.

The first one and a half years was spent finding out how to operate such an economic organisation. The board of directors decided that a strong storing, processing and marketing capacity must be built up. Their strategic plan was ambitious:

- to organise training
- to develop an information system
- to develop a quality-control system
- to adjust to the EU requirements
- to co-ordinate of the co-operatives operating in the micro-region

The board of directors came to the conclusion that the co-operative as an organisation of the owners and the co-operative’s enterprise as the economic organisation must be separated. A consequence of this decision was that the management of the co-operative has been doubled. The president has remained the representative of the co-operative’s owners (membership) and an executive director has been hired for the operative management. The executive director is not a co-operative member and has been employed by the board of directors. Hiring an executive director from 1997 proved a good decision and strengthened the “enterprise” character of the co-operative.

The responsibility has been shared between the president and the executive director. The president is responsible for operation of the forums, represents the interest of the members towards the co-operative enterprise and represents the co-operative in the National Union of the Hungarian Marketing and Servicing Co-operatives. The executive director is responsible for the operative management of the economic activity of the co-operative. Included in this is the marketing work. The co-operative employs about 50 paid workers also, who are hired by the executive director.

The main spheres of authority for the general assembly are:

1. Selection of the board of directors, the president of the co-operatives
2. Selection of the controlling committee and its chairman

3. Approval of budgets, production plants, and market plants
4. Approval of the report on the co-operative enterprise's performance
5. Decision on the use of surplus.

The main fields of the responsibilities of the board of directors are:

1. Definition of co-operative objectives, policies and goals
2. Matters where member decision are due
3. Approval of major plans and commitments
4. Long range financial commitments, including sources and types of financing
5. Selection of the executive director
6. Definition of the duties of the executive director
7. Approval of the benefit programs
8. Evaluation of the activity of the co-operative enterprise.

The main fields of the co-operative president's responsibilities are:

1. General representation of the co-operative
2. Operation of the fora of the co-operative
3. Representation of the interest of the owners' members
4. Representation of the co-operative in the National Union.

Main fields of the responsibilities of the executive director are:

1. Definition of operating objectives, policies and goals
2. Short run commitments of resources
3. Preparation of budgets, production plants, and market plants for approval of the board of the directors
4. Selection of the employees
5. Determination and administration of the employee salary and benefits program
6. Employee working conditions
7. Measurement of employee performance.

Common responsibilities of the board of directors and of the executive director are:

1. Selection of the business partners
2. Relations with authorities, contractual partners
3. Employee benefits plans

4. Appraisal of the co-operative's performance
5. Distribution of the earnings
6. Changing in the basic organisational structure

In this co-operative, from the beginning the "enterprise" character dominated the "agency" one. This co-operative carried out a vertical integration of the production. The co-operative leaders told to the members what to produce and in which quality. The co-operative has integrated not only the production of its members but of the non-members too. The members take priority in the buying up process, but in the accounts the co-operative does not distinguish between the members and the non-members.

From Year 2000, the co-operative entered into contract with the members and non-members, too. The contracts concern the quantity, the quality and in some case the deadlines. The contracts are involved in the so-called mutual undertaking of obligations. The co-operative undertakes and buys all products of members (and non-members) that are in accordance with required quality, and the members undertake the selling of all products through the co-operative exemption to products going for personal consumption (that may not exceed 20 per cent of production). The price is not included in the contract.

The co-operative has a good marketing policy. For instance it applies very modern marketing techniques, such as buying "own" gondolas in the supermarkets for their products, having their own part at the wholesale markets and some top-quality shops. The co-operative has a well-known and attractive logo. The mission statement of the co-operative speaks about the importance of using environmentally friendly production techniques. Their environmental awareness is one-sided. They do not understand at all that not only the plant and "product" protection is important but also the human and animal health. They have not realised that the pesticides' residues may be very harmful for the human, and with regard to the animals for their endocrine system.

The co-operative operates on a non-profit basis. Now the co-operative realises fairly good prices. At the beginning the co-operative deducted from the prices 10-12 per cent, later 20 per cent. About 18 percentage points of deduction covers the expenses and about 2 percentage points remains as a surplus before taxation. The after taxation surplus is used regularly for accumulation. On this the general assemblies decides by the suggestion of the board of directors.

The co-operative has made investments into storage-building and cold-storage plant, bought lorries, automatic fruit sorting machine, digital weighing-machines connected to the computer system and so on. The investment was covered by member-loan (10 per cent), by co-operative accumulation (30 per cent) and by subsidy (60 per cent). (The co-operative pays interest-rate for the member-loan.)

Thanks to the successful marketing strategy purchasing of the fruit and vegetable products increased rapidly. The most important thing is that the members' and partly the non-members' income has increased rapidly, it multiplied.

The board of directors of the Mórakert Purchasing and Servicing Co-operative had a target to co-ordinate the co-operatives operating in the micro-regions. The Mórakert Purchasing and Servicing Co-operative entered into contract with 9 other co-operatives practically with the same conditions as with its member-farmers. The Mórakert Co-operative sold its know-how, more exactly it's putting on the market, and the other nine co-operatives bought it. The integration was created voluntarily and operated on the basis of mutual advantage. In my view this way of integration may threaten the co-operative character not only of the nine integrated co-operatives but also of the integrator.

## 6. SOME CONCLUSIONS

1. The old and the new co-operative laws put emphasis on the obligations of the members towards the co-operative. This is a bad "heritage" of the communist time.
2. Main obstacle to the development of the farmers' self-organisations is the lack of enough number of commercialised farms due to being stuck of the restructuring the farm sector.
3. In some new grassroots farmers' self organisations under the direct membership control "instinctively" know the real character of such organisations, but they are hesitating as regards the future.
4. The co-operative operates on a non-profit basis: in every co-operative a deduction of a predetermined percentage from the price for covering their expenses.
5. It is necessary to elaborate the basic requirements for which economic organisations can be regarded as co-operatives.
6. It is necessary to popularise the best and good practices of the farmers' self-organisations, mainly the "new" type co-operatives.
7. It is necessary to organise conferences, workshops, training for the policy makers, state, regional and local officials.
8. It is necessary to establish a co-operative service network of public interest, research, and training; an extension service must be included in its activity.



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# ECONOMIC SUBSTANCE AND LEGAL REGULATION OF PRODUCERS' ORGANISATIONS IN THE HUNGARIAN FRUIT AND VEGETABLE SECTOR

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## **1. INTRODUCTION**

*The main goal of the paper is to show briefly the new Hungarian co-operative laws and regulation and to analyse their impact on Producer Organisations (PO), which are active in the fruit and vegetable sector. Two case studies are also presented as two examples of different stages of agricultural co-operation in the form of POs in Hungary.*

According to our main goals, the study consists from *two main parts*. First, after brief examination of the situation and possibilities of agricultural producers, the new laws and legislation on agricultural co-operatives and POs will be discussed. In the second part of the study we are going to analyse two case studies on POs (in the Hungarian regulation the abbreviation is: "TÉSZ") in the Hungarian fruit and vegetable sector. *Mórákert Purchasing and Service Co-operative ("TÉSZ"-PO)* works as a very successful (e.g. in terms of increasing annual turnover and membership) co-operative in the fruit and vegetable sector. The other case study is about a new PO (TÉSZ), and we try to find out what kind of experiences can be drawn for the latter one from the success story of the Mórákert Co-op. Finally, we discuss briefly the theoretical justification of alternative forms of organisations of agricultural producers compared to traditional co-operatives.

*Main methods used to carry out present research were: literature review, collecting secondary (statistical) data, interviews and case study analyses.*

## 2. THE SITUATION AND POSSIBILITIES OF PRIVATE FARMERS IN THE HUNGARIAN FRUIT AND VEGETABLE PRODUCTION

Table 1 summarises the main numbers of agricultural production in Hungary in the nineties and year 2000. As can be seen from Table 1 the level of agricultural production is lower during '90-ies, including year 2000, compared to the year 1990, since there is a significant drop in the total production in general. However, the volume of crops and horticultural production have higher values compared to the animals and animal production numbers in general. Especially, the production of the live animals and animal products has been declining (62-67% in the years 1993-2000), but there is also a significant drop in the case of crops and horticultural products (69-83% in the same period). In year 2000 the values are very close to each other compared to the basis of the level of year 1990 (70% for crops and horticultural products and 67% for live animals and animal production).

**TABLE 1.**  
**VOLUME INDICES OF GROSS PRODUCTION OF AGRICULTURAL PRODUCTS**  
**(1990=100.0) AT CONSTANT PRICES, %**

1990 = 100.0			
Year	Crops and horticultural products	Live animals and animal products	Total
1991	102.5	84.4	93.8
1992	76.1	73.8	75.0
1993	69.1	66.1	67.7
1994	75.9	63.3	69.8
1995	77.3	65.5	71.6
1996	84.9	66.6	76.1
1997	84.0	62.6	73.6
1998	80.9	66.5	74.1
1999	83.2	65.4	74.5
2000	70.1	67.9	69.2
2001	93.7	66.8	80.6
2002	86.7	66.3	77.3

Source: Adapted from Statistical Yearbook of Agriculture 2000, pp. 21 (Hungarian Central Statistical Office, Budapest, 2001).

Regarding of the growth of total production compared to the previous year in the case of crops and horticultural products, year 1994, 1996 and 2001 were the best ones, where almost 10% growth has been reached. Year 1992, 1998 and 2000 were the only years, when the percentages of the animal production was higher than in the case of crops and horticultural production.

Between 1992 and 1994 the growth of vegetable production was lower than the growth of the total agricultural production, however from 1993 onwards the vegetable production has higher percentages. In case of vegetables regarding the period 1992-2002, we have to stress years 1995, 1998 and 2001 as the best ones according to the growth compared to the previous year, with the percentages of 30.2, 37.7 and 30.6 respectively (Table 2). In the case of fruits the growth of 73.7% (1996) and 30.5% (2000) were the peak points.

**TABLE 2.**  
**VOLUME INDICES OF SALES (BUYING UP) OF AGRICULTURAL PRODUCTS**  
**(PREV. YEAR=100.0)**

Previous year=100.0											
Denomination	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Crops	99.8	54.2	106.9	122.6	94.9	92.5	94.0	119.0	73.8	136.9	91.4
Vege-tables <sup>a</sup>	60.7	76.0	125.1	130.2	94.8	100.1	137.7	78.6	100.3	130.6	127.6
Fruits	116.9	62.1	93.7	67.5	173.7	88.7	10.5	80.7	130.5	96.2	98.5
Crops and horticult. products	95.9	57.4	106.0	119.7	99.6	94.7	100.2	107.5	83.2	127.8	95.2
Agricult. products, total	86.6	70.0	95.6	114.4	103.9	95.8	99.3	106.3	92.0	110.1	98.8

Source: Adapted from Statistical Yearbook of Agriculture 2000, p. 32 (Hungarian Central Statistical Office, Budapest, 2001)

a) Hungarian red paprika is excluded from 1996

As can be seen in Table 3 and Table 4 the share of the agricultural private farmers is relatively high in Hungary. Most of them are relatively small farmers, sometimes with only a household plot. It is very important, therefore, that the farmers have to use marketing channels which could give them the strengths of a more concentrated organisations. It is indispensable for them to know the possibilities of the different forms of vertical co-ordination and integration in their sector.

**TABLE 3.**  
**THE SHARE OF THE AGRICULTURAL PRIVATE FARMERS OF THE HUNGARIAN**  
**FRUIT AND VEGETABLES SECTOR**

Denomination	(ton)							
	1) 1991-1995 average	2) 1996-2000 average	3) 1997	4) 1998	5) 1999	6) 2000	6/1 in %	6/5 in %
a) Private farmers	1232609	1439879	1330715	1534687	1740415	1189206	96.5	68.3
b) Total production	1415451	1682626	1548319	1796031	1971863	1499864	106.0	76.1
Share (a/b)	87.08	85.57	85.94	85.45	88.26	79.29	—	—

Source: Adapted from "Vegetables and Fruit Production in Hungary in 1999" and "2000". Central Statistical Office (C.S.O.), Budapest, 2001, 2000.

According to Table 3 the share of private production (in ton) in fruit and vegetables sector is higher than 85%, with the only exception of year 2000. In the year 1999 it has reached almost the 90% of the total production. From that aspect the importance of an efficient co-ordination system, including closer forms of co-ordination, like vertical integration and co-operatives is vital in Hungary.

**TABLE 4.**  
**THE SHARE OF THE AGRICULTURAL PRIVATE FARMERS OF THE HUNGARIAN**  
**FRUIT AND VEGETABLES SECTOR (HECTARES)**

Denomination								
	1) 1991-1995 average	2) 1996-2000 average	3) 1997	4) 1998	5) 1999	6) 2000	6/1 in %	6/5 in %
a) Private farmers	68623	80813	96099	84484	88661	61728	90.0	69.6
b) Total production	93471	104647	117675	108653	111657	90190	96.5	80.8
Share (a/b)	73.42	77.22	81.66	77.75	79.40	68.44	—	—

Source: Adapted from "Vegetables and Fruit Production in Hungary in 1999" and "2000". Central Statistical Office (C.S.O.), Budapest, 2001, 2000

As one can find in Table 4 the share of private production according to the production area (in hectares) is lower than in the case of comparison in volume. However, the share is above 70%, with the exception of year 2000 again. The highest share was in 1997, that was the peak point for the private production.

According to the quality requirement, one has to keep in mind, that there are alternative quality measurements in Hungary, so it is hard to compare individual cases. Basically Hungary applies the standards of European Union, however the control of using them by producers, traders and other actors in the fruit and vegetable market is acting place only in the case of export. However, the increasing influence of the retail chains also lifts the standards to a higher level, since consumers can see the origin, price and class of the product in the retail shops e.g. hyper- and supermarkets (Juhász, 1999).

*The main co-ordinators/channels used in Hungarian fruit and vegetable sector are the following ones:*

- local market
- wholesale markets
- wholesalers for export
- traders for domestic market
- transformed production type co-operatives
- processing industry as company
- "new type" marketing co-operatives
- so-termed producers' organisation
- retailers.

As can be seen from the list, there is a variety of channels and markets exist for the agricultural producers. We have to underline however, that spot markets and different types of contracts (including in some cases contract production) are the most common forms of co-ordination. Different retail chains gain bigger and bigger share from fresh fruit and vegetable market. However, marketing co-operatives and producers' organisations also can solve the marketing problems of the fruit and vegetable producers, in a growing number.

### **3. RECENT LEGISLATION AND REGULATION REGARDING HUNGARIAN AGRICULTURAL CO-OPERATIVES**

POs are exist in other legal forms as well, like joint stock companies, LTDs etc., however *majority of them are co-operatives in Hungary*; so it is indispensable to review basic data and recent legislation-regulation on co-operatives in Hungary

According to Hungarian Central Statistical Office (CSO), on 30 September in the Year 2003 the number of co-operatives in the Hungarian economy is 5,561, of which 1,561 co-ops work in the agriculture and forestry. This is the second largest number, after real estate, renting and business activity sector (1,939). Co-operatives are also exist in relatively great number in the wholesale and retailing sector (1,036).

The *definition* of the co-operative, incorporated into the new (CXLI/2000) co-operative law (MK, 2000b), is *very complex*, however it is *in accordance with the*

*international theory and definition(s) of the co-operatives.* The co-operative is an *economic organisation* and a *legal entity*, with *open membership* and *variable capital*, aiming to meet the requirement of *promoting* (complementing) the *members' business* (farming) or the *consumption* in a case of natural persons, and *in certain cases* to meet the demands of membership according to their *cultural, educational and social needs*. It is clear from the definition that the main aim is to promote/help the farming of the members, however the law *does not exclude the possibility of the collective (agricultural) production* in the co-operatives. It is very interesting that the law makes *possible for the co-operative to require agricultural land to be offered for rent to the co-operative or personal contribution from the potential members applying for membership*. However, it is interesting that agricultural co-operatives use less and less land compared to corporations and private farmers. Thanks to uncertainty (mentioned above) and other economic disadvantages, *the arable land used by co-ops decreased* in the last 12 Years (see Table 5).

**TABLE 5.**  
**DISTRIBUTION OF ARABLE LAND BY TYPES OF FARMS\* IN %**

Denomination	1990	1998	1999	2000	2001	2002
Corporations	14,2	17,4	19,2	24,4	26,6	27,4
Co-operatives	73,1	26,8	24,3	20,5	14,9	11,5
Private farmers	12,7	55,8	56,5	55,1	58,5	61,1
Total	100,0	100,0	100,0	100,0	100,0	100,0

\* Land area by use.

Source: AKII-CSO, 2003.

According to the financial basis for co-operatives, it is very important, that *the co-operative has to get at least 3 million HUF* (proximately 11,500 EURO in 2002) as *property* of co-operatives shares. In the case of *secondary co-operatives the minimum amount is 10 million HUF* (proximately 38,500 EURO in 2002). The members get co-operative shares in exchange for their investments and they are eligible for earnings per share according to the results of the farming of the co-op. The liability of the members is limited, it is only up to their financial contribution.

*Altruism* appears in more paragraphs in the law. According to those parts, the co-operation between the members and the co-operative is not businesslike. However, as part of the co-operative's activity the co-operative has also business activities carrying out for third persons or parties. The co-operative is operating *on business at cost principle*, it does not aim to gain profits from the economic relations with members.



The *institutions of the self-governance* (democratic decision making) *are still the same as in the past*. The *one member – one vote principle is still valid*, everybody in the General Assembly has got one vote (democratic control), however the *earnings per share is depends on the transactions with co-operative or on the personal contribution* in the period. It is significant change, that according the new law, the leaders and officers of the co-operative can be outsiders, non-members as well, not just members as before. They can even participate in the general assembly and they have got the right to make a proposal there.

The law fixed the *common rules for the organisational changes*, like merger, transformation into (joint stock or limited liability) company, demerger, etc. It is a very new rule that in a case of merger, the result has to be in accordance with the relevant regulation of the competition policy. This regulation is aiming to avoid the monopoly position by certain co-operatives on the domestic market.

The last paragraph of the law mentioned above contains the rule that *every co-operative has to be transformed into a new type of co-operative according to the Law CXLI/2000 (MK, 2000b) or into a (joint stock or limited liability) company in five years*. The most important difference is the fact that the new co-operatives have not possess the so-termed co-operative business shares.

#### **4. THE REGULATION OF THE FRUIT AND VEGETABLE SECTOR IN THE EU AND HUNGARY, ESPECIALLY REGARDING POS**

There is a great significance of different (marketing) organisation of agricultural producers in the agri-food economy of European Union, like agricultural co-operatives and Producers' Organisations (PO), which are active in the fruit and vegetable sector. POs exist in other legal forms as well, like joint stock companies, LTDs etc., they have to only fulfil certain requirements. A significant advantage of the organisation, that the fruit and vegetable producers could afford the support of the EU solely through their POs.

The Hungarian regulation (25/1999 Decree of Ministry of Agriculture and Rural Development) takes over the European Union's one [Regulation (EC) No 2200/96 on the common organisation of the market in fruit and vegetables] concerning POs. According to the above mentioned decree, the POs (in the Hungarian regulation the abbreviation is: "TÉSZ") organise production; store, grade, process and market products and are set up by producers of a certain product or (sub)region.

The process of establishment of POs is *rather slow* in Hungary so far. In 1999, which is the year when 25/1999 Decree of Ministry of Agriculture and Rural Development was come into force, only one, in the year 2000 only three (among them the Mórakert co-op) and in 2001 only eight organisations were *provisionally acknowledged according to the above decree* (Padisák, 2001/2002). In August 2003, the number of *provisionally acknowledged organisations* was 36, and only *one* was *officially acknowledged* (certified): the Mórakert Co-operative, which will be our

first case study in the next section of present paper (Mórákert, 2003). At the end of April 2004, there are *86 provisionally acknowledged* and *6 officially acknowledged* POs which *cover 10% of the total Hungarian fruit and vegetable production*. The POs marketed products of members in value *21 billion HUF* (Németh, 2004)

## 5. HUNGARIAN CASE STUDY NO. 1 ON THE MÓRAKERT PURCHASING AND SERVICE CO-OPERATIVE<sup>1</sup>

In the next part of our study we will briefly show a case study on the development of the first officially acknowledged Hungarian TÉSZ (Mórákert Beszerző, Értékesítő és Szolgáltató Szövetkezet), which works as a very successful (e.g. in terms of increasing annual turnover and membership) co-operative in the fruit and vegetable sector.

The *Common Agricultural and Entrepreneurial Society, Móráhalom* was established in January 1994 with the aim of organising small-holders within a loose network. It is a non-profit organisation. Noteworthy is that, due to the existence of the former co-operatives in Móráhalom, people were reluctant to use the word co-operative. Therefore they established an intermediate form, to co-ordinate certain parts of members' activities. The basic principle of setting up this society was to co-operate, to enable members to step forward, particularly in the input and output market. The main activity, in addition to organising joint projects, was the *organising of collective purchasing activities*. This type of co-ordination was successful, and in some cases *savings of 18 or 20 per cent of the purchase cost* were achieved. A countervailing power was thus established, and due to the greater volumes involved and cash payment it was possible to buy seeds and chemical fertiliser much more cheaply than would have been possible for the small-holders individually.

Because the society was financed from membership fees the revolving fund proved insufficient to finance purchases. Consequently, in practice, the members put together amongst themselves the sums required for the quantities to be purchased. Members were informed of delivery dates, and they transported the input materials by means of their own vehicles and stored them on their sites. As mentioned above, these joint purchasing activities were extremely successful. However, the main problem was rather to co-ordinate the marketing of the small-holders' produce. Therefore, the next step was to set up the *Mórákert Purchasing and Service Co-operative, Móráhalom* in April 1995.

The *Mórákert Purchasing and Service Co-operative, Móráhalom*, a successful so-called new type co-operative, is a co-operative of a type built on the Danish model. The co-operative itself has no machinery or land capacity connected with agricultural production. *The main (in fact, the only) aim of the co-operative is to co-ordinate purchasing and selling activities*. The input side of the members' activities was

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1. See more details on the case study co-operative in Szabó, 2002b.

organised first, as this was a simpler task. Co-ordination of sales began later. The co-operative had 52 founding members in April 1995; by April 1998 membership had increased to 66, by October 1999 the number of members was 134 and in the Year 2002 the co-op had 289 members. All members have their own land property and assets for farming.

The co-operative *employs a staff of 64 throughout the year*, which is of great significance, since work is otherwise rather sparse and co-operative employees enjoy relatively high salaries in comparison with the local average.

The main aim of the co-operative is to *purchase input materials* and to *sell vegetable and fruit products* produced by the members. In line with this main aim the co-operative is endeavouring to establish secure markets for the long term. It offers *services* and organises the buying of input materials and the functioning of selling outlets in a more co-ordinated way, therefore promoting farming for the small-holders through better market prices. Providing *information* is also very important with respect to the success of the co-operation between the co-operative enterprise and its members. Another basic aim is for the co-operative to be a kind of non-profit organisation, so it runs according to the *business at cost* principle. After the subtraction of deposits and cost from the surplus made annually the co-operative *reimburses members in proportion to their turnover with the co-operative*.

The co-operative follows wholesale market prices, collecting data on a daily basis from the two major prices indexes. Members can obtain information from a published circular, which provides practical details such as when and how input materials ordered can be delivered.

One of the main steps enabling competitiveness to be achieved on saturated markets is for the co-operative to differentiate its products from those of other producers. The co-operative sells potatoes and onions in different packaging bearing its name, which makes it easier for the consumer to remember and recognise its produce. Bar codes are also used, and a registration system is being developed to enable the co-operative to control its selling parameters on computer. The system allows those operating it to distinguish which member's vegetables are being sold to a specific market, and therefore the farmer can be tracked down if problems arise. This facilitates the work of the two purchasers, particularly at peak times, when vast quantities of vegetables and fruit have to be procured within hours.

70% of the produce purchased from members is sold on the domestic market and 30% abroad (Estonia, Latvia, Lithuania, The Czech Republic, Slovakia, Slovenia). The co-operative marks the onions, potatoes and peppers it sells with its own label, and is now attempting to increase the range of products sold in packaging showing its name.

About 90% of the products distributed on domestic markets by the co-operative are sold to retail chains (Tesco, Metro, Spar, etc.); wholesale markets are avoided where possible, in order to shorten the marketing chain. Some products are sold on a contractual basis according to weekly prices. The co-operative is attempting to increase the proportion of export sales, but it presently uses exporters to sell its produce abroad. However, the aim is to export as part of co-operative activity.

Table 6 shows that the development of net revenues of the co-operative has increased continuously between 1998 and 2002.

**TABLE 6.**  
**NET REVENUES OF MORAKERT PURCHASING AND SERVICE**  
**CO-OPERATIVE, MORAHALOM**

**in 1,000 HUF**

<b>Year</b>	<b>Net revenues coming from agricultural activities</b>	<b>Net revenues in total</b>	<b>Proportion of agricultural and total net revenues %</b>
1998	250837	251410	99,77
1999	566775	567810	99,81
2000	1248737	1250464	99,86
2001	1584329	1586604	99,86
2002	2281186	2282966	99,92

Source: Mórakert Purchasing and Service Co-operative, 2003.

Because of the higher turnover, *marketing costs per producer and/or per unit of transaction are decreasing*. The co-operative can control bigger quantity and higher quality, which ability increases its strength. That process could lead an *expanded marketing activity*.

*Various marketing channels* are being used, from individual shopkeepers through wholesale markets to *retail chain networks*. In accordance with the trends in Europe and the US, the importance and share of the retail chain networks is increasing year by year. It is very difficult to achieve a foothold in one of the chains, but such a foothold is a secure position if the co-operative can deliver the entire range of produce to the network, while also guaranteeing top quality and a high degree of flexibility.

To achieve competitiveness, in certain cases the co-operative works on the basis of so-termed production contracts, which involve the co-operative detailing the requirements for the producer to ensure that the necessary quantity is produced. At the same time efforts are made always to purchase input materials of the same type, to enable members to accomplish excellent, balanced quality in their production. The co-operative also deals with produce derived from non-members, in the interest of achieving better exploitation of its capacity, but its activity does not extent to purchasing on behalf of non-members.

Probably, because of the organized trust and the excellent human factors in the Mórakert co-operative the *agency problem is not really significant* at this level of development.

They reinvest the surplus made in the co-operative annually. The ambitious plan is to establish a so called *secondary or regional type co-operative* which can be a good institution to secure markets for the members, to increase product's prices and in the meantime to reduce transaction costs. However to be able to establish such countervailing power and to reduce the co-operative's transaction costs, the co-operative is more and more dependent on non-members trade, which practice *could arise free-rider problems*. Despite the co-operative can solve some of the horizon problems, if the co-operative is going to grow, *it may face with the common property and horizon problems*. The main important weapons in the hands of the co-operative manager and president are secure markets and relatively high prices for good quality products coming from members and non-members alike. However, in a following stage of co-operative development the co-operative can face with the same problems emerged in the case of traditional (countervailing power) co-operative model and can *influence and change the marketing, financial and possibly the organizational strategies of the co-operative*.

## 6. HUNGARIAN CASE STUDY NO. 2 ON THE DEVELOPMENT PLAN AND AIMS OF THE PROVISIONALLY ACKNOWLEDGED "VAJASMENTI" VEGETABLES PO<sup>2</sup>

The *provisionally acknowledged "Vajasmenti" Vegetables PO* is a *co-operative of vegetable and fruit producers*. It is active in trading of leaf vegetables produced in arable land, canned and deep-fridge vegetables and fruits and in drying industry. The co-operative has applied for provisional acknowledgement as PO in April 14, 2003, so it is indeed a new organisation. The membership is consist of *48 private farmers and 7 legal persons*. They established the PO according to the new (CXLI/2000) co-operative law (MK, 2000b).

The *main aim* of the co-operative is to *increase the income of the individual members* and therefore the function of the PO is to *co-ordinate demand and supply of members* so thus to *establish countervailing power* on the market. The established co-operative does cover 60% of neighbouring producers.

Production capacity is given since there is a *significant tradition* of producing of leaf vegetables, tomato, red pepper (paprika), different types of cabbages, onion and other vegetables on neighbouring arable lands, therefore producers have great *professional knowledge*. The traditional production evolved through years has resulted in *excellent quality recognised nation-wide*. The members have already sales capacity towards processing companies, so the functions of the PO are to *co-ordinate supply thus to increase the negotiated price and to establish more supply channels*. Beyond the above functions, the PO represents members on receipt of their products, thus

2. This section is based on Kuti, 2003, 2004.

complaints coming from objections to quality can be eliminated (*“monitoring”* function).

Such in case of Mórakert Co-op, they realised the fact that significant cost saving can be reached by *direct co-ordination of demands of producers*. Therefore, the PO figures on the necessary quantity in advance and then approach the input suppliers, thus it *may negotiate in a favourite price* because of the big quantity (countervailing power).

In 2003 the PO has become a member of a partnership, consisting of 19 POs from the South Great Plain as members, which works as a joint stock company named “Datész Rt”. The joint stock company is active in co-ordination of *obtaining information, market research, and marketing*. The founder POs are all active in fresh fruit and vegetable market, therefore their first action was to establish a cold-storage depot from joint resources. This investment makes possible to *avoid the significant decrease of profit* caused by (first type) post harvest hold-up problems (Hendrikse – Veerman, 200b) coming from the surplus of supply at peak times of harvest.

One of the aims of the organisation is to produce *products with higher value added*. They have no drying and packaging capacity at present, these will be established in the following two years. The total value of investments is more than 100 million HUF, therefore they are entitled for the so-termed “European Credit” according to the Agricultural Credit Programme of the so-called “European Plan” (6/2004 Decree of Ministry of Agriculture and Rural Development).

The PO pays significant attention to *searching for potential markets*. They would like to become *supplier of any of the retail chains* and they redesign their production structure to demand of *niche markets*. They would like to sell part of their packaged and pre-processed products by *by-passing traders*, therefore they *reduce transaction costs and strengthen market image* of their own products. They plan to be present on export markets in long term.

The production structure does match the market demand. The co-operative give *general recommendations* and guidelines for its members. Adherence of technological procedures is prerequisite of selling through the co-operative. Detailed service regarding the specific crop land is given by consultants of the co-operative. They, according to the characteristics of a certain habitat, define the species which can bring the biggest yield then they determine the necessary production-technology steps in order to be able to exploit the production potential. The organisation uses a number elements of quality improvement in order to be able to secure evenly quality.

During the processing process the PO would carry out quality control of raw materials and finished products as well in the next years. They plan to establish the whole system till 2006 and they can apply for support for agricultural and rural development from national funds of 2004 according to the 25/2004 Decree of Ministry of Agriculture and Rural Development.

The PO tries to limit environmental burden (damages) caused by production. They would like to carry out *environmentally sound management of production* in practice, so for example they pay attention to the use of chemical fertiliser. The execution of the so-termed integrated pest control, the establishment of forecaster

system of plant protection, regular extension and consultancy services all serve the above mentioned purpose. They also plan to invest into technology which hopefully will cause quality improvement of tomato production on arable land and also will decrease production cost.

The PO plans its revenues coming from fruit and vegetables for the next few years as can be seen in Table 7.

**TABLE 7.**  
**PLANNED REVENUES OF FRUIT AND VEGETABLES OF "VAJASMENTI"**  
**VEGETABLES PO UNTIL 2007 IN 1,000 HUF**

	2003	2004	2005	2006	2007
Total revenues	191,000	268,000	323,000	372,000	445,000

Source: Kuti, 2003.

POs provisionally acknowledged or acknowledged till 29 February 2004 are eligible for national support according to 25/2004 Decree of Ministry of Agriculture and Rural Development based on 25/1999 Decree of Ministry of Agriculture and Rural Development. The basis for their support is the (certified) net revenues coming from marketing of fruit and vegetables of members in 2003.

**TABLE 8.**  
**REVENUES OF "VAJASMENTI" VEGETABLES PO IN 2003 IN 1,000 HUF**

Net revenues coming from marketing of fruit and vegetables of members . . . . .	275,004
	(incl. quality support)
Net revenues coming from marketing of other agricultural products of members . . . . .	29,270
Other revenues (marketing of input materials, services etc.) . . . . .	4,471
Quality support . . . . .	44,521 t

Source: Kuti, 2004.

One can see the actual revenues of the co-operative in 2003 in table 8. It is important to pay attention to the amount of quality support (almost 45 million HUF).

## 7. LIMITATIONS OF TRADITIONAL MARKETING CO-OPERATIVES

There are POs exist in agriculture in other forms (e.g. conventional firm: CF) than marketing co-operative (MC), so it is not without reason to examine whether: is there *any limitations (drawbacks)* for co-operatives in the current *fundamental of changes of agribusiness environment*? We stress that in differentiated product markets co-operatives need additional risk-bearing capital to be able to compete, difficult to provide due to their financial structure. This fact shed light on the problem, under what circumstances is better to choose an other co-ordination-organizational form, despite the fact that co-ops can decrease for example transaction costs and can solve hold-up problems as well.

The *hold-up problem*, probably the most known example for ex post problem/cost, relevant in agriculture, "... arises when one party in contractual relationship seeks to exploit the other party's vulnerability due to relationship-specific assets" (Royer, 1999: 49). The hold-up problem is significant in the dairy and fruit-vegetable sectors, explaining the existence high share of co-operatives in these industries (Staatz, 1984, van Bekkum - van Dijk, 1997, Kyriakopoulos, 2000). The *members of a MC are not likely to fear* that after investing into relationship-specific assets, the other party (e.g. the processor or wholesaler) will change its mind and force them to accept lower prices for their products otherwise terminate their contractual relation.

However, searching for an *appropriate governance structure*, it is more precise if (according to Hendrikse – Veerman, 2001b) we are going to distinguish *two specific hold-up problems* in agricultural production chain: *first, prevent post harvest hold-ups* (for perishable products) and *second, the necessity to attract outside (risk bearing) investments (funds)*.

Because of the countervailing power feature of the marketing co-operative, both of the problems can be solved in homogeneous product markets and when the investments of the co-op are not specific. However, in differentiated product markets marketing co-operatives are not able to provide the necessary level of investment with a high level of asset specificity, like the development of brand names (Hendrikse-Veerman, 2001b). The *democratic decision making will be more problematic* in a co-operative (Hendrikse-Veerman, 2001b), with heterogeneous members due to increasing internal organization costs (Harte, 1997). However, the farmer-member has to make decisions to invest, *taking into consideration to put money into his farm and/or into the co-operative*, therefore to collect enough capital for further vertical integration is challenged by the opportunity to invest into the farms' assets. It is difficult to collect financial funds provided by outsiders for the co-operative as well, because the *principle of domination of membership control set worse terms* for them. Therefore the second hold-up problem can only be solved by a switch from MC to a CF (Hendrikse-Veerman, 2001b).

We may conclude that agricultural co-operatives (and thus POs) have *advantages*, where *there is a significant market failure problem*, especially in the cases of some perishable products like fruit- vegetables and milk, and when the market is not saturated. When the market-mechanism is working well and the different types



(contracting, monitoring, enforcement) of transaction costs are not high compared to the internal organization costs, then a *vertical integration (and the co-operative organizational form) is not as desired governance structure and/or marketing strategy*, than in the previous case (Harte, 1997). Hendrikse-Veerman (2001a) also argue that in differentiated product markets with a high level of asset specificity, a marketing co-operative is probably not the best solution as a governance structure. They predict governance structures in which members (farmers) have less decision power. However, recent empirical evidence is sparse in this regard, and various studies reported controversial experiments on the viability of the co-operatives in modern agriculture.

## 8. CONCLUSIONS

The practice of the European Union shows that significant number of organisations aiming integration are set up in form of joint stock companies or LTDs. The main reason behind it is the fact that significant decisions can be made more easily in such an organisation compared to a co-op where the principle of one member – one vote is still valid. There are number of examples of such hybrid organisations in Hungary as well, however the majority of POs are exist in co-operative legal form. The “Vajasmenti” Vegetables PO is one of the new, emerging ones serving its members with growing markets. To establish a secondary (regional) co-operative, which can strengthen the countervailing power and raise the value of own capital is also a good aim to follow.

The case of a newly established Mórakert co-operative in the Hungarian fruit and vegetable sector shows, such organisations can be a solution for farmers to cope with their problems arising from incomplete pricing mechanisms and to reduce transaction costs, at least at the regional level. It must be emphasized that the problems of farmers cannot be solved simply by government support, however it seems to be vital in the case of emerging producers’ organizations, like co-operatives, to be able to set up (Meulenbergh, 2000). The co-operatives, analyzed in present case studies, are good examples, how agricultural co-operatives and POs can achieve some of the potential advantages, solving many “traditional” Transaction Cost Economics and agency problems and serving its members with continuing growth.

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**PART 9**  
**COOPERATIVES AND  
WOMEN**





# DO WE NEED BALANCE THE POWER BETWEEN WOMEN AND MEN IN COOPERATIVES?

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## 1. FEW WOMEN AT THE TOP POSITIONS OF BUSINESS

This study concerns women's representation in co-operatives and is based on secondary data and primary data like interviews conducted with four women managers and with other actors in different organisations. The aim of the study is to identify if women's representation influences and contributes to co-operatives development. The study carries forward the exploration of a link between representation of women and the character and structure of co-operatives.

There are few women as Chairpersons at the top positions in Swedish companies. There are 18 per cent women as managers in all organisations and 82 per cent men. Regarding women's positions as members of the boards, women make 17 per cent of the boards and men 83 per cent. A large part of those women are union representatives, 31 per cent of the female board members. There is more equality of opportunities between women and men at the intermediate level of business where 24 per cent of personnel managers are women (SOU 2003:16 p 49-51). In the European Union there are 83 per cent men at the top positions and 37 per cent women as leaders in special positions like administration manager and personnel managers.

There are few women as Chairpersons at the top positions in companies at the stock-exchange house in Stockholm. In 1996 there were 96,6 per cent men and 3,4 per cent women as ordinary members of the boards (Hultbom, 1997, p 55). According to Nyberg & Sundin 50% of the members of the Swedish Government are women but only 0.4% per cent women are Chief Executives in Stock-Exchange House companies (SOU 1997:135, p 7-9). Women representation in power positions i.e. as Chief Executives in 2002 was 1,5 per cent or 271 men and 5 women (Renstig, 2003, p 26-27).

It is more equality of opportunities between women and men at the intermediate level of business where 42% of the information managers and 45% of personnel managers are women (Stenshamn, 2001, p 30-32) in the 500 biggest companies. There is a discussion about how to get more women at top positions of Swedish business. The statistics show that State or State controlled companies are better in

having women as leaders. Of those having women as leaders eight are State or State controlled companies (Christenson, 2004).

The Federations of Swedish Agricultural and Consumer Co-operatives are positive to women and work to take into consideration women's knowledge and experience. Both of them elected women as Chairpersons. Women always have had an important place in agriculture. They are farmers' partners and advisers. In most families the farmer and his wife discuss before they will do investments in the farm.

Women farmers are tradition keepers and responsible for continuity and unity. They influence future generation's opinion about agriculture. Women's importance is not showed by representation in important influential boards and in organisations where co-operatives are represented. This is in conflict with women's importance for the survival of countryside and agriculture.

When municipalities decentralized their activities during the 1980s many of them reorganized the activities in cooperatives like in the children care sector. The majority of the employees in

such companies are women and there are many women in other social care companies too. We can say that women are more represented in such occupations.

A fundamental democratic cooperative principle is the principle of, one member-one vote, and it could then be said that any gender discrimination should not exist. The question addressed then in this paper is the follow: Can women's representation influence and contribute to co-operatives development?

## **2. WHY MORE WOMEN?**

Three Swedish governmental investigations have studied women representation. The first one during the 1980s, studied women's political power in the society and the second one, during the 1990s, studied women's economical power in the society. Both of them suggest and argue for higher women representation. The third one during 2002-2003 studied the progress towards an even representation of women at managerial level in different companies and industries since 1993 by using a critical power and structure based perspective on issues of management and gender. In order to increase the representation of women in the political process, the following arguments are given: 1) the issue of democracy 2) the issue of resource use, and 3) the issue of interest.

### **2.1. The issue of democracy**

The system of representative democracy demands that women and men should be members of representative bodies at the same rate. Politics formed for all citizens may be formed of women and men together. Otherwise the decisions taken are not complete.

## **2.2. The issue of resources**

Women and men have different experiences. Women can then arise discussions about new problems and contribute with new answers, because of their own experience. They can introduce new questions and other perspectives than men do and help others understand why those issues are relevant. There is a women's perspective in every question and problem, if women are excluded the decisions taken are not totally complete and women as human resources are ignored.

## **2.3. The issue of interest**

Women and men have different interests and they give priority to different areas e.g. when resources should be divided. A very important issue for different members of boards is to distribute resources. The areas members of boards give priority to get often more money. Different sexes give priority to different areas. There are different interests between men and women as group. If women's interests are not represented where/when decisions are taken both democracy and the decisions about resource allocation are not complete (SOU: 1987:19, p 15-16 and 51-55).

The studies of the investigation committee showed that with more women in politics soft questions, like children day care and social and cultural issues get priority and status (SOU 1987:19, p 93).

Blomqvist (1994, p 160) studied computer and advertisement companies. She found that they try to have as many women as men as employees. In this way they have improved their relations to customers and the relations between their own employees.

Fregidou-Malama found (2000) that relations between the members of co-operatives are meant to anchor cooperatives economic and social values in the political process. Legitimised actors interact in order to secure their view of reality. The author's observations on the issue indicate that different interest groups manifest different value dimensions.

In a study about attitudes to cooperatives, it is shown that according to different actors, co-operatives spread responsibility, risks and influence and the co-operative framework is suitable to women. Different actors and specially Members of the Swedish Parliament consider that women in co-operatives can contribute to the establishment of small business and new work opportunities, to better quality of life and in training people in democratic spirit. Respondents are of the view that: "We have a democratic crisis in the society and it is seen as positive if more people are engaged." (Fregidou-Malama, 1998). They mean that cooperative businesses as such, because of their democratic character, can contribute to people's engagement.

To sum up, earlier studies show there are some motives for increasing women representation in business. Women and men have different interests and articulate different value dimensions. Women often point social values as important and they communicate differently than men do.

### 3. WHAT HAPPENS TO WOMEN?

Empirical studies show that we can find segregation in different sectors and job areas mainly with women concentrated within handcraft, social care and housing cooperatives and taking responsibility of the families and cooperatives everyday activities and needs. Women can be found in small cooperatives and low positions i.e. there exists a horizontal and vertical segregation even if the principle of -one member- one vote- is a fundamental cooperative principle.

Research studies show (Giroux and Fenocchi, 1996) the most important issue, to increase women representation, is to broaden the basis for recruitment of women. The first step is to get more women as members of the co-operatives. If women are members their interest for the problems discussed with others, who have the same interests, increases. To be a member gives the opportunity to formulate new questions and get them to the agenda. Member's engagement increase members commitment and active interest. Even as members women meet problems as minorities and are isolated from other women, they do not have the support of others, they do not know what kind of education or information they need to fulfil their obligations as members and they have to think about their roll as parents and co-operators.

Women in agriculture have other experiences than men (Lewin 1990, p 5-6). They often take care of the animals, the homework, the accounts and taxes and decide about financial issues. In that way they know what happens in farms. They are responsible for the children, the house and the garden, to buy food and take care of elderly people. They also have the responsibility for the family's economy. They take care of the relations between family members and the relationship and networking with other farmers and with authorities. They want to produce products with high quality.

Men are responsible for the machines, the cultivation and the production of raw materials. This means that work division creates different experiences for men and women. Women and men discuss with each other about different problems and help each other. Even if women know a lot about the farm their responsibility is often concentrated at homework. Women's great responsibility and those constraints for their influence make it hard for young women to stay at the countryside and the farm. Women have a long run perspective and a holistic view. They want to keep the countryside alive (Svala & Andersson, 1993, p 160).

We can see that there are special issues women work for. It is the care for children and elderly people, engagement for food quality, environmental issues and life quality. This division of work shows that there are areas that culturally can be defined as female or male and membership in a cooperative does not change women situation.

In a study by Giroux and Fenocchi (1996) in the culture sector in Quebec women said that they worked more in the cooperative than their male colleagues. According to them men rely on women for resource planning and control mean time they do the work as such i.e. to produce and deliver products. They also pointed out that there are often men who make the decision-making because it is said that they are

rational and their ideas should be good and rational. The women were also united in the opinion that men dominate the discussions and suggest things even if their ideas are not well structured. Women want to understand the actual issues discussed and to be well formulated when they participate in the discussion and they are not used to publicly present their opinion, as they are few.

When we talk about the distribution of power women talked about the importance of cooperation and relations and not the individual power. They prefer cooperation instead of competition and are afraid to take responsibility. They mean that it is more difficult for women to have leading positions and to change the rules of the game. Women are more emotional than men and they appreciate recognition and confirmation from others.

Women think that it is easier to be in a meeting if more women are there and they also point that men use another type of language (Carlbrand-Howe, 1985, p 37). Women are good listeners; they are not aggressive and often play the role of negotiator and conflict solver during meetings. Women mean they use more of their time to cooperative issues and point the importance of diplomacy and respect for other members and their opinions. To sum up, membership in the cooperative did not solve the problem of women double work both at the workplace and home, and the participation in the decision-making process and the leadership.

Good relations to co-workers, communication and respect to each other are important factors in the process of changing the conditions for women in cooperatives. According to Giroux & Fenocchi (1996) by allowing more women being members and getting leading position we can create a change and give women equality in the cooperatives, as this is a fundamental value principle.

Primary data from women cooperative leaders show, they think that in their workplaces hierarchies do not exist. They characterize women leadership as modern leadership. According to them, a leader should participate in the work that has to be done, cooperate with the workers in defining the goals of the organisation and allow the workers to participate in decision-making process. In their opinion, it is important to understand members' and others' needs and to see it as positive with many different perspectives, to use and show emotions, to be interested in people and give them the same possibilities. They also mean that women are better in understanding how other people feel, prefer to do things together, are not prestigious and respect the values of other people. It is important for women to know that they can combine work, care for children and their family. If there have been more women as leaders in the company they are seen as models and to work in networks together with other women is considered as positive.

According to the leaders, women think and talk differently than men they use the critical perspective openly and are used to give feed back. They have the same values as private and public persons. They mean it is easier for women to tell what e.g. is good in a project and what is bad. What they see as a disadvantage when being woman and leader is that men do not understand why women want to cooperate and do things together, a leader tells what has to be done, men mean. By summing up,

the leaders opinion is that women in cooperatives take care of other people because of their mother instinct and that participation, cooperation and values are important for them.

#### 4. MAKE WOMEN VISIBLE

As we can observe there are some gender patterns and we can see a segregated division of labour in cooperatives. Some jobs in cooperatives can be seen as typical for women to occupy. Women emphasize their special interests, values and experience as workers and women. Women and men's different experience leads to the fact that they do different jobs. We can also identify a numerical distribution with more men in leading positions. This dominance of men in particular jobs and in hierarchy influences the construction of gender and leadership and the development of co-operatives.

In the study we could see that women talked about to be alone and few in numbers between men. They talked about emotions, participation and nurturance. Kanter (1977, p 210) argues that numerical shifts transform social interaction that means that change in ratio of women to men can affect power relations in the organisation. Arguably, if more women should be members of co-operatives other questions should be in focus of the discussion and on the agenda. Women representation creates possibilities for broader information data basis. Women in Co-operatives use words like care for others, democracy and interaction, feeling and flexibility, sustainable environment and life quality to describe their own interests. Issues like the environment, how the countryside can be alive, and children contacts with parents, food quality and important consumer issues like local produced food, are raised and are on the agenda. Women's experience and interests can then give creative ideas about how to establish new companies at the country side (and not just only agriculture businesses) and in this way contribute to the development of the agriculture and the country side and the creation of new work opportunities. Women's representation, in my opinion, is a matter of focusing on new perspectives and finding new solutions to different problems and thus contributes to the rejuvenation of the cooperative business.

Alvesson and Billing (1997) discuss four fundamental approaches on the issue of women managers: the equal opportunities that uses motives like democracy and moral issues, the meritocracy which argues for the importance of personal merits and qualifications, the alternative value which means that women do not share men's interests or attitudes and stresses the differences and the conflicts between men and women and the special contribution approach that emphasizes differences, values, feelings or thinking between women and men. The empirical results of the study indicate that when more women are involved in the political process, *soft questions*, like social and cultural issues, get high priority and status. Women take into account social issues and want to get power without wishing to control others but to influence a sustainable development. They are considered to have a holistic view and try to

understand the consequences their decisions have on other people and the development. Those women become positive models and important ideals for other women and win more respect for their knowledge. This process legitimises them to gain self-confidence on being women and decision makers. Relationship with authorities and other companies can also be better which can result in better decisions and can be used as a new concurrence means and a competitive advantage. As I understand it, women representatives give the opportunity to concentrate on co-operatives dual aim i.e. as a company with economical issues and as a social and cultural unit. As I see it, women's representation is an issue of democracy, an issue of interest and an issue of resources use.

Both men and women are needed in co-operation for the development of co-operatives. It is important to engage more women if we think about and take under consideration the decreasing number of farmers all over the world. More women in co-operatives, as I interpret it, means that farmers voice and co-operative issues should be on the agenda and better known of people. This can contribute even to positive attitudes to co-operatives. My observations on the issue indicate that different interest groups, in this case men and women, manifest different value dimensions. For this reason, it is argued that it is particularly important to consider the interests and representation of women in Co-operatives and thus create creative conditions for successful and sustainable development of the organisations and bring cooperative issues into the public eye.

In summing up thereof, the study shows that we need more women in cooperatives as members and in high positions to bring new issues on the agenda, discuss different problems from different perspectives i.e. economic and social and thus balance the power between men and women in cooperatives. More women as members of representative boards can contribute to better working conditions at meetings and at the same time can influence and balance the economic and social aim of cooperatives.

## 5. CONCLUDED REMARKS

In this paper women representation in cooperatives is discussed based on empirical studies. In exploring women representation it can be argued that more women in cooperatives is a matter of increasing democracy and widening the basis for decision-making. It is a means to raise new questions and new problems and to take under consideration every one's interest.

Furthermore, women become respected for their knowledge and contribute to cooperatives development and their commercial success. When then state authorities guarantee influence to different groups a balance is needed between women's and men's representation. In that way, in my opinion, different motives and aims can be taken under consideration e.g. when legal or employment issues or resource distribution are discussed and new solution to problems can be found. Women get

more power, formulate alternative solutions to problems and their possibilities to influence agricultural production and other production possibilities can be better. The relationship between men and women in cooperatives and cooperatives relationship to the state can also be better.

In this work, I argue for increased women representation in co-operatives and their relationship to the state and other actors. With more women representatives, women's interests can be taken under consideration, new perspectives are in focus and democracy is strengthened. However, with more women representatives both commercial and social and cultural issues can get higher priority and status. Women are allowed to influence a viable societal development and to contribute to the rejuvenation and sustainable development of co-operatives.

This study discusses women's representation in cooperatives and just raises some issues. Further research is needed to understand the value of women's representation. One area to be studied could be women and men as leaders in different cooperative organisations and in different leading positions to analyse if and how increased women representation can contribute to cooperatives' development.

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# THE FULFILMENT OF THE FIRST CO-OPERATIVE PRINCIPLE: AN ANALYSIS OF GENDER DISCRIMINATION IN SPANISH CO-OPERATIVES

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## 1. INTRODUCTION

The paper begins by outlining the main characteristics of discrimination against women in the labour market that have been widely observed in different countries, including the most developed economies. Following this, the first co-operative principle is emphasized, with its explicit reference to non-discrimination between the sexes. Before making an analysis of the situation in Spain, an examination is made of the benefits the co-operative movement can bring women, together with the advantages that female participation at all co-operative levels represents, with a reference to women's involvement from a historical perspective.

Three different aspects of the female labour situation in Spanish co-operatives are analysed. Firstly, data is presented showing male and female participation in Spanish co-operatives and worker-owned companies, based on different variables (age, sectors, fields of activity, employment situations etc.), dealing with workers' co-operatives as a specific case. A description is then made of the most significant recent initiatives by the co-operative movement to promote sex equality. Lastly, some examples are given of the numerous co-operatives founded and managed by women in Spain in recent years.

## **2. DISCRIMINATION AGAINST WOMEN IN EMPLOYMENT**

In general, differences can be observed between the male and female labour situation both in developed and developing countries. Different indicators reflect these inequalities.

In Spain, as in other countries, signs of occupational segregation of both kinds can be observed. Horizontal occupational segregation reflects the division of labour between the sexes, with certain sectors or activities being regarded as typically male and others being considered female. At the same time, a low proportion of women in top-level managerial positions and posts of responsibility has been detected: a phenomenon known as vertical occupational segregation.

As well as the above, there is also other evidence that women are at a disadvantage in the workplace. Earnings discrimination is common, that is to say different wages are paid to men and women doing the same job or carrying out work of a comparable nature.

Finally, it should also be mentioned that differences can be observed in the way men and women are hired, because women are more prone to be given temporary or part-time contracts than men.

## **3. “NON-SEXUAL DISCRIMINATION” IN THE CONTEXT OF THE CO-OPERATIVE PRINCIPLES**

Among the seven co-operative principles defined by the International Co-operative Alliance, from the perspective of the issue at hand, the most interesting is the first, since it refers explicitly to non-discrimination:

“Co-operatives are voluntary organizations, open to all people able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.”

It is necessary to specify that the inclusion of the “non-gender discrimination” requirement in the first principle is a relatively recent achievement, since it was introduced when the co-operative principles were reviewed at the Manchester Congress in 1995. The issue had already been raised by the Women’s Committee, above all at the Tokyo Congress, where the inclusion of equal male and female representation in the management of co-operatives was requested in the second principle. However, this last proposal was not admitted in the revised version of the co-operative principles in 1995 in Manchester (Gómez, 1998: 42).

Low female representation in co-operatives highlights the existence of a big contradiction or lack of coherence, since co-operatives are based on specific working rules such as democracy, openness and equality, with underlying values that include solidarity, and an interest in people and the community.

According to Apelqvist (1996), gender imbalance in co-operatives is one of the most striking contradictions between co-operative theory and practice<sup>1</sup>, weakening co-operative identity, credibility and the possibilities of the fulfilment of co-operative purposes. As they stand now, co-operatives are conceived by men for men and they are based on masculine values, rules and priorities<sup>2</sup>.

## **4. WOMEN AND THE CO-OPERATIVE MOVEMENT: MUTUAL BENEFITS**

### **4.1. The contributions of the co-operative movement to women**

According to Chávez (1996), co-operatives can help women's welfare in many ways. Access to productive employment, credit and low-cost quality services, education and training, medical assistance and the incorporation of women into decision-making are some of the most outstanding factors<sup>3</sup>.

Evidence shows that co-operatives are valid instruments in the social integration and incorporation into the labour market of certain excluded groups. Co-operatives offer significant advantages in the creation and maintenance of employment, offering women the opportunity to develop a professional career, not only as employees, but also by allowing them to found a company or be directly involved in it, facilitating unique business initiatives that meet their needs and those of the local area.

### **4.2. Female contributions to the co-operative movement.**

Debate on female representation in co-operatives not only focuses on the discriminatory situations women might find themselves facing, but on the key issue of the highly positive potential contributions they could make to the co-operative movement, since women possess qualities and sufficient skills to carry out their work in a professional way. If the co-operative movement fails to value or take advantage of women's aptitudes, considerable human and professional potential is therefore being wasted.

As Itkonen comments (1995: 71-72) "gender equality should be promoted, not only because women are subordinate, but rather because their capacities, experience and formation are necessary for co-operative competitiveness"<sup>4</sup>.

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1. This paradox is also commented on by Itkonen (1995: 72).

2. The necessities and the way of life of women have been ignored, under the supposition that by taking into account men's needs, women and children automatically benefit from this. In some countries, this leads to the introduction of legislation that is detrimental to women. In co-operatives, women do not have the same opportunities for acquiring basic skills and higher training in finance, technology and management. High value is attributed to 'male' aptitudes and experiences and little to 'female' aptitudes and experiences (Apelqvist, 1996: 42).

3. Gómez (1998: 33) coincides in citing these same female benefits.

4. This argument is part of the approach developed in recent years to deal with discrimination against women in the workplace. The "diversity criterion" adopts a more positive tone and it stresses the benefits that "gender diversity" can contribute to organizations and to social progress in general (Barberá et al., 2002: 62).

Gómez (1998: 35) highlights the fact that women's involvement in the co-operative movement is not only related to female equality and women's rights, but also to other important aspects such as peace, development and education.

## **5. WOMEN'S INVOLVEMENT IN THE CO-OPERATIVE MOVEMENT FROM A HISTORICAL PERSPECTIVE**

As Gómez remarks (1998), women have been part of the co-operative movement from the outset, playing a prominent role in the development of British co-operatives. A woman, Ann Tweedale, is even mentioned among the Rochdale Pioneers. Moreover, women also played an important role in the stage prior to the creation of the Alliance. Through the co-operative movement, women struggled to achieve greater prominence. Under the principle of democracy (one person, one vote), women upheld their right to share full responsibility with men in the management of co-operatives.

With the aim of defending their interests better, women soon organized female associations within the co-operative movement (Women's Co-operative Guilds). The development of these associations finally led to the creation of a federation of associations at an international level and, in this way, women became involved in the international co-operative movement.

This is how the International Committee of Co-operative Women was formed in order to promote the woman's movement in places where it did not exist and foment a spirit of solidarity and common co-operative purpose. This first temporary committee was soon replaced by a permanent organization: the International Women's Guild (ICWG).

At the 1963 Bournemouth Congress, the ICA Women Co-operators' Department and Women Co-operators' Advisory Council (WCAC) were founded. The function of the second body was to advise the Alliance on the promotion of female representation in co-operative activities. Latterly, the WCAC became the ICA Women's Committee. More recently (at the 1995 Manchester Congress), the Women's Committee was transformed into the Global Women's Committee, with a view to achieving a co-operative movement led by men and women based on the principles of democracy, development and welfare.

The International Co-operative Alliance currently includes a body called the ICA Gender Equality Committee, which promotes equality between women and men and gender integration in the co-operative movement and in society. The foundation of this body was discussed at a plenary meeting held in Rio de Janeiro on December 4th 2000 and it was finally approved by the Board of the ICA in April 2001. The ICA's Gender Equality Committee is based on the former ICA Global Women's Committee (ICA GWC), whose creation was approved on September 18th 1995 in Manchester.

## 6. AN ANALYSIS OF THE SITUATION IN SPAIN: THE EMPLOYMENT STATUS OF WOMEN IN SPANISH CO-OPERATIVES

### 6.1. Female involvement in Spanish co-operatives and worker-owned companies.

The following table contains information on the distribution of workers by sex and by the following types of company: co-operatives, employee-owned public limited companies or employee-owned limited liability companies.

**TABLE 1.**  
**PERCENTAGE OF WORKERS ENGAGED IN THE SOCIAL ECONOMY BY SEX**  
**AND TYPE OF COMPANY ON 31-12-2003**

Sex	Total	Co-operatives	Employee-Owned Public Limited Co.	Employee-Owned Limited Liability Co.
% Men	61.1	57.2	76.9	70.1
% Women	38.9	42.8	23.1	29.9
Total	100.0	100.0	100.0	100.0

Source: Spanish Ministry of Labour and Social Affairs. Directorate-General for the Promotion of the Social Economy and the European Social Fund (2003).

The data in Table 1 shows that Spanish co-operatives and worker-owned companies have a high percentage of men (over 61%), although female representation varies considerably according to the type of company. There is a significant difference between female representation in co-operatives and their representation in worker-owned companies. While women account for almost 43 % of the workforce in co-operatives, in employee-owned public limited and limited liability companies the corresponding figure is quite a lot lower: 23.1 % and 29.9% respectively. Therefore male and female labour representation is more balanced in co-operatives.

The percentages presented below, showing male and female representation in Spanish co-operatives and worker-owned companies, are taken from census data. They show the joint figures for both types of companies.

**TABLE 2.**  
**PERCENTAGE OF WORKERS ENGAGED IN THE SOCIAL ECONOMY BY SEX**  
**AND THE SIZE OF THE COMPANY ON 31-12-2003**  
**(EXCLUDING SELF-EMPLOYED WORKERS)**

Size	% Men	% Women	Total
From 0 to 5 people	66.7	33.3	100.0
From 6 to 10	71.4	28.6	100.0
From 11 to 25	68.3	31.7	100.0
From 26 to 50	62.5	37.5	100.0
From 51 to 100	57.9	42.1	100.0
From 101 to 250	50.9	49.1	100.0
More than 250	48.9	51.1	100.0
Total	60.4	39.6	100.0

Source: Spanish Ministry of Labour and Social Affairs. Directorate-General for the Promotion of the Social Economy and the European Social Fund (2003).

In each interval, a predominance of male workers can be observed, although female representation rises as the size of the company increases, reaching an almost balanced proportion of men and women in larger companies (with 101 workers or more).

**TABLE 3.**  
**PERCENTAGE OF WORKERS ENGAGED IN THE SOCIAL ECONOMY BY SEX**  
**AND AGE ON 31-12-2003**

Age	% Men	% Women	Total
Under 25 years	60.3	39.7	100.0
From 25 to 39 years	58.4	41.6	100.0
From 40 to 54 years	62.6	37.4	100.0
55 years or more	71.6	28.4	100.0
Total	61.1	38.9	100.0

Source: Spanish Ministry of Labour and Social Affairs. Directorate-General for the Promotion of the Social Economy and the European Social Fund (2003).



The proportion of men and women varies according to their age group, with a higher percentage of women among the younger workers, particularly in the 25 to 39 year old age group where women represent 41.6 % of the total workforce.

**TABLE 4.**  
**PERCENTAGE OF WORKERS ENGAGED IN THE SOCIAL ECONOMY BY SEX**  
**AND BUSINESS SECTORS ON 31-12-2003**

Sectors	% Men	% Women	Total
Agriculture	57.3	42.7	100.0
Industry	72.8	27.2	100.0
Construction	94.0	6.0	100.0
Services	49.2	50.8	100.0
Total	61.1	38.9	100.0

Source: Spanish Ministry of Labour and Social Affairs. Directorate-General for the Promotion of the Social Economy and the European Social Fund (2003).

The distribution of male and female workers varies according to the business sector in question. In the service sector, the proportion of men and women is practically equal, while the remaining sectors have a big majority of male workers, with men representing 94 % of the workforce in the construction industry, almost 73 % in industry and more than 57 % in agriculture.

If one observes the workers' gender distribution for different fields of activity (Table 5), it can be confirmed that most fields have a greater proportion of male workers, particularly activities like the mining industry, the production and distribution of electricity, gas and water, construction, and transport, storage and communications. Women are only well represented in service activities like education, health and veterinary activities and social and personal services.

**TABLE 5.**  
**PERCENTAGE OF WORKERS ENGAGED IN THE SOCIAL ECONOMY BY SEX**  
**AND DIFFERENT FIELDS OF ACTIVITY ON 31-12-2003**

Field of activity	% Men	% Women	Total
Agriculture, livestock, hunting, forestry and fishing	57.0	43.0	100.0
Mining industries	94.9	5.1	100.0
Manufacturing industries	72.7	27.3	100.0
The production and distribution of electricity, gas and water	86.4	13.6	100.0
Construction	94.0	6.0	100.0
Trade and the hotel business	51.4	48.6	100.0
Transport, storage and communications	83.5	16.5	100.0
Finance	65.2	34.8	100.0
Real estate, rental activities and managerial services	46.6	53.4	100.0
Education, health, veterinary and social activities	31.8	68.2	100.0
Total	61.1	38.9	100.0

Source: Spanish Ministry of Labour and Social Affairs. Directorate-General for the Promotion of the Social Economy and the European Social Fund (2003).

These differences in male and female involvement in different sectors and fields of activity reveal the existence of horizontal occupational segregation in Spanish co-operatives and worker-owned companies.

**TABLE 6.**  
**PERCENTAGE OF WORKERS ENGAGED IN THE SOCIAL ECONOMY BY SEX**  
**AND THEIR EMPLOYMENT SITUATION ON 31-12-2003**

Employment situation	% Men	% Women	Total
Permanent worker	62.9	37.1	100.0
Temporary worker	57.0	43.0	100.0
Total	61.1	38.9	100.0

Source: Spanish Ministry of Labour and Social Affairs. Directorate-General for the Promotion of the Social Economy and the European Social Fund (2003).

Nearly 63 % of all permanent workers are men. Meanwhile 57 % of all temporary workers are men and 43 % are women. This shows that women are more strongly affected than men by temporary employment contracts.

71.7 % of all male workers employed by Spanish co-operatives and worker-owned companies are hired on a permanent basis, whereas only 66.3 % of their female counterparts benefit from this employment status (Spanish Ministry of Labour and Social Affairs. 2003).

**TABLE 7.**  
**PERCENTAGE OF WORKERS ENGAGED IN THE SOCIAL ECONOMY BY SEX**  
**AND TYPE OF WORKING WEEK ON 31-12-2003**

Type of working week	% Men	% Women	Total
Full time	93.7	82.2	89.2
Part time	6.3	17.8	10.8
Total	100.0	100.0	100.0

Source: Spanish Ministry of Labour and Social Affairs. Directorate-General for the Promotion of the Social Economy and the European Social Fund (2003).

The figures in the above table show that a higher percentage of women work on a part-time basis than men: only 6.3 % of men have part-time contracts in comparison with 17.8 % of women.

The data presented here shows that men have better labour conditions than women. A greater percentage of men are in stable, full-time employment than women. In contrast, more women are hired as temporary or part-time workers.

**TABLE 8.**  
**PERCENTAGE OF WORKERS ENGAGED IN THE SOCIAL ECONOMY BY SEX**  
**AND SOCIAL SECURITY CATEGORIES ON 31-12-2003**  
**(EXCLUDING SELF-EMPLOYED WORKERS)**

Social security category	% Men	% Women	Total
Graduate engineers	64.3	35.7	100.0
Technical engineers, expert specialists and assistants	41.3	58.7	100.0
Managerial workers	77.7	22.3	100.0
Unqualified assistant staff	64.0	36.0	100.0
Skilled administrative staff	57.7	42.3	100.0
Junior staff	48.0	52.0	100.0
Administrative assistants	31.9	68.1	100.0
First and second-class skilled workers	87.3	12.7	100.0
Third-class skilled workers and specialists	61.6	38.4	100.0
Unqualified workers over the age of 18	53.5	46.5	100.0
Workers under the age of 18	77.5	22.5	100.0
Others	50.0	50.0	100.0
Total	60.4	39.6	100.0

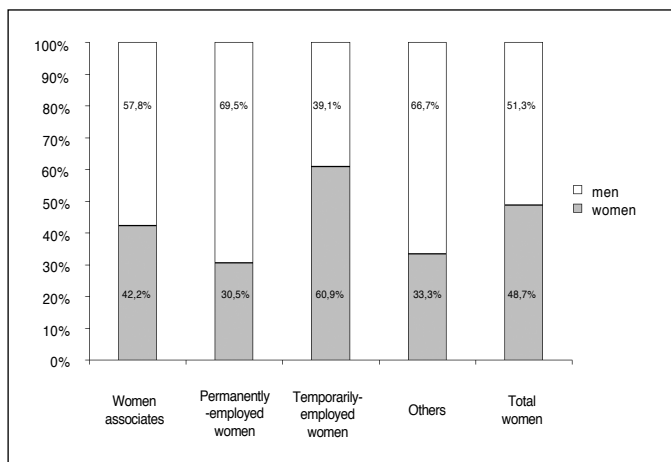
Source: Spanish Ministry of Labour and Social Affairs. Directorate-General for the Promotion of the Social Economy and the European Social Fund (2003).

Table 8 shows the distribution of the workforce in co-operatives and worker-owned companies by sex and the worker's labour category. Women are more strongly represented in the "administrative assistants" category, where they account for 68.1 % of all workers. In the "technical engineers, expert specialists and assistants" category, 58.7 % of the workers are women, and in the "junior staff" group they account for 52 % of the total (with relatively balanced percentages of men and women). In the remaining employment categories most of the workers are men. They represent a clear majority in the "first and second-class skilled workers", "managerial workers", "graduate engineers" and "unqualified assistants" categories, and they also account for 77.5 % of all workers under the age of 18.

## 6.2. Female labour representation in workers' co-operatives in Spain.

In continuation, based on data produced by the Spanish Confederation of Workers' Co-operatives (COCETA: *Confederación Española de Cooperativas de Trabajo Asociado*), a specific analysis is made of co-operatives and, more particularly, Spanish workers' co-operatives.

**GRAPH 1.**  
**THE PERCENTAGE OF WOMEN IN EACH CO-OPERATIVE EMPLOYMENT**  
**CATEGORY**



Source: Spanish Confederation of Workers' Co-operatives (COCETA).

According to the available data, in Spain, it can be seen that women are more highly represented as co-operative employees than as associate workers, only accounting for 42 % of all partners<sup>5</sup>. It can also be observed that women are hired on a more precarious employment basis: 61 % of all temporary employees are women and they only account for 31 % of all permanent employees. Moreover, women also account for approximately 65 % of all part-time co-operative workers (Delso, 2001: 6).

An analysis by sectors reveals that there is a higher female presence in service co-operatives, where they represent 62 % of the labour force (37 % of all partners as opposed to 59 % of all employees). This contrasts with the industrial sector, where women only account for 36 % of the total (67 % of all partners and 28 % of all employees). However, the distribution by sub-sectors is far from balanced, since women abound in the textile and clothing sectors but are scarcely present in co-operatives from the metallurgic or furniture industries. Women are also only marginally

5. According to data compiled by the National Institute of Statistics (INE: *Instituto Nacional de Estadística*), in the second quarter of 2003, 32.69 % of all co-operative members were women and 67.31 % were men. 74.39 % of all agricultural co-operative members were men, while only 25.61 % were women. In the case of non-agricultural co-operatives, the gender difference was less acute, although there was still a clear male majority, with men representing 66.08 % and women 33.92 %. Within this last type of co-operative, sectoral differences can also be observed, with women representing 29.81 % of all industrial co-operative members, 7.22 % of all members from the construction industry and 45.08 % of all members in the service sector.

present in the construction and non-traditional agricultural industries (2 %) (COCETA; Delso, 2001: 6; COCETA Women's Department, 1998: 5).

Nevertheless, because women are more strongly present in one particular sector, this does not imply access to more stable employment and to positions of greater responsibility. This is reflected by the data on partners in the service and industrial sectors, where a respective 37 % and 67 % of their associates are women. These figures, however, are not comparable to the female workforce of the two sectors, where women account for 62 % of all service sector employees and 36 % of industrial employees. In the industrial sector, women represent a third of the labour force in terms of its working partners (38 %) and temporary workers (36 %), indicating that gender does not affect access to a partnership. In the service sector, nonetheless, 49% of all partners are women, but they represent 76 % of all temporary workers. That is to say, in this case women have difficulty in becoming a partner (COCETA).

"49% of the total workforce (associates and hired workers) of workers' co-operatives are female. The average number of women holding managerial positions is higher in co-operatives than in other types of businesses, with a current percentage of 36%. In spite of the high percentage of female partners and workers, there is no comparable female presence in their governing bodies" (COCETA). This reveals the existence of a certain degree of vertical occupational segregation. That is to say, men are more strongly present in higher positions of authority, whilst a greater proportion of women can be found in lower employment categories.

### **6.3. Initiatives by the Spanish co-operative movement to promote gender equality**

We should point out that Spanish co-operative organizations are not unaware of the labour situation women face. In recent years these organizations have paid attention to the specific problems women in co-operatives experience and they have tried, in many ways, to promote greater equality between men and women.

In Spain, one of the most important pro-female initiatives by an organization from the co-operative movement was possibly the creation of the Women's Department of COCETA (the Spanish Confederation of Workers' Co-operatives) in March 1997. In addition to the confederation's own team of experts, the department also included representatives of other federations from Spain's different autonomous communities.

COCETA's Women's Department was created to offer national coverage of different initiatives by co-operative organizations at a regional level. The purpose of the department is to design policies that are mainly directed at women, and its prime objectives are:

- "1. To promote the creation of a Women's Department in different co-operative organizations.

2. To eliminate discrimination against women in workers' co-operatives from the perspective of sexist terminology and the female image.
3. To find out the situation of women in workers' co-operatives.
4. To foster and contribute towards the presence and participation of women in the managerial and governing bodies of workers' co-operatives and in their representative structures.
5. To make the activities of the Women's Department known to others, using COCETA's own communication channels and those of other co-operative organizations.
6. To stimulate an interest in specific fields of training for women and encourage their participation in existing educational programmes.
7. To promote health programmes for women, in relation to their social and working lives. And in general, to improve the living conditions of female workers and female co-operative members, thus enhancing their social, employment and cultural opportunities as well as facilitating and improving their permanency and place in the private sector." (COCETA).

These objectives have been put into practice through a series of activities: the diffusion of completed initiatives, field work on the reality of women in workers' co-operatives, the organization of courses and seminars, the creation of forums and opportunities for debate and communication, training activities in administration and managerial techniques, an analysis of occupational hazards for women, advice and support by female entrepreneurs, the promotion of standard rules in correspondence and communications by co-operative organizations so as to avoid the use of sexist language, and the promotion of the creation of a Women's Department in each workers' co-operative (COCETA).

The Aragonese Federation of Workers' Co-operatives (FACTA: *Federación Aragonesa de Cooperativas de Trabajo Asociado*) imitated COCETA's national initiative and CECOP's European initiative by creating its own Women's Department. The objectives of the FACTA Women's Department are "to eliminate discrimination against women in workers' co-operatives from the perspective of sexist terminology and the female image, to find out the situation of women in workers' co-operatives, and to foster and contribute towards the presence and participation of women in the managerial and governing bodies of workers' co-operatives and in their representative structures" (FACTA, 1999).

In Madrid, a group of women co-operators decided to form an association to promote female participation within the co-operative movement. That is how the Association of Co-operative Women Entrepreneurs (AMECOOP: *Asociación de Mujeres Empresarias de Cooperativas*) came into being, in response to "the low level of female representation in co-operatives' managerial bodies and the lack of political and representative participation in the co-operative movement." The Madrid co-operators were also aware of the need for greater training and motivation to promote

higher female representation. Their main proposals and activities are focused on participation in co-operative events, seminars for businesswomen, round table debates, collaboration with the different local councils that form part of the Autonomous Community of Madrid, specific courses on women and employment, the promotion of studies on opportunities for female employment in co-operatives, coeducation in different co-operatives, positive action etc. AMECOOP is currently part of COCETA's Women's Department (Martin, 1998).

In December 1998, following a proposal by AMECOOP, COCETA's Women's Department founded a biannual publication called *Cuadernos Mujer y Cooperativismo*, with a "view to creating new opportunities for communication, exchanges and discussion that are clearly focused on direct strategic intervention to promote gender equality within the co-operative movement, in particular, and in employment in general". As the leading article of the first issue (Nº 0) outlines, the objectives of this publication are:

- "To sensitize people and make them aware of what a co-operative identity is, i.e. our ideas, work, projects, initiatives ...
- To promote real, active female involvement, opening up new forums for debate and opportunities for relations and action, creating a new framework for co-operative exchanges and knowledge of other experiences.
- To include the perspective of gender in the environment of Social Economy, supplying ideas, opinions, studies, experiences ... and using this publication as an instrument to promote action and change.
- To publish information on research, study proposals and conclusions, meetings, seminars etc. that contribute to the promotion of women and the elimination of prejudice and cultural and employment stereotypes.
- To investigate and propose strategies and models of female co-operative management and social participation in the working world and in access to employment and the creation of employment."

In collaboration with the University of Valencia (the public body in charge of the project) and the Government of Valencia's Department of Employment<sup>6</sup> (as co-sponsor), the Valencia Federation of Workers' Co-operative Enterprises (FEVECTA: *Federación Valenciana de Empresas Cooperativas de Trabajo Asociado*) has set in motion an initiative called the *Carme* Project, within the framework of the NOW (New Opportunities for Women) EC initiative. The main objective of the project is to offer support and facilitate female access to managerial positions in co-operative enterprises based in the Autonomous Community of Valencia (Real, 1998: 8).

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6. *Consellería de Empleo.*



FEVECTA was one of 20 selected bodies that created the best NOW projects in the whole of the European Union. From among these bodies, it was one of five that were visited by a EUROPS representative (the Technical Support Office for the NOW project) so that the latter could get first-hand experience of FEVECTA's work in the field of female labour integration. The project aroused interest for two reasons: on the one hand, because of the work done by FEVECTA's Central Business Service for Women (*Servicio de Centro de Empresas para Mujeres*)<sup>7</sup>. This service, which was originally created with the support of the Demetra European Project, is aimed at students who have completed training courses for women attached to the Demetra Project either wishing to set up their own business or else wanting to join a co-operative already in operation. FEVECTA also stood out from the rest because it was the only organization from the 20 selected bodies that promotes joint female employment through the co-operative system, rather than just employment on an individual basis (FEVECTA, 1997).

At present FEVECTA is taking part in projects within the framework of the EQUAL EC initiative, some of which concern equal opportunities. EQUAL MIMA is a project that is being run in the municipalities of Mislata and Manises, directed at promoting and facilitating better reconciliation between family and working life. The EQUAL-CAMP DE MORVERDE project, which is focused on the Sagunto area, explores the strong horizontal segregation that persists as a legacy of Sagunto's industrial past (Tarazona, 2003).

#### 6.4. Co-operative enterprises created and managed by women

Since its creation in 1998, successive issues of the publication *Cuadernos Mujer y Cooperativismo* have described some of the most significant initiatives by co-operative enterprises in Spain to incorporate women into their workforces (as partners and workers). A presentation will now be made of some of these experiences.

One of these co-operatives, *Confecciones OLAIA*, was set up by a group of women in an area of fishing tradition in Galicia. Given the precarious, temporary nature of work in the port, they decided to found a co-operative clothing company. Some of the women who started the company had already worked for a co-operative which served as a model for *Confecciones OLAIA*, and this is how, in 1990, a group of women who were either unemployed or in unstable employment came to organize their own co-operative (UGACOTA Women's Department, 1998).

*ASERMUT Soc. Coop.* is a co-operative and social initiative that was created in Torremocha del Jarama (the province of Madrid) in response to an urgent need for global assistance for older members of the community who still live in rural villages. *ASERMUT* runs a municipal service that provides attention for the elderly, involving

7. This service is directed at promoting, advising, guiding and supporting initiatives that might lead to the creation of employment through the formula of a workers' co-operative.

its workers (partners and professionals) in a common project. The global solution designed to deal with the problem included the construction of a municipal old people's home and the foundation of the co-operative to run the service. 90% of *ASERMUT*'s workers are women, and this determines how the co-operative operates. One of the key services it provides is job training for unemployed women from different communities, thereby combating the existing training deficit and offering them real work opportunities. This has led to high quantitative and qualitative female labour integration in the area (Castillo, 1998).

*DONAVOI Soc. Coop. Ltda.* is a co-operative formed by a team of educators who specialize in the management and running of school dining rooms and nursery schools and the organization of out-of-school and leisure activities. These monitors are specialists in leisure education for children and young people. "*DONAVOI* was created and has survived thanks to certain commitments by its working partners: participation at all decision levels, efficient management, and professional suitability, meaning that each partner is responsible for tasks she specializes in and is motivated to do" (Agua Sánchez, 1998).

*COMUPA (Cooperativa de Mujeres Paradas: the Unemployed Women's Co-operative)* was also founded by a group of women who were either unemployed or else in an unstable labour situation with a view to providing them with a decent, stable job, as well as ensuring their integration into the labour market under appropriate working conditions. What they intended was to create a company worth working for, specializing in professional cleaning work. For this reason, they established certain work methods and procedures: work uniforms, horizontal relationships, solidarity among the members of the group, properly completed work and fair payment. The company's main singularity was probably the need for childcare for the members of the co-operative's children. This made them contemplate the creation of a nursery, which had to be located in the co-operative building. The result was the involvement of their own families in the children's care, since older daughters were in charge of looking after younger ones. In this way, a worthwhile, mutual employment initiative was achieved, with the participation of their families. Originally created by 4 people, six months later a further 9 working partners had joined the co-operative (López, 1998).

In 1995, *5 y Más* was founded by 5 women. It was created in western Salamanca from an association of neighbours (*ZOES*), and it was the first social services management initiative in Salamanca. The co-operative specializes in managing socio-cultural, entertainment and training services, with a 95% female workforce (that varies depending on the programmes being run) who have different specialist degrees (social work, psychology, pedagogy, social education, local development, leisure and free time, socio-cultural entertainment etc.). The aim was to contribute to social welfare and people's personal development. The creation of *5 y Más* has led to new realities, forcing Salamanca's authorities to make a public invitation for tenders for certain services like children's play-centres, occupational workshops in the Day Centre and others. This represents a movement towards the professionalization and legalization of this type of public management service (Cid, 1999).

In the third issue (Nº 2) of the magazine *Cuadernos Mujer y Cooperativismo*, published by COCETA and AMECOOP in November 2000, two pioneering co-operative experiences are described (COCETA).

The first is a collaboration agreement between *Taller de Ses Òlibes* and the Balearic Union of Workers' Co-operatives (UCTAIB: *Unió de Co-operatives de Treball de les Illes Balears*). This agreement had a dual purpose: to provide specialist woodwork training, particularly in inlay and finishes, and subsequent labour integration through a workers' co-operative. The project formed part of the *Enllaç* Training Plan promoted by the Government of the Balearic Islands' Department of Labour and Training<sup>8</sup> and co-funded by the European Social Fund. The final objective was the labour integration of the 17 students who participated in the project, thus meeting the employment needs of carpenter's and cabinetmaker's workshops in the Pla de Mallorca area (*Comarca del Pla de Mallorca*), where there was a big demand for specialists in "natural finishes and fine carpentry work".

The second experience concerns a co-operative in Rincón de Soto, La Rioja, called *Madera y Envases S. Coop.* Of its 27 partners, 18 were men and 9 were women, only one of whom worked in management. In this co-operative, women have the same working conditions as men in terms of wages, leave and types of work, with the sole exception of maternity leave, where there are specific regulations. At the women's request, the co-operative's governing body regulated this issue. An internal regulation establishes the leave system, but because the workers are self-employed, their jobs are based on hourly work, which means the working day can be reduced at will, with considerable flexibility in this sense. In such cases, employees are hired under temporary contracts to cover reductions in the partners' working hours. The company is a pioneer in facilitating flexible timetables in response to family and personal needs.

According to its manager, the co-operative *Cangurs SCCL* is an offshoot of a free baby-sitting service run by the *Federació de Dones de Catalunya* (Catalonia Women's Federation) since 1997. This free service is aimed at single-parent families with financial difficulties. However, it was noticed that families who could pay a little for the service (although not much) telephoned but were excluded from it because they were able to pay. The co-operative was therefore created in the year 2000 to satisfy that demand, as well as offering stable employment to people working as baby-sitters. The *Federació de Dones de Catalunya* is linked to *Cangurs* and offers support by sharing its headquarters with the co-operative. This has helped the co-operative become known to people and in addition to private baby-sitting services, it also provides monitors for schools. The six women who began the co-operative seek to offer a professional, good quality service. They consider the job to be one that entails considerable responsibility and they offer their services as professionals (the co-operative's partners and workers have qualifications in the field of infancy), with

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8. *Conselleria de Treball i Formació del Govern de les Illes Balears*

experience that other younger girls do not have. The biggest difficulties they encounter are competition and the little social recognition they get for their work, due, in their opinion, to the low value that is placed on women's work (Colomé, 2001).

Nevertheless, not all co-operatives with female representatives or women members of management specialize in work that is considered typical of women. Located in the city of León, *Specum S. Coop., Arqueología y Patrimonio* is made up of three partners who are all archaeologists, two men and a woman, who is the founder partner and sole administrator of the co-operative and so she deals with the management of the company at an administrative and bureaucratic level, as well as being responsible for institutional dealings. All three members used to work for a private limited company, but they were not happy with the work system or the labour conditions, and they decided to create their own company with their own personal vision of how to manage and look after the region's historical and archaeological heritage. The co-operative's only woman is immersed in a completely masculine world and she recognizes that "the really sad thing is that the higher the cultural level of my colleagues is (architects, engineers etc.), the worse they treat professionals of the female sex". In her opinion, they are the ones who behave in a more openly male chauvinistic, paternalistic way, and she has to prove she is a professional to them each and every day, whilst with her male colleagues this is taken for granted. However, she comments that her working conditions within the co-operative are the same as those of her two male partners (and friends), which leads to less paternalism. In her opinion, there is no sex discrimination in the field of archaeology (Martínez Muciego, 2002).

## 7. CONCLUSIONS

The problem of discrimination against women in co-operatives is an important issue for two main reasons. Firstly, the co-operative principles that form the basis of all co-operative enterprises call for the elimination of discrimination among people, including sex discrimination. Secondly, if women are not fully integrated in the co-operative movement, their potential, capacities and aptitudes will be wasted, and this will have a detrimental effect on the full-capacity running and development of co-operatives.

When an analysis was made of the labour situation of workers in Spanish co-operatives and worker-owned companies, inequalities between men and women were observed. Women are less strongly represented than men, although this varies according to the age of the workers or the company's type and size. The existence of occupational segregation was also detected, since the workers' distribution by sex varies according to the sector and field of activity in which they are engaged. Differences in the way men and women are hired can also be observed, because women are more affected by temporary contracts, as well as tending to work part-time more than men.

An analysis of the female labour situation in Spanish workers' co-operatives again reveals stronger male representation and greater difficulty by women in joining a company as a partner or in occupying managerial positions and jobs of responsibility.

In recent years in Spain there has been a growth in initiatives aimed at promoting equality between the sexes. Co-operative organizations are aware of the need to promote gender equality among their staff and so specific women's departments have been created by different co-operative federations, publications have been created to sensitize people to the problem, and specific programmes have been run directed at full female integration, etc.

From the experiences that have emerged in our country, it seems that co-operatives are ideal instruments for helping women to develop managerial and professional aptitudes. At the same time, co-operatives also offer a solution to female unemployment or job instability by integrating them into the labour market.

Observed attitudes and initiatives within the co-operative movement show that some co-operatives have a high awareness of the problem of female labour inequality, that they are committed to overcoming this problem, and that they try to follow the co-operative principles on which they are based (including non sexual discrimination). Co-operative enterprises that abide by these co-operative principles are businesses whose functions go beyond the boundaries of finance. They also have a social role, which entails an active involvement in the problems and situations of the co-operative's business partners and those of the community. By trying to promote women's social integration and their incorporation into the labour market, including management, those organizations from the co-operative movement that do so are behaving in consonance with the spirit of cooperation.

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**PART 10**  
**HISTORICAL PERSPECTIVES**



# **HISTORICAL RECORDS OF 20TH CENTURY AGRICULTURAL CO-OPERATIVE MOVEMENT IN EUROPE: A COMPARATIVE SYNTHESIS IN THE EUROPEAN UNION**

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## **1. INTRODUCTION**

If the goal of the European co-operative movement and the agrarian in particular is to be able to play a relevant role in the world of globalization by looking ahead to the future, making proposals and planning challenges, it must also look historically into its own origins, beyond the merely quantitative and statistical elements (MIGNOT, DEFOURNY and LECRERC, 1999)

In the present paper we provide an account of the initial period of the agrarian co-operative movement in several countries (Belgium, Denmark, France, Italy, The Netherlands, Portugal, United Kingdom) in the search for coincidences and differences that may account for, and possibly avoid, problems of joint actions in the coming years.

Two main parameters have been distinguished in the development of the co-operative movement. On the one hand a number of countries like France, Italy, Portugal and Belgium have been considered, where the ideological-utopian-co-operative project seems to promote the initiatives of the various social groups that are in favor of its development. On the other hand, there are other countries like Denmark and Holland where the development of a joint action can be explained, to a great extent, from competitive advantages in the market rather than from the standpoint of the ideological principles as a valid framework.

The elements of analysis are, among other, the legal framework, the public institutions of promotion and development, the social groups that encourage them,

the underlying values and the type of co-operative entities that characterize them and finally the sub-sector where they play a more relevant role.

This piece of research work has been broken out into three aspects: Firstly, Italy, France, Portugal and Belgium cases are discussed from a ideological utopian logic. Then we approach the Danish, Dutch and British models from a spontaneous, liberal viewpoint and lastly we draw some conclusions.

## 2. THE IDEOLOGICAL UTOPIAN LOGIC

### 2.1 France

The co-operative model in French agriculture is shaped out in agreement with the rules of workers' trade unions. After the 1884 law the *boutique* trade unions increase their number and they orientate their activities towards the stocking and marketing of production, both cases being forms of pre-co-operative actions.

Also the agriculture credit helped to develop the co-operative movement through the new co-operative bank societies. In 1885 the Agriculture Credit Society of Poligny is created where the land-workers get their personal credit with the only guarantee of their trade union membership.

In 1890 Meline proposes the creation of the *crédit agricole* in rivalry with the Union of Rural and Workers' Bank Societies, created 3 years later by Durand in the line of Raiffeisen network.

In the eve of the World War I the co-operative movement, the credit and the mutual benefit society had already a recognized legal status, co-existing various association forms: the *boutique* trade unions were part of the *Union Central des Syndicates Agricoles* (UCSA), whereas the regular trade unions, co-operatives, credit and insurance societies had not achieved as yet a nation-wide organizational structure (GERVAIS *et al*, 1986).

After the World War I the co-operativist movement was seen as a promoting element of the agricultural development, and through it the credit and mutual benefit societies were boosted as complementary instruments.

The great period of co-operative success is that between the two great wars, where a specialization of the associations can be seen that aims at defending the specific interests of agricultural workers. It is during that period when the spreading of wine-growing and milking co-operativist movement took place.

With the German occupation the *Corporation Nationale Paysanne* was started. The implementation of this co-operative project meant the transference of the representative power to the new corporative trade unions (BOUSSARD, 1980)

The *Corporation* transformed the co-operative societies, the credit banks and the mutual benefit societies into actual economic organisms. The *Caisses Nationales de Reassurances* were taken up by the *Caisses Centrales* and the federations of co-operative societies, of credit banks and the mutual benefit societies were taken up by the *Fédération Corporative de la Mutualité Agricole*.

The process of democratic reconstruction of the agricultural associative movement was started in 1943, in the *Congr s National de la Mutualit *, of the *Coop ration et du Cr dit Agricole*, that was held in Argelia, organized by the recently created *Conf d ration G n ral de l'Agriculture* (CGA).

The CGA established a dividing line between credit, mutual benefit and co-operativism by re-structuring them into different federations. In contrast with credit and mutual benefit, co-operativism did not enter the CGA as an only federation, but rather it was split into two: *F d ration Nationale de la Coop ration Agricole* (FNCA) and the *Conf d ration G n ral des Coop ratives Agricoles* (CGCA). In 1966 both were joined together in the CFCA (*Conf d ration Fran aise de la Coop ration Agricole*). Owing to the internal conflicts in the CGA it become an utopian project.

In the 60's production overcomes consumption, thus giving way to the *Soci t s d'Int r t Collective Agricole* (SICAs), entities that are complementary to the co-operative societies and whose legal status allows them freedom of action in the process of marketing. The co-operative societies become agro-food, vegetable food, stocking and polyvalent industries. In the 80's the era of the creation of co-operative societies seems definitely finished.

## 2.2. Italy

During the decades of the 60's and 70's of the 19<sup>th</sup> century the agricultural regions of the north and south reacted against the crisis with associative formulas like the following:

- a) Agricultural circles, promoted by the land-farmers aiming at spreading among the hired farming hands its revolutionary ideas. They would teach and give education and also would carry out trading activities and finally became *magazin* (stores).
- b) Local taverns, where the small owners, rentees and tenant-farmers would lay their attention on giving life to 'social taverns' (co-operative cellars), milk co-operatives and 'social baking ovens'.
- c) *Consorti agrari*, devoted to the common delivering of raw material (DE MARZI, 1987). The first *consort* originated in Italy in 1866 was the "Friulian agricultural association", which had the aim of importing new species of silk-worms. Then they would develop activities concerned with agricultural credit, and also insurance and machinery renting.
- d) *Braccianti* co-operatives, with hired farming hands basis, would come up whenever there was a chance of work public contract. They would fight for employment and they were the foundations of socialist ideal as they would control the work offer in local markets (ANCA-LIGA, 1986; VALLAURI, 1987).

- e) Collective land-renting (*conduzione*), collective association movement that was a reflection of the socialist power in the rural environment (ALLEVA et al., 1988). These societies of communal exploitation of land represented an experiment of the commune.

During the 'giolittianian' period co-operativism had an outstanding quantitative and qualitative development<sup>1</sup>, but owing to lack of common actions and objectives, caused by their heterogeneity and deep differences between north and south, two opposed trends stood out: the socialist or "red co-operativism"; and the catholic or "white co-operativism". The strong point was still the great consumption co-operatives in urban nuclei, though they were also notable in the rural world through the *braccianti* societies. In the *Lega Nazionale delle Cooperative e Mutue (Lega)*, the red co-operativism was predominant.

The *consorzi agrari* also received great encouragement, drawing benefits from a more favourable legislation. The elements of greater modernity and administrative efficiency in Italian agriculture were then represented by those *consorzi agrari*, whose national federation (the *Federconsorzi*) included already in 1911 over 100 entities and 22.000 members. In 1913 the *Istituto Nazionale di credito delle Cooperazione* was created, as an entity providing financial means to co-operatives. The consumption and agricultural co-operatives could have access to initial credits so as to carry out their investment actions.

In the eve of World War I Italian co-operativism had already acquired the features of a mass movement, even if deficiently organized. With the outbreak of war the reaction of co-operativism, aimed at giving an adequate response to the state of war, was the task of starting an internal re-structuring that would allow them an integration in the mobilization apparatus of the State. The relations between co-operativism and State were intensified, and this provoked strong debates within the movement itself. The social base of the *Lega*, predominantly working class oriented, claimed its hallmark as working class movement and demanded the adoption of a non-collaborative position with capitalist interests, thus coming closer in their discourse to the anti-war socialist party. The re-structuration of the co-operative movement had a vertical character, as national federations of the sector were created within the *Lega* for the various categories of co-operatives: of work, of production, of consumption and agricultural. Though each federation reached a different degree of development, a common feature in all of them was that they were originated as a response to meet the needs of the co-operative movement to break with their traditional isolation and wide-spreading (VALLAURI, 1987).

In spite of the fact that many co-operative societies disappeared during the war years, co-operativism came out stronger than before, since they had shown their efficiency in unfavorable circumstances. Co-operativism was then presented as one of the key elements for the economic re-structuring of the country. In less than two

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1. According to Stupazzoni (1984), there were in 1902 as many as 4.000 co-operatives with 1.000.000 members.

years the production co-operatives became double, those of consumption remained the same in number whereas those of credit and agriculture<sup>2</sup> were re-dimensioned.

In 1921 the *Banca Nazionale dell'Agricoltura* was created on *Federconsorzi*'s<sup>3</sup> initiative, which was a specialized section of the *Istituto Nazionale dei Crèditi per la Cooperazione*. The granted credits were devoted to financing the investments for the improvement of exploitations and were used for encouraging the exportation of agricultural products and the construction of factories of agro-industrial transformation, which were most useful for the more modern groups of Italian agriculture with a view to neutralizing the growingly stronger invasion of urban industry. The procedural line of the *Federconsorzi* kept having at their core the interest of supporting big and medium size exploitations.

There reappeared the old polemic between socialists and catholics on the role to be played by co-operatives. It proved more and more difficult that the *Lega* should continue to play the unitary role that had been playing until then, thus giving way to co-operatives, like the Catholic Confederation of Co-operatives, the Federation of Ex-servicemen Co-operatives, the National Trade Union of Co-operatives or the Italian Trade Union of Co-operatives, of fascist tendency.

The catholic current of opinion, so far included in the *Lega*, founded its own co-operative central, named *Confederazione delle Cooperative Italiane (Confcooperativa-CCI)*, which embodied the traditional aspiration of catholic co-operatives to have an independent representation that would counter the power of the *Lega*, ruled till then by the socialist current of thought. The catholic co-operativism embraced as many co-operatives as the *Lega* by 1920's (some 8.000 centers each), which gave rise to a balance between both currents and a struggle for hegemony, thus generating a situation of conflict and antagonism that, extrapolated to socio-political sectors, would be used by fascism to reach the central power of the State.

The main goal of fascism was to control the co-operative movement. In 1922 a violent wave broke out that caused fires, plunder and looting of the co-operative premises, both socialist and catholic and led many of their leaders to gaol and exile. In 1924 the leaders of the two great co-operative currents attempted to co-ordinate their actions in order to oppose to fascism in a common front, but their mutual distrust hindered that project.

In 1925 both the socialist *Lega* and the catholic CCI were declared illegal, their base co-operatives being now compelled to be integrated in the co-operative organisms ruled by fascism. (ATUPAZZONI, 1984). This integration was in the *Ente Nazionale delle Cooperative (ENC)*, a corporative organism that, under the direct rule of the Ministry of National Economy, would apply a strict control over the whole movement.

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2. More concretely, in the agricultural sector, the *Federazione Nazionale delle Cooperative Agrarie*, based in Bologna and legalized in December 1918, increased the number of associated co-operatives from 81 to 176 (VALLAURI, 1987).

3. In relation with the *Federconsorzi* (*Federazione Nazionale delle Consorzi Agrari*), the tendency was of increase, embracing over 900 entities in 1920 and widening their heritage with the creation of their own network of exploitations aimed at the production of selected seeds and factories for the manufacturing of fertilisers (BARBADORO, 1961).

The *consorzi agrari* and the National Institute of Credit for Co-operation were both nationalized, and as a consequence the co-operative movement lost its whole autonomy.

After World War II, co-operativism was again boosted through the recuperation of liberties and through the re-appearance of political parties, eager to restore their traditional bases of support. To this other facts made also their contribution, like the wish and need of all social groups to overcome the economic problems caused by the reconstruction of the country. A co-operative boom took place in the *Mezzogiorno*. Years later, the scarcely consistent character of that expansion was confirmed, since the co-operatives created in the southern region showed their inability to function independently, unless vitally supported by local public entities (NARDONE Y RUSSI, 1989).

In 1945 the socialist and communist *Lega* re-appeared and the catholic CCI (*Confcooperativa*). The Christian Democracy promoted its own autonomous federation, both in the trade unionist domain, where the *Coldiretti* was created, and in the co-operative. The *Confcooperativa* was also re-established with the intention of finding a way out through 'white' associationism. During the 50s the two co-operative institutions carried out a project of internal re-structuring which ended up with the creation of highly specialized organizational models.

Within the *Lega* a split up took place of the social-democratic wing and the liberal, giving rise to the *Allianze Generale delle Cooperative Italiane* (AGCI), unacknowledged by the public rulers as a representative body till ten years later. In contrast, the catholic movement of the *Cofcooperativa* increased its numbers by encouraging provincial and regional unions and specializing their activities. This federation was to be integrated within the "moderate block" through its incorporation to the *Comitato Nazionale d'Intesa*, an unitary action platform created in 1964 by the *Federconsorzi* and the trade unions *Coldiretti* and *Confagricoltura*, bound together by their opposition to the left movements (MOTTURA, 1987; MOYANO, 1988; ALBANESE et al., 1993).

With the creation of the EC a new phase arose in the development of co-operativism, characterized by its increasing specialization and a deeper penetration in the market<sup>4</sup>. At the beginning of the 70s the co-operative movement showed clear signs of a considerable evolution<sup>5</sup>. In the 90s, in spite of the general step forward of co-operativism at the entrepreneurial level through the creation of second degree structures and the patrimonial consolidation of some outstanding co-operatives, agricultural co-operativism revealed itself as a scarcely relevant sector in the economic system, still too disordered and localist, and having insufficient dimensions for their full integration in the market. This was, to a great extent, due to the scarce specialization of the base co-operatives.

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4. From 1958 to 1963 the number of co-operatives promoted by the Agricultural Reform Institutions did not increase whereas the number of specialized ones was tripled, basically in the wine, oil and milk sectors.

5. The CCI associated to 11.000 co-operative societies, the biggest section being that of agriculture with 36,9% of the members. To the Lega 8.200 co-operatives were adhered, where the agricultural sector was in third place (18,8%). Lastly, the AGCI embraced just over 2.000 societies, more than half of which belonged to the construction sector (STUPPAZZONI, 1984).



### 2.3. Portugal

The co-operative movement in Portugal, understood as an organized mutual support, goes a long time back<sup>6</sup>. The first embryo comes up in close connection with the mutualist experiences in the middle of the 19<sup>th</sup> century.

These associations were characterized by the carrying out of commercial activities, of solidarity and mutual support, and no less so vindicative actions. It was difficult to distinguish between a trade union and a co-operative association, since they seem to practically do similar functions in support of their social base. Also, they acted in connection with political and religious movements.

In order to fill the existing doctrinal gap, a group of illustrated men introduced in the intellectual and political sectors the new co-operative ideology. As a result, the Basiliar Law was passed 1869, which can be considered the first regulatory text of co-operativism.

The co-operatives are defined in it as “associations” of variable capital, of unlimited number of members and created by their members to contribute to the development and promotion of their own activities. They are considered associations aimed at the poorest social strands of the population and are clearly identified with the implementation of the principle of solidarity and mutual support (FERREIRA DA COSTA, 1980).

In 1888 the Commercial Code was passed and in it the co-operatives gained a juridical status of commercial societies. This economist view will remain in full force in the Portuguese co-operative legislation until the passing of new Co-operative Code in 1980.

The initial impact of the Portuguese co-operative movement was mainly centered on the activities of an industrial type and had little relevance in the agricultural sector, characterized by its permanent disorganization, save for the exceptional cases of wine and cattle.

The decree of 1894, which was complemented by law of 1896, established that the new agricultural trade unions could “constitute, promote or encourage the creation of mutual support banks, co-operative societies, insurance mutual benefit societies, credit banks, economic banks or any other institution which would help increase the regional development (INSTITUTO “ANTONIO SERGIO, 1980). In 1908 there were already 66 trade unions, but there were a scarce number of agricultural co-operatives, also connected to the trade union movement.

The I Republic supported numerous co-operative projects among the less economically developed sectors in the line of Gide, laying more emphasis in the consumption co-operatives. *Caixas de Crédito Agrícola Mutuo*, after Raiffeisen’s model (REBELO DE ANDRADE, 1983).

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6. There are numerous references on solidarity and co-operative activities that mark the origins of that movement. We can mention the various experiences of communal exploitation of land, the collective raising of cattle, the exchange of services, the village bread ovens etc were all accomplishing social functions so that the popular strand would overcome the economic troubles of the period.

The law of 1914 defined the *caixas* as credit co-operatives compulsorily integrated in an agricultural trade union and obliged to admit as members only those land-farmers who were affiliated to a trade union, and determined that the trade unions could not give loans to their affiliated if this was not done through *caixas* (MOYANO, 1988).

The decrees of 1917 and 1918 on support and incentives to agricultural and forest co-operatives and on the creation of agricultural co-operative societies, independent of trade unions, boosted co-operativism.

During Salazar's regime, the co-operative societies kept their old legal status and continued to be acknowledged as autonomous entities. However, the activity of the guilds of *lavoura* and the interference of administration interrupted the projects of expansion of co-operatives.

During World War II the government encouraged sectors of co-operativism with major incentives, such as that of milk products, the wine-growing, and the olive oil, granting privileges to the activities of the guilds and their adherent co-operatives rather than to those of autonomous co-operatives. These last could only face the guilds' competitiveness in regions and sectors in the north and in the coast (BELO MOREIRA, 1984) by creating important commercial structures like the Union of Co-operatives of Milk Producers from the region between Douro and Minho, the Union of Co-operatives of Potato Producers and the Union of the Adegas Co-operatives of Extremadura, the Union of Co-operatives of Olive-oil Producers of Alto Alentejo or the Union of Co-operatives of Agricultural Product Manufacturing.

As for the *caixas* of agricultural credit, they remained unchanged when they were incorporated to a corporative organism, the *Caixa Nacional do Crédito* and also by the *Caixa Geral de Depósitos*<sup>7</sup>.

In the years after the revolution of April 1975 the agricultural co-operativism began a new phase when the corporative organisms were dissolved, thus recuperating their autonomous movement and developing associative formulae linked to the regions of agricultural reform (LUCENA, 1985; MOYANO, 1988).

The dissolution of the guilds raised the problem of the transference and management of their stored up heritage which gave rise to important conflicts within the "liquidating committees". The procedural criterion was to hand down the guilds' heritage to the co-operative movement, either to the adherent co-operatives, which became sale and purchase co-operatives, or to the autonomous co-operatives, whose activities were more limited, or else to the new co-operatives, which were founded for the only purpose in their agenda of receiving and managing the heritage handed down to them.

Once finished the process of dissolution of the guilds, agricultural co-operativism began to set down the bases of its structuring as an autonomous movement by founding

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7. The loss of autonomy meant a disappearance of many of the old credit banks. As an example of this, it can be noted that, from the 48 banks created in the period of 1930-40, only 18 remained in the period of 1940-50, 17 banks in the period of 1950-60 and only 4 in the 60s.

their own federations with the purpose of exerting the representation and defense of their respective interests. The first years of the revolution were conflictive, since the agricultural hegemony was handled by the two most relevant land-farming trade unions, the Confederation of Agricultural labourers of Portugal (CAP) and the National Confederation of Agriculture (CNA) (MOYANO, 1988; HENRIQUES Y REIS, 1993).

The CAP included one part of the sale and purchase co-operatives and also the most relevant specialized co-operatives. The CNA embraced a sizeable sector of minor agricultural farmers, while also including numerous smaller size co-operatives, many of which stemmed from the very process of the dissolution of the guilds. The leadership of these two agricultural trade unions and their influence on the co-operative movement delayed the process of consolidation of the truly independent co-operative federations until Portugal joined the EC in 1986. This process would actually end up with the founding of the CONFAGRI.

It is worth while underlying, among the newly formed co-operatives, unrelated to the old guild structure, those which stemmed from the lands expropriated to their large estate owners in the areas where the land reform was carried out. The co-operatives were named Collective Units of Production and they were co-operatives of communal exploitation of the land, whose activities and articulation were implemented with no concern for the rest of the Portuguese co-operativism.

## **2.4. Belgium**

It was just after 1850 when Belgium witnessed the appearance of the first co-operatives in the region of Flanders. They were initially food stores that provided their members with basic products, like potatoes and flour. The first law involving co-operatives is that of 1873. The idea behind it was to give legal form to the societies that had sprung from Rochdale model (SOMVILLE, 1991). Both economic liberalism and the law-giver's caution in avoiding too many restrictive measures for the new commercial associations brought about a divorce between the legal frame and the activities developed by the actual co-operatives (MOYANO, 1993)<sup>8</sup>.

This divorce would last until the founding of the National Council of Co-operativism (CNC) in 1955 by law. From the beginning this organism took on the task of promoting and encouraging co-operativism. Then, after the publication of the Royal Decree of 1962 on the homologation and registration of co-operatives, the CNC assumed a leading role, as it was given competence on those issues. The CNC has been acting as an intermediary so as to channel the co-operative demands to the public power representatives, and also as the organism responsible for managing and supervising the homologated co-operatives.

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8. The law acknowledged the co-operatives as new forms of association, but it made no reference to the doctrinal principles, which meant they acknowledged as co-operatives associations that paid scarce attention to the principles of solidarity and mutual support.

The CNC design embraces four committees: consumption co-operatives, agricultural co-operatives, production and distribution co-operatives, and services co-operatives.

In 1991 a new law of co-operatives was passed in order to fight spurious co-operatives, which had been using a juridical formula for the purpose of getting benefits out of the facilities offered by the previous laws. In the debate previous to the passing of the new law it was argued whether it was practical to establish such heterogeneous rules in the already heterogeneous Belgian co-operative movement, and whether it was an advisable measure to adopt flexible rules, as it was obviously done in the previous legislation, in order to allow co-operatives of various kinds (MOYANO, 1993).

Experience had shown that flexible norms could only benefit those faked co-operatives that were far from having a social mutualist logic.

### **3. THE SPONTANEOUS LIBERAL LOGIC**

#### **3.1. Denmark**

Danish co-operativism was developed in the last two decades of the 19<sup>th</sup> century, closely linked to the transformation of products of the cow and swine livestock.

The first milk co-operative center in Denmark was founded on the initiative of the local farmers in 1882. These co-operatives spread out through the whole country. In 1888 as many as 244 co-operatives were founded and some time later one third of the Danish livestock exploitations delivered their milk in a co-operative center. Soon after, the milk co-operatives were able to compete in the butter market, thus turning over the handcraft production. (BJORN, 1988).

Since the beginning of 1880s the English demand of bacon encouraged Danish farmers to focus their attention on pork production. The waste matter of dairies was an excellent food for pigs and in 1887 a local farming trade union made the decision of setting a slaughterhouse in Horsens, based on the same principles as milk co-operatives.

In 1890 there were already 10 slaughterhouses which had the control over one third of the pork production destined to exportation, although they had to face a strong opposition on the part of privately owned slaughterhouses. They then decided to increase their capacity for transformation rather than their number. Thus, whereas the milk co-operatives were small, short of personnel and located in rural areas, the co-operative slaughterhouses actually became factories -hence, their name "bacon factories"- which employed a lot of workers and were located in towns, though out of the ordinary routes by train or by boat.

The co-operative slaughterhouses promoted a rapid expansion of the pork livestock in cattle exploitations, when they achieved, by means of their activities in the British market, an increase in the export of bacon<sup>9</sup> (JUST, 1990).

The organizing model that eventually imposed itself was that of the monovalent co-operatives which only develop a type of activity. They attempted to center the efforts and resources of the co-operatives in one sole activity with the purpose of achieving better results and leaving aside the development of scarcely efficient activities that could become a serious hinder to their functioning<sup>10</sup>.

The Danish co-operatives are well known because their main purpose is the carrying out of activities of commercial and industrial character. They lack all interest for social issues, since they understand that efficiency of trade management is the best way of achieving benefits for their members. There is no specific legislation that regulates co-operativism, which allows the fact that each co-operative may adopt the statutes that best fit the activity concerned.

One century later a committee was formed in order to study the feasibility and the convenience of a legislation specifically for co-operatives. In 1986 the committee presented their conclusions in a report consisting of a number of proposals.

### 3.2. The Netherlands

The origins of the co-operative movement in the Netherlands seem to date back to the last quarter of the 19<sup>th</sup> century. The widespread of the Rochdale, Raiffeisen and Shulze-Delitzsch principles, the upsurge of the working movement and the end of century crisis of agriculture are some reasons for such origins. When the first co-operatives were founded, farmers were frequently supported in their projects by the existing agricultural organizations (trade unions, agricultural societies...) or by the rural elites, also being encouraged by the public programs of education, which promoted the principles of solidarity and mutual help. This cultural context, together with the Dutch agricultural social structure<sup>11</sup>, characterized by its internal cohesion and its low level of polarization, are two possible factors to be considered when one wishes to account for the rapid evolution and prosperity the first co-operatives had.

The economic situation of the country was favorable for the agricultural sector and of great importance for the organization of agricultural credit, since, thanks to the better well-being of the land-farmers, the formation of relevant savings was possible. They were channeled through the new saving banks of agricultural credit. For the

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9. In 1900, for instance, the number of slaughterhouses were 26 and they control 60% of Danish export of pork.

10. In agreement with this model, it can hardly be found a co-operative in Denmark that should provide inputs to land-farmers while commercializing and transforming their products.

11. The mentioned social structure was known by the small class differences among rural inhabitants (at least in comparison with other countries), which explains somehow the good disposition of better-off strands to support the new credit co-operatives, by accepting an unlimited responsibility in the acquired commitments.

purchase, distribution and manufacture co-operatives of agricultural goods the context proved decisive (NCR, 1986).

The first agricultural co-operative dates back to 1877, when farmers from Zeeland joined together to found a co-operative so as to buy good quality and low price chemical fertilizers, which they called “Welbegrepen Eigenbelang” (well-understood self-interest). In 1886 the first milk co-operative was founded, in 1887 the first co-operative public sale of vegetables, and in 1896 the first agricultural credit bank. Later on the first co-operatives of transformation of sugar beetroot, of potatoes and of straw-carton were founded, so that, when the World War I broke out, the network of agricultural co-operative organizations was already spread out over the whole country.

The majority of these organizations were specialized or monovalent co-operatives<sup>12</sup> that operated in a particular sector for a product or group of products, accomplished a well defined task in the market and pursued exclusively economic goals. In fact Dutch agricultural co-operatives have always been a useful device for farmers with a view to backing their economic standard in a position of unfavorable competitiveness, by tilting the balance against the commercial monopolies, and by playing an essentially economic role without the social mutual component, a characteristic feature of co-operativism in other countries<sup>13</sup>.

Until 1934 no representative organization of the co-operative movement took place. A Co-operative National Council (NCR: Nationale Coöperatieve Raad) was established by the central organizations of cooperatives of agricultural delivery, of consumption and of the credit banks.

After World War II an increasing concentration of co-operatives was developed through the fusions which, though necessary to maintain their balance role till then, could generate a decrease of the existing links between the affiliated members and the co-operative. This evolution has run parallel to the increasing role played by the central organizations and the NCR.

### 3.3. Great Britain

The origins of agricultural co-operativism in Great Britain have been associated to the history of Rochdale pioneers and to the development of consumption co-operatives. In 1867 the first agricultural co-operative was founded under the name of *Agricultural and Horticultural Association*. It functioned as a supply co-operative and followed the standard models of consumption co-operatives<sup>14</sup>. The development

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12. The greater part of these first Dutch co-operatives were founded by productive groups already specialized (animal farmers, vegetable farmers, consumers, shop-owners), with the purpose of improving their economic standard.

13. This does not mean that in the Netherlands co-operativism on the whole had been disconnected from the social development of the country.

14. This co-operative had a rapid development and worked for 50 years before it closed down, in the middle of the World War I (KNAPP, 1965).

of agricultural co-operativism was slower than industrial co-operativism, due to the landowners' opposing force, but the farming slump at the turn of the century created a more suitable atmosphere for agricultural co-operation (BAILEY, 1988).

Following the model established by the *Irish-AOS*, a group of 12 English and Welsh co-operatives founds in 1901 the *Agricultural Organization Society* (AOS), from which the *Welsh-AOS* split for Wales. Similarly, the *Scottish-AOS* and the *Ulster-AOS* were also created. These models of representation meant a real structure of political representation of agricultural co-operativism<sup>15</sup>.

A great part of the one hundred co-operatives concentrated their activities in the supply of fertilizers, mixed feed and seeds for the associated members. The development in the area of trading followed at slower pace, even if some dairy milk co-operatives now appear promoted by the farmers themselves.

The World War I brought prosperity to the sector, raising the interests of the farmers in forming new co-operatives and the AOS designed a plan of promotion and creation of new regional structures as a base of representation of all the co-operatives in a specific area.

After the war agricultural co-operativism underwent a deep crisis, which resulted in the OAS's dissolution. The trade union *National Farmers Union* (NFU) took over and founded the *Co-operation Committee* within its own structures. The political solutions sought after by the NFU were based on the proposal of an intervention in farming markets by the creation of the compulsory *marketing boards* as monopolist societies of trading that had an effect on the voluntary co-operation in agriculture. This put an end to the whole co-operative movement in the sectors where such monopolies had settled.

In the sector of trading co-operatives the dairy milk co-operatives were almost totally taken over by the *Milk Marketing Boards*, remaining only 30 egg co-operatives as the most important group of trading (KNAPP, 1965). Some supply co-operatives managed to carry on, doing the job of an encouraging element in the recuperation undergone by co-operativism in World War II.

The Agricultural Act of 1947 defined the new position of public administration towards co-operativism. The disputes between trade unionism and co-operativism set the general tone in the search for a central structure representative of the co-operative movement. In 1945 the *Agricultural Co-operative Association* (ACA) was founded as a result of an agreement between NFU and the co-operative leaders. In 1950 they embraced as many as 103 co-operatives (KNAPP, 1965).

But the clash between NFU and ACA soon came up to the surface. The NFU held the idea that there must be only one voice that represented the whole British agriculture against the government, and this voice must be that of the NFU. The co-operatives, however, wanted to have direct access to the government. The trade union NFU was

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15. The expenditure of the AOS was funded by the affiliated members' fees, which did not seem enough to continue with the task of counseling and promotion, and as a result the AOS applied for a government financial support. It was granted by the "Board of Agriculture" as a yearly subsidy.

not prepared to lose the privileges that they had been granted in 1949 as the only valid interlocutor faced with the public administration, hindering the development of an autonomous representation in the co-operative movement (MORLEY, 1975). As a consequence, the NFU created a new organization named *Farmers' Central Organization* (FCO).

The FCO had a relative success in the affiliation of co-operatives, as the great majority remained in the old ACA. The NFU recognized their mistake and in 1956 both organizations joined together again, founding the *Agricultural Central Co-operative Association* (ACCA).

In the first steps of the ACCA important achievements were made for agricultural co-operativism. The good relations between the NFU and the co-operatives were instrumental to make the government give a relevant turn in the agricultural policy in favor of voluntary-oriented co-operativism.

The *Horticulture Act* of 1960 defined the co-operatives establishing two lines of help, one for the commercial development of co-operatives and the other for promoting the establishment of professional managers. Once again the good relationships between the NFU and the co-operatives came to a close, this time due to a debate over the conceptual grounds of the co-operative development. As a consequence, many co-operatives were transformed into "companies" (BAILEY, 1988). In the light of the disagreements between co-operativism and trade unionism the government appointed a committee to study the actual state of agricultural co-operativism and provide some recommendations that would improve the situation<sup>16</sup>. In fact a publication came out in 1965, a *White book on the development of agriculture* that approached the problems of agricultural co-operativism related to other sectors and proposing goals that would improve the general structure of agriculture<sup>17</sup>.

The change of attitude towards agricultural co-operativism of a voluntary base must be found in the need of a reform of the co-operative movement in the face of the new integration of Great Britain in the *Economic European Community*. During the 1960s the U.K carried out a number of attempts in order to be integrated in the EEC before their actual entry in 1971. Also, the British agriculture had to be prepared for the time when the *Common Agricultural Policy* was in force by demanding the substitution of the obligatory *marketing boards* for voluntary co-operatives as a base for the development of the suitable trade structures in the agricultural sector.

The *White book* recommendations were substantiated in the *Agricultural Act* of 1967 that created the *Central Council for Agricultural and Horticultural Co-operation* (CCAHC) and the *Agricultural and Horticultural Co-operation Scheme* (AHCS), as a co-ordinated program of subsidies for the modernization of the co-operative sector.

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16. The main suggestions were: the creation of representative structures of co-operativism, independent of the trade union NFU, and the increase of the subsidies to co-operativism of a voluntary base.

17. An improvement of the subsidies to co-operatives was proposed, in addition to the promotion and encouragement to co-operativism among the land-farmers and the creation of a specific organism was recommended in order to channel the public activities in this area.



The CCAHC was funded by the government and the functions assigned to this organism was to promote, develop and co-ordinate all the initiatives of land-farmers in matters of co-operations; to manage the plan of public support to co-operativism and give counsel to the minister of agriculture in issues related to the co-operatives of a voluntary base<sup>18</sup>. The AHCS was foreseen for a period of 10 years, being prolonged on successive occasions and keeping in force today under the supervision of *Co-operative Development Board*.

The other fact that fostered modernization of agricultural co-operativism was, undoubtedly, United Kingdom joining the EEC (ENNEW and RAYNER, 1987). From the moment of integration, the majority of the activities were devoted to the area of trading, since it was through the commercial structures that the greatest part of the EEC's funding support was channeled towards the agricultural co-operatives. Groups that were specialized in animal farming products, vegetables, potatoes and cereals were founded. Also, in the 70s and 80s co-operative associations were formed with commercial aims, while the old input supply co-operatives began to carry out trading activities with some products, like cereals, thus spreading out the co-operative activities of polyvalent character. The execution of these projects was financed, to a large extent, by funds from the European community FEOGA, the cereal and vegetable sectors receiving 80% of the funding support.

In the face of the Great Britain's imminent joining the EEC, the co-operative movement acknowledged the need of creating a sole body of representation. The three AOS together with other associations linked to the agricultural associationism, found the *Federation of Agricultural Co-operatives* (FAC), with whom the articulation of the co-operative movement was first performed at a national level.

The latest promotion of agricultural co-operativism has been the founding of the organism *Food from Britain* (FFB) under the frame of the agricultural *Marketing Act* of 1983. The working field of this new entity is to promote food products of British origin inside and outside the country, and to continue the task started by the CCAHC through a specific organ named *Co-operative Development Board* (CDB)<sup>19</sup>.

## 4. CONCLUSIONS

In the narrative of the historic memory of these seven territories in the European Union one can distinguish two strategies of development of the co-operative movement which transversely influence its economic and social structuring \_general or specific laws, monovalent-polyvalent cooperativism.

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18. In the CCAHC the co-operatives were represented, through their association, and the hegemonic trade union NFU, and also independent members of great prestige appointed by the minister of Agriculture himself.

19. The CDB develops the following functions: promotion and evolution of agricultural co-operativism; co-ordination and promotion of relations among the various co-operatives through second grade co-operatives and vertical integrations; to promote the improvement of trading methods.

On the one hand, there is the spontaneous-liberal logic according to which cooperativism is a practical response to an economic problem that benefits its members financially. The co-operative movement arises from inside this sector itself, independent from other social movements, and it develops without any support of the State, even before any law on cooperatives has been enacted, and having to rely on laws concerning societies in general (as in the Danish and the Dutch cases) in order to be legally recognized.

On the other hand, there is the mutualist-utopian-ideological logic according to which cooperativism is a coherent element with a previous conception of social structure: a factor and instrument of transformation of the society in the economic world. In these cases -such as the French and the Italian- the ups and downs of the co-operative movement are dictated by the ideological tensions and they are a catalyst as well as an obstacle to their advance and their stagnation.

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# COLONIAL CO-OPERATIVES THROUGH THE EYES OF THEIR CO-OPERATIVE REGISTRARS

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## 1. INTRODUCTION

An enlarging European Union, de-regulation and the collapse of communism are requiring European co-operatives to redefine and reposition themselves. Such a process, along with the creation of new co-operatives, may be labelled co-operative development. This paper explores the lessons gained from an earlier period of co-operative development, namely that under the British Empire between 1900 and 1960 and attempts to assess how relevant these may be to contemporary European co-operative development. Study of these lessons is appropriate inasmuch as the British Empire was global and encouraged co-operatives in virtually all its territories. It therefore constituted the largest co-operative development organisation before the United Nations' agencies in the post-colonial period. British imperial co-operative development had a number of distinguishing features including the position of Co-operative Registrar, or in some territories Co-operative Commissioner. In a position with powers deriving from co-operative legislation, he spearheaded British colonial co-operative development.

Early colonial co-operative registrars are interesting as a group. Middle-class and professional colonial administrators, they were distinct from the aristocratic advocates of colonial co-operation such as the 4th Earl Grey (1851-1917) and Sir Horace Plunkett (1854-1932). They were also different from those they sought to help through the formation of co-operatives. Moreover, unlike their counterparts in Britain, the Chief and Assistant Registrars of Friendly Societies, colonial co-operative Registrars had organisational powers. This meant that they frequently introduced a new and pre-co-operative element into the setting up of many new co-operatives whose members needed to be persuaded, motivated and trained for co-operative action. Consequently, the majority of colonial co-operatives were not organisations of spontaneous combustion as they invariably were in Britain and elsewhere in western Europe.

Colonial co-operative registrars therefore comprise an important and significant group, study of which may help us better understand the methods and dynamics of British imperial co-operative development. This paper explores the views of three notable colonial registrars during the inter-war years. Although middle class

professional colonial civil servants, they became enthusiastic co-operative supporters as can be seen from their writings in which they invariably speak of co-operation rather than co-operatives. These writings also helped to shape the British Labour Government's post 1945 colonial policy in which co-operative development assumed some importance.

At the outset it might be helpful to describe the position of the colonial co-operative registrar.

## 2. COLONIAL CO-OPERATIVE REGISTRAR

In Britain the position of Co-operative Registrar derives from Friendly Society legislation dating from 1793. Friendly Societies were the forerunners and later cousins of British co-operatives. However, early co-operatives were not allowed to register under their legislation because it did not cover trading organisations such as co-operatives. Moreover, Friendly Societies had only limited State support and their narrowly-based legislation was primarily intended for societies comprising the poor but under the patronage of members of the upper classes. There was also resistance to registering societies that had branches in case they corresponded with each other which could then bring them within the scope of the Corresponding Societies Act. Passed in the wake of the French Revolution, this forbade societies to have corresponding relations with other societies. Such strictures were eased somewhat in 1834 when the scope of the Friendly Societies' legislation was widened to give legal recognition to societies which formed "for any purpose not contrary to law". Another Act in 1846 allowed the establishment of societies, including co-operatives, whose purpose included "the frugal investment of the savings of the members, for better enabling them to purchase food, clothes, or other necessities, or the tools or implements for their trade or calling, or to provide for the education of their children or kindred." (1)

Even so, Friendly Society legislation remained inappropriate for the growing number of retail co-operatives forming on the Rochdale model in the mid-19th century. With the help of the Christian Socialists, British co-operators secured a series of Acts between 1852 and 1876 which gave them an "independent and almost self-contained code of law." (2) The name of these Acts, the Industrial and Provident Societies Acts, was "intended to intimate...that such societies should be industrial as making their profits by the mutual personal exertions of the members and provident as distributing their profits by way of a provision for the future." (3) The "I & P" legislation, as it came to be called, laid down the areas in which co-operatives could and could not form, limited the number of shares a member might hold and the interest that could be paid on such shares and provided protection against fraud. Later Acts in the series conferred corporate status, granted limited liability and allowed one co-operative to invest in another so paving the way for the development of federal societies. In the context of this paper, two important points to note are that the British Industrial and

Provident Societies' legislation evolved from the earlier Friendly Societies' legislation, and that while it moved out from under its provisions, it retained one of its features, namely that of the position of Registrar of Friendly Societies with whom British co-operatives now registered.

The role of the British Registrar was primarily that of recording the formation and dissolution of societies, approving their rules, receiving their annual accounts and reports and checking that no abuses occurred. In these functions he was little different from the British Registrar of Companies. Their existence underlines a British tradition of using Registrars as the interface between State and companies and friendly societies.

The latter included not only co-operatives but also trade unions and mutual benefit societies such as local "slate clubs" or lodges of the Oddfellows.

India's early co-operative legislation of 1904 and 1912 took the role of the colonial co-operative registrar far beyond that of his British counterpart and created a model for subsequent colonial co-operative development. Both the Co-operative Credit Societies Act, 1904, and the Indian Co-operative Societies Act, 1912 were intended to help India's rural and urban poor overcome indebtedness by forming thrift and credit societies. These closely followed the German models pioneered by F.W. Raiffeisen (1818-1888) and F.H. Schulze-Delitzsch (1808-1883), but the legislation introducing them was a mixture of British Friendly Society legislation and Indian Company legislation both of which provided for the position of registrar.

The Indian co-operative legislation proved workable and durable and became widely replicated throughout the British Empire. Margaret Digby, who did much to shape post-1945 British colonial co-operative legislation through her work at the Plunkett Foundation, observed that it was also "carried by its own reputation and by the writings and travels of men like Mr. H. Calvert, Mr. C.F. Strickland and Sir Malcolm Darling, who had first been concerned with its administration in India." (4) This paper will explore the views of Calvert and Strickland and also W.K.H. Campbell, who became Co-operative Registrar in Ceylon (Sri Lanka). All three worked elsewhere in Asia and Africa. Before examining their writings it might be helpful to examine the professional background of colonial co-operative registrars.

### 3. THE BACKGROUND OF COLONIAL CO-OPERATIVE REGISTRARS

We have already observed that they were middle-class professionals who were members either of the Colonial Service (CS) or the Indian Civil Service (ICS). By imperial convention they were chosen by these Services' London Offices rather than by their seniors in the field. While avoiding the risks of local patronage, this system nevertheless meant that London recruitment resulted in similar types of person being appointed: male, upper middle-class, educated in public schools and the old British universities.

Entry to the Indian Civil Service was the more rigorous. In the wake of the Indian Mutiny of 1857, it and the government of India had come under direct Westminster control. The India Act, 1858, abolished the earlier powers and prerogatives of the East India Company and placed these with the Secretary of State for India, a newly created position within the British Parliament and he assumed overall responsibility for the Indian Civil Service. (5) This now became the more specialised of the two colonial services its appointees operated only within the Indian Empire including Burma. Possible entrants were identified at school or university from where they were encouraged to sit for two highly competitive examinations. The first demanded a high level of general British education while the second could only be taken if the first were passed and after a year's probation at an English or Scottish university. This second examination was more Indian oriented with compulsory papers in the Indian penal code and procedures, the principal language of an India area and the Indian

Evidence and Contract Acts. Optional papers included other aspects of Indian law and languages. Salary levels of successful recruits were linked to the outcome of yet another test, namely that of ensuring that a successful recruit could journey on horseback (6).

By contrast, selection for the Colonial Service was less focused. Those likely to serve in Malaya, Hong Kong and Ceylon, took the same examinations as those joining the Indian Civil Service. Candidates for positions in Africa and the lesser tropical colonies, however, were often appointed by private interview. Those who were successful were expected to stay in the same position for the rest of their working lives and to learn the job in post. The following observation sums up their position:

*"As a whole the Crown Colonies were ruled by willing all-rounders...They were recruited more for character than brain power...The Colonial Office had woven a mesh of contacts with university tutors and headmasters, and found its men quietly and privately on what the British would later call "the old boy net." (7)*

Once in post, colonial officers were expected to be very hard-working. Under the Conduct Rules for Indian Government Servants, the Government could demand 24 hours per day of its employees' time. Colonial officers might serve in a variety of settings but whenever they met, their shared class, education and home background facilitated an easy fraternity. The question arises as to what such men, particularly those of the Indian Civil Service, made of legislation encouraging the formation of co-operatives.

We should note that the British Empire was open to shifts in ideas from which Colonial and Indian Civil Servants were not immune. Thus, some in the ICS could support liberal ideas and even those of eventual Indian independence. Some of these were sympathetic to co-operative ideas including Sir William Wedderburn (1838-1918) and Hodgson Pratt (1824-1907). Pratt had the stronger co-operative credentials being prominent in the British Co-operative Movement (8) and in the early International Co-operative Alliance. (9) Both remained active in Indian affairs after retirement. Sir



William, whose father had also served in the Indian Civil Service, helped to found the Indian National Congress, and served as its President in 1899 and 1910. He remained active in its British Committee and frequently contributed to its journal, *India*. Between 1893 and 1900, Sir William was a Member of the British Parliament and set up the Indian Parliamentary Committee. (10) Hodgson Pratt was a founding member of the National Indian Association in 1872 and wrote frequently on Indian affairs in the *Economist*. (11)

A number of co-operative histories credit Sir William with being the first to propose co-operative solutions to India's problems. This, however, is disputed by Henry Wolff (1840-1930) (12)

*"It was in 1882 on the initiation of Sir William Wedderburn, who was then the District Judge of Poona, that the Government of India proposed to the Government of Bombay the experimental establishment of an agricultural bank in the Puriandhar Taluqa in that district, for providing capital to agricultural classes on reasonable terms. The principle of operation of the proposed bank was to borrow money at moderate interest from the big capitalists, whether Indian or European, and to hand it over to ryots at a higher rate, but at once considerably lower than the rates charged by the sowcar...."* (13)

However, Sir William's idea, although accepted by the Bombay and Indian Governments, was not approved by the Secretary of State for India in London, an indication of the strength of Westminster's power of veto. Nevertheless, Wedderburn's proposals set in train some reforms. His ideas were partly implemented in two Acts, the Land Improvements Loans Act of 1883 and the Agriculturalists' Loans Act of 1884 which can thus be considered stepping stones to the Co-operative Credit Societies Act of 1904.

Wedderburn and Pratt's dedication to Indian advancement illustrates how members of the Indian Civil Service could hold liberal views and have the latitude to act upon them. Similar freedoms seemed to apply in the Colonial Office and it has been said that:

*"...the bias of the Office had generally been towards a liberal generosity..since its inception the Colonial Office had, in an often timid but generally consistent way, regarded itself as a trustee for the underdogs of Empire. It was often blamed for sickly weakness by the more hell-for-leather class of colonist, and there were settlers from Jamaica to Bulawayo to whom its very name spelt a betrayal of white interests, of imperial interests, in the name of fuddy-duddy philanthropy."* (14)

Such a statement suggests that British imperialism was not monolithic in governance or underlying ideas. Within a spectrum of imperial ideas, those relating to co-operative

development were likely to be near the far left. This may lead us to suppose that the registrars we are about to note who were sufficiently enthusiastic to write books on co-operation, were similarly liberal-minded.

We should begin our examination of their views on colonial co-operatives by noting early Indian co-operative legislation which is significant for two reasons. First, it became a model for co-operative legislation elsewhere in the British Empire. Secondly, two of the registrars we will consider became directly involved in Indian co-operative development while the third studied it closely and worked in nearby Ceylon (Sri Lanka).

#### 4. REGISTRARS' VIEWS ON COLONIAL CO-OPERATIVES

The object of the Co-operative Credit Societies Act, 1904 was:

*"..the encouragement of individual thrift, and of mutual co-operation among the members, with a view to the utilisation of their combined credit, by the aid of their intimate knowledge of one another's needs and capacities, and of the pressure of local public opinion."* (15)

The Act applied to the rural poor and to urban artisans of limited means. It provided for residents of an area to become co-operative members by election. Thereafter, they could borrow from their society as long as they had previously saved with it. Under the Act Indian Local Government had a far more prominent role in Indian co-operatives than British Local Government did in their British counterparts. Co-operative registration was simple but if fraud occurred, or if bogus societies were established, they could easily be dissolved but had the right of appeal to Local Government and to the Civil Courts.

Another important difference between British and Indian legislation applying to co-operatives was that the former enjoyed limited liability while the 1904 Indian Act granted it only to urban societies. Limited Liability was denied to rural societies in the belief that they had a stronger need for mutual confidence and that, and their self-discipline, was likely to be enhanced if they lacked the safety net of limited liability.

Many of the leading co-operative registrars gained their initial co-operative experience under the Indian legislation. A number of them wrote books about this work which can also be studied from their more formal reports. For the purposes of this paper, however, we are concentrating on their published books. To avoid repetition we deal with only one or two aspects of each registrar's thoughts on colonial co-operation. We start with H. Calvert and his views on co-operative law and principles. In 1933 he wrote what came to be known as a "co-operative classic", (16) He dedicated *The Law and Principles of Co-operation* "To My Colleagues M.L. Darling and C.F. Strickland", two leading co-operative registrars with whom he worked extensively in India. We shall refer to Strickland later in greater detail.

Calvert's book stresses the linkages between co-operative law and principles with particular reference to India's Co-operative Societies Act, 1912. Unlike the 1904 Act, this applied to the whole of India and to all kinds of co-operative. It also influenced subsequent co-operative legislation in Indian territories.

Calvert clearly states the responsibilities of the Registrar contrasting them with both the Indian Companies Acts and the British Friendly Society legislation. He notes that although the Indian Co-operative legislation follows closely that of Indian Companies, certain modifications were made to allow the co-operative registrar ultimate responsibility for co-operative principles.

*"The conservation of co-operative principles....is left to the rules and by-laws, the former are to be framed by the Local Government and the latter to be approved by the Registrar before registration." (17)*

"..the strictest adherence to rules and by-laws" was necessary because Indian co-operative legislation was a "modified code of company law". Calvert was easy with this because India's Company Acts closely followed English Company law and included many of its judicial rulings. Moreover, while India had some experience of company legislation she had none with any equivalent of Britain's Friendly Societies and Industrial and Provident Societies' Acts. Indeed, Calvert observed, laws permitting voluntary association even in Britain and Europe, were still of relatively modern origin. Referring to the Friendly Societies, and Industrial and Provident Societies' legislation he said:

*"The rigid provision of these various laws....may seem to contrast strangely with the simplicity and elasticity of the Indian Act. They must be presumed to be based on the knowledge of the people with whom the legislatures were dealing and their absence from the latter Act must not be construed as reflecting the opinion that they were not necessary here. The Government of India has thrown upon Local Governments and Registrars the responsibility for insisting on the necessary rigidity adapted to local conditions. It will not be seriously argued that a strictness which seventy or eighty years of experience has shown to be necessary in Europe can be lightly dispensed with in India...the simplicity and elasticity which characterise the Indian Act give local Governments and the Registrars a free hand either in the determination or in the application of the principles of co-operation." (18)*

Here, and elsewhere in his book, Calvert elaborates upon the responsibilities of the Co-operative Registrar and marries these to "co-operation" rather than to co-operative principles. Despite the "Principles" in his title, Calvert has no chapter on these. Instead, he has a lengthy discourse on What is Co-operation? which surveys co-operative definitions and experiences in Britain, Austria, Switzerland, Canada and America. Calvert emphasises the importance of the co-operative spirit and from American experience notes that:

*"The key to the success of the co-operative method of doing farm business is to develop the co-operative spirit, that is the willingness and desire to sink individual opinions and interests to such an extent that a group of men can work together for common interests. When this spirit is developed to a high degree it means a sort of loyalty and patriotism that lends men even to sacrifices, if necessary. Clearly, there is in Europe such a thing as the co-operative spirit, co-operation cannot long exist without it." (19)*

Calvert also stresses that the essence of co-operation is that "each shall work for all and all shall work for each in the attainment of their common need" but members need to be assured that all will work equally hard in this. However, he considered that insistence on co-operatives being voluntary organisations, "conflicted with certain practical examples", and cited practices in Belgium, Tunisia, French West Africa, South Africa and Russia. Nevertheless, he concluded that:

*"The end becomes so desirable that the means appear to become less important. Compulsory co-operation, wisely conducted, is compulsory adult education in business methods. Compulsory thrift is generally admitted to be beneficial. The result, however, can never be the same as voluntary co-operation. Voluntary membership not only strengthens individual responsibility, but it differentiates co-operation from State schemes of social reform." ( 20)*

When contrasting co-operation with capitalism, Calvert believed co-operation was "specially suitable to people who have no capital sufficient for the full satisfaction of their needs on a joint-stock basis." Finally, he believes that:

*"The absolutely necessary principles are that people should agree to associate voluntarily on terms of equality in order to secure satisfaction of some common need. Human beings, and not capitalists, bind themselves together to "work each for all and all for each."*

*"...co-operation stands out for moral uplift, for honesty and for the homely virtues that count for so much in the daily lives of the people. It possesses the peculiar faculty of making virtue pay.....Moreover, the morals of an individual cease to be a purely private matter for his own conscience, they become of importance to the whole community to which he belongs." (21)*

From such sentiments we might conclude that while Calvert began as an Indian Civil Servant he ended as a convinced co-operator. His book goes on to examine possible alternatives to co-operation and then becomes sternly practical as it lays out the Objects of Co-operative Societies, Liability, Interest, and Conditions necessary to create a Credit Society and, finally, the provisions of the 1912 Act.

While Calvert elaborated upon the co-operative registrar's responsibilities for co-operative principles, W.H.K. Campbell in his book "Practical Co-operation in Asia

and Africa" (22) concentrates more on the registrar as someone who animates and facilitates pre-co-operatives. Unlike Calvert, and his two fellow registrars, Strickland and Darling, Campbell did not work in India although he studied Indian co-operative developments in 1925 as part of a study tour preparing him for co-operative work. His main work was done in Ceylon although he later worked in China as an Adviser on Co-operation for the League of Nations to the Central Government of China, and in Kenya, Tanganyika, Nyasaland, Northern and Southern Rhodesia, Basutoland and Sudan, as well as in Cyprus and Malta. His views on co-operative development can be found in his various reports but are very well summed up in his book for which he invited Strickland to write the Foreword. Like Campbell, Strickland had also worked with, and had written about African co-operatives.

Campbell wrote his book out of need. While he found much written about co-operatives in developed countries, and some some in India, little literature existed to help "a Registrar who is about to develop Co-operation out of nothing." Far more than Calvert's book, Campbell's discusses how to motivate and organise people in pre-co-operative and activities; later how to encourage them to engage with each other in meetings both formal and informal. Nevertheless, Campbell agrees with Calvert on many things. Both became enthusiastic about co-operatives and their potential in overall development. Each also recognised that a country's existing level of political, economic and social development impinged on what co-operatives might develop within it.

Let us now examine in greater detail the pre-conditions that Campbell thought necessary for effective co-operative development and on the role of the co-operative registrar in creating these. His ideas were shaped not only by his work but by the way he was precipitated into co-operative service without any previous experience.. After "15 years of the ordinary revenue and judicial duties of an Administrative Officer in Ceylon," he was appointed the country's Registrar of Co-operatives. He was, however, given the opportunity to learn about co-operatives elsewhere, being sent on co-operative study tours in England, Ireland, Italy, Yugoslavia, Rumania and India.

His later service in Ceylon and elsewhere led him to conclude that indigenous populations were suspicious of colonial civil servants, even those with good intentions.

*"Their experience in dealing with their fellow men has not, for the most part, been a fortunate one. They, and their fathers before them, have been accustomed to expect that anyone richer or better educated than themselves would use his advantages to exploit, defraud and oppress them. The not unnatural result has been to get in them a suspicious habit of mind. They find it difficult to believe that anyone is quite genuinely trying to help them, and are apt to consider this too good to be true and to seek a sinister hidden motive which does not really exist. They do not always react to suggestions in what seems to the educated pioneer to be a rational manner. Their whole attitude to life is different from that of the inhabitants of more developed countries. They are apt to be resigned and even apathetic, unwilling to believe that*

*anything which they, even in combination with their fellows, can do could possibly have any effect in mitigating troubles to which they and their ancestors have been subject..." (23)*

This is an interesting statement for a number of reasons. First, it reveals the attitudes of colonial subjects to their imperial regime. Secondly, in speaking of the 'educated pioneer', Campbell reflects on a shift in British colonialism that had led to the recruitment of more humane colonial civil servants. In other words, imperialism had become something more than the exploitation of colonies' human and natural resources, although that, together with strategic considerations, remained a large part of its *raison d'être*.

Because of colonials' suspicions and apathy, Campbell believed that co-operative officers required patience to achieve any successful co-operative development. He worked with people who had no ingrained sense of personal advancement. Moreover, Campbell questioned how far it was possible to transplant a co-operative success stories from other countries that were more advanced to those that were little developed, and he cited failures to reproduce 'the Irish system in the Cape Province of South Africa and the Danish in the Transvaal.' Campbell believed that nothing genuinely co-operative could be achieved until the "suspicion of the co-operators has been allayed, and their confidence has been won." (24)

He also stressed the importance of motivation, arguing that potential co-operative members must truly want for themselves what was being proposed. It was no good an educated professional trying to organise a marketing co-operative if the members wanted something else such as access to credit. They might only be more prepared to listen to professional advice after they had gained successful co-operative experience. After that Campbell was confident that co-operation's traditional concern and success in helping the poor to help themselves, would become the natural remedy for the problems of indigenous colonial populations.

Campbell sounds refreshingly modern in expressing such sentiments. However, a factor in his more enlightened attitude may be the period in which he was writing, namely the 1950s rather than the 1930s in which Calvert had written. In the meantime the Second World War and a post-war British Labour Government had shifted attitudes on overall colonial development.

For all that, Campbell shows a practical turn of mind on the role of the colonial co-operative registrar. We should note that he was always male. He said of him that:

*"He has to light a fire of enthusiasm and prevent it going out, guiding meanwhile the activities of enthusiasts, devising constitutions and forms of accounts, and shielding them from what might be costly errors... The Registrar has to apply to his work a nicely modulated blend of caution. I am as brave as anyone when it is a question of losing a certain amount of government money in a good cause. The trouble with Co-operation in new countries is that the stakes with which the game has to be played are the savings for the*

*most part of very poor people. These have not been easily acquired, nor has it been easy to persuade their owners to risk them in a co-operative society.....If the stakes are lost, the effect on the owners and the resulting set-back to the prospect of the movement are serious beyond all proportion to the amount of money which was involved.” (25)*

Campbell also discusses the recruitment of co-operative registrars and identifies two possible sources. The first was to appoint someone who knew little about co-operation but was familiar with the people, languages, social customs, and prejudices of a country. Lack of co-operative knowledge could be remedied, as it had been in Campbell's own case, by study tours of co-operatives elsewhere. The second choice was to appoint someone who knew about co-operation but had little knowledge or experience of the country in which he would work. Campbell preferred the first option because it took a long time for someone to get to know a country and, in any event, there was a scarcity of co-operative experts.

*“There are not very many territories in which these forms of Co-operation have definitely achieved success. Such territories have had to invest appreciable sums in the training of their co-operative staff, and are not unnaturally reluctant to release them. Moreover, Co-operation is an occupation which takes so strong a hold on its adherents that it is not likely to be easy to persuade the officers themselves to migrate to a new country.” (26)*

Of new co-operative officers Campbell observed that while ‘an excessively law-ridden habit of mind is most unsuitable, it is necessary for the Registrar to help in drafting Ordinance, framing rules under it, and devising constitutions suitable for the different types of society which are required.’ This was another reason why an Administrative Officer who had previously spent time on judicial work, would be appropriate for such work.

Throughout his book Campbell shows a practical turn of mind. He recognises that most ordinary people in their relations with government are compelled by laws to do what governments require. A co-operative registrar, however, cannot force people to co-operate. He could not even make them attend co-op.meetings. Persuasion, motivation and voluntarism were everything but they required a co-operative officer to spend an “appreciable time in a village chatting to a group of people” he hoped to organise.

Campbell emphasised that the only penal powers a registrar held were those cancelling the registration of a failing co-op and liquidating its affairs in order to protect its members from loss. Such limited powers set co-operative registrars apart from other government officials who enjoyed greater coercive powers. He repeated the need for the co-operative registrar to be able persuade and motivate possibly sceptical or hostile people which led them, far more than other government officials, to work with people rather than with papers. The posts of co-operative registrar required ‘the very best men available’ and should not go to misfits who had failed elsewhere.

If governments were not prepared to spare the right men, they would be better advised 'to leave Co-operation alone...' (27)

The last co-operative registrar we shall note is C.F. Strickland. He had considerable colonial co-operative experience, working for 12 years as co-operative registrar in three Indian provinces, and later in Egypt, Malaya, Palestine, Zanzibar and Tanganyika. (28) He also worked with William Campbell in 1925 advising on co-operative development in Ceylon and, in 1928, after extensive study, recommended the introduction of co-operative societies in Nigeria. Strickland also assisted co-operative development in Singapore and the Cameroons. (29) It seems reasonable to speculate that arising from their joint work in Ceylon, Campbell was Strickland's protoge.

In 1933, the same year in which Calvert wrote his *Law and Principles of Co-operation*, Strickland wrote a book entitled *Co-operation for Africa*". Like Calvert and Campbell, Strickland is very conscious of how co-operative development is shaped by its location and target population. He refers to differences between India and Africa and devotes a whole chapter to African Society. This in-depth analysis is perhaps what sets his book apart from those of Calvert and Campbell. Elsewhere, however, he follows a similar pattern to theirs of illustrating co-operative achievements in other countries, different types of co-operative, co-operative law, finance, audit and supervision. Whereas Calvert deals at length with the 1912 Indian Act, Strickland performs a similar service with the Co-operative Ordinance of Tanganyika, together with draft Rules and By-Laws.

Apart from Strickland's Chapter on African society, the most interesting thing about his book is its Introduction written by Lord Lugard. This helps to confirm our earlier suggestion that early colonial co-operative registrars were among the more liberally minded of the Colonial and Indian Civil Services.

Lugard is little known today but is mentioned in a number of leading histories of the British Empire. He is notable for various things but perhaps most for having begun his career as an arch-imperialist and ending it with almost devolutionist ideas of imperial trusteeship. One writer has described him as 'one of the most creative and thoughtful of British colonial theoreticians...' (30) That a man of Lugard's standing should endorse Strickland's book by writing its Introduction, suggests that in the 1930s British colonial co-operative development was coming of age, at least among liberal imperialists. For this reason it is interesting to note Lugard's career to try to see what he saw in co-operation. He is one of the few figures in whom British imperialism and co-operation incongruously combine, the fourth Earl Grey (1851-1917) being another.

Lugard was the son of a British chaplain in Madras. Unlike Strickland, Calvert and Campbell, he failed the Indian Civil Service examination. With the help of his uncle the Permanent Under-Secretary at the War Office, he joined the army instead and fought in various campaigns in Afghanistan, the Sudan and Burma. In 1888 he joined a force raised by the African Lakes Company to protect its interests from raids by Arab and Swahili slave-traders. He was later recruited by the Imperial British East Africa Company and became the virtual founder of British Uganda. (31)



In East Africa Lugard was impressed by Scottish missionaries and the way that they ran their affairs, with their neat clean mission houses and the tidy and well-dressed pupils in their schools. This, he felt, epitomised European superiority and believed that the white man in Africa should always maintain his separate way of life so as to assert the 'superiority which commands the respect and excites the emulation of the savage.' Native 'insolent familiarity' should never be allowed because, like the British lower classes, the natives would instinctively recognise and respect a 'gentleman' and 'follow his lead.' (32) To modern ears such sentiments are at best quaint and at worst offensive. Moreover, they make it all the more incongruous that any person holding such views could ever later endorse co-operative development.

Having said that, Lugard's career illustrates how harsh colonial conditions could be. They obviously demanded pioneering and even quixotic temperaments. Lugard devised his own survival routine which included wearing a wide-brimmed hat, drinking large amounts of weak tea or water and always wearing a flannel cummerbund to prevent chills on the stomach, spleen or liver that could lead to fever, dysentery, diarrhoea and cholera. He also believed in eating a hearty breakfast but this had to be just after sunrise so as to prevent the sun overheating an empty stomach. Whenever he did succumb to fever, Lugard dosed himself with quinine and covered himself with voluminous clothes so as to sweat it out. (33)

Lugard became famous for the epic marches he undertook in harsh conditions. One was over 700 miles in Bechuanaland through the Kalahari Desert in order to explore a mineral concession. (34) Another was a long and difficult march to secure British interests in West Africa. This was in 1894 when he was hired to lead a small expedition into northern Nigeria to negotiate treaties to bring local leaders into the British sphere of influence. The French mounted a similar expedition and there were rumours that a German one was also being attempted, but Lugard got there first. His successful 'treaty-gathering trek' was hailed as a 'superhuman feat of perseverance' and involved travelling in extreme temperatures in which his dog died of heat exhaustion, and torrential rain. His expedition suffered fevers and an ambush during which Lugard's skull was wounded by a poisoned arrowhead but he survived by taking native medicines in addition to his usual remedies. On another occasion when he developed a fever during this trek, Lugard sweated it out by a thirteen-mile march in the blazing sun. Having successfully obtained his treaty, in 1897 he became Britain's special commissioner for northern Nigeria. The newspaper, *The Times*, observed that for the French, Lugard 'symbolised....the fierce grasping spirit of perfidious Albion. He is for them the stuff of which legends are made.' (35)

Lugard later became Governor-General of Nigeria. (36) We have already noted that Strickland worked there and this is most likely where they met. Certainly it was in Nigeria that Lugard began applying new ideas of imperial government. These had matured in his mind over some years and involved a system of imperial trusteeship under which the British ruled indirectly through natives' existing social and political forms. Lugard urged that 'administration would be impartial, firm, and respect local institutions and conventions.' (37) He had practical reasons for his proposals, believing that indirect rule through existing structures and established leaders would be less costly

than introducing new systems of government. They also ran less risk of alienating local populations. Local leaders appreciated keeping their positions, even if this meant signing treaties which allowed Britain possible mineral concessions, untold local practices such as slavery, or agreeing to exercise power in ways approved by British advisers.

For all this, it was still a big step for Lugard to endorse co-operatives. What, then, did he write in his Introduction to Strickland's book? He observes that:

*'The co-operative society...works with its own definite objective - social, moral, or economic according to circumstances - but in no case political. It satisfies the desire - always a tendency in Africa - for the formation of unions, clubs, or associations, which is an invariable concomitant of the early stages of self-expression and marks the emancipation of thought in a community entering on a new era of development and progress.'*

Lugard also observed that the co-operative movement was not confined to the economic sphere.

*'The chief emphasis indeed is laid on the need for guidance in the conflict between the old order and the new moral forces and temptations which threaten alike the social fabric and the individual. Societies for inculcating 'Thrift' and 'Better Living', for promoting Education, Health, Arbitration to replace litigation, &c., are devoted to this moral and social aspect. They may be formed to promote sanitation, vaccination, provision for marriage of children, or for higher education, to combat witchcraft, or to teach sobriety  
'On the economic side they aim to prove that co-operation is better than competition, to relieve both the consumer and producer from the extortions of unnecessary middlemen...' (38)*

It nevertheless remains remarkable that someone of Lugard's imperial past should speak enthusiastically of co-operatives. His Foreword to Strickland's book *Co-operation for Africa*, undoubtedly represents a high-level endorsement of co-operative development within the British Empire.

## 5. CONCLUSIONS

Having summarised how three leading co-operative registrars saw British colonial co-operatives is there anything we can take from their views that has relevance for today's European co-operative development?

There would seem to be three things. The first is that although their tone is often paternalistic, many of their ideas would not be out of place today, particularly those of Campbell in the need to motivate and encourage potential co-operative members,

and Strickland's emphasis on the need to understand local society. Although their powers derived from law, these colonial co-operative registrars were suitably liberal-minded to exercise them with due regard to future co-operative members.

The second thing we note is the importance they attach to the "co-operative spirit". They found this in Europe and elsewhere at the time and recognised its importance as a motivating and moral force. Perhaps this is something that we have lost sight of in our more pragmatic and managerial times. It seems interesting to speculate that it was this that led these three registrars to speak more of "co-operation" rather than "co-operatives" when writing their reports and books.

The third thing we can deduce is that they comprised a "historical co-operative network". (39) Our three registrars worked with each other and undoubtedly exchanged and reinforced each others' ideas. They also referred to each other in their writings and sometimes dedicated these to them. Such historic co-operative networks are important in attempting to trace lines of influence, who influenced whom, on what and when. Not all colonial co-operative registrars were as distinguished. The three we have considered were undoubtedly notable among inter-war colonial co-operative registrars. The body of expertise they developed also helped to shape post-war British colonial co-operative development in which Strickland and Campbell played prominent roles.

For all these reasons it has been useful to recall these figures. Their influence long outlived them as a recent communication illustrates. In an e-mail Trevor Bottomley, Deputy Registrar of Co-operatives in Basutoland in the early 1960s, later Registrar in Bechuanaland and later still Chief of Development and Education in the International Co-operative Alliance, wrote:

*"Your reference to Calvert also brings back memories. When I was in Basutoland with Bert Youngjohns I found in the files in the Co-op Office a very thick, yellow binder marked Ceylon Co-operative Manual. It was a collection of official forms, specimen by-laws, commentaries, reports, and other papers and documents issued, often written by Calvert. It was an amazing source of information -for instance, several of the documents were lecture notes (eg. On economics) written by Calvert and used for staff training. I asked Bert where it had come from but he had no idea, presumably the previous, or even previous, Registrar had known Calvert and had obtained it from his friend. (Bert was the first Co-op trained Registrar, as distinct from a civil servant given the job, in Basutoland). Once discovered we used it often - a proposal to register a "house construction" society? No problem, what did the draft of Calvert's by-laws for such say? A gold mine!"*

Little more need be said on the long-lasting influence of British colonial co-operative registrars.

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# ABSTRACTS

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## **THE FUTURE OF THE COOPERATIVE MOVEMENT IN THE BUILDING OF EUROPE**

**Juan Juliá**

**Elena Meliá**

Cooperatives have\* made very significant contributions to the social and economic development of Europe in recent decades, as is shown by their social and business evolution over the period.

In the future of the European Union, cooperatives can contribute to a more harmonious and balanced economic development that counts on people, envisages commitment to the area and, above all, does not widen the wealth gap between developed and developing countries, as has occurred to date. With no doubt, this entities are destined to be a key element that dynamises true, sustainable social and economic development with greater social and geographical cohesion, due to their particular characteristics, and that is something that a fairer, more equitable society cannot forego.

**KEY WORDS:** European cooperatives, social economy, unemployment, banking cooperatives, agricultural cooperatives, workers' cooperatives.

**ECONLIT:** Q130, J 540, O100, P130

## **PART. 1. CREDIT UNIONS**

### **THE WORLD PROFILE OF FINANCIAL SERVICES COOPERATIVES: AN APPROXIMATION BASED ON THE RELATIONSHIPS WITH THEIR REPRESENTATIVE BODIES**

**Inmaculada Buendía**

**Benoît Tremblay**

The lack of information and the difficulty to obtain it is a common characteristic to every knowledge area. Business management does not escape this limitation with the corresponding negative impact in the ability to produce relevant studies to offer solutions to problems and challenges of organizations. The needs of research in the financial sector are stronger and urgent due to the complexity of the organizations - this is primarily a consequence of deregulation, the increase in internationalization, and the adoption of new information and communications technologies.

The objective of this study is to highlight the scarce knowledge available on financial services cooperatives at the world level. In order to achieve this, we have analyzed the publications of the last thirty years as well as the available information from the representative organizations of the financial services cooperatives at world and regional level.

**KEY WORDS:** financial services cooperatives, credit unions, representative bodies, world profile, credit unions research.

**ECONLIT:** G 290, G390, P130.

## **WHY DO AGRICULTURAL CREDIT COOPERATIVES MERGE? THE PORTUGUESE EXPERIENCE**

**Paula Cabo**  
**João Rebelo**

Over the last decade, increasing financial problems in the Portuguese Agricultural Credit Cooperatives (ACCs), mainly the difficulty in gathering capital, has forced them to adopt an intensive merger activity. This paper examines the economic reasons that have led the ACCs to merge, and evaluates the ex-post merger impact on their economic performance. Our results show that in merger decisions the determining factors are the achievement of minimum efficient size, the reaping of efficiency gains at credit management level, as well as meeting legal requirements, in relation with the solvency ratio. Regarding the mergers' impact on the ACCs performance, we find no positive influence on cost reduction, credit management and solvency ratio.

**KEY WORDS:** cooperatives, credit, mergers, multinomial logit.

**ECONLIT:** P130, G 30

## **THE ROLE OF CREDIT COOPERATIVES IN DEVELOPMENT BY THE CREATION OF CAPITAL. THE SPANISH CASE**

**Inmaculada Carrasco**  
**Agustín Álvarez**

In regional development, credit cooperatives are provided of a wider role (by their cooperative character) than the rest of credit and deposit institutions. This role acts, at least facilitating the creation of fiscal, human and social capital. In this work, a theoretical presentation of the different ways by which credit cooperatives affect the economic and social development are analysed. Also, capital creation is studied and the contributions of Spanish credit cooperatives to regional GDP creation is measured. For that purpose, a fixed effects data panel model for the 17 Spanish autonomous communities is applied. The final goal is to verify if, in regional development, the role of credit cooperatives is common to all the communities, or if it has some particularities thorough them.

**KEY WORDS:** credit cooperatives, regional development, data panel model, Spanish regions

**ECONLIT:** G 200; O120; O160; O180, P130.

## **ISSUES OF SUSTAINABLE DEVELOPMENT IN A TRANSITIONAL CREDIT UNION SYSTEM: REFINING THE UK RESEARCH AGENDA**

**Charles Ferguson**

Since the late eighties both central and local government in Great Britain have invested heavily in the credit union ideal. However with few exceptions, this has not resulted in the creation of self-sustaining financial institutions able to make a significant impact on social and financial exclusion. For the most part, the British credit union movement is still made up of small, institutionally weak credit unions lacking the capacity to serve large numbers of members. Recent changes in the regulatory environment introduced by the Financial Services Authority aims to increase consumer confidence in credit unions and create an environment in which credit unions can potentially enjoy a period of sustained growth. However, many smaller credit unions, especially those heavily reliant on part-time volunteers with limited expertise, are finding it difficult to comply with the new regulations. This, in turn, has resulted in a strong pressure for increased merger activity between smaller credit unions. It is apparent that some forced mergers are already taking place amongst smaller credit unions established in inner-city areas which are largely dependent on external assistance and financial support. Under the new regulatory regime, credit unions that are likely to prosper are those based upon a more inclusive common bond. Both merger activity and the management of partnerships to create more inclusive common bonds will therefore impact heavily on future sustainable development in this transitional credit union system.

The purpose of this paper is to examine the current dynamics of both increased merger activity and credit union growth through more inclusive common bonds as these affect future sustainable development. Attention will be paid in particular to an examination of a proposed empirically based methodology employed to better analyse these issues and to suggest ways in which the UK research agenda on credit union development might be refined.

**KEY WORDS:** credit unions, mergers, sustainable development, research

**ECONLIT:** L300, L890, L390, P130

## **DEVELOPMENT AND PROSPECTS OF A NEW COOPERATIVE CREDIT SYSTEM: THE GREEK CASE**

**Simeon Karafolas**

The credit co-operative system was established in Greece in 1993 following the creation of the appropriate legislative framework. The Greek system distinguishes two types of institutions: the co-operative bank that functions as a bank and the credit co-operative that cannot provide banking services.

The Greek co-operative system is characterized by the autonomous and non-homogenous development of the co-operative banks and credit co-operatives. In

addition, in 2001 the cooperative banks created a central nation-wide bank that has since helped the further development of the credit co-operative system. However and despite the large number of geographic departments involved in the credit co-operative system, the expansion of co-operative banks in the Greek bank market is limited principally due to legislative restrictions and the lack of dynamism these restrictions create to the credit co-operative system, while operating in a very competitive market environment.

**KEY WORDS:** Co-operative bank, credit union, credit co-operative, co-operative credit system, Greece

**ECONLIT:** G21, O16, Z13, P130

### **THE ROLE AND PERSPECTIVES OF CREDIT COOPERATIVES - CREDIT UNIONS - IN LITHUANIAN FINANCIAL SECTOR JOINING EUROPEAN UNION**

Dalia Kaupelyte\*

Jurga Igaryte\*

European integration process and consolidation of financial markets forces financial institutions to review their strategies and policies and to adjust to changing environment. In Lithuanian financial sector nearby commercial banks there are active cooperative financial institutions – credit unions. The enlargement of European Union and the globalization, consolidation processes in the financial sector not only opens new possibilities for the development of credit unions, but also raises new threats and questions of the perspectives of these cooperative financial institutions. The main goal of this paper is to discuss changes in credit unions activities caused by Eurointegrational processes and to point out major preconditions for credit unions development in Lithuanian financial sector considering the analysis of the role and impact of credit unions sector in Lithuanian retail banking market and the role of cooperative banking systems in the other European countries.

**KEY WORDS:** credit cooperatives, credit unions, financial sector, retail banking.

**ECONLIT:** P130, G230

### **CO-OPERATIVE BANKS' ROLE IN RURAL HOUSEHOLDS' FINANCIAL ASSISTANCE (POLAND'S CASE)**

Elżbieta Kołodziej

Polish agriculture as well as rural society are in difficult transition period so rural finance system is necessary to reinforce the progress in restructuring and transformation processes.

The paper is prepared on the base of rural households survey as well as on rural bank's research. Investigations show the majority of rural households locate savings

in cooperative banks. They are the most important creditors. In 1999 - 2001 cooperative banks serviced about 70% of rural households credits amount.

Cooperative bank assistance is mostly based upon its members' capital. Survey showed that both organizational and social relations between cooperative bank and great number of its members were broken what is confirmed by their behaviors like: resignation of members from participation in representation organs, low activity level and lack of loyalty.

Cooperative bank assistance in local environment was estimated by respondents on the average level in scale from 1 – bad to 5 - very good. Taking into account other banks cooperative banks have far more better notes - about 4.

**KEY WORDS:** co-operative bank, rural household, local environment, households' income situation, savings, credits, indebtedness.

**ECONLIT:** D14, G21, I31, P13, Q12, R20, P130

### **AIMING FOR LESS FINANCIAL EXCLUSION VIA NEW REGULATIONS FOR UK CREDIT UNIONS: COST EFFICIENCY ANALYSES HIGHLIGHTS POSSIBLE BENEFITS AND DANGERS**

**Donal G. McKillop**

**J. Colin Glass**

**Ann-Marie Ward**

This study uses a stochastic frontier analysis to evaluate the relative performance of UK credit unions over the period 1991 to 2001. The period under investigation is immediately prior to recent and significant legislative amendments which commentators have argued will increase the regulatory and compliance burden on credit unions resulting in many either being acquired or closing for business. Those most likely to succumb to this fate are smaller under-resourced credit unions many of which draw their members from areas of significant deprivation.

The analysis found that UK credit unions are subject to high levels of [gross] inefficiency. The analysis also revealed that the environment within which individual credit unions operate plays a critical role in the relative efficiency of credit unions. In terms of direction of influence, the analysis of environmental effects highlighted [main insights] that larger credit unions are more cost efficient as are credit unions which do not draw their membership exclusively from areas of high deprivation. These directional influences were viewed as offering some encouragement to the thrust of the Financial Services Authority's new policy regime for credit unions which they expect will result in a smaller number of larger credit unions each with a more varied membership mix. However, it was also stressed that the social outcome may not be as beneficial if acquisition and closure results in members, located in deprived areas, no longer having easy access to credit union services.

**KEY WORDS:** Credit Unions, stochastic frontier, deprivation, financial exclusion.

**ECONLIT:** G21, G14, L31, P130

## **CONCENTRATION PHENOMENON AS A GROWTH STRATEGY IN THE CO-OPERATIVE BANK SYSTEM: THE CASE OF SPANISH RURAL SAVINGS BANKS**

**Amparo Melián Navarro**

In practically all European countries, co-operative credit societies have evolved towards a system which is comparable to other financial groups. The co-operative bank model has 3,700 local and regional banks, more than 51,300 branches, 37 million partners, almost 106 million customers, 572,000 employees and a 17% market share of deposits.

The purpose of this paper is to analyse the recent evolution of Spanish credit co-operatives and in particular rural savings banks. The creation of "Grupo Caja Rural" in 1989, which 96% of rural savings banks belong to, has meant the greatest commitment to the integration of Spanish credit co-operatives. The concentration process is on a par with balance growth and an increase in the market share of deposits and credits.

**KEY WORDS:** Co-operative banking, co-op credit, financial groups, intercooperation strategy

**ECONLIT:** P 130, Q 130

## **THE COLLAPSE OF THE CZECH CREDIT CO-OPERATIVES - LACK OF CONFIDENCE (CASE STUDY FROM THE PERIOD 1990 - 2004)**

**Lidmila Němcová**

In the history of the co-operative movement the credit co-operatives in Central Europe were among the most successful and highly respected financial institutions offering services in the most remote localities with a perfect know how of local conditions and also with a considerable social impact and moral influence. Their role was not only economic but also social and cultural one. Their network was in early 1950' replaced by State saving banks as part of the centrally planned economy system. After 1989 the renaissance of their network besides the existing banking institutions has been made possible by a new law. Unfortunately in the course of this renaissance new serious deformations occurred and co-operative ideas were misused for egoistic personal purposes. Extremely negative experiences with some credit co-operatives evoke suspicions and distrust of the population. An almost complete collapse of the system occurring since about 1999 had many reasons. Radical consequences for the existence of this sector are expected with the EU legislation process.

**KEY WORDS:** Czech credit co-operatives history; renaissance of Czech credit co-operatives after 1989; collapsing reasons; Czech credit co-operatives expectations in the EU

**ECONLIT:** P130, G230

## **CREDIT UNION SUPERVISORY COMMITTEES IN THE REPUBLIC OF IRELAND: A DISTINCTIVE GOVERNANCE APPROACH**

**Olive McCarthy**

**Noreen Byrne**

The credit union supervisory committee, as a model of internal auditing, is very much invisible within corporate governance research. The focus is almost entirely on its corporate counterpart, the audit committee. This means that best practice is based almost entirely on audit committee experience, even though the audit committee model has not prevented recent large corporate losses. Audit committee and corporate and co-operative governance literature may benefit from the perspective of alternative models, such as that of the credit union supervisory committee. Given the changing nature of regulation of credit unions in Ireland, the role and value of the supervisory committee is coming under increased scrutiny, particularly as a result of its increased importance under the 1997 Credit Union Act.

This paper explores the role of the supervisory committee in credit union governance and the structure of supervision, oversight and regulation within the Irish credit union movement. It reports the findings of a survey of credit union supervisory committees and qualitative interviews with key players in credit union supervision and development in Ireland, including the regulators of the credit union movement. A profile of the composition, activities and skills levels of supervisory committees is examined. A detailed discussion on the issue of independence is also presented. It is hoped that this paper will be a useful starting point for further research into the Supervisory Committee model of internal auditing.

**KEY WORDS:** credit union; oversight; regulation; corporate governance

**ECONLIT:** P130, G230

## **PART. 2 WINE AND OLIVE OIL COOPERATIVES**

### **FAIR TRADE AND ETHICAL PROJECTS : NEW CHALLENGES FOR WINE CO-OPERATIVES?**

**Yuna Chiffoleau**

**Fabrice Dreyfus**

**Jean-Marc Touzard**

Fair trade has been developed in the mid 60s and since then this concept extended itself to a growing number of sectors and diffused from North-South to North-North trade. Part of this social movement, co-operatives appear as specific organisations assuming ethical values quested by “responsible consumers”. However, there is a need to develop sociological and economic analyses that address their relevance as

ethical trade leaders in Northern situations (e.g. Languedoc Co-operative Cellars). Firstly, we present the main issues of fair trade, ethical sourcing and responsible consumption in Southern and Northern countries. In the second part, we analyse the evolution of Languedoc wine co-operatives projects and the expression of co-operative ethics at each step of their development. In the third part, we discuss the nature of an ethical project, its current conditions of development in wine co-operatives and suggest operational proposals.

**KEY WORDS:** ethics, wine co-operatives, territory, sociology, management.

**ECONLIT:** D630, L190, L390, M140, P320, P130

### **MANAGING TO SURVIVE INNOVATION AT SOUTH AFRICAN COOPERATIVE WINE CELLARS IN THE AGE OF GLOBAL COMPETITION**

**Joachim Ewert**

**Larissa Bouwer**

**Yvonne le Riche**

For the last ten years or so South African wine cooperatives had to weather a number of storms: deregulation, democratization and international competition. Coming from a highly regulated and protected past, they had no blueprint for facing this tidal wave of change. Although a wine industry 'cluster' can be said to exist, it is of little practical value at the strategic and operational level. To make matters worse, there are no government subsidies of any sort and the tax regime is less favourable than in the past.

Despite these obstacles and challenges, some wine cooperatives have developed a remarkable capacity for adaptation and organizational innovation. These include a systematic move towards differentiated quality production and creative ways of marketing. The two case studies discussed in the paper raise important questions both for the conventional wisdom regarding change in the South African wine industry, as well as theoretical notions of organizational change at cooperatives.

**KEY WORDS:** wine co-operative, innovation, change management, South Africa

**ECONLIT:** X963; O361; E649, P130

### **ANALYSIS OF THE AGRICULTURAL CO – OPERATIVE MEMBERS COMPROMISE LEVEL. SPECIAL REFERENCE TO THE CASE OF WINE CO – OPERATIVES IN “DENOMINACIÓN DE ORIGEN ALICANTE”**

**David B. López**

**Francisco J. Del Campo**

**Fernando Vidal**

This paper tries to introduce a perspective in the analysis of co – operative success looking at members satisfaction as a way of measuring this success. It is possible to



approximate this perspective analysing the factors that could affect the compromise level of members with their organisation. It can be said that the higher the satisfaction, the higher the compromise. However, the inverse should be asked: a higher compromise could lead to a higher member satisfaction.

The first point of the paper looks at some literature and previous studies that can be helpful to clarify the several perspectives that have to be taken into account. These works look at the level of compromise as an essential element for ensuring the co – operative long – term survival analysing the factors that influence this compromise.

According to this approach, the members' level of compromise is a classical example of the future player problem. The problem can be solved using non – co – operative game theory. This allows to model members' loyalty towards their organisation.

Some questions can be pointed:

- Does the level of compromise change according to the member's age?
- Does the level of compromise change according to the member's debt level? This could be related to full time or part time farmers.
- Does the level of compromise change according to the member's perception of his/her ability to participate in the co – operative benefits through the allocation of the results of this compromise?
- Do the farmers feel the need for a differentiated treatment and are there members that leave the co – operative because of this treatment lack?
- Is there any different feature in co – operative organisations that makes these organisations better than short – term advantages (better prices)

These questions are answered in the case of wine co – operatives in "Denominación de Origen Alicante" through a survey to co – operative members and interviews to the presidents and the managers of these organisations.

**KEY WORDS:** member, satisfaction, compromise, wine co – operative, DO Alicante

**ECONLIT:** D230; M140; Q130, P130.

## **THE CONTROL FOUNDATIONS IN THE MANAGEMENT OF OLIVE-OIL COOPERATIVES**

**M<sup>a</sup> Carmen Ruiz Jiménez**

**M<sup>a</sup> Jesús Hernández Ortiz**

**Elia García Martí**

The control process is an essential component of successful performance in any organisation. In olive-oil cooperatives, where the partners place their trust in managers, control becomes a critical issue in the attempt to ensure that all interests within the company are taken into account. Thus, from the perspective of the agency theory, this paper attempts to analyse those aspects that characterise the delegation of power

and management in this type of company with the aim of identifying the fundamental aspects of the control enforced by the partners.

**KEY WORDS:** Organizational Control, Olive-oil cooperatives, Control Foundations, Agency Theory.

**ECONLIT:** M110, M140, P130, Q130.

## **PART. 3 COOPERATIVE GOVERNANCE AND WORKER COOPERATIVES**

### **CONTROL STRUCTURE AND STAKEHOLDER INVOLVEMENT IN CO-OPERATIVE GOVERNANCE: A COMPARATIVE ANALYSIS**

**Akira Kurimoto**

Co-operatives have many common features with investor-driven firms in the corporate governance structure, but they have the different characteristics as user-driven enterprise. They have the similar internal control mechanism with regard to board-manager relations and auditor's role. But the external control is quite different since co-operatives are not threatened by the corporate control market, which may result in the lack of accountability of incompetent managers. So, it is needed to introduce the supplemental controlling and monitoring mechanism by or for co-ops. In addition, co-operatives have membership as the principal stakeholders, combining investors and users roles. So, member participation is to be given the priority, to enable them to give the real influence on co-op's decision-making and the effective feedback to co-op's operation. At the same time, the other stakeholders, especially employees and suppliers, also need to be involved in the governance process.

**KEY WORDS:** corporate governance, control structure, stakeholder, co-operative principles, participation

**ECONLIT:** P130

### **HUMAN RESOURCE MANAGEMENT AND THE ORGANISATION OF INCENTIVES IN WORKER COOPERATIVES**

**Waldo E. Orellana Zambrano**

**Rafael Chaves Ávila**

In Associated Labour Co-operatives (worker cooperatives in Spain), the functions of the Human Resources Manager (place people in the most suitable jobs according to their potential and ability; provide people with the necessary encouragement to obtain from them the best identification with the collective objectives), will take place in an organizational context of "relations among equals". Consequently, all human resources policies that will take place according to the job title and functions

will need to be applied according to these particularities, as opposed to traditional capitalist companies.

We analyse here the different questions that the Human Resources Manager will face at an organisational level at an Associated Labour Co-operative and people's behaviour. Accordingly, we draw an action framework following several works on different organisational theories and organisations' economy.

**KEY WORDS:** Cooperatives, Work, Human Resource, Incentives

**ECONLIT:** M100, M120, M140, P130

### **HOW SHOULD THE COOPERATIVE NETWORK AND ITS GOVERNANCE STRUCTURES BE DESIGNED TO REMAIN COMPETITIVE IN A GROWING EUROPE. THE MCC CASE**

**Iosu Iizarralde**

**Iñazio Irizar Etxeberria**

This work focuses in the mentioned third level, analyzing the networks created from the Social Capital perspective. For a better understanding we will develop:

- Firstly the literature around the importance of the social capital in the economic context of competitiveness,
- Secondly the evolution of the structure of MCC since his creation in the late fifties, and
- Finally the challenge of MCC in accomplishing its ongoing networking process respecting the cooperative values, creating more member-jobs, but at the same time finding a new status to the increasing number of salaried employees in the subsidiaries of the new EU members.

**KEY WORDS:** Cooperatives, Mondragon, Social Capital, Personal Networks, Shared Value System, Institutionalised Social Interaction, Corporate Strategy, Growing Europe.

**ECONLIT:** O180, P130

### **PARTICIPATION AND DEMOCRACY IN INTERNATIONALISED COOPERATIVES**

**Anjel Errasti**

**Baleren Bakaikoa**

**Agurtzane Begiristain**

In this paper we analyse the possible ways of developing another model of multinational enterprise from three points of view: firstly, we analyse the role that can be played by the codes of conduct as complementary instruments for designing an the social policy of the internationalised cooperatives; in second place, we briefly look at the intercooperative multinational or global cooperative as an alternative to the capitalist multinational business model; finally, from a broader perspective, we

make reference to how to develop a model for a more democratic multinational enterprise, as well as to some conditioning factors that affect the functioning and the decision-making process of multinational companies.

**KEY WORDS:** cooperatives, internationalisation, Mondragon Corporacion Cooperativa, multinationals, participation, democracy, intercooperation

**ECONLIT:** D2000, D290, G300, G390, J540, P130

## **PART. 4 PATHS IN INNOVATION, EDUCATION AND COOPERATIVE DEVELOPMENT SYSTEMS**

### **THE PRESENCE OF SPANISH CO-OPERATIVES ON THE INTERNET AND “COOP.” DOMAIN**

**Gabriel García  
Juan Juliá**

At present the co-operatives stood to benefit from the internet and e-commerce revolution, just as they did from the co-op principle itself when it was first established in the 19th Century. This has been underlined by the securing of the “.coop” top level domain name by the International Co-operative Alliance, meaning that co-operatives register electronic addresses with this domain which can be an important tool in branding co-operatives differently from other businesses in the virtual economy. The objective of this research is to analyse the evolution, current situation and the future function of “.coop” domain in the Spanish co-operatives.

**KEY WORDS:** Co-operatives, Internet, Web, Domain.

**ECONLIT:** P130, Q860

### **ICT SUPPORT SPECIFYING CO-OPERATION BETWEEN MEMBERS WORLDWIDE**

**Zdenek Linhart**

The information processing problem and rigidity of organisations is proposed to be solved by e-business technology in this article. Project development based methodology is used to gain and prove validity of expected results. EU program supports initial training and implementation of e-business for small businesses. It is expected that these small entrepreneurs will discover and return to initial values of co-operation through Internet.

EU grant for training and implementing e-business for small and medium entrepreneurs is decomposed into processes. Bee keepers, handicapped people and employers, and salespersons, independent manufacturers, eventually organizers of different actions applied for this e-business proposal because it simplifies co-operation between

them and others. International dimension of this co-operation seems to be very easy and important as partners from different EU countries agreed upon.

**KEY WORDS:** co-operative, co-operation, e-business, order, representative, competence, interest

**ECONLIT:** M190, M290, M390, M590, P130

### **THE IMPACT OF AGE AND EDUCATION ON TENDENCIES TOWARD DIFFERENT TYPE OF CO-OPS IN IRAN**

**Nasser Mirsepassi**

The basic question of the research, considered being: has the age and education significant impact on people's tendency toward different type of Co-ops in Iran? Based on the researcher's deductive reasoning, it was hypothesized that the younger, educated mail and female have less tendency toward Agriculture Hand made carpet and Mining Co-ops and more tendency toward Industry, Construction, Transportation and Services.

Since the population of Iran is young and almost 70% of the 70 million populations are under 30 years of age, the objective of the research was, to search for the area of employment opportunity for younger unemployed who might be attracted toward cooperative organizations.

The hypothesis was tested though the data gathered from Lorestan Province in the west part of Iran which is more agricultural and less industrial.

The required data related to the research hypothesis was gathered from the Co-op Government Office in the Lorestan Province, and includes 792 registered Co-ops.

Based on the data and the rank order of the member's age and education level, the research hypothesis was to some extend supported.

The only unexpected case is handmade carpet Co-ops which has the highest level of younger members, and the second lowest level of education.

It might be concluded that younger mail and female in at least western area of Iran have less tendency toward agricultural Co-ops which are more appropriate, particularly in this area in which, there is the highest rate of unemployment.

**KEY WORDS:** Co-operatives, age and education, employment.

**ECONLIT:** P130.

## THE SWEDISH COOPERATIVE DEVELOPMENT SYSTEM: AN EMERGENT COMMUNITY OF COOPERATIVE PRACTICE

**Yohanan Stryjan**

The Swedish Co-operative Development System (FKU) discussed in this paper can be seen as an ingenuous effort to address the paradox of central support to local entrepreneurship, and to create an institutional setup that is at one at the same time both national in scope and funding, and capable of both adjusting- and responding to local variation in terms of needs and resources. It is argued that the system's evident strength can be traced back to the following features:

- 1) Public baseline financing, that provides a minimum level of stability and continuity (and, thus, reliability in the eyes of important others)
- 2) Resource dependence on the political center is balanced by an institutional requirement for matching financing, that motivates each LKU (local agency) to cultivate its local contacts and maintain its embeddedness.
- 3) A loosely-coupled federative structure that allows sufficient leeway for member-LKUs in accommodating to local demands, while handling relationships with central political levels.
- 4) A community of practice: that stewards and nurtures its own body of knowledge and competence, and links the individuals active within the association in a professional organization of cooperative consultants.

Success should not be attributed to any single feature of the design. Instead, it hinges on a careful balancing of all these ingredients. The paper explores the four elements, and provides a brief review of the process that gave rise to the organization, in the course of which the FKU's key institutional features emerged gradually, and were incorporated into the system.

**KEY WORDS:** Co-operative development system, public financing, matching financing, federative structure, community of practice.

**ECONLIT:** P130.

## PART. 5 COOPERATIVES AND SOCIAL ENTERPRISES

### SOLIDARITY-BASED ENTERPRISES: NEW COMPRISING CONCEPT FOR THE ENTERPRISE OF THE FUTURE

**José Luis Retolaza Avalos**  
**Aitziber Mugarra Elorriaga**  
**Marta Enciso Santocildes**

Nowadays to be excluded from the labour market supposes an exclusion of the social life and even the loss of the citizen rights. The effects of social disintegration and marginality that these phenomenons bring with them are acquiring structural character. New times demand a new generation of responsible companies, deeply rooted in their environment and guided with new criteria beyond the logic of the exclusive economic benefit.

In last years we can see new alternative socio-economic initiatives that identified themselves as 'solidarity-based companies'. This paper focuses on the identification of the main characteristics that conform this new emerging model, as well as the interrelations and differential factors with others more developed experiences, as the social economy, or the third sector. Besides, we will deepen into the typology that describes the diversity grouped under that new denomination.

**KEY WORDS:** Solidarity-based Companies, Social Economy, Third Sector, Entities of Social Initiative, Special Centers of Employment ...

**ECONLIT:** A130, J230, J540, L290, L390, P130

### SHARPENING THE NOTION OF 'NONPROFIT': THE SOCIAL ENTERPRISE

**Yair Levi**

The notion of 'nonprofit' is nowadays applied to such diverse organizations as philanthropic and charitable institutions, voluntary associations, foundations, NGOs, groups dealing with ecological, cultural and sport activities, and - albeit with some reservations - cooperatives and social enterprises. Nonprofit organisations differ with regard to their ideology, their scope and legal form, and their relations with the state (mainly its welfare agencies). Under the same label we find organizations based mainly on voluntary work, along with those employing mainly remunerated workers. While some of the nonprofits rely on donations to perform their work, other avail themselves of production factors (like capital and labour) to produce and supply work and services needed by their members, or other beneficiaries. On the whole, the term 'nonprofit' tends to lump under the same roof organizations that accept the neo-liberal paradigm as a fait accompli, and those that challenge it and strive for an alternative to it. Based on a comparative view of the nonprofit third sector, the social economy, the social cooperative and the social enterprise, this paper attempts to sharpen the unclear meaning of the notion of nonprofit. This might be seen as a first

step towards distinguishing between 'conservative' and 'transformative-alternative' nonprofits

**KEY WORDS:** nonprofit; social economy; third sector; cooperatives; conservative versus alternative nonprofits.

**ECONLIT:** L31, P1, P13,

## **WORKER'S SOCIAL ENTREPRENEURSHIP. A CASE STUDY OF TEXTILE FACTORY IN LODZ, POLAND**

**Zdzislawa Janowska**

The paper contains a description of a case of the workers' civic initiative which led to the restart of the textile company's (privatized in a pathological way) production after its bankruptcy.

A bankruptcy of a company which was privatized in a criminal way, e.g. purchasing it for a very low price and wasting money on senseless and absolutely non-obligatory activities and ventures that in the end led the enterprise to ruin became a regular feature of the Polish transformation after 1989. Whole branches of industry are consciously liquidated/destroyed in such a way in order to create the space for more imported goods or simply to eliminate the competition from other companies. It is all done because of the attitude of the people who hold high posts in the civil service or in the local government. They often disregard the existing law and possibly accept the current state of affairs in return for some personal gains. This only deepens the social-economic crisis of our country and increases the unemployment rate which has just rocketed to 20,6%. The dominant group among the Polish unemployed consists of the people who were fired alongside hundreds of their colleagues from the formerly state owned enterprises.

The case of the textile factory/company is a successful example of the workers' struggle with the new owners who on purpose tried to destroy the enterprise and its well known quality.

The paper features:

- information on the criminal privatization of the company confronted with the ongoing activity of the workers who informed the police and the Treasury about the dealings and proceedings within the company,
- the conflict between the owners and the workers who did not receive their wages during a time of a full scale production which in the end led to the stoppage of the production,
- the mediation of the report's author (Senator of the Republic of Poland) and the effects of this process,
- author's cooperation with the workers and the police which resulted in the official bankruptcy of the company,



- the description of the workers' new initiative and the formation of the workers' joint venture performed during the governance of the bankrupt company by a state appointed syndicate,
- the description of the first few months of the venture's functioning.

**KEY WORDS:** workers civic entrepreneurship, pathology of privatization, unemployment preventing, social initiative of workers

**ECONLIT:** P130, J530

## **PART. 6 MERGERS AND DEMUTUALIZATION**

### **THE DEMUTUALIZATION PROCESS OF EUROPEAN COOPERATIVE SOCIETIES**

**Josefina Fernández Guadaño**

For several years, one tendency in the development of the european co-operative movement are becoming apparent and it is analysed in this study: towards a growth process via formulas which aim to group broadly incompatible capital assets whilst maintaining certain co-operative principles. There is a tendency toward processes of demutualization as many traditional cooperative societies respond to increased competition and the globalisation of markets. This de-cooperativization o demutualization shows up, in one way, in the process of corporate mergers; and, in another way, in the increase and consolidation of funds acquired by cooperative societies through resources furnished by investment partners.

**KEY WORDS:** Co.operatives, demutualisation; capitalist investors; concentration; European Cooperative Society Statute.

**ECONLIT:** P130, O100.

### **ESTABLISHMENT OF EUROPEAN CO-OPERATIVE SOCIETIES BY MERGERS OF COOPERATIVES FROM DIFFERENT MEMBER STATES**

**Elena Meliá Martí**

**M<sup>a</sup> del Mar Marín Sánchez**

Council Regulation (EC) No 1.435/2003, of 22 July 2003, concerning the European Co-operative Statute (ESCE), constitutes the legal basis for the creation of societies with participation of companies from different Member States, at the same time that regulates the possibility of formation of these societies by merger of cooperatives from different Member States, or from the transformation of cooperatives.

Spanish cooperatives will be regulated, depending on whether they participate in a crossborder or internal formation by merger, by the ESCE or by the cooperative law in force in Spain (national or regional), what will promote the appearance of differences

in the steps to follow by cooperatives and in the merger itself. The aim of this paper is to show the specific features of formation of crossborder cooperative by merger, covered by the ESCE, with special attention to those aspects that distance them from the internal formation by merger, within the Spanish legal framework.

**KEY WORDS:** Statute for a European Cooperative Society, Spanish cooperative regulation, co-operative mergers, crossborder activity.

**ECONLIT:** K290, P130

## **A STUDY OF MERGERS IN THE UK CONSUMER CO-OP SECTOR**

**Roger Spear**

This paper is based on preliminary findings from a quantitative study of almost all of the mergers in the UK consumer co-operative sector during the 20th century. The paper describes the growth and extent of the consumer co-operative sector. It examines the pattern of mergers. It then goes on to explore the reasons for these patterns, by examining concurrent socio-economic data both within the sector and outside it. The paper will examine a number of hypotheses including the extent to which mergers can be considered “mergers of last resort”, or defensive mergers to avoid failure, rather than aggressive mergers to gain economies of scale, and growth. It will attempt to examine hypotheses around co-operatives supposed reluctance to engage in mergers. Finally it will examine the part played by institutional players in mergers – such as the role of co-operative federations in promoting mergers to combat economic issues such as declining market shares.

**KEY WORDS:** mergers, consumer co-operatives, institutional factors, UK.

**ECONLIT:** P130.

## **PART. 7 COOPERATIVE PRINCIPLES**

### **MATURE CO-OPERATIVE GROUPS SEEKING NEW IDENTITIES: THE CASE OF BELGIUM**

**Patrick Develtere**  
**Peter Raymaekers**

The co-operative sector in Belgium has always been very much linked to other social movements. In the 1990s the backbone of the sector, namely the co-operative banks, have undergone major transformations. In this paper, the two most important co-operative financial holdings that were created to replace the stand-alone co-operative banks are looked at: the Cera and the ARCO-group. We see that they follow a similar path but have opted for a slightly different positioning in the Belgian social and

economic landscape. Both have sought a new identity by repositioning themselves vis-à-vis the market, civil society and the state. The consequences of the new 'co-operative trilemma' are gradually becoming clear.

**KEY-WORDS:** co-operative, social movement, sustainable development, corporate social responsibility, co-operative trilemma

**ECONLIT:** P130, G230.

## **OWNERSHIP IDENTITY OF COOPERATIVES IN THE NEW EUROPE**

**Zbigniew Galor**

The paper presents the analysis of identity function of the co-operative ownership with reference to the new European social-economical reality. The analysis premises: the general economic sociological theory of ownership and the increase of the social economic contradiction resulting from the process of European integration and enlargement of European Union in 2004. The results concern: reduction of co-operative ownership to state (in the past) and private ownership that occurs nowadays in theory and practice e.g. in Poland; different forms of participation in the cooperative property (membership and ownership), cooperative ownership degeneration.

All these lead to the claim that the identification function of co-operative ownership in the economic relations loses its stability. This is manifested by considering forms such as some social associations or corporations as cooperative enterprises. Emphasizing dimensions of cooperative property: the social in Western Europe and the private in Eastern Europe - it is a long-time tendency in general growing of the Europe.

**KEY WORDS:** cooperative, ownership, identity, European transition, cooperative degeneration, cooperative ideology.

**ECONLIT:** O110, P120, P130, P260.

## **THE BLENDED SCORECARD: A TOOL TOWARDS BALANCING CO-OPERATIVES' PERFORMANCE**

**Harvey Johnstone**  
**Mikel Cid**

Each firm has by nature a socio-economic structure. Since a co-operative is defined as a group of people that develops an economic activity to meet their own needs (ILO, 1956), this dual reality becomes even more intense and manifest. This same definition also stresses the fact that any co-operative faces the same economic difficulties as any other firm, and this is exactly the point where this work is based on.

Keeping a balance between both is essential. It is not a matter of making one more important than the other, but it is simply a matter of maintaining balance. Getting economic goals is what makes possible getting social goals. It is being economically efficient in order to be socially successful.

The goal of this paper is to show the strength of a widely accepted conventional business tool, Kaplan and Norton's Balanced Scorecard, in balancing the performance in co-operatives. Other tools like the EFQM model, which is more spread in Europe, have the same value and are meaningful examples as well, because they address basically the same goals. All these means improve firms' economic performance, which in our point of view is what eventually makes them more likely to accomplish their social goals.

The combination of both, the features of the conventional Balanced Scorecard with social indicators, will with no doubt strength the value of co-operatives as efficient and competitive organizations. Getting just economic goals is not enough for a co-operative, but getting just social goals is not possible at all for any firm.

The proposed card has been designed not just to merge social and economic features in management but also to stand as a first step towards the very challenging idea of exploiting the benefits of the co-operative organization to successfully develop any economic activity in which they have been or could be operating.

**KEY WORDS:** Co-operatives, social mission, economic performance, excellence, the Balanced Scorecard, measurement, management tools.

**ECONLIT:** P130.

## **THE ACCOUNTING PRINCIPLES VERSUS THE CO-OPERATIVE PRINCIPLES: INFLUENCE ON THE CO-OPERATIVE IDENTITY**

### **Fernando Polo**

From the time the International Co-operative Alliance was founded in 1895 (henceforth ICA), it has been recognised as the authority in charge of defining what a co-operative is, as well as drafting the ruling principles upon which co-operatives should work.

The ICA has made three formal declarations on co-operative principles up to this date. The first declaration took place in 1937, the second in 1966 and the last one in 1995 in its 31st Congress held in Manchester. The revisions to the initial declarations "prove how the co-operative philosophy can be applied to a changing world" (ICA, 1995).

Drawing inspiration on the report by Sven Ake Book, the Alliance established in 1995 in the above-mentioned Manchester Congress that the principles are guidelines towards self-help, self-responsibility, democracy, equal opportunities and solidarity "whereby co-operatives can put in practise their values" (ICA, 1995). The guidelines are, therefore, "like behaviour guidelines" (García-Gutiérrez, 1999).

These principles are reflected in the majority of the co-operative legislation throughout the world, in laws, regulations, as well as in the statutes of each co-operative society's in particular.

The bringing in the corporative legal corpus of the co-operative principles has been a favourite research theme for some time (Vicent, 1999). They have also been a

research subject from an economic analysis point of view (Ballestero, 1990), and from a business administration point of view (García-Gutiérrez, 1999). However, little progress has been made in the research on their influence on areas such as accountancy.

We believe that an analysis on the repercussions on the accountancy field is both timely and due because of the current normative accounting environment, which is highly geared towards international accounting.

In this respect, we ought to mention the ICA Press Release "Accounting Standards Threaten Co-operative Identity" from 20th November 2003 as well as other publications that saw the public eye thanks to the European Association of Co-operative Banks in October 2003 as a result of the revisions of IAS 32 and 39, finally approved in December 2003. Under the new IAS 32 and 39 social co-operative capital is no longer considered net (equity) but a debt.

We understand that the former situation is a consequence of the general conceptual framework for financial information (Framework for the Preparation and Presentation of Financial Statements), as it has been drawn ignoring the inherently distinguishing characteristics of co-operative societies.

More situations such as the above-mentioned could happen if the question of co-operative philosophy in financial statements is not presented correctly.

Our work would like to start a re-thinking of this process, both from an internal point of view to co-operativism and from the point of view of a user of financial information not connected to the co-operative world.

**KEY WORDS:** Co-operative accounting, Generally Accepted Accounting Principles., equity, Co-operative principles.

**ECONLIT:** G320, K220, M410, P130.

## **CO-OPERATIVE PRINCIPLES AS "CATALYTIC MECHANISMS"**

**Sonja Novkovic**

The paper explores Jim Collins' (2001) managerial technique termed catalytic mechanisms in the co-operative context. Co-operatives possess a wide range of potential business strategies in the co-operative values and principles, but managers do not necessarily turn them into an advantage, in part because their entrepreneurial role is downplayed in user-oriented organizations. We argue that effective use of co-operative principles as catalytic mechanisms in co-operative organizations would lead to a better chance of building a successful business, and preserving the co-operative identity in the process.

**KEY WORDS:** Co-operative Management; Co-operative principles;

**ECONLIT:** M00, M12, M14, P130

## **PART. 8 COOPERATIVES, LAW AND PUBLIC POLICY**

### **THE EUROPEAN COOPERATIVE SOCIETY AND ITS APPLICATION IN SPAIN**

**M<sup>a</sup> del Mar Marín Sánchez**

**Elena Meliá Martí**

The European Union, in order to ensure equal terms of competition and to contribute to its economic development, has endowed cooperatives, with a European legal form, through Council Regulation (EC) No 1435/2003, of 22 July 2003, on the Statute for a European Co-operative Society. It would enable them to operate outside their own national borders in all or part of the territory of the Community.

However, in Spain there are thirteen different cooperative laws according to the Autonomous Region in which they develop their activity. Therefore, we analyse in this paper the common regulations and their possible application to Spanish cooperatives, as well as the mechanisms that will allow to adapt the Statute for a European Cooperative Society.

**KEY WORDS:** Statute for a European Cooperative Society, Spanish cooperative regulation, adaptation, crossborder activity

**ECONLIT:** K290, P130

### **HUNGARIAN EXPERIENCES IN REFORMATION OF AGRICULTURAL CO-OPERATIVE SYSTEM**

**Ferenc Laczó**

The basic question in the transition period in Hungary was whether the country would be able to transfer farm structure. So far the large scale (company and co-operative) farms continue to dominate the structure. This circumstance seems to be the main obstacle of recreation of the agricultural co-operative system.

Thanks for a campaign for the last years about 800 selling-, servicing-, and supplying-co-operatives, machine rings, and organic-products organisations were created. Due to the campaign most of them does not operate or operate as pseudo-co-operative.

Among the real “new type” co-operatives there are so-called “agency” type where the aim of co-operative were determined directly by the members’ needs and “enterprise” type ones where the autonomy of such co-operative has increased achieving its own economic goal and independent business policy. This two type of co-operation has raised as a dilemma of the further development.

**KEY WORDS:** restructuring of the co-operative system, legal development, pseudo-co-operatives, dilemma of agency type and enterprise type co-operatives

**ECONLIT:** P130, Q130.

## **ECONOMIC SUBSTANCE AND LEGAL REGULATION OF PRODUCERS' ORGANISATIONS IN THE HUNGARIAN FRUIT AND VEGETABLE SECTOR**

**Gábor G. Szabó**  
**Alexandra Kiss**

There is a great significance of different (marketing) organisations of agricultural producers in the agri-food economy of EU, like co-operatives and Producer' Organisations (POs), which are active in the fruit and vegetable sector. The Hungarian regulation takes over the European Union's one concerning POs which organise production; store, grade, process and market products and are set up by producers of a certain product or (sub) region.

In our study, first we analyse the Hungarian fruit and vegetable sector, than briefly review the new Hungarian co-operative laws and regulation, especially concerning POs. In the second part of the paper we show two case studies. One will show the brief development of the first officially acknowledged PO, which works as a very successful co-operative. The other case study is about a newly established PO. Finally, we discuss briefly theoretical justification of alternative forms of organisations of agricultural producers compared to traditional co-operatives.

**KEY WORDS:** co-ordination, vertical integration, co-operation, co-operative, Hungary, agribusiness, Producer Organisations, fruit and vegetable sector

**ECONLIT:** Q130, L140, L220, P130

## **PART. 9 COOPERATIVES AND WOMEN**

### **DO WE NEED BALANCE THE POWER BETWEEN WOMEN AND MEN IN COOPERATIVES?**

**Maria Fregidou-Malama**

This paper concerns women's representation in co-operatives, identifies if women's representation influences and contributes to co-operatives' development and is based on secondary data and on interviews conducted with four women managers. The study carries forward the exploration of a link between representation of women and the character and structure of co-operatives. Relations between the members of co-operatives are meant to anchor cooperatives economic and social values in the political process. Legitimised actors interact in order to secure their view of reality. Women are considered to take into account social issues and want to get power without wishing to control others but influence a sustainable development. They are considered to have a holistic view and try to understand the consequences their decisions have on other people and the development. In order to increase the representation of women in cooperatives, the following arguments are given: the

issue of democracy, the issue of resource use, and the issue of interest. The results illustrate that women's representation is a matter of increasing democracy and widening the basis for decision-making possibilities. It is a means to raise new questions, like social, cultural and environmental issues, and new dimensions of thinking and to consider everyone's interest economic and social. My observations on the issue indicate that women as an interest group manifest different value dimensions. It is argued, it is particularly important to consider women's interests and representation in co-operatives and thus create conditions allowing women influence cooperatives successful development and bring cooperative issues into the public eye.

**KEY WORDS:** Women, Co-operatives, Representation, Relationship, Economic and Social Values, Sweden.

**ECONLIT:** J160, J210, J220, J710, J820, P130

### **THE FULFILMENT OF THE FIRST COOPERATIVE PRINCIPLE: ANALYSIS OF THE GENDER DISCRIMINATION IN SPANISH COOPERATIVES**

**Antonia Ribas**

**Antonia Sajardo**

**Rafael Chaves**

This paper explores the problem of discrimination against women in co-operative employment environments, focusing its analysis on Spain. It is an issue of some interest because the principles on which co-operatives are based make an explicit reference to equality and non-discrimination among people and, more particularly, the first co-operative principle refers specifically to non-discrimination between the sexes. From this perspective, this study makes an analysis of the reality of the female labour situation in Spanish co-operatives and worker-owned companies, as well as examining different initiatives and experiences that have been developed in the Spanish co-operative movement in recent years to promote sexual equality.

**KEY WORDS:** Co-operatives, sex, inequality, labour discrimination, co-operative principles.

**ECONLIT:** J160, J210, J220, J710, J820, P130



## PART. 10 HISTORICAL PERSPECTIVES

### HISTORICAL RECORDS OF 20TH CENTURY AGRICULTURAL CO-OPERATIVE MOVEMENT IN EUROPE: A COMPARATIVE SYNTHESIS IN THE EUROPEAN UNION

**Alfonso Carlos Morales Gutiérrez**

**M<sup>a</sup> Dolores Muñoz Dueñas**

**Teresa Romero Atela**

To ignore the historical perspective of socio-economical phenomena while looking ahead to the future, in an attempt to raise expectations and set new challenges, can prove a risky move when approaching the co-operative movement as a whole, and more particularly, the European agricultural one, if its purpose is to play a relevant role in the overall panorama of a globalized world. The aim of this paper is to trace the origins of the agricultural co-operative movement in seven European countries (Belgium, Denmark, France, Italy, The Netherlands, Portugal and The United Kingdom) and discuss the coincidences and differences which account for common problems with a view to avoid them in future joint ventures. Some issues discussed here are, among other, the legal framework, the public institutions concerned with the promotion and development of co-operatives, the promoting social groups, the underlying values involved and last the various types of co-operatives and the important role they play in specific economic sectors. The analysis includes a comparative synthesis as a point of departure for new challenges in the near future.

**KEY WORDS:** Economic History, Micro-Business History, Cooperative Enterprises, Agricultural Markets

**ECONLIT:** N540, N840, P130, Q130

### COLONIAL CO-OPERATIVES THROUGH THE EYES OF THEIR CO-OPERATIVE REGISTRARS

**Rita Rhodes**

An expanding European Union, de-regulation and the collapse of Communism are requiring European co-operatives to redefine and reposition themselves. Such a process, along with the creation of new co-operatives, may be labeled co-operative development. This paper examines lessons gained from British imperial co-operative development and explores how far these might be relevant today.

Focusing on the writings of senior co-operative Registrars, it notes their belief that co-operatives can assist overall development, and that co-operative development should be rooted in Co-operative Principles and imbued with the Co-operative spirit. The paper further notes the methods and approaches they employed. It concludes that the Registrars studied comprise an important "historical co-operative network" and that lessons from their work remain relevant to contemporary European co-operative development.

**KEY WORDS:** co-operative, development, pre-co-operatives, registrars, network

**ECONLIT:** P130.



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